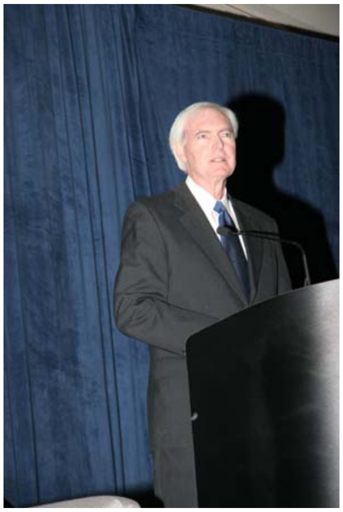
Remarks of Jim Sullivan - former Commissioner, Alabama Public Service Commission at NARUC's 120th Annual Convention

The Toughest Job in America



I sincerely thank President Marsha Smith and NARUC for the opportunity to share my thoughts today. I was 37 years old back in 1983 when I took the oath of office to become Alabama's eighteenth Public Service Commission President. That was twenty-five years ago and I was the youngest Chair of any commission in the country.

Today, I have retired as the senior commissioner in the United States. According to Jan Beecher, from Michigan State University, the average commissioner's term today is 4.5 years – which means that I have spent nearly six lifetimes as a regulator. I have been doing this a long time. But let me be clear up front. I have come here today, not as an omniscient sage; rather, with gratitude for the opportunity of sharing my thoughts with you, who are all smarter and wiser than I. And I come, not with pride of office; rather, with the humility of service.

For 25 years NARUC has been central to my life…and to the lives of my family. In fact, many of you helped raise my children who were 5 and 10 years old when I attended my first NARUC meeting. My daughters have always considered you as part of our extended family, and they learned valuable lessons watching how you and I conducted our business. For it is the business of NARUC to be the voice of reason in an environment sometimes fraught with unreasonable ideas. And the charge of NARUC is to build up rather than tear down; to seek consensus rather than encourage dissention; to pursue solutions rather than giving up. They learned from you and me that it is better to serve others rather than to be self-serving. And to sow friendships that reap goodwill, like NARUC has done across the U.S.A., and North America, and, indeed, the world.

You can see the virtues of our organization in the faces of our members. NARUC helps people. And no one has been more helped, more benefited, more supported than I. And I am grateful to all of you here, for you are NARUC.

I wish that I could stand here this afternoon and tell you all the wonderful experiences that I have had during the past two and one half decades as a seated commissioner, as a member of NARUC, as past President of this organization.

That would be fun, nostalgic and gratifying for me. But today we don't have time for reminiscing; and besides, this is not about me.

This convention, this regulatory arena, this troubling time, and this unique opportunity are all about you….you, the regulatory commissioners and staff; and you, the regulated companies and support team; and you, the representatives of tomorrow's consumers, and you, the stakeholders of our environment.

In fact, if I have any value to offer, it is to remind you not to make past mistakes again, and to alert you to issues none of us have ever addressed before. Your watch as stewards of America's most critical infrastructure is the most perilous our nation has ever witnessed….and it is you that must rise to the call. Indeed, no regulator, no regulated company, has ever seen the coming challenges which you must endure and overcome to protect America's economy and America's national security.

Every part of our critical infrastructure is important: water, communications, gas and electricity. Today much of what I say will apply, in principle, to all our regulated industries, but I want to talk about energy.

When you read that energy is the most critical issue facing our country during the next twenty years, who do you think is going to be charged with finding a solution? You, like it or not, will be responsible for cultivating new ideas, forging new policies, implementing new programs, and making the difficult decisions for assuring energy security and therefore national security again for America.

In a broad sense, you in this room, are looking down the barrel of a global gun loaded with energy problems for which there are no current solutions. You have no Cabinet, you have no Congress, you have no judicial clokes behind which to hide. In short, you who are sitting here together today, will tomorrow be standing alone, and facing the hardest job in America.

We have seen some "golden years" in the electric industry, but I am convinced those days are over. We are in serious times. The world is changing faster than we ever imagined, and we must be ready for the most dramatic shift in industry culture that we have ever seen.

Commissions, companies and customers alike are facing unprecedented challenges in the coming years, perhaps even serial rate increases. And, in my view, you cannot stop it – at least not in the short term. Whether you are fully regulated or in an organized market, you may … no, I really believe you all will, soon feel public, regulatory and investor pressures you have not felt in decades.

That's why I want to raise five caveats today, all of which can increase costs, and therefore rates. And all of which have the potential to adversely affect our energy security and national security.

