

ORIGINAL

HOUSE OF REPRESENTATIVES
COMMONWEALTH OF PENNSYLVANIA

IN RE: JUDICIARY COMMITTEE HEARING
ON HOUSE RESOLUTION 100

CITY COUNCIL CHAMBERS
PITTSBURGH CITY HALL
414 GRANT STREET
PITTSBURGH, PENNSYLVANIA

SEPTEMBER 5, 2002, 1:00 P.M.

BEFORE:

HON. THOMAS GANNON, CHAIRMAN
HON. STEPHAN MAITLAND
HON. KATHY MANDERINO

ALSO PRESENT:

MICHAEL SCHWOYER, CHIEF COUNSEL
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1 C-H-A-I-R-M-A-N GANNON: The House
2 Judiciary

3 Committee will come to order.

4 Today's hearing is as a result of House
5 Resolution 100 which calls for an
6 investigation into energy crises across the
7 Commonwealth, and this is the second in a
8 series of hearings that we've held on this
9 issue.

10 And our first witness for the hearing
11 here today in Pittsburgh is Douglas L. Biden,
12 president of the Electric Power Generation
13 Association.

14 Mr. Biden?

15 MR. BIDEN: Where would you like me?

16 CHAIRMAN GANNON: You can come up here.
17 We're a friendly group.

18 MR. BIDEN: I'm due for knee surgery,
19 so I'm happy to sit down.

20 Chairman Gannon and distinguished
21 members of the Judiciary Committee and staff,
22 good afternoon.

23 My name is Doug Biden. I'm president of
24 the Electric Power Generation Association or
25 EPGA. EPGA is a regional trade association

1 of electric generating companies with
2 headquarters in Harrisburg.

3 Our member companies include Allegheny
4 Energy Supply, Exelon Generation,
5 FirstEnergy, Midwest Generation, PPL, and
6 Reliant Energy.

7 These companies own and operate more
8 than 110,000 megawatts of electric generating
9 capacity in the United States. Approximately
10 half of this capacity is located in the
11 mid-Atlantic region. One third of it is in
12 Pennsylvania.

13 EPGA provided testimony before this
14 committee in November of last year, and we
15 appreciate the opportunity to appear before
16 you again today.

17 In the aftermath of the California
18 energy market meltdown and the demise of the
19 merchant energy market leader Enron, we
20 believe it is vitally important that our
21 policy makers understand how restructured
22 energy markets can and do work, and we trust
23 our comments today will help contribute to
24 that understanding.

25 EPGA's members own and operate power

1 plants and sell their output into the
2 deregulated wholesale power market. As you
3 know from the last hearing, the market that
4 includes most of Pennsylvania is conducted by
5 the PJM Independent System Operator or ISO.

6 In April of this year, Allegheny Power
7 joined PJM and formed PJM West. This
8 development, together with the completion of
9 some new power plants, has resulted in the
10 expansion of PJM's capacity 58,000 megawatts
11 to now nearly 72,000 megawatts.

12 Many new merchant generators have built
13 or currently have under construction new
14 power plants in Pennsylvania and in PJM. In
15 addition to the plants being built by current
16 EPGA members companies like AES Corp.,
17 Calpine, Conectiv, Constellation Power,
18 Dominion Resources, FPL Energy, Mirant, and
19 WPS Power have all found Pennsylvania and PJM
20 a promising place in which to risk their
21 investment capital.

22 In fact, a recent survey by EPGA
23 revealed that more than 15,000 megawatts of
24 new generating capacity has either come on
25 line in PJM within the last year or is

1 scheduled to be in service by 2004 more than
2 half of which has been or will be built in
3 the Commonwealth of Pennsylvania.

4 Clearly, the supply of electric energy
5 is ample today, and wholesale competition in
6 our state and region is robust. Competition
7 will likely become more robust in the next
8 two years as new generating capacity is
9 added.

10 According to figures compiled by the PJM
11 market monitoring unit, wholesale prices
12 averaged \$24.75 per megawatt hour. That's
13 2.45 cents per kilowatt hour for the first
14 six months of 2002 in the PJM day ahead
15 market compared to \$35.01 for the same period
16 in 2001.

17 In the real-time or day of market,
18 wholesale prices averaged \$24.10 for the
19 first six months of 2002 compared to \$33.09
20 in 2001. These represent the declines of 29
21 and 27 percent respectively in the day ahead
22 and real-time markets.

23 Calculated averages for the months of
24 July and August unfortunately were not
25 available from PJM at the time of our

1 request; however, if members of the Judiciary
2 committee or staff are interested in tracking
3 prices, PJM publishes hourly wholesale prices
4 on its web site.

5 Also, there are a number of publications
6 which track and report wholesale electricity
7 prices such as Power Daily, Platts, and
8 Bloomberg Daily Power Report.

9 Power Daily Northeast provides the most
10 recent 21-day average of on-peak power prices
11 for PJM, the New York Independent System
12 Operator, New England Power Pool, and the
13 Ontario Independent Market Operator or IMO.

14 For the 21 days ended August 28th, these
15 prices were reported as follows: In New
16 England, approximately \$58 per megawatt
17 hours; New York A, which is the western part
18 of New York where they have some very cheap
19 generation, prices average \$49 per megawatt
20 hour; New York G, which is the capital area
21 surrounding Albany, is about \$60 per megawatt
22 hour; in New York City, \$80 per megawatt
23 hour; Ontario, \$74 or \$75 approximately,
24 although that's Canadian dollars so to
25 convert that to American currency, I think

1 the conversion rate is 150 cents or 100 cents
2 approximately, so you would have to divide
3 that by 1.5; and PJM 51.

4 So you can see wholesale market prices,
5 even during this protracted heat wave that we
6 had in PJM, prices in PJM were very
7 competitive compared to the rest of the
8 northeast power markets.

9 House Resolution 100 specifically
10 requests information on energy price hikes of
11 more than 50 percent. At the wholesale
12 level, spot market electricity prices rise
13 and fall by more than 50 percent every day.

14 Prices at 3 a.m., when demand is very
15 low, can often be less than \$10 a megawatt
16 hour or one cent per kilowatt. On the other
17 hand, prices at 3 p.m. on a hot summer
18 afternoon can often reach hundreds of dollars
19 per megawatt hour as successively more
20 expensive power plants are called upon to
21 meet demand.

22 This volatility in prices is
23 characteristic of wholesale electricity spot
24 prices primarily because electric energy,
25 unlike other commodities, cannot be

1 stockpiled.

2 However, the vast majority of retail
3 consumers never see these price spikes
4 because they pay for their electricity at
5 average rates.

6 Only the very few customers who have
7 agreed to be billed for their electricity
8 consumption on time-of-day rates would
9 experience anything approaching the
10 volatility of the spot market, and these are
11 mostly industrial customers who have the
12 ability to shift their consumption to
13 off-peak periods when prices are lower.

14 Furthermore, it's important to remember
15 that Pennsylvania and other PJM states, in
16 their retail restructuring orders, put no
17 restrictions on their utilities ability to
18 reduce their exposure to spot market
19 volatility through long-term bilateral
20 contracts.

21 As an example of proficient use of that
22 ability, only 15 to 18 percent of PJM energy
23 is purchased through the spot market. That
24 means that 82 to 85 percent of the energy is
25 transacted through long-term agreements

1 between consenting parties based on their
2 knowledge and expectations of wholesale
3 market conditions.

4 This is in stark contrast to California
5 where utilities were effectively prohibited
6 from entering long-term power supply
7 contracts and were left heavily dependent on
8 the spot market for energy purchases.

9 I should point out here that that 82 to
10 85 percent of energy in PJM being transacted
11 through long-term contracts is probably not
12 true of this year because spot market prices
13 are so low.

14 I would expect utilities and other
15 generation suppliers to shift more of their
16 purchase to the spot market simply because
17 the spot market has been low. So these, I
18 believe, are for the years 2000 and 2001 and
19 are not representative of 2002.

20 Another element of the PJM market that
21 we believe contributes to relative price
22 stability is the capacity reserve
23 requirement.

24 Under this provision, all utilities and
25 retail generation suppliers are required to

1 purchase an amount of generating capacity
2 equivalent to their retail customers'
3 contribution to peak demand plus an adequate
4 reserve margin.

5 As noted previously, electric energy
6 cannot be stored, so installed capacity as
7 well as utilization of that capacity insures
8 that electric power is produced when it is
9 required.

