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REPORT TO THE CONSERVATION AND
NATURAL RESOURCES SUBCOMMITTEE
COMMITTEE ON GOVERNMENT
OPERATIONS
HOUSE OF REPRESENTATIVES

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California's Central Valley
Project — Proposed Power
Rate Increase

B-125042

Department of the Interior

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

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090646

NOV. 19, 1973



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-125042

C1
The Honorable Henry S. Reuss, Chairman
Conservation and Natural Resources
Subcommittee
Committee on Government Operations
House of Representatives

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Dear Mr. Chairman:

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In accordance with your July 24, 1973, request and subsequent discussions with your office, we are reporting on the reasonableness of 11 contentions made by opponents of the power rate increase proposed by the Department of the Interior for the Bureau of Reclamation's Central Valley Project in California. 7
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We discussed the substance of our observations and conclusions with Bureau officials, but, as your office requested, we did not submit a copy of the report to that agency or to the Department of the Interior for review and comment.

We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,

James B. Stacks

Comptroller General
of the United States

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ABBREVIATIONS

CVP	Central Valley Project
GAO	General Accounting Office
PG&E	Pacific Gas & Electric Company

COMPTROLLER GENERAL'S
REPORT TO THE CONSERVATION AND
NATURAL RESOURCES SUBCOMMITTEE
COMMITTEE ON GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES

CALIFORNIA'S CENTRAL VALLEY
PROJECT--PROPOSED POWER
RATE INCREASE
Department of the Interior
B-125042

D I G E S T

WHY THE REVIEW WAS MADE

At the request of the Chairman of the Subcommittee, GAO reviewed the reasonableness of 11 contentions made by opponents of a proposed increase by Interior in the power rate to be charged customers of the Bureau of Reclamation's Central Valley Project (CVP) in California.

Basic facts

The Chairman was concerned that the substantial increase (51.6 percent) was based on highly complex data and unexplained, or poorly explained, assumptions included in the rate and repayment study.

GAO did not review all aspects of the Bureau's study supporting the proposed rate increase, but it did obtain sufficient information to evaluate the reasonableness of the 11 contentions.

In accordance with the request of the Chairman's office, GAO did not submit its report to Interior for comment; however, GAO did discuss the substance of its observations and conclusions with Bureau officials.

FINDINGS AND CONCLUSIONS

CVP is a large multipurpose project consisting of 19 dams and related water conveyance systems, hydro-

electric generating plants, and transmission facilities. The project provides irrigation water, municipal and industrial water, power generation, flood control, and fish and wildlife enhancement.

Project costs allocated to power--and part of the costs allocated to irrigation--are required to be recovered in rates charged power customers and to be repaid to the U.S. Treasury.

To determine whether power rates are adequate to recover the Federal investment within the required repayment period (50 years after the in-service date of each project facility), CVP periodically makes and publishes rate and repayment studies. CVP studies show actual costs and revenues through the current fiscal year and include projected costs and revenues through the remainder of the repayment period.

On the basis of assumptions made in the June 1973 CVP study, the Bureau estimated a 51.6-percent increase would be needed, starting in January 1974, to meet repayment requirements by the end of the repayment period in fiscal year 2031.

2 On November 1, 1973, Interior announced a different rate increase to become effective in two steps--on April 1, 1974, and January 1, 1977. GAO did not review the basis for this increase.

The rate and repayment studies have inherent weaknesses which cause them to give speculative results. These weaknesses result from uncertainties from projecting revenues, costs, and changes in operating methods for extended periods. (See p. 8.)

Several contentions involved suggestions which would require agreement with a contractor, and GAO cannot predict what the terms of the agreement would be. (See pp. 10 and 18.)

Of the 11 contentions, 4 had merit: 3 involved separate rate and repayment study procedures which the Bureau could change unilaterally and 1 involved using updated hydrology studies.

Two of the procedures used in CVP were not consistent with criteria set forth in a 1966 report of the House Committee on Interior and Insular Affairs or with procedures used for other Federal power projects. These procedures involve:

--Planning to avoid a deficit in any year of the repayment period. (See p. 30.)

--Planning for an operational surplus at the end of the repayment period. (See p. 21.)

A Bureau study estimates that, if the Bureau were to change these two procedures, the present power rate would have to be increased about 36 percent instead of the proposed 51.6 percent.

The third procedure involved treatment of replacement costs and probably would have little effect on the rate increase if the other two procedures were changed. (See p. 24.)

The proposed rate probably could be further reduced if the Bureau used water availability data from updated hydrology studies in its rate and repayment study for CVP. (See p. 16.)

Opponents of the power rate increase generally have questioned only those study procedures and assumptions which if changed, would tend to mitigate the power rate increase. (See p. 8.)

CHAPTER 1

INTRODUCTION

In accordance with the July 24, 1973, request of the Chairman, Conservation and Natural Resources Subcommittee of the House Committee on Government Operations (see appendix), and subsequent discussions with his office, we reviewed the reasonableness of 11 contentions made by opponents of an Interior-proposed power rate increase to be charged customers served by the Bureau of Reclamation's Central Valley Project (CVP) in California.

We did not review all aspects of the Bureau's study supporting the need for the proposed rate increase, but we did obtain sufficient information to evaluate the reasonableness of the 11 contentions. In our review, which we made primarily at the Bureau's regional office in Sacramento, California, we examined pertinent documents and studies supporting the rate increase; reviewed pertinent legislation, congressional hearings, and reports applicable to power rate determinations; and discussed our work with Bureau officials, some of the opponents of the proposed rate increase, and officials of the Pacific Gas & Electric Company (PG&E). We completed our review in September 1973.

CVP is a large multipurpose water resources development project consisting of 19 dams and related water conveyance systems and power generation and transmission facilities. The project's primary purpose is to provide irrigation water to the Sacramento and San Joaquin Valleys. The project's secondary purposes are providing municipal and industrial water, hydroelectric power generation, flood control, and fish and wildlife enhancement.

The project's costs are allocated to its various purposes. Certain costs, such as those for irrigation, power generation, and municipal and industrial water, are reimbursable and must be repaid to the U.S. Treasury from charges made to the project beneficiaries. Other costs, such as those incurred for flood control and for certain fish and wildlife activities, are considered Federal responsibilities and are nonreimbursable. As of June 30, 1973, the estimated total costs of the

authorized project was about \$3 billion, of which \$2.6 billion was reimbursable.