First is the vulnerability of our domestic economy.

Second, the relative decline of U.S. influence globally.

Third, global competition. "Globalization" is a concept; global competition is American industry fighting for its life.

Fourth, long-term availability of, and access to, energy.

And fifth, national security: Whose electricity is it, anyway?

These caveats concern me because electricity is the lifeblood of our production efficiency and therefore our economy, just as oil is the lubrication for economic delivery.

When I came to the Alabama Public Service Commission in early 1983, the U.S. economy was still reeling from the aftershocks of the Arab oil embargo 10 years before, which had caused oil prices to quadruple within a few months. The ensuing period of "stagflation" was taking an enormous toll as well, with our economy in recession and the cost of living and doing business spiraling through the roof. It was in that environment that Alabama Power Company requested, in less than a year, two rate increases totaling over 30%. People were out of work, inflation was in double digits, and the public was irate. The commission was inundated with protests, threats of bodily harm and calls for impeachment. It was a very “interesting” time to take office.

And I would offer these regulatory lessons, learned under duress, to anyone who is willing to consider a suggestion:

In any rate proceeding, cooperation is better than confrontation.

The only winners when controversy dominates a rate case are the media and the lawyers, for they thrive on controversy, while your commission, your company and the customers pay for it, both in monetary terms and with reputation.

Communication cannot nullify, but it can mitigate, significant conflict if it is timely, and reciprocally accurate and honest. Sit down together with your consumer advocates, industrialists, environmentalists and media prior to a rate filing, before ex parte rules apply, and talk.

And don’t forget the commission staff. In a world where the average term of a commissioner is 4.5 years, staff becomes increasingly important.

It was also that period of conflict back in the 1980’s – marked, as it was, by serial rate increases – that helped shape my regulatory philosophy, which is centered on my state’s economy. If I cannot use regulation to enhance Alabama’s economy, then what purpose do I serve? If our electric rates and service quality attract industry, create jobs, and generally contribute to our economic expansion, then I have done my job.

My job is not to “control” the companies we regulate. My job is to ensure that rates are fair, service is reliable and the return to investors is adequate. And to help provide business and industry with a strong electric, gas, water and communication infrastructure that will encourage profits and growth. I am an economic regulator.

And I am doing my job. So says Mercedes, Honda, Hyundai, Toyota, ThyssenKrupp, and Airbus, all companies based outside the U.S. that have located in Alabama in the past 10 years. And, so say Alabama ratepayers, who have consistently given Alabama Power Company ninety-five percent approval ratings over the past decade. But I am not here to talk about Alabama; I’m just proud of our state and what industry and government have accomplished by working together.

Times have been good for us in Alabama and across the United States, but now I worry that the days of serial rate increases – and all that goes with them – may soon be upon us again. While the Federal government has not yet declared an official recession, both Warren Buffet and Alan Greenspan stated months ago that we are, for all practical purposes, in a recession. We have committed $750 billion in government funds to salvage our largest financial institutions, and perhaps, automobile manufacturers. Banks in Japan, Russia, China, Great Britain, Kuwait and all over the globe are in crisis. I don’t know, but how do we come to the brink of completely destroying the world’s economy without experiencing a recession?

And we all know what is happening to costs. Gasoline and diesel, energy or fuel costs, O&M, and healthcare have all skyrocketed. Yes, I am aware that oil and gas prices have subsided to reflect the instability of the world’s current economic equilibrium. But please hear me. Even though the financial meltdown has dampened China’s and India’s economic growth from summer highs, demand for basic materials in both China and India is still enormous.

And it's not just Asia. This past summer USA Today quoted Diane Munns, (so even though I read it in the newspaper, I know it must be true.) Diane said the U.S. electric industry projects expenditures by 2030 of over a trillion dollars for generation and transmission. Add to that the ever-increasing government red tape and the prospects of carbon containment costs, and we're over $1.5 trillion.

So, what, you may ask, do these domestic issues have to do with the electric industry? Well, remember the story I mentioned a moment ago about my first days at the Alabama PSC? We had recession, rising costs, repetitive rate increases and irate customers. If, indeed, we do fall into recession with skyrocketing commodity prices, then America's ratepayers will pay an ever-increasing percentage of their income, or profits, for your electricity. As Yogi Berra would say: "This could be déjà vu all over again."

But now, we could be facing "stagflation on steroids" in contrast to the seventies and eighties. Today we are even more at risk, for we are in an economy where costs from developing countries on the other side of the world are driving demand for construction materials. China, with 21 percent of the world's population, already uses 1/2 of the world's supply of cement, 1/3 of its steel, and 1/4 of its aluminum. Timber imports there will increase 33 percent in the next two years.

