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STATEMENT
OF

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BEFORE THE

SUBCOMMITTEE ON ENERGY AND POWER

OF THE

HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

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INTRODUCTION

Mr. Chairman and distinguished members of the subcommittee, I appreciate the opportunity to appear before you today on the subject of electric utility rate and regulatory reform.

The regulation of electric power, in fact the entire concept of electricity, has been the subject of intense discussion and disagreement for some time. The legislation we are focusing on today, H. R. 12461, is a response to part of a broad range of complex and inter-related problems. Before I make any statements about the pros and cons of such a response, I would like to discuss briefly the overall situation facing this critical energy sector.

BACKGROUND

Over a year ago, when the Administration first introduced Title VII of the Energy Independence Act, the electric utility industry was in the midst of an unprecedented crisis. The problems touched upon many key National issues: energy availability, fuel mix, financial, regulatory, environmental, consumer and conservation.

We agree that, in some ways, the crisis situation has abated. However, this does not mean that any of the basic problems have been solved. Just the opposite is true. Many of the problems -- which clearly preceded the 1973 embargo and subsequent rapid rise

in fuel costs -- are still here today. What has happened is that we have become "accustomed" to the way things are. The economy, consumers, and industry have come to accept the original crisis factors - higher fuel costs, higher rates, - as the status quo.

As a nation, we are still faced with the underlying problems which have yet to be fully understood and which must be resolved. These problems can be summarized as: increased uncertainty and a lack of timeliness.

Uncertainty affects all aspects of the energy and electricity situation and tends to increase consumer costs. The industry faces uncertainty in fuel costs and availability, in demand projections, in construction and expansion plans, and in rate of return decisions.

It is the consumer who pays the ultimate cost of uncertainty in higher interest rates, delays and fewer jobs.

It is also the consumer who bears the brunt of our second basic problem - the lack of timeliness. Electric power and energy decisions must be made now to determine where we will be 10 years from now. Delay due to the regulatory process, construction cutbacks, or financing problems will significantly affect our ability to adequately meet our future energy needs at the lowest possible cost.

As a nation, we can afford neither unnecessary delay nor excessive uncertainty. We have the capability of ensuring the future generation of electric power in quantities sufficient to meet our needs using domestic fuel resources. And we have the responsibility to develop this capability to its fullest potential.

The focus of our attention today - the regulation of electric power - has a significant impact on our ability to reduce this delay and uncertainty. Regulation does not operate as an isolated, distinct activity. Regulatory decision-making impacts, either adversely or positively, on many important National, State or local policies and goals. For example, consider the relationship between rate-making decisions and fuel choices. Then consider the significance of fuel choice in light of national energy policy and the development of domestic energy sources.

The basic process of regulation is one of balancing and weighing a variety of objectives. The responsibility for this massive task falls heavily upon state regulatory authorities. These groups are faced with complex problems which demand timely, well-reasoned responses. They must deal with a broad spectrum of consumers, utilities and government agencies who want their problems answered and their demand met.

We believe that state regulatory authorities deserve and need increased federal leadership and guidance to assist them

in meeting their expanding responsibilities. I want to emphasize my personal commitment and that of FEA's to help strengthen the role of state regulatory bodies. They have the important decisions to make, they are truly on the front lines, and they should have the support and information necessary to make these decisions.

ADMINISTRATION RECOMMENDATIONS

Before addressing the overall purposes and impact of H. R. 12461 the Electric Utility Rate Reform and Regulatory Improvement Act, let us briefly review what the President has previously proposed. H. R. 12461 embodies a series of general remedies for an undefined problem. It is a complex, unfocused proposal for sweeping regulatory reform. The Administration proposals encompass a larger part of the many inter-related problem areas.

In his 1975 State of the Union Address, the President proposed the Energy Independence Act. Within this Act are two titles, VII and VIII, which deal on a more specific, limited basis with utility regulatory reform and state energy planning. We believe that these two proposals constitute a more effective legislative approach to achieving regulatory improvements that perserve the integrity of state regulation.

The provisions of these two titles are specific reforms which provide the flexibility necessary for each state to respond to the needs and problems of individual situations.

These legislative recommendations are and should be supported with administrative and technical assistance to achieve their focused objectives. Specifically, I am referring to FEA's leadership in the areas of load management, peak load responsibility, and our program of cooperative agreements with state commissions to study these complex subjects.

A brief overview of Titles VII and VIII would be helpful at this point.

Title VII, the Utilities Act of 1975, mandates minimum regulatory standards, but relies heavily on continued vigilance by state regulatory authorities to see that standards are applied effectively and fairly. The Act contains six major provisions.

1. Five-month suspension limitation on proposed rate schedules. After five months from the date of filing, a proposed rate schedule would go into effect on an interim basis until the authority delivers a final order approving or otherwise disposing of the proposed change. No regulatory authority would be required to restrict its hearing and ruling process to a five-month time period. Regulatory authorities would be expected to exercise their full responsibility of review.