Irrigation beneficiaries are required to repay, without interest, their share of project costs on the basis of their "ability to pay." If the irrigators' ability to pay is less than their share of the costs, the Bureau uses the revenues from sale of power and municipal and industrial water to repay the deficit. CVP estimated that, during the scheduled repayment period, \$321 million of power revenues and \$202 million of municipal and industrial water revenues will be needed to repay the irrigation costs which the Bureau considers to be beyond the irrigators' ability to pay.

CVP POWER OPERATIONS

CVP power generation began in 1944. For the first several years, virtually all power output was sold to PG&E, an investor-owned California utility company. During 1951 the Bureau and PG&E entered into two contracts. The first contract provided for partially integrating the two electrical systems and permitted delivering CVP power over PG&E transmission lines to preference customers.¹ The second contract provided for the sale to PG&E of surplus CVP power not required by preference customers.

Although the two contracts were modified from time to time, they remained in effect until July 31, 1967, when the Bureau and PG&E entered into a new sales and transmission contract. The new contract, which basically is a continuation of the previous two contracts, runs through the year 2004. An important distinction in the new contract, however, is that each year the Bureau must import from the Northwest about 400 megawatts² of power over the Pacific Northwest-Pacific Southwest Transmission Intertie System. Since CVP customers, however, did not immediately need all of this power, the Bureau and PG&E agreed that PG&E would purchase (bank) the power when it exceeded CVP needs and would resell it to the Bureau when it was needed.

¹Include municipalities, cooperatives, and Federal agencies.

²1 megawatt equals 1,000 kilowatts.

CVP estimated that, with the banking arrangement, it would be able to meet its customers' firm (consistently relied on) load of 1,050 megawatts from 1980 through 2004. CVP estimated also that, without the banking arrangement, its ability to satisfy its customers' firm load would steadily decrease from 925 megawatts in 1976 to about 440 megawatts by 1980, due to the increased power needed to pump project water, primarily for irrigation. The Bureau estimated that the banking arrangement would allow CVP, in addition to being able to satisfy a firm load of 925 megawatts, to meet the load growth (increased demand for power) of certain customers up to 1,050 megawatts.

The contract provides that Northwest power be sold to PG&E at the established CVP rate of \$0.75 per kilowatt (kw) for capacity¹ and the sliding charge of 4, 3, and 2 mills per kilowatt-hour (kwh) for energy.² Although in 1967 the Bureau did not know the exact cost of Northwest power,³ it estimated the cost to be about the same as that to be charged PG&E under the contract. The contract further provides that "Rates and charges under this contract shall be fair and equitable and shall * * * be jointly reviewed, and adjusted as appropriate on April 1, 1971, and every five years thereafter * * *."

BASIS FOR ESTABLISHING POWER RATES

Interior uses 50 years from the date a hydroelectric project is placed in service as a reasonable repayment period. Although the investment in each project is required to be repaid within 50 years, repayment of the Federal investment in the entire system will extend substantially beyond 50 years because each project in the system is placed in service on a different date.

¹The power which a project can produce at a given time, expressed in kws.

²The power which a project produces over a given time, expressed in kwhs.

³The term "power" is used in a broad sense and includes capacity and energy.

To determine whether power rates are adequate for recovering the Federal investment in a system within the required repayment period, each Federal power agency generally makes and publishes periodically consolidated rate and repayment studies covering all power projects in the system. These studies show actual costs and revenues for all projects through the current fiscal year and projected estimated costs and revenues through the remainder of the repayment period.

Power system revenues generally are used first to repay funds appropriated by the Congress for operation and maintenance expenses and then to pay interest on the Federal investment. Any remaining revenues are used to repay the Federal investment and thus reduce the amount on which interest is computed in the following year.

When the Secretary of the Interior announced on April 17, 1963, the present procedures for preparing rate and repayment studies for Federal projects for the Federal Columbia River Power System, he said that the procedures were already in effect for CVP.

These procedures were elaborated on in a report¹ the House Committee on Interior and Insular Affairs issued on April 1, 1966, when it was considering legislation that would authorize constructing a third power plant at Grand Coulee Dam in the Federal Columbia River Power System. The report, in introducing the rate and repayment procedures, stated that it was pertinent:

"* * * to have a clear, concise statement setting out this repayment policy which is embodied in the 50-year system-repayment plan approved by the Secretary of the Interior in April of 1963."

The principal features of the policy are that generally each investment in the system must be repaid within 50 years after the facility financed by the investment is placed in service but that no repayment is required in any particular year. After the investment in a particular project is repaid.

¹H. Rept. 1409, 89th Cong., 2d sess.

revenues from that project are available to help repay the investments in other projects in the system.

The investment in a project is included in the rate and repayment study as an allowable unamortized investment until the 50th year after the project was placed in service, at which time the total investment is deducted from the allowable unamortized investment.

CHAPTER 2
CONTENTIONS BY OPPONENTS OF
PROPOSED POWER RATE INCREASE

On January 27, 1973, Interior announced that it proposed to increase power rates at five Bureau multipurpose water resource projects, including CVP. At that time the rate for CVP power was \$0.75 a month per kw for capacity and a sliding charge (decreasing with increased consumption) of 4, 3, and 2 mills per kwh for energy, for an average power rate of 4.08 mills per kwh. The proposed rate announced for CVP--to be effective in January 1974--was \$1.64 a month per kw for capacity and 3 mills per kwh for energy up to a 60-percent load factor¹ and 5 mills per kwh above the 60-percent load factor, for a Bureau-estimated average power rate of 6.15 mills per kwh. The proposed rate change from 4.08 to 6.15 mills per kwh is a 51.6-percent increase.

On July 10, 1973, the Bureau held hearings on the proposed CVP rate increase at which opponents of the increase submitted written objections to the procedures the Bureau used and the assumptions it made in preparing CVP's rate and repayment study showing the need for the rate increase. These objections are hereinafter referred to as contentions.

The 11 contentions generally questioned only those study procedures and assumptions which, if changed, would tend to mitigate the power rate increase. The rate and repayment studies have inherent weaknesses which cause them to give speculative results. These weaknesses result from the uncertainties in projecting revenues, costs, and changes in operating methods for extended periods.

Several contentions involved suggestions which would require agreement with PG&E, and we cannot predict what the terms of the agreement would be. Therefore we have not made a conclusion as to the validity of such contentions, although we question the wisdom of preparing rate and repayment studies based on predicting changes in operating methods that are subject to agreement.