According to Vince Matthews of the Colorado Geological Survey, China now controls 98% of the rare earth metals worldwide, and they will eventually corner the global markets for most materials. Just this past week, China announced a government infusion of billions of dollars to continue their construction projects. And there are more dynamics at work than simple economic expansion.

We have 300 million people in the United Sates; however, during the next 22 years, China expects to relocate 400 million people…400 hundred million… in a grand urbanization plan. Fully one-half of all construction in the world will take place in China during that period.

Again, the balloon is being squeezed on the other side of the globe but the pressure will be, no less, felt here. Even with all the power inherent in DOE or FERC or NARUC or EEI or AGA – none of us, singularly or together, can control the external dynamics that will determine the future cost of America's electricity – or, more critically, the reliability and very availability of our electricity.
Is the domestic stage set for a recurrence of stagflation? Will you be caught between declining revenues and increasing costs?

I don't know; but if that does occur, this time you will be responsible for providing higher cost energy to customers trying to make economic ends meet.

Obviously, global markets are having an effect on our domestic tranquility. And thanks to the ongoing advance of information technology, our world continues to shrink. Or, in the words of Thomas Friedman, the New York Times columnist and author, "The World Is Flat." But we should also take note, "flat" does not mean "level", and our world is tilting towards the East.

And our shrinking, flat, tilting world is presenting challenges we have never encountered from nations with economic and/or political influence essentially equal to that of the United States.

Richard Haass sums it up in a recent issue of Foreign Affairs magazine. In his article titled "The Age of Nonpolarity", Haass writes: "The principal characteristic of 21st century international relations is turning out to be nonpolarity: a world dominated not by one or two or even several states but rather by dozens of actors possessing and exercising various kinds of power. This represents a tectonic shift from the past."

In short, the United States no longer dominates the global economy in the way we did for much of the 20th century. Yes, we still maintain the world's strongest military force, and our GDP strength far exceeds that of any other country. But, in terms of global trade, we are simply one more country vying for finite energy and construction resources where demand may soon exceed supply. Perhaps "nonpolarity" is simply the evolutionary challenge spawned by globalization and global competition. "Globalization" is a concept, perhaps best defined by Thomas Friedman as a merging or the internet, common computer languages and personal computers, making information available world wide in real time. By contrast, "global competition" is our industry fighting for it's life.

What's worse, we have no energy policy to guide us through the labyrinth of a new global order where there is no longer a "third world", and no longer the unipolar dominance of the United States. Our country is pursuing a nebulous policy of adding enormous costs to electric generation through environmental remedies and purchasing energy abroad at internationally derived market prices, compounded by exorbitant and ever increasing transportation costs. Meanwhile, China, India and others will not incur the environmental costs, they will lower their average market price by utilizing more coal, and they will subsidize their electricity prices.

The disparities are obvious and compounding. The resulting spread in electricity costs will be a serious challenge on our ability to compete in a global economy, if all the current policies and trends continue.

The result is that China and India will have lower electricity costs than the United States. Again, "flat" is not necessarily "level". Our handicap may be the same, but if you allow me a "gimmy" on every hole, I'll beat you every time. And, so will China.

This scenario reminds me of a conversation I had with my friend Dan Fessler many years ago. You remember Dan, the chair of the California Commission prior to, and during, that state's "great experiment" with deregulation. Dan said: "Jim, we have to do something. Our economy is imploding because our electric rates are too high for our industries to produce competitively. Our factories are closing, people are losing jobs and we are in a tailspin."

I could empathize: The concept of globalization and the reality of global competition are not new in the South. We were introduced to them more than a decade ago, as our textile plants began moving offshore. Ask Southern textile manufacturers about it … if you can find one.

Yes, current energy costs have subsided. Gasoline and natural gas prices are lower. But this is the lull before the storm, and rates are going up … on top of the average 35 percent they have increased over the past six years. The question is: How high must they go before we start losing industrial customers to China, India, or other countries hungry for a higher standard of living? It happened in California. It happened in the South. It's happening in Michigan and Ohio. It can happen to you. Industry will relocate where it can produce more efficiently and deliver closer to its markets.

Losing industry is not good, for that means losing load. Then workers lose jobs, and we lose even more of our load. Again, not good. And if you have the same embedded assets, valued in the same amounts, coupled with the same revenue requirements, the result is, again, a request for higher rates to be charged to the remaining customer base. At some point, commissions or customers will shout: “Enough!”