2. Automatic Fuel Adjustment Clause. Regulatory authorities may not prohibit, as part of any rate schedule, a fuel adjustment clause that permits monthly changes in a utility's rates to compensate for changes in the cost of fuel to the utility.

3. Removal of Prohibition Against Off-Peak Pricing. Regulatory authorities may not prohibit a utility from charging a lower rate for consumption of electricity during off-peak hours than that charged during on-peak hours.

4. Inclusion of CWIP in the Rate Base. Regulatory authorities may not prohibit the inclusion in a utility's rate base of the cost, to a specified maximum, of construction work in progress.

5. Inclusion of Environmental Control Costs in the Rate Base. Regulatory authorities may not prohibit utilities from including the costs of pollution control equipment in the rate base.

6. Normalization. Regulatory authorities may not prohibit utilities from using a normalization method of accounting with regard to benefits from the investment tax credit and accelerated depreciation.

Title VIII, the Energy Facilities Planning and Development Act of 1975, proposes a three-pronged attack on the problems of providing for energy resource development.

1. The National Energy Siting and Facility Report. This report would provide an informational framework for local, state, regional and national decision-making on energy problems.

2. State Energy Facility Management Programs. These programs, to be developed by each state, would provide consistent procedural frameworks for energy planning and development. Federal financial assistance would be provided for the development and implementation of these programs.

3. Streamlined Facility Approval by Federal Agencies A single application process would be established for the Federal regulatory review process. Applications would have to be reviewed and decided upon within an 18-month period. FEA would supervise the overall approval process.

These two Acts, unlike H. R. 12461, approach the general problems of rate-making and energy planning in a precise, limited manner. We believe that the most effective approach is one which provides leadership and assistance to state authorities without limiting their efforts or actions unduly. Above all, they need flexibility if they are going to be capable of dealing with the complex and dynamic requirements of regulation and planning now and ten years from now.

In addition to these proposals, the President endorsed the recommendation of his Labor-Management Committee by submitting a utility tax reform proposal to assist in the rapid completion of needed coal and nuclear generating facilities. These tax incentives were to be conditional upon two key aspects of regulatory change: construction work in progress in the rate base and normalization of the tax benefits. The key aspects of the proposal are:

1. increase the investment tax credit for generating facilities not fired by oil or gas;

2. allow depreciation to begin during construction for non-gas or non-oil facilities;

3. extend the current amortization provision for pollution control facilities and for the cost of conversion; and

4. permit establishment of stock dividend reinvestment plans.

Once again this proposal focused on specific objectives and did not limit the flexibility of state authorities and impose areas of greater uncertainity.

A different type of financial support is embodied in the Administration's proposed legislation to establish an Energy Independence Authority. Under this proposal potential assistance to utilities is conditional upon the signing of a three-party rate covenant between the utility, its regulatory authority and the EIA. The purpose of this approach is

to:

1. Protect EIA's investment by assuring that utility earnings will be 2.75 times all interest requirements, including interest on EIA loans.
2. Reform state regulatory ratemaking to assure that utility rates are established on a timely basis to provide adequate earnings.
3. Improve bond ratings on existing and future conventional bonds and thus allow for conventional financing in the future.
4. Lower consumer costs over the long term.

In effect, this mechanism would provide a resolution of some of the tough choices facing regulatory authorities such as insuring adequate rates today in return for sufficient levels of lower cost, domestically produced energy tomorrow.

The broad problems of the utilities also encompass many of the uncertainties facing the development of the Nation's coal and nuclear resources. The resolution of surface mining standards and the balancing of air and water quality requirements with other essential national objectives are both prerequisites to coal availability. Passage of the Nuclear Fuels Assurance Act is necessary to provide enriched uranium for the Nation's nuclear programs and is but one aspect of the complex problems surrounding this form of domestic energy development.

H. R. 12461

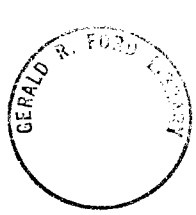
H. R. 12461 deals with a small part of the world utility problem, and in many aspects this legislation would tend to contribute to increasing the problems rather than resolving them. To begin with, the proposal does not provide the necessary element of flexibility needed in this dynamic regulatory environment. In fact, we believe it may increase complexities and uncertainties and result in higher consumer costs. By their nature, the problems of rate reform and regulatory improvement are nebulous and complex. A sweeping approach which requires mandated solutions for only part of the problem may only serve to exacerbate the situation.

During the next week of hearings, the major areas of concern will be discussed in detail by several FEA witnesses. I would like to limit my discussion today to those areas I consider most significant.

One major issue which this Act presents is the question of whether ratemaking practices should be mandated on a national basis. We believe that this approach puts excessive constraints upon state regulatory authorities. They are required to adopt certain practices, which, although worthwhile in concept, may not be uniformly beneficial in practice -- at least not with our current limited knowledge of the effects.