10 A capacity market complements the energy
11 market in that it sends a long-term price
12 signal to power plant developers that more
13 capacity is needed before an electricity
14 shortage develops.

15 As the capacity reserve margin falls
16 below the required level, capacity prices
17 increase and power generators have real
18 economic incentives to invest in power supply
19 while the market is still in balance.

20 Without a capacity market, generators
21 must recover all of their costs, fixed and
22 variable, from energy transactions. Such a
23 market can be expected to produce periodic
24 capacity shortages with associated price
25 booms followed by capacity gluts with

1 associated price busts.

2 A market where capacity and energy were
3 attempted to be recovered through the energy
4 charge only was the path that California was
5 on. Today, California plans to implement a
6 capacity market similar to PJM's as the old
7 path proved to be neither economically nor
8 politically sustainable.

9 Looking to the future for a moment,
10 predicting future electricity prices is an
11 exercise fraught with many uncertainties.
12 As EPGA stated in its earlier remarks before
13 this committee, future electricity prices
14 will be largely determined by supply and
15 demand, power plant fuel prices,
16 environmental and other regulatory
17 requirements.

18 Many of the factors that were mentioned
19 in that testimony have not changed. Rather
20 than repeat them here, I've attached a copy
21 of our earlier remarks to this testimony.

22 And I would like to devote the remainder
23 of my time to some significant developments
24 that have occurred since the Judiciary
25 Committee's last meeting nine months ago.

1 As mentioned earlier, PJM expanded to
2 include PJM West in April of this year. Now,
3 in response to the Federal Energy Regulatory
4 Commission's or FERC's directives, four more
5 utilities have announced their intention to
6 join PJM West.

7 They are American Electric Power,
8 Commonwealth Edison in Chicago, Dayton Power
9 & Light, and Illinois Power. In addition,
10 Dominion Virginia Power has announced its
11 intention to form PJM South.

12 If these plans come to pass, PJM
13 generating capacity will expand to more than
14 158,000 megawatts serving a peak load of
15 approximately 132,000 megawatts.

16 Other things being equal, more supply
17 competing to serve load in an expanded
18 regional market should yield lower wholesale
19 prices than the market would otherwise see.

20 Another significant development is the
21 announcement by the Midwest Independent
22 System Operator, PJM, and the Southwest Power
23 Pool of their intent to form a joint and
24 common wholesale market.

25 According to a cost-benefit study

1 recently conducted by Energy Security
2 Analysis, the development of a single Midwest
3 ISO, PJM, Southwest Power Pool market will
4 save consumers from several billions of
5 dollars to several tens of billions of
6 dollars over the next ten years

7 Not all of the developments affecting
8 our industry have been positive. In the
9 aftermath of the Enron collapse and with
10 disappointing earnings reports due to lower
11 wholesale prices and a sluggish economy, the
12 energy merchant sector has lost nearly
13 \$225 billion in market capitalization since
14 May of last year.

15 U.S. power producers as a group,
16 struggling to shore up balance sheets amid
17 increased investor scrutiny, have scaled back
18 plans for new generating plants, a move
19 industry analysts warn could tighten electric
20 supplies later in the decade.

21 Also, declining credit ratings in the
22 merchant energy sector could affect some
23 developers' ability to complete some plants
24 on schedule.

25 Nevertheless, generating capacity

1 appears to be adequate in our state and
2 region for at least the next three or four
3 years. After that, if merchant developers do
4 not or cannot commit to more capacity, things
5 could get tighter.

6 So we look forward to a brighter future
7 for our industry. Part of that will depend
8 on the pace of the economic recovery, but
9 more than anything else, what our industry
10 needs to adequately perform its role in our
11 economy is predictability and consistency in
12 the market rules that we must abide by. A
13 capital intensive industry such as ours
14 simply abhors uncertainty.

15 Enter the FERC standard market design.
16 On July 31st, the FERC issued its eagerly
17 awaited notice of proposed rule making on
18 standard market design or SMD.

19 This document, more than 600 pages in
20 length, is expected to help alleviate the
21 uncertainty that has accompanied our nation's
22 development of workable competitive wholesale
23 markets since passage of the Energy Policy
24 Act in 1992.

25 There is particular reason for optimism

1 in PJM territory in that many of the SMD's
2 recommendations are based upon practices and
3 market rules that are already in place in
4 PJM.

5 I'm certain that my industry does not
6 support every provision in the draft SMD rule
7 making. However, I can tell you that I
8 expect our industry to take issue with
9 comparatively few of the SMD's
10 recommendations.

11 On balance, we believe it represents a
12 significant step in the right direction, and
13 we are hopeful that when adopted in its final
14 form, the SMD will provide for the rapid
15 development of larger and better functioning
16 wholesale generation and transmission markets
17 similar to what we have experienced in PJM
18 for the past few years.

19 And this would redound to the benefit of
20 all market players -- generation providers,
21 transmission owners, distribution companies,
22 and consumers alike.

23 I thank you very much for your kind
24 attention. I would be happy to answer any
25 questions you may have.

1 CHAIRMAN GANNON: Questions,
2 Representative?

3 REPRESENTATIVE MANDERINO: Thank you.

4 I kind of remember only half of how this
5 works, so it's a bit of a basic question, but
6 my recollection of the PJM is it's kind of
7 like this grid coordinator, and not referee,
8 but I can't quite -- I don't have a deep
9 enough understanding of what the PJM does to
10 understand why the expansion of their network
11 is going to lead to a price reduction.

12 MR. BIDEN: Primarily based on the fact
13 that you're bringing in more generation to
14 compete. Now, admittedly, the load is
15 growing too, but if you noticed -- first of
16 all, you should understand that FERC
17 originally wanted PJM to merge with the New
18 York ISO and New England Power Pool.

19 REPRESENTATIVE MANDERINO: PJM was the
20 one that kind of stopped half way across the
21 state, that all of the central and eastern
22 part of the state was in with Delaware,
23 Virginia, et cetera?

24 MR. BIDEN: Right. It's New Jersey,
25 Delaware, most of Maryland, most of

1 Pennsylvania, parts of Virginia, and the
2 District of Columbia. That was the original
3 pool, PJM power pool.

4 REPRESENTATIVE MANDERINO: And are all
5 of the competitors of these power pools,
6 whether it's this one or any of them, is
7 everyone who is selling electric energy in
8 that geographic area part of that particular
9 power pool?

10 MR. BIDEN: Yes, they are, but they can
11 also sell outside the power pool if they have
12 excess capacity to sell.

13 We regularly, from PJM, export power to
14 New York, and we also regularly import power
15 from the Midwest because the generation fleet
16 in the Midwest tends to be slightly lower in
17 cost than it is in PJM.

18 You have a lot of very large coal fire
19 power plants. They are mine mouth
20 operations, meaning they're right there where
21 the coal comes out of the ground. They don't
22 have to incur the transportation costs. Coal
23 is a considerably cheaper fuel than most of
24 the fuels burned in the Northeast.

25 So the predominant flow of power is west

1 to east. So states like Pennsylvania that
2 are now physically located in PJM load could
3 probably stand to benefit more from this
4 expansion west.

5 And when I say load, I mean consumers
6 probably stand to benefit more from this with
7 us merging to the west and south rather than
8 to the northeast. Generally --

9 REPRESENTATIVE MANDERINO: Because now
10 there will be energy generators in this grid
11 that are generating lower cost energy and
12 able to sell this far east; is that it? Am I
13 understanding?

14 MR. BIDEN: Correct. And the more
15 megawatts you have chasing the load, the
16 lower prices will be other things being
17 equal.

18 Of course, there are a lot of other
19 variables going on at the same time, fuel
20 prices could be changing, but yes, I think
21 the larger the market, the larger the single
22 market too, you have fewer seams in between
23 them, so there are fewer transmission markups
24 for generators in the Midwest to get their
25 power to the eastern market.

1 REPRESENTATIVE MANDERINO: And there is
2 nothing in these --

3 MR. BIDEN: Did I say generation
4 markups
5 or transmission markups?

6 REPRESENTATIVE MANDERINO: I don't
7 remember.

8 MR. BIDEN: I meant transmission
9 markups.

10 REPRESENTATIVE MANDERINO: Okay. See,
11 my head wasn't even there yet. I'm still at
12 the point between more competition versus
13 limiting the market and just trying to
14 understand if there is any downside to the
15 expansion of these grid networks that will
16 reduce competition, and it's just my
17 knowledge is only one level deep, so I'm
18 trying to understand it in layman's terms.