Global competition has risen because emerging countries are using all the resources at their disposal to gain an edge. After all, we have encouraged the world to democratize and to embrace capitalism and free markets for decades. They are rising throughout the world to compete with us. And that’s good.

We cannot expect them to settle for less. It is we who must understand this new global competitive environment, and adapt. Again, this is not a talk about energy independence; rather, it is about energy security. It is we who must find a way to secure our least cost, most reliable energy resources to feed our ravenous industrial complex, protect our production efficiency and maintain our ability to compete globally.

The long and short of it is: We need to understand the dynamics of “globalization”; but, it is “global competition” we need to keep in our sights.

And then there is this whole dilemma with hydrocarbons. I had dinner with Mark Ward, COO of T. Boone Pickens’ Mesa Corp. last week. Mark reminded me that last summer, for over a month, the global production of oil reached 85 million barrels per day; yet, daily demand exceeded 87 million barrels per day. Friends, we are there…where oil demand exceeds supply. EIA projects oil consumption will increase more than 40 percent by 2025. Huge increases in demand also are forecast for natural gas at 57% and coal up 42%.

You have all heard that China is building a new 1500 MW coal fired plant per week. Coal prices have doubled during the past two years. An October issue of Energy and Capital projects 500 new coal plants in China and 200 more in India during the next six years. What do you think will happen to coal prices during the next six years? Energy prices are going up.

And where will the petroleum resources go? China is adding about 14,000 vehicles per day to its in-service fleet and expects to have over 160 million cars and trucks on 57,000 new miles of highways in the near future. In fact, China’s auto explosion will double the number of cars worldwide by 2025. The trend is already visible: This year, for the first time, the combined oil consumption of China, India, Russia, and the Middle East will exceed that of the United States.

Two-thirds of the world’s oil reserves are in just five countries: Saudi Arabia, Iran, Iraq, Kuwait, and United Arab Emirates. Of the world’s known gas reserves, 45% are located in Russia and Iran. If you include the other Middle Eastern countries, the total rises to 65 percent. That's troubling enough. But think about the transportation of the oil and gas coming from the Middle East. The major collection point is in Kuwait on the Persian Gulf, then transportation by tanker through the Straits of Hormuz, a narrow outlet bordered on the north and east by Iran. Eighty percent of the oil produced in the Persian Gulf, and 25 percent of the world's oil, or 13 million bbls/day, pass through the Straits of Hormuz. It would not take much effort to stop exports if Iran, or any terrorist organization, were to choose to do so. Obviously, from a U.S. perspective, the location of the world’s oil and gas supply is just as daunting as its availability.

These issues are scary, but there is another that concerns me as well, and I confess that I am not certain how to frame it. Nevertheless, I feel compelled to raise the question, for I truly believe at some juncture it may become pivotal in our approach to energy policy and security in the U.S.

Banking regulatory adjustments in the 1990s were a catalyst of the credit crisis. And now, our financial markets have been propped up by sovereign wealth funds from none other than Saudi Arabia, China, South Korea and Singapore. Of course, now our own government has pitched in as well by taking an ownership interest in nine of the country's financial institutions.

Although I am unaware of any major concern about the financial structure of the companies in our energy industries, I worry that our national security might be threatened if our energy were controlled by investors whose only priority is profit.

If lenient government policies can cause financial crises in banking and real estate financing, can a comparable laxity adversely affect the energy industries and the industrial complex they feed? Am I concerned about nothing?

I am acutely aware that many U.S. energy companies, perhaps the majority, have institutional, banking, or other types of ownership considered unconventional during the last century. And I know that the U.S. president could prevent, through executive order, the takeover of an American electric utility by a foreign entity. But what if the buyer is one of our New York-based, money-center banks? In more than one instance, a pretty hefty chunk of those banks is now held by foreign interests.

I realize, of course, that many executives in this room are all too familiar with the pressure to make quarterly numbers. But you have done so in the context of ensuring that your companies are prepared to meet long-term obligations – including quality-of-service obligations. Is there still any value in the old concept of a "regulatory compact?"

Whose electricity is it, anyway? Is electricity merely a vehicle for profit for the investors who generate it; or, on the other hand, is electricity the most critical part of our nation's economic infrastructure?

Perhaps the answer is found within the proper balance of a public-private application designed to benefit from both government policy and market forces. Perhaps the answers will evolve as the industry explores continuing domestic diversity.

