Click here for Full Issue of EIR Volume 17, Number 39, October 12, 1990

U.S. electric power supply in doubt

Public utilities commissions wreak havoc with electric power industry, reports Steve Parsons. Part II of II.

The financial battering of the electric utilities industry through the combination of economic depression, social and industrial breakdown, environmental warfare, and Wall Street's financial manipulations, which was presented in Part I (see *EIR*, Oct. 5, 1990), has been enforced and enormously augmented by increasingly hostile actions of regulatory agencies, especially the local public utilities comissions (PUCs). Prior to 1973, PUCs had generally played a positive and vital role in working with the industry to ensure provision of reliable electric power. Costs for both consumers and the utilities were more or less constantly decreasing, thanks to an assured flow of profits to the industry which were reinvested in more efficient, modernized plant and equipment.

In the 1970s, all of that changed. In the words of a study entitled "Rate & Regulatory Developments in 1988" put out by the Rate Regulation Department of the Edison Electric Institute in Washington, D.C., "the regulatory compact . . . broke down." Supposedly responding to "public concerns" over alleged price gouging and the "dangers" of nuclear power and waste, PUCs have increasingly reflected the anti-scientific hysteria of so-called public opinion and the growing policy insanity emanating from Washington and New York. Wholly embracing the ideology of rabid environmentalists and anti-industrial purveyors, the media have retailed endless scare stories about utilities and nuclear power, replete with incessant scandal-mongering and charges of cronyism between PUCs and the industry.

Enforcing deindustrialization

While the utilities have been circumspect in commenting on this shift in the PUCs, there is no doubt that the occupational background and training of PUC members has shifted dramatically, as has their roles. PUC members have always been political appointees, beholden to the powers that be. But in the last two decades, they have more and more tended to be the most labile technocratic hacks, dominated by the ideologies of pragmatism, the "free market," and "competition." In California, for example, where the industry has been hit with tons of restrictions, rules, shifting standards, and arbitrary decisions, four of the five PUC members are careerists in public relations, media, and legal wrangling; only one has any background in science or engineering.

The California PUC is now actually *funding* environmentalist groups directly. On July 18, it awarded $23,293 to the Natural Resources Defense Council—one of the worst anti-industrial organizations around—for its "substantial contributions" as "intervenors" in regulatory decisions on utility rates adverse to the industry, to be paid by the state's three largest utilities.

Perhaps the worst case is Peter Bradford, the chairman of the New York State Public Service Commission. Bradford is an environmentalist who is opposed to nuclear power and an advocate of zero-growth policies. In 1977, he was appointed to a five-year term on the federal Nuclear Regulatory Commission by President Jimmy Carter, where he had an opportunity to vote his anti-nuclear views following the Three Mile Island incident.

In 1968, he participated in a Ralph Nader-sponsored study on the Federal Trade Commission; from 1968-71 was an adviser to the governor of Maine on the environment, oil, and power policies; and in 1971, became a member of the Maine Public Utilities Commission when it was initiating policies on environmental protection and the investigation of utilities.

Slashing rate increase requests

In the last few years, PUCs have hit utilities with an escalating number of cuts in requested rate increases, as well as with outright denials and actual decreases. Such actions dovetail perfectly with, and feed into, the Wall Street financial warfare operations.

Since 1986, these adverse rate request actions have been central in sharply lowering utilities' revenue per kilowatt-hour of electricity provided. In 1985, utilities on average received 6.72¢ per kilowatt-hour (kwh); by 1989, this had fallen to 6.60¢ per kwh. In constant dollars, the drop is a far more dramatic 11%—from 6.68¢ in 1986, to only 5.89¢ last year (see **Figure 1**).

