ENERGY REGULATION: A QUAGMIRE FOR ENERGY POLICY

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INTRODUCTION

The ultimate effectiveness of any policy is largely dependent on the individual efficacy and coordination of the agents or agencies that implement it. There are ample illustrations of the truth of this premise in the recent attempts by the Administration and Congress to formulate and implement a national energy policy; as a result, that policy, irrespective of any intrinsic soundness, could inevitably become trapped in a quagmire of regulatory policies and practices.

The difficulties that energy policymakers in the United States have experienced in 1974 and 1975 are in many respects symptomatic of the very problem that they have intended to resolve—the lack of a comprehensive and coordinated national energy policy. Decisions concerning energy supply and general policy that have been made over the years have contributed to the creation of areas of special concern and interest, institutionalized them, and nourished them through dedicated sponsorship by either the Congress, the Executive Branch, the independent federal agencies, or industry. The difficulties that stymied congressional consideration and executive implementation of an effective energy policy in 1974 and the first half of 1975 mirror this state of affairs.

In 1974, energy policymaking literally resembled a Rube Goldberg production with an abundance of action and few real results. More than 2000 energy-related bills and resolutions were introduced in the 93rd Congress. More than a thousand days of exhaustive hearings were held; and finally, about forty laws were enacted. Among these was the extremely important Energy Reorganization Act that established the Energy Resources Council and separated the functions of the Atomic Energy Commission into the Nuclear Regulatory Commission and the Energy Research and Development Administration. This measure consolidated most of the government's energy R & D efforts and removed the conflict-of-interest stigma that had stymied the AEC's efforts to both develop and regulate nuclear energy. In the final analysis, however, the legislative record of the 93rd Congress with respect to
energy matters reflected neither a guiding philosophy nor a strategy for coordinated and comprehensive action.

The 94th Congress, on the other hand, has in some ways begun to approach the energy situation as a composite whole, rather than as a collection of distinct and separate issues. And, in 1975, the Administration seemingly settled on an energy strategy and, through the Energy Resources Council, has provided some continuity of purpose and support to its energy proposals.

These developments, while often bearing the seeds of productive action, have sometimes resulted in political confrontation and conflict. Where once there was no proposal detailing a comprehensive national energy policy, at least three competitive plans emerged—the President's (S 594), the House Ways and Means Committee's (HR 5005) and the Democratic Majority's. Congress became embroiled in a surplus of energy proposals and internecine competition for oversight to such a debilitating extent that Senate Majority Leader Mansfield suggested the creation of a new congressional committee to which all energy-related bills could be referred. Minority Leader Hugh Scott called the existing situation a "legislative nightmare." An example of this congressional congestion is the fact that issues that were once the almost exclusive province of the Joint Committee on Atomic Energy are now subject to consideration before several congressional committees. In late April, for example, Congressman Morris Udall's Subcommittee on Energy and the Environment of the House Committee on Insular Affairs began hearings to review the entire range of issues associated with nuclear energy. In the Committee's view, it has been given, through the jurisdictional rules of the House of Representatives, special oversight functions to review and study activities in this area. Other committees too are competing for this role at a point in time when prompt congressional action on nuclear issues is needed if utilities are to proceed with the kind of advance planning necessary to assure a reliable electrical supply and if industry is to attract and commit substantial financial resources to further development of the nuclear fuel cycle.

The irony in the present situation is that there essentially is agreement on the goals of a national energy policy. The three major energy plans before Congress all center on four distinct goals:

1. Reduction of US dependency on energy imports
2. Protection against disruption of foreign supplies
3. Increased conservation and efficiency
4. Increased domestic energy supplies

The differences among the various proposals are over means rather than ends.

The opportunity to formulate national energy policy with enough staying power to outlast the next energy crisis does exist. However, there are some obvious impediments to the achievement of such a policy. For almost every piece of positive legislation that has been put forward, there seems to be other legislation with either a countervailing purpose or effect. What sense does it make to talk about legislative action to increase domestic fuel supplies when other proposed legislation, if enacted, would have the effect of prohibiting such an increase? Such competition between
congressional goals can in no way be construed as supportive of the goal of a comprehensive national energy policy.

