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[Feb. 1975?]

CONCEPTS FOR STIMULATING EQUITY INVESTMENTIN ELECTRIC UTILITIES*

While the Nation is struggling to minimize the depth and duration of economic recession, it would frustrate the national objective of increased productivity and the creation of new jobs if because of investor disinterest a serious deficiency in power supply should develop.

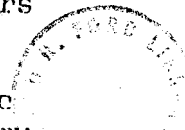
The role of electricity in achieving national self-sufficiency is to displace petroleum and scarce natural gas with the direct use of electricity generated from coal and uranium. This role for electricity contemplates that by the year 2000, electricity could be as much as 60% of the total of energy consumed -- instead of the 50% projected by many before the Arab oil embargo.

At the present time the capital crunch is a serious threat to the availability of electricity and stands as a real barrier to electricity performing its assigned role.

FLOW OF FUNDS

The Federal Reserve Bank's analysis of the flow of funds demonstrates that during the four-year period, 1970-73, direct investment in corporate equities by individuals was -\$22.2 billion (a net divestment of holdings). During this period, 1970-73, corporate equities as a percentage of personal financial assets dropped from 35% to 30% while the total personal financial assets increased 20% in the same period. This flow of funds analysis clearly points to the flight of investors

* This paper was prepared to address the problems of the electric utility industry only, but it is not intended to indicate that the concept involved is not applicable to other elements of the economy in varying degrees.



from the corporate equity markets while their individual savings were being invested in temporary or short-term savings and securities.

CANCELLATION AND DEFERRAL OF POWER PLANT CONSTRUCTION

As of October 1, 1974, announcements have been made by electric utilities to the effect that 132,490 megawatts of planned capacity have been postponed or canceled, of which 89,326 megawatts were planned as nuclear plants. This represents more than half of the scheduled nuclear capacity. Some of these postponements and cancellations were related to reduction in estimates in load growth, but most of the nuclear announcements were related to the expected unavailability of capital.

Nuclear capacity requires approximately twice as much capital per kilowatt of capability but because nuclear fuel is only 1/4 or less the cost of fossil fuel, nuclear power is less costly for consumers.

ELECTRIC UTILITY EQUITY INVESTMENT

Electric utilities generally now have debt ratios in excess of 50% -- some as high as 55%. Further increases in debt ratios are not acceptable to investors and would have the effect of making equity investment less attractive. The ability of electric utilities to market senior securities, bonds and preferred stock, is directly conditioned upon the ability to market common stock.

The central problem in the future financing of an adequate supply of electricity is the raising of equity capital. Because equity investors believe that management and regulation will not cause electric pricing to reflect rising costs of service as rapidly as costs rise, electric utility common stocks are selling substantially below book value --

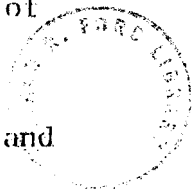


many as low as 50% of book value. Construction budgets contemplate the sale of substantial amounts of common stock in the next five years, but companies whose stock is priced substantially below book value are limited in the amount of equity dilution that can be absorbed.

The future financing of electric utilities thus turns first on earnings and then on how to get the market value of electric utility common stocks nearer to book value fast enough to permit adequate funds to be raised in the public markets. Success in this effort will facilitate the orderly continuation of construction thereby avoiding a major disruption of the economy because of the unavailability of adequate electric power.

REGULATION

The need for more adequate and more expeditious regulatory response has been the subject of broad public discussion and writing. The essence of that discussion is not repeated here but this paper is predicated upon the assumption that while inadequate regulatory response will be corrected, the national interest required additional stimulation of interest in electric utility equity investment. It is not conceivable that investor confidence in electric utilities will be so rapidly restored by regulatory action as to attract adequate common stock investment without the necessity of additional action. Such additional action does not obviate the need for adequate and timely regulatory response but the additional action is intended to add the further needed stimulus to attract the required equity investment. Increasing market value of common stocks to more nearly book value level will alleviate some electric rate pressures by reducing the number of new shares issued and reducing the dilution effect of new issues.



INCOME TAX IMPACT

As a direct product of inflation, bond interest rates and preferred stock dividend rates have increased more than 50% since 1969. This has required electric utilities to seek comparably higher rates of return on common equity investment. Because of the capital intensive nature of electric utilities, the impact of the corporate income tax has exacerbated the electric rate problem.

PROPOSED FEDERAL GOVERNMENT ACTION

The Congress should provide immediately that dividends on all common stocks and dividends on all subsequently issued preferred stocks of electric utilities are excluded from taxable income of the recipients of such dividends.