To illustrate, let's take the concepts of load management and peakload pricing. FEA strongly supports the concept of these two practices and urges their adoption where practicable. However, we have not taken the position that these practices should be adopted and implemented now on a nation-wide basis, without regard to other equally important considerations. Regulatory authorities have to be able to respond to particular problems and individual situations. For example, implementation of load management should take into account the increased need to use coal and nuclear base load plants, rather than rely on the increased use of intermediate or peak gas or oil-fired plants.

H. R. 12461 mandates the implementation of "lifeline" rates, or an alternative means of alleviating the burden to low-income consumers. We are acutely aware of the plight of utility customers. However, we are not convinced that "lifeline" rates are the most effective answer. In fact, there are studies which show that low-income groups are not necessarily the minimum-use electricity consumers. Equating low income to low energy consumption therefore, may not be correct. So, in effect, "lifeline" might be subsidizing middle and high-income consumers who do not need such a subsidy. Such lifeline provisions, therefore, may well not contribute to conservation.



FEA is studying this particular concept and is in the process of funding demonstration projects employing "lifeline" rates. At this time, we would advise against the adoption of such a practice on any wide-spread scale. State regulatory authorities should be free to study and adopt those rate structure concepts best suited to the needs of their particular situation.

There are two other ratemaking concepts which I will briefly discuss leaving the more detailed discussions for later witnesses.

H. R. 12461 provides for automatic adjustment clauses within certain specified limits. FEA generally supports the concept of such clauses and believes that they played an essential role in the period immediately after the Embargo. Many utilities would have suffered financial disaster if they had been unable to recoup rapidly rising fuel costs. However, we realize that automatic adjustment provisions may raise questions which affect other national energy objectives such as fuel mix. We are currently looking into the possible negative effects of automatic adjustment clauses in these areas.

H. R. 12461 also limits the inclusion of construction work in progress in the rate base to a specified percentage and excludes it entirely from bulk power rates. FEA believes that the construction of future facilities (particularly coal and nuclear base load plants) must be planned and financed with far more certainty than is now possible.

Consumers must be assured of a contunuing supply of electricity and utilities must be assured that they will be able to meet this future demand.

For these reasons, the inclusion of CWIP should not be arbitrarily limited to a certain percentage, or be contigent on fulfilling other requirements, or be entirely excluded.

I emphasized at the beginning of my statement that state regulatory authorities bear the brunt of ratemaking and planning responsibilities. To meet these responsibilities, they need support and assistance. FEA strongly advocates programs to provide them with the technical assistance they need in specific areas related to National objectives.

However, we do not support the establishment within FEA of a separate office of Electric Utility Ratemaking Assistance. State assistance projects can and are being effectively carried out within the existing FEA structure.

Closely related to the existing approach is our belief that any financial assistance should take the form of grants earmarked for specific, precisely definded purposes. Title VIII of the Energy Independence Act would provide authority for grants to assist states in developing Energy Facility Management Programs. In this way, we would achieve urgently needed state programs and reforms and provide appropriate assistance at the same time.

One of the areas which H. R. 12461 designates for financial assistance is the development of consumer representation programs. Various other parts of the bill deal with the consumer issue in relation to intervention and judicial review processes. Consumer input and participation are necessary and important to any regulatory process. However, we think that current mechanisms for consumer participation are adequate and effective. Improvements should come in the area of assisting the consumer to better understand regulatory procedures.

Legislatively mandated standards in this area would probably increase the confusion of an already complicated process and create more uncertainty and delay.

The final issue that I would like to discuss this afternoon is the concept of long-range energy planning. H. R. 12461 limits its provisions for such planning to bulk power facilities. Title VIII of the Energy Independence Act recognizes the need for overall energy planning which necessarily involves the non-power generation activities of the state, such as transportation, land use and employment.

H. R. 12461 also provides for the establishment of area planning councils for the purpose of regional planning. However, this process appears to be one mainly of compilation and coordination. Under Title VIII of the Administration Bill, states are authorized to enter into compacts with one another in order to develop and implement energy projects. This would seem to be a more effective way of accomplishing regional cooperation and coordination.

CONCLUSION

The subject under discussion today and for the next several days is one of great importance and great complexity. As I have discussed in my statement, there are many aspects of H. R. 12461 with which we disagree and cause us serious concern. In many areas, passage of this bill could lead to greater uncertainty, unnecessary delay and higher energy costs. During the next few days, we will clarify and elaborate on some of these concerns.

FEA recognizes the necessity for electric utility regulatory reform and for further necessity to cooperate with and appropriately encourage state authorities in this regard. We look forward to a continuing dialogue with the Committee and with representatives of the states in order to facilitate these long run objectives.

Electricity is an essential part of many National objectives: energy, econ omic, employment, and environment. In light of this significant role, it is imperative that we work together to develop effective programs for rate reform and energy planning.

Thank you, and I would be pleased to respond to any questions the committee might wish to ask.