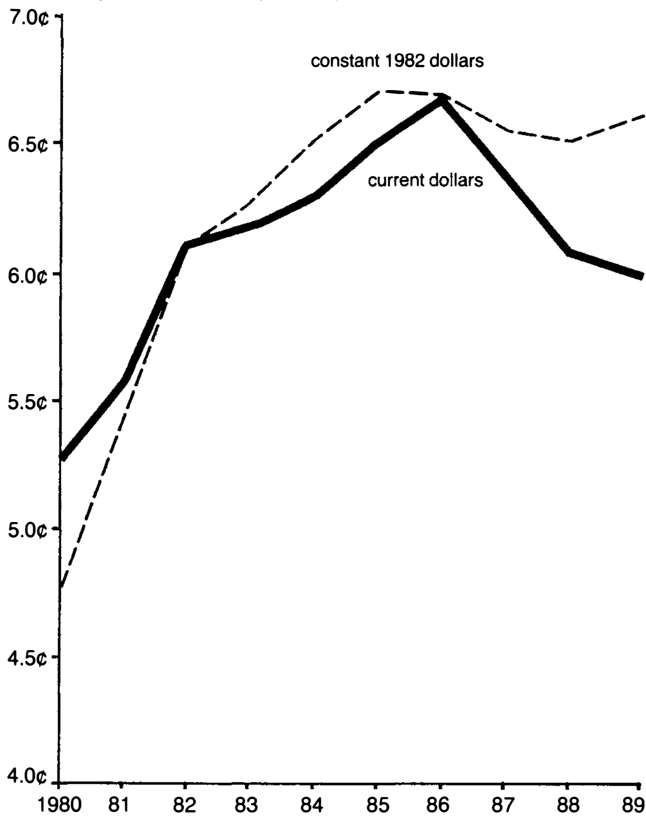
Rate requests today are almost routinely lowered, particularly for requests involving nuclear plants. Astonishingly, for the first time, utilities recently made more requests for

© 1990 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

FIGURE 1

Revenue per kilowatt hour declines in absolute and constant dollar terms

Revenue per kilowatt hour (in cents)



Source: Edison Electric Institute.

lowering rates than for raising them. The reason: to try to control the damage they knew PUCs would wreak if utilities tendered requests for increases.

There have been two criteria used by the PUCs that characterize the primary rationales for cuts in requested rate increases: "excess capacity disallowances" or "used and useful capacity," and "imprudence disallowances." Both criteria are inherently absurd.

Many utilities that have requested rate increases to amortize the costs of constructing new capacity have been denied either part or all of their requests on the basis of these criteria. PUCs have, in most cases arbitarily, de facto penalized utilities for building "excess capacity" that puts reserve margins above projected levels of such anticipated necessary capacity for a given period. PUCs have given little consideration to increases in demand beyond the low projections, nor to the relatively long lead time needed to build a baseload plant.

At the same time, shifting environmental and other regulatory rules have disrupted and tremendously extended the construction time of any new plant, driving up costs. But increasingly, utilities have been slammed with "imprudence disallowances by PUCs" for failing to plan for contingencies and interruptions that they not only had no way of anticipating, but had forced upon them by the PUCs and other regulatory agencies. According to electric utilities analyst Sanford Cohen of Morgan Stanley, there has been $13 billion in imprudence disallowances since 1984.

Two examples show the utter depravity of such PUC standards.

The case of Illinois Power

In March 1989, the Illinois Commerce Commission (ICC), the name for its PUC, ruled that only 27% of the added power capacity of the recently completed Clinton nuclear power plant was actually needed, and that Illinois Power had "imprudently" spent $666 million too much on its construction due to alleged "waste" and bad management decisions. This meant, first, that Illinois Power would not be able to raise its rates to cover more than 27% of the costs of construction—including the bonded debt—and would be forced to write off a huge chunk of its earnings. On top of that, the 27% would not include the $666 million, which the utility would simply have to take as a loss. The $666 million "imprudence disallowance" forced the company to write off $346 million and to eliminate common stock dividends.

The many years of delay in the completion of the Clinton plant, which added hundreds of millions of dollars in additional expense, was caused by a combination of new regulatory requirements from 26 federal, state, and local agencies on plant safety and construction, new environmental regulations, and company concern that the ICC would not grant rate increases sufficient to meet the added costs. When the ICC gave the utility the green light to complete Clinton, it was with the understanding that the added generating capacity of the plant was indeed "useful."

In fact, the Clinton plant has already seen full "usefulness." During the heat wave and drought of 1988, Illinois Power was operating nearly at peak capacity. With Clinton going full steam for 44 days that summer, the utility just barely met demand. Furthermore, with Clinton in operation, current forecasted planning reserve is 25%; without Clinton, it would have been 1.3% for 1989, and actually *negative* in 1991—which would have made blackouts a regular occurrence from 1988 on. On top of this, the four utilities in the Illinois Power region are on the verge of a capacity shortage. The Central Illinois Light Co., for example, is constantly scrambling to buy power outside its own system.

Illinois Power appealed both rulings and filed a lawsuit challenging the order. At a hearing in June of this year, the ICC modified the order, declaring that 61% of Clinton was needed and "useful." Although four paragraphs stated that 100% of the capacity of Clinton would soon be "used and useful," the increasingly "consumer-oriented" commission could not openly admit that its original decision was that far off base, and thus compromised at 61%.