AID OF LAST RESORT

Aid of last resort for companies that otherwise might be bankrupt is not dealt with in this paper and should be treated as a separate subject.



Flow of Funds
Amount and Composition of Individuals' Savings
Seasonally Adjusted Annual Rates
(Dollars in Billions)

	1968*	1969*	1970*	1971*	1972*	1973*
Total Increase in Financial Assets	\$73.3	\$62.1	\$78.3	\$99.7	\$125.7	\$138.2
Financial Assets Purchased						
1. Currency and Demand Deposits	\$12.5	\$ 1.6	\$ 9.0	\$ 11.1	\$13.4	\$13.1
2. Savings Accounts	30.3	6.0	44.4	70.3	75.4	67.7
3. Securities						
a. U.S. Savings Bonds	.4	-.4	.3	2.4	3.3	2.7
b. Other U.S. Treasury Securities	5.4	10.5	-12.7	-11.8	- 2.6	6.5
c. U.S. Govt. Agency Securities	-.2	2.8	2.8	- 5.0	-.1	11.1
d. State and Local Obligations	-.8	9.6	-.8	-.2	1.0	4.3
e. Corporate & Foreign Bonds	5.2	6.6	10.7	9.1	4.8	1.1
f. Commercial Paper	.7	4.8	-1.5	-3.9	1.5	3.5
g. Investment Company Shares	5.8	4.8	2.6	1.1	-.7	-1.6
h. Other Corporate Equities	-12.3	-8.6	-4.4	-6.5	-4.7	-6.6
Total Securities	\$ 4.2	\$30.1	\$-3.0	\$-14.8	\$ 2.5	\$21.0
4. Private Life Insurance Reserves	4.6	4.9	5.1	6.1	6.5	7.2
5. Private Insured Pension Reserves	2.9	2.9	3.3	5.2	6.0	5.2
6. Private Non-insured Pension Reserves	6.4	6.3	7.1	7.3	6.8	7.7
7. Govt. Ins. & Pension Reserves	5.6	7.1	8.8	9.4	11.5	11.5
8. Misc. Financial Assets	6.8	3.1	3.6	5.1	3.7	4.8
Total Increase in Financial Assets	\$73.3	\$62.1	\$78.3	\$99.7	\$125.7	\$138.2

- * Revised
- / First Quarter
- # Less than \$500,000

Note: Components may not add to total because of rounding.

Source: Flow of Funds, Federal Reserve System. Statement for Households, Farm and Non-farm Non-incorporated Business.

Prepared: September 17, 1974

YEAR-END ASSETS AND LIABILITIES OF HOUSEHOLDS
YEAR-END LEVELS

(Dollars in Billions)



	1967	1968	1969	1970	1971	1972	1973	1973/1967 % Increase	Compound Annual Growth Rate
Total Financial Assets	1,729.4	1,945.3	1,891.5	1,958.5	2,176.3	2,450.6	2,350.1	35.9	5.2%
1. Demand Deposits + Currency	128.0	140.5	142.3	153.6	164.6	176.7	189.7	48.2	5.3
2. Savings Accounts	341.5	371.7	377.8	422.3	492.5	567.9	635.6	86.1	10.9
3. Securities									
U.S. Savings Bonds	51.1	51.5	51.1	51.4	53.8	57.1	59.8	17.0	2.7
Other U.S. Treasury Sec.	29.6	34.9	45.3	32.6	20.5	17.9	24.4	(17.6)	(3.2)
U.S. Govt. Agency Sec.	10.3	10.2	13.0	15.7	11.0	10.9	21.1	104.9	12.7
State & Local Obligations	37.7	37.0	46.1	45.4	45.2	46.2	50.5	34.0	5.0
Corporate & Foreign Bonds	19.0	23.7	30.3	41.0	50.5	55.6	56.8	198.9	23.0
Commercial Paper	.6	1.4	6.1	4.6	.7	2.2	5.7	850.0	45.5
Investment Company Shares	44.7	52.7	48.3	47.6	56.7	59.8	46.5	4.0	.7
Other Corporate Equities	689.0	812.4	701.7	685.9	777.0	899.3	657.9	1.3	.2
Total Securities	882.0	1,023.7	941.9	924.2	1,015.4	1,149.0	962.7	9.1	1.5
4. Private Life Insurance Res.	108.2	112.9	117.8	122.9	129.0	135.5	142.7	31.9	4.7
5. Private Insured Pen. Res.	32.1	35.0	37.9	41.2	46.4	52.3	57.5	79.1	10.2
6. Private Non-Insured Pen. Res.	89.4	101.4	102.5	110.8	130.5	156.5	133.3	49.1	6.9
7. Govt. Insurance + Pen. Res.	71.0	77.2	84.2	93.0	102.2	113.3	124.6	75.5	9.8
8. Miscellaneous Finan. Assets	77.2	84.0	87.0	90.6	95.7	99.4	104.2	35.0	5.1
Total Liabilities	497.7	540.1	580.4	612.6	669.3	755.9	842.5	69.3	9.2
1. M.g. Debt on Non-Farm Homes	229.4	244.0	260.1	272.5	296.4	334.8	379.0	65.2	9.7
2. Non-Corp. Bus. Mortgage Debt	75.4	82.0	89.0	97.0	107.9	121.1	133.0	76.4	9.9
3. Consumer Credit	100.8	110.8	121.1	127.2	138.4	157.6	180.5	79.1	10.2
4. Security Credit	12.7	15.6	12.2	10.4	13.1	17.7	13.1	3.1	.5
5. Policy Loans	10.8	12.1	14.7	17.0	18.0	15.0	21.2	96.3	11.9
6. Other Debt	68.7	75.6	83.3	88.5	95.6	105.7	115.7	68.4	9.1

