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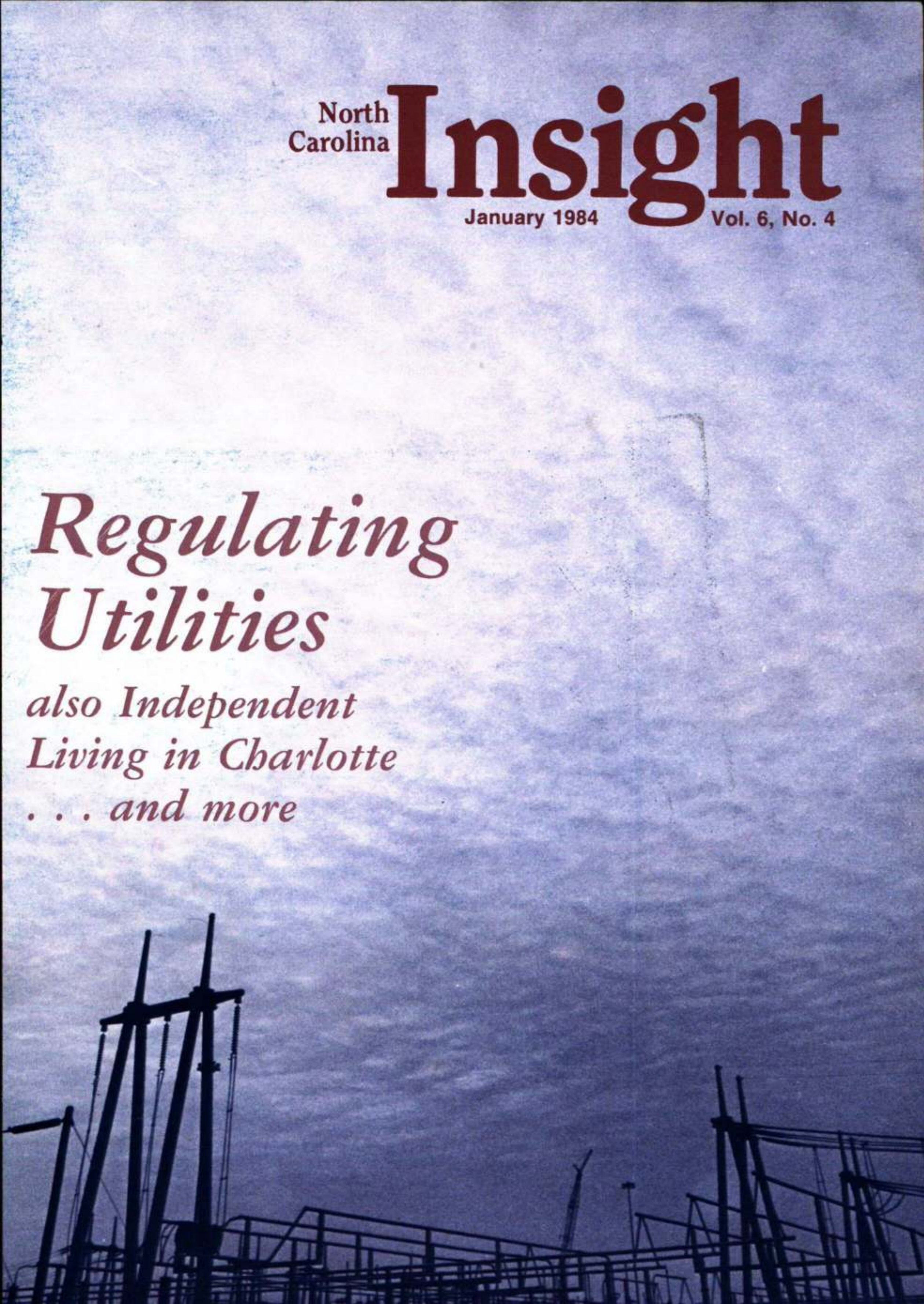

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A NEW CHAPTER IN UTILITY REGULATION

The nuclear power debate no longer dominates the utility scene. Deregulation, diversification, and alternative energy sources have come to the forefront. Despite increased federal action, state regulators still have substantial power over utility operations.

by Steve Adams

The N. C. Utilities Commission at a hearing on telephones.

Late on a cold afternoon last February, a van rented by Southern Bell Telephone and Telegraph Co. arrived at the loading dock of the Dobbs Building in Raleigh. Its cargo for the N.C. Utilities Commission was the paperwork for a rate case — 35 sets of a two-foot stack of documents.

Through the weighty business of a rate increase hearing, Southern Bell was seeking to boost its annual revenues in North Carolina by $122 million. If the Utilities Commission approved the request, the monthly charge for basic residential local service would go from $11.15 to $17.40, a jump of 56 percent. Installation of a residential telephone would be an even steeper increase of 65 or 85 percent (depending on whether wiring had already been installed).

A three-member panel of utility commissioners assembled to hear Southern Bell justify its $122 million request. The February chill matched the mood not only of the public but also

Steve Adams is a Raleigh-based free-lance writer. Adams has followed utility regulation in North Carolina for 10 years, as a reporter, editorial writer, and magazine editor.

of the regulators towards the proposed jump in rates. Seven months later, in September, the panel made its ruling. It agreed to raise local residential rates by only 3.5 percent and gave Southern Bell less than 30 percent of its $122 million request. The ruling showed the substantial power the Utilities Commission still had over telephone rates in 1983. But the panel's decision hardly settled the matter.

Before September was out, members of the Utilities Commission and its consumer-advocate Public Staff traveled to Washington in a rare effort to lobby the North Carolina Congressional delegation. Regulating telephone rates was quickly moving out of the Dobbs Building and into various arenas on Capitol Hill. On January 1, 1984, Southern Bell's parent company, American Telephone and Telegraph Co. (AT&T) was breaking up. Under AT&T's court-approved antitrust settlement with the U.S. Justice Department, the 22 local operating Bell companies spin off into seven "Baby Bells" independent of AT&T. These seven companies continue providing local service. AT&T — and competitors — provide long-distance service.

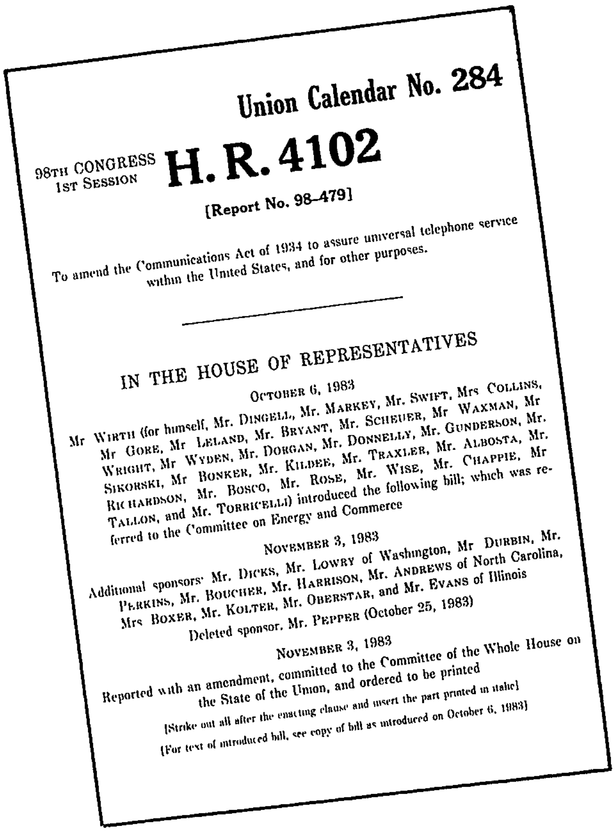
Historically, long-distance revenues have provided a heavy subsidy to local service. Now the "Baby Bells" have to make ends meet primarily through local-service revenues. Southern Bell sought the $122 million in rate increases, in part, because of new pricing systems caused by the breaking up of AT&T. Meanwhile, the Federal Communications Commission was planning to require telephone customers to pay an "access charge" to local companies like Southern Bell to offset the lost subsidies from interstate long-distance service.

Some members of Congress objected to the FCC plans and sought to alter them. In a stunning setback to AT&T and the Reagan administration, legislation altering the FCC plan — the legislation which the N.C. Utilities commissioners had traveled to Washington to support — passed the House. The legislation (HR 4102) would, among its many provisions, eliminate the FCC access charge for residential and single-line business customers. Similar legislation is pending in the U.S. Senate.

Whether Congress can soften the blow of the AT&T divestiture on local telephone rates or not, one thing has become certain about utility regulation. The issues are changing. And so is the axis of power. The AT&T divestiture has set into motion a complex chain of events that involves not only the courts and the telecommunications industry but Congress, the Federal Communications Commission, state utilities commissions, and scores of business and public interest lobbying groups. State utility regulators retain much authority over the utility franchises operating in their states. But ironically, as the Reagan administration pursues its policies of deregulation and "new federalism," more policymaking power seems to be shifting *to* — not away from — Washington. At the same time, new technology has catapulted the telephone industry into highly sophisticated telecommunications and data-processing fields.

Meanwhile the electric utilities, after two decades of hopes for nuclear power, are slowly but surely abandoning an old dream. Carolina Power and Light, for example, has put in mothballs the blueprints for Shearon Harris units number three and four. In December 1983, CP&L announced it had canceled Harris number two. Soaring capital needs for new nuclear facilities, slowed demand, and the fall from public favor due to the Three Mile Island incident are causing electric utilities to cancel nuclear plants, place more reliance on coal, and examine alternatives, including alternative energy sources (like solar, for water heaters) and conservation (like home insulation).[1]

HR 4102 would reverse the Federal Communications Commission's access-charge decision.



Union Calendar No. 284

98TH CONGRESS
1ST SESSION

H. R. 4102

[Report No. 98–479]

To amend the Communications Act of 1934 to assure universal telephone service within the United States, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

OCTOBER 6, 1983

Mr WIRTH (for himself, Mr. DINGELL, Mr. MARKEY, Mr. SWIFT, Mrs COLLINS, Mr GORE, Mr LELAND, Mr. BRYANT, Mr. SCHEUER, Mr WAXMAN, Mr WRIGHT, Mr WYDEN, Mr. DORGAN, Mr. DONNELLY, Mr. GUNDERSON, Mr. SIKORSKI, Mr BONKER, Mr. KILDEE, Mr. TRAXLER, Mr. ALBOSTA, Mr. RICHARDSON, Mr. BOSCO, Mr. ROSE, Mr. WISE, Mr. CHAPPIE, Mr TALLON, and Mr. TORRICELLI) introduced the following bill; which was referred to the Committee on Energy and Commerce

NOVEMBER 3, 1983

Additional sponsors: Mr. DICKS, Mr. LOWRY of Washington, Mr DURBIN, Mr. PERKINS, Mr. BOUCHER, Mr. HARRISON, Mr. ANDREWS of North Carolina, Mrs BOXER, Mr. KOLTER, Mr. OBERSTAR, and Mr. EVANS of Illinois

Deleted sponsor. Mr. PEPPER (October 25, 1983)

NOVEMBER 3, 1983

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed

[Strike out all after the enacting clause and insert the part printed in italic]

[For text of introduced bill, see copy of bill as introduced on October 6, 1983]

The state grants utility companies exclusive franchises as natural monopolies

The natural gas companies also face complex shifts in regulations and economic conditions. Deregulation from Washington, through the Natural Gas Policy Act of 1978, has resulted in both a glut on the market and, paradoxically, soaring prices to consumers. This economic paradox may have to be resolved by new *federal* actions. Meanwhile, as AT&T begins to spin off various telephone services into separate companies, natural gas companies and electric utilities have turned more and more to diversified activities. Electric companies have invested in uranium processing and overseas financial enterprises. Gas companies are expanding into propane and cable television.

These three issues — diversification, soaring capital costs, and deregulation — are recasting the regulatory landscape. After a decade of obsession with energy shortages and prices, utility regulation is slowly closing a chapter. Energy supplies will certainly remain an important concern. But, in the new regulatory era now beginning in North Carolina, attention will focus on corporate structures, high interest rates, and alternative energy sources. Above all, regulatory commissions will have to contend with new corporate priorities. In a two-page ad in major newspapers, E. F. Hutton, addressing the AT&T divestiture, characterized this corporate transition as "a turning point in American industry." Even allowing for some Madison Avenue hype, state utility regulators obviously have their hands full.

Utility Regulation — The Whys and Wherefores

The state entered the utility regulation business in 1891 by creating the Railroad Commission. Fifty years later, in 1941, the legislature established the N.C. Utilities Commission, with three full-time members serving six-year terms. The commission now has seven members serving eight-year terms (see box on page 5). In 1977, the General Assembly, at the urging of Gov. James B. Hunt Jr., reorganized the commission.

Despite the complexity of utilities cases and the quasi-judicial nature of Utilities Commission proceedings, until 1977 only a small contingent of lawyers from the state Attorney General's Office represented consumers. The commission staff reported to the commission and, in recent years, generally played a neutral, fact-finding role. (On occasion, the commission hired outside experts who played the role of consumer advocate.) The utilities, on the other hand, were able to hire experts to press their cases.

In 1977, as public concern grew over rising utility rates, the legislature, at Hunt's urging, divided the state's regulatory resources between the commission staff and a new "Public Staff." The Public Staff represents ratepayers before the Utilities Commission so as to counterbalance the utilities' lawyers, accountants, economists, and other specialists.[2] For fiscal year 1983-84, the Utilities Commission has a budget of \$2.2 million with 56 staff positions; the Public Staff has a budget of \$2.6 million with 81 positions.

The Utilities Commission, like most regulatory bodies in Washington and Raleigh, exists in theory as an arm of the legislature. The legislature, which has delegated its authority to regulate utilities to the commission, monitors utility activities in the state through a six-member Utility Review Committee. The Utilities Commission functions under the administrative aegis of the Department of Commerce and through a quasi-judicial process of formal hearings and investigations. The commission regulates the rates and services of about 1,000 utility and transportation companies in the state. These include electric, telephone, natural gas,

The Commission sets rates at a level that will allow *but not* guarantee *operation at a profit.*

—Hugh Wells, Former Utilities Commissioner

water, and sewer utilities as well as radio common carriers and rail and motor carriers of passengers and/or freight. The commission follows court procedures since its decisions can be appealed into the courts. But, unlike most trials, commission hearings have often been used as a public forum for policy debates.

The state grants utility companies exclusive franchises as "natural monopolies" since duplicating utility services — for example, building parallel electric wire or telephone cable systems — would be unnecessarily expensive. State regulation in effect serves a similar purpose for these monopoly franchises as does competition for companies without a state-granted monopoly. That is, state regulation is intended, in the absence of competition, to ensure that the franchise holders provide needed services with acceptable quality and at a reasonable cost. As the N.C. Supreme Court has put it, "An uncontrolled legal monopoly in an essential service leads, normally and naturally, to poor service and exorbitant charges. To prevent such a result, the legislature has conferred upon the Utilities Commission the power to police the operations of the utility company so as to require it to render service of good quality at charges which are reasonable."[3]

The most visible of the Utilities Commission's "policing" duties is the regulation of rates. The commission may also initiate an investigation into a utility's operation on its

The North Carolina Utilities Commissioners

The Governor appoints the seven utilities commissioners (8-year terms) and the executive director of the Public Staff (6-year term), all of whom presently are Democrats. They make $50,300 (except the Commission Chairman, who makes $51,300). Note that the terms of two commissioners expire in 1985. The next governor will appoint these two to the commission shortly after being elected. In January 1984, Leigh Hammond resigned from the Utilities Commission. His resignation left a vacancy on the commission as this issue of North Carolina Insight *went to press.*

A. Hartwell Campbell, 67, was a minister (B.D., Yale) before managing radio and television stations in eastern North Carolina. He served in the General Assembly (1969-79) and was appointed commissioner in 1979. His term ends in 1987.

Ruth Cook, 54, studied at New York University and first worked as a fashion copywriter. She has been a leader in consumer affairs, as director of the State Council for Social Legislation (1966-74), and as a member of the General Assembly (1974-83). Appointed in 1983, she completes her term in 1991.

Edward B. Hipp, 62, is an attorney (J.D., University of North Carolina), originally from Charlotte. He was special counsel for the N. C. General Statutes Commission Utility Law Revision (1962-63) and general counsel for the Utilities Commission (1963-77). Appointed (to fill an unexpired term) in 1977, he completes his current term in 1989.

Robert Koger, 47, is chairman of the Utilities Commission. A licensed professional engineer in North Carolina, he holds a B.S. in electrical engineering and an M.A. in economics from N.C. State University. Before joining the Utilities Commission staff as an engineer in 1967, he worked for the U.S. Rural Electrification Administration (1958-67). He was appointed to the commission in 1977 and reappointed in 1981. His term ends in 1989.

Douglas P. Leary, 48, graduated from East Carolina University in business administration. He worked for the Four County Electric Membership Corporation (1961-72) and was general manager of the Wake Electric Membership Corporation (1972-79). Appointed in 1979, he completes his term in 1985.

Sarah Lindsay Tate, 56, is an attorney (LL.B., University of North Carolina), formerly an associate with the Raleigh firm of Sanford, Adams, McCullough, and Beard. Originally from Charlotte, she has been an associate counsel for insurance companies. She was appointed in 1977. Her term expires in 1985.

own, but usually it monitors a utility when a company requests a rate increase.[4] The commission usually decides cases in panels of three, as it did in the Southern Bell case. Because of the volume of evidence, hearings may last two weeks or more (see sidebar by Hugh Wells below for a step-by-step summary of this process).

Consumer reaction to rate cases inevitably concentrates on the size of next month's utility bill. But to reach that bottom line, the commission must examine three related, but separate, issues: 1) how much it costs a utility to provide service; 2) whether the utility operates efficiently; and 3) how much the utility needs to earn to retain and attract capital and be fair to its existing investors. State and federal law require the commission to set rates that permit a fair return for investors and financial stability for the utility, so that the company can raise new capital on reasonable terms.[5] The commission sets rates at a level that "will *allow* but not *guarantee* operation at a profit," as former Commissioner Hugh Wells put it in a recent *Popular Government* article (see sidebar).

Such words as "allow" and "guarantee" however, require judgments. First, the commission must employ awesomely complex measurement tools. Discounted cash flow analyses help determine the proper rate of return for investors; multiple regression analyses isolate the effects of a single variable in a utility's cash flow plans; heat rate analyses and other techniques measure the efficiency of power plants. But despite such sophisticated efforts, these measurements do not work with scientific precision.

In the Bell case, for example, the commission and the company used the same basic

How The Utilities Commission Establishes Rates

by Hugh A. Wells

Rates are established through this process:

- The utility company applies for new or different, usually higher, rates;
- The commission holds a hearing in which it hears evidence from the utility, the Public Staff, and other interested parties about whether the increase is needed;
- The commission issues an order deciding whether or to what extent the proposed new rates may go into effect.

The controlling statute, NCGS 62-133, requires the commission to go through five basic steps in each general rate case:

1) Determine the reasonable cost of the property used by the utility in furnishing service, called the "rate base";

2) Estimate the utility's revenue under its present and proposed rates;

3) Ascertain the utility's operating expenses;

4) Fix such rate of return on the cost of the utility's property as will both produce a fair return for its shareholders and permit the company to maintain its facilities properly and compete in the market for capital funds on reasonable terms; and

5) Fix the rates as such a level as will cover the utility's reasonable operating expenses and earn the utility the allowed rate of return.

While the process of utility rate-making often becomes complicated, the basic aim is quite simple: to set rates at a level that will allow the utility to recover its *reasonable* operating expenses; to recover its *reasonable* investment in plant facilities, through depreciation; and to make, by sound management, a *reasonable* profit for its owners.

The obvious key to the success of this process is that magic word "reasonable." And that, essentially, is what ratemaking is —or ought to be — all about. The absence of competitive forces in the marketplace requires that regulation become the substitute for competition, which leads to the possibility that regulated utilities may be only as efficient as they are required to be by those who regulate them. This proposition, while simply stated, constitutes an immense challenge to regulators.

This is excerpted, with permission, from "Utilities Regulation in North Carolina" by Hugh A. Wells, Popular Government, *Winter 1983 issue. Now a judge on the N.C. Court of Appeals, Wells served on the N.C. Utilities Commission (1969-75) and as the first executive director of the commission's Public Staff (1977-79).*

measurement techniques. Even so, they did not agree on what profit level the company needed. Southern Bell claimed that its stockholders required a 17 percent return on their equity, but the Public Staff put the figure at 13 percent. The commission's judgment fell just below the midpoint at 14.75 percent.[6] After all the measurements were said and done, the commission made a judgment — in essence, predicting that the stock market in general and the Bell investors specifically would view a 14.75 percent return as satisfactory.

Utilities function as a kind of closed hydraulic system with money being the fluid that keeps them going. If the Utilities Commission reduces the flow of fluid — i.e., cash — from ratepayers, the result is likely to be increased pressure elsewhere in the system. For example, if Southern Bell fails to earn an adequate return for its stockholders, the value of its stock may drop and the rate it must pay to borrow money may increase. Higher-priced loans and higher returns desired by existing and potential stockholders increase the company's cost of doing business, which in turn exerts pressure for higher rates — i.e., together, functioning as a closed system.[7]

This "hydraulic system" exists not only because of the absence of competition but also because public policy prevents utilities from responding as free-market enterprises would to adverse business conditions. For example, state law requires utilities to serve all comers; hence utilities are severely limited in how they can retrench during an economic recession.[8] Because there are no competitors to provide necessary services, a utility cannot be allowed simply to go out of business. There has never been a utility bankruptcy in the United States, but if one should occur, a very large rate increase probably would be required to maintain service.[9] In the final analysis, the Utilities Commission must attempt to keep utilities healthy and operating efficiently so that ratepayers receive reasonable and uninterrupted service.

Telephone Deregulation

The AT&T divestiture, combined with giant leaps in telecommunications technology, will radically alter the way telephone rates are set. To offset the loss of the traditional subsidy of local rates by *interstate* long-distance tolls, the Federal Communications Commission (FCC) proposes to require consumers to pay "access charges" to their local company. Southern Bell (and most independent telephone companies operating in the state) have filed a request with the Utilities Commission for a similar type fee to offset the loss of intrastate long-distance subsidies.* By 1989, when the subsidies would be completely eliminated, the two proposed fees could increase Southern Bell's average monthly bill in North Carolina from the current \$11.58 to \$30.58, according to a position paper by the N.C. Utilities Commission. The Utilities Commission has adopted a resolution supporting the legislation now pending in the U.S. Senate to block the proposed FCC fees. Meanwhile, the Public Staff is opposing Southern Bell's proposal in North Carolina. If the FCC policy remains intact, however, the Utilities Commission probably can do little more than try to cushion the blow as local telephone rates rise.

In a related matter, the N.C. House of Representatives passed a bill in 1983 to allow competition in the *intrastate* long-distance market. Several companies offer such service, even though it is now technically illegal to do so. That bill, sponsored by Rep. George Miller (D-Durham), could come before the state Senate in 1984.

For further discussion of the many issues concerning telephone regulation, see the article by Utilities Commissioner Edward B. Hipp on page 28.

Diversification

As AT&T and perhaps its local operating companies eventually pursue other types of communication ventures besides telephone service, they will be following a path now well worn by other types of utilities. In North Carolina, natural gas companies are moving into unregulated markets in an effort to diversify their business and boost profits. Ironically, the 1956 AT&T antitrust settlement with the U.S. Justice Department, which the current divestiture settlement replaces, deals with almost exactly the same diversification issues that are growing in North Carolina. One of the purposes of the 1956 decree was to prevent AT&T from taking unfair advantage of its monopoly position and monopoly-generated revenues to compete in unregulated markets.

The Utilities Commission must determine how the utility companies' unregulated enterprises affect the ratepayers and the overall financial strength of the utility. For a detailed discussion of four types of "subsidization" between the utility franchise business and a spinoff venture, see the article on page 13.

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*On December 16, 1983, in an *interim order*, the Utilities Commission rejected the proposed intrastate access charge. The commission is scheduled to release a broader decision by April 3, 1984.

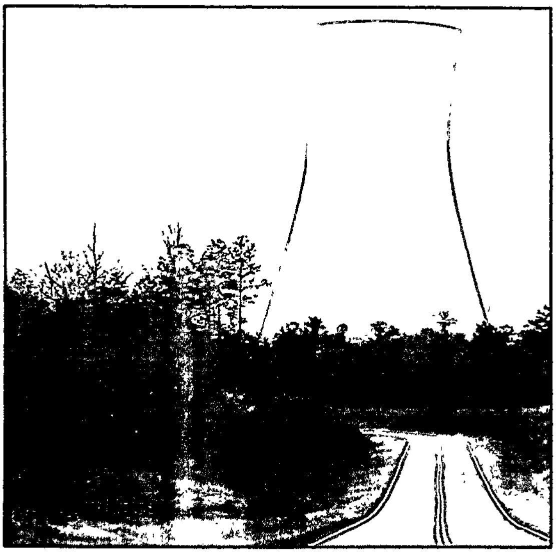
The End of the Power Plant Boom — the Electrics Retrench

Nuclear power has not proven to be as cheap as people once thought it would be, primarily because of the massive cost of plant construction. The federal Nuclear Regulatory Commission regulates nuclear plant construction and safety. A wide range of factors, including the complexity of federal regulation, has resulted in huge cost overruns on almost all nuclear facilities. As construction costs increased, utilities had to raise larger sums of money, which drove the construction costs still higher.

CP&L's first nuclear plant, H.B. Robinson (in South Carolina), came on line (i.e., into customer use) in 1971 at a cost of *$126 per kilowatt* of capacity. Duke Power Co.'s McGuire nuclear plant in Mecklenburg County, scheduled for completion in 1984, will cost *$800 per kilowatt* of electric capacity. In 1986, unit 1 of CP&L's Shearon Harris nuclear plant in Wake County is expected to come on line, at a cost of *$3,000 per kilowatt.* In other words, in building Shearon Harris, CP&L is expected to spend $3,000 to produce the generating capacity to light 10 lamps burning 100-watt bulbs (10 x 100 watts = 1 kilowatt). In 16 years, the cost of generating capacity at a CP&L nuclear plant jumped more than 20-fold. After McGuire and Shearon Harris, no major power plants are likely to be built in the state in the near future.[10] A moderation in rate increases should occur.

"Even with higher costs for later units, the average cost of CP&L and Duke Power capacity will be low on a national basis," says CP&L's Chairman Sherwood Smith.

During the nuclear plant building boom, electric rates skyrocketed. "Two aspects of ratemaking for electric utilities have been particular targets of public indignation," says Hugh Wells, "fuel clauses and construction work in progress." In 1982, the General Assembly made changes in the statutes affecting both of these issues.



Michael Matros

CP&L's Shearon Harris facility under construction.

Fuel Clauses. In 1975, the legislature granted utility companies specific permission to come before the commission to ask for rate adjustments to reflect shifts in fuel prices. In these "fuel clause" hearings, held between general rate cases, the commission at first continued to consider the general efficiency of the utility plant. But VEPCO appealed this practice into the courts, and the N.C. Court of Appeals ruled that the "fuel-clause" law prohibited the commission from considering any factors other than fuel prices.[11]

In 1980, after the Court of Appeals ruling, all three of CP&L's nuclear units were out of service during peak summer demand. CP&L had to produce electricity utilizing more expensive coal-fired generating plants or had to purchase electricity from other utilities. As a result, fuel expenses rose by some $51.5 million, which was passed along to the ratepayers. The next year, 1981, CP&L's nuclear units were again out of service at the peak cooling time, and about $50 million in fuel-related expenses were passed along to the ratepayers in higher rates. In these hearings, the commission was limited by the VEPCO decision to a consideration of fuel prices and could not examine the reasons for the nuclear plant shutdowns.[12]

In 1982, the General Assembly changed the law and gave the commission the authority to assess all aspects of a power company's operation during a fuel clause hearing. In addition, there can be only one fuel clause hearing per year.

Construction Work in Progress (CWIP). The commission bases its "reasonable" rate of return for a utility company on the company's plant investment, called the "rate base." The rate base thus is extremely important in arriving at the final rates consumers pay. Before 1977, only plants *actually in use* could be included in the rate base. In 1977, the same year it created the Public Staff, the legislature allowed, effective in 1979, utility companies to include "construction work in progress" in the rate base (see "CWIP: Shifting the Investment Risk to Utilities' Consumers," *N.C. Insight,* Spring 1979). CWIP is a tradeoff for both consumers and for power companies. For utilities, the provision improves cash flow but does not dramatically increase profits. For consumers, it means higher rates in the short term but — in theory at least — lower rates than there would otherwise be after a plant goes into service.[13]

In 1982, the legislature gave the commission discretion over whether to allow utility companies to earn a return on money invested in CWIP. The old law *required* such a return. Since the change, the commission has generally allowed a return on CWIP only for major facilities nearing completion, including McGuire and Shearon Harris. In such cases, the commission has allowed fairly significant amounts of CWIP in the rate base in order to optimize financial viability and to avoid dramatic increases in electric rates. By phasing new investment into the rate base — rather than not using CWIP and having the new generating facility become part of the rate base all at once when completed — moderate, uniform rate increases will result, says Commission Chairman Robert Koger, not infrequent, exceedingly large rate increases (i.e., when the entire new plant becomes part of the rate base). Koger believes this practice will significantly lower the overall cost of electric energy and hence is in the public interest.

The Public Staff argues against this commission policy. Executive Director Robert Gruber agrees that the policy will mean lower rates in the long run. "Nevertheless, it requires current customers to pay now for benefits they may not receive in the future," says Gruber. Secondly, says Gruber, the law authorizes the commission to allow a return on CWIP only when it is necessary to protect the financial health of the utility and when it is in the public interest. "It appears that the commission is allowing more CWIP than is needed in the rate base to protect the financial health of the industry," argues Gruber. "It's a matter of degree."

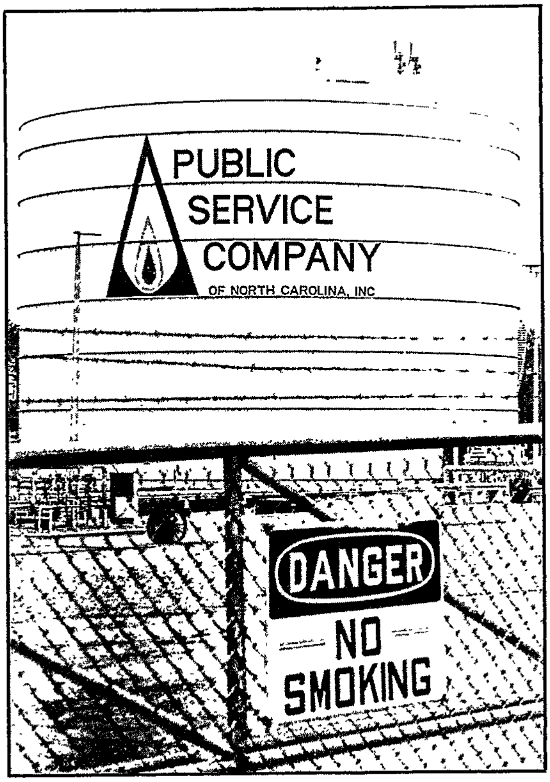
As a practical matter, the CWIP debate is likely to become moot when the Harris unit is completed. Both the commission and the Public Staff say they expect no other major plants to be built in the near future.

Other Electric Issues. As power companies turn from new plant construction to refurbishing older plants, the commission will remain responsible for exerting pressure to promote efficiency, as it has done when it penalized power companies for poor management in recent rate cases.[14] Beyond that, the hydraulics of regulation may stabilize—that is, provided new forces do not appear. Dennis Nightingale, director of the Public Staff's Electric Division, sees acid rain clouds gathering on the horizon. Solving the acid rain problem, he says, may require massive investments to clean up emissions from coal-fired plants.

Natural Gas Deregulation

Consumers are paying record prices for natural gas despite a huge glut on the market. The situation appears to violate the law of supply and demand, but there's scarcely anything the Utilities Commission can do about it. The National Association of Regulatory Utility Commissioners describes the predicament this way: " . . . [T]he largest cost components in burner-tip [retail] gas prices are controlled only at the federal level. Our experience thus far in making the transition to partial deregulation of wellhead prices shows that state regulators are forced to deal with the *consequences* of a poorly fashioned transition . . . but are precluded from making the regulatory decisions which are actually *shaping* it."[15]

The natural gas industry has three components: 1) the gas producers (concentrated in the South and Southwest); 2) the gas transporters, which operate an interstate business and hence are regulated by the Federal Energy Regulatory Commission; and 3) the gas distributors, which operate within states and are thus regulated by state utilities commissions. Residential natural gas prices have nearly doubled in North Carolina since passage by Congress of the Natural Gas Policy Act of 1978, which calls for gradual deregulation of producer—i.e., wellhead—prices through 1985. The residential increases are almost entirely the result of these wellhead



hikes. Transcontinental Gas Pipe Line Corporation, the transporter supplying all North Carolina gas, has actually lowered its markups over wellhead prices; the N.C. gas distributors have increased their markups over the Transco prices only slightly.[16]

Increases in wellhead prices, while beyond the Utilities Commission's control, do impose new pressures on the companies the commission does regulate. For example, heavy fuel oil is now less expensive than natural gas for some industrial uses. *If industrial use of natural gas declines, residential rates rise* because the fixed costs of operating the distribution system must be spread over a smaller quantity of gas.

To help limit residential rate increases, the Utilities Commission has adopted two strategies to keep industrial customers using natural gas. First, industries are generally allowed to buy gas directly from producers and may contract with Transco and the distribution companies to ship it to them. Second, industries may negotiate their own rates with gas distributors in order to compete with the cost of industrial fuel oils.

The action on natural gas, however, is in Washington. Both houses of Congress are considering a number of bills to modify the Natural Gas Policy Act. One Senate bill (S 1715) would, for example, lift all remaining regulations on natural gas prices over a 44-month period. Various House bills would make more modest changes. Most proposals would give pipelines, such as Transco, relief from contracts that require them to pay for gas they cannot sell.

Conclusion

Many of the factors that most dramatically affect the rates consumers pay — producer gas prices, the cost of nuclear plant construction, federal telecommunications policy — are beyond the control of the N.C. Utilities Commission. Further, the "hydraulics" of regulation limits the ways the commission can respond to various financial market pressures.

Edward B. Hipp, who chaired the three-member panel that decided the Bell case in September, acknowledges that the decision might be no more than a holding action against pressures beyond their control. "You could expect the company to want to be prepared [for the federal changes]," says Hipp. "But they've got to experience it before they can start charging for it."

Commissioner Ruth Cook, a former legislator and a consumer advocate, was also on the panel. "There is no question there will be major changes in the years ahead," says Cook. "But we will deal with those changes as they happen."

Michael Matros

Utilities Commission Chairman Robert Koger and Commissioner Ruth Cook.

Commenting on the Southern Bell case, the *Greensboro Daily News* said, "It's tough to say who is wedged more firmly between the rock and the hard place these days: Southern Bell or the N.C. Utilities Commission." The telephone company will have to operate in a significantly new environment after divestiture, the newspaper acknowledged. "But the state's utilities commissioners live in a slightly different environment. They must take into account not only economics, but political realities."[17]

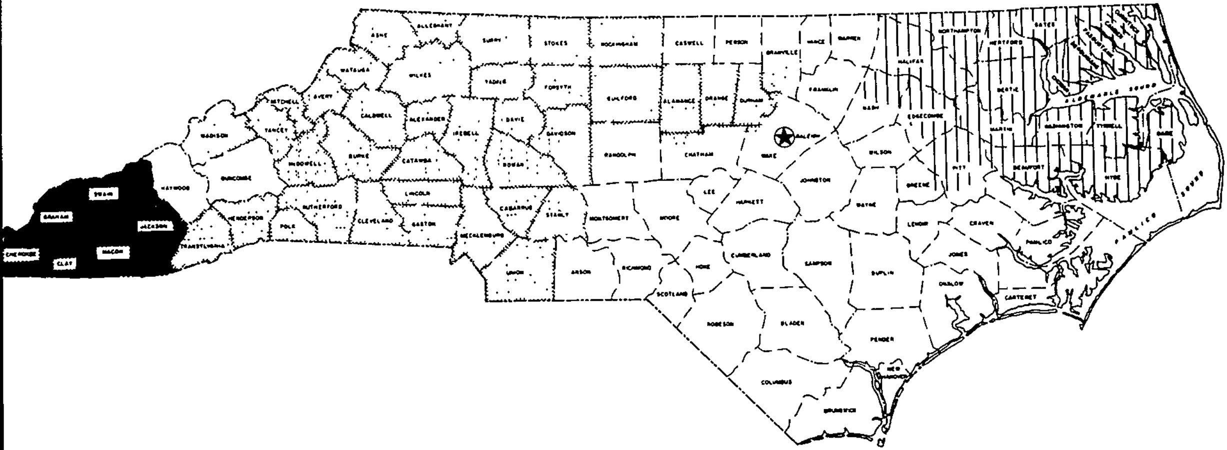
Consumer advocacy and public pressure play an important part in utilities regulation. The furor over electric rate increases in the early 1970s led Gov. Hunt to make utility reform a major part of his platform in the 1976 gubernatorial race. The creation of the Public Staff was a direct result. It is clear that the Public Staff has improved the quality of arguments put before the commission on behalf of consumers. It is equally clear that in the last six years the utility commission has been more attentive to consumers.

In recent years, consumer advocacy has increased, by the Public Staff and others. Meanwhile, the proportion of companies' rate requests approved by the commission has generally declined, according to the Public Staff. For electric companies, for example, from 1974 to 1977 (pre-Public Staff), the commission granted 90.3 percent of the companies' rate requests; from 1977 to 1980, the figure dropped to 70.2 percent.

In the day-to-day world of utility regulation in North Carolina, the seven men and women who make the final decisions must contend with the short run and the long term at the same time. Sorting out the avenues of power available to them requires reflection and balance.

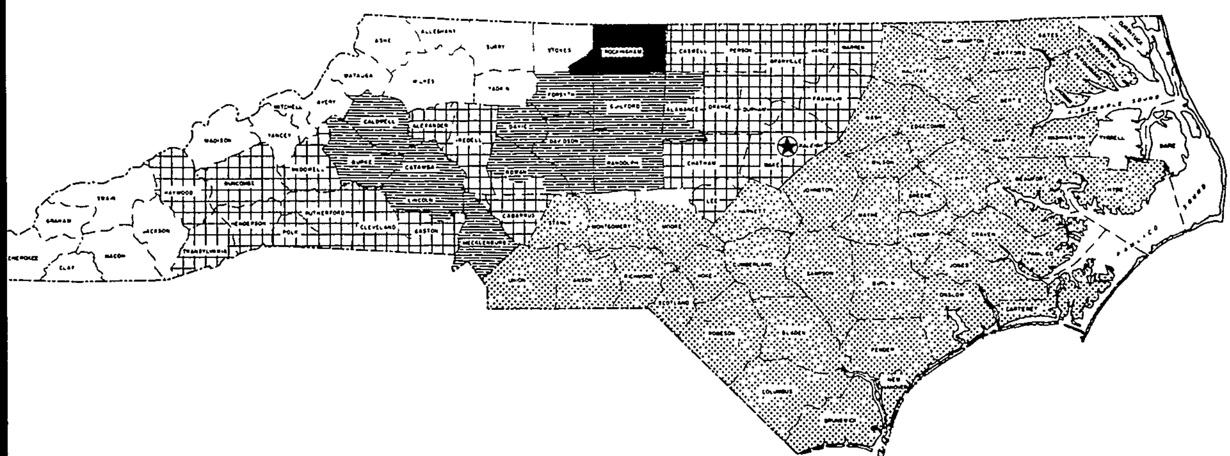
Many factors that directly affect utility rates are beyond the control of the N.C. Utilities Commission. Even so, many aspects of the utility franchise system are regulated by the commis-

Private Power Company Service Areas in North Carolina



- Carolina Power & Light Co.
- Duke Power Co.
- Virginia Electric & Power Co.
- Nantahala Power & Light Co. (serves portions of indicated counties)

Natural Gas Service Areas in North Carolina



- North Carolina Natural Gas Co.
- Public Service Company of North Carolina Inc.
- Piedmont Natural Gas Co. Inc.
- North Carolina Gas Service, Division of Pennsylvania and Southern Gas Co.
- No natural gas service

Maps by Carol Majors

Source: N.C. Utilities Commission

sion. Because of the increased cost of utilities in general and the factors at work in Washington and on Wall Street, the N.C. Utilities Commission may not be able to keep a $75 utility bill from rising, but its decisions might keep the bill at $85 or $90 instead of $100.

A new chapter in utility regulation is beginning. While many of the regulatory trends are in transition, the utility companies continue to function for the most part under the same monopoly franchise system that has existed for a generation. Given this framework, how can the N.C. Utilities Commission best function to ensure reliable service at reasonable rates? Answering that question may be the most important public purpose to be served by utility regulators, legislators, political leaders, and the concerned public.□

FOOTNOTES

[1]In a pre-publication review of this article, Carolina Power & Light Chairman Sherwood Smith emphasized that *utilities still believe* that uranium should play a major role in meeting the country's energy needs in future times. "The nation is making a mistake in not pursuing breeder reactor technology as a source for the future, particularly since it is being pursued in other parts of the world," says Smith.

[2]For a review of the first six years of the Public Staff's activities and accomplishments, see "Public Staff Power Struggles" by Barry Jacobs and Dee Reid, *N.C. Independent*, September 16-29, 1983.

[3]*State ex rel. Utilities Commission v. General Telephone Co.*, 281 N.C. 318, 189 S.E. 2nd 705 (1972).

[4]NCGS 62-132; NCGS 62-130.

[5]NCGS 62-133; *Federal Power Commission v. Hope Natural Gas Co.* (1944), 320 U.S. 591; *Bluefield Water Works & Improvement Co. v. West Virginia Public Service Commission* (1923), 262 U.S. 679. Federal cases cited in "A Bankrupt Utility — What If?" (see footnote 9).

[6]"Return on equity" refers to the return "common stock" shareholders in utility companies earn on investments in the form of retained earnings and dividends. Bondholders and preferred stock shareholders have first claim on revenues above operating expenses. Their returns are fixed and are not ordinarily in dispute in rate cases. Profits, after all other costs, accrue to the common shareholders, the owners of the company.

[7]For a discussion of the effect of regulation on rates see "Does Electing Public Utilities Commissions Bring Lower Rates?" by Malcolm C. Harris and Peter Navarro, *Public Utilities Fortnightly*, September 1, 1983, p. 23 ff. The authors note that both opponents and proponents of elected (rather than appointed) commissions believe that elected regulators tend to adopt strategies intended to hold rates down in the short term. However, they cite academic research showing that such efforts at rate suppression actually can lead to higher rates in the longer run. In their own analysis, the authors conclude that the method of selecting commissions has a negligible effect on rates and that other factors, particularly geographic location, are highly significant.

[8]NCGS 62-32 and 62-42.

[9]"A Bankrupt Utility — What If?" by Robert D. Stewart Jr., *Public Utilities Fortnightly*, September 15, 1983, p. 15 ff. Stewart, an attorney for Oklahoma Gas and Electric Co., calculates that rates of a hypothetical but typical electrical company would jump by nearly 50 percent if the company went bankrupt and was bought by another utility. The increase would occur because the utility's long-term bonds would become due immediately, forcing refinancing and higher rates, and because investors would require a higher return on common stock because they perceived the investment to be riskier.

[10]Interviews with Robert K. Koger, chairman of the N.C. Utilities Commission; Robert Gruber, executive director of the Public Staff; and Dennis Nightingale, director of the Public Staff's Electric Division. Until December 1983, a second Harris unit was still on CP&L's construction schedule. When a power company cancels a plant afer a sizeable investment, the commission splits the cost between investors and consumers by allowing the company to amortize the investment over a 10-year period.

[11]48 N.C. App. 453, 269 S.E. 2nd 657; certiorari denied by N.C. Supreme Court, 301 N.C. 651, 273 S.E. 2nd 462 (1980).

[12]In a subsequent general rate case, Docket E-2, Sub 444, the commission did find that CP&L had not operated Brunswick unit No. 1 efficiently and thus penalized CP&L $14 million. CP&L also contends that it actually under collected its fuel-related expenses by $82.5 million during the 1980-81 time period, a contention which still may have to be addressed by the commission.

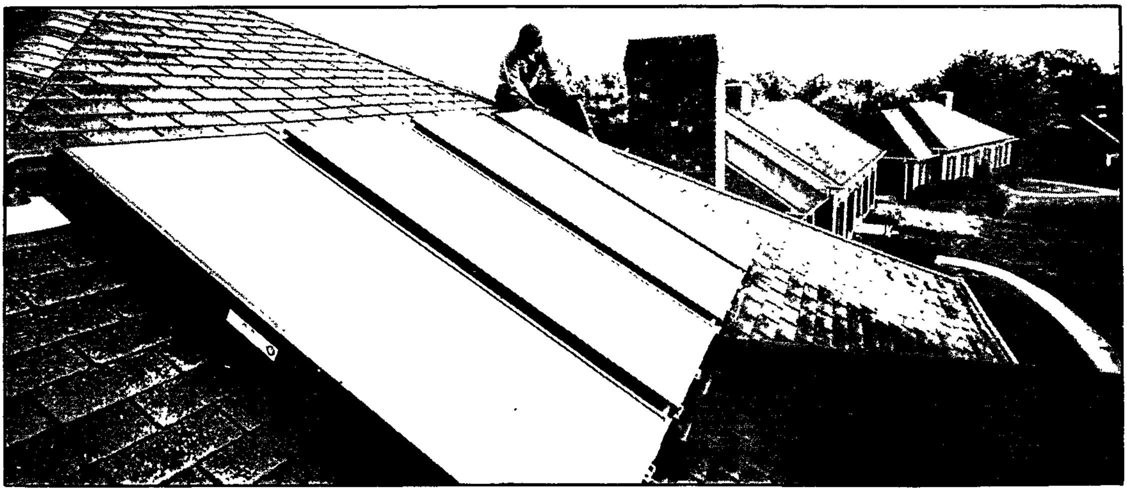
[13]In general, NCGS 62-133 allows utilities a return only on "property used and useful in providing service," which does not include plants under construction. Without CWIP, utilities claim on their books an "Allowance for Funds Used During Construction" (AFUDC) — a paper return on their investment. AFUDC appears on the company's books as revenue and is added to the cost of the plant when it goes into service, raising the rates consumers must pay at that time. Generally, Wall Street has accepted AFUDC as revenue in the year it is claimed. However, in the early and mid-1970s, when utilities were engaged in massive construction programs, AFUDC accounted for a large proportion — in a few cases all — of electric utilities' profits. Investment analysts expressed concern that this diminished cash flow would cause investors to perceive an increased risk, driving up the company's cost of capital and consumer's rates.

[14]CP&L was penalized $14 million and $13 million, respectively, in its last two rate cases. In 1980, the commission penalized Virginia Electric & Power Co. five percentage points in return on equity for inefficiency, poor maintenance, and failure to convert quickly enough from expensive oil to more economical coal.

[15]Letter circulated to chairpersons of state regulatory agencies and members of the U.S. Senate by Linda Kent, director of congressional relations, National Association of Regulatory Utility Commissioners, October 21, 1983.

[16]Between 1978 and 1982, Transco's markup on gas *dropped by six cents* per 1,000 cubic feet. During the same period, N.C. Natural Gas (NCNG), which serves eastern North Carolina, *increased its markup by only four cents.* Even so, the price of gas to an average NCNG residential customer increased $2.16, from $3.00 to $5.16 per decatherm (a metric measure of energy content similar to a BTU, almost exactly equal to 1,000 cubic feet of gas). The source of the entire $2.16 was the change in wellhead prices, controlled entirely by federal regulations. Rate changes for Piedmont Natural Gas Co. and Public Service Co. of North Carolina showed a similar pattern. Although their markups increased by more than NCNG's, they accounted for only a fraction of the overall increase. Calculations based on figures provided by Public Staff.

[17]"Southern Bell's Rock" (editorial) *Greensboro Daily News*, September 16, 1983, p. 10.



Courtesy Piedmont Natural Gas Co.

Utility Companies Expand Into New Markets

Utility companies, like other corporations, are increasingly diversifying—into solar products, home insulation, even cable television. But utilities, unlike other corporations, have a state-awarded monopoly franchise for their principal product. The N.C. Utilities Commission has a mixed record of monitoring the flow of capital between a regulated utility business and a nonregulated subsidiary venture.

by Ken Friedlein, Bill Finger, and Anne DeLaney

"The profits of the natural gas utility belong to the shareholders."

—John H. Maxheim, President and Chief Executive Officer, Piedmont Natural Gas Company

"The significant [regulatory] concern is for protecting the public interest as utilities pursue diversification."

—*1982 Report of the Ad Hoc Committee on Utility Diversification,* National Association of Regulatory Utility Commissioners

In October 1978, John Maxheim took over the presidency of the largest natural gas company in North Carolina. Piedmont Natural Gas (PNG) had just been through a rough time—laying off employees, offering less than adequate service, and paying a poor rate of return to its shareholders. Availability of gas supplies from the southwest had been part of the problem. Maxheim, who had been working to diversify United Cities Gas Company in Nashville, Tenn., wanted to avoid being dependent on a single product at his new corporate home.

The PNG Conservation Company, which sells solar energy systems, is a division of Piedmont Natural Gas Co.

Maxheim's diversification campaign began modestly, with an ad for PNG's home insulation business. Actually PNG hadn't sold any insulation yet, but that didn't deter Maxheim. Under the National Energy Policy and Conservation Act (PL 94-163), then about to be signed into law, public utilities not already engaged in the insulation business would not be allowed to get in. The ad qualified PNG, which is

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a public utility, to add insulation to its growing list of products.

Piedmont Natural Gas still hasn't sold much insulation, $258,000 worth in 1981. But in hedging his diversification bets, Maxheim signaled a new course for PNG's future. No longer was PNG merely a public utility serving 200,000 Carolinians. To accommodate its diversification, PNG created in 1980 a wholly owned subsidiary, PNG Energy Company, with six separate nonutility companies. The subsidiary's product lines included propane, coal, oil, solar installations, a cable television franchise, and satellite TV systems. Unlike PNG's main "product line"—its monopoly franchise to sell natural gas to residential, commercial, and industrial customers in 60 North and South Carolina communities—none of the PNG Energy Company ventures is subject to regulation by the N.C. Utilities Commission. By 1982, the total operating revenues from the company's nonregulated ventures had climbed to $14.4 million, about 5 percent of its total revenues of $315.8 million. Maxheim hopes that these nonregulated ventures can eventually account for 20 percent of PNG's profits.

"Natural gas distribution companies are entering a potentially very difficult period," said Maxheim. "The present [federal] level of deregulation will cause many of us to lose substantial markets. If we are to stay financially viable corporations, which can attract capital at reasonable rates and maintain our experienced and valuable work force, we must be allowed to enter nonregulated activities without the crippling stranglehold of utility regulation."

Some analysts contest whether gas companies face such a bleak picture. Indeed, Piedmont's own annual report points with pride to its growing number of customers. But Maxheim's major point sums up a growing controversy within utility circles throughout the country. To what extent should state utility commissions regulate the diversification of utility companies into subsidiary ventures?

Increased Diversification Poses Regulatory Challenge

In 1982, the National Association of Regulatory Utility Commissioners (NARUC) released its second major report in a decade on the importance of diversification. "Persuasive arguments can be made both in favor and in opposition to utility diversification," says the report. "Potential risks to monopoly ratepayers are associated with diversification by utilities. How significant are these risks? This determination ultimately *must be made by each state regulator*" (emphasis added).[1]

The "state regulator" in North Carolina is the Utilities Commission. Like most such regulators, the seven commissioners in North Carolina do not come to diversification cold (see page 5 for a biographical sketch of each). In fact, the first nonutility subsidiary in North Carolina predates the N.C. Utilities Commission, formed in 1941, by 31 years. In 1910, Duke Power Company organized the Mill-Power Supply Company to supply equipment to textile mills and other industries then converting to electricity. In recent years, however, the commissioners have had to deal with a growing number of ventures outside of the utility field.

Duke Power, for example, expanded into timber, mining, and other areas not generally regulated by the Utilities Commission. In 1969, Duke Power formed the Crescent Land & Timber Company (one of the largest land owners in the state, 270,000 acres); in the 1970s it formed the Eastover Mining Company and Eastover Land Company; in 1978, it formed Western Fuel Inc. to explore for uranium; in 1982, it formed Duke Power Overseas Finance in the Netherlands Antilles "to provide Duke Power with financial resources from outside the United States," as the company's 1982 annual report puts it; and since 1981, the company's marketing department has been expanding into such new services as providing statistical information to other companies.

The oil embargo of the early 1970s prompted many utilities to try to gain control over their energy sources. Hence, they diversified "vertically"—that is, within the energy field, from fuel source through means of distribution to home appliances. But, as they diversified, many utilities were going through a particularly difficult period for other reasons. Electrics (especially those committed to building nuclear plants) faced soaring construction costs and capital accumulation problems while gas companies coped with complex federal supply regulations. Meanwhile, a more conservation-conscious public began using less energy, and "alternative" energy sources hit the market (see "Alternative Energies for Future Needs," *N.C. Insight,* Winter 1980).

By the early 1980s, major business and utility publications were analyzing the key diversification issues before state regulators. A sampling of the titles suggests the scope of the articles: "Why Electric Utilities are Buying into Coal"; "The Coming Transformation in Electric Service: Entry into Cable Television"; "Can 'Advance Approval' Control Diversification?"; and "A High-Risk Era for the Utilities."[2] Many of the journals discussed the diversification strategies from the viewpoint of a utility

Subsidiaries

DUKE POWER COMPANY

Subsidiary Investments

(dollars in thousands)

	December 31 1982	1981
Property and investments—at cost		
Real estate, recreational and land development	$ 33,391	$ 32,057
Coal mining	56,545	89,457
Net current assets, principally investments, receivables and inventories	46,820	7,104
Total assets	136,756	128,618
Coal production commitments	(24,868)	(37,272)
Deferred income taxes	(36,458)	(36,365)
Total liabilities	(61,326)	(73,637)
Investments in and advances to subsidiaries	$ 75,430	$ 54,981

Crescent Land & Timber Corp.

Formed in 1969, this subsidiary manages approximately 270,000 acres of "non-utility" property consisting primarily of timber lands surrounding Duke Power's hydroelectric facilities, but also inclu[illegible]

Crescent has instituted new programs to search for other natural resources which may exist on its properties, including oil, gas and various minerals. Additional programs are under way to determine the best use for properties, which [illegible]

In 1982 Crescent harvested 32 million board feet of timber and 62,000 cords of pulpwood. Approximately 2 million new trees are being planted each [illegible] Since Duke [illegible] tion ac[illegible]

From Duke Power's 1982 Annual Report

company. But, in the end, most brought the concern back to the regulatory table. As *Business Week* put it on February 23, 1981, "State regulators are becoming increasingly fearful that diversification will distract utility management's attention from its primary business."

Asked if he was "fearful" about the impact of diversification, N.C. Utilities Commissioner Edward B. Hipp responded that such uneasiness has surfaced more often in other states than in North Carolina. "We have the concern and always watch to be sure that nonutility costs are separated out in rate cases," says Hipp, who served on the NARUC committee that released the 1982 diversification report. "But we've never discouraged diversification because, number one, the statutes recognize the rights of utilities to engage in nonutility business. Number two, it's a fact of life and has been for a long time."

No specific enabling legislation exists for public utilities to engage in diversified activities, but a number of statutes recognize such corporate activity. "If any person conducting a public utility shall also conduct any enterprise not a public utility, such enterprise is not subject to the provisions of this Chapter," reads the N.C. statute that addresses the issue most directly.[3]

The "fact of life" that Commissioner Hipp has observed is becoming more prevalent with Duke Power, PNG, and other utilities. "We plan to expand our propane operation throughout our 26-county natural gas territory," says Jack Knox, vice-president for consumer affairs, Public Service Company of North Carolina. Carolina Power and Light (CP&L) now owns 100 percent of two coal mining operations.

Diversification by American corporations is, of course, nothing new. R.J. Reynolds Inc. bought Hawaiian Punch in 1963 and now, tucking Del Monte Corporation and Heublein Inc., among others, under its belt, has become a major American foods concern. Meanwhile, Spring Mills Inc. tried frozen foods, flopped, and returned to textiles. The managements of R.J. Reynolds and Spring Mills took calculated risks and lived with the results. Stock prices rose or fell, profits and losses were absorbed, and capital became more or less accessible to the parent company, depending upon the vagaries of the market and the successes of the diversification. But the utilities are not tobacco or textile companies.

Executives at PNG, Duke Power, and other utility companies begin their business day with a state-awarded franchise atop their desks. The state of North Carolina has granted these managers an unusual opportunity in a free enterprise economy: the opportunity to have a monopoly. In return for committing to provide telephone, gas, electric, and similar services, utility companies receive from the state the right to operate exclusively in a given territory and to charge rates that will cover expenses and return a profit to the companies' stockholders.

This franchise serves two purposes. First, consumers—denied a choice in utility suppliers—have some protection from pricing abuses by a utility monopoly. Second, the utility is allowed an opportunity to earn a "fair rate of return," or profit, which the company can use to reinvest in the business and pay dividends to shareholders. The allowed rate of return is set to make utility stock attractive to investors; thus the utility can raise capital and remain strong financially. As far as a utility's principal business is concerned, the state follows rigorous ratemaking procedures to balance the interests of both consumers and utility shareholders. (For more on the process of setting rates, "fair rate of return," etc., see sidebar by Hugh Wells on page 6.)

The state has not been so rigorous, however, in monitoring how a utility's expansion into a nonregulated business affects the ratepayers, the stockholders, and the nonregulated markets into which utilities are expanding. In considering diversification issues, state regulators seldom analyze closely such questions as these: Who is paying for a utility's expanding into, and operating, its nonutility businesses? Are the nonregulated ventures generating additional profits and enhancing the utility stocks, or are they draining resources and jeopardizing a utility's overall financial health?

Diversification poses difficult questions for state officials charged with regulating and monitoring utilities in North Carolina. The primary concern revolves around the potential for "cross subsidization" between regulated and nonregulated businesses. Financial jargon aside, "cross subsidization" boils down to this question: How and to what extent may dollars flow within a public utility's corporate structure? A "cross subsidy" refers to some type of financial support—i.e., "subsidy"—from one operation within the utility's corporate structure to another, usually from the regulated to the nonregulated venture.[4]

There are four primary ways in which a subsidy can pass from the regulated business to a nonregulated activity: improper cost allocation, inflated transfer prices, capitalization of a nonregulated venture, and below market pricing. These four terms, like "cross subsidization," would do admirably in competition for "Best Obtuse Jargon." But the admission price would be worth paying. In each case, the jargon translates into cold cash.

Cost Allocation: Whose Figures to Believe?

The costs of running a nonregulated venture should be borne by the customers of that activity, not by the ratepayers. For over a decade, the N.C. Utilities Commission has been unequivocal on that point. "It seems clear that under the statutory law of North Carolina, Duke [Power] has the corporate authority to engage in nonutility activities," the commission ruled in a 1971 rate case involving Duke Power Company and its subsidiary, Crescent Land & Timber. "[But] the ratepayers are not required to provide any return on this wholly unrelated investment. No service shall be rendered to Crescent Land & Timber Corporation by Duke employees without compensation from Crescent to Duke."[5]

Few argue with such a premise on allocating costs—in theory. But separating all the costs of nonregulated ventures from those of the regulated activity—on which utility rates are based—can be arbitrary at best and misleading at worst.

In 1981, Piedmont Natural Gas had a rate hearing before the Utilities Commission that raised a variety of questions regarding cost allocation. The Public Staff, which represents the public before the commission in rate hearings, hired a consulting firm to analyze PNG's subsidiary operations. Currin and Associates, the Raleigh-based firm that conducted the PNG study, provided the Public Staff with an 83-page report and testified before the commission during the hearing.

Currin and Associates examined how PNG allocated costs in transportation (using the same vehicles for installing propane and gas), staff time (employees working for several PNG companies), insurance premiums, joint properties, and other areas. When an exact allocation could not be determined among the subsidiaries and the utility, PNG used a "common pool" approach. Overall, Currin and Associates gave PNG a clean bill of health, but they did discover some minor irregularities.

"The subsidiaries were not being charged rental for utility land which it utilizes in its operation," Currin found, for example. Ten PNG storage tanks in Charlotte had been assigned to the PNG Propane Company subsidiary. "The land on which these tanks are located remains on the books of the utility, and no rental fee is charged to PNG Propane."[6]

Currin felt that in its *common pool calculation* alone, PNG overallocated the natural gas business by $133,403. "It is difficult to find an all inclusive cost allocation method since Piedmont is engaged in subsidiary activities of widely differing natures," the Currin researchers concluded.[7] Currin did suggest, however, an improvement in the accounting procedures used in the common pool costs. "The Massachusetts Formula [an accounting system] used by Piedmont is acceptable, with the provision that the formula would be modified to an *end-of-period* level which is consistent with normal regulatory practice" (emphasis added).[8] PNG had used an *end-of-year* adjustment under the Massachusetts Formula rather than an *end-*

of-period adjustment. End-of-period, when customer rates for natural gas change, does not necessarily coincide with the end of either a calender year or a company's fiscal year.

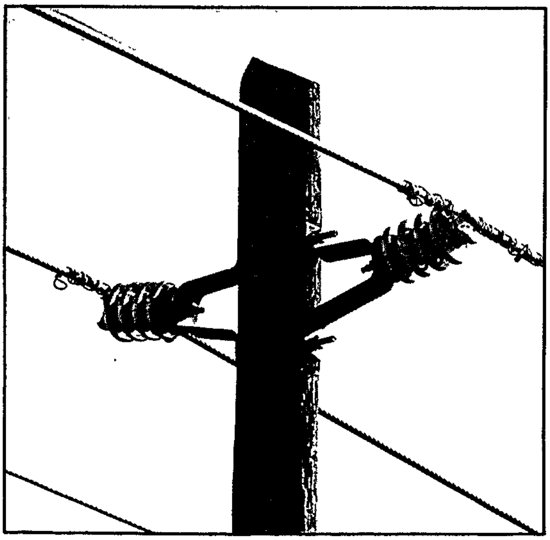
In determining cost allocations during the 1981 PNG rate hearing, the Utilities Commission treated cost allocation as "an art, not a science," as the 1982 NARUC report put it. The Utilities Commission ruled that PNG had overallocated some $467,000 in nonutility expenses to its utility operations.[9] If this amount had not been disallowed, residential customers, who buy about one-fourth of PNG's gas, would have "subsidized" PNG's nonutility operations with only 69 cents of an average yearly bill of $486. Similarly, commercial and industrial customers of PNG gas would have also "subsidized" PNG's nonutility ventures.

"In 1983, the company decided that the best way to handle allocation issues was to completely, physically separate all nonutility activities from the utility operation—separate office buildings, payrolls, computer operations, and billings—so that no question could be raised regarding the proper method of allocation," says PNG President Maxheim. "Actually, the propane dealers had recommended this in their intervention [in the 1981 rate case]."

As diversification increases, proper cost allocation by the utility can never be assumed. Given the scope of new product lines, the variations in acceptable accounting procedures, and the complexity of utility operations, only close scrutiny by the commission can ensure that the ratepaying public will not subsidize the stockholders of a utility company.

Inflated Transfer Prices—Buying from Yourself Isn't Always Cheaper

In the 1970s, Duke Power and CP&L decided to diversify "vertically"—that is, to expand into an area functionally related to its production of electricity. They wanted to secure reliable fuel supplies and theoretically to cut their operating expenses. Both Duke Power and CP&L bought substantial interests in coal mining operations, which would fuel their generating plants. "CP&L entered into coal mining not as a money-making venture but to ensure (at a time when national concern over future coal supplies was high) reliability of supply of good quality coal," says CP&L Board Chairman and President Sherwood Smith. "Use of the corporate subsidiary structure was a means of drawing on the services of an experienced coal mine developer [which invested with CP&L in the coal venture]." Entering into coal mining, says Smith, was "an integral part of the company's duty to serve."



Jackson Hill

In buying coal from its own subsidiaries, Duke Power and CP&L were engaged in "transfer pricing." These utilities had to decide on how high to price the transfer of goods and services from their subsidiaries to the parent operations. Both Duke Power and CP&L sought to recover from its ratepayers a transfer price for the coal *based on cost.* But utilities are regulated companies and thus must live with a transfer price approved by the N.C. Utilities Commission. The commission takes into consideration not only the costs to the parent company but also such factors as the going market rate.

The Utilities Commission has recently determined in several instances a fair transfer price between a utility and its subsidiary. In 1978, the commission denied Duke Power's request to charge its utility operation $55 per ton for coal purchased through the Peter White Coal Company. (Duke Power put up the capital to open this mine and purchased the coal on a cost plus management fee basis.) The commission permitted only $32 a ton, which approximated the market-level price. In 1982, the commission again cited Duke Power for charging its utility operations more than necessary for coal. The commission did not allow Duke Power to charge its customers the full cost of coal from its subsidiary, the Eastover Land Company, and accordingly reduced the company's rate increase request by $6.7 million.

"The evidence clearly shows that for the period January 1979 through May 1982," the commission found, "the prices Duke paid for coal purchased from Eastover were significantly greater than the prices Duke paid for slightly higher quality coal purchased from its nonaffiliated long-term contract suppliers."[10]

Duke Power, trying to recover what it was costing to mine its coal, wanted to pass as much of the costs as possible on to its electricity users, instead of to its stockholders. The Utilities Commission, with regulatory authority over the *electricity-producing part of the Duke Power conglomerate*, ruled otherwise. The transfer price allowed by the Utilities Commission in the end caused Duke Power to get out of the coal business. "The Company determined to sell these [coal] properties after the most recent rate order from the North Carolina Utilities Commission prohibited full recovery of the cost of coal from these mines," Duke Power explained in its 1982 annual report.[11]

Duke Power is not the only electric utility with coal troubles. In 1974, CP&L requested permission from the Utilities Commission to buy into coal. The commission gave CP&L a green light on buying 80 percent of the stock of two coal mining ventures known as "Leslie" and "McInnes." The Leslie mine was completed in 1979, and McInnes started producing in 1980. "After doing the adjustments in the Duke case, we decided to look at CP&L's coal activity more closely," says Bill Carter, director of accounting for the Public Staff. "This was the first year [1983] that we've gone in and examined it closely."

After its investigation, the Public Staff argued that CP&L was recovering too much from the ratepayers for its coal costs. The commission agreed. "CP&L has mistakenly interpreted and applied prior orders of this commission which specified and directed the methodology to be used to compute the amounts charged to North Carolina retail ratepayers for coal purchased from CP&L's affiliated coal mines," the commission reported. "It is appropriate that such mistakes be corrected by this commission."[12] To correct the coal costs CP&L charged ratepayers from 1979 through April 1983, the commission reduced CP&L's 1983 rate request by $6.5 million.[13]

Transfer pricing will remain an important potential "subsidy" from ratepayers to stockholders as long as utilities buy part of their goods and services from a subsidiary. "The most familiar danger is backward [i.e., vertical] integration—of gas companies into gas production, electric companies into the coal business, telephone companies into equipment manufacture—along with artificially high transfer prices, as a means of effectively circumventing regulation and exploiting ratepayers," explained Alfred Kahn, representing 5 gas distribution companies and 15 electric utilities, to the National Association of Regulated Utilities Commission Ad-Hoc Diversification Committee. Kahn, a former New York Public Services Commissioner and economic adviser to President Jimmy Carter, went on to say that regulators generally have the tools they need to control improper transfer pricing. "Where the utility has integrated into a relatively competitive industry, this danger can be readily avoided. Commissions can apply a fair market price to test whether the utility is overcharging itself, and ultimately its ratepayers, for transferred products and services."[14]

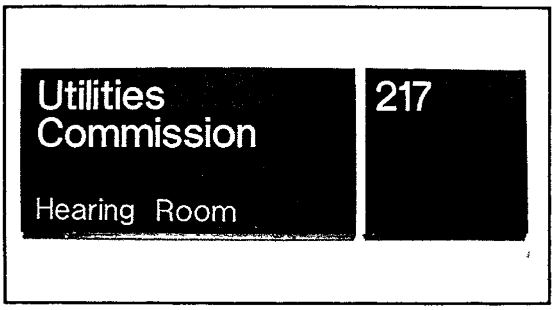
Capitalization of a Nonregulated Venture

"How will a utility finance the start-up of a new diversified venture or the acquisition of an existing company?" asks the NARUC diversification study. In a paragraph-length answer to its own question, the NARUC study summarizes this important issue:

"Utilities choosing to diversify must find ways to finance their new ventures. . . . Regulators may be concerned if utilities use their monopoly business credit or funds from the sale of utility securities [i.e., stocks and bonds] to raise capital for nonutility operations, particularly if the utility has large capital requirements of its own. This funding mechanism could be considered as an indirect subsidy from ratepayers. Nonutility financing may impair utility financing."[15]

Regulators in North Carolina generally think NARUC overstates the point in saying "this funding mechanism could be considered as an indirect subsidy from ratepayers." The N.C. statutes certainly give the commission ample power to address this type of subsidization: "No public utility shall pledge its faith, credit, moneys, or property for the benefit of any holder of its preferred or common stocks or bonds nor *for any other business interest with which it may be affiliated* . . . without first making application to the Commission and by order *obtain its permission so to do*" (emphasis added).[16]

In granting permission to expand, however, the commission has usually focused on cost allocation or transfer pricing concerns, not on sources of capital. In 1974, for example, the



Michael Matros

commission allowed CP&L to proceed with its plans to buy into the Leslie and McInnes coal mining ventures. But in its ruling, the commission concentrated on defining "fair market value" of the coal, the issue discussed above under transfer pricing. In giving CP&L the go-ahead, the commission hardly mentioned the capital issue, following a longstanding rule of thumb regarding company earnings.

"A utility is allowed to make a certain return on its franchise business," says Joe Smith, director of finance, statistics, and planning for the commission. "Normally, a company returns 60 to 70 percent of its earnings to its common stockholders, to keep them happy. About 25 to 30 percent are retained by the company and normally used for working capital. What the company does with that 25 to 30 percent is more or less their own business," says Smith.

A company might, for example, use those retained earnings to buy into a coal company, with the commission's blessing. "In effect, CP&L put in a small amount of equity—that is, retained earnings—and borrowed funds for the rest of the investment," remembers Smith. "Once it gets to retained earnings, it's the stockholders' money."

Robert Weiss, director of the economic division of the Public Staff, essentially agrees with Smith. "In a rate case, the commission sets a rate of return which it allows the utility to try to earn. The earnings by the utility then belong to the stockholders," Weiss says. "So there's no way the ratepayers can subsidize a utility's investing into a subsidiary if the rate of return is set correctly."

Before expanding into a new venture, utility companies have generally sought to have the commission clarify how the expansion will affect the rate base. The cost of products a utility purchases from a subsidiary includes a return on the capital invested in that subsidiary. The costs of these products are either included as expenses in the year purchased or are capitalized and included in the rate base, depending on the type of product. The larger the rate base, the larger the return the commission will grant the company, all other things being equal.

"Before a utility would expand, it would want the assurance that the commission would allow it to recover the cost later," explains Public Staff Director Robert Gruber. "If the commission has blessed the [subsidiary] transaction, the company feels sure it can recover the costs."

In a 1978 Duke Power request to invest in a uranium venture, the commission blessed the effort without raising significant questions about the Duke Power ratepayers subsidizing the company's stockholders. In a notable but hardly remembered dissent, however, then Commissioner Leigh Hammond, an economist and formerly a vice-chancellor at N.C. State University, did raise the issue of cross subsidization through capital sources.

"This [majority] decision takes the commission another step in the direction of forcing the customers of public utilities to assume risks and provide financing for activities that should be pursued by nonutility business firms, and supported by the venture capital market," began Hammond. Next he hammered at "one of the foundation stones of our enterprise economy," as he put it, the "risk and reward principle."[17]

"Apparently the Company (Duke) is unwilling to let its wholly owned subsidiary enter this exploration and mining venture without being tied back to the security of the utility operation. . . . Those individuals, or institutions, who *voluntarily* provided investment funds would reap the benefits from a successful venture or the risks of loss if the venture fails" (emphasis in original).

Hammond then got to the heart of the matter, even as he introduced the accounting subtleties involved. "More importantly, this decision approves an accounting provision that 'any exploration costs incurred in conjunction with this project which do not result in uranium concentrates being produced *will be charged off to electric operating expense* . . .' (emphasis added). This can mean nothing more than the customers of Duke Power Company will ultimately pay for any losses incurred by this venture. . . . This is a clever mechanism to provide a 'guarantee against loss' for a high risk non-utility subsidiary."

Duke Power officials complained about the commission's ruling for a quite different reason than did Commissioner Hammond. "It limited the return that the utility could earn [on the nonregulated uranium business] to whatever the regulated [business] return was," says Steve Griffith, senior vice-president and general counsel for Duke Power.

CP&L Chairman Smith makes the same point about his company's investment into coal. The commission limits shareholder earnings when the investment turns out well, he says. "This is imposing on stockholders a large risk in order to fulfill the duty to serve." If shareholders have to take a higher degree of risk, contends Smith, the utility may have a harder time raising capital, which can have a negative impact on rate levels and future service reliability.

While this issue has not attracted wide attention among N.C. regulators, it has a high profile in other states and in the national arena.

In 1982, U.S. Rep. Timothy Wirth (D-Col.), chairman of the House Subcommittee on Telecommunications, Consumer Protection, and Finance, held hearings on a rewrite of the Communications Act of 1934. This bill would have permitted American Telephone & Telegraph Co. to enter nonregulated data-processing businesses but only through subsidiaries *which raise their own capital.* If AT&T were to buy into a data-processing enterprise, said the bill, it must do so without using capital from the lucrative—but regulated—long-distance business. The bill, voted out of Wirth's sub-committee, faced strenuous objections from AT&T in full committee, where it died.

In the 1982 hearings before Wirth's subcommittee, AT&T Vice-President and Treasurer Virginia A. Dwyer made the position of regulated utilities crystal clear on this capitalization issue. "The requirement . . . that subsidiaries raise their own capital . . . makes no sense at all," said Dwyer. "If the company elects to invest earnings, which belong to shareowners, in new lines of business, it does so on behalf of shareowners. It is not a subsidy; it is simply a prudent investment decision. To assure fair competition [in nonregulated markets], AT&T needs the same flexibility as its competitors."

A competitor such as an IBM might note, however, that a competitor's flexibility doesn't include whatever profits were generated by AT&T's $30 billion in 1981, through federally regulated long-distance phone revenues. And if a major corporation, like an IBM, has some concern about such subsidization, what might a small-time businessman in North Carolina think about competition from a public utility?

Below-Market Pricing — The Competitive Edge

The three types of cross-subsidization discussed above — cost allocation, transfer pricing, and capitalization of a new venture — all affect whether ratepayers are somehow subsidizing a utility company's venture into a nonregulated area of business. A fourth type of cross-subsidization, "below-market pricing," affects primarily the companies already doing business in an area into which utilities diversify. When a utility company uses its capital assets, retained earnings, market credit, or sheer size to help it underprice the competition, it is engaging in "below-market pricing."

One group of N.C. businessmen worried about utility diversification are companies selling propane (i.e., liquefied petroleum gas). Propane dealers sell on the open market without regulation from the Utilities Commission. During a 1981 Piedmont Natural Gas rate hearing, propane dealers complained that PNG had an unfair advantage in expanding into their area of business. "Our complaints are not about competition per se, but about what we allege to be competition with a public utility which is subsidizing their nonregulated businesses with revenues from the ratepayers and assets of natural gas operations," said G. W. Rowden of the Durane Gas Company in Charlotte, which sells propane gas for home, industrial, and commercial use.

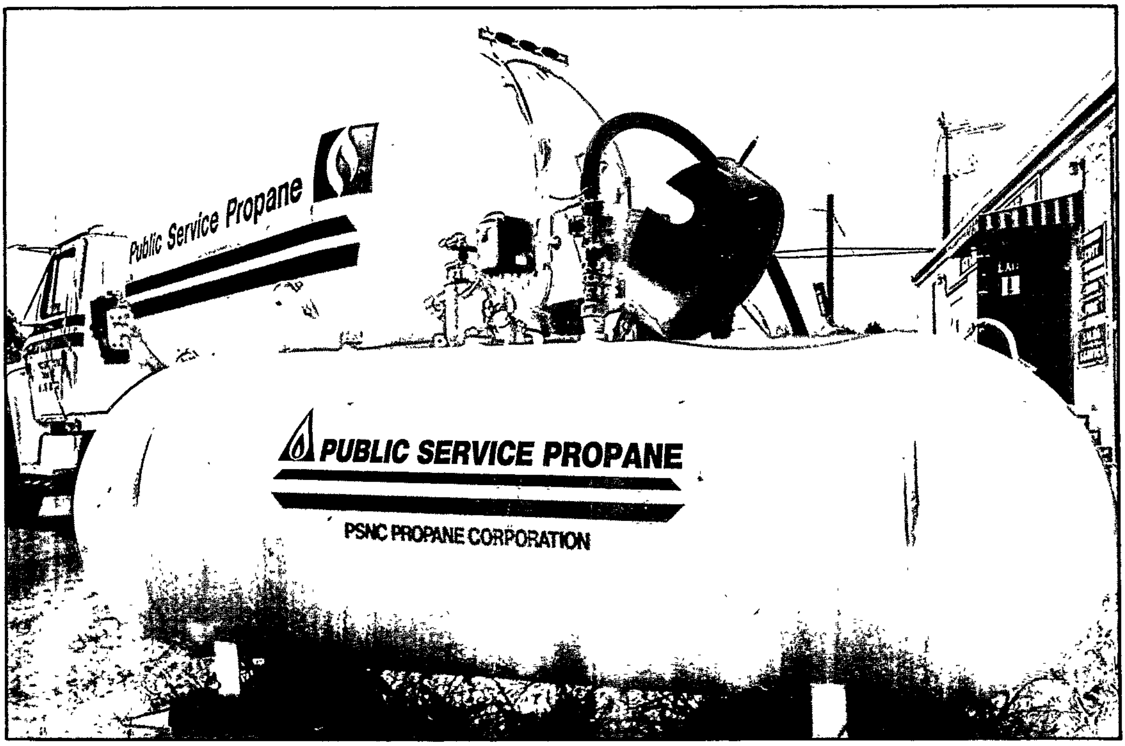
In a report to the Utilities Commission, PNG reported netting in its fiscal year 1980 about $11,300 on $952,000 in retail propane sales, a 1.2 percent return. Rowden of Durane Gas Company says he couldn't live on that kind of return. "You'd like to see 10 percent before taxes," he says. "That would leave at least 5 percent on sales after taxes." In 1980, PNG did hit 5.5 percent on its *natural gas sales* — its regulated business.

If a 1.2 percent return would slow a firm like Durane Gas Company, it did just the opposite to Piedmont Natural Gas. The company's 1981 annual report explains what happened: "Retail [propane] sales were up 252 percent, from $952,000 to $3.35 million, reflecting the aggressive marketing emphasis placed on this segment of the Company's activities."[18] People like G. W. Rowden of Durane Gas Company might ask the question: Where did PNG get the funds for an "aggressive marketing emphasis" if it made only $11,300 on its 1980 sales? The Utilities Commission does not require PNG to answer such a question.

"The propane dealers see a large company using its size and financial clout to get in their business," says Robert Fischbach, director of the Public Staff during the 1981 PNG rate hearing. "That's a fact of life — large companies doing that. I have a lot of sympathy for [the propane dealers'] position." But Fischbach didn't have enough sympathy to hire a firm like Currin and Associates to research possible evidence of below-market pricing (as he had to investigate cost allocation).

"Is the commission going to say, 'You can't involve yourself in nonutility questions'?" Fischbach asked rhetorically. "Those questions were raised [by the propane dealers] in Piedmont's rate case and the commission didn't bite."

The expansion of natural gas companies into the propane business continues to be a concern for small propane dealers. "Early this year [1983] we were visited by Mr. Robert T. Watkins, the marketing vice-president for Public Service, asking about buying part of our



Courtesy Public Service Co. of North Carolina

operation in Shelby," says Bruce E. Byers of North State Gas Service in Forest City, N.C. "They recently bought another propane company there and in Kings Mountain."

Charles E. Zeigler, chairman and president of Public Service Co. (PSNC), explained the PSNC hopes for propane in a May 1983 letter to his shareholders. "We have in place a nonutility retail marketing program to sell propane gas in areas adjacent to our natural gas mains in the central and western counties in North Carolina. . . . This should prove to be an attractive future profit center closely related to our utility expertise, operated by PSNC Propane Corporation, a wholly owned subsidiary."

The PSNC & PNG propane operations appear to be a serious threat to the 200-odd small propane businesses in North Carolina. However, neither the Public Staff nor the Utilities Commission appears to be willing to address this result of diversification. "If a utility engages in a nonutility operation and hurts another business, that operation is not in our jurisdiction," says Public Staff Director Gruber. "That's an antitrust issue, for the Attorney General's office or for the Antitrust Division of the U.S. Department of Justice."

While the antitrust issues may fall outside the Utility Commission's traditional jurisdiction, the policy questions raised by the expansion of utility companies into related but nonregulated ventures fall well within the historical concern of the commission. For example, most gas and electric companies are moving into various conservation and "alternative" energy business areas, from the home insulation business to the solar hot water heater trade. In a 1979 rate ruling, the commission encouraged the electric utilities to help create a new nonprofit N.C. Alternative Energy Corporation (see "Alternative Energy Corporation," *N.C. Insight*, Winter, 1980).

David Aylward, chief counsel and staff director for the U.S. House of Representatives Subcommittee on Telecommunications, Consumer Protection, and Finance, sees advantages to allowing utilities to get into nonutility operations that are closely related to the utility function. Successful diversification efforts, for example, could improve the overall financial health of the utility company. But he also sees a danger.

"Allowing a natural gas utility to insulate homes makes an awful lot of sense, but it immediately raises questions about competitors in the home insulation business," said Aylward in a telephone interview. "Will we have a net economic and social loss? A utility may have a willingness to live with very low profits in the nonregulated areas in the short term in order to use one monopoly [i.e., natural gas] to create another [i.e., home insulation]. *The cost in the long-term is loss of competition in the nonregulated area*" (emphasis added).

Diversification and the New Corporate Structure

While the N.C. statutes give the Utilities Commission substantial power in regulating utility companies, the statutory tools are not as strong as in some states. Under Virginia law, for example, a utility company may engage in activities beyond its franchise only "so far as it may be related to or incidental to its stated business as a public service company," explains Lewis Minter, general counsel to the State Corporation Commission of Virginia, which regulates utilities. "But this statute may be moot," Minter continues. "A utility can circumvent the entire thing by creating a holding company, which is exactly what VEPCO did."[19]

Early in 1982, Virginia Electric and Power Company (VEPCO) created a new corporate structure, a holding company called Dominion Resources Inc. The utility company became only one of several planned subsidiaries. This corporate shift affects North Carolina too, since VEPCO serves northeastern North Carolina.

"They're trying to split up the utility into separate components," says Minter. "Under our existing law, they can set up a holding company, but don't have to come to us. They can create subsidiaries 'til hell freezes over. We're very concerned about cross-subsidization in diversification ventures. We're reviewing this new structure right now to determine up front whether these subsidiaries are in the public interest and how best to control the proposed affiliate arrangements and necessary raising of capital."

VEPCO is proposing to put one or more generating plants into a separate subsidiary which would sell its electricity to VEPCO. "If you have a separate generating company with its capacity sold under contract to VEPCO, then it can have a more favorable capital structure than VEPCO could have," contends Everard Munsey, executive director for public policy for VEPCO. "It would have an increased proportion of debt, resulting in lower total costs. You get more leveraged capital structure and it's cheaper for the ratepayers."

"That's the VEPCO argument," counters Minter, "but we're not ready to buy it." This specific subsidiary arrangement will have to be

Recommendations on Utility Diversification

From the National Association of Regulatory Utility Commissioners

Below are excerpts from the recommendations chapter of the 1982 Report of the Ad Hoc Committee on Utility Diversification, *published by the National Association of Regulatory Utility Commissioners (NARUC). These recommendations address a broad spectrum of diversification issues and provide a national context for the specific recommendations made in the accompanying article. Among the 10 members of the NARUC committee that compiled these recommendations were N.C. Utilities Commissioner Edward B. Hipp and former N.C. Commissioner John Winters Sr. To obtain a copy of the full NARUC report, send a check for $15.00 to NARUC, Publications Department, P.O. Box 684, Washington, D.C. 20044. These excerpts are reprinted with NARUC's permission.*

These recommendations represent a synthesis of the committee's varied views and concerns about utility diversification. The subject is an important one for regulatory commissioners even if no utility within a jurisdiction is presently planning to diversify. In jurisdictions where utilities have announced diversification plans, the issue has quickly become controversial, often involving state legislators. It is very difficult to develop a carefully considered policy when the subject of the policy is part of a highly visible controversy. If a utility wants to pursue diversification activities in a timely fashion, it will not appreciate experiencing "regulatory lag" as regulators grapple with the issues raised.

1. While diversification may complicate the already complex and crowded regulatory agenda, efforts to establish satisfactory rules during the early stages will likely pay off by reducing the need to spend time in the future, avoiding future arguments, and possibly averting legal challenges.

2. The burden should be on the utility to show that diversification is consistent with the public interest and that ratepayers will be protected from unreasonable risk and from involuntarily subsidizing diversified (nonutility) activity.

3. Regulators should review their statutory and administrative powers regarding control of the following aspects of utility diversification: (a) affiliated interest relationships; (b) transactions between the utility and any affiliates; (c)

approved by the Virginia State Corporation Commission (SCC) and by the Federal Energy Regulatory Commission (FERC). If the Virginia SCC and FERC approve the VEPCO proposal, the subsidiary composed of generating plants could sell electricity at wholesale rates to its holding company, as regulated by FERC. The holding company would in turn distribute the electricity to the customers.

"My hunch," says Minter, "is that VEPCO is hoping the deregulation fever in Washington would allow them to charge its electric distribution company anything that FERC would approve as a wholesale rate for the electricity."

VEPCO spokesman Munsey insists that "regulation by FERC is incidental."

Gruber, of the N.C. Public Staff, however, shares the Minter hunch. "If FERC regulated the rates instead of the commission, the rates would probably be much higher. FERC is not as vulnerable to ratepayers. People don't go to FERC hearings in Washington like they do to Utilities Commission hearings here."

If Dominion Resources, the holding company of which VEPCO is one subsidiary, gets approval for breaking down its utility franchise into separate components, this new holding company could utilize the transfer pricing technique discussed above *within the franchise portion of its business.* The transfer pricing questions raised above involved a utility company purchasing goods or services from a *non-franchise subsidiary* (i.e., Duke Power or CP&L buying its subsidiary's coal). A separate electric generating subsidiary, in its contract to supply electricity (regulated by FERC), might charge rates higher than the Virginia SCC would allow — just as Duke and CP&L assessed their ratepayers more for the cost of its subsidiaries' coal than the N.C. Utilities Commission eventually allowed.

The Virginia commission is reviewing the VEPCO proposal carefully and expects to issue a decision in 1984. VEPCO's Munsey says that separate subsidiaries will make it easier — not more difficult — to allocate costs correctly to different operations and to prevent cross subsidization. But Minter worries about the impact of FERC taking over some of the regulatory authority and the overall effect of the proposed arrangement on the public interest.

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accounting procedures; (d) dividend payments; (e) transfer pricing; (f) common cost allocation; (g) holding company formation; (h) conditions on the establishment of a holding company; and (i) periodic review of the impact of diversification on the utility and its ratepayers.

4. Regulators should consider establishing a policy wherein any utility wishing to diversify is required to prepare and present the following:

a. a statement of purpose including a showing that the diversification will be consistent with the public interest;

b. a statement of the goals of the diversification including the types of nonutility activity contemplated and the time frames expected for various stages of diversification (perhaps measured by extent of involvement);

c. a description of the corporate organization plan by which diversification will be accomplished including a showing of the impact on the utility's corporate and financial structure;

d. a description of the proportion of the total business of the holding company that will be represented by the utility using, for example, a proportion of total assets, sales, revenues or other relevant measure;

e. a methodology for allocating common costs and setting prices for affiliate transactions; and

f. a plan of review that will trigger periodic regulatory review of the impact of diversification on the utility and that will allow amendments to the original application as plans and circumstances change.

5. While state commissions should not regulate nonutility subsidiaries, they must have the power, after finding a problem in the utility, to pursue that problem into the books and records of the holding company and its subsidiaries. This power and the preceding policy may have a deterring effect on diversification, but they are necessary for the protection of the utility ratepayers. However, truly proprietary information should be subject to a mechanism to assure protection of proprietary interests.

6. Regulators should not divert diversified earnings from shareholders to subsidize rates, except as ratepayers may deserve a share of those earnings to the extent that ratepayers are put at substantial or identifiable additional risk.

7. It is inappropriate for regulators to approve in advance specific acquisitions or other business ventures so long as they are within the general framework of the application approved by the commission. However, regulators should be aware of differences between diversification activities which are related versus those which are unrelated to traditional utility operations. In addition, regulators may want to give special attention to those cases where affiliate transactions will occur between the utility and the nonutility operations of the diversified business.

Conclusion and Recommendations

As federal policy continues to tilt towards deregulation, utilities will quite naturally attempt to find good business opportunities in the new legal structures open to them. Consequently, the regulatory issues involved in diversification become all the more important. After the deregulation dust settles in the telecommunications area (see article on page 28), local telephone companies—not to mention AT&T—might well take a page or two from the diversification book now being written by gas and electric companies around the country.

John Naisbitt, in his best seller *Megatrends*, views the diversification trend among the nation's utilities as part of a general corporate effort to find new directions. "Companies, like people, find it difficult to change, mainly because people run companies," writes Naisbitt. "Utilities, so often under highly regulated mandates, have been in the business of winning rate cases; now they must reexamine what business they are in as the industry is deregulated and decentralized."

Naisbitt then moves directly to the point. "As in so many other industries, diversification is the early direction: Utilities are increasingly involved in real estate, fish hatcheries, insurance, oil drilling, coal mining, pipelines, and barge transport. So far, it is not very significant, partly because they don't know how state regulatory agencies are going to respond."[20]

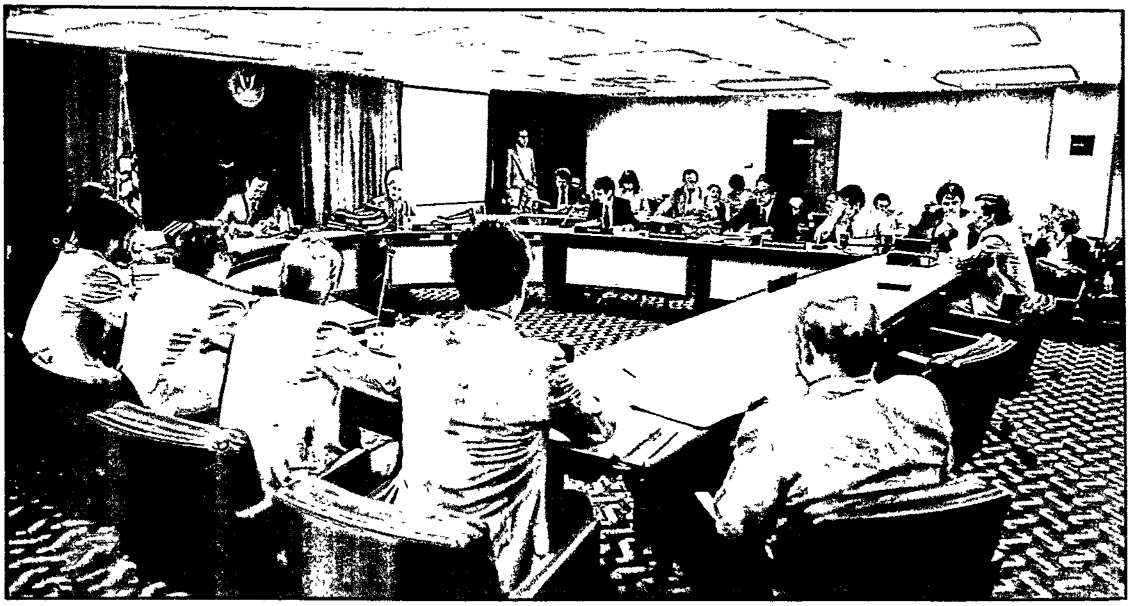
Thus far, much of the diversification in North Carolina has been into utility-related areas — coal, propane, uranium, insulation, and solar water heaters. In addition, the scope of diversification has been small in North Carolina compared to that in many states. Even Piedmont Natural Gas, one of the most aggressive diversifiers, only grossed 5 percent of total sales from products other than natural gas.

Nevertheless, utility companies in North Carolina have moved into ventures not related to the supply of the utility service. Piedmont Natural Gas, for example, recently created PNG Communications Company division, which operates a franchised cable service for a 700-home residential community in York County, S.C. "In 1982, the communications division also entered the Satellite Master Antenna Television (SMATV) business of providing localized cable service to apartment and condominium developments using on-site, satellite dish antenna systems," PNG said in its 1982 annual report.[21] "At year end, the division was actively operating seven SMATV projects with over 1,000 subscribers in the Charlotte, N.C., metropolitan area."

State officials, despite clear national trends towards increased diversification, have—with few exceptions, such as former Commissioner Hammond's dissent quoted above—considered diversification issues secondary in the complex regulatory process. Commissioner Hipp seems to summarize the commission's approach in calling diversification a "fact of life."

On November 23, 1983, the most recent meeting of the legislature's Utility Review Committee, attention focused on telephone deregulation issues. Near the end of the meeting, the question of diversification came up, prompted

A meeting of the Federal Energy Regulatory Commission (FERC).



Courtesy Federal Energy Regulatory Commission by a letter to Speaker of the House Liston Ramsey (D-Madison). A propane gas proprietor had complained to the Speaker that a natural gas company was using its utility logo in advertising its nonregulated propane business.

Steve Rose, staff counsel for the Utility Review Committee, reported that the N.C. statutes recognize that such nonregulated ventures are "not subject to the provisions of this Chapter" (see footnote 3). No further discussion ensued about the logo. Nor did the legislators weigh whether the statute should be construed as *sanctioning such action*, or merely recognizing that it exists. No one questioned whether the statute should be amended. Rep. J. P. Huskins (D-Iredell), co-chairman of the committee, did instruct Rose to write the propane distributor and invite suggestions from him on whether the law should be amended.

Like the commission and the legislative committee, the Public Staff seems to downplay the issue. "We would be concerned if the utilities got into any ventures that are losing money because that would have an impact on the overall company performance," says Director Gruber. "If the ventures were large, I think we could be involved. But I don't foresee that happening."

Utility company executives, particularly within the electrics, also question the extent to which diversification poses a problem in North Carolina. "It is good to prepare for future developments, but the prospect for *major* diversification in the electric industry is small in terms of capital employed and revenues," says CP&L Chairman Smith.

Small or large in scope, the regulatory issues outlined above could well become more prevalent as deregulation trends in Washington tend to dovetail with diversification trends within the utility business. Most pro-business analysts argue that diversification is definitely a good trend, likening it to an individual investor with a diversified portfolio. Other analysts, ranging from the NARUC report to Robert Gruber, think it can work either way.

"We're concerned over whether the ratepayer is subsidizing a nonutility operation and whether the nonutility venture can pay its own way," says Gruber. "If it can, it can contribute to the overall health of the utility, and we favor it. If it has a negative impact on the taxpayer, then we have problems with it."

But how does Gruber know whether diversification has a negative impact on the ratepayer? The commission and Public Staff have fragmentary and inconsistent information about the diversification process. For example, Piedmont Natural Gas did not release publicly how much home insulation it sold in 1982. Did that part of the PNG overall operation lose money? Did the utility portion of PNG have to subsidize its home insulation business through some internal financing techniques? In some cases the Utilities Commission, after finding evidence of cross subsidization, has reduced rate increases appropriately. These instances have occurred sporadically, however. The potential problems in the four types of cross subsidization and in the new corporate structures discussed above lead to five recommendations. These should be viewed in the broader context of the NARUC recommendations (see sidebar on pages 22-23).

1. **The Utilities Commission should establish a consistent policy on cost-allocation and transfer-pricing issues.** The commission has demonstrated an ongoing concern for these two issues. Where specific, in-depth investigations have been undertaken, the commission has usually reduced rate increases. In 1981, the Public Staff hired Currin and Associates to examine cost allocation in a Piedmont Natural Gas rate case. But no similar investigation has been done since. Similarly, after discovering problems with Duke Power's coal prices, the Public Staff took a close look at CP&L's coal prices. In 1983, when the Public Staff "examined it closely," as Public Staff accounting director Bill Carter puts it, the commission adjusted CP&L's rate increase for coal priced above market levels from 1979 through 1983.

What prompts such steps as hiring Currin and Associates or choosing in a particular year to examine an issue "closely"? Neither the commission nor the Public Staff appears to have a consistent policy to trigger such action.

One method of determining the relative importance of these two cross subsidization issues in relationship to the myriad of other issues involved in a rate case would be for the commission to establish a "threshold" measurement. For example, the commission could establish a rule that when a company *either* has invested two percent of its total assets in, *or* has received five percent of its total revenues from, subsidiary ventures, *then* the Public Staff and the commission *must* conduct an in-depth review of cost-allocation and transfer-pricing issues.[22] The commission has the statutory authority to establish such a policy.

2. **The Utilities Commission and Public Staff should undertake a review of present and future staffing requirements in light of the growing trend of utility diversification into nonutility activities.** Currin and Associates made this exact recommendation—verbatim—in

"We're concerned over whether the ratepayer is subsidizing a nonutility operation and whether the nonutility operation is paying its own way."

—Robert Gruber, Executive Director
N.C. Utilities Commission Public Staff

1981. But the commission and the legislature have taken little notice. In 1983, the commission and Public Staff have essentially the same size staff as they did in 1981. Given the current legislative concern over a tight budget, adding positions exclusively for diversification concerns may be difficult. As an alternative, the commission and Public Staff should consider assigning persons within each section (natural gas, electric, accounting, etc.) to devote some portion of their time to monitoring cross subsidization issues on a systematic basis.

3. **The Utilities Commission should review and approve the sources of capital that a utility proposes to use in expanding into a nonregulated venture.** Currently, a utility must obtain commission approval *to expand* into a subsidiary venture but it is *not required* to gain approval for *how it expands.* The Utilities Commission regards the retained earnings of the utility as belonging to the stockholders and thus takes no responsibility for how the utility uses these retained earnings. But the retained earnings of the utility inevitably are tied back into the utility operation, especially in the complex world of high finance. Commissioner Hammond expressed the rationale behind this recommendation best in his dissent to the commission approval of the 1978 Duke Power request to expand into the uranium business. "This market system should be able to perform without requiring utility customers to 'involuntarily' provide the investment funds and assume the risks of exploration and mining operations."[23]

4. **The Utilities Commission should require utility companies to submit profit and loss statements to the commission for all nonutility businesses.** Unless the commission knows the quality of a utility's performance in its nonutility businesses, the commission will have great difficulty in determining to what extent a subsidiary's business might affect the utility operation. Inevitably, management concern will be spread across the spectrum of operations of a utility. Likewise, one could assume that the financial resources of the utility might be called upon to bolster a sagging nonutility effort, or perhaps to undergird a start-up operation. Without the profit and loss statements, the commission will not be able to make the best determination of what rates it should allow the utility to charge.

5. **The Utilities Commission and the General Assembly should monitor in a more formal fashion the structure of utility companies and the relationship of their structures to diversification.** The N.C. statutes do not appear to provide any means of addressing the "holding company" structure now being pursued by VEPCO. If new corporate structures allow a utility company to skirt the degree of oversight of nonregulated ventures that now exists, that corporate restructuring must be addressed in its early stages. Examining this process may require a statutory change or it may simply require a formal, ongoing effort by the Utilities Commission to issue rules and regulations regarding diversification issues *before* the new corporate structure takes hold (see NARUC recommendations, Nos. 1, 3, and 4.)

Utility companies, like much of corporate America, will continue to diversify into various markets. As utility companies are generally structured in this country — i.e., as publicly owned corporations — diversification is not necessarily good or bad. Hence, this article does not pass judgment on whether diversification is a positive or negative trend. This article instead attempts to underscore the urgency of recognizing — and monitoring — how diversification affects ratepayers, utility stockholders, business competitors, and the general public.

Utilities have a state-awarded franchise to serve all ratepayers in a given geographical area. Hence, the state regulates this activity. Utility companies also operate businesses in the free enterprise sector of the economy. The N.C. Utilities Commission cannot and should not regulate the diversified activities to the same extent that it regulates the utility franchise. The commission should, however, as former Commissioner Hammond puts it, "forever keep the diversified activities separate from the utility business."□

FOOTNOTES

[1]"1982 Report of the Ad Hoc Committee on Utility Diversification," National Association of Regulatory Utility Commissioners, October 11, 1982, p. 8.

[2]See "Why Electric Utilities are Buying into Coal" by James Cannon, *Business and Society Review*, Winter 1980-81, pp. 53-59; "The Coming Transformation in Electric Service: Entry into Cable Television" by Steven R. Rivkin and Virginia S. Carson, *Public Utilities Fortnightly*, February 4, 1982, pp. 21-27; "Can 'Advance Approval' Control Diversification?" by Louis Iwler, *Electrical World*, June 1982, pp. 25-27; "A High Risk Era for the Utilities," *Business Week*, February 23, 1981, pp. 76-86; and many other such articles, especially in *Public Utilities Fortnightly* and *Electrical World*. The report cited in footnote 1 includes a very helpful bibliography.

[3]NCGS 62-3(23)d. See also NCGS 62-51 ("To inspect books and records of corporations affiliated with public utilities."); NCGS 62-153 ("Contracts of public utilities with certain companies and for services."); and NCGS 62-160 ("Permission to pledge assets.").

[4]The term "nonregulated" is used throughout this article to refer to any subsidiary venture not part of the state-granted monopoly franchise of the public utility. All American businesses contend with government regulation to some extent, starting with the IRS and working from there. Tobacco companies are restricted in advertising, textile companies in international trade. Through its regulation of the utility franchise, the N.C. Utilities Commission regulates in some ways how a utility company interacts with its subsidiaries, as discussed throughout this article. But the Utility Commission *does not* regulate the operations of a utility's subsidiary as an independent business venture. The subsidiaries of utility companies, in many cases, function in the open market, just as a tobacco or textile company does.

In May 1981, the Edison Electric Institute, the trade association of electric companies, released a summary of diversification trends, "Investor-Owned Electric Utility New Business Ventures: A Survey of Utility Diversification Activities." In the "Summary of Results" (Table 2, pp. 4-5), the report listed a total of 247 diversified ventures reported by the electric companies that returned the Edison Electric survey. Of those 247 ventures, the table listed a total of 66 as "regulated." In the category where the highest number of ventures appeared, for example, "Fuel Exploration and Development," Edison Electric listed 36 out of 75 ventures (almost half) as "regulated." These ventures would include the coal subsidiaries of Duke Power Co. and CP&L discussed later in this article.

For the purposes of this article, the authors call all utility subsidiaries, including the Duke Power Co. and CP&L coal ventures, "nonregulated" ventures. This linguistic choice serves to differentiate more clearly the purpose of a subsidiary from that of the utility franchise. This choice of words — "nonregulated" rather than "regulated" for the coal ventures, for example — does not affect the content of the discussion in the article.

[5]*North Carolina Utilities Commission Re Duke Power Company*, Docket No. E-7, Sub 120, February 12, 1971, 88 PUR 3rd, p. 247.

[6]"Before the North Carolina Utilities Commission in the Matter of Application of Piedmont Natural Gas Company Inc. For Increase in Rates, Docket No. G-9, Sub 212," testimony of Robert F. Drennan Jr. and Richard W. Seekamp, Currin and Associates Inc., November 13, 1981, Exhibit C, "Report to the Public Staff," p. 27.

[7]*Ibid.*, Exhibit C, p. 48.

[8]*Ibid.*, Exhibit C, pp. 57-58.

[9]In commenting on a pre-publication draft of this article, PNG President Maxheim contended that of this $467,000, only $81,000 was actually an over-allocation of nonutility expenses to the utility business. "In this case, the Public Staff changed the method of allocation in the merchandising area which had been used for 30 years," Maxheim said. "Except for [amounts resulting from] changes in the accounting formula, the commission found only a difference of $81,000."

[10]"Application by Duke Power Company Inc. for Authority to Adjust and Increase its Electric Rates and Charges," Docket No. E-7, Sub. 338, November 1, 1982, p. 40.

[11]*Duke Power 1982 Annual Report*, p. 42.

[12]"Before the North Carolina Utilities Commission In the Matter of Application of Carolina Power & Light Company for Adjustment in its Rates and Charges Applicable to Electric Service in North Carolina," Docket No. E-2, Sub 461, September 19, 1983, p. 8.

[13]Bill Carter, director of accounting for the Public Staff, computed this figure, summarizing the yearly amounts for Leslie and McInnes.

[14]See "Can 'Advance Approval' Control Diversification" by Louis Iwler, *Electrical World*, June 1982, p. 26.

[15]"1982 Report of the Ad Hoc Committee on Utility Regulation," *op. cit.*, p. 18.

[16]NCGS 62-160.

[17]"Before the North Carolina Utilities Commission In the Matter of Agreement Between Duke Power Company and Western Fuel Inc., for Production and Sale of Uranium," Docket No. E-7, Sub 244, Dissent by Commissioner Hammond, June 7, 1978, pp. 1-2.

[18]*Piedmont Natural Gas Company 1981 Annual Report*, p. 11.

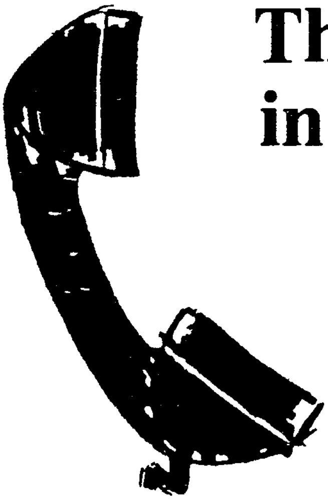
[19]Code of Virginia 13.1-50. Even if this statute is "moot," the Virginia Commission has substantial powers under its code, especially sections 56-55 through 56-75 and 56-78.

[20]*Megatrends: Ten New Directions Transforming Our Lives* by John Naisbitt, Warner Books, 1982, pp. 86-90.

[21]*Piedmont Natural Gas Company 1982 Annual Report*, p. 12.

[22]The threshold levels might vary from utility to utility. The NARUC report explains why in one of its recommendations: "The circumstances of each utility type and even of each utility are different and it would not be appropriate to recommend a single set of standards that all must meet. The utility should bear the burden of showing that its company-specific plan is consistent with the public interest. For example, if a proportion of assets standard is used, it is possible that initially a 5 percent level for an electric utility would be large and that 15 percent for a gas utility would not. An independent telephone company with deregulated CPE [Customer Premise Equipment] and inside wiring might be looking at 35 to 50 percent for functionally related but nonregulated activity." "1982 Report of the Ad Hoc Committee on Utility Regulation," *op. cit.*, p. 82.

[23]Duke Power Company and Western Fuel Inc., *op. cit.*, p. 4.



The Coming Changes in Telephone Service

The most important decisions affecting telephone rates are now being made in Washington, but the N.C. Utilities Commission still controls many aspects of telephone service. The new regulatory structures, combined with sweeping technological changes in the industry, threaten the concept of "universal" service. Many of the costs of the new technology will fall upon those customers who will continue to use only local service.

by Edward B. Hipp

The long-forecast changes in the way telephone service will be provided in North Carolina will soon be in place. Telephone customers in North Carolina will notice the changes in gradually increasing telephone bills, in the number of companies they will deal with in securing telephone service, and in a broad new group of choices to be made in the type of service they desire to have. The forces for these changes come primarily from the federal level, particularly the recent settlement of the federal antitrust case against American Telephone and Telegraph Company (AT&T) and the Federal Communications Commission's access charge orders taking effect during 1984.

On August 24, 1982, U.S. District Judge Harold Greene issued the now well-publicized "divestiture" order, which as of January 1, 1984, split AT&T into eight new corporations—a "new AT&T" and seven new holding companies for the local-service providers. In essence, Judge Greene's order allows AT&T to engage in enterprises which a 1956 antitrust consent decree had prohibited AT&T from pursuing. In exchange, AT&T must give up the local service aspect of its business. The case, *U.S. v. AT&T*, is still subject to further orders and decisions by Judge Greene.

This settlement has shaken the world of telephone regulation at its foundations. Moreover, the telephone industry has recently taken a quantum leap into the vast and complex world of telecommunications, computers, and data-processing. The telephone instrument is now associated with everything from calling your next door neighbor to breaking into computer banks. The consent order by Judge Greene has prompted new rules by the Federal Communications Commission (FCC), new legislation by Congress, and increased lobbying activities by AT&T competitors, public interest groups, and state utilities commissioners. This spate of activity has forced an untangling of the various components of telephone service and regulation. Just as rapidly, however, the technological revolution is hurling new considerations into the regulatory arena.

The recasting of the telephone industry and of the federal/state matrix of telephone regulation threatens the concept of "universal" service —*a telephone available to all households based upon an affordable rate for local service.* The divestiture will cause a shift in costs from the long-distance network to the local customer. This shift of cost endangers the current standard of universal service. Historically, the FCC, the state utilities commissions, and the industry have

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agreed to have the long-distance component of AT&T pay a fee to the local component for using the equipment maintained at the local exchange. Telephone companies have called this a long-distance "subsidy," resulting in an average nationwide cost of only $11.00 per month for local telephone service.

This low monthly charge has made the concept of universal service a near reality. Nationwide, 93 percent of all households have telephones; in North Carolina, 87 percent have phones. The lower percentage here stems partly from slightly higher rates in the low-density exchanges in the mountains and other rural areas ($12 to $14) and partly from the below-national-average family income in the state.

Now that long-distance and local service will be divided, the so-called long-distance subsidy will no longer exist. The FCC has ruled that local customers must pay an "access charge" for being connected to the *interstate* long-distance network.

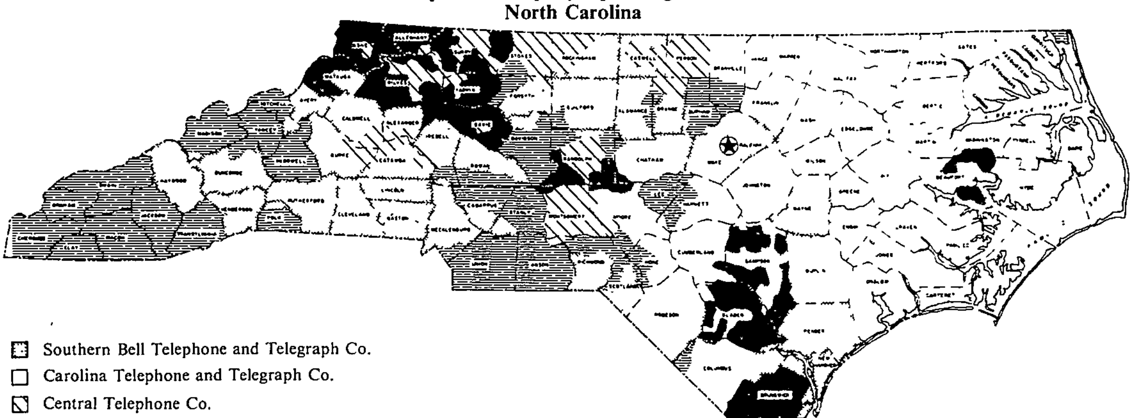
New competition among long-distance companies should provide local customers more choices. Those who can afford to enter an expanding long-distance market will shop for new telephone services much like they do for new television sets or home computers. But those who want only local telephone service will in effect be paying more for basic service. State utilities commissions and consumer representatives believe that the proposed FCC regulations resulting from the divestiture order will drive local service rates up beyond the affordable point for an increasing number of low-income households and thus reduce the possibility of achieving universal service.

The most important decisions affecting telephone rates are being made in Washington. The N.C. Utilities Commission, however, still controls many aspects of telephone service wholly within North Carolina. Under N.C. law and under the laws of most states, telephone service is still basically defined as a public utility service. During the development of the present telephone system over the last 30 to 40 years, the N.C. laws have not changed substantially. Companies provide this utility service under a monopoly franchise for a specified service area. The company must in turn provide adequate service to everyone who requests it in the franchise area at rates fixed by the Utilities Commission.

In North Carolina, 29 different telephone systems have franchises. Southern Bell has the franchise for the major cities and areas surrounding them, covering 48 percent of N.C. customers (see map below). Nineteen independent telephone companies serve varying parts of the state. The largest, Carolina Telephone and Telegraph Company, serves 26 percent of the N.C. customers and most of eastern North Carolina; the smallest, Barnardsville Telephone Company, serves one town with 654 telephones in the far western part of the state. Finally, nine telephone membership corporations, financed primarily by the Federal Rural Electrification Administration, and not regulated by the Utilities Commission, serve various rural areas.

All of these 29 systems are linked together by an *intrastate* toll network owned primarily by Southern Bell prior to January 1, 1984, but also, in part, by five of the independent companies. Under this network, the Utilities Commission has fixed *uniform intrastate* long-distance

Telephone Company Operating Areas in North Carolina



Southern Bell Telephone and Telegraph Co.

Carolina Telephone and Telegraph Co.

Central Telephone Co.

Other Companies (*Barnardsville, Citizens, Concord, Continental Telephone of N.C., Continental Telephone of Va., Ellerbe, General Telephone, Heins, Lexington, Mebane Home, Mid-Carolina, North State, Pineville, Randolph, Saluda Mountain, Sandhill and Service telephone companies*)

Membership Corporations (*Atlantic, Piedmont, Randolph, Skyline, Star, Surry, Tri-County, Wilkes, and Yadkin Valley telephone companies*)

Source, N. C. Utilities Commission

Carol Majors

rates. Revenues from all intrastate calls were first pooled and then allocated back to the 29 systems according to the costs of service and a return on the portion of the local facilities used to originate and terminate intrastate long distance messages.

Much of this structure of telephone service in North Carolina is being recast by the AT&T divestiture. The 29 companies will continue to serve the local areas shown on the map. But intrastate long-distance service will change a great deal, and all 29 companies must eventually offer their customers access to the *interstate* long-distance services of AT&T competitors (see box below).

Major Results of Divestiture

A decade ago, AT&T competitors in the telephone equipment market and the interstate market — companies like MCI and Sprint—prompted the U.S. Justice Department's antitrust investigation of AT&T, and the eventual litigation which resulted in the recent divestiture. Because of the structure of the telephone industry, the divestiture order and the resulting actions by the Federal Communications Commission go far beyond promoting competition within the interstate telephone market. The divestiture—coupled with changing technology—affects virtually every aspect of telephone service. Below are the major results of the divestiture.

Structure. The present 22 Bell subsidiary operating companies, as of January 1, 1984, were spun off from AT&T into seven regional holding corporations. These seven own the stock of the present 22 Bell operating companies. Southern Bell Telephone and Telegraph Company, which will continue to serve North Carolina, South Carolina, Georgia, and Florida, is part of the newly organized BellSouth Corporation of Atlanta, one of the seven regional corporations. BellSouth also owns South Central Bell Telephone Company, which serves Kentucky, Tennessee, Alabama, Mississippi, and Louisiana. The divestiture was accomplished primarily by AT&T issuing shares of stock in the seven regional holding companies to the stockholders of AT&T. The "new AT&T" stock and stock in the seven new holding companies was first sold over the market in November 1983.

The "new AT&T" is now released from the 1956 antitrust consent decree, which for 27 years prohibited AT&T from engaging in certain new services and enterprises. AT&T's first expansion appears to be into more computer-related telephone services and the general computer field, although anything might be possible in the future.

Equipment. On January 1, 1984, all of the telephones (technically called "customer premise equipment") owned by Southern Bell and leased to its customers were transferred to AT&T. Hence, AT&T now operates the phone stores in North Carolina and will continue to lease telephone sets presently in people's homes to those who desire to have the telephone sets

Interstate Companies Competing With AT&T

Beginning in 1969, Microwave Communications Inc. (MCI), earned the right through the federal courts to construct microwave facilities between St. Louis and Chicago. MCI subsequently earned the right to expand this system and has developed into a major communications supplier in the United States. Nearly 200 other common carriers operating over different parts of the United States now offer some kind of long-distance service. Companies like GTE's SPRINT (formerly Southern Pacific Communications), ITT Longer Distance, Satellite Business Systems, and MCI offer services throughout the major areas of the United States.

Those companies referred to as "other common carriers" (OCCs) normally own a portion of their operating system through owned microwave lengths or leased satellite channels. They are also sometimes tied together with private lines and WATS lines leased from the telephone companies. Some, such as MCI, are constructing their own fiber optic light wave systems.

Other companies moving into the long-distance market are known as "resellers." They offer service almost entirely through the resale of WATS lines, which they rent on low 24-hour-a-day rates and resell on a minutes-of-use basis. Some companies utilize WATS resale, leased satellite services, and leased private lines.

Together, these AT&T competitors have gained some six percent of interstate toll revenues, a portion which is growing at a very rapid rate, estimated to reach 14 percent by 1984. Many new prospective entrants into the market have announced plans for ambitious national service offerings as new technology develops.

Some very large long-distance customers are developing private communications systems that do not utilize the major national interstate owned and maintained by AT&T. Prior to January 1, 1984, residential customers could have purchased the sets from Southern Bell, along with certain single line business sets (see box on page 34). Customers may now purchase their telephones sets from sources registered with the FCC, including AT&T, and may plug them in themselves. Telephones are now available even at grocery checkout counters. The Bell operating companies will re-enter the business of selling or marketing new customer premise sets on a deregulated basis in areas where they can compete with the new suppliers.

Local Service. The Bell operating companies, i.e., Southern Bell in North Carolina, will be restricted primarily to providing local telephone service, new equipment sales, and limited long-distance calls. This local service has a broader definition, however, than just calls within Raleigh, for example. A new local area is called a "local access and transport area" or LATA. A call from Raleigh to Chapel Hill, for example, is within the *same* LATA and hence is considered "local service" by the divestiture order. Customers, however, will still pay a "long distance" fee for calls between two towns within a LATA, e.g., from Raleigh to Chapel Hill.

The divestiture order divided the North Carolina service area of Southern Bell into five LATAs, based on areas around Wilmington, Raleigh, Greensboro, Charlotte, and Asheville. All of the independents *except* the largest, Carolina Telephone and Telegraph Company, have joined the LATA system. Carolina Telephone and Telegraph Company will have two separate "geographic transport areas" or GTAs (in Rocky Mount and Fayetteville), which will function like the LATAs.

Intrastate Long Distance. On January 1, 1984, Southern Bell, the 19 independent telephone companies, and the 9 telephone membership corporations providing local service in North Carolina began a new system of intrastate, long-distance calls. It is based on the LATA system prescribed by the federal court. A new subsidiary of AT&T, called AT&T Communications of the Southern States Inc. (ATTCOM), now provides all *inter-LATA* service—i.e., service *between* any two of the five Bell LATAs —and most service between a Bell LATA and a Carolina Telephone GTA.

For example, a call from Raleigh to Asheville travels *between* two of the new "local-service" areas, called LATAs; a call from Raleigh to Rocky Mount goes between a LATA and a Carolina Telephone GTA. The new AT&T subsidiary ATTCOM will provide this service—not Southern Bell. Southern Bell must withdraw from the inter-LATA long-distance service in North Carolina and transfer all of the equipment used in this service to ATTCOM. Hence, a Raleigh customer, even for calls *within* North Carolina, will have to pay a monthly bill to Southern Bell (for local service and long-distance calls within a LATA) and to AT&T (for most intrastate calls). AT&T may contract the actual billing procedure for these intrastate calls to Southern Bell.

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switched system owned by AT&T. This fact—called "bypass" (see discussion in article, page 33)—has caused an important debate in Congress concerning an access bypass charge *for not using the central national switched system.* Congress is considering legislation that would require parties using communication systems that bypass the switched network to pay a charge in support of the national network in lieu of the common carrier access charges and the surcharge to support universal service. Such legislation has passed the House and the Senate committee.

"The authors of the House communications bill [HR 4102] consider bypass a serious threat to their plan to continue the long-distance subsidy," explains a recent issue of *State Policy Reports.** "Their solution? Make the bypassers pay a subsidy also . . . If you start from a desire to use long distance to subsidize local rates and believe bypass is a serious problem, you wind up either with prohibiting [such companies as] GM and the railroads from developing a communications system or charging them for using systems totally independent of phone companies."

The theory for this "non-use access charge" goes like this. Bypassers are using part of the national communications resources—radio frequencies, satellite licenses, and private lines—and therefore should support the national network as a national resource. Exemptions could be awarded to parties which demonstrate sufficient reason through: 1) a system that uses neither the switched network nor any connection to a facility in joint use with the switched network (i.e., private lines); and 2) have a volume high enough to provide service cheaper than the network can provide it. Such systems exist, but adequate and objective studies have not been made of the extent of such uses and the cost-benefit results of such use under the new technologies now available in the communications field.

—*Edward B. Hipp*

**State Policy Reports* special telephone issue, December 2, 1983, p. 24. Copies available from 3518 South Wakefield, Arlington, Va. 22206.

Table 1. N.C. Telephone Companies
Estimated Single-Party Flat Residential Telephone Rates, 1984-1990

Company[1]	No. of Residential Lines[2]	Percent of Total	1983 Actual Rate[3]	Average Residential Flat Rate[4] 1984	1987	1990	Increase, 1983-1990 Dollars	Percent
1. Barnardsville	654	0.03%	$ 9.55	$12.37	$17.72	$23.61	$14.06	147.2%
2. Carolina	497,429	26.10%	L[5] 6.75	9.25	14.85	21.34	14.59	216.1%
			H 14.15	16.65	23.42	31.25	17.10	120.8%
3. Central	128,744	6.75%	L 9.65	11.65	16.91	23.31	13.66	141.6%
			H 14.14	16.14	22.10	29.33	15.19	107.4%
4. Citizens	9,035	0.47%	10.20	13.02	18.66	24.91	14.71	144.2%
5. Concord	53,898	2.83%	L 7.90	10.72	16.31	22.43	14.53	183.9%
			H 9.90	12.72	18.62	25.10	15.20	153.5%
6. Continental/NC	61,419	3.22%	L 12.60	15.42	21.75	28.72	16.12	127.9%
			H 15.30	18.12	24.87	32.34	17.04	111.4%
7. Continental/VA	337	0.02%	12.75	15.57	23.30	29.72	16.97	133.1%
8. Ellerbe	1,199	0.06%	11.00	13.82	19.80	26.39	15.39	139.9%
9. General Tel/SE	70,406	3.69%	L 11.25	14.25	20.11	25.22	13.97	124.2%
			H 12.35	15.35	21.38	26.69	14.34	116.1%
10. Heins	15,160	0.80%	6.45	9.27	13.27	17.69	11.24	174.3%
11. Lexington	15,981	0.84%	8.25	11.07	15.85	21.13	12.88	156.1%
12. Mebane Home	3,970	0.21%	9.15	11.97	17.16	22.87	13.72	149.9%
13. Mid-Carolina	60,831	3.19%	L 10.00	12.82	18.73	25.22	15.22	152.2%
			H 13.95	16.77	23.31	30.52	16.57	118.8%
14. North State	53,532	2.81%	4.50	7.32	10.48	13.97	9.47	210.4%
15. Pineville	595	0.03%	4.75	7.57	10.85	14.46	9.71	204.4%
16. Randolph	2,124	0.11%	8.70	11.52	16.50	21.99	13.29	152.8%
17. Saluda Mountain	885	0.05%	6.10	8.92	12.77	17.02	10.92	179.0%
18. Sandhill	2,380	0.12%	6.95	9.77	14.00	18.66	11.71	168.5%
19. Service	712	0.04%	7.55	10.37	14.85	19.80	12.25	162.3%
20. Southern Bell	926,733	48.63%	L 10.02	13.11	19.51	26.91	16.89	168.6%
			H 12.48	15.57	22.35	30.20	17.72	142.0%
Total/Weighted Avg.	1,906,024	100.00%	L $ 9.00	$11.82	$17.74	$24.50	$15.50	172.2%
			H $12.74	$15.56	$22.06	$29.51	$16.77	131.6%

[1]The nine telephone membership corporations, which are not regulated by the N.C. Utilities Commission, are not shown on this chart.

[2]Source: Station Development Reports and Company Contacts.

[3]Average residential single party tariffs of each company on file with the Utilities Commission as of October 27, 1983.

[4]Data for the four largest companies (Carolina, Central, General Telephone, and Southern Bell) developed from company contacts. Data for all the other smaller companies based on average of increases of the four largest. Estimates compiled by increasing 1983 flat rates by the estimated access charges anticipated because of the AT&T divestiture. Also there is added a five percent annual factor to cover other increases which may or may not be related to the divestiture (inflation, etc.).

[5]L is lowest flat rate and H is highest flat rate for one party residential service based on company calling scope.

Table prepared by N.C. Utilities Commission, November 16, 1983.

Interstate Service. AT&T will continue to own and operate its "long lines" division operating the primary national long distance network. AT&T will also retain ownership of Bell Labs and Western Electric Corporation. Finally, most of the long distance equipment and facilities owned by Southern Bell and the other 21 operating companies will be transferred to AT&T.

AT&T's *interstate* long-distance network will be interconnected with ATTCOM, the AT&T subsidiary providing *intrastate* service between LATAs. This interconnection allows for joint utilization of the existing local and toll facilities in North Carolina in originating and terminating interstate calls.

Long Distance Competition. All Bell operating companies, by specific order of the federal court, are required to offer *equal access* to their local exchange to any long-distance telephone company seeking to connect to that local exchange. While not parties to the AT&T suit, the independent local telephone companies are currently in an FCC rule-making proceeding to require such equal access. Those local exchanges without sufficiently modern equipment to offer the equal access immediately must comply within three years (exchanges with over 10,000 subscribers) or by the 1990s (for smaller exchanges). This aspect of the settlement—directly related to the antitrust origins of the suit—allows local customers to select the long distance company they desire to use. Customers using MCI, Sprint, and other new carriers can eventually use the same dialing techniques as they use now for AT&T long lines and Southern Bell intrastate.

Some states, based upon their statutes, have approved other common carriers for *intrastate* long-distance service. The North Carolina law, based upon a *franchise system*, does not allow competition for intrastate service. Thus far, the Utilities Commission has not issued operating rights for new intrastate service to any carriers competing with Southern Bell.

Even so, several companies offering *interstate* toll service to and from North Carolina are located in the major North Carolina cities and are also providing *intrastate* service without authority. In 1983, the N.C. House of Representatives passed HB 1365, sponsored by Rep. George Miller (D-Durham), which would authorize the Utilities Commission to permit competition in North Carolina intrastate telephone service. This bill will probably be considered in the N.C. Senate in June 1984 for determination of the state policy on intrastate telephone competition.

Access Charges Boost Local Rates

The local telephone plant is used for both local and long-distance service. This plant has two major components: 1) the distribution or "outside" plant; and 2) the central office switching equipment. The outside plant includes the "local loops," the wires running from home or office to the central office. This outside plant is considered *non-traffic sensitive* (NTS)—that is, the cost of the outside plant (installation, maintenance, etc.) has to be incurred whether the lines are in use or not. The outside or NTS plant makes up 60 to 70 percent of the local-plant costs. The central switching equipment *is traffic sensitive* and hence is designed to cover the percentage of lines in use at peak periods.

Before divestiture, the local plant was considered a joint expense for long-distance and local use, but the *long-distance* providers paid more per minute of use than local users, based on a higher value assigned to long-distance service. After the divestiture order, the Federal Communications Commission devised a new theory for dividing the joint-use costs. Under this theory, the local customers—not the long-distance providers—will pay most of the NTS or outside plant costs through a system of "access charges."

The new FCC theory goes like this. Local customers should pay for the local loops—that is, the cost of getting a call from a local residence or business to the central office equipment. These local loops have to be built for the customers' convenience, regardless of the volume of use. Hence, reasons the FCC, the end user should pay the entire cost of this non-traffic sensitive plant. The interstate long-distance providers are secondary users of this NTS plant so they should be able to use it without charge, says the FCC. Because the cost of the central office switching equipment *is* traffic sensitive, the long-distance companies will continue to pay local providers a fee for using this equipment. This FCC theory could lead to a two-tiered system of new charges for access to the interstate and intrastate telephone network.

Interstate Access Charge. According to an FCC regulation, beginning April 3, 1984, all residential end users were to pay a $2.00 per month charge and all businesses up to $6.00 per month for access to the interstate network. The charges were to be phased in through 1989 when the national average for residences and businesses would be $6.00 per month. State utility regulators have no authority over this charge; only Congress or the FCC can alter it. Indeed as this issue of *North Carolina Insight* went to press, the FCC delayed the schedule until 1985.

A principal justification used by the FCC for this access charge is the "bypass" problem. Unless all local customers absorb the joint costs of the outside plant in a flat monthly fee, contends the FCC, extensive long-distance users will "bypass" the switched network. Put another way, if the NTS costs of the local telephone plant are included in long-distance tolls—rather than being paid by *all customers* as a flat-fee charge—these toll rates will be higher than the cost of new alternative long-distance services. Without reducing interstate tolls through the new access charge, interstate rates would drive some customers away from the switched toll network to many new technological means of direct communications, argues the FCC.

The FCC points to existing bypass systems using primarily microwave and private-line networks and to the beginning availability of even more advanced private networks utilizing satellites and shared ownership of fiber optics systems. Some of these modern bypass installations will be able to compete against *any possible rates* on the switched network, even after transferring the NTS costs to the local customer. Other systems, called "uneconomic bypass" systems, would be feasible only against the higher toll rates that would result if there was no flat-fee access charge. The FCC program is designed to discourage these systems.

Consumer groups and others opposed to the FCC's system of customer access charges argue that no adequate analysis has been made of the bypass problem. Moreover, all evidence shows that users of the present long-distance switch system are growing at a rate of 8 to 9 percent each year. Finally, they argue that most of the bypass systems will have little overall effect on the current network and will benefit only those customers that use interstate services extensively.

The cost of the outside plant varies extensively from area to area depending upon the density of customers using a distribution plant. Since the outside plant is 60 to 70 percent of the local joint-use costs, shifting the burden of this joint cost to the local customer will result in varying increases across the country. Present estimates indicate that local rates will double in most exchanges and triple in some rural and low-density exchanges by 1989 (see Table 1), although the FCC contends the increase will average no more than 50 percent.

Because of the recognition of the value of universal service and the need to maintain affordable rates, the Federal-State Joint Board on Implementation of the Access Charge, composed of three members of the FCC and four members of state utilities regulatory commissions, has recommended to the FCC that a new "universal service fund" be created. This fund, supported by a surcharge on long-distance calls, would help support those local companies with NTS costs greater than 15 percent above the national average due to low density or other geographic considerations. The FCC approved this proposal by voice vote on December 1, 1983.

For nearly a decade, Congress has been studying the need to revise the Communications Act of 1934. As recently as 1982, the U.S. House and U.S. Senate passed bills aimed at this purpose, but they were so divergent in approach that no bill reached a conference committee. In the 1983 Congress, both the full House and a Senate committee governing communications matters passed bills entitled "The Universal Telephone Service Preservation Act of 1983." These bills (HR 4102 and S 1660) would reverse the FCC end-user access-charge decision and institute a substantially different approach to the access charge. Each bill incorporates a universal service fund for assistance similar to the Joint Board recommendation approved by the FCC. (Both bills would aid those local companies with costs greater than 10 percent above the national average; the figure is 15 percent in the Joint Board recommendation.) In an action considered a rebuff to the Reagan administration and AT&T, the House passed HR 4102 in November of 1983, shortly before adjourning. The Senate will probably consider S 1660 in its 1984 session. A conference committee may well be the critical arena for deciding whether the FCC access-charge system will stand.

Intrastate Access Charges. The second-tier access charge related to the joint-use plant *is regulated* at the state level. In North Carolina, the new AT&T subsidiary ATTCOM, Southern Bell, and the other telephone companies requested that local customers pay an end-user access charge for connection to the intrastate long-distance network. Following the FCC method in its request, these companies want end users to pay for access to the intrastate long-distance network with a flat monthly rate. Local customers would have to pay this fee even if they never make an intrastate long-distance call.

The Utilities Commission Public Staff, which represents consumers in rate hearings, filed a plan which would put *all of the charges on the long-distance providers* seeking access to the local exchange. Consumers would pay no access charge to intrastate service.

The commission completed public hearings on November 4, 1983, on this proposed intrastate access charge. Numerous participants

Have you bought your telephone yet?

The federal rules authorizing customers to provide their own equipment apply to North Carolina local service. North Carolina subscribers have the right to provide their own telephone sets and to save the $1.50 to $4.60 per month charge per set for lease and maintenance from AT&T. North Carolina customers have not exercised their option to any great degree to date, although the rate of transfer to customer-owned equipment is increasing month to month.

In October 1983, there were 2,442,226 access lines in North Carolina, to which there were connected 3,348,407 company-owned telephone sets. In other words, in North Carolina, for each access line, there are still 1.42 *company-owned* sets. During October 1983, North Carolina customers turned in 70,587 company-owned sets, while the number of access lines increased by 7,247. Should this rate continue, it would represent approximately 840,000 conversions to customer-owned sets per year—or about 25 percent of the total company-owned sets. If this rate were to continue, there would be a substantially complete changeover to customer-owned equipment in four years. An unknown factor in these conversions is the final number of customers who will continue to prefer or need company installation and maintenance as compared with those who prefer to own and maintain their own sets.

From January through August 1983, 18,500,000 telephone instruments were imported into the United States, compared to 2,100,000 for the same period in 1982. The effect of this increase in imported telephones on manufacturing employment in the United States has not been fully reported.

—Edward B. Hipp

presented evidence during the two-week hearing. On December 16, the commission released an interim order rejecting the proposed flat-rate, monthly, end-user fee. The commission will release a broader decision by April 3, 1984, regarding access charges to be paid by long-distance companies providing intrastate service.

Telephone Rate Designs and Other Changes

The new deregulation policies and technological advances will alter service in other ways besides the new access charges. Local rates will increase due to changes in depreciation methods and because of reduced revenues from customer premise equipment. In addition, many new petitions will emerge from various parties to modify telephone rate designs. These modifications could also alter local rates.

Depreciation Rates. The national deregulation policy requires local exchanges to offer equal access to all toll providers. Consequently, local exchanges must modernize older "step-by-step" and "cross-bar" exchanges and install modern digital and electronic exchanges and the more advanced "fiber optics" transmission paths. This redesigning of equipment drastically "shortens" the expected life of the old equipment. Formerly, the state commissions fixed the depreciation rates. The FCC has now preempted that state-level authority in order to prescribe higher rates of depreciation expense. Local companies have consequently applied for rate increases based upon a more rapid rate of depreciation to get the old equipment off the investment books.

Customer Premise Equipment Revenue. Beginning in 1957, initially, and receiving more complete approval from orders in 1967 and 1977, customers have won the right to attach their own equipment to the telephone network. The federal courts in the AT&T divestiture and the FCC in a separate ruling have deregulated all new customer premise equipment (CPE). These actions totally open up the marketplace for customers to purchase their own equipment, as contrasted to the former practice of the telephone company leasing the equipment to the customer, and the practice before that of including one set in the monthly subscriber charge. The profits from the lease of equipment helped support the local exchange. To offset the revenue lost from the lease of equipment, some increases in local rates will take place. It is also causing some dislocation in the telephone workforce by eliminating the obligation to maintain the customer-owned equipment.

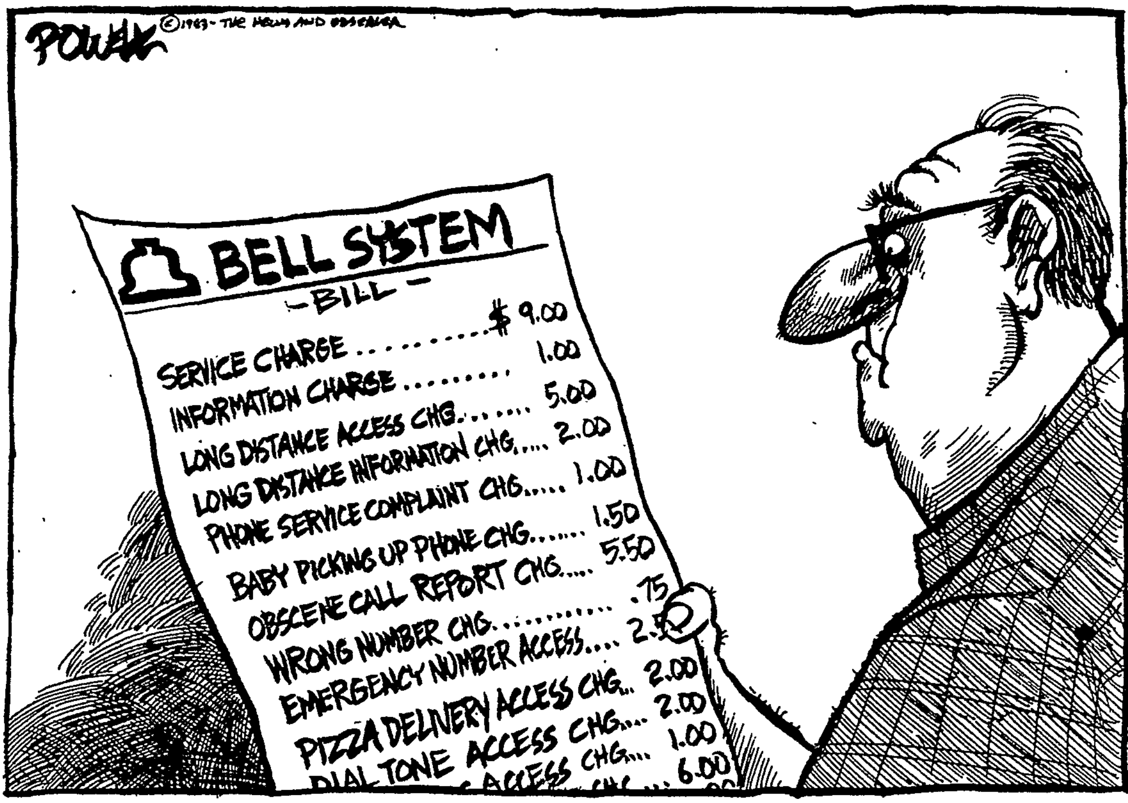
The FCC has also begun a program of getting the wiring on the customer's premises out of the "rate base" (see sidebar by Hugh Wells on page 6 for an explanation of this term). The FCC now requires that the inside wiring on the customer's premise be an *expense item* rather than a *capital item.* This causes local rates to increase in the short run because a one-time *expense item* is a higher cost of service for the first few years than this item would be if capitalized as part of the telephone plant, as it has been under North Carolina practice.

Local Measured Service (LMS). The AT&T system has for several years sought to convert most local-exchange rate structures from a flat rate to a *local measured service* (LMS) which measures local calls in essentially the same way as long-distance calls (i.e., the duration of the call, the distance of the call, the time of day of the call, and the number of calls). Some state commissions have approved local measured service, but North Carolina has not. Some customer groups have opposed LMS as a reduced grade of service which infringes upon their present freedom of conversation and inhibits use. Since some 70 percent of the local plant is in the outside distribution wire loops, which is largely non-traffic sensitive (NTS), the same costs are being incurred whether the NTS plant is used or not. These costs are capital costs for installation, maintenance, depreciation, and cost of capital for the wire network.

On June 3, 1983, the N.C. Utilities Commission approved on an experimental basis an offer of *optional* local measured service in nine representative Southern Bell exchanges (Charlotte, Raleigh, Asheville, Wilmington, Gastonia, Shelby, Cary, Apex, and Forest City). The commission viewed this as a possible alternative for a customer seeking to escape increasing local rates. A thorough study of the use and application of the LMS plan needs to be conducted. Research on cost data is also needed for future consideration.

Many large cities in other states have long had very complicated local exchange rates based upon calling zones and number of calls, a system similar to local measured service. Consumer groups which oppose local service when measured all four ways (i.e. duration, distance, time-of-day, and number of calls) have sought a more simplified rate design based only on the number of calls. This method would offer a reduced monthly rate for the first 30 or 60 calls of any length or distance or time, with an extra charge per additional call.

Extended Area Service. The N.C. Utilities Commission has had a program for many years of authorizing and ordering "extended area service" in communities willing to pay an increased flat-rate monthly charge for additional calling scope. This program has most often



Courtesy Duane Powell

provided countywide flat-rate telephone service. It has not been achieved for all 100 counties in North Carolina. Extended area service has been implemented only: 1) after a study of the cost to serve the additional area has been made upon petition by customer groups; and 2) if the study shows an adequate need, subscribers have voted in a post-card ballot system to receive the service at the increased charge. The new structure of intrastate service in North Carolina will affect this system to some degree.

De-averaging of Uniform Rate Design. Competition for long-distance service may affect the continued viability of uniform toll rates on a nationwide or a statewide basis. As competition in interstate service has begun to drive prices down in the choice high-density markets, the question has emerged: Should the FCC require AT&T to maintain uniform rates (and hence lose business) or should the FCC allow AT&T to adjust its rates to meet competition in the choice markets? Once the uniform-rate design plan is broken—a step called "de-averaging"—lower rates will result in the high-density markets but high rates in the low-density markets. This result would in fact achieve some economic efficiency through cost-based rates—just as AT&T, the FCC, and others argue. *But the result would also chip away at the public policy of having universal telephone service at uniform rates.*

Historically, public policy has recognized the value of a national telephone network with uniform treatment and nondiscriminatory rates for all users. Competitors to AT&T have already reduced interstate rates from 30 to 60 percent for certain calls, effectively de-averaging the uniform interstate rate structure. In response to this competition and to the new divestiture structure, AT&T has filed with the FCC a proposal to reduce its *uniform* interstate rates by approximately 10 percent; this reduction is based upon the transfer of cost to the end user through the interstate access charge discussed above. The reduction would presumably grow as the end user access charge is phased in during each year through 1989.

If the legislature changes the present N.C. law to authorize competition on intrastate calls, the companies currently holding the franchise for intrastate service would face the same competitive pressures. They would undoubtedly request reductions in the *uniform* intrastate rates based upon *increased* intrastate flat-fee monthly access charges. Without some kind of surcharge system for relief for low-income persons not using the intrastate services, universal service would be further weakened.

Business/Personal Rate Differentials. Business rates are generally between two times and two-and-one-half times the residential rates, based upon peak-hour use and value of service. The FCC interstate access charge will ultimately be the same $6 per month on residential and business lines after the full phase-in period. Such developments will require more analysis of the rate differentials now assigned between residential and business service.

Negotiating the Future Telephone System

The telephone system of the future in North Carolina, as well as the national network, will depend upon the complex interactions now going on between the federal courts, the Federal Communications Commission, and the Congress for the balance of power in writing the combination of laws, regulations, and court decisions that will control the system. The states, primarily through the state utilities commissions, are seeking to protect the jurisdiction of the states in that national decision—to retain jurisdiction of the local exchange and intrastate long-distance, based upon the overwhelming majority of telephone calls being in local and short-haul toll service. All of the present participants in the system and the potential new entrants are participating fully before the courts, Congress, and the FCC—including AT&T, the other common carriers, the new Bell operating companies, the large users of toll service, the equipment manufacturers, the private communication system operators, and many consumer groups.

Congress could have the final word, but for ten years Congress has been investigating and considering bills to rewrite the Communications Act. The many diverse views in the Congress and the many conflicting parties calling on Congress have so far prevented Congress from enacting any new legislation. The federal courts have participated heavily in granting rights to new entrants in the customer premise equipment field and the interstate toll field. It must be assumed that the federal courts will continue this trend in monitoring the divestiture of the AT&T system and in possible new proceedings concerning issues down to the intrastate level. The Federal Communications Commission is actively pursuing policies that support competition in interstate tolls, customer premise equipment, and in the new cellular radio and radio paging systems.

The substantial changes now taking place in telephone regulations will allow extensive use of new advanced technologies. The drive of the FCC to reduce interstate toll rates by shifting costs to the local exchange will help promote the use of new interstate communications equipment. The new entrants to the competition will offer services through satellites, microwave, new radio services, and fiber optic circuits, together with new uses of the present wire-line system and conversion to digital service. Tremendous advances in computerized telephone sets will offer many new features in services, including the many proposals now linking data banks and other central services through the communications network.

The goal of the state regulatory commissions will be to see that the costs of the new technology are not shifted to the many residential customers who will not be able to afford the expensive new services and who still want only basic telephone service. There will be a substantial number of middle- and low-income customers who will only want a telephone to reach fire, police, and medical services and to call their friends and family for personal and social reasons.

Some aspects of the existing access-charge plan and other results of deregulation *will place many of the costs of the new technology upon those who will not use it.* The major changes will help those customers who use large volumes of long-distance service through advanced telephone equipment. Most local consumers will rarely use the advanced technologies but will be paying a heavy part of the costs of the transition.

A 100 percent increase in local rates will threaten significant drop-off among low-income customers. This threatens the ability of these persons to reach necessary and essential services by telephone. It also reduces the value of the telephone network for *all customers,* who can then reach a declining percentage of the population by phone. Maintaining affordable rates means that many low-income persons who are housebound or living alone can remain in contact with society through the telephone and hence take care of themselves. Without the telephone, many may have to turn to the far more expensive alternative of nursing homes or other health care institutions.

Advanced technology and deregulation are beginning to offer new services to telephone customers. Competition is bringing reduced rates from long-distance companies. New rate concepts propose options in local rates for limited use customers. All of these changes come at the price of increased local rates and loss of uniform long distance rates.

Unless the changes are accomplished with great care, the public policy supporting universal telephone service will be compromised and a valuable public resource will be weakened. A major issue for the future will be to revise the costing system to protect those customers who need and want only the existing basic telephone. They should not have to pay a disproportionate part of the change-over to the new deregulated system.□

Memorable Memo(s)

North Carolina
Department of Administration
116 West Jones Street
Raleigh 27611

State Property Office
Charles E. Grady, Jr., Director
(919) 733 4346

James B. Hunt, Jr. Governor
Jane Smith Patterson, Secretary

November 7, 1983

MEMORANDUM

TO: Mr. Jim Woodall
Department of Human Resources

FROM: Charles E. Grady, Jr. *Charles E. Grady, Jr.*

SUBJECT: McCain Hospital

I recently received a copy of the minutes of the State Farm Operations Commission's September 1983 meeting. I noted in those minutes the statement that, "the rest of the McCain property has been turned over the Corrections department."

I would appreciate being briefed on this matter by you and, if appropriate, the Department of Corrections. Reallocations of State property (land, buildings, or space in buildings) can not be made without the approval of the Department of Administration and, in certain instances, the Governor and Council of State. I am not aware of this office or the Council of State reallocating this property.

Please advise.

JHH/jf

cc: Dr. Sarah Morrow

An Eq

STATE OF NORTH CAROLINA
DEPARTMENT OF HUMAN RESOURCES
325 NORTH SALISBURY STREET
RALEIGH 27611

...UNT, JR.
...VERNOR

SARAH T

November 8, 1983

MEMORANDUM

TO: Charles E. Grady, Jr.
State Property Officer

FROM: Jim Woodall, Director
Budget and Analysis *Jim Woodall*

SUBJECT: McCain Hospital

Thank you for your November 7 memorandum. I suggest that your offic consider the language contained in Chapter 761 of the 1983 Session Laws (Senate Bill 23). Section 51 states that:

"The McCain Specialty Hospital shall be closed by DHR on or before October 1, 1983,...all property...is transferred to the Department of Correction, Division of Prisons, for use as a prison medical facility. The property transferred shall include land and buildings..."

Human Resources has complied with this statutory requirement, and to my knowledge, Correction has done likewise. If there is a conflict with other statutes that assign this responsibility to your office, then I believe the matter should handled between your office and the Legislature. Alternatively, your records could be adjusted to indicate what has already occurred.

Please feel free to contact me if I can be of additional assistance.

JW/cd

cc: Jane Patterson

***North Carolina Insight** depends on its readers for Memorable Memos. Don't you have a good one in a file somewhere? Anonymity guaranteed.*


Martin Marion

Living More Independently— It Gives Them Hope

by Holly Hales Marion

Up until 1959, if you had a physically or mentally disabled child in Charlotte you had two options. You could keep the child at home, dependent on a family member for care. Or you could send the child to an institution, more than likely a state or private mental institution or a nursing or rest home.

In 1959, a group of parents of mentally retarded children got together to seek other alternatives in the Charlotte community. They expressed a strong desire to keep their children out of institutions. But at the same time, if their disabled children were to continue to live at home, they needed qualified day care and training in skills necessary for independent living. These parents believed their children had the same right as any child to learn to take care of themselves for the inevitable day when mom and dad would no longer be there. From this core group of parents, the movement in Charlotte began towards greater independence for retarded and disabled citizens.

Former Special Olympics gold medalist Julie Rayburn is now employed as a helper-aide for mentally retarded children.

The program these parents started depended on volunteers and a part-time director, who primarily provided day care for retarded children. The program evolved, however, into classroom training under contract with the Charlotte-Mecklenburg Schools. Several years later, the public school system opened its own classes for the educable mentally retarded students. At that point, the parents decided to turn their original program into a sheltered workshop and vocational training center, now called Nevins Center.

Nevins Center represents only one of the new opportunities that persons with a mental disability now have available to them. From attending regular classes in public schools to

Holly Hales Marion is a free-lance writer living in Charlotte. She currently advises students with learning disabilities at the University of North Carolina at Charlotte.

Martin Marion

Nevins Center is the oldest sheltered workshop in the state.

receiving assistance from the Metrolina Independent Living Center, persons with mental or physical handicaps have more avenues available to them than ever before for living an independent life.

Confinement to a single family or to an institution is no longer the only or even the primary choice available to persons with a mental or physical handicap. Below is a sketch of some of the alternatives available in Charlotte.

Sheltered Workshops. Nevins Center, the oldest workshop in the state, provides work and vocational training to about 200 mentally retarded persons on an average day. Many of these persons also have physical handicaps, such as hearing impairments or orthopedic problems. Typically, a client comes to Nevins at the age of 18 after completing the public school program.

"When people first come here, we spend the first six weeks trying to determine what they *can do*", says Rick Dancy, director of Nevins. "Everybody has evaluated them from birth to find out what they *can't do*. We're not really interested in that. We are more interested in taking a success and building on it."

Clients go to the center Monday through Friday twelve months a year (except for two weeks' vacation at Christmas). The first four hours of the day are spent in work activity under contract with area businesses and industries. Typical jobs are building parts for phones, assembling washer and screw sets, packaging screws in bags, building wooden furniture, and making greeting cards. The last two hours are spent in recreation or in basic education classes.

Wages for their work depend on the clients' productivity. For example, if a business pays $5 an hour to an employee who assembles 100 washer and screw sets each hour, it pays a Nevins client $1.25 an hour if he only assembles 25 sets each hour.

According to Dancy, 85 percent of the clients at Nevins will never work in a competitive job environment. However, a person can work at Nevins for years if he or she wants to, and many do. Presently, there is a six-month waiting list to get into the program at Nevins Center.

"For a lot of folks, if it weren't for getting up and coming over here each day, they wouldn't get up," says Dancy. "Others realize that if they're going to get a competitive job they are going to have to learn some skills."

Nevins is a private, non-profit organization with a 1984 budget of $769,000. About half the budget comes from state and local government funds. The other half comes from private contributions and earned income from the products made at the workshop. The state Division of Mental Health, Mental Retardation, and Substance Abuse Services certifies the health and program standards at Nevins.

Area Mental Health Authority. Success at a sheltered workshop depends not only on developing job skills but on behavioral skills as well. If behavioral problems arise at Nevins, the client may go to a temporary program like the Adult Behavior Adjustment program at the county-operated Center for Human Development in Charlotte. Funded by state and local government, the center is part of the Mecklenburg County Area Mental Health Authority, one of 41 such programs that cover the entire state. These area programs offer a wide variety of services, primarily in community-based settings.

In 1981, the Adult Behavior Adjustment (ABA) program opened in Charlotte to help adults who were being dismissed from programs like Nevins—or who couldn't get accepted there as clients at all—because of behavioral problems. Some clients are easily upset and throw things or take another person's possessions, explains ABA director Janet Hince. Another person might continually leave the work area or refuse to cooperate with his supervisor.

"We reinforce desired behavior. This is our basic program. Reinforcement could be taking the client out to lunch or on a field trip. It could be praise or special attention," Hince says. "A lot of our clients only get social attention when they do what they are not supposed to do. As much as possible, we try to ignore that kind of behavior and reinforce positive behavior."

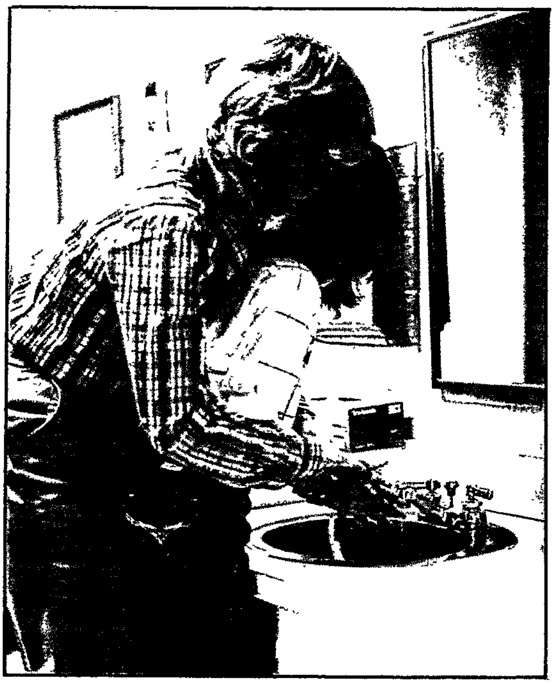
All clients at the ABA program are mentally retarded and are required to do certain tasks for which they receive reinforcement. "We are very goal oriented to seeing clients go on to less restrictive environments. This is a treatment environment, a behavior program for the entire six hours they are here each day," Hince says. "Some of our clients have never been in a program as an adult. ABA becomes an entry to other programs like Nevins."

Developmental Day Program. Until a decade ago, no alternative to family or institutional care existed for profoundly and severely retarded persons aged three and older. In 1973, St. Mark's Center opened. St. Mark's now serves more than 80 children and adults on a daily basis with a low three-to-one ratio of students to teachers. As a day school, St. Mark's concentrates first on developing a highly individualized curriculum for each student. Students might focus on developing gross or fine motor skills, self-care skills, or sensory skills. The school helps children and adults learn everything from brushing their own teeth to using playground equipment.

Older clients, or those who have progressed through the initial curriculum, might enter the Adult Developmental Activity Program (ADAP). Here students learn more advanced interpersonal and independent living skills. Students are exposed to recreational activities such as skating and swimming. Some may be able to learn vocational skills, which can lead to employment at a sheltered workshop. Local, state, and federal funds, along with private donations, support St. Mark's Center. St. Mark's works closely with other private and public groups, including the Nevins Center, the Association for Retarded Citizens, and local schools.

Pre-Vocational Training. In the last ten years, opportunities for handicapped persons have increased dramatically, from mainstreaming in public schools to community-based mental health services and sheltered workshops. Before this increase in services, however, many handicapped persons did not have access to training that could help them get into a sheltered workshop or other job situation. And some persons are still missing out on the new programs. In Charlotte, a program called Project LEAR (Leisure, Education, and Recreation) helps such persons.

St. Mark's Center



Martin Marion

LEAR offers the only in-home, continuing education training for developmentally disabled persons in Charlotte. The LEAR clients are between the ages of 30 and 60, with an average age of about 40. LEAR staff conduct an in-depth questionnaire of incoming clients (or their parents or guardians). In 1982, of the 105 LEAR clients, 41 percent had received no special education, social services, vocational rehabilitation, or recreation programs—no community instruction or support services of any kind.

"When our clients were growing up, few special education services existed. Most of their parents basically lost hope," says Pat Keul, coordinator of Project LEAR. "There are not a lot of programs that work with the older adults. These people mostly show up on welfare roles, but most are ineligible for programs like Goodwill Industries or vocational services."

LEAR teaches independent living skills on a one-to-one basis in the client's home. The counselors also take clients on field trips to learn how to use public transportation skills, get along with others, handle money and personal grooming, and much more. LEAR estimates that 72 percent of its clients lack the skills to succeed in the work force or at a sheltered workshop.

Project LEAR, which has received federal funds and support from the University of North Carolina system, will soon merge with Goodwill Industries. The new program, to be called the Community Resources Training Project, will receive funding from the Charlotte/Mecklenburg Mental Health Authority and the United Way.

Respite Care Homes. Despite a growing number of programs in Charlotte to teach independent living skills, they all had one serious drawback until 1975. They were *day programs only*. There was no place where parents could leave their family member overnight in order to take a trip or just go out for the evening. In 1975, Respite Care Homes, under contract with the Area Mental Health Authority, began offering 24-hour overnight care for people with developmental disabilities or retardation.

Respite Care Homes places the client in a carefully screened, monitored, and state-approved household. The persons providing the care, usually parents themselves, are selected on the basis of their skills and sincere desire to care for the retarded or disabled client.

Funded by the county and state, Respite Care also charges fees based on a sliding income scale. One of its primary goals is to offer parents a periodic break or rest to reduce the possibility of institutionalization of their family member.

Group Homes. Institutions are no longer the only alternative outside the family for mentally retarded persons. For the person who gains the skills to live independently, group homes are an attractive option. Fifty mentally retarded persons currently live in 10 group homes in Mecklenburg County. There's a waiting list of 172 people for spots in the homes.

"There comes a time when just about all of us leave home. Why should the mentally retarded be any different?" asks Dancy, director of the Nevins Center sheltered workshop. Forty-six of the 50 persons living in the group homes in Charlotte come to Nevins Center every day, he says.

"The group homes serve as a place to live for the kinds of people who work in a sheltered workshop during the day," adds Dancy. This is one of the reasons that Nevins started planning in 1971 for a group home "community" on their own 45-acre campus. Ground breaking for the first home was in December 1983.

Nevins plans a total of nine group homes with six residents in each. Funding for the group homes came from grants from the City of Charlotte and the Kate B. Reynolds Health Care Trust of Winston-Salem.

"I'm a big believer in scattered house sites in the community. But I also believe that just like everybody else, mentally retarded persons should have the option to live in a neighborhood with other people like themselves," Dancy says.

One group home in a residential Charlotte community caused heated controversy when it was announced in May 1982. St. Mark's Center sponsored the house for five retarded persons on Windsor Drive. The first of the five residents moved into the house in July 1982 despite a series of community meetings and dissent from more than 70 area residents.

"It would be a shame for a person who had never been in a mental institution to end up in one," Dancy says. "But I'm not just interested in keeping them out of an institution. I'm interested in keeping them out of any inappropriate environment."

Support Groups. For adults with mental illness who may have been in and out of institutions for years and unable to live independently, the Mecklenburg County Mental Health Center sponsors a club called "New Directions." Max Nunez, director of New Directions, says that it is called a club in order to get away from the idea that these people are sick or incompetent.

"Traditionally, these people have been treated as sick," says Nunez. "But the club takes away the aspect of sickness and lets them know that the club will work if they work." Each club member has duties and obligations to various committees on which they serve.

Since the beginning of New Directions in 1981, 80 members have joined to participate in every aspect of running the club—from kitchen and maintenance to clerical, research, and newsletter committees. Currently, the club meets one day a week but Nunez says the goal is to operate five days a week. He also hopes to find a house in the community for the club and move it away from the Mental Health Center to further break the connection to mental illness.

New Directions staff work with the members to help them find housing or employment. But members are responsible for running the club themselves. Staff will offer direction and assistance, but the work must be carried out by the client. "Basically, we involve people in normal functions of life. We put responsibility on the members. We let them know we expect them to do it, and most of them do," Nunez says. "They might have done nothing at home, but here they become productive." Most of the members have chronic schizophrenia and are referred from the mental health center or from local psychiatrists.

Independent Living Center. The U.S. Census reports 35,000 mobility-impaired persons in Mecklenburg County. Many of these physically disabled persons have no mental disability at all. In 1980, the Metrolina Independent Living Center (MILC) was founded to help primarily physically disabled persons live more independently. The Metrolina Center provides direct client services and works cooperatively with other city and community agencies. For example, the Metrolina Center helped start the Special Transportation Service, a van service run by the city of Charlotte which picks up disabled persons at their homes.

Rusty, a peer counselor for amputees at MILC, is a quadruple amputee from severe electrical shock. He came to MILC because he was bored. Unlike most disabled persons, Rusty was not working but had a fairly good income and needed something to do with his time. When he first came to MILC to volunteer, his wife was driving him everywhere.

"We asked him why he didn't drive himself," says John Ross, until recently MILC executive director. People like Rusty, who have lost both hands and both feet but still have some part of their arms and legs, can be fitted to driving devices. "He had never thought for one minute that he might be able to drive," adds Ross. MILC put Rusty in touch with an expert who modifies cars and vans for handicapped persons. Now Rusty drives himself everywhere with the use of arm controls in a van with a wheelchair lift.

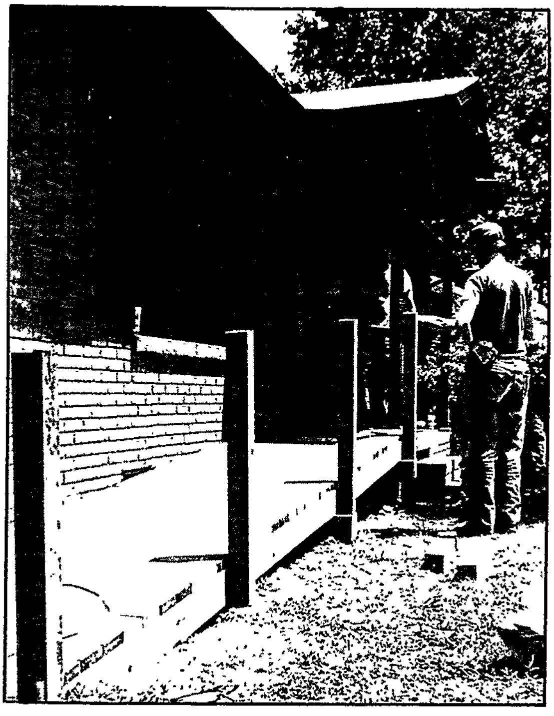
Another client, Jim, is a 44-year-old amputee who recently had a stroke. Jim's wife tried to lift him in and out of their mobile home but dropped him twice. They could not afford the ramp which would allow him in and out of his home.

A physical therapist who sees Jim three times a week contacted MILC. A staff member designed a ramp, then found a church to contribute the labor and materials and to build it. Another church widened Jim's bathroom door so he could wheel himself into the bathroom.

Ross says that, since MILC began, it has worked principally with housing assistance, housing modifications, and attendant care. MILC trains and certifies attendants and matches them with clients. In 1983, the legislature appropriated $50,000 to MILC for the attendant care program as a pilot project for North Carolina.

Ross says that MILC has applied to the federal Department of Housing and Urban Development for a $1 million loan to build a 40-unit apartment complex in Charlotte for physically disabled persons. If approved, the complex would be the first in North Carolina for non-elderly disabled persons, according to Ross. The City Council has reserved a 33-acre site in the city for the housing complex, pending acceptance from HUD.

U. S. Navy Seabees volunteer to help the Metrolina Independent Living Center construct a ramp for a girl in a wheelchair.



Courtesy Metrolina Independent Living Center

Most of the funding for MILC has come from the federal Vocational Rehabilitation Title 7 program, but that will end next year. After that, the agency hopes to become a member of United Way for a third of its $650,000 operations budget. Another third would come from fund-raising and the last third from fees for services.

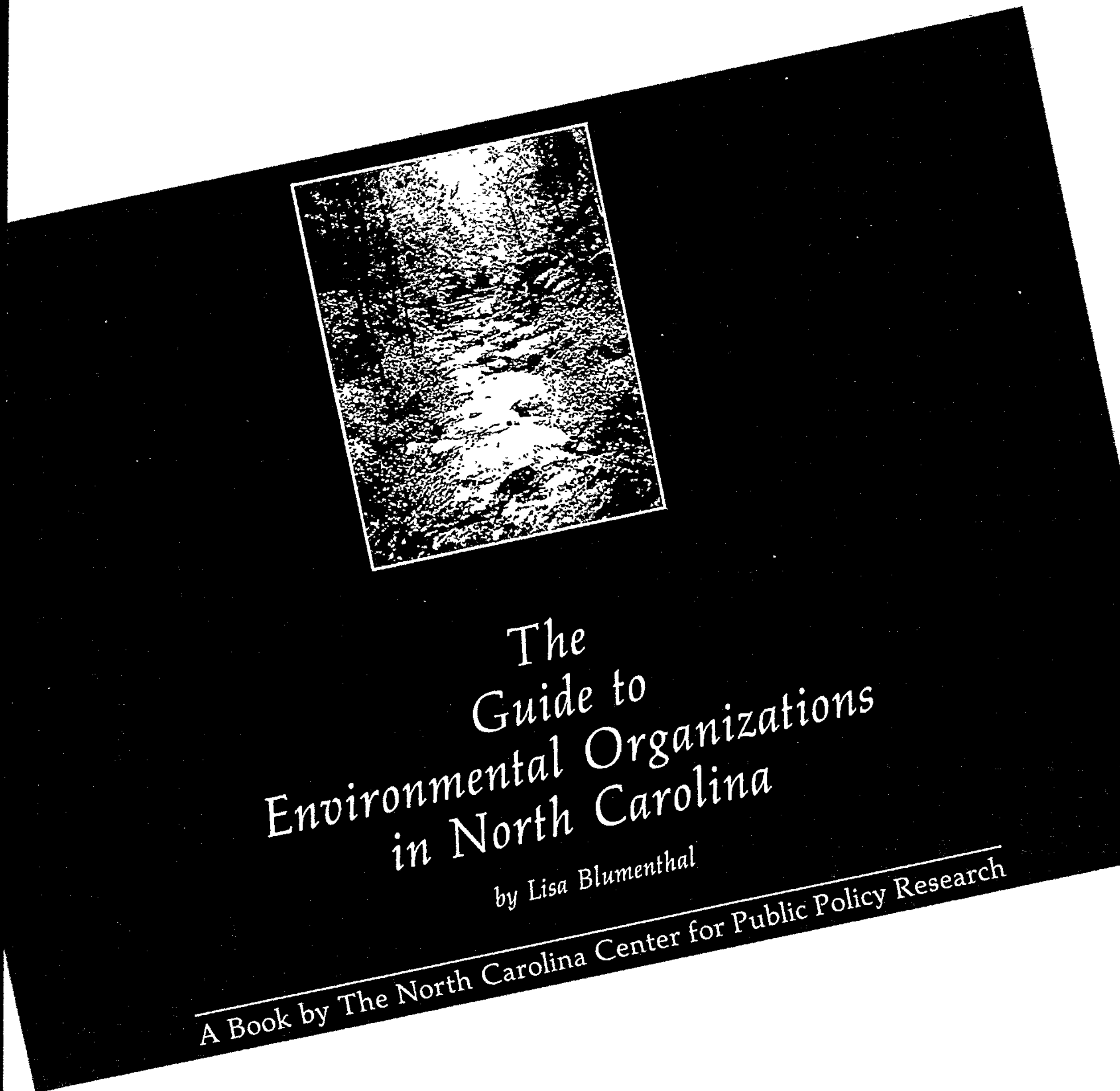
The Metrolina Independent Living Center, the Nevins Center sheltered workshop, the St. Mark's developmental day program, and other Charlotte programs are actively educating the public about the importance of independent living skills for citizens with disabilities. At the same time, they are helping persons with mental and physical handicaps learn to live more independently. People like Julie Rayburn would convince a wide range of people—from policymakers to neighborhood association members—of the value of these programs.

Julie, 34, is moderately retarded. In 1979, she was the first person from Charlotte to participate in the Special Olympics. She went to Rochester, New York, where she won a gold medal in the 50-yard dash and third place in the standing broad jump. She is now a volunteer helper at the Marion Diehl Recreation Center, a Charlotte Parks and Recreation project for the developmentally disabled. Her parents say the recreation program at Nevins helped Julie develop her physical coordination to a higher level.

Julie's father, retired Presbyterian minister Robert W. Rayburn, is on the Nevins Center Board of Directors. He says of Nevins: "It's a through street. Before Nevins, there was only a dead end street."

This year, after working at Nevins Center for 11 years, Julie left. She accepted a job as a helper-aide at Ramsey Kindergarten, a private school for mentally retarded children. Even though Julie says she enjoyed working at Nevins, she is thrilled with her new job. "I love working there," Julie says. "When I got there, I was overwhelmed. There was lots of love."

Julie's parents, happy with Julie's new career as a kindergarten aide, also see what a difference their daughter makes for other people. "Parents [of the Ramsey students] are encouraged," says Julie's mother. "They see someone who is retarded working and contributing. It gives them hope." □



The Center Releases A New Guide

by Lisa Blumenthal

On January 10, 1983, the N.C. Center for Public Policy Research released its latest book, The Guide to Environmental Organizations in North Carolina. *Compiled over an 8-month period by Lisa Blumenthal, the 274-page softbound book includes listings and descriptions of private environmental organizations, other groups for which the environment is a secondary concern, and state government agencies (including boards, commissions, and councils) with responsibilities in environmental management.*

The Guide *concentrates on groups that are supported primarily by membership contributions from the general public and which are concerned primarily with the physical environment—air, water, and land. The Z. Smith Reynolds Foundation funded this guide through a grant to the N.C. Center. The excerpts below, from the executive summary to the book, explain the methodology used and summarize the major findings that emerged. To order a copy of* The Guide, *see insert card.*

In March and April 1983, the N.C. Center for Public Policy Research identified, sent letters of introduction to, and then surveyed nearly 200 organizations believed to be private environmental groups in North Carolina. Of these 200, some were found not to exist anymore, others were found to be groups whose primary concern was something other than the environment, while a few simply failed to return the survey. In all, we identified 108 environmental groups in the state, of which 89 are actually listed in the guide. The computations and analysis are based on the information in the surveys returned by these 89 groups.

The environmental movement is relatively young in North Carolina. Table 1 lists the numbers and percentages of groups that were established during four different time periods. Thirty-six organizations, or 40.5 percent of the total groups in the state, were established in the 1970s. Forty-two groups, or 47.2 percent of the total number of organizations, were founded since 1980.

Lisa Blumenthal has a masters degree in environmental management from Duke University and has worked with various coastal management and energy conservation projects.

Table 1. History of the Environmental Movement

Period Established	Number of Groups	Percent of Total Groups
Pre-1960	6	6.7%
1960-1969	5	5.6%
1970-1979	36	40.5%
1980-Present	42	47.2%
Total	89	100%

Geographic Spread

The map on page 48 illustrates the geographic spread of private environmental groups across North Carolina. Even a quick glance suggests that about half of the groups are located in the Research Triangle and Greensboro/Winston-Salem/High Point Triad areas. Specifically, Raleigh and Chapel Hill lead with 13 private groups each, followed by Durham, Winston-Salem, and Greensboro, which contain 6, 5, and 4 groups, respectively. Very few citizens' environmental groups are located in the western and eastern parts of the state. Thirteen groups are west of Asheville, while 12 are east of Greenville. The remaining 23 organizations are distributed fairly equally in the mountains, Piedmont, and coastal areas of North Carolina.

According to the survey, identifiable gaps in geographic coverage appear just east and west of the state's center. For example, no private environmental groups are located in Surry and Yadkin counties southward to Rowan, Stanly, and Anson counties. Likewise, none exists in the northeast counties of Halifax and Northampton, nor in Edgecombe, Wilson, Wayne, Duplin, and Pender counties. Finally, 71 of North Carolina's 100 counties are without any environmental group whatsoever, and many of the counties have only 1 group.

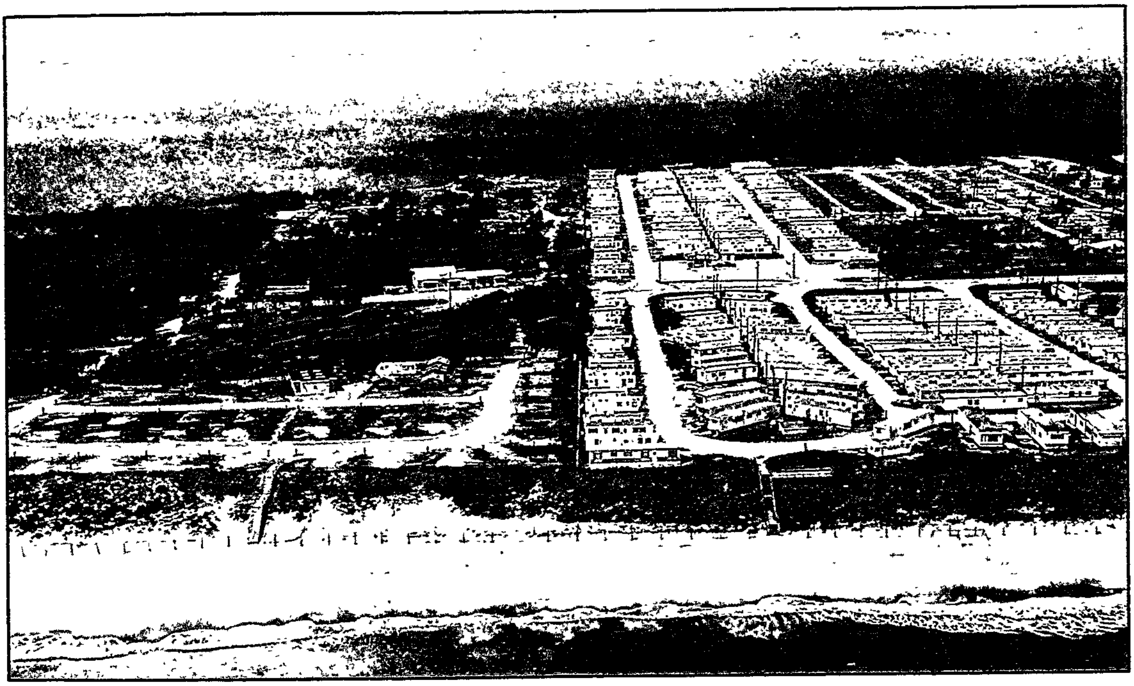
The survey also shows that 32 out of 89 organizations that responded to the Center's survey, or 36 percent of the environmental groups in North Carolina, are concerned with issues statewide, as opposed to local issues. These 32 groups with statewide concerns are listed in Table 2.

Table 2. Environmental Groups with Statewide Emphasis

1. The Acid Rain Foundation, Inc.
2. Artists and Musicians United for a Safe Environment—USA
3. Association for the Preservation of the Eno River Valley
4. Audubon Society—North Carolina Council
5. Audubon Society—Wake Chapter
6. Carolina Bird Club, Inc.
7. Center for Reflection on the Second Law
8. Central Carolina Environmental Defense Fund
9. Conservation Council of North Carolina
10. Conservation Foundation of North Carolina
11. Energy and Environmental Services Network
12. Environmental Law Project
13. Friends of State Parks
14. League of Women Voters of North Carolina
15. North Carolina Chapter of the National Wild Turkey Federation
16. North Carolina Chapter of the Wildlife Society
17. North Carolina Citizens Action on Toxic and Chemical Hazards
18. North Carolina Consumers Council Inc.
19. North Carolina Land Trustees of America
20. North Carolina Land Use Congress, Inc.
21. North Carolina League of Conservation Voters
22. North Carolina Nature Conservancy
23. North Carolina Outdoor Education Association
24. North Carolina Public Interest Research Group
25. North Carolina Trails Association
26. North Carolina Trout Unlimited
27. North Carolina Wildlife Federation
28. Pomona Action Community
29. Sierra Club—North Carolina Chapter
30. Sierra Club—Research Triangle Group
31. Sierra Club—Wenoca Group
32. Waste Information Research and Education —Piedmont Waste Exchange

The Conservation Council of North Carolina, North Carolina Citizens Action on Toxic and Chemical Hazards, and North Carolina Nature Conservancy are just three examples of groups concerned with issues like water resource management, hazardous waste control, and land preservation on a statewide basis. Locally oriented groups include such river groups as Committee for the New River, Deep River Citizens' Coalition, and Lumber River Basin Committee, as well as other specific issue-oriented organizations such as Onslow County Conservation Group and the Triangle Land Conservancy. Each of these groups was developed to effect changes in particular, geographically limited areas.

Coastal management ranks first among areas of concern for North Carolina environmental groups.



Jim Page

Table 3. The Ten North Carolina Environmental Groups With The Largest Membership (1982)

Name of Group	1982 Membership
1. North Carolina Wildlife Federation	30,000
2. North Carolina Public Interest Research Group	9,000
3. Sierra Club: North Carolina Chapter	5,300
4. North Carolina Nature Conservancy	3,800
5. League of Women Voters of North Carolina	1,480
6. Friends of Currituck	1,275
7. North Carolina Citizens Action on Toxic and Chemical Hazards	1,200
8. Sierra Club: Research Triangle Group	1,193*
9. Carolina Bird Club, Inc.	900
10. (tie) Sierra Club: Central Piedmont Group	800*
(tie) N. C. Chapter of the National Wild Turkey Foundation	800
(tie) N. C. Trout Unlimited	800

*This group's membership is included in the N.C. Chapter's total membership, listed in number 3 above.