The ICC thus wound up granting only $75 million of Illinois Power's requested $215.8 million yearly rate increase. As a result, Illinois Power might have to write off another $248 million and suspend payment of preferred stock dividends.

After the 1989 decision, Moody's downgraded Illinois Power bonds to BBB, only one level above junk bonds, virtually precluding any new construction and jacking up further loan and interest costs. On May 23, just days before the June hearing, Moody's dropped its rating of Illinois Power's preferred stock from "uncertain" to "down"—even before the results were in!

Long-term investors are simply getting out, with utility stock subject to the vagaries of speculation and manipulation on Wall Street. And that fuels more unfavorable rate decisions in a downward spiral that has buffeted the industry over the last two decades.

What is about to further decimate Illinois Power and utilities across the nation is the Clean Air Act. Illinois Power has five 30-year-old fossil fuel plants in which they are required to put in scrubbers. The cost will be at least $1 billion, which will have to be raised as ever more costly bonded debt from investors that are increasingly less attracted to an industry saddled with such costs, and from rate increases that the ICC will likely grant since it's for environmental reasons.

As a result, utilities like Illinois Power have been forced to implement sharp austerity measures that are bound to affect service. Illinois Power cut 500 positions—11% of staff—in 1989 to "save" $30 million per year, and closed or consolidated a number of offices in their service territory. Particularly affected will be customers in outlying areas. Service offices will have smaller staffs and repair crews, which will "save" all of $3 million a year, while repairmen will now have to travel farther to serve smaller towns.

To make matters worse, slick consultants and accountants have been hired to "streamline" and "modernize" company management practices. The so-called "dinosaurs," who cared nothing for Madison Avenue techniques but knew their business backwards and forwards, are being pushed out. What is "in" are sophisticated—and expensive—efforts to "build up the company's image" among the public through substantial expenditures on things like new company logos and "good news" advertising.

The meat-axe austerity and "modernization" have caused such chaos that the company was forced to rehire some of its more experienced people.

The case of Philadelphia Electric

On April 19, the Pennsylvania Public Utilities Commission granted the Philadelphia Electric Co. only $242.2 million of a requested $548.6 million rate increase. The company's rate request was made largely to recoup the costs of constructing its Limerick 2 nuclear power plant, which went on line Jan. 8.

The PUC cut Philadephia Electric's request because of "excess capacity" and "imprudence" disallowances. First, it ruled that the company now had 400 megawatts (MW) "excess capacity" out of the total 1,100 MW the Limerick 2 plant can produce. Second, it said that the company had spent $60 million "imprudently" due to bad management decisions that caused delays and suspended construction in the 1970s.

The PUC's decision is absurd on many counts. Philadephia Electric now has 28% reserve capacity. After a PUC investigation in 1985, prior to the restarting of construction on Limerick 2 in 1986, the PUC concluded that a reserve capacity of 25% was reasonable. On April 19, however, the PUC capriciously changed its earlier capacity ruling to 22%, and penalized the utility.

The company's 28% reserve capacity figure can hardly be termed excessive. Unlike many utilities, Philadephia Electric "is now well-positioned to meet the demand for power in the 1990s," says Neil McDermott, a company spokesman. Its strong reserve margin has played a vital role in supplying needed power to the nine companies in the Pennsylvania-Maryland-New Jersey interconnect region. In 1989, the region provided by these companies had five instances of voltage reductions during periods of heavy demand. If the company's "excess capacity" had not been available, there could possibly have been blackouts.

As for the "imprudent" management decisions, the three to four years of delays and suspension in construction were ordered by the PUC itself because load use declined in 1976 and 1978. Contributing factors were the soaring cost of fuel from the oil crises, the Three Mile Island nuclear scare, and zooming interest rates. All of these affected anticipated growth in demand and raised doubts about Philadephia Electic's ability to finance the completion of Limerick. It was, therefore, "prudent" at the time for the company to back off from the anticipated service dates. If it had just gone ahead and continued building Limerick, it could well have been slapped with lower rates for having built "excess capacity" that would not have been "used and useful." Nevertheless, the PUC ruling in April insisted that $60 million was "imprudently" spent because of the delays!

The rate request reduction will cost Philadephia Electric $306 million a year, and it has instituted an immediate 45% cut in stockholder dividends and a program of deferred maintenance while carving $100 million—10%—out of this year's operating budget. To avoid layoffs, the company has had to offer early retirement to its employees. Top management is taking pay cuts from 2-10%. Although bond ratings have not yet been lowered since the April decision, the machinations over Limerick 2 since 1974 have lowered the company's bond ratings to a level now just above junk bonds.