Note: Components may not add to total because of rounding.
Source: Federal Reserve System. Statement for Households, Farm and Non-farm Non-incorporated Business.
Prepared: October 15, 1974.

SUMMARY STATEMENT

of

HOWARD P. ALLEN

EXECUTIVE VICE PRESIDENT

SOUTHERN CALIFORNIA EDISON

Before The

SUBCOMMITTEE ON ENERGY AND POWER

Of The

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

U. S. HOUSE OF REPRESENTATIVES

February 20, 1975

Southern California Edison Company provides electric service to about 8 million people in a 50,000 square-mile area and has hydroelectric, nuclear, coal-fired, and oil- and gas-fired generating plants.

About 77% of our electric capacity is oil- and gas-fired plants. Up to 1969 about 80% was gas fuel and we used about 10 million or less barrels of oil per year. The decline in availability of natural gas has reversed this where in 1975 we will get only about 11% natural gas and estimate we will burn 53 million barrels of foreign-source low-sulfur oil. California electric utilities will require about 120 million barrels of such oil for electric generation this year.

Edison is the largest consumer in the nation of fuel oil for electric generation. Edison alone uses a little less than 20% of all low-sulfur oil (0.5% or less) and a little less than 10% of the total oil, regardless of sulfur level, purchased in the U. S. for electric generation during the last two years. California electric utilities use about 32% and 15% respectively.

Air pollution regulations prevent Edison from burning oil in excess of 0.5% sulfur content by weight. Therefore, we are totally dependent upon high-cost foreign imported low-sulfur crude for domestic refining into low-sulfur residual oil and upon direct importation of low-sulfur residual fuel. Edison has no domestic alternative to obtain sufficient quantities of such low-sulfur fuel oil.

If we are to keep the lights on and meet the air pollution standards, we have to buy from domestic refiners who have access to limited supplies of low-sulfur foreign oil. Most of our low-sulfur crude is imported from Indonesia and processed in domestic refineries in California. Edison's average cost of low-sulfur residual fuel has increased from \$2.35 per barrel in 1970 to in excess of \$16.00 per barrel in January of 1975, more than 600% in 5 years. Our fuel oil bill has increased from \$29 million in 1970 to \$750 million in 1975. Our total fuel bill in 1975 is estimated to be \$1 billion.

New England utilities and their customers were given an entitlement credit under the Old Oil Entitlement Program which has now become a credit against the \$3.00 import fee under the President's Import Fee Program. The only difference between New England utilities and California electric utilities is that the New England fuel is refined outside the U. S. and brought in as residual oil, whereas our fuel is imported as crude and refined in the U. S. This credit, which amounts to a difference between \$3.00 per barrel and \$1.20 per barrel import fee unjustly discriminates between electric utilities and their customers. The use of residual oil by California electric utilities is no different than the use made of such oil by New England electric utilities. Edison's cost per barrel of limited-supply, low-sulfur, foreign oil exceeds oil costs of electric utilities in other regions, including New England. The New England credit, contrary to established national policy to increase domestic refining, encourages refining outside the U. S.

California electric customers have already been subject to mandatory conservation programs. Edison's sales in 1974 were 6% below 1973. Electric rates for Edison customers have more than doubled and in some cases nearly tripled in

the last few years, primarily because of increases in the price of oil used in generating electricity. Formerly 20 cents out of every dollar of revenue went for fuel and purchased power. This year it is estimated to be 55 cents out of every dollar of revenue, before the imposition of any import fee, which could raise electric rates for Edison customers about \$85 million in 1975 and \$150 million in 1976. For all California electric utilities a \$3.00 import fee would be about \$160 million in 1975 and nearly \$300 million in 1976.