Well, there you have the problems du jour, but what can we do to help preserve our production efficiencies, compete globally, and guard our energy security and therefore our national security? The good news is: We have an answer, and you already know it.

For at least the past year and a half, NARUC leadership, industry executives, U.S. government officials, and presidential candidates have all been saying we must conceive, plan and implement a national energy policy which can provide alternative energy resources, including energy efficiency, that are secure and reasonably priced. I think it should be a policy, not of energy independence, but rather of energy security.

We know the answer, but now it's time to act. Sometimes, it seems, we are so concerned about not throwing the baby out with the bath water that we forget the baby needs a bath now! Being careful is important; being overly cautious can be perilous. I am not suggesting we act irresponsibly; I'm simply saying: "It's time to act"

Yesterday we ruled the world's economy. Today we are in a race to sustain our economy, preserve our standard of living and retain our ability to compete with emerging countries. Without reliable and reasonably priced electricity, our ability to produce efficiently is lost.

This is not our first race for survival and not even our second. The first was the Manhattan Project. The second was the race to space with the Apollo program. We won both those races, and the enormous scientific advancements in nuclear energy and physics, communications, electronics and computers helped boost our economy through the last fifty years.

In a global economy where GDP is destined to expand fourfold by 2050, where will we find the energy to feed that growth? Again, we must race to utilize all the scientific, research and development resources our nation can muster to meet this unprecedented challenge. This is our third race. And whether you like it or not, you are in the middle of it.

I heard Jeff Sterba, I believe here at NARUC last year, say that we should put at least $2 to $3 billion per year into energy R&D. And Revis James from EPRI suggests a total research budget ranging from $1.4 billion to $2 billion annually through 2030.

I said in September of 2007 at the Emerging Issues Policy Forum in Amelia Island that $ 3 billion per year in energy R & D is not enough. I said it again at this summer's EEI meeting in Toronto. Today I am sticking to my guns: Why not commit and invest no less than 1/10 of 1 percent of our annual GDP to energy R&D?

Based on 2007 GDP that would amount to about $14 billion – several billion dollars LESS than Americans spent on Valentine's Day this year. We spend nearly $14 billion every month in Iraq. And we pay our professional football, basketball and baseball players more than half that amount every year. Energy R&D is a value added investment, and not an expense. EPRI, to cite just one example, says the value of lowering the costs of emissions reductions could be $1 trillion. Why not invest $14 billion a year for five years to save trillions in cap-and-trade experiments or carbon taxes? That's still less than the $160 billion we spent to "jump start" our economy. And where are those dollars? What is $14 billion compared to $750 billion?

Government should get this research started, as it did for commercial nuclear reactors, with government research and development in atomic weaponry. Or, like the advances for commercial airlines through the federal funded R&D done to develop our military aircraft; or, for communications through the R&D done for space exploration.

But then, industry should be incented to continue the work. Government, that is, should establish the policy and fund the initial R&D, but delivery to the public is always more efficient by private industry.

I know $14 billion a year is a dramatic number; and yes, it does bother me to leave $14 billion a year in the hands of politicians. But we have 17 national scientific laboratories with over 10,000 scientists who are available to do the work both timely and well. Why can't they work with EPRI and GTI to get the job done?

And think of the upside when our R&D is successful. We will be selling the technology and new equipment and our coal around the world. We will be expanding existing industries; growing new industries; increasing capital investments, creating more jobs, and expanding our economy. At the same time, we will be divorcing ourselves from a bad marriage to countries that do not have our best interests in mind.

I truly believe, of all the variables that will determine our country's security in the 21st century, energy issues will have the most impact. For the past century, our energy policy has been more foreign oil; now, our foreign policy must be more domestic energy.

Now, I know for every point I have made, you can suggest a counterpoint, or an alternative. And you may well see my caveats as just a blip on the radar screen. I will remind you that, at one point in time, Hurricane Katrina was also merely a blip on the radar screen.

I know it's a sea change in our thinking and our direction. And the fact is: Nothing is going to happen until Congress buys into it. But I have seen what the voice of NARUC coupled with the voice of EEI and AGA, regulation and industry, can do together. Congress will listen because the NARUC agenda is public welfare and industry's agenda is feeding America's economy. Collectively, no one in our country has more influence to motivate Congress than the people in this room.

Our country needs it; your duty demands it; our children and grandchildren deserve it, and you can do it. If not you, then who? If not now, then when?

After 25 years, a quarter of a century, I am leaving NARUC, but I know I am leaving this organization in good hands…..your hands.

Thank you.