¹The ratio of the average load, in kws, supplied during a designated period to the peak or maximum load occurring in that period.

Of the 11 contentions (see p. 36), 4 related to procedures or information which reasonably could be questioned and which the Bureau could change unilaterally. If the Bureau were to change its rate and repayment study to recognize these four contentions, it would tend to reduce substantially the amount of the rate increase CVP supposedly needs. These four contentions--2, 6, 7, and 10--concerned hydrology studies, earned surplus, replacement costs, and the no-deficit-year concept, respectively.

On November 1, 1973, Interior announced a two-step rate increase which Bureau officials said would total about 47 percent. The first increase, effective April 1, 1974, will be 28 percent; the second increase, effective January 1, 1977, will bring the total two-step increase to approximately what the January 1974 increase would have been. We have not reviewed the basis for this two-step increase. This report is concerned only with those contentions related to the Bureau's rate and repayment study supporting the proposed January 1974 rate increase of 51.6 percent.

CENTRALIA POWER PURCHASES--CONTENTIONS 1 AND 5

"That virtually all of the proposed increase in CVP would be unnecessary but for the facts that the Bureau of Reclamation is selling, and proposes to continue selling, Centralia-generated power to the Pacific Gas and Electric Company at far less than the cost of generation; that the Bureau failed to adjust the rate on April 1, 1971, as specified under its contract with the Company; and that the loss to the government now resulting from these facts is about \$10 million per year and will total \$40 million by April 1, 1976."

"That the Bureau overstates its costs by purchasing Centralia capacity to deliver to PG&E at less than the cost thereof with no expectation of receiving returns from the capacity bank account."

Discussion

CVP first began receiving power from the Northwest in January 1972. The power was purchased from the Centralia plant¹ in the State of Washington. For the 18-month period ended June 30, 1973, CVP purchased 382 megawatts of capacity and associated energy (after adjustment for transmission losses) at an average cost of 7.694 mills per kwh. All the capacity and about 55 percent of the energy was sold (banked) to PG&E at an average rate of 4.925 mills per kwh; the remaining energy was sold to preference customers at an average rate of 2.653 mills per kwh.

On the basis of the Bureau's current projections of costs and revenues from the purchase and sale of Northwest power, we estimated that the loss to CVP by April 1, 1976, would be as shown below. (Under the Bureau-PG&E contract, April 1, 1971, was the first date that the rate to PG&E could have been changed and April 1, 1976, is the next rate adjustment date.)

¹A large coal-burning non-Federal electric generating plant.

<u>Transactions through April 1, 1976 (note a)</u>	<u>Capacity (note b)</u>	<u>Energy (note b)</u>
Cost of purchases of Northwest power	\$49,551,000	\$53,746,000
Revenues from sales of Northwest power to:		
PG&E (banked)	12,975,000	12,221,000
Preference customers	2,897,000	19,693,000
Loss to CVP on sales to:		
PG&E	31,434,000	8,597,000
Preference customers	2,245,000	13,235,000

^aThe amounts for fiscal years 1972 and 1973 are based on actual costs and revenues. The amounts for fiscal years 1974 through 1976 are based on the Bureau's projections in the June 1973 "Power Rate Adjustment Study."

^bThere is a single charge for power purchased from the Northwest. CVP allocates the charge between capacity and energy on the basis of formula it devised. If less of the charge were allocated to capacity, the loss from sales to PG&E would be less and the loss on sales to preference customers would be more.

The CVP's contract with Centralia for the purchase of Northwest power requires CVP to pay a proportionate share (relationship of power purchased by CVP to the total power capability of the plant) of fixed cost and operation, maintenance, and other costs of the Centralia plant. When selling the power to PG&E and its preference customers, CVP charges the established system rate. According to the rate adjustment study (supporting the proposed increase in power rates), CVP estimates that it will pay about 9 mills per kwh for the Centralia power and will sell it to its preference customers beginning January 1974 and to PG&E beginning April 1976 at about 6 mills per kwh. Thus even with the rate increase, CVP anticipates a loss of about 3 mills per kwh in its sales of Centralia power.

Effect of charging PG&E
less than cost of Northwest power

To determine whether the need for the CVP rate increase was due primarily to the Bureau's selling Northwest power to

PG&E at less than the Bureau's cost, the Bureau advised us that after the July 10, 1973, rate hearings it made a study in which it assumed that Northwest power would be sold to PG&E beginning April 1, 1976, at the Bureau's cost. The study showed that it would still be necessary to increase preference customer rates but not to the extent presently proposed.

According to the Bureau's study, the effective power rate required from its preference customers, if PG&E were charged the same rate for Northwest power as the rate paid by the Bureau, would be about 5.892 mills per kwh, compared with the proposed rate of 6.15 mills per kwh, an increase of about 44 percent instead of the proposed increase of 51.6 percent. Under the terms of CVP's contract with PG&E, the rate charged PG&E for Northwest power shall be fair and equitable and shall be jointly reviewed each 5 years and adjusted as appropriate. If the parties cannot agree to a change in rates, the matter shall be submitted to the Federal Power Commission for final decision.

Rate adjustment not made as
of April 1, 1971

The Bureau's regional officials told us that they did not jointly review the rate with PG&E to negotiate a change in PG&E's rate as of April 1, 1971, because (1) the general concept was to charge all customers, including PG&E, the CVP system rate rather than the specific cost of the Centralia power, (2) what the cost of Northwest power would be was not known because CVP did not begin receiving the power until January 1972, and (3) by banking the power at a low rate, CVP would reduce the surcharge to be paid to PG&E because CVP, when repurchasing the power, must pay PG&E a rate based on the sale price to PG&E plus an estimated surcharge of 14 percent.¹ The Bureau acknowledged that, sometime before April 1971, it had an indication that the cost of Northwest power would be higher than originally estimated but it did not know how much higher.

¹A Bureau estimate. The contract does not appear to state what the surcharge percentage would be on and after April 1, 1971, but indicates that it would be 14 percent before April 1.

An official of the Bonneville Power Administration¹ told us that information was available before April 1, 1971, showing that the construction cost of Centralia, including the cost of money, was going to be higher than originally estimated, but information showing that other costs were going to be substantially higher than originally estimated was not available at that time.

Banking Northwest capacity with
no expectation of future Bureau use

According to the CVP rate adjustment study, the Bureau plans to sell (bank) to PG&E, from July 1972 through 1999, 8,271 megawatt-years of Northwest capacity for which the Bureau has no present or future needs. This capacity, which the Bureau estimates will cost CVP \$258 million, will be sold to PG&E for an estimated \$142 million. The estimated effect of this transaction on the rate and repayment study is a loss to CVP of \$116 million.

