

*Electricity: Powering The Change That America Needs*

*Remarks by*

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Good afternoon. It is our pleasure to meet with you and share our outlook for the year ahead. And what a year it promises to be. During the election last year, we heard a lot about the need for change. In November, America voted for change. In January, the Inauguration was a celebration of change. Now, it is February, and we are here to tell you that electricity powers the change that America needs. And the electric power industry is transforming itself to make that change possible.

Our industry is optimistic. Our issues are at the center of the debates over economic policy, energy strategy, national security, and the environment.

We are excited by the challenge and optimistic that we—by continuing to work with all of the stakeholders and policymakers involved in our issues—can help form the right framework to transform the way our industry works and the way the nation addresses its energy future.

We have many details to discuss today about the actions we are taking, but I am going to start with the headline. These are the essential elements of the right framework:

- Energy Efficiency
- Smart Grid and Advanced Transmission
- Plug-in Hybrid Electric Vehicles
- Advanced, Low- To No-Carbon Electric Generating Technologies

What I want to talk with you about is what each of these elements offers America, and how we are going to make each of them a reality. Speaking of reality, the current economic situation looms over everything else that we are doing to transform our electricity system.

There are many questions about the length and depth of this recession and whether the economic stimulus package being debated in Congress will be enough to jump-start a durable recovery.

But there is a positive side to this downturn. This economic situation brings sharply into focus the essential nature of electricity to our economy and to any

economic recovery. It also ensures that issues, which at times may have been considered too difficult to deal with, must now be addressed.

### **Financial Backdrop**

As you know, the electric utility industry is among the most capital-intensive sectors in the country. We anticipate that our capital expenditures for the 2008-2010 period will amount to \$230 billion. This total includes a drop in excess of 10 percent for the 2009 and 2010 projections, because of the ongoing economic crisis.

And these capital expenditures are not discretionary; they involve transmission and distribution investments, without which reliability becomes an issue. They also include environmental expenditures of \$25 billion.

Looking out over the next 20 years, we estimate the need to spend between \$1.5 trillion and \$2 trillion dollars, net of projected savings from our aggressive energy efficiency and demand response programs.

EEI continues to help educate key constituents about this need to invest in new generation, transmission and distribution infrastructure enhancements. Our “*Investing in America’s Electric Future*” campaign is reaching political leaders at all levels of government, state and federal regulators, the investor community, opinion leaders, and the public at large. This effort provides the underpinning and the intellectual framework that supports all of the issues confronting our industry.

Because electricity is a necessity for nearly every aspect of our personal and professional lives, the recession arguably has affected our industry to a lesser degree than it has other business sectors. Although electric utilities certainly had a setback in 2008, we still outperformed the broader indices for the fifth straight year. And although many companies were forced to cut their dividends since the financial crisis escalated in the fourth quarter, none of the 59 EEI Index companies did so.

The electric power industry is also maintaining its credit quality. Although the 26 downgrades barely outnumbered the 24 upgrades in 2004, the overall volume of actions was very low by historical standards.

Additionally, there is virtual unanimity across the political and regulatory spectrum on the need for healthy and effective electric utility infrastructure, and the affordable, reliable electric power it provides for American families and businesses.

### **Dividend Taxes**

Electric utilities remain focused on dividends, evidenced by the 63 percent of companies that raised their dividends in 2008, which was just below the 70 percent in 2007—the highest percent since 1990.

To preserve our dividends in the future, we, along with the American Gas Association and a number of utility shareholder associations, have launched a national grassroots advocacy campaign, *Defend My Dividend*, to make the current 15-percent dividend tax rate permanent. The campaign is reaching a broad-based audience, including utility employees, shareholders, retirees, and, importantly, senior citizens.

As you recall, changes in tax law in 2003 and in 2006 reduced the top tax rate on qualified dividend income from 38.6 percent to 15 percent. Unless Congress acts, this lower rate will expire at the end of 2010, and the maximum rate could increase to 39.6 percent.

Last year, the consulting group Ernst & Young completed a study that found that the dividend tax rate reduction has benefitted a broad range of American utility shareholders, especially older citizens who depend on utility dividends for steady income.

In particular, the study showed that in 2004 (the latest year for which complete data are available), 64 percent of federal tax returns with qualified dividends from direct ownership of utility shares were filed by taxpayers age 65 or older. The study also found that 68 percent of those returns were from taxpayers with incomes of less than \$75,000, and 42 percent were from taxpayers with incomes of less than \$25,000. Taxpayers

in the 10 or 15 percent tax brackets pay no taxes on their dividend income under the current law.

Our grassroots campaign is educating utility shareholders, retirees, employees, and labor forces about the issue, so that they can be activated when needed.

### **Electric Transformation**

There is a lot of uncertainty over how best to get the economy moving again, but one thing is certain. The cornerstone of the revived economy will be reliable and affordable electricity supply.

The electric power industry is moving forward to transform itself for the future. We are developing and deploying innovative, new ways to generate, transmit, distribute, and use electricity more efficiently.

Importantly, this effort is complemented by the capability of today's electric appliances and technologies to deliver higher and higher levels of comfort, convenience, entertainment, and satisfaction. And do so using less and less energy.

When you combine these increasingly efficient appliances with more efficient generation, transmission and distribution, you can lower the country's total overall energy use—and its carbon emissions.

This “electric transformation” that the industry is undergoing can continue to create jobs, stimulate economic growth, and build a greener, lower-carbon electricity industry. President Obama ran his campaign focused on the need for change. We are embracing that change.

### **Energy Efficiency Advances**

One area where change is urgently needed is in how efficiently the country uses its energy. The President realizes this and has put efficiency front and center in his priorities for stimulating the economy. We will work with the Administration and Congress to transform how we use energy.

We strongly support Congress' efforts to promote energy efficiency through the stimulus packages. These include funding for a variety of efficiency activities.

This funding would be spent on simple, low-tech conservation measures—things like insulating attics, replacing drafty windows, and installing energy-efficient light bulbs and appliances. It also would strengthen the nation's construction codes. Houses and buildings account for over 40 percent of America's total energy use, as well as three-fourths of its electricity use. Both of these measures can benefit consumers and businesses today, as they lay the foundation for long-term energy and environmental savings tomorrow.

But we still need to do more with energy efficiency. We need to start looking at energy efficiency as the first means for meeting electricity demand. Since 1989, electric utility efficiency programs have saved consumers enough electricity to power more than 83 million homes for one year. But most utilities make more money selling energy than they do trying to save it.

We want state utility regulators to adopt regulatory policies that encourage investments in energy efficiency. To turn efficiency into a business, we must be able to recover our energy efficiency costs. And importantly, we should have an incentive to promote efficiency that is similar to our incentives for building new infrastructure. We formed a partnership with the Alliance to Save Energy, the Energy Future Coalition, the Natural Resources Defense Council, and a number of other organizations to encourage regulators to change how they regulate efficiency.

Once energy efficiency becomes a business for the utility industry, I think you will agree that electric companies have the expertise and the resources to make it a very successful business.

We are the trusted energy advisor for all categories of customers—from low-income homeowners to national chains to large industrial customers. And these relationships are based on years of service and trust.

Significantly, we have also established partnerships with builders, developers, engineers, and other trade allies. These relationships are essential for expanding our own energy efficiency efforts. And, as you know, our investment focus is for the long run.

The industry's Institute for Electric Efficiency is helping the industry to focus its efficiency efforts. We created the Institute to establish a forum for the industry to share information, ideas, and experiences on what is working and what is not. The goal is to help customers use their electricity more efficiently.

### **Smart Grid**

We are also delighted to see in the stimulus package support for transforming the nation's transmission and distribution grids. This can help create jobs now, and it can help the grid to meet the demands of the 21<sup>st</sup> century. A number of electric companies already have begun modernizing their grids by installing digital electric meters and technologies that enable two-way communication capabilities between themselves and their customers. This transformation to a "smart grid" will benefit the companies and their customers.

The smart grid will enable us to detect and repair outages faster, hook-up customers quicker, and give consumers the capability to manage their home's appliances more efficiently and conveniently. When coupled with innovative approaches to ratemaking and rate design, the smart grid also can help to reduce a company's peak demand period, which saves money and protects the environment.

### **Plug-in Hybrid Electric Vehicles**

A smart grid also can promote electric transportation technologies, particularly plug-in hybrid electric vehicles (PHEVs). We are working as partners with the auto industry to demonstrate the first generation of PHEVs. And we are studying the impact of PHEVs on the grid.

A PHEV connected to the grid will enable consumers to charge up during the overnight hours when electricity is cheaper, and then wake up to a car ready for their morning and evening commutes. Someday, the smart grid could even allow electric utilities to draw power from a PHEV's battery during the day, giving consumers a credit on their electric bill. This also will help to reduce stress on the grid during peak periods, keeping rates lower.