19 MR. BIDEN: I don't see a downside to
20 that extent. Where I do see a potential
21 downside is that investment in transmission
22 infrastructure will not keep pace with the
23 increase in wholesale energy market
24 transactions.

25 So the lines will or could become

1 increasingly overloaded, and in the presence
2 of transmission constraints, which we call
3 congestion, a lot of times, the system
4 operator has to take plants out of their
5 merit order.

6 Normally, what we do is plants bid into
7 the wholesale market at a certain price. If
8 the price doesn't get that high, then your
9 unit doesn't get picked.

10 But if you have transmission constraints
11 running west to east, and those lines are
12 overloaded, now the system operator must pay
13 generators on the other side of that
14 transmission constraint to boost their power
15 output, and they might be higher in cost and
16 wouldn't normally be taken in their economic
17 order, so you have to take them out of
18 economic order for reliability purposes.

19 That's the danger that I see, but with
20 the standard market design, I see at least
21 the hope to have the certainty that
22 transmission developers will need to make
23 those kinds of investments to address those
24 transmission constraints.

25 REPRESENTATIVE MANDERINO: And if I

1 could ask one more question. I mean, I
2 remember from our discussion on deregulation
3 the difference between the generation
4 companies and the transmission companies.

5 Are all of the lines that form the power
6 grids owned by individual utilities all over
7 the country, and are they also part of this
8 grid network, or is it just the generators
9 that are in this?

10 MR. BIDEN: No, the transmission --

11 REPRESENTATIVE MANDERINO: I don't even
12 know if I'm asking the questions right. I'm
13 sorry.

14 MR. BIDEN: The transmission owners are
15 all part of it, they are one of the stake
16 holders, the distribution companies, and
17 sometimes they are one and the same.

18 PJM controls the wires. They make the
19 wholesale market rules that determine how
20 those lines are going --

21 REPRESENTATIVE MANDERINO: What goes
22 over which -- right.

23 REPRESENTATIVE MANDERINO: Right. But
24 the individual utilities still actually own
25 the wires, and they are entitled to a return

1 on their investment in these wires.

2 And another thing that we're seeing now
3 is something new, we're seeing independent
4 transmission companies who want to try to fix
5 these what we call seams issues between the
6 different wholesale markets.

7 There's an organization, I think they're
8 called TransEnergy Now, that is trying to
9 build power lines between New York and PJM
10 because there is such a tremendous shortage
11 in New York City.

12 REPRESENTATIVE MANDERINO: Yes. See,
13 that's what I was trying to get to. As the
14 grid grows, as the capacity grows, and you
15 started talking about these places where
16 there can get congestion, I didn't understand
17 who in the system would decide and would have
18 the economic incentive to say we need to
19 build more lines to relieve the congestion.
20 I didn't understand how that happened in this
21 whole marketplace.

22 MR. BIDEN: Eventually, that will be
23 the role of what we have called regional
24 transmission organizations. It will be up to
25 them to decide where the optimal investments

1 in transmission should occur.

2 Of course, once you decide that, you
3 still have a long road to hoe before you
4 actually get it built, because building
5 transmission lines -- I mean, it's hard
6 enough to get a power plant cited. Building
7 the transmission lines is considerably more
8 difficult than getting a power plant cited.

9 And this was an issue that I think we
10 addressed at the last hearing. Generation
11 is, up to an extent, a substitute for
12 transmission.

13 You can always build another power plant
14 at the other end of that transmission
15 constraint, and then that will relieve the
16 constraint and load will be served, but up to
17 a point.

18 You need to make those -- that becomes
19 extremely uneconomical when you keep taking
20 these power plants out of economic order and
21 you're paying more for power than you need
22 to.

23 REPRESENTATIVE MANDERINO: Okay. So in
24 this whole deregulation, is this deregulation
25 competition thing working and resulting in

1 lower energy prices to the consumer?

2 That's a very important part of the
3 equation because if something isn't working
4 there, and there is either not an economic
5 incentive to build the additional lines, I
6 don't know if I'm saying this right, or if
7 the economic incentive is to build a more
8 expensive generation plant, then I don't know
9 that we created that problem because of what
10 we're doing with deregulation.

11 I'm just trying to understand if that's
12 some by-product that we've created that we
13 think we're doing this wonderful thing and
14 we're going to solve it, but we're not
15 because we've created these new problems that
16 didn't exist before.

17 MR. BIDEN: Well, you've touched on
18 certainly an important and growing issue.
19 There is the question that investment in
20 transmission has lagged behind investment in
21 generation, and that has created these
22 transmission bottlenecks, and they do result
23 in inefficiencies.

24 But until we get through -- at least as
25 far as I see this, until we get through this

1 standard market design process and everyone
2 has some degree of assurance as to what the
3 market rules are that we're going to play by,
4 who is going to have control over those
5 wires, what's going to be a fair rate of
6 return for our investors in those wires, I
7 think it's going to continue to lag, but we
8 at least have something that starts us off on
9 that path.

10 And like I said, we're already seeing
11 independent transmission providers come out
12 of the woodwork in response to just a hope of
13 having that.

14 REPRESENTATIVE MANDERINO: Just one
15 last question. Why is it easier to cite a
16 generation plant than it is to put in new
17 transmission lines? Is it a public problem,
18 a regulatory problem, an economic problem?

19 MR. BIDEN: You're basically taking the
20 Nimby (phonetic) problem and multiplying it
21 by several hundred times because you have so
22 many landowners who don't want those power
23 lines across their properties.

24 And even though there is power of
25 eminent domain for these companies, it's

1 still an extremely painful process, not just
2 for the developers, but any regulatory
3 entities that have to preside over that.

4 REPRESENTATIVE MANDERINO: Thank you.
5 Thank you, Mr. Chairman.

6 CHAIRMAN GANNON: Any questions?

7 REPRESENTATIVE MAITLAND: Kathy really
8 asked my question, so just to comment, I'm
9 Steve Maitland from Gettysburg, and Reliant
10 is building a generation plant, gas fired, in
11 Gettysburg because they have the existing
12 transmission lines already there.

13 They're within a mile of a natural gas
14 main, and they told me that the purpose of
15 their plant is to meet peak demand, so it's
16 not a plant that's going to operate
17 continuously.

18 So it's just that after having been
19 briefed by Reliant on these issues and the
20 PJM, your presentation really illustrates
21 exactly what role that plant will serve.

22 MR. BIDEN: That's a combined cycle
23 natural gas plant, extremely efficient, and
24 even if gas prices jump up, which let's face
25 it, most of these power plants that are

1 coming on line are going to burn natural gas,
2 it looks at least to me from where I sit,
3 that demand for natural gas is going to
4 expand at least in the near term faster than
5 gas supply can.

6 But that plant, because it is so --
7 these new combined cycle plants, because they
8 are so efficient, they can still operate
9 economically during at least a portion of the
10 hours even if gas prices get fairly high.

11 But that is the, I hesitate to call it
12 the fuel of choice, natural gas, it's really
13 the fuel of regulatory necessity. It's
14 almost impossible to build a new coal fired
15 power plant as much as we would love to do
16 it.

17 REPRESENTATIVE MAITLAND: Thank you.

18 CHAIRMAN GANNON: The type of plant that
19 was just mentioned that Reliant is building,
20 is that one of the plants that are very
21 expensive when they actually go on line,
22 their costs are high in terms of the energy
23 costs?

24 MR. BIDEN: It depends on their fuel
25 costs. Most fossil fuel burning plants,

1 roughly 80 percent of their operating costs
2 are going to be determined by the cost of
3 their fuel.

4 So the cost of the output of that plant
5 will be largely determined -- at least what
6 they bid into the market will be determined
7 by the cost of the natural gas fuel that they
8 burn.

9 CHAIRMAN GANNON: It seems to me from
10 what we've got now at these hearings -- we
11 were in Philadelphia and met with
12 Philadelphia Gas Works.

13 One of the issues that they had was that
14 they had a tremendous amount of gas that they
15 hadn't sold of two liquid fuel storage tanks
16 down there because of the weather, because of
17 the warm winter, they had a lot of that left
18 over.

19 But it seems to me, if we get a cold
20 winter, then of course that gas will be used
21 very rapidly, and then they will be demanding
22 more.

23 I think they have some reserve storage
24 facilities, underground storage facilities,
25 someplace out in, it's either Western

1 Pennsylvania or the western part of the
2 country, that they can draw on.

3 But my thought is with these new plants
4 coming on line, you're saying that the fuel
5 of choice, because of regulatory necessity,
6 that the consumer of electricity is really
7 going to be at the mercy of the cost of
8 natural gas, and that's going to be driven by
9 the weather predominantly in terms of -- for
10 example, I'm just thinking of Philadelphia
11 Gas Works specifically, but I'm sure there's
12 other facilities that the weather is going to
13 determine that.

14 I guess I'm making more of a comment
15 than a question, but I'm concerned. You
16 know, one of the reasons that we're here is
17 because of the cost of energy and what was
18 driving that, and we were asked to look into
19 it.

20 And we've got a lot of good information,
21 and we've talked a lot today about the
22 transmission issue and the bottlenecks, but I
23 feel that perhaps the cost of coal is pretty
24 stable and the cost of natural gas is pretty
25 volatile; is that a fair --

1 MR. BIDEN: Absolutely.

2 CHAIRMAN GANNON: And that that's going
3 to really be driving the cost of energy since
4 now all of these plants are predominantly
5 natural gas.

6 MR. BIDEN: What we call the market
7 clearing price in PJM will certainly be set
8 by natural gas fired units over an increasing
9 number of hours compared to what we're used
10 to in the past.

11 We are fortunate in that a large
12 percentage of our generation mix still comes
13 from coal and nuclear. I believe we get,
14 according to the Energy Information
15 Administration, approximately 58 percent of
16 our total electric output in Pennsylvania
17 still comes from coal fired facilities.

18 A little less than 35 percent comes from
19 nuclear. The rest comes from natural gas,
20 oil, hydro, and other renewables, but gas is
21 the fastest growing one.

22 CHAIRMAN GANNON: That is the next point
23 I was going to ask is that with all of the
24 newer generating plants that are being built
25 and coming on line, they're predominantly or

1 they're all natural gas?

2 MR. BIDEN: Reliant Energy is building
3 one coal -- they are actually retowering a
4 plant. And I think that's 520 megawatts of
5 existing coal fire power plant that they are
6 tearing down and retowering to burn waste
7 coal.

8 Allegheny Energy Supply is building one
9 or two plants to burn coal methane gas. The
10 rest of those 15,000 megawatts that I
11 mentioned to you will all burn natural gas,
12 the same natural gas that the residential
13 consumer is burning in their homes.

14 So what you were getting at, if we have
15 some -- we burn gas in the summer too to make
16 electrons. A hot summer followed by a cold
17 winter, affecting a substantial portion of
18 the United States, could certainly send gas
19 prices up.

20 And that's a concern too, so much so
21 that we have four presentations at our
22 conference next month in Hershey on that very
23 subject. It's of concern to us too because
24 we are -- this new dependence on natural gas
25 is something new for Pennsylvania.

1 We always took the coal out of the
2 ground, and we built the nuclear power
3 plants, and the fuel supplies were relatively
4 stable. So we need to understand this too.

5 People in the gas industry are fond of
6 telling us that you people in the generation
7 business just don't get the gas business, you
8 expect the fuel to just show up when you
9 build the power plant. And I suppose there
10 is more than a kernel of truth to that. We
11 do have something to learn about the gas
12 industry.

13 And I invite any members from the
14 committee or your staff to come to that
15 conference if you're interested in that
16 subject, but it very much interests us too.

17 And we do have some concerns not just
18 about the supply of gas, but the
19 deliverability of it. The investment in gas
20 infrastructure is also lagging in market
21 demands.

22 CHAIRMAN GANNON: I think at one of our
23 hearings we did talk about the transmission
24 pipelines, predominantly from Texas, that
25 come up through here. I guess they go up to

1 New England, and I guess we tap in here.

2 But that price can change from the time
3 it leaves its source until the time that
4 somebody says we want to draw the gas from
5 that pipeline.

6 It concerns me and it seems to me that
7 our electric consumers are really not so much
8 at the mercy of how much the demand for
9 electricity is, but the price of the fuel
10 that's going to power that to create that
11 electricity, and then it's even compounded by
12 the volatility of that price.

13 You could have no additional load or
14 demand, and yet the price can fluctuate
15 wildly because of factors that don't come
16 into play in how much electricity is used but
17 what the demand for natural gas is, not only
18 in Pennsylvania but in other areas of the
19 country, because we're competing I guess for
20 that gas with other states when we try to
21 purchase it.

22 MR. BIDEN: That's very true. And we
23 are certainly subject to that price risk, but
24 there are various things that we can do to
25 hedge that risk too. One of which is invest

1 in storage.

2 CHAIRMAN GANNON: Is Enron still
3 active,

4 are they still involved, are they involved in
5 Pennsylvania in trading energy at all?

6 I know they're in bankruptcy but I don't
7 know --

8 MR. BIDEN: I don't believe they're
9 involved in trading. They sold their trading
10 operations to a Swiss firm. I forget the
11 full name. One of them is Warburg. Most of
12 their trading operation has been sold off.

13 They do still own -- I know they own a
14 utility in Oregon, Portland Gas and Electric
15 I think it's called. I know they still own
16 some -- they had some pipeline interests, but
17 their trading activity has been dramatically
18 curtailed if they trade at all because of the
19 drop in their credit rating. No one trusts
20 them to trade with them.

21 CHAIRMAN GANNON: They're not a factor
22 at all in Pennsylvania?

23 MR. BIDEN: No.

24 CHAIRMAN GANNON: You had mentioned that
25 sometimes what you do to hedge against the

1 spot market fluctuation is get into a
2 long-term contract, and you kind of backed
3 off a little and said that the spot market is
4 so low right now that some companies are
5 opting to go to the spot market rather than a
6 long-term contract.

7 How long is a long-term contract, and
8 what is the usual length of that?

9 MR. BIDEN: Oh, it can go anywhere from
10 six months to a number of years.

11 CHAIRMAN GANNON: So it's flexible?

12 MR. BIDEN: Right. Some utilities, such
13 as Duquesne Light and General Public
14 Utilities who chose to divest themselves of
15 their generating assets, had that option to
16 go into long-term contracts, and I think they
17 did to varying degrees.

18 CHAIRMAN GANNON: It seems from what you
19 say, and I also have a report here from the
20 Public Utility Commission, that everybody is
21 pretty much satisfied with Pennsylvania's
22 capacity situation at least five to four
23 years out, but then we're looking at the
24 potential of some problems, but just
25 elaborate on that a little bit, where we're

1 headed on that issue.

2 MR. BIDEN: Well, the drop in market
3 capitalization was a serious problem for us
4 long term, and until the economy turns around
5 and until we convince our investors that we
6 are a good investment -- right now all
7 they're seeing is the risks.

8 They saw what happened to Enron. They
9 knew that Wall Street viewed Enron as the
10 merchant energy leader. They told all the
11 rest of us why aren't you more like Enron.

12 And then when Enron collapsed amid all
13 of these off balance sheets transactions --
14 and keep in mind that their chief financial
15 officer was CFO of the year in 1999.

16 All the other CFOs in the energy
17 merchant industry were told to emulate them
18 and the things that they were doing. Now,
19 fortunately, they only emulated them in one
20 or two places, and you saw some of that in
21 these so-called round trip trades.

22 I think you had industries that were
23 just newly spinning off, that they were
24 becoming new merchant players, and I think
25 they were actually -- they were very anxious

1 to become the darlings of Wall Street. And
2 in fact, they were for a while.

3 And I think some companies made some
4 mistakes. They did some things to inflate
5 the revenues. I don't think they violated
6 any laws at the time. Whether what they did
7 was ethical, I think that still remains to be
8 seen.

9 But the fact of matter is when the
10 leader of the industry collapsed like that,
11 and there were all of these allegations out
12 there, people put the power generation
13 industry under a real microscope, and they
14 started looking for things wrong. And when
15 you're looking for something wrong, you're
16 going to find it somewhere along the line.

17 And I think that's one of the reasons,
18 that plus depressed wholesale energy prices,
19 what's happening in California with all the
20 talk of refunds and so forth, the investor
21 doesn't want to hear that, and they voted
22 with their dollars.

23 CHAIRMAN GANNON: It seems for me from
24 what I'm hearing in the testimony, we've had
25 two prior, and that is that everything seems

1 to be going pretty good right now, but there
2 are real concerns about long term, where
3 we're going to be three to five years from
4 now.

5 And my question to you, and you don't
6 have to answer it right now, but I would like
7 to get some input from the folks that you
8 represent as to what, if anything, we can be
9 doing today that will alleviate some of those
10 long-term concerns or modify them to some
11 extent.

12 We have two issues. We have the
13 capitalization which apparently dried up to
14 the point now that people are saying this is
15 going to be a long-term problem.

16 The second thing is capacity, where
17 we're going to be, which is really tied into
18 capitalization, if we don't get the
19 capitalization.

20 I mean, we're going to hit a brick wall
21 in about four years as far as our capacity is
22 concerned assuming things keep in the same
23 progression they have, and there is no reason
24 to believe that they won't, and that's kind
25 of what I'm sensing from what I'm hearing.

1 MR. BIDEN: I think there is a concern
2 long term, but I really think that there's
3 going to a shakedown in this industry. I
4 wouldn't be surprised to see perhaps some
5 additional firms go bankrupt or be bought out
6 by a stronger competitor.

7 But I think someone, if the need is
8 clearly there and if forward energy prices
9 can justify it, someone from somewhere, even
10 if they perhaps might be from overseas, will
11 come forward with that capital and make that
12 investment in the immediate generating
13 capacity.

14 And to the extent that the standard
15 market design rules are successful, that can
16 only help the process. So we do look forward
17 to brighter days, but I think it's going to
18 take a couple of years to turn around.

19 CHAIRMAN GANNON: I would rather be
20 looking at now what we can do to the future
21 than being confronted with a crisis a couple
22 of years from now where we're looking at the
23 taxpayers to bail out some energy producing
24 company so that they can continue to provide
25 energy which people are not getting and are

1 paying an exorbitant price for.

2 I'm sorry. Just speculating here, but I
3 don't see a real bright future down the road
4 on this issue.

5 MR. BIDEN: Well, I personally think
6 that someone -- that after the experience of
7 California, I can't believe that the Federal
8 Energy Regulatory Commission would not
9 develop in its standard market design the
10 proper incentives to send those price signals
11 to generators that more capacity is needed.

12 And keep in mind, we have that in place
13 until we get to that point. We're still not
14 sure if PJM's capacity market will be
15 consistent with FERC's standard market
16 design. They certainly differ in some key
17 areas right now.

18 We think what PJM has as a group
19 actually right now is superior to what
20 they've proposed on paper in terms of
21 assuring adequate investment in future
22 capacity.

23 And we're still, at least at this point,
24 optimistic that we can make some of the
25 tweaks to what they have proposed to bring

1 that about.

2 But if the market incentives are there,
3 the capital is going to be found somewhere.
4 It's just that some of the market players
5 that are out there right now are struggling,
6 and they may not be around to do it. It
7 might be someone else.

8 CHAIRMAN GANNON: Thank you. Any other
9 questions from the board?

10 Thank you very much. That was very,
11 very helpful, Mr. Biden.

12 MR. BIDEN: Thank you.

13 CHAIRMAN GANNON: I appreciate your
14 appearing for the committee and providing us
15 with testimony.

16 Our next witness is Paul J. Simon, III,
17 International Representative for the
18 International Brotherhood of Electrical
19 Workers, third district office; and Brian
20 McCarthy, National Deregulation Coordinator
21 for the Utility Workers of America.

22 Gentlemen?

23 MR. SIMON: Thank you.

24 CHAIRMAN GANNON: Thank you very much
25 for appearing before the committee today

1 concerning the issue of energy prices
2 available in Pennsylvania, and you may
3 proceed when you are ready.

4 MR. SIMON: If it's all the same to
5 you, I'm not going to read it word for word.

6 CHAIRMAN GANNON: Okay. That's good.

7 MR. SIMON: Honestly, I think getting
8 to the conversation part is probably the
9 better part of valor here.

10 Brian is going to follow me because he's
11 from Massachusetts, and prior testimony that
12 we've given, specifically, the House and
13 Senate members asked well, what about these
14 other states that you keep referencing, where
15 are they at, what are they doing, how are
16 they coping with the issues, so Brian
17 volunteered to come down from Massachusetts
18 and share with us what they're doing.

19 So after I get done with Pennsylvania,
20 he can give you a little more insight so
21 you're not just looking in a vacuum at
22 Pennsylvania.

23 And I would like to thank you, Chairman
24 Gannon, for having me here and your committee
25 and the staff.

1 I just wanted to give you a little bit
2 about myself. I've been in the utility
3 industry for 30 years. I was a full-time
4 business manager at Conectiv, the old
5 Delmarva Power, for ten years. I have been a
6 substation electrician and I've been an
7 international representative for about five
8 years.

9 As you're looking at the prices of
10 energy, I don't think you can look at a
11 vacuum just with the Commonwealth. You just
12 had a long conversation with Doug about what
13 happened to gas and what can we expect in the
14 future. I think that's a guess on anybody's
15 part.

16 And I have presented some stuff that I'm
17 not going to read. I'll tell you right here
18 and now, the issue with gas, the problem that
19 happened at that point in time was supply and
20 demand. The cost of gas was down and there
21 was no incentive for anybody to go out and
22 explore for more gas.

23 So at that time, the companies weren't
24 spending money to go and make sure that our
25 reserves were sufficient in case we ran into

1 an extreme situation or a cold winter. What
2 happened was we ran into extreme situations
3 in a cold winter, and the reserves weren't
4 there, and the price spiked up.

5 The problem being because there were the
6 rate caps. That is completely a deregulated
7 industry when it comes to cost because you
8 can pass that straight through to the
9 transmission costs straight through to the
10 customer.

11 The only people that were insulated, and
12 thank God I was one of them, were people that
13 signed a long-term contract with your gas
14 provider that said -- they offered you up to
15 four years when the prices were down, and
16 believe me, I took all four, and I'm thanking
17 my lucky stars I did at that time.

18 As Doug had said, as you start looking
19 at new electric generation however, you're
20 talking about huge consumers of natural gas.
21 My son works back at a power plant, Connecticut
22 back in Delaware, that is 1,150 megawatts.

23 They run that plant -- it's actually
24 two, three CT units, a combustion turbine. A
25 combustion turbine is just like a jet engine

1 and where you get the value from a combustion
2 turbine is when you put a heat recovery steam
3 generator on the end which, in essence, burns
4 your exhaust.

5 So now you take and drop the cost of the
6 load, the cost of the fuel to come in because
7 that is the number one cost. And now you
8 have an opportunity to be able to generate
9 1,150 megawatts of power with roughly 35
10 people. And you're talking about to do a
11 coal fire power plant or a nuclear power
12 plant, you're talking about hundreds of
13 people.

14 So the incentive is not just from a
15 natural gas standpoint, the incentive is
16 about the labor intensiveness, because
17 there's two costs that utilities or
18 generators bear, one is the cost of fuel, and
19 the other is the cost of labor.

20 And if you can't do anything with the
21 cost of fuel, our concern is you're going to
22 do something with the cost of labor, and I
23 think it's shown that.

24 As you look through here, I think you've
25 got to look at California. What concerned me

1 in 2000 and 2001 when we appeared before the
2 other committees was that everybody kept
3 saying -- it was almost like the Wizard of Oz
4 where they said pay no attention to that man
5 behind the curtain, we're over here, look at
6 us.

7 Well, the issue is, yes, did they do a
8 lot of things wrong, yeah, but inevitably,
9 it's still supply and demand. It's still how
10 much demand did you have and how much supply
11 do you have.

12 And once the rate caps came off,
13 especially in San Diego, they found out that
14 we didn't have enough supply, our demand was
15 too high. And all of a sudden, prices
16 started to spike through the roof where they
17 actually tripled their prices of electric.

18 Now, New York City, if you go from coast
19 to coast, New York City was next because they
20 now had removed -- they paid off their
21 stranded assets, and they now are a
22 deregulated market. And when they had the
23 summer of 2000 when they dealt with that,
24 through '99 and 2000, their prices of Con Ed
25 went up 40 percent.

1 And that's my concern as you sit here in
2 the Commonwealth, but I think you were right
3 on the money, Chairman, when you said well,
4 what can we expect three to five years from
5 now, because the first customers that are
6 supposed to come off of this system that will
7 be exposed to those kind of rates will be
8 Duquesne Light right here in Pittsburgh and
9 that's 2004.

10 And the PUC argued long and hard to make
11 sure that there was an extension put on what
12 -- they would already be out by now. It
13 would have been June 2002, but they argued
14 long and hard to make sure there was going to
15 be an extension to that to make sure that the
16 customers were protected.

17 The problem that we've got is, if you
18 look in my report, when you talk about --

19 REPRESENTATIVE MANDERINO: I'm sorry.
20 Come out from underneath what, the rate caps
21 that we put into the dereg?

22 MR. SIMON: Yes, once you --

23 REPRESENTATIVE MANDERINO: I just wanted
24 to make sure that I was following you.

25 MR. SIMON: Once you go into an open

1 market, because I'm trying -- trust me, I'm
2 in the industry, and I'm like you, I'm trying
3 to figure out every week what's going on.
4 It's not something that anybody has a total
5 grasp on, because it just keeps shifting and
6 moving.

7 If you look at the -- Doug had actually
8 mentioned it, but if you look at the price of
9 what the stocks have done, and that was with
10 Reliant Resources, with Allegheny Energy, and
11 with DQE, that we've picked out here in
12 Western PA if you notice Reliant Resources on
13 the 31st of August 2001 was \$19.68 back on
14 page 6 I think it is.

15 Reliant Resources actually had a stock
16 price of \$19.68 on August the 31st, 2001. On
17 August the 28th of 2002, it was selling for
18 \$5.41. And you can see what happened with
19 Allegheny. They went from 44 08 to 21 92.
20 And DQE, that went from 21 20 to 14 98. It's
21 not brain surgery to figure out.

22 And I think Doug really capped it well
23 for you that Enron has had a spillover effect
24 on the entire energy industry, but part of
25 that problem is because when people were

1 buying generators, they were buying them for
2 more than what the actual market value of
3 generation was.

4 The reason being, there was a
5 competitive market to get in there and
6 capture the market like what happened
7 initially with what was Sithe Energy, which
8 became Orion Power, which is now Reliant,
9 which is now for sale by the way, so it's
10 going to be somebody else down the road.

11 They have 21 power plants in the state
12 of Pennsylvania. And to make sure that you
13 got it, you paid more than what the market
14 bore for those power plants.

15 So now when Enron had it's problems with
16 its creative financing and what went down,
17 they went back and looked at the power
18 producers to say how much debt did you
19 encumber and how are you going to be able to
20 pay for that, how will your books show that
21 when you start to trade on the open market.

22 So many power producers like Reliant, as
23 a for instance, they've actually -- Moody's
24 has actually downgraded them to almost junk
25 bond status. I mean, it really hit them

1 hard.

2 Unfortunately, it leaves our members and
3 your constituents that work there certainly
4 and those investors, of which I am one, that
5 put money in those utilities figuring you're
6 going to get a good return on your
7 investment, and while you're never going to
8 make a lot of money, at least you're getting
9 dividends, it's put those people at a
10 disadvantage.

11 Our concern is as we go forward, as the
12 employees -- I already said, there's two
13 basic cost factors of utilities or power
14 generators, first was fuel, and second was
15 labor. And you can't do much about fuel if
16 you can get out and buy it.

17 I disagree with Doug on one point, that
18 coal prices remain stable. That's not the
19 case. Again, it's supply and demand, and
20 there was a point last winter where because
21 of the freeze and coal wasn't available,
22 where actually power producers out here, even
23 in Western, PA, were scrambling to get coal,
24 and the net result was the price of coal
25 started to go up.

1 So as long as you've got that supply and
2 demand, Chairman, and as long as you have
3 people right now that are protected by rate
4 caps, we're okay, because nothing is going to
5 happen to those individuals.

6 Now what happens though is the producer
7 has to eat the costs. So our concern is the
8 only way that they're going to cut costs and
9 the only way they've cut costs up to now is
10 to cut the work force.

11 And now, by putting off your maintenance
12 schedules, by pushing back your PMs, by
13 changing the way you do things, by
14 eliminating your work force, by dropping down
15 to a skillable staff to be able to operate a
16 plant and hopefully be able to contract it
17 out or operate your T and D system and
18 contract out the rest, it's left us in a
19 terrible situation as labor to be able to
20 still be out there and go out to that
21 customer at 2:00 in the morning and say by
22 the way, I'm sorry you've been out for six or
23 eight hours. They don't want to hear your
24 explanations.

25 Our concern is that that's where it's

1 heading and that's why we feel very strongly
2 there has to be -- the PUC has looked into
3 this, and as a matter of fact, there was a --
4 let me get back to my prepared statement.

5 The PUC -- matter of fact, Reliant,
6 since they've sold Amergen, announced
7 yesterday that they now are potentially in
8 the market to sell their nuclear power
9 station, TMI, and that they wanted to move
10 that back into the market because British
11 Energies, which they're actually a partner
12 with, is having serious financial problems.

13 Exelon is fairly healthy, but Amergen is
14 a combined company with British Energy, which
15 is another part of what we had said before,
16 we are concerned that the money that these
17 folks took in for their stranded costs, they
18 not only moved outside of Pennsylvania, they
19 moved outside of the country.

20 So the dollars that were taken in
21 weren't really kept in to be able to provide
22 service and protect the consumers who
23 inevitably will, sooner or later, be subject
24 to higher costs once the rate caps come off.

25 Now, will there be good times and bad

1 times? Yeah, because you will have, in the
2 spring and the fall when you don't have
3 maximum load and capacity, there will be
4 plenty of -- should be plenty of generation
5 available, and that shouldn't be a problem:
6 but in the mid winter and in the mid summer,
7 which has traditionally been the high
8 consumption either for gas or electric,
9 whatever it might be, you now are going to
10 stand the same opportunity as those folks in
11 San Diego and New York City, because it's
12 going to be on supply and demand, again,
13 unless you've bought some kind of a contract
14 with a company to say that this is going to
15 be my capped rate, this is all I'm going to
16 be charged.

17 So you can read in here what we've asked
18 for the benchmarks. I actually put in here
19 -- there was a chart that we pulled together
20 about the hourly costs of July for 2002.
21 It's the last page. That's for Allegheny
22 Energy.

23 And you'll see that even though it was
24 for a short period of time, it actually was
25 on July 29th at 4:00 p.m., the actual hourly

1 rate cost, the real-time cost was \$499.03 per
2 kilowatt. Now that's -- that is extremely
3 high.

4 You can see the average rate was \$26.35,
5 but you start looking at when the people have
6 to be able to use energy so the other thing
7 that we had in here was -- now some people
8 are saying fine, then let's incent people to
9 use it off hours, let's make sure that we
10 reward people who use their washing machines
11 between 4:00 and 12:00 at night or midnight
12 or 8:00 in the morning, but our concern is
13 what do you do with the folks that work the
14 second and third shift that are only home
15 during the daytime, and what do you do with
16 the elderly that have to use air-conditioning
17 during the daylight hours.

18 I mean, our concern as we go forward is
19 to make sure that there is a set of standards
20 that we have people, enough people, out there
21 to do the job.

22 Now, we're not saying to do the job no
23 matter what, we're not saying that if you're
24 going to have a plant shutdown, you need
25 enough people to go out and represent the

1 plant all the time.

2 We're saying just give us enough people,
3 at least from a legislative standpoint, to
4 take a look at establishing standards like
5 they've done in Massachusetts, like they've
6 done in Illinois, like they've done in
7 Wisconsin, where we can go out and do the
8 work and make sure that your constituents,
9 our members and our customers, can get safe,
10 reliable power at a decent price.

11 I mean, I don't think you want to
12 totally base your decisions on price. It's a
13 great idea if you can get a fairly cheap car,
14 but it's a terrible idea if it's in the shop
15 two days a week. It's not really doing you
16 much good.

17 And the same would be the case with any
18 kind of a power company that if I only turn
19 my lights on ten times, and two out of those
20 ten times, they didn't go on, I don't think
21 we're doing a very good job.

22 So that was my concern, and that
23 summarizes my presentation. And if it suits
24 you, if it fits your needs, Chairman Gannon,
25 I would like to introduce Brian McCarthy so

1 he can share a little bit with us from
2 Massachusetts.

3 CHAIRMAN GANNON: Okay. Great. Thank
4 you. Just a comment though, and you touched
5 on it a little bit in your testimony, and
6 that is that two things come into play here,
7 sometimes one more so than the other, and
8 that is service, cost and service.

9 When we were asked to look at the
10 Philadelphia Gas Works, my recollection is,
11 and I can stand corrected by members of the
12 committee, but to my recollection, the
13 biggest complaint was the service that was
14 being provided.

15 Costs were spiking at that time, and
16 that was one thing, but the real problem that
17 was -- and Kathy was from Philadelphia, so
18 she can probably -- it was probably more true
19 because the service was just so abominable
20 that the people were just outraged.

21 Just a comment there to slide in between
22 your testimony. Go ahead, Mr. McCarthy. I'm
23 sorry, I didn't mean to interrupt you.

24 MR. MCCARTHY: Thank you, Chairman
25 Gannon, members of the committee. My name is

1 Brian McCarthy. I'm the deregulation
2 coordinator for the Utility Workers Union of
3 America.

4 And I might as well add in, in my
5 history, I spent 28 years as a service
6 technician for a gas distribution company, a
7 utility up in Massachusetts, before I was an
8 officer in the union back there in Boston.

9 Then I went to work for the national
10 digging into these energy issues. The guy
11 that held my job prior is now a public
12 utility commissioner in the state of
13 California, Carl Wood.

14 So we are concerned with the utility
15 deregulation issues, the divestiture of the
16 plants, the decline of service reliability
17 across the country, but I don't necessarily
18 believe it has to take place.

19 Your PUC just recently -- I just read
20 them two days ago, the reliability audits
21 that they issued in the state of
22 Pennsylvania, the reporting criteria, and I
23 think it's a great step forward.

24 I don't pretend to understand fully what
25 they enacted at this time, but Massachusetts

1 took a step probably a year ago relevant to
2 some major outages they had up in Boston in
3 the summer of 2001.

4 What they enacted at that time was
5 electronic reporting of outages for these
6 investor owned utility companies. And it
7 used to be if you had outages of 5,000
8 customers or greater for a longer period of
9 time, you know, you send in the report, we'll
10 pile this pile of paper up and sort through
11 it and try to make something worthwhile out
12 of it.

13 Well, they hooked up with this company,
14 who I have no connection with, is this
15 LiveData from Cambridge, Massachusetts.
16 Through electronically, every investor owned
17 utility company in the state of Massachusetts
18 has to now report their outages that
19 encompass 500 customer hours.

20 So if you had 1,000 customers out for 30
21 minutes, those have to be reported right to
22 the PUC within 30 minutes, the cause of the
23 outage, the number of customers, the circuit,
24 any hospitals or needy people that are on
25 that circuit.

1 And I spoke to a gentleman yesterday, he
2 said that is working extremely well. They're
3 putting in the ability to go back and
4 actually amend the form within 10 days,
5 because sometimes, within 30 minutes, you may
6 not truly know the cause of the outage, so
7 they don't want to -- you know, the utility
8 company wants to default and do the best they
9 can to comply.

10 But my point is that the ability to
11 enter this information electronically allows
12 the PUC and other people to compare the
13 reliability of one system to the next, and
14 just that ability tends to seem like it has
15 helped correct some of the bad actors up in
16 Massachusetts. They don't want to be known
17 as -- they know people are still watching how
18 they're maintaining their system.

19 The other thing of interest is that
20 during that outage or shortly thereafter, we
21 had major outages up in Boston in the summer
22 of 2001 as I had said, and what they did is
23 under political and regulatory pressure,
24 NSTAR, which used to be the Boston Edison
25 Company, NSTAR had recently completed a major

1 merger with Commonwealth Energy, so we had
2 two major utility companies merging
3 together. NSTAR was acquiring Commonwealth
4 Energy paying a huge premium.

5 And it kind of ties into what Paul was
6 talking about. The generation plants get
7 sold off at a premium price. Well,
8 somewhere, somebody is going to seek to
9 recoup that investment.

10 It's worth so much on the books, but if
11 you're paying a 65 percent premium above what
12 the stock is selling for on a Monday morning
13 for the stock of another utility company,
14 somewhere along the line, they're going to
15 have to seek to recoup that investment, only
16 investors just aren't going to fund that
17 merger.

18 So what happened, NSTAR was forced to
19 hire an independent consultant, ABB from
20 Raleigh, North Carolina. It's in my
21 testimony here. They came in and went
22 through their actual books at NSTAR. They
23 checked out their maintenance records, their
24 reliability; internally, all their mechanisms
25 that they have in place.

1 And of interest in what they found was
2 in August of 1999, NSTAR, just right when the
3 merger was getting completed, NSTAR had 1,800
4 outstanding corrective tickets.

5 In other words, a crew gets dispatched
6 for a problem, they make a temporary repair,
7 and they write up a work order saying hey,
8 next week, you should go back and make a
9 permanent repair, you know, run new cable
10 here or whatever, they just made a temporary
11 repair.

12 So they had 1,800 temporary repairs with
13 follow-up work orders that were on their
14 books. They were waiting to send out crews
15 to 1,800 locations.

16 Well, by August of 2001, two years after
17 the merger, that outstanding work order pile
18 had grown to over 12,000 tickets, and ABB
19 estimated it would take 270,000 man hours to
20 complete the backlog of outstanding temporary
21 repairs, to actually go back and sort through
22 all this.

23 And they cite in their report, they
24 actually were on location. They did a great
25 job. They went out in the field, took

1 pictures of the infrastructure, went on calls
2 with the crews to see exactly the conditions
3 that they were finding.

4 And they cite in their report, while
5 they were actually on the site, they came
6 across an exact condition of a temporary
7 repair resulting in another 10,000 customers
8 losing service because the backup circuit was
9 shut off, and now you're running a section of
10 the city on one circuit rather than two. The
11 backup circuit goes down, so now the whole
12 section of the city has nothing to rely
13 upon.

14 So it's very important I believe as we
15 go through these and you see the effects of
16 these mergers and the high premiums that are
17 being paid, at some point in time, when
18 you're talking about reliability, high energy
19 prices, to have an independent assessment of
20 the companies to see -- not one from labor.
21 Labor had no recommendation in the
22 independent consultant to this company.

23 We argued strenuously that they should,
24 and the company selected ABB themselves.
25 They came in. And to be perfectly honest

1 with you, if we had written that report, we
2 couldn't have done a better job detailing the
3 conditions of the system.

4 But another one that comes to mind is in
5 the summer of 1999, there were major outages
6 in the city of Chicago, in the city of New
7 York. The majority of these outages, once
8 again, were from distribution failures,
9 infrastructure failures, not lack of capacity
10 as was the case in California, but just
11 failure of the infrastructure.

12 As a result of that, the power outage
13 study team was convened by the Department of
14 Energy in Washington. They called it the
15 Post Team.

16 And they went around and they actually
17 did field inspections yet again of the causes
18 of these outages. They were going to get in
19 and find the root causes of the outages.

20 And I'll just read you the bottom
21 paragraph on page 1 if I could, the quote
22 from the actual Post report, and I think it
23 kind of summarizes what's going on with a lot
24 of utilities.

25 It says in anticipation of competitive

1 markets, some utilities have adopted a
2 strategy of crosscutting that involves
3 reduced spending on reliability. In
4 addition, responsibility for reliability
5 management has been disaggregated to multiple
6 institutions with utilities, independent
7 systems operators, independent power
8 producers, customers, and markets all playing
9 a role. The overall effect has been that the
10 infrastructure for reliability assurance has
11 been considerably eroded.

12 So it just shows you that at the same
13 time that they did the report, they went out
14 to Commonwealth Edison in Chicago, and what
15 they found was that Commonwealth Edison had a
16 huge backlog of maintenance on their
17 infrastructure.

18 They found that the actual substation
19 maintenance investment, the capital
20 investments in their substation maintenance
21 was at a high in 1991 of \$45 million. By
22 1998, the summer prior to these massive
23 outages, it had dropped consistently every
24 single year until it was down below 15
25 million for the preceding year.

1 It is interesting to note that NSTAR had
2 this massive merger going on that they kind
3 of had to swallow while Commonwealth Edison
4 was in the process of building six new
5 nuclear power plants. And once again, the
6 financial resources of the company, I
7 believe, were getting shifted away from the O
8 and M, the maintenance criteria, to the power
9 plants to something else.

10 This is going to put off -- it's kind of
11 like we're all talking labor, but the first
12 things that get cut from our budgets are the
13 safety training. The company just says we'll
14 just give you two hour instead of four,
15 they'll start knuckling that, because no one
16 on the outside really sees that unless a
17 tragedy happens as most recently happened
18 here.

19 In the utilities, what the companies
20 will do is start trimming that maintenance
21 budget. They'll just trim it and trim it and
22 trim it because this year, they can get by,
23 but it's the accumulation of the effects of
24 all this trimming that causes the long-term
25 effects.

1 And while all this was going on at
2 Commonwealth Edison, they had just about the
3 highest prices in the nation for
4 electricity.

5 It's just the case of dollars and cents,
6 shifting their resources over to someplace
7 else, and it's the consumers that end up I
8 think first realizing the reliability of the
9 system.