The reason CVP banks with PG&E capacity which CVP will not need appears to stem primarily from assumptions--since changed--made in 1964 when construction of the intertie was being considered. At that time it was assumed that, due to planned increases in power that would be needed to pump water for CVP purposes, such as increased irrigation, the Bureau would be able to satisfy a customer load of only 440 megawatts by 1980 unless the Northwest capacity was available. Therefore the Bureau arranged to import about 400 megawatts over the intertie, sell (bank) it to PG&E, and retain the option to repurchase it. The Bureau estimated that this would allow CVP to meet a firm customer load of 1,050 megawatts from about 1980 through 2004.

The Bureau told us that, because of changes in project priorities, it no longer appeared that there would be as substantial an increase in the CVP project pumping load as had been anticipated and that consequently the project would be able to satisfy the bulk of its capacity requirements and there would be no need to purchase any of the capacity banked with PG&E.

¹An Interior agency responsible for marketing power in the Pacific Northwest from the Federal Columbia River Power System.

Because CVP was incurring a loss on the sale of un-needed capacity to PG&E, some opponents of the CVP rate increase recommended that CVP stop importing Northwest power as soon as the Centralia contract expired and that CVP purchase from PG&E only the energy that was necessary to meet preference customer load. The opponents stated that they assumed that CVP would be able to get energy from PG&E in the future at about 4 mills per kwh, which was less than CVP's combined cost of capacity and energy from Centralia that was estimated at about 9 mills per kwh and less than the current price at which PG&E sold energy.

PG&E stated in its comments for the record concerning the CVP rate increase that "recent purchases of fuel oil indicate that PG and E's cost of producing energy will exceed nine mills per KWH." PG&E stated that producing energy presently cost that company about 9 mills per kwh.

Also the opponents' assumption implied that CVP could modify the provision of its contract with PG&E concerning the purchased Northwest power without disturbing the other contract provisions. PG&E advised us, however, that the contract provision for importing Northwest power was an important consideration in negotiating the contract and implied that any Bureau action to enter into negotiations to eliminate that provision could open up other contract provisions for renegotiation.

Conclusion

If the Bureau were to sell Northwest power to PG&E at the same rate that CVP pays for such power, the rate increase being proposed by CVP--all other factors remaining the same--would be about 44 percent rather than 51.6 percent. However, the contract provides for adjusting the rate only after joint review by the parties.

The Bureau and PG&E did not jointly review the rate, and the Bureau did not try to negotiate a rate increase with PG&E at the first opportunity in April 1971, because, according to the Bureau, the rate then being charged PG&E was the CVP system rate and the Bureau did not have complete data as to what the cost of Northwest power would be. The next rate adjustment date with PG&E is April 1, 1976, and it is

impossible to state at this time what rate will be negotiated with PG&E. In CVP's rate and repayment study, however, the Bureau estimated that it would negotiate a rate with PG&E in 1976 which was equal to the estimated CVP system rate, not the estimated cost of Northwest power at that time.

Estimates by opponents of the rate increase of savings to CVP if it were not involved in the Northwest power arrangement assume that CVP could purchase the energy it needs from PG&E for substantially less than CVP pays for Northwest power. On the basis of our discussions with PG&E, both of these assumptions seem to be highly speculative.

HYDROLOGY--CONTENTION 2

"That the Bureau's estimates understate power generation because they are based on average hydro generation in the low water period 1922-1954 rather than on longer periods, and that actual water run-off since the completion of the Shasta Dam in 1949 has been 16 percent greater than Bureau estimates."

Discussion

The Bureau uses hydrology studies based on historical data, to ascertain how much water will be available for future power generation. The Bureau has been using hydrology studies based on the 1922-54 period to represent average future conditions within CVP.

The Bureau acknowledges that historical runoff for the 1954-71 period was appreciably greater than the average run-off during the 1922-54 period and said that the study which was underway but not yet completed would use updated data. According to the Bureau's preliminary estimates, including the 1954-71 period in the hydrology study would support an 8-percent increase in the average annual CVP power generation. One of the opponents of the rate increase estimated that, if hydrology data back to about 1895 also were included, it would support a 10-percent increase in the average annual CVP power generation. We did not evaluate this contention.

Conclusion

We estimate that, on the basis of the Bureau's study using the updated hydrology data, the effective rate for both capacity and energy would be approximately 5.97 mills per kwh instead of the proposed 6.15 mills per kwh, an overall rate increase of about 46 percent compared with the proposed increase of 51.6 percent.

FUTURE WATER USES--CONTENTION 3

"That the Bureau's studies overstate the amount and timing of projected future water uses, thus understating future revenues from power sales."

Discussion

This contention was based on a statement made by a civil engineer at a public hearing the Bureau held on July 10, 1973, on the proposed CVP power rate increase. On the basis of his review of a Bureau report,¹ the civil engineer concluded that the CVP rate and repayment study reserved about 2 million acre-feet of CVP water for water projects which were in the planning stages and which had not been authorized by the Congress. He concluded that the 2 million acre-feet of water should not be reserved for unauthorized water projects but, instead, should be considered as being available to maximize power generation.

The Bureau's regional officials advised us that, in preparing the CVP rate and repayment study, the 2 million acre-feet of water had not been reserved for unauthorized water projects but, instead, had been considered as available to maximize power generation.

On the basis of subsequent information, the civil engineer stated that the Bureau report on which his conclusion had been based was in error and in an August 10, 1973, letter to the Bureau's regional office he withdrew his objection.

Conclusion

The Bureau's rate and repayment study for CVP apparently does not overstate the amount and timing of projected water uses and, as a result, does not understate future revenues from power sales. It appears that the contention was based on a misunderstanding which has been resolved.

¹"A Financial Analysis of the Authorized Central Valley Project," region 2, May 1972.

PROJECT DEPENDABLE CAPACITY--CONTENTION 4

"That the Bureau is understating the Central Valley Project's dependable power capacity, which could be sold and produce additional revenue."

Discussion

The Bureau-PG&E contract defines "project dependable capacity" as:

"the lowest electric capacity available for use within Contractor's [PG&E's] Service Area, estimated in accordance with the methods used in Reclamation Study, which could be available with energy support from Project Plants in any month during the most adverse period of stream-flow conditions of record (as set forth and applied in Reclamation Study), after deducting the estimated capacity required from Project Plants for Project Load during Contractor's Peak Load Period."