Importantly, these next-generation electric hybrids will also give consumers an alternative energy source for powering their cars and trucks, one that is three to four times more energy efficient than today's internal combustion engines. And consumers can get the convenience of filling up through a wall outlet instead of driving to the gas station. Overall, the nation will import much less oil. And the environment will be happier, too.

### **Environmental Issues**

This need to invest in energy efficiency programs, the smart grid, and PHEVs comes at a time when we already are facing the need to make significant investments to meet the country's continually growing demand for electricity and for environmental protection.

The unknown costs of potential climate change legislation and state or federal renewable portfolio requirements pose another substantial financial challenge for many utilities. With Congress likely to begin debating the climate issue later this year, the EEI Board of Directors adopted a climate framework in January that we hope can both achieve our carbon reduction goals and help mitigate the substantial costs to our customers

The climate framework calls for reducing carbon emissions by 80 percent by 2050, from current levels. You may recall that in February 2007, the EEI Board adopted climate change principles that supported the concept of mandatory federal legislation to cap carbon emissions.

The new EEI framework recommends allocating emissions allowances to the utility sector and other sectors in the early years of a cap-and-trade program, followed by a gradual transition to an auction-based approach. We propose that

the initial emission allowance allocation to our industry be 40 percent, which is equal to our portion of the country's carbon dioxide (CO<sub>2</sub>) emissions.

The best way to mitigate cost impacts to customers is to allow the benefits of the allowances to flow directly through to them. And this best can be achieved by allocating allowances to local distribution companies—a process that would be overseen by state utility regulators—split evenly between emissions and sales. Remaining allowances would be allocated to merchant coal generators.

To protect customers further, as well as the international competitiveness of U.S. industries, the EEI framework also calls for a price collar—one that gives the price of carbon both a firm floor and a firm ceiling. This collar should be tight at the beginning. As “climate-friendly” technologies become more readily available, it should be allowed to expand in price at both ends of the spectrum. Offsets—both domestic and international—also should be permitted. These are another important means for mitigating costs.

### **Advanced Generating Technologies**

Effective legislation to reduce carbon emissions is vital. But the real key to achieving those emission reductions—while keeping costs under control—is having the technology we need to make those reductions.

Toward that goal, we, in partnership with the government and others, need to develop, deploy, and fund a full suite of climate-friendly technologies and measures, including energy efficiency, advanced nuclear plants, more efficient coal technologies that are coupled with carbon capture and storage, and renewable energy resources.

## **Nuclear**

Nuclear energy generates about 20 percent of the nation's electricity and gives us one of our only sources of on-demand, zero-emissions electricity. It was not that long ago that the U.S. nuclear industry was considered in a state of decline. Today, though, the industry is preparing for a new beginning. Last year, the Nuclear Regulatory Commission (NRC) saw 13 applications filed, for a total of 19 new units.

And as of January, the NRC expects three applications for another four units will be filed this year. In 2010, the NRC believes it could issue its first combined construction and operating license for new nuclear plants in 30 years. The stimulus package includes additional loan guarantees for nuclear that we are strongly supporting.

By the way, the renewed interest in nuclear reflects the efforts by electric utilities around the world to build advanced nuclear plants and reduce their carbon emissions.

## **Coal**

Coal is another energy resource we must sustain. Because of its low cost and abundance, coal comprises almost 50 percent of the U.S. generation portfolio.

But as you know, building coal plants brings up many challenges today. To maintain coal's viability, we have begun to develop advanced coal plants that can generate electricity more efficiently. And we are well on the way toward developing and implementing technologies that can capture, transport, and store CO<sub>2</sub> emissions from coal-based power plants—which will be a linchpin in our efforts to combat climate change.

We are advocating government support for legislation that promotes carbon capture and storage research, development, and deployment. And we are excited to see more demonstration projects being undertaken by our member companies both here and abroad.

The aggressive development of carbon capture and storage technologies are critical, not only for meeting our own national environmental goals, but also international goals, given the heavy dependence on coal by nations throughout the world, particularly China and India. We are working to keep the U.S. at the forefront of this technology's development.

Although these carbon capture and storage technologies hold much potential, much work remains before they can be fully developed and deployed. There are significant cost, energy, and performance challenges facing large-scale capture technologies and permanent underground storage. As a result, they are not expected to be commercially deployable on a large and widespread scale until at least 2020-2025.