The same need for cohesive and coordinated action is apparent when one looks at the broad field of energy regulation. Quite obviously, the energy industry in this country is significantly affected by the actions of regulatory agencies. Thus, how effectively energy is regulated becomes an inseparable factor in determining how close we come to achieving energy self-sufficiency. That is why in early 1973 the President called for a "comprehensive study" of all energy regulatory activities. Submitted to the President in April 1974, the Federal Energy Regulation Study concluded that the present energy regulatory framework lacks overall policy direction and coordination of effort. In the face of today's energy challenges, energy regulatory mechanisms cannot keep pace; concerned regulatory agencies fail to act in concert or cooperation; and some, in effect, have the powers of veto over others. These fundamental deficiencies in the regulatory framework represent the Achilles' heel of the nation's hopes for energy self-sufficiency.

REGULATORY PHILOSOPHY

For too long energy regulation has been an institutionalized concept in which principles, procedures, and organization are for the most part reviewed in the context of a narrow case or a discrete regulatory issue. As a result, the demands of a coordinated policy have been irresponsibly avoided. Regulation has not taken place with sufficient emphasis on its real goal, which is the protection of the total public interest while assuring that essential services are provided as needed.

Walter Lippman, in his book *The Public Philosophy*, defines the public interest as "what men would choose if they saw clearly, thought rationally, and acted disinterestedly and benevolently." From the perspective of regulation, it is an awesome challenge to meet these qualifications. And yet, notwithstanding the difficulty of perceiving the public interest, this is exactly what the regulator must do. Thus, it is not surprising to find that regulation, particularly at the federal level, is and has always been a controversial subject. Indeed, it has often been perceived as a restraint on our free enterprise system.

The path of the regulator since the passage of the Interstate Commerce Act in 1887 has transversed a thicket of criticism. The regulatory system by its very nature has traditionally been an easy target. Those bent on change argue that the regulatory system perpetuates the status quo, that regulatory agencies are the compliant captives of the industries they are supposed to regulate, and that money and access to high places coupled with the personal career ambitions of the regulator usually guarantee to the industrial interest favored treatment. Industry, on the other hand, today poses the same argument it has always made—that regulation, or over-regulation as industry sees it, is counterproductive. It stridently claims to be tangled in a worsening maze of rules and nonsensical procedures that bureaucratic types have developed and nurtured through the years; to industry, the regulator is essentially a timid soul who fears to do the "right" thing lest he be denounced by public interest representatives. The consensus of both groups is that the energy
regulatory system is confused, indecisive, expensive, duplicative, excessively pliable to pressure, and partial to narrow interests.

It is perhaps unnecessary to observe that many of these criticisms contain some truth. Yet, the fact is that the regulatory function is and was intended to be one of the major "pressure points" in government. Regulatory processes are rightfully an arena for contests involving high stakes. But they were never intended to be the spit on which the public interest is roasted.

REGULATION AND PRACTICALITIES

Today there exists a compelling need for regulators to reexamine the question of what a philosophy of serving the public interest really means. This need became undeniable in 1974 when the bonds ratings of many utilities declined to less favorable ratings, forcing cancellation or deferral of major construction projects. Unfortunately, the propensity of many regulators to remain wedded to patterns and approaches that were devised and perfected during a period of declining costs for electricity has become one of the factors that is perpetuating, and even exacerbating, the current phase of difficulties for utilities. For example, there is the often-cited tradition of regulatory lag—a prolonged time lapse between rate requests and rate actions. Prior to 1968, when consumer rates continued to decline, utilities found economic value in regulatory lag. But today, with rates on an upswing, lag is a grave threat to the economic health of those same utilities.

In a sense, regulation has become part of a problem, rather than part of a solution. If utilities are to garner and maintain the amounts of capital required for the construction of generating capacity, bold steps to eliminate regulatory lag are essential.