Also, since sufficient domestic supplies of low-sulfur oil are not available, the imposition of the fee would not alter Edison's dependency on foreign oil for producing electricity. The purpose of the import fee is to increase price to cause conservation to reduce importation. Edison and similarly situated electric utilities have already had doubling and tripling of rates, meaningful conservation, and cannot decrease importation because of the lack of availability of such low-sulfur oil domestically. Therefore, we urge that electric utilities like Edison be exempt from the import fee on oil. Specifically we suggest the following:

- (1) Exempting low-sulfur residual fuel oil entirely from the increased import license fees and granting refiners exemptions for foreign crude used to domestically produce low-sulfur residual fuel oil if the importing or purchasing utility can show that:
 - (a) It is required to burn low-sulfur fuel oil for environmental reasons,
 - (b) Such low-sulfur fuel oil is not available domestically, and
 - (c) It has instituted an energy conservation program.

Such modifications could be done in a manner similar to the Oil Imports Regulation 213.14 as follows:

Each person with refinery capacity in District V who produces in District V low-sulfur residual fuel oil to be used as fuel which contains not more than five-tenths of one percent (0.5%) sulfur by weight and which is delivered to consumers for use as fuel in order to comply with governmental requirements respecting air pollution shall receive an exemption from the increased import fee for the amount of imported crude oil equal to the amount in barrels of such low-sulfur residual fuel oil to which the applicant certifies both as to production and delivery. The benefits of this exemption are to be passed on to the purchasers of the low-sulfur residual fuel oil.

The financial condition of the electric utility is deteriorating. Some say it is a crisis. Electric utilities are experiencing a debilitating erosion of revenues due to reduced consumer demand, lack of timely and adequate rate relief, enormous and wasteful increases in plant costs due to the stretch-out of construction periods of major projects, substantial environmental expenditures, soaring operating and fuel costs, depressed stock prices, and record interest rates on debt offerings. Electric utilities throughout the country have deferred billions of dollars of construction programs with the attendant impact on jobs, manufacturing, economic slow-downs and reduction in reserve margins which may impair future electric service. Utilities are the most capital-intensive of all industries. Many utilities' bonds have been downgraded. Recently shares of

90% of listed utilities were selling well below book value. Recently over 40 utilities have had to postpone or revise security offerings. What should be done?

In order for utilities to be able to raise the estimated \$600 billion needed over the next 15 years to meet this nation's demand for electric power and maintain service reliability of which about \$400 million will have to be raised in security markets, Congress should enact incentives for investors of electric utility common and preferred stocks. The most effective incentive would be for Congress to provide immediately that dividends on all common and dividends on all subsequently issued preferred stocks of electric utilities be exempted from taxable income of the recipients of such dividends.

Another proposal which would be less effective, but may be easier to enact, would be to provide that cash dividends on common stocks of electric utilities which are reinvested in the common stock of the dividend-paying corporation would be exempt from federal income taxes of the recipients.

Another way to help the capital formation problem is for Congress to increase the investment tax credit allowance for utilities with removal of the limitation against which the tax applies and with normalization accounting. Unless electric utilities can raise the capital necessary to build high-capital cost nuclear and coal electric generating plants which are necessary to reduce this nation's reliance on imported oil this country cannot meaningfully reduce foreign oil imports and the attendant foreign government control of a substantial part of our national energy base.

In addition to the import fees and substituted \$2.00 per barrel tax and the investment tax credit, the President has proposed a series of bills entitled "The Energy Independence Act of 1975" which includes opening up the naval reserves, establishment of strategic petroleum reserve storage to guard against future import disruptions, price deregulations of new natural gas, provisions to increase the use of coal by utilities, provisions to speed up utility rate cases, including mandatory fuel adjustment clauses, construction work in progress in the rate base and other provisions, an energy production plant siting procedure, a proposal to help speed up the siting and construction of nuclear plants, an energy development security act, development of new building codes by state and local agencies, energy consumption labeling of appliances and vehicles, special standby authority to propose rationing and changes in the Clean Air Act. In general, Edison supports the objectives of all of these proposals. We would, however, like to reserve detailed comments until the bills are considered, at which time we may wish to make certain recommendations regarding improved or alternate ways which should be considered to accomplish the objectives.

In closing, we do not think that the two-tier price system for crude oil should be eliminated at this time. We are not convinced that the removal of the price ceiling on old oil would affect or contribute to the increase in the production of domestic oil, but would foreseeably have an added burden on our customers in an already inflationary economy.