### **Natural Gas**

Natural gas, meanwhile, generates about 20 percent of the nation's electricity, a ratio we expect to remain constant for the decade to come. More important, to sustain this use of natural gas—not only for electric generation, but also for all other uses—we need policies that enable the country to continue to develop and expand its access to our domestic supplies. We need to increase our capacity for importing natural gas as well.

### **Renewables**

The rapid development of renewable energy sources—particularly wind—continues as well. Last year, renewables were the main power projects announced, accounting for almost 80 percent of all new announcements. Wind energy additions averaged almost 700 megawatts (MW) per month in 2008, accounting for more than 40 percent of the industry's capacity additions.

Preliminary data for 2008 show that renewables added almost nine gigawatts (GW) to the generation fleet. This was an increase of 54 percent over 2007, bringing the country's total renewable capacity to about 41 GW, or almost 4 percent of the total U.S. generation portfolio.

Although renewable energy sources are growing in the U.S., at the same time their use has raised challenging public policy issues, particularly the need for supporting tax credits. Last October, after a long effort led by EEI and a variety of coalitions, Congress extended the federal renewable production tax credit (PTC) for one year in its present form, and the investment tax credit (ITC) for solar properties for eight years.

A long-term extension of the PTC is contained in both the House and Senate stimulus bills, and we are strongly encouraging Congress to include it in the final package. The short-term, start-and-stop nature of these tax credits has deterred utilities, developers, manufacturers and investors from maximizing the vast potential of renewable technologies.

State renewable portfolio standards also have helped to stimulate renewable energy development. Lots of states have standards—which are geared to their own resources and needs.

At the federal level, the best way to support renewables is through tax incentives, such as those in the stimulus package, and research and development—both of which are intended to help make them more competitive with traditional generation sources.

In addition, the federal government can help to facilitate the siting of transmission to bring the power generated from renewables in more remote areas to the load centers where it is needed.

## **Transmission**

Reinforcing and expanding the nation's transmission system—the very backbone of our industry—continue to be a major priority for us. As policymakers ratchet up the importance of integrating renewable generation sources, the transmission challenge becomes even more acute, as we work to connect remotely located renewable capacity to heavily populated load centers.

The total number of transmission miles is projected to increase by 9.5 percent (15,700 circuit-miles) in the U.S. over the next 10 years. But because new power

plants are coming online twice as fast as the pace of transmission development, more transmission investment will be needed to maintain reliability and integrate these new energy resources.

Beyond the cost, difficulties in planning, siting, and cost allocation remain key hurdles to expanding our transmission networks. We were delighted, therefore, with the recent decision by the Bureau of Land Management and the Forest Service to designate more than 6,000 miles of energy transportation corridors on federal lands in 11 Western states. This will help to strengthen the grid. It also will help to minimize the environmental impact on the federal lands.

The controversy continues, however, over state siting of transmission lines, especially if they have regional implications. One issue that we will be working on strenuously is providing additional authority to the Federal Energy Regulatory Commission (FERC or the Commission) for siting of much-needed transmission.

The only way we can move all that new wind and solar energy to load centers is by significantly expanding the nation's transmission network. Given the continually vexing NIMBY problem we face in siting new power lines, we believe that FERC will need to be equipped with stronger siting authority to help get that job done.

Although the Commission was given limited backstop authority to address this issue in the Energy Policy Act of 2005, it has come under heavy criticism and litigation. And we expect more votes in Congress to try to overturn it. With the help of businesses and industries who understand the critical need for new transmission, we will remain active and vigilant in defending FERC's authority.

### **Regulatory Initiatives**

As we look to build a new, more efficient and environmentally sensitive electric power industry, we also are strengthening our outreach to state and federal regulators. I would like to introduce EEI's Executive Vice President of Business Operations, David Owens. David will offer you insights on our initiatives in the regulatory arena.

Thank you, Tom. As Tom mentioned, we are working closely with both federal and state regulators. Together, we can develop the thoughtful and supportive regulatory policies necessary to obtain the capital we need on reasonable terms. This is vital, not only for keeping our debt costs down but for keeping our customers' electric rates down as well.

Just as our industry is facing challenging economic circumstances, consumers are feeling the full effect of the economic crisis as well. Many of our customers are having a harder time not only paying their rent, mortgages, and credit cards, but also paying their utility bills.

The number of households falling behind in their utility payments has increased almost 10 percent from 2007 to 2008. This number includes many families who have never fallen behind before. And applications to the federal Low Income Home Energy Assistance Program (LIHEAP) have reached record levels and are projected to increase by about 25 percent over last year. Our efforts in 2008 to gain full funding for LIHEAP have proved to be essential in dealing with this crisis.

To do more for the customers who need it, electric companies are taking proactive measures to encourage them to weatherize their homes. We also are expanding our community-based efforts to assist customers. Longer term, the measures that Tom mentioned, such as taking a new approach to promoting energy efficiency and developing the smart grid, will give all of our customers even more tools to take control over their electricity costs.

What is clear is that electric companies and their regulators—now more than ever before—need to communicate effectively and work together to find the right balance in satisfying the needs of all constituencies in this challenging environment. Maintaining a solid regulatory compact is critical. And we are looking for creative ways to do so.

## **Credit Ratings**

As Tom pointed out, we also are working to maintain our historically strong credit ratings. This is absolutely essential. To preserve credit ratings, the answer is the same, whether for traditional vertically integrated utilities, distribution utilities or generation companies operating in restructured markets: achieve stable, predictable, and sufficient revenues, earnings, and cash flows.

At the onset of our last major capital expenditure cycle in the 1970s and 1980s, our senior debt was largely rated “A” and “AA.” Today, the average S&P senior debt rating is “BBB.”

In addition to the relative impact of declining credit ratings over this longer period, the current credit crisis drastically increased bond spreads and increased the cost of debt capital for all utilities. This effect was magnified for the lower investment grade rated companies.

For example, in mid-2008, the credit spread on existing corporate bonds for the average “BBB+” utility was around 50 basis points higher than for the average “A” utility. By the end of the year, this had risen to around 100 basis points higher. The average coupon rate for new 10-year utility debt issuances across the industry rose from 6.1 percent to 8.2 percent over the same period.

In addition to the increased cost of long-term debt, the credit market freeze also resulted in difficulty in accessing short-term capital markets for A2-P2 commercial paper and in negotiating new bank credit lines. Although the A2-P2 commercial paper market is a small segment of the overall market for commercial paper, electric companies have been a large issuer in the A2-P2 market.

We have been working with a coalition of our CEOs and CFOs to reach out to policymakers in Washington to make sure that we keep our credit lines open. We also are addressing this issue by asking the Federal Reserve to expand its Commercial Paper Funding Facility to the A2-P2 market to bring needed liquidity back to this important market. The recent drop in rates in the A2-P2 market has been encouraging.

Our Wall Street Advisory Group is also facilitating communication and strengthening relationships between our industry and the financial community on which it depends. The group, working with utility chief financial officers, participates in dialogues with state commissioners and Wall Street to discuss key financial issues confronting the industry.

And we are pursuing a frank and open discussion with FERC to help federal regulators understand our challenges on Wall Street, along with the importance of utilities being able to access capital for needed infrastructure projects.

We have commended FERC for using many different regulatory tools to help foster creditworthiness, including “construction work in progress” (CWIP), incentive returns for transmission, market-based rates, and a demonstrated willingness to consider performance-based or other innovative rate practices, such as formula rates.

Finally, we must maintain a constructive and transparent dialogue with regulators at both the federal and state levels to keep them apprised of our capital investment plans. In the course of these dialogues, innovative solutions may come about that result in a positive outcome for customers and investors.

Tools such as the recovery of pre-construction costs through CWIP and appropriate securitization that can help preserve financial viability at the most reasonable costs to consumers should be considered. But at the very least, regulators must understand the need for solvent, financially healthy electric companies in these times when we must build new electricity infrastructure to promote economic growth and prosperity.

We anticipate that the Commission also will be emphasizing the delivery of electricity in the most efficient, smart, and technologically sophisticated manner possible. We welcome the move toward this goal.

**Conclusion**

This is among the most exciting times to be in our industry. With great challenges come great opportunities. The transformation of our electricity system and the way the world thinks about energy will not be a quick or an easy task. But it already has begun. And it will happen.

Thomas Edison once said, “Discontent is the first necessity of progress.” No question, there is a lot of discontent around these days. Our goal must be to achieve a measure of progress that far exceeds the level of discontent that necessitated it.

Electricity will continue to be the lifeblood of the American economy. With the adoption of innovative technologies and the harnessing of our collective resources, we are confident that we can create energy policies that will enable our industry to continue to provide the affordable, reliable and environmentally sustainable electricity supply that America needs.

Thank you.