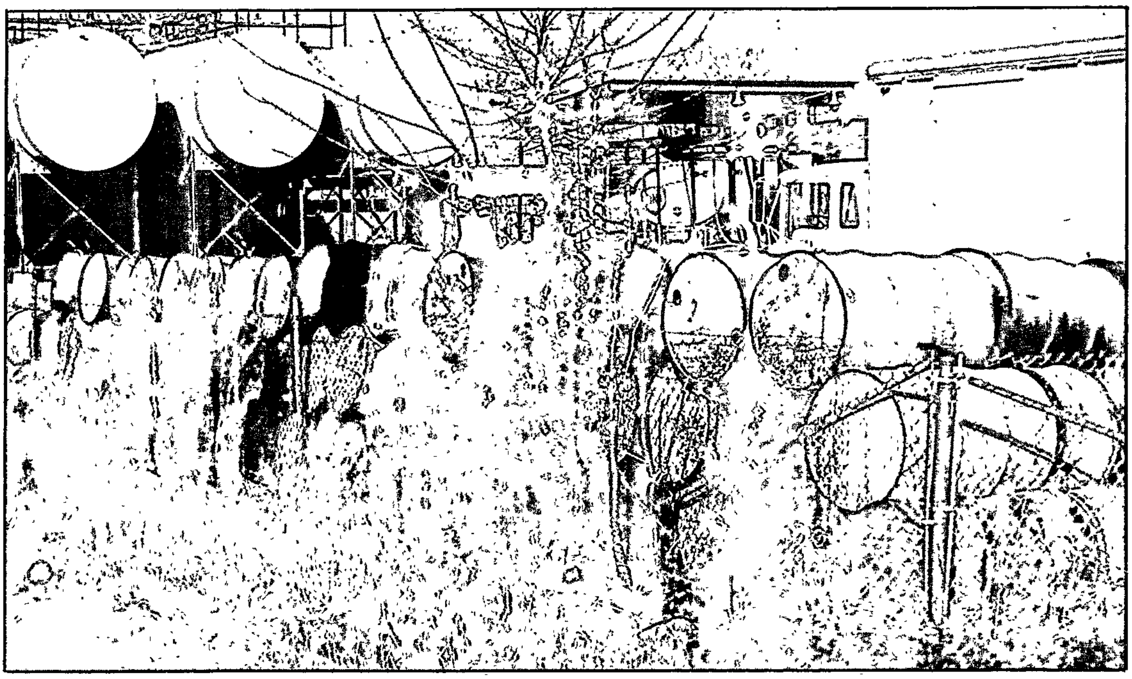
Membership

Over 60,000 individuals in North Carolina are members of at least 1 private environmental citizens' group in the state. As shown in Table 3, the North Carolina Wildlife Federation clearly has the largest constituency of all the groups surveyed. Representing a cross-section of backgrounds and occupations, the N.C. Wildlife Federation claims more than 30,000 members. The N.C. Public Interest Research Group is second with 9,000 members. As many as three Sierra Club organizations are listed in this table, demonstrating the great popularity enjoyed by the Sierra Club due both to its long history and a variety of outreach and educational programs. Finally, with its extensive network of 3,800 corporate and private members, the North Carolina Nature Conservancy ranks fourth on this list. The remaining groups appearing in the table each have less than 1,500 members.

Budget and Sources of Funds

Table 4 describes the ten environmental groups in North Carolina with the largest budgets. The North Carolina Wildlife Federation not only has the largest membership but also the largest budget of any group, reporting a figure of $250,000. The N.C. Nature Conservancy is second with its $168,798 budget. The Carolina Wetlands Project (an offshoot of the N.C. Wildlife Federation) is third on the list with $105,000. Fourth and fifth are the Eno River Association and the Acid Rain Foundation, with budgets of $75,000 and $72,000 respectively. The remaining groups in this table report budgets of less than $50,000, with Recycle Raleigh for Food and Fuel tenth at $30,300.

Hazardous waste management is the second most important concern among the state's environmental organizations.



Paul Cooper

Table 4: The Ten North Carolina Environmental Groups with the Largest Budgets (FY 1982)

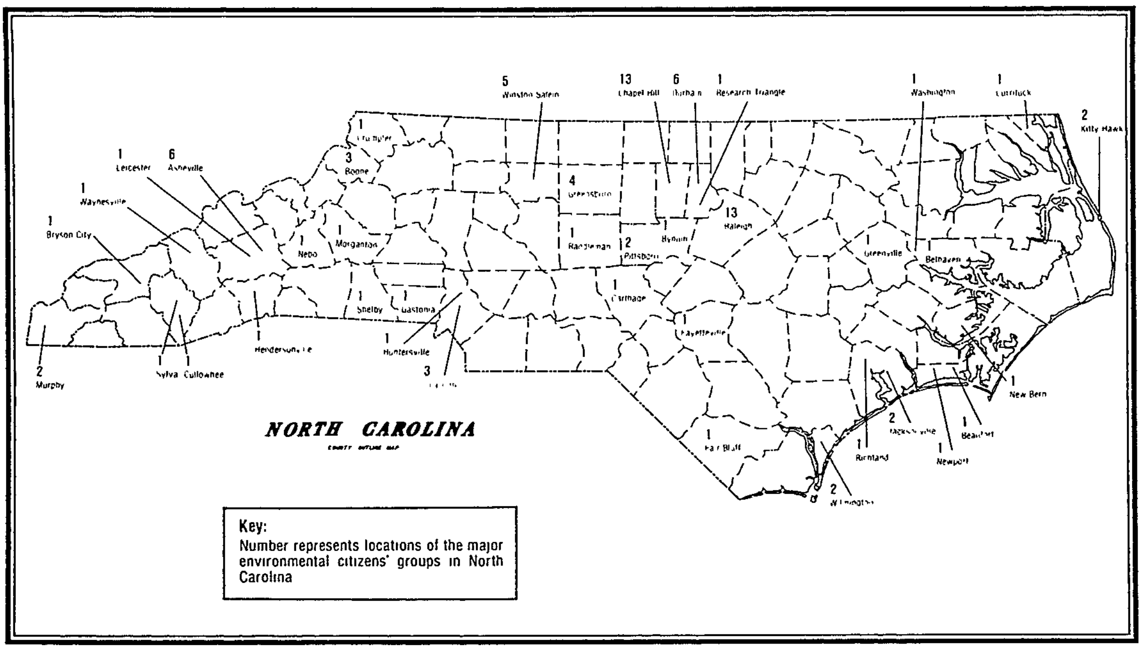
Name of Group	FY 1982 Budget
1. North Carolina Wildlife Federation	$250,000
2. North Carolina Nature Conservancy	$168,798
3. Carolina Wetlands Project	$105,000
4. Association for the Preservation of the Eno River Valley	$ 75,000
5. The Acid Rain Foundation	$ 72,000
6. Long Branch Environmental Education Center, Inc.	$ 48,600
7. The Land Stewardship Council of North Carolina	$ 43,114
8. North Carolina Public Interest Research Group	$ 40,000
9. North Carolina Citizens Action On Toxic And Chemical Hazards	$ 38,500
10. Recycle Raleigh For Food And Fuel	$ 30,300

Eight of the ten groups with the largest budgets are private, nonprofit, tax-exempt corporations under Section 501 (c) (3) of the Internal Revenue Code, a classification for religious, educational, charitable, scientific, or literary organizations. The other two groups are under the 501 (c) (4) classification for social welfare organizations. Though this classification means that the organization will not be eligible to solicit tax-deductible contributions, it does allow the organization to undertake substantial lobbying.

Most of these environmental organizations receive funds from a variety of sources. Almost all collect *membership dues.* For example, the N.C. Wildlife Federation receives 80 percent of its budget from membership dues; the N.C. Public Interest Research Group receives 90 percent of its $40,000 budget from member colleges student fees. The second most widely tapped sources of funding are *individual contributions*, and in some cases, *corporate gifts.* The N.C. Nature Conservancy receives over 30 percent of its funds from corporate and individual donors; 75 percent of the Eno River Association's budget stems from private contributions; a majority of the Acid Rain Foundation's budget is provided by a single donor. Recycle Raleigh for Food and Fuel obtained a grant from ITT, which comprises 80 percent of its budget.

The largest remaining source of funding for many environmental organizations in North Carolina is grants from *foundations and*

Geographic Coverage of Private Environmental Groups in North Carolina



governmental agencies. Carolina Wetlands Project, for example, gets 80 percent of its budget from a grant from the Environmental Protection Agency. The Land Stewardship Council of N.C. receives one-third of its budget from foundation grants, including the Blumenthal (N.C.) and Schalkenbach (N.Y.) Foundations. Finally, the Z. Smith Reynolds and Mary Reynolds Babcock Foundations have helped fund several groups, including the Long Branch Environmental Education Center, N.C. Citizens Action on Toxic and Chemical Hazards, and the N.C. Nature Conservancy.

The N.C. Center for Public Policy Research plans to publish a directory of North Carolina foundations early in 1984. Compiled by Anita Gunn, the directory will be of great use to many private environmental groups in the state. The directory will include an index identifying the subjects foundations have historically funded, including: agriculture, energy utilization, land conservation/preservation, pollution, recreation, and wildlife management.

Table 5. Environmental Groups with Full or Part-Time Staff (1982)

Name of Group	Staff: Full Time	Staff: Part-time
1. North Carolina Nature Conservancy	5	0
2. North Carolina Wildlife Federation	4	1
3. Carolina Wetlands Project	3	0
4. Long Branch Environmental Education Center, Inc.	2	3
5. North Carolina Public Interest Research Group	2	3
6 Waste Information Research and Education, Piedmont Waste Exchange	1	3
7. Triangle Land Conservancy	1	1
8. Western Carolina Alliance	1	1
9. The Acid Rain Foundation	1	0
10. Center for Reflection on the Second Law	1	0
11. Committee for the New River	1	0
12. Conservation Council of North Carolina	1	0
13. The Land Stewardship Council of North Carolina	1	0
14. North Carolina Coastal Federation, Inc.	1	0
15. Recycle Raleigh for Food and Fuel	1	0
16. Timberlake Residents Association	0	4
17. North Carolina Citizens Action on Toxic and Chemical Hazards	0	3
18. Clean Water Association of Coastal North Carolina, Inc.	0	2
19. Northwest Environmental Preservation Committee	0	2
20. Carolina Bird Club, Inc.	0	1
21. Carolina Environmental Study Group	0	1
22. League of Women Voters of North Carolina	0	1
23. North Carolina Land Trustees of America	0	1
24. Yadkin-Pee Dee River Basin Committee	0	1

Staffing

The majority of North Carolina's environmental groups have little or no staff. As seen in Table 5, only 15 of the 89 organizations listed have any full-time staff, with an additional 9 groups having only part-time staff. A closer look indicates that the number of staff per group is extremely low. Finally, as one might expect, those organizations having the largest budgets are also those with full or part-time staff.

Areas of Concern for Environmental Groups

According to the survey of environmental organizations, two major environmental issues confront North Carolina today, each one involving about one-fifth of all the groups surveyed. They are (1) coastal management, involving 21 percent of all groups, and (2) hazardous waste management, involving 19 percent. Other important issues among environmental groups in the state are water resource management—including groundwater and surfacewater quantity and quality; land use planning and management; wilderness area designation; and pollution resulting from poor environmental management. About 15 percent of all groups concentrate on each of these issues.

Environmental and conservation groups in North Carolina are taking several paths to achieve their objectives. Some are taking opponents to court (Carteret County Crossroads), while others are lobbying in the General Assembly for environmental legislation (Conservation Council of North Carolina). Still others are buying up prime natural habitats to protect them for future generations (The Nature Conservancy).

The N.C. Center's survey shows that 37 percent of the 89 environmental groups in North Carolina are actively involved in legislative lobbying, either by individual members of groups or by providing financial support to groups who pursue such activities. Even so, lobbyists for environmental organizations are many fewer in number than representatives of business and industry in the halls of North Carolina's General Assembly. Eleven percent of the groups engage in education efforts while seven percent do grassroots organizing.□

FROM THE CENTER OUT

Resources on Issues Affecting Disabled Persons

On October 26, 1983, we released a special double issue of *North Carolina Insight* on state policies affecting persons with disabilities (Volume 6, No. 2-3). By mid-November, we had already distributed over 2,600 copies to state agencies, private advocacy groups, university researchers, reporters and editors, and others. The 96-page edition provides an in-depth analysis of special education for handicapped children, transportation and architectural accessibility concerns, implementation of laws guaranteeing civil rights for handicapped citizens, state programs on an agency-by-agency basis, the "Willie M." program for troubled children, and more.

In placing orders for the magazine, many individuals and groups asked us for even more background information and ongoing resources. The annotated listing below should help meet that need. Special thanks to Lockhart Follin-Mace and Dwight Hopewell of the Governor's Advocacy Council for Persons with Disabilities for assistance in preparing this.

If you are interested in additional copies of this issue of *North Carolina Insight* at $6.00 per copy, please let us know so that we can decide whether to reprint it.

Directories/Organizations

Directory: North Carolina Consumer Groups and Professional Associations for Persons with Special Needs, N.C. Council on Developmental Disabilities, Suite 616, 325 N. Salisbury St., Raleigh, N.C. 27611, January 1983. A valuable listing of organizations working in this area, with brief descriptions of purpose and addresses and phone numbers.

Directory of National Information Sources on Handicapping Conditions and Related Services, prepared by then HEW Office of Human Development Services, Office for Handicapped Individuals, May 1980. Good source on national organizations. Available for $8.00 from Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

Governor's Advocacy Council for Persons with Disabilities, N.C. Department of Administration, 116 W. Jones St., Raleigh, N.C. 27611. The state agency that functions as a clearinghouse of information on all handicapped-related issues.

Disability Rights Center, 1346 Connecticut Ave., N.W., Suite 1124, Washington, D.C. 20036. Established in 1976 as an advocacy group for the rights of disabled persons.

Disability Rights Education Defense Fund, 2032 San Pablo Ave., Berkeley, Calif. 94702. Established in 1979, this educational and advocacy organization addresses national, long-term disability rights reform.

Mental Health Law Project, 2021 L St., N.W., Washington, D.C. 20036. Has handled such cases as a patient's right to treatment, patients being used as unpaid laborers, and civil commitment procedures.

National Center for Law and the Deaf, 800 Florida Ave., N.E., Washington, D.C. 20002. A cooperative effort between Gallaudet College and the National Law Center of George Washington University, it develops and provides legal services, information, and educational opportunities.

Periodicals

Amicus, a publication of the National Center for Law and the Handicapped. This excellent review of legal and policy issues was published six times a year from 1975-1980. Neither the publication nor the Center now exists. Back copies of *Amicus* can be ordered, bound by volume, from William S. Hein and Co., Periodicals Division, 1285 Main St., Buffalo, N.Y. 14209, for $32.50 per volume or $150 for all five volumes (plus postage and insurance).

Handicapped Americans Reports, a weekly 10-page newsletter providing valuable information on federal and state legislative issues, resources, meetings, etc. Available for $140 per year from Capital Publications, 1300 N. 17th St., Arlington, Va. 22209.

Mental Disability Law Reporter and *Clearinghouse Review*. Two periodicals that cover disability issues from a legal viewpoint.

"Mental Health," *Law and Contemporary Problems*, School of Law, Duke University, Vol. 45, No. 3, Summer 1982. A special issue of this legal journal, the volume includes articles on the rights of the mentally ill, employment issues for mentally ill persons, and various issues concerning hospitalization.

Popular Government, published by the Institute of Government, University of North Carolina at Chapel Hill, has recently included a series of articles on mental health. See particularly "Early Intervention: Help for Emotionally Disturbed Young Children" (Fall 1981), "Seriously Troubled Youth: North Carolina Confronts the Problems (Summer 1981), and "The Willie M. Case: The State's Obligation to Violent Disturbed Children" (Winter 1982).

References and Overview

Disabled Persons and the Law: State Legislative Issues, by Bruce Dennis Sayles, et. al., published by Plenum Press, 233 Spring St., N.Y., N.Y. 10013, 1982. A comprehensive view of state legislation affecting disabled persons; includes draft model statutes.

Disability Policies and Government Programs, edited by Edward D. Berkowitz, Praeger Publishers, 383 Madison Ave., N.Y., N.Y. 10017, $18.95. The first in a series of volumes collecting papers concerned with disability and rehabilitation.

Federal Tax Provisions of Interest to the Disabled and Handicapped, prepared by the Congressional Research Service of the Library of Congress, Report No. 79-95E. A summary of federal tax code provisions applicable to handicapped persons, current through the Revenue Act of 1978. Check with your representative in Congress for updated information.

A Handbook of Services for the Handicapped by Alfred H. Katz and Knute Martin, Greenwood Press, 1982. A valuable 300-page reference and overview book. Includes chapters on housing, financial aids for the disabled, employment and vocational rehabilitation, family, children, and social activities.

Notes from a Different Drummer: A Guide to Juvenile Fiction Portraying the Handicapped, edited by Barbara H. Baskin and Karen H. Harris. Available for $17.50 from P.O. Box 1807, Ann Arbor, Mich. 48106. An annotated guide with critiques of over 300 titles, indicating reading levels and the kinds of disabilities that are presented in each book. A supplement entitled *More Notes From a Different Drummer* available fall 1984.

The Rights of Physically Handicapped People by Kent Hull, part of a series on individual rights sponsored by the American Civil Liberties Union (ACLU). Available from the ACLU, 132 W. 43rd St., N.Y., N.Y. 10036, $2.25 each.

The Rights of Mentally Retarded Persons and *The Rights of Mental Patients*, also part of the ACLU series, can be ordered from the same address as in the previous listing.

The Role of the Governor in the Implementation of Programs for the Handicapped, National Governors' Association, Washington, D.C., published in 1980. An overview of the governor's role with case studies of Arizona, Maryland, Michigan, and New York.

"Who Decides Disability?" a transcript of the television show *Frontline*, program No. 121, broadcast on PBS on June 20, 1983. The late Jessica Savitch focuses on the changing eligibility requirements of the Social Security Administration for disability.

Architectural Accessibility

Barrier Free Environments, edited by Michael J. Bender, published by Dowden, Hutchinson, and Ross Inc., Box 699, 523 Sarah St., Stroudsburg, Pa. 18360. Identifies environmental barriers, provides case study examples of their removal, and establishes philosophical and practical directions for coordinating the various efforts in the field.

Creating an Accessible Campus, from the Association of Physical Plant Administrators of Universities and Colleges, 11 Dupont Circle, Washington, D. C. 20036. This guide book traces the steps that must be taken to develop an accessibility program to comply with Section 504 of the Rehabilitation Act of 1973; what constitutes a barrier and how to design sites and buildings. Available for $15.00 for members, $21.00, non-members.

An Illustrated Handbook of the Handicapped Section of the North Carolina State Building Code, edited and illustrated by Ronald L. Mace and Betsy Laslett, Special Office for the Handicapped, N.C. Department of Insurance, June 1977. See also *Accessibility Modifications* (1976) and *Accessible Housing* (1979), similar illustrated guides to the N.C. Building Code, edited by Mace and Laslett and published by the Special Office for the Handicapped.

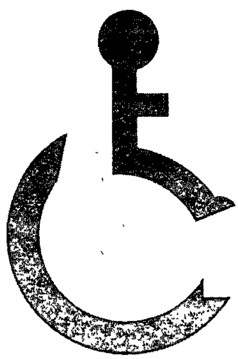
Mental Health

The Law and the Mentally Handicapped by H. Rutherford Turnbull III and Carolyn McAllaster, Institute of Government, University of North Carolina, Chapel Hill, N.C. 27514. A valuable book on legal and community issues regarding involuntary and voluntary commitment, group homes, voting rights, architectural barriers, right to education, and family rights.

Mental Health Services in North Carolina: An Overview of State Programs and Community Programs, compiled under the direction of The Mental Health Study Commission for the N.C. General Assembly, 1977 Session, 1977.

Parents Speak Out, Views from the Other Side of the Two-Way Mirror by Ann P. Turnbull and H. Rutherford Turnbull III, Charles E. Merrill Publishing Co., 1978. A collection of 15 articles that focus on mental health issues through the eyes of parents. Includes case studies.

Strategic Plan 1983-1989. Division of Mental Health, Mental Retardation, and Substance Abuse Services, N.C. Department of Human Resources, a five-volume effort to outline the general direction to be taken by the mental health, retardation, and substance abuse systems in the state. Volume I provides an overview of the statewide system; Volumes II-V address each of the four geographical regions within this mental health structure.



Section 504 of the Rehabilitation Act of 1973

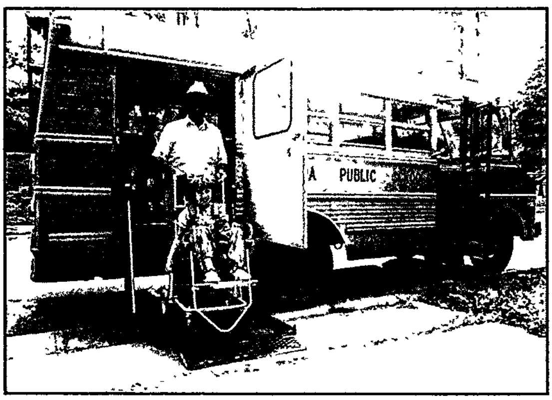
Accommodating the Spectrum of Individual Abilities, U.S. Commission on Civil Rights, Washington, D. C. 20425, 1983. Provides a helpful framework for viewing requirements for nondiscrimination against handicapped persons. Includes a special legal section for lawyers, regulators, and judges.

"Discrimination Against Handicapped Persons—The Costs, Benefits and Economic Impact of Implementing Section 504 of the Rehabilitation Act of 1973 Covering Recipients of HEW Financial Assistance," by Dave M. O'Neill for the Office of Civil Rights (DHEW), May 4, 1977. This is a revised version of an economic impact statement published in the *Federal Register* (May 17, 1976).

"Nondiscrimination on Basis of Handicap in Programs and Activities Receiving or Benefiting from Federal Financial Assistance," Rules and Regulations issued by the Office of the Secretary, Department of Health, Education, and Welfare, *Federal Register*, Part IV, *May 4, 1977*. These are the basic federal regulations governing recipients of federal financial assistance.

Report of the 504 Steering Committee to Governor James B. Hunt Jr., Recommendations for the State of North Carolina to Implement Section 504 of the Vocational Rehabilitation Act of 1973, April 1979, available from the N.C. Department of Administration, 116 W. Jones St., Raleigh, N.C. 27611.

Section 504 Transition Plan, N.C. Department of Human Resources, submitted to the Department of Health and Human Services in order to comply with Section 504 of the Rehabilitation Act of 1973, July 10, 1981, by Ran Coble, Jane Allen, Richard Bostic, Larry Bowman, and Ed Lueth. See similar plans compiled and published by the Department of Public Instruction, the Department of Community Colleges, and the University of North Carolina.



Michael Matros

Special Education

Financing Special Education in North Carolina, Richard M. Clifford *et. al.* Frank Porter Graham Child Development Center, University of North Carolina at Chapel Hill, Chapel Hill, N.C. 27514, May 1983. Commissioned by the General Assembly, the study analyzes the distribution and use of special education funds in the state.

94-142 and 504: Numbers that Add Up to Educational Rights for Handicapped Children, Children's Defense Fund, 122 C St., N.W., Washington, D.C. 20001, available for $2.50. Explains eligibility for special education, the legal responsibilities of school districts, and rights and responsibilities of parents and advocates.

Parents Together: A Resource Manual for The Parents' Education Advocacy Center, Center for Urban Affairs and Community Services, N.C. State University, available from the Governor's Advocacy Council for Persons with Disabilities, 116 W. Jones St., Raleigh, N.C. 27611. Valuable guide to rights, resources, and the process of seeking an appropriate education.

Public Policy and the Education of Exceptional Children, edited by Frederick J. Weintraub, *et. al.*, published in 1976 by The Council for Exceptional Children, 1920 Association Drive, Reston, Va. 22091. The best book in the field on state and federal policies for handicapped children, educational rights, and avenues for change in public policy.

The Rules Governing Programs and Services for Children with Special Needs, 1981. Guidelines which must be followed by public schools in North Carolina. Available from the Department of Public Instruction, Division of Exceptional Children, 114 W. Edenton St., Raleigh, N.C. 27612, (733-3921).

Seven Special Kids: Employment Programs of Handicapped Youth by R. C. Smith, MDC Inc., P. O. Box 2226, Chapel Hill, N.C. 27514, June 1983. This study, done for the Office of Youth Programs, U.S. Department of Labor, shows how job training must be tied to special education. Uses case studies of seven children to dramatize the gaps in services.

Study of Exceptional Children in North Carolina, Fiscal Research Division, N.C. General Assembly, by Ran Coble and Ray Shurling, August 1, 1973. One of the earliest overviews of the organization, budgetary, legal, personnel, and quality issues regarding special education in North Carolina.

Tim McKay

Services for Handicapped Persons

Access: The Guide to a Better Life for Disabled Americans by Lilly Bruck, 1978, Random House, N.Y., N.Y. An excellent guide for disabled persons on making better use of their resources to obtain needed goods and services.

The Source Book for the Disabled, edited by Gloria Hale, 1979, Paddington Press, distributed by Grosset and Dunlap. An illustrated guide to more independent living for physically disabled people, their friends, and their families. Covers attitudes as well as practical aids and equipment.

Travel Information Center, The Moss Rehabilitation Hospital, 12th St., and Tabor Rd., Philadelphia, Pa. 19141 (215-329-5715). Provides excellent travel tips including transportation facilities, accessible tourist attractions, hotel and motels, and more. The service is free and covers both U.S. and foreign cities.

Contributors to the N.C. Center for Public Policy Research

The North Carolina Center for Public Policy Research wishes to express a special word of appreciation to the foundations and corporations that supported the Center's efforts during 1983. Their help made it possible for the Center to produce quality research on important public policy issues facing the state.

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THE MARY REYNOLDS BABCOCK FOUNDATION

and

THE Z. SMITH REYNOLDS FOUNDATION

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