In simpler terms, project dependable capacity is the amount of CVP capacity available for commercial sale during an adverse water period.

Project dependable capacity, which is not a fixed amount, is changed from time to time to reflect the addition or deletion of generating units or increases or decreases in project load. In 1967, the year in which the present Bureau-PG&E contract was signed, project dependable capacity was 875 megawatts; it is now 925 megawatts.

One of the consultants opposing the CVP rate increase maintained that the installed capacity of CVP was materially greater than the project dependable capacity provided for in the Bureau-PG&E contract and that all the additional "capacity flows to PG&E to be used exclusively for its benefit, without compensation or remuneration to the Federal government for this valuable capacity."

The consultant estimated that the additional revenues which would result from the sale of this capacity, at a rate of \$10 per kw-year, would total \$187,580,000 for 1974-2004.

The consultant was correct in his analysis to the extent that some CVP capacity was made available to the PG&E system without charge; however, the Bureau told us that it appeared questionable that the amount and value of this capacity was as extensive as that computed by the consultant.

Bureau officials stated that, for example, the capacity available would be far less than that shown in the consultant's analysis and would change extensively throughout the year because of variations in the height of water in the reservoir and the need to meet project pumping requirements. According to the Bureau, the consultant's analysis considered neither of these factors.

The Bureau also questioned whether it was practicable to assume that capacity that would not be available for some days each month or for some months each year could be sold at \$10 per kw-year, as indicated in the consultant's analysis. The Bureau said that, in its previous contract with PG&E, capacity which could not be reliably scheduled--referred to as nondependable capacity--was sold for \$3 per kw-year, providing it could be made available for 5 successive months. The Bureau told us that the provision for the sale of non-dependable capacity had been negotiated out of the present contract because the capacity could not be reliably scheduled.

The Bureau's position was that the consultant's contention was invalid because the capacity made available to PG&E without payment was recognized to be one of the benefits PG&E derived in exchange for providing the Bureau with reserves and backup support for project dependable capacity, as well as other benefits, included in the contract. PG&E said that during 1972 (1) CVP made available to PG&E an estimated 178 megawatt-months of nondependable capacity and (2) PG&E supplied the Bureau with 555 megawatt-months of capacity during periods when CVP generation was out of service for overhaul or maintenance.

Two of the consultants also maintained that the project dependable capacity was determined on the basis of fitting CVP capacity into the regional load curves.¹ The consultants

¹A curve on a chart showing power (kw) supplied plotted against the time of occurrence and the varying size of the load during the period covered.

indicated that, to determine whether the project dependable capacity was reasonable, it would be necessary to thoroughly analyze PG&E and PG&E-CVP load curves. The consultants requested from the Bureau the data necessary to make the analysis, and the Bureau, in turn, requested the data from PG&E by letter dated August 10, 1973. The consultants had not received the information by August 31, 1973, the deadline for submitting comments to the Bureau on the proposed rate increase. As far as we know, the consultants have not yet made the analysis.

Conclusion

CVP does make certain amounts of capacity available to PG&E without charge. It appears, however, that this arrangement was anticipated when the Bureau-PG&E contract was negotiated and that the Bureau, in turn, received certain benefits from PG&E. Also, since the arrangement is a part of the Bureau-PG&E contract, any change would have to be agreed upon by the parties and we cannot predict what the terms of the agreement would be. We did not evaluate the reasonableness of the arrangement.

EARNED SURPLUS--CONTENTION 6

"That the proposed rate increase will establish an unjustifiable cumulative earned surplus of about \$500 million after payment of all costs, interest and amortization."

Discussion

The CVP rate and repayment study showed--on the basis of the Bureau's assumptions, projections, and proposed rate increase--that all costs and amortization requirements would be met by the end of the system repayment period (fiscal year 2031) and that a cumulative earned surplus of about \$496 million would exist. The Bureau's power rate adjustment study stated that the estimated surplus would provide a contingency of about \$78.4 million to pay deferred CVP costs and would accrue an operating reserve of about \$417.6 million.

The \$496 million surplus automatically accrued in the rate and repayment study by 2031 as a result of the Bureau's proposing a rate increase which was adequate to meet other study criteria, particularly that criterion which provided that the rate increase be adequate to avoid a deficit in any single year. (See contention 10, p. 30.) Therefore, according to a Bureau regional official, the surplus did not contribute to the proposed rate increase.

If the surplus had not automatically resulted from complying with such other criteria, however, the Bureau might have requested rate increases adequate for providing a surplus of about \$350 million. The original Bureau instructions for preparing the CVP rate and repayment study directed that provision be made for a \$350 million surplus. On September 7, 1973, the Bureau's regional office responsible for administering CVP advised the Bureau's Washington, D.C., office that:

"The Region believes that a prudent amount of operating reserve, including a provision for deferred cost should be about \$350,000,000."

The regional office stated that the operating reserve was needed to cover constantly increasing costs for construction, operating expenses, and contingencies.

Our review of the criteria used by some of the other Federal power agencies in preparing rate and repayment studies did not disclose any requirement for an operating reserve (surplus) to cover increasing costs or contingencies. In fact, Interior, in commenting on our report to the Congress entitled, "Southwestern Federal Power Program--Financial Progress and Problems" (B-125031, Nov. 22, 1972), said that inflationary factors were considered for expenses, but only for a 3-year period, as follows:

" * * * Continuing inflationary components on the expense side of the ledger emphasizes two critical issues: (1) just how many years beyond the rate filing should costs continue to be escalated and (2) is it reasonable to continue escalation of costs without also forecasting future rate increases? We believe it is more prudent to hold costs and revenues constant beyond the rate filing timeframe [3 years]."

The criteria for preparing rate and repayment studies, as set forth in House Report 1409, 89th Congress, 2d session, did not, in our opinion, envision that provision would be made for future cost increases or decreases. The House report stated that future variations would average out. The House report stated, on page 10, that:

"This approach to repayment scheduling has the effect of averaging the year-to-year variations in costs and revenues over the repayment period. This results in a uniform cost per unit of power sold, and permits the maintenance of stable rates for extended periods * * *.

"If the conditions assumed in the study for future years remain unchanged, the power rates established pursuant to the study will be sufficient throughout the entire repayment period. However, pursuant to the requirements of the Bonneville Project Act, Bonneville Power Administration reviews its rates each 5 years so that rate levels can be adjusted if conditions change."

If conditions change and CVP costs increase above present levels or if contingencies occur, CVP rate levels

can be adjusted on the basis of a rate and repayment study made at the time such changes occur.

The present rate and repayment study should provide for the items referred to by the Bureau as deferred costs and estimated to cost about \$78.4 million. Deferred costs include such items as (1) excess capacity in, or authorized for, the Folsom South and Tehama-Colusa Canals and (2) facilities being constructed at Auburn Dam for the installation of generators which have not yet been authorized.

House Report 1409 stated, on page 7, that some projects included provisions for the installation of additional generator units and that substructures for future additions were considered to be in service at the time the initial generator was installed. An official of the Bonneville Power Administration told us that, consistent with this criterion, the rate and repayment study which that agency prepared for the Federal Columbia River Power System included the estimated costs for those items CVP referred to as deferred costs.

Conclusion

The estimated \$496 million surplus shown in the CVP rate and repayment study resulted from the Bureau's setting a power rate which was adequate for meeting other rate and repayment study criteria and did not contribute to the proposed rate increase. If the other criteria were changed, however, the Bureau's stated intention to provide for a \$350 million surplus could affect the amount of the rate increase needed.

On the basis of the rate and repayment study criteria presented to the Congress and used in other Federal power systems, we believe that, except for providing for those items referred to by the Bureau as deferred costs, power rates should not be increased to provide a surplus. Some surplus less than that cited above may result, however, from rate increases which may be necessary to meet other rate and repayment study criteria, such as insuring that the unamortized investment is less than the allowable unamortized investment.

REPLACEMENT COSTS--CONTENTION 7

"That some of the Bureau's rate increases are due to overstating reserve requirements in particular years by expensing, instead of capitalizing, replacements."

Discussion

Bureau regional officials said that it was true that the CVP rate and repayment study expensed system replacement costs in the year they were estimated to occur rather than capitalized such costs. Interior instructions issued on August 2, 1972, directed Federal power agencies to capitalize replacement costs by June 30, 1973.

Bonneville Power Administration officials said that replacement costs were capitalized in the Federal Columbia River Power System. Also Federal Power Commission regulations provide for capitalizing replacements.

The replacement costs shown in the CVP rate and repayment study as being expensed through fiscal year 2031 are estimated to total \$79.8 million. A Bureau regional official said, however, that this estimate was based on replacing items at their original costs and that the estimate would be increased about \$30 million if it were based on 1973 costs. Also present departmental policy requires that, if the replacements were capitalized, interest be charged on the investment in such replacements at the rates applicable at the time of replacement. Bureau regional officials estimated that capitalization of replacements would tend to magnify, rather than reduce, the need for a rate increase if the same surplus (see contention 6, p. 21) were maintained.

Bureau officials said that the Bureau's expensing such costs tended to require a power rate increase primarily because of CVP's policy of not allowing a deficit to occur in any single year. (See contention 10, p. 30.) If that policy were eliminated, rates probably would not be affected much by expensing, rather than capitalizing, replacements, because the expenses would not have to be met in any particular year. This could be conclusively determined, however, only if the Bureau were to make computer analyses of the rate and repayment studies using both bases.

A Bureau regional official said that the new departmental policy requiring replacements to be capitalized had not been used in the CVP rate and repayment study supporting the proposed rate increase because of the complexities in modifying computer programs to reflect current (1973) cost levels and interest rates. He also said that such costs would be capitalized in the next rate and repayment study prepared for CVP.

Conclusion

On the basis of departmental policy, practices followed by other Federal power systems, and Federal Power Commission regulations, CVP should capitalize, rather than immediately expense, replacement costs. Although it is impossible to conclusively state the effect of this practice on the proposed rate increase in the absence of computer analyses using both bases, we believe that the effect probably would be to reduce the proposed rate increases but the effect would be small, particularly if the Bureau's no-deficit-year concept were eliminated.

PROJECT PUMPING COSTS--CONTENTION 8

"That the Bureau's increased costs of producing power should be borne, at least in part, by increases not only for the power sold to preference customers but also for the pumping power."

Discussion

Bureau-owned pumps are used to pump water, primarily for irrigation, through the CVP canals. Power used by these pumps is provided by CVP's power activity. The part of the construction cost of the power activity considered as being used for project pumping is allocated to the non-interest-bearing irrigation function. Also the irrigation function is charged a power rate designed to recover that part of the power function's operation, maintenance, and replacement costs which are considered applicable to providing project pumping power. Generally these charges became part of the non-interest-bearing irrigation costs to be repaid by power revenues. Therefore CVP's power customers must repay these costs and their only savings in transferring these costs to the irrigation function is in interest costs.

Reclamation instructions provide that power rates for project pumping for irrigation normally be determined by ascertaining the amount required to cover the average cost per kwh of operation, maintenance, and replacement of the power system. The instructions do not require that the rate include a charge to amortize part of the construction cost of the power facilities, apparently because part of such costs previously had been allocated to the irrigation function. The instructions provide also that the project pumping power rate normally be 2.5 mills per kwh unless a special project rate is justified and established.

Bureau regional officials told us that 2.5 mills per kwh was charged for power used for CVP project pumping purposes in earlier years when a lower rate could have been justified under Reclamation instructions.

We made analyses of project pumping rates which presently could be justified under the Reclamation instructions using various combinations of historical and estimated future

operation, maintenance, and replacement costs. Our computations, which were based on Reclamation instructions, did not justify increasing the present CVP project pumping power rate above 2.5 mills per kwh.

Conclusion

The 2.5 mills per kwh rate charged for CVP project pumping power appears to be appropriate on the basis of criteria set forth in Reclamation instructions. Even if the project pumping rate were increased, it probably would have little effect on the need for the proposed power rate increase to CVP's preference customers, because such customers would have to pay for most of the increased project pumping rate in the form of aid to the irrigation function.

POWER MARKETING POLICY AFTER 2004--
CONTENTION 9

"That the Bureau is unjustifiably increasing rates in 1974 to take care of expected decreased revenues after 2004, and that such long range estimates are sheer speculation."

Discussion

CVP's rate adjustment study assumes that after 2004, the year in which the Bureau-PG&E contract will expire, the amount of power available for sale to preference customers will steadily decrease from 1,050 megawatts to about 554 megawatts. This reduced amount is the power which the Bureau could sell from CVP without PG&E support. This assumed change in marketing policy would reduce the need for CVP to purchase energy from others.

A consultant opposing the rate increase contended that this assumed change would reduce operating revenues from a maximum of \$56.4 million in 1998 to approximately \$38 million or less after 2004. The consultant maintained that it would be more valid for the Bureau to assume a continuation of its contract after 2004 with PG&E which would be as favorable to the Bureau as the present contract. Such a change in marketing policy, according to the consultant, would increase CVP's revenues by \$446 million more than those shown in the rate adjustment study.

We agree that the assumed change after 2004 is speculation and that CVP's study does assume a decrease in capacity and energy for sale to preference customers and a corresponding decrease in gross revenue. We noted, also, that the assumed change in marketing policy after 2004 would result in an estimated increase from \$10.7 million in 1998 to over \$22.9 million in net revenues to CVP after 2004. Thus, all other factors remaining the same, the Bureau's changed marketing policy actually reduces, rather than increases, the need for a rate increase.

The reason that the assumed change results in a decrease in gross revenues but an increase in net revenues is that the Bureau assumes the decrease in gross revenues to be more than offset by cost decreases resulting, under the new policy,

from eliminating the need to purchase energy from other sources and to sell it at a loss to preference customers.

Conclusion

We believe that the Bureau's assumed change in power marketing policy after 2004--assuming that all other factors remain the same--tends to lessen, rather than increase, the need for a power rate increase.

NO-DEFICIT-YEAR CONCEPT--CONTENTION 10

"That the Bureau is unjustified in increasing 1974 rates to a level that will produce no deficit in any single year from 1974 to 2031."

Discussion

Bureau officials said that an Assistant Secretary of the Interior had established the criterion that, in preparing the present CVP rate and repayment study, the power rate be at least adequate to provide revenues in each year of the remaining repayment period (1974-2031) to pay all operation and maintenance expenses, the interest expense, the purchase power cost, and the replacement cost (no-deficit-year concept). Bureau officials told us that the basis cited for this concept was that it was good business practice to plan for no deficit in any single year.

Bureau officials told us that no written policy had been issued setting forth the no-deficit-year concept and that, to their knowledge, it had been established as a criterion only for the current CVP rate and repayment study. Bonneville Power Administration officials told us that they were unaware of the no-deficit-year concept and did not intend to use it as a criterion in the rate and repayment study the Administration was preparing for the Federal Columbia River Power System.

In some years of a repayment period, abnormal expenses may be anticipated because of such factors as planning for new power projects coming on line. Such new projects may result in increased expenses in the first few years that may be greater than the estimated initial increased revenues resulting from the projects. Also the cost of CVP's purchasing power from others (purchase power cost) is anticipated to be substantially more in some years than in others. If power rates are established for the entire repayment period on the basis of avoiding a deficit in every abnormal future year, the result can be power rates which provide substantially excessive power revenues in all other years of the repayment period. According to Bureau regional officials, the no-deficit-year concept was primarily responsible for proposing CVP power rates which would result in an estimated surplus of about \$496 million at the end of the repayment period.

We believe that the no-deficit-year criterion is not consistent with the averaging concept inherent in rate and repayment studies and that it establishes a new criterion which is inconsistent with the 1963 repayment policy statement issued by the Secretary of the Interior. A concise statement of the repayment policy embodied in the 1963 statement was set forth in an April 1, 1966, report¹ by the House Committee on Interior and Insular Affairs.

The report pointed out that the test for sufficiency of revenues was whether the capital investment could be repaid within the repayment period and that there was no annual schedule of capital repayment. The report also recognized that operating costs and revenues might vary from year to year and pointed out that the approach to repayment scheduling embodied in the 1963 policy "has the effect of averaging the year-to-year variations in costs and revenues over the repayment period." In our opinion, the no-deficit-year concept used in CVP's rate and repayment study is inconsistent with this "averaging" approach to repayment.

We believe that the sole basis intended for testing the adequacy of the power rate is clearly stated in the report, as follows:

"As long as the unamortized investment is less than the allowable unamortized investment, this demonstrates that each generating project, and each increment of investment in the transmission system, is being repaid within the allowable period."

The Bureau's regional office made a study in which it indicated that, if the no-deficit-year concept were eliminated and if a surplus were provided which was approximately adequate to cover deferred costs (see contention 6, p. 21), the effective net power rate for CVP would have to be 5.55 mills, rather than the proposed 6.15 mills, per kwh. The present net power rate is 4.08 mills per kwh. A power rate of 5.55 mills would represent about a 36-percent power rate increase compared with the presently proposed power rate increase of 51.6 percent.

¹ H. Rept. 1409, 89th Cong., 2d sess.

Conclusion

The no-deficit-year concept used in CVP's rate and repayment study is not consistent with the criterion used by other Federal power projects or with congressional statements as to the concepts which should be used in preparing a rate and repayment study.

INTEREST DURING CONSTRUCTION--CONTENTION 11

"That the Bureau's accounting procedures are unsound in charging interest on new plants from the time they are completed in 1984 until their reservoirs are filled and can produce revenue, instead of capitalizing such interest like interest-during-construction, which procedure results in increasing the power rate."

Discussion

Bureau, Corps of Engineers, and Federal Power Commission regulations do not require that interest continue to be capitalized on hydroelectric projects until the reservoirs are filled. The Bureau's practice is to capitalize interest during construction until the end of the fiscal year in which facilities reach the revenue-producing stage and to record interest as an operating expense from the first day of the following fiscal year. The Corps of Engineers' regulations require that interest during construction be capitalized to the end of the month in which facilities reach the available-to-serve stage and that thereafter interest be recorded as an operating expense. The Federal Power Commission's Uniform System of Accounts provides that interest during construction be capitalized only until the facilities are ready for service.

The Bureau's Reclamation instructions state that:

"* * * only that part of the multipurpose facility that is related to revenue producing activities, based on installed capacity to ultimate installed capacity, will be considered as having been transferred insofar as the transfer of interest during construction to plant accounts is concerned."

An official in the Federal Power Commission told us that filling the reservoir was not a factor considered by that agency in ascertaining when interest costs would no longer be allowed to be capitalized on a hydroelectric project.

Capitalizing interest during the reservoir-filling years would reduce interest expense and thus the size of the estimated deficit during those years. Under the no-deficit-year concept used in CVP's rate and repayment study, this

would tend to reduce the amount of the rate increase needed. If, however, the no-deficit-year concept were eliminated (see contention 10, p. 30), there probably would be little effect on the power rate needed by CVP, regardless of whether interest during the reservoir-filling period were expensed or capitalized. This could be determined conclusively, however, only if the Bureau were to prepare repayment studies on both bases.

Conclusion

CVP procedures for capitalizing interest during construction generally are consistent with those followed on other Federal power projects and with Federal Power Commission requirements. The primary reason that these procedures tend to magnify the need for a rate increase, compared with the procedure proposed by opponents of the rate increase, is because of another concept used in preparing CVP's rate and repayment study--the no-deficit-year concept. Our views on the propriety of this concept are discussed under contention 10. (See p. 30.)

HENRY G. REUSS, WIS., CHAIRMAN
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APPENDIX

GUY VANDER JAGT, MICH.
GILBERT GUDE, MD.
PAUL N. MCCLOSKEY, JR., CALIF.
ALAN STEELMAN, TEX.
JOEL PRITCHARD, WASH.

225-6427

NINETY-THIRD CONGRESS
Congress of the United States

House of Representatives

CONSERVATION AND NATURAL RESOURCES SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS
RAYBURN HOUSE OFFICE BUILDING, ROOM B-349-C
WASHINGTON, D.C. 20515

July 24, 1973

Mr. Elmer B. Staats
United States Comptroller General
General Accounting Office
441 G Street, N.W.
Washington, D. C. 20548

Dear Mr. Staats:

On January 27, 1973, the Interior Department announced that it would increase power rates at five Bureau of Reclamation multi-purpose projects. The projects are: Central Valley, Colorado River Storage, Parker-Davis, Eastern and Western Divisions of the Pick-Sloan Missouri Basin Program, and Rio Grande. Hearings on the proposed rate increases were recently held in Sacramento, California (July 10); Boulder City, Nevada (July 10); Salt Lake City, Utah (July 12); Denver, Colorado (July 11); Billings, Montana (July 10); and Amarillo, Texas (July 9). Our Subcommittee requested the Department to provide full information to us and to the public concerning the bases for the proposed rate increases; to afford adequate time for study of these data prior to the hearings; and to conduct the hearings with adequate opportunity for presentation of evidence, cross-examination of Bureau and public witnesses, and other essential elements of due process.

The proposed rate increases are very substantial. In the Central Valley alone the increases would amount to \$1.3 billion over the repayment period. The Department has furnished some, but not full, information to our Subcommittee and to the public. It is apparent that the proposed rate increases are based on highly complex data and on as yet unexplained or poorly explained assumptions. Neither the Subcommittee nor the public has assurance that the increases would comply with the criteria specified by law.

According to information we have received concerning some of the recently held hearings, the Department's hearing officers did not afford the public the opportunity to have the Bureau of Reclamation officials answer their questions concerning the facts and assumptions used in preparing the rate and repayment studies on which the proposed power rate increases are based, and Bureau officials refused to comment on the validity of points raised and suggestions made by power customers and others interested in the proposed rate increases.

We would appreciate your examining whether the Bureau's proposed rate increases and the procedures by which the Bureau is putting them into effect (including the extent to which base data is being made available and the manner in which the hearings are being held) are in accord with law and sound accounting principles.

We recognize that such an examination may involve exceedingly complex data and assumptions. Yet we would like to have your views substantially before the proposed rate increases become effective on January 1, 1974. We therefore suggest that you focus your examination on the issues which have already been raised at the hearings in the six cities mentioned above.¹

For example, as to the Central Valley Project, some of the contentions by opponents of the proposed increases are:

- (1) That virtually all of the proposed increase in CVP would be unnecessary but for the facts that the Bureau of Reclamation is selling, and proposes to continue selling, Centralia-generated power to the Pacific Gas and Electric Company at far less than the cost of generation; that the Bureau failed to adjust the rate on April 1, 1971, as specified under its contract with the Company; and that the loss to the government now resulting from these facts is about \$10 million per year and will total \$40 million by April 1, 1976.
- (2) That the Bureau's estimates understate power generation because they are based on average hydro generation in the low water period 1922-1954 rather than on longer periods, and that actual water run-off since the completion of the Shasta Dam in 1949 has been 16 percent greater than Bureau estimates.
- (3) That the Bureau's studies overstate the amount and timing of projected future water uses, thus understating future revenues from power sales.
- (4) That the Bureau is understating the Central Valley Project's dependable power capacity, which could be sold and produce additional revenue.
- (5) That the Bureau overstates its costs by purchasing Centralia capacity to deliver to PG&E at less than the cost thereof with no expectation of receiving returns from the capacity bank account.

¹GAO note: Pursuant to arrangements made with the Chairman's office, GAO's review was limited to an evaluation of the 11 contentions involving the Central Valley Project.

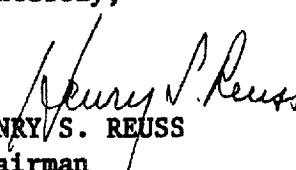
July 24, 1973

- (6) That the proposed rate increase will establish an unjustifiable cumulative earned surplus of about \$500 million after payment of all costs, interest and amortization.
- (7) That some of the Bureau's rate increases are due to overstating reserve requirements in particular years by expensing, instead of capitalizing, replacements.
- (8) That the Bureau's increased costs of producing power should be borne, at least in part, by increases not only for the power sold to preference customers but also for the pumping power.
- (9) That the Bureau is unjustifiably increasing rates in 1974 to take care of expected increased costs¹ after 2004, and that such long range estimates are sheer speculation.
- (10) That the Bureau is unjustified in increasing 1974 rates to a level that will produce no deficit in any single year from 1974 to 2031.
- (11) That the Bureau's accounting procedures are unsound in charging interest on new plants from the time they are completed in 1984 until their reservoirs are filled and can produce revenue, instead of capitalizing such interest like interest-during-construction, which procedure results in increasing the power rate.

Enclosed are copies of our Subcommittee's correspondence with the Department, and two statements concerning the CVP increases presented by Messrs. David S. Kaplan and Arthur Simon at the July 10 hearing in Sacramento.

Our Subcommittee staff will be available to meet with representatives of your staff to discuss the scope and progress of your examination into these issues.

Sincerely,



HENRY S. REUSS

Chairman

Conservation and Natural Resources
Subcommittee

Encls [Not included in this report]

¹GAO note: In accordance with instructions from the Chairman's office the phrase "increased costs" should be changed to "decreased revenues".