The 'conservation equals power' absurdity

Similar horror stories abound throughout the electric power industry. Many utilities reported sharp profit drops in

the second quarter due to higher costs that they are not being permitted to recoup through needed rate increases. The latest is Baltimore Gas and Electric Co., which registered a 40.6% drop in profits for the second quarter and 35.4% drop for the first six months. Its earnings rate was half the level expected.

Another recent hit was sustained by Commonwealth Edison Co. in Illinois, which reported a huge $398.8 million loss in the second quarter, all due to refunds ordered by the Illinois Commerce Commission and backed up by the state courts. The utility was penalized $523 million for its alleged "imprudent cost overruns" in building three nuclear power plants. The "imprudence" was almost entirely caused by regulatory and environmental rulings that delayed construction of the plants and inflated costs far beyond original projections.

Even more lunatic are punitive rate actions to enforce power "conservation," which PUCs are viewing as the alternative to building costly new plants. In cases before PUCs in New York and Washington, D.C., electric utilities have been told that instead of being granted requested rate increases to ensure the provision of reliable power, they must enforce consumer "conservation" programs to cut demand.

The July 7 *Washington Post* reported that Potomac Electric Power, which had to black out 70,000 customers two days before because of inadequate reserve capacity margins, was granted a 1.6% rate increase compared to the nearly 7% it requested. The commission, according to the *Post,* penalized the utility for failing "to enact aggressive energy conservation programs." PEPCO blasted the Commission's action, stating that the increase was "inadequate to cover costs." Its last rate increase was in 1984.

In New York, the Public Service Commission has recommended that Orange and Rockland Utilities have its rate frozen until Jan. 1, 1991, and then be granted 2.7% of its requested 5.8% increase—provided it includes a $3 million increase for conservation programs.

The PSC also proposed to "decouple" the relationship between earnings and electricity sales to "eliminate both extra profits from increased sales of electricity and lost profits resulting from energy conservation." Thus, a company which is in business to sell electric power will now make money paying customers not to buy their product.

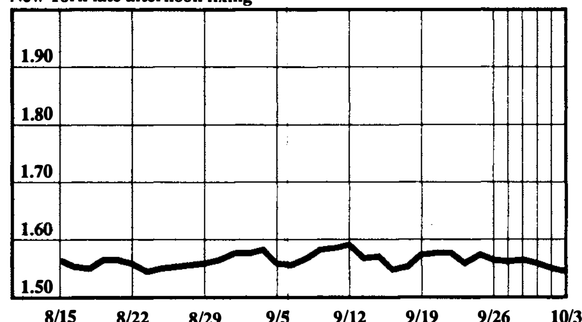
The depths of this newspeak was evinced by the Bonneville Power Administration which announced a new program on July 17 "to pay customers to find ways to use less power. The program is called "billing credits." BPA actually calls this "acquiring" power; such cutbacks, it says, will mean "acquiring 50 megawatts through this program."

These "policies have been quite effective in stopping new construction and eroding investor confidence," says Edison Electric in its 1988 Rate Regulation report. There is no doubt that such "effectiveness" will soon mean the end of the United States as an advanced industrial nation.

Currency Rates

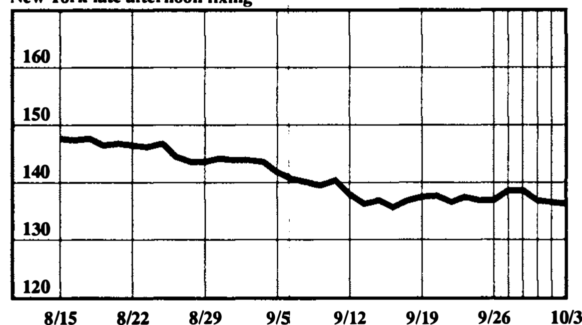
The dollar in deutschemarks

New York late afternoon fixing



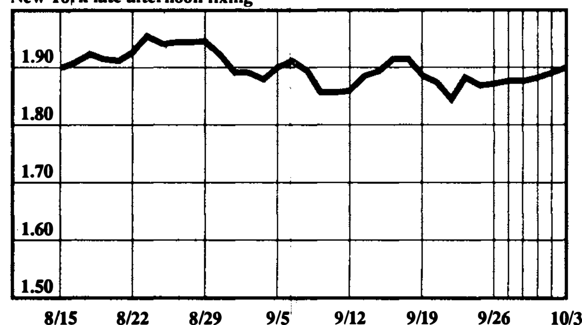
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing