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C. F/ Central Files

THE PRESIDENT HAS SEEN....

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

May 12, 1975

OFFICE OF THE ADMINISTRATOR

INFORMATION MEMORANDUM

MEMORANDUM FOR THE PRESIDENT

FROM : Frank G. Zarb

THROUGH: Rogers C. B. Morton

SUBJECT: Electric Utility Financing Problems
Additional Government Initiatives

BACKGROUND

The investor-owned electric utility industry, which supplies nearly 80 percent of the Nation's electricity, is in serious financial difficulty. Industry problems that were developing prior to the 1973 oil embargo have greatly increased due to the ensuing rapid escalation in fuel costs, inflation rate, and interest rates. As a result of these problems, the Nation's energy, environmental and economic objectives are being threatened.

Although there is no longer the imminent threat of a utility bankruptcy or the omission of a stock dividend, a basic financial recovery has not taken place. One indication of the continuing nature of the problem is the discount of utility common stock prices from book value. At the end of February, the average common stock was selling at approximately 70 percent of book value.

Short-term financial stability has been achieved by a $22 billion cut-back in capital expenditures. In 1974 there were 235 coal and nuclear plants delayed or cancelled. This represents 114,000 MW of nuclear capacity--nearly 60 percent of the total planned nuclear facilities--and 74,000 MW of fossil fuel plants--or 30 percent of planned capacity. Nearly 70 percent of the nuclear cancellations and deferrals and 45 percent of the coal plant decisions were attributed to financing problems. In addition to jeopardizing the Nation's energy objectives and the adequacy of future electricity availability, these cancellations and deferrals accelerated and deepened the recession and increased unemployment by more than 120,000.

CURRENT PROGRAMS

1. Utilities Act of 1975

The Utilities Act of 1975 was submitted to Congress as Title VII of the Energy Independence Act. This Act addresses the basic financing problem--the inability of state regulatory commissions to react to the new economic problems in a timely manner. The intent of the Act is to increase utility cash flow and return on investment and to restore investor confidence. As you know, this would be achieved by establishing a series of minimum Federal standards for several key state regulatory practices, including (a) the elimination of regulatory lag, (b) the inclusion of construction-work-in-progress (CWIP) in the rate base, and (c) the use of normalized accounting practices.

2. Other Provisions

Additional provisions of the Program are:

A. Administration Proposal:

Increase the investment tax credit (ITC) to 12 percent for three years followed by a permanent level of 7 percent.

Legislative Status:

The "Tax Reduction Act of 1975" H.R. 2166, provides for a 10 percent ITC for two years reverting down to the current 4 percent level.

Additional ITC provisions may be requested after Treasury completes its general review of capital formation tax policies.

B. Administration Proposal:

Introduce a special class of preferred stock, the dividends of which are tax deductible by the issuer.

Legislative Status:

Part of H.R. 5005 in the House Ways and Means Committee. The Bill is in mark-up.

Since enactment and implementation of these provisions may not occur on a timely basis, the Energy Resources Council has decided to move forward with supplementary actions. These initiatives are indicated below for your information.

ADDITIONAL ACTIONS TO BE IMPLEMENTED

A. Executive Actions

1. Issue National Guidelines for Electricity Ratemaking:

   The Guidelines will be consistent with the provisions of the Utilities Act of 1975 and will be designed to make state regulatory practices more responsive to our national energy and economic needs. They will establish a basis for future Federal actions if necessary. Typical guidelines might be:

   - accelerated rate hearings
   - include construction-work-in-progress into the rate base
   - fuel adjustment provisions
   - use of innovative rate structures, such as peak-load pricing.

   In addition, criteria for energy conservation, plant reliability, and consumer protection will be included. The Guidelines will be developed by FEA in cooperation with the ERC and representatives of the private sector.

2. Initiate an Aggressive Information and Education Effort:

   An essential feature of the Guidelines approach is an aggressive campaign by the Administration to communicate with state legislators, state regulatory authorities, utility companies, consumer groups, and the public.

   To be effective, the Administration must present a unified and consistent position, emphasizing the role that electric utilities must play in meeting our National energy and economic goals. This effort will be directed and coordinated by FEA.

B. Legislative Initiatives

To induce state regulatory authorities to incorporate these Guidelines, tax incentives are necessary. These incentives would be available only to those states which incorporate the key provisions of the Guidelines.

However, Treasury is now evaluating tax incentives to encourage capital formation as part of a general tax reform package. Specific incentive recommendations may be forthcoming upon completion of this review.

C. Other Financial Alternatives

The Energy Resources Council has several other far-reaching financial alternatives under consideration. A thorough evaluation of these options is currently underway and recommendations are scheduled to be submitted to you on July 15.

These alternatives include:

° Guarantee of utility debt

° Government purchase of utility stock

° Tax-free stock dividends

° Contract to purchase electricity from new plants (to remove uncertainties in demand)

° Government purchase or construction of power generating plants and lease back to utilities.