Although the current climate of consumer activism makes even the most stoic regulators uneasy at the thought of higher utility bills, the alternatives to rate increases are even more undesirable. The costs of postponing capital plant expansion are twofold. Decreased reliability of services becomes a distinct possibility, and the costs of installing additional capacity at a later date will escalate. The history of the regulation of the nation's railroads provides some idea of where this course might eventually lead. From a public interest perspective, the level of profitability of the utility industry is designed primarily to serve only one function: to assure that a utility's financial position is sufficiently vigorous to permit optimization of services to the consumer. At present, there exists increasing evidence that traditional rate treatment is failing to meet this test.

The increase in investment tax credit for utilities for three years, proposed by the Administration early in 1975, represents a means to reduce capital expansion costs, while the provisions to allow deduction of preferred stock dividends could stimulate equity rather than debt financing. But the most significant initiatives have been those recommending reforms in regulations. Without a uniform, timely, and realistic basis for consideration of rate applications by the diverse state and federal regulatory authorities, there is little hope of restoring financial stability to the utility industry.

The Administration's Omnibus Energy Bill is designed to meet this need for
reform by aiming at the heart of what some have come to view as a sacrosanct area—the activities of state regulatory commissions. In essence, that proposed legislation would require state public utility commissions to: (a) act on requested rate increases within five months after a utility has made an application; (b) conform with provisions for pass-through of fuel adjustment clauses; (c) permit higher pricing for electricity produced for peak-load consumption; and (d) permit utilities to include capital costs of environmental controls and current construction in the rate structure.

The reactions of state regulatory bodies to these problems have been predictable and perhaps understandable in light of the fact that many of those bodies interpret any attempt at such reforms as an infringement upon fundamental state prerogatives. Some observers have gone so far as to characterize the problem posed by this attitude as purely political. Thus, they argue that there is little chance that the situation will improve unless legislation such as the Administration's proposal is enacted. Lacking such legislation, there is little the federal government can do directly to effect any reform in the regulation of electric utility rates since federal control of rates is limited to wholesale energy supplies that move across state lines—less than 15% of the power generated in this country. However, given the lack of support for the Administration's proposal from any segment of the electrical energy community, its chances for survival in Congress seem slim. Of course, the very fact that such suggestions were made at all may stimulate the states themselves to take the kind of action needed to remedy, if only partially, the present situation.

While many favor federal intervention in state controls of electric utility rates, others like L. Manning Muntzing, former Director of Regulation of the US Atomic Energy Commission, argue for a middle ground—a position more likely to succeed in the present political climate. He has recommended a federal program designed to guide the states toward providing successful capital attraction incentives for the utility industry. Any implementation, as related to individual utilities, should be the continuing responsibility of state public service commissions. Mr. Muntzing has also suggested that "an agency such as the Bureau of Labor Statistics, which has credibility in the public and private sectors, should provide a judgment—broadly developed—of the cost of capital needed by utilities to meet the nation's energy goals." This guideline approach appears more amenable to all the parties involved than the prescriptive form of reform contained in the Omnibus Bill now before Congress.

FEDERAL ENERGY REGULATION: AN OVERVIEW

Energy-related regulatory problems do not stop at state lines. Regulation at the federal level teems with even more controversies. In the present economic circumstances, federal regulators have become the scapegoats for almost everyone—consumers, Congress, industry, the Administration, and even fellow regulators. These attacks upon federal regulation have produced much that is merely polemical. However, in at least one sense they have also been productive since they have resulted in a consensus of the need for what is generically termed "regulatory reform." In the case of energy regulation this consensus has resulted, as mentioned
above, in specific legislative proposals to reform state regulatory practices, legislation to improve licensing procedures for energy facilities and, more broadly, proposals to create a National Commission on Regulatory Reform that would investigate all aspects of regulation in the US economy. Virtually all of these initiatives, discussed more fully below, reflect the recommendations and positions set forth more than a year ago in the Federal Energy Regulatory Study (FERS).

FERS began with the recognition that federal energy policy must result from concerted efforts in all areas dealing with energy, not the least of which was the manner in which energy is regulated by the federal government. Energy self-sufficiency is improbable, if not impossible, without sensible regulatory processes, and effective regulation is necessary for public confidence. Thus, the President directed that "a comprehensive study be undertaken, in full consultation with Congress, to determine the best way to organize all energy-related regulatory activities of the government." An interagency task force was formed to study this question.

With 19 different federal departments and agencies contributing, the task force spent seven months deciphering the present organizational makeup of the federal energy regulatory system, studying the need for organizational improvement, and evaluating alternatives.

More than 40 agencies were found to be involved with making regulatory decisions on energy. Although only a few deal exclusively with energy, most of the 40 could significantly affect the availability and/or cost of energy. For example, in the field of gas transmission, there are five federal agencies that must act on siting and land-use issues, seven on emission and effluent issues, five on public safety issues, and one on worker health and safety issues—all before an onshore gas pipeline can be built. The complexity of energy regulation is also illustrated by the case of Standard Oil Company (Indiana), which reportedly must file about 1000 reports a year with 35 different federal agencies. Unfortunately, this example is the rule rather than the exception.

Despite the involvement of a multitude of agencies, there is no central organizational mechanism to coordinate these scattered operations. Until a few years ago, this was not an unworkable situation because, traditionally, regulatory agencies were primarily concerned with economic questions, like rates and competition. Today, however, a different situation prevails. At almost every stage of the energy cycle new technologies and aroused public concern bring forth complex issues—land use, air quality, water pollution, recreational and aesthetic needs, and public health and safety, together with equally valid requirements for economic growth, new sources of energy that may cost more and confront us with higher levels of environmental risk, and more efficient methods of obtaining and using vital fuel resources.

The primary problem of today's compartmentalized approach to energy regulation is not one of duplicated legal authority and excessive overlapping of jurisdiction among the agencies involved. Applicable laws and directives have been drawn very carefully, and responsibilities among agencies have largely been clearly defined in an historical sense. Ironically, the problem is that agencies are, for the most part,
very diligently pursuing narrowly conceived goals that are legitimate and appropriate to their mission. In this pursuit, the major agencies often exercise what almost amounts to an effective veto power over the regulatory actions of each other and ultimately over a particular project or at least its schedule.

One of the key recommendations of FERS was the formation of a permanent National Energy Council to formulate national energy objectives and provide policy guidance to energy regulatory agencies. This concept was largely reflected in the Energy Resources Council established by the Energy Reorganization Act of 1974.

Experiences with regulating natural gas prices and emissions from fossil fuel plants have illustrated the overriding need for such an approach. In the early 1960s the Federal Power Commission, spurred by a series of court decisions, instituted a program of area rate-pricing for field sales of natural gas. This program is believed to have dampened the incentive to explore for new natural gas supplies, and the resulting reduction in the rate of new discoveries prompted large consumers of natural gas to look to alternate fuels, like coal and oil. But when the environmental movement gained momentum in the early 1970s and the Environmental Protection Agency began a program directed at limited emissions of sulfur dioxide, these same large consumers were further limited in fuel options and were forced to purchase low-sulfur oil. The concentrated switch to low-sulfur oil, in combination with other factors, necessitated an increase in imports and growing dependence on foreign sources. This, in turn, exacerbated balance-of-payments problems and raised questions about the national security implications of the projected large-scale dependence on imported oil. Thus, in 1975, the Federal Energy Administration instituted an effort to have utilities switch from oil to coal in any boilers that could make such a conversion. Today, all three regulatory objectives are being pursued simultaneously.

Admittedly, there are logical justifications and considerations that have resulted in the independent stature of a number of regulatory agencies. To ignore the validity of these considerations would be foolhardy; rather, it seems sensible to provide the regulatory agencies with a backdrop of broad national policies and goals, against which they can make their decisions with full appreciation of the collateral implications of what at first glance might appear to be narrow decisional issues. The Energy Resources Council is a step in this direction.

The FERS project also investigated the conflicts that exist between federal, state, and local regulatory activities. Local and state governments are deeply involved in the evaluation of proposed energy sites and facilities. Their regulatory functions embrace rate-making, zoning approvals, construction permits, safety inspections, and pollution controls. And while a few of these regulatory matters are the exclusive prerogative of state and local officials, many involve areas in which the federal government shares an interest or responsibility. But despite the interdependence between these levels of government, there is no effective, sustained mechanism to coordinate action and reconcile objectives. This has contributed to the tendency of energy regulatory agencies to adopt procedures and actions that sometimes embrace purely local and parochial concerns. To help remedy this situation FERS recommended a three-pronged program to coordinate energy regulation at all
governmental levels and to assure that energy projects are treated from an integrated regulatory perspective, rather than as a series of loosely connected actions. Essentially those recommendations were:

1. Establishment of a federal office to improve the operational relationships between federal and state energy regulatory agencies—to facilitate the meeting of regional and national energy needs, largely by providing the guidance and assistance required to achieve timetables that will satisfy regional and national needs for energy facilities.

2. Establishment of a permanent organization of state representatives to work intensively and continually with this federal office, perhaps built upon already existing Regional Reliability Councils. Such an organization would require a strong working relationship with, and the support of, such groups as the National Governors Conference, the National Association of Regulatory Utility Commissioners, and the Council of State Governments.

3. Development of an extensive energy-related information exchange system between the federal and state levels. This recommendation has in some ways been reflected in the development of a data base by the Interagency Task Force on Energy Information and the Federal Energy Administration.

**REGULATORY REFORM INITIATIVES**

During testimony before the Senate Government Operations Committee in November 1974, at hearings on legislation to establish a National Commission on Regulatory Reform (S 4145), I stated that it was imperative, especially in the area of energy matters, that such a Commission incorporate a review of both federal and state regulatory entities within its scope. I remain convinced that the disparity among local, regional, and national interests in energy facility siting and licensing is among the most serious issues facing energy regulation today. The question of federal-state-local relationships in the siting and licensing of energy facilities is as compelling as the need to have agreement between state practices and national policies in the matters that impinge on the reliability of the nation's electric utility system—especially when consideration must eventually be given to the ramifications of locating large energy centers in the future. The difficulties are legal, political, and philosophical. It is nevertheless clear that a concentrated and coordinated effort is needed at both the federal and state levels if current and future conflicts are to be resolved.

While the Energy Reorganization Act of 1974 mandates that the President submit to Congress no later than mid-1975 any possible executive recommendations related to a “consolidation in whole or in part of regulatory functions concerning energy,” it is unlikely that the report will go as far as suggesting a federal energy regulatory super-agency. What appears more likely are proposals for selective regulatory reform measures to improve mechanisms for federal-state interaction, especially on questions of facility siting and licensing.

While recent actions in this area do not go as far as the recommendations in the FERS report, they do show promise of minimizing many of the delays associated with the siting and construction of power plants. For example, the Administration’s
proposed “Energy Facility Planning and Development” bill, would (a) require the Federal Energy Administration to set forth the number, type, and approximate location of needed energy projects; (b) require each state to submit a State Energy Facility Management Program to meet its energy needs; and (c) establish a five-year matching grant program to aid states in preparing their energy plans.

In addition to this comprehensive siting bill there are several bills pending in this Congress concerning siting of nuclear power plants. These proposals, which are in many ways similar to legislation introduced on behalf of the Atomic Energy Commission and the Joint Committee on Atomic Energy in the 93rd Congress, offer an opportunity to perform virtually all of the needed safety, environmental, antitrust, and safeguards reviews for nuclear power projects early, before any decision to add power is made. The proposed bills deal essentially with procedural matters and would not modify substantive standards for protecting the public health and safety or the requirements of the National Environmental Policy Act.

By utilizing the concepts of predesignated sites and standardized plants, they provide an effective way to reduce the completion times for a nuclear project from the current 7–8 years to about 5–6 years, without decreasing the quality of the regulatory review. In fact, the proposed bills entail every precaution included in the present approach to licensing—but they also provide the structure to complete regulatory considerations earlier and with enhanced opportunity for the kind of meaningful public participation needed to help achieve public acceptance. Other features of one or more of the pending bills that commend them as examples of positive regulatory reform include hearings only when requested, interim operating licenses for power reactors prior to completion of hearings, and strengthened federal-state cooperation.

There are also promising nonlegislative initiatives in the nuclear energy area. For example, the Nuclear Regulatory Commission, which is responsible for licensing an increasingly significant share of new power facilities, is pursuing efforts to foster improved federal-state cooperation in licensing matters and has been joined by other involved federal agencies, such as the Environmental Protection Agency and the Federal Energy Administration. These initiatives encourage the varied groups involved to work jointly through the decision-making process from the start, thus reducing the likelihood for a project veto by some involved regulatory entity when an ultimate decision is reached.

Given the apparent lack of support for the proposal for a National Commission on Regulatory Reform, it appears that actions such as those described above, other ad hoc manipulations of specific regulatory mechanisms, or self-reform initiatives by regulatory agencies themselves or through the efforts of such institutions as the National Association of Regulatory Commissioners, represent the only tangible forms of regulatory reform that can be reasonably expected for the immediate future.

CONCLUSIONS

The President’s Council of Economic Advisors estimated in its January 1975 report that the cost of compliance with federal regulations represents about $14 billion
annually. Energy regulation inevitably contributes to these costs, but the idea of the complete deregulation of energy has become moot. Rapidly changing pressures and world political as well as economic developments so affect the domestic energy situation that they have compelled innovations in regulatory philosophy and practice. In many respects, regulation has become a response as well as a control mechanism. Many seemingly settled concepts of regulation have been challenged and some already discarded. Issues considered in the past to be irrelevant to regulation have often been made paramount by courts and legislatures. A decade ago, for example, environmental impact was seldom at issue. Now its evaluation is institutionalized in regulatory processes by laws such as the National Environmental Policy Act of 1969. Legal suits on environmental questions have become the rule rather than the exception. Likewise, economic conditions prior to 1968 supported efforts to maximize energy production and consumption at the lowest price possible. Today, a different situation prevails; shortages in fuel supply threaten curtailments and regulatory responsibilities have assumed the dimension of determining the equitable distribution of these curtailments. And, while a decade ago traditional cost-of-service rate-making was a workable formula, this no longer is the case, and other cost allocation methods have been fashioned upon assumptions once considered unacceptable.

The need to reevaluate regulatory goals and approaches has become clear. Unchecked, the trends toward further complications in the existing system of state and federal regulation will in all likelihood continue. And the challenges to this system will only intensify throughout 1975 and the immediate years ahead.

Fifty-five years have passed since the federal government first entered into energy regulation as licensors of hydroelectric facilities in 1920. Subsequent years brought increasing federal regulation that included control of monopolies, maintenance of interstate transmission efficiencies, protection of public health and safety, controls of environmental impact, and management of fuel supply. Each such federal intrusion into the energy market was carefully calculated to remedy a specifically perceived difficulty (or crisis); however, as the regulatory system grew, it became less and less responsive to changing situations—it became like a tradition that people faithfully practice without knowing why. In essence, this is the case against energy regulation. Corrective action probably lies somewhere between continued tolerance, or creating new regulations to undo the old, and complete rejection of the system. The Federal Energy Regulatory Study recommended certain measures to enhance the responsiveness of energy regulation; the Energy Reorganization Act contains the ingredients for a central policy guiding force; legislative initiatives represent ad hoc remedies; and a National Commission on Regulatory Reform, while not a total solution, is surely a constructive suggestion. Beyond the immediate situation, however, there is a legislative, as well as an administrative, lesson to be learned—governmental regulation should not be permitted to become so institutionalized that it is considered permanent. In many respects, the priority goal of regulatory agencies, except those involved with ongoing health and safety concerns, should be to put themselves out of business. There is no service to the public interest when regulation occurs for the sole benefit of either the regulated or the regulator. Each
fiscal year should bring close scrutiny to the questions: Is this regulatory function still required? Does it serve the public interest? The legislation to establish the Federal Energy Administration intentionally made this kind of approach mandatory and it seems to have sharpened congressional oversight. Perhaps similar legislatively built-in appraisal requirements for other areas of federal regulation would prove as effective.

A status quo, business-as-usual approach to energy regulation in the United States could lead to failure on one level to assure the continued service provided by electric utilities and, on another level, to a failure to foster the nation's goal of energy self-sufficiency. Neither result could by any conceivable stretch of the imagination serve the public interest.