10 You know, high energy prices are a
11 tremendous burden for a homeowner or consumer
12 to pay. They have to pay their own, then
13 they have to pay all the municipal buildings,
14 the school budgets get effected, the cities'
15 and towns' budgets to heat and light the
16 buildings around, the hospitals, but when
17 you're paying a high price to begin with, and
18 you can't depend upon your energy to keep
19 coming through those lines, it just adds to
20 the burden. I think that's where you hear
21 most of it.

22 So I conclude by encouraging the
23 committee to go back -- let me just add one
24 other thing about California. We had talked
25 about the California problems out there with

1 the rolling blackouts and everything that
2 they had beginning in January of 2001, and as
3 I had said, the majority of those outages
4 were from capacity problems, whether they
5 were man-made capacity problems or what, the
6 jury will determine that, but it wasn't from
7 distribution failure.

8 The distribution system of the local
9 utility companies worked fairly well. You
10 didn't hear any headlines about this feeder
11 line out or this line out.

12 And the reason, in 1997, just when they
13 were passing the deregulation law, California
14 adopted prescriptive inspection and
15 maintenance criteria for the public utility
16 companies.

17 It said on every three years, you must
18 do this; every five years, your must inspect
19 this; every ten years, you must inspect
20 this.

21 And what they did is they gathered in,
22 it's my understanding what the utility
23 companies did at that period of time,
24 consulted the Edison Institute and what they
25 felt were reasonable, and said here's a

1 reasonable standard you must comply with.

2 And even when PG and E filed for
3 bankruptcy, they applied for a waiver from
4 these standards. They said hey, we're
5 bankrupt, we can't possibly maintain this
6 level of inspection and maintenance of our
7 system. We want to lay off, I think, 1,000
8 workers out there in California.

9 And the state PUC and the courts said
10 that's the rule, you will have to comply with
11 that, and they did. And luckily that they
12 did, you know, with all these outages for
13 capacity, the infrastructure was maintained
14 at a level that the consumers are paying
15 for.

16 I mean, built into the rates is a
17 certain level of confidence that the
18 infrastructure is going to be maintained.
19 And I think for the utility companies, if
20 they are shifting those resources elsewhere,
21 that's not the deal.

22 The deal is you maintain this
23 infrastructure. If we sell it off to another
24 company, we should expect that with that sale
25 goes an infrastructure that we can count on

1 in the future not something that has been cut
2 up and dissected and slowly diminished year
3 after year after year.

4 And I encourage you to look at the
5 Department of Energy Post Report because it
6 truly is -- it's an independent resource that
7 truly -- just the graph on Commonwealth
8 Edison just goes straight down hill like this
9 year after year after year until they finally
10 had all these outages.

11 John Rowe, who's the chairman out there,
12 I think the company right now is Exelon --
13 John Rowe used to be the CEO of a major
14 utility company in Massachusetts. We tend to
15 follow his career.

16 And he came out there the year before
17 the outages and finally he got up in a press
18 conference and said no more excuses, I'm
19 going to invest \$1 billion into the
20 infrastructure out here.

21 And interesting to note, he actually
22 hired Vantage Consulting of Wayne,
23 Pennsylvania, to go out there and follow up
24 the Department of Energy's investigation and
25 investigate Commonwealth Energy's maintenance

1 system, their internal documents, how they
2 were conducting their maintenance on their
3 infrastructure. And similarly, the Wayne
4 consulting obviously backed up what the
5 Department of Energy had found.

6 So I just want to encourage you to give
7 some more thought to adopting prescriptive
8 standards. I know that's not necessarily,
9 you know, what you're having this hearing
10 for, but when I read through that order, I
11 said jeez, it seems like a great step
12 forward, but prescriptive standards really
13 worked, to my knowledge, worked tremendous
14 value in California.

15 When you had utilities -- PG and E is
16 one of the biggest utilities, if not the
17 biggest utility, in the United States --
18 filing for bankruptcy, laying off hordes of
19 people, and to be assured that when they come
20 out of bankruptcy, their level of maintenance
21 for the infrastructure will be what the
22 consumers expect it to be. I think that's a
23 very important piece to that.

24 Thank you.

25 CHAIRMAN GANNON: Thank you.

1 Representative Manderino?

2 REPRESENTATIVE MANDERINO: Thank you.

3 Paul, in your remarks, when you were
4 talking about the value of various energy
5 companies' stocks and the phenomena of, as
6 you termed it, kind of they're overpaying for
7 power plants to position themselves for the
8 competitive economy, and my level of economic
9 understanding is a little bit deeper but not
10 much more than my knowledge of this energy
11 industry, but having said that, and I
12 understand the point that you were making
13 about the economics of it, but my gut
14 reaction keeps telling me isn't that just a
15 temporary phenomena.

16 Nobody is telling me out there that
17 capacity is devalued. To me, it seems
18 capacity is still very valuable; that if you
19 project forward, we're only going to continue
20 to increase exponentially our reliance and
21 dependence on energy, that the demand will
22 continue to grow.

23 And so while there may have been some
24 internal shifting of resources and overpaying
25 that may effect stock prices in the short

1 run, am I correct that there's still very
2 much an important value to that capacity or
3 are we over capacity in the whole energy
4 market? I didn't think we were.

5 MR. SIMON: No, and I think it's just
6 the opposite. I think there's still room to
7 build more capacity. I didn't mean to say
8 that that was a bad thing.

9 What it is though is what the
10 accountants did was take a look at the whole
11 industry as to what you had incurred for debt
12 and what you had as assets, and now what
13 you're listing on your books because that's
14 really what Enron did a lot of was to paper
15 shuffle, moving debt from one company to
16 another.

17 So what the subsidiaries that different
18 companies have -- for Reliant Energy for
19 instance, they're based out of Houston,
20 Texas. They have a utility, but they have
21 Reliant Resources that goes and buys power
22 plants at other locations outside of the
23 Texas area.

24 So they started to look at what they had
25 incurred for debt versus what they needed to

1 expand over the basic economics, you know,
2 how can you pay the bills, how can you make
3 your dividends, how can you do that. And
4 that's when they started raising those
5 questions is when the stock prices started to
6 drop dramatically.

7 It wasn't just reliant I might add. It
8 was AES. It was NRG. It was a lot of the
9 companies that actually are the independent
10 power producers out there that started to be
11 questioned about what is your financial
12 solvency really, and that's what it came down
13 to.

14 REPRESENTATIVE MANDERINO: Brian's
15 testimony raised a really good point that I
16 really don't know how did we treat it in
17 Pennsylvania when you contrasted what
18 happened in Massachusetts and Boston versus
19 California and the distribution network and
20 investment. And probably part of what
21 happened in some of this is money went from
22 maintenance to buy new capacity.

23 MR. MCCARTHY: It's going somewhere.

24 REPRESENTATIVE MANDERINO: So we were
25 buying capacity and shifting what we were

1 spending on maintenance.

2 Do you know, since you're Pennsylvania
3 based, what -- I mean, I know that we left
4 distribution regulated to some extent, but I
5 don't know what we prescribed, if anything,
6 in terms of continued maintenance and
7 investment in that distribution network so
8 that we could be assured of its reliability
9 to the customers.

10 Do you have a perspective that you can
11 share with us?

12 MR. SIMON: Yes, I do. As a matter of
13 fact, it's in my sworn testimony, it's in the
14 written testimony, but what had happened was
15 recently, the Pennsylvania Legislative Budget
16 and Finance Committee had actually done a
17 review of the PUC to see where they were at
18 with oversight and what problems there might
19 be with accessing -- and actually, it was
20 called accessing the reliability of
21 Pennsylvania's electric transmission and
22 distribution system.

23 What they came back with was some
24 disturbing items associated with the
25 oversight of utilities and what they were

1 actually reporting versus what maybe they
2 should be reporting. It's a pretty
3 comprehensive study.

4 But to make a long story short, they
5 gave a number of recommendations to the
6 legislature saying here are the problems that
7 we see.

8 Now, I've got to commend the PUC and
9 Chairman Thomas because they actually now
10 have released a report where they are now, at
11 least tentatively, they're going to adopt a
12 number of those particular issues about
13 oversight, about making sure that there are
14 standards, that you have reporting
15 requirements, those types of things.

16 What we see though is there's nothing in
17 there that says anything about staffing,
18 there's nothing in there that talks about
19 maintenance standards, there's nothing in
20 there that talks about the types of things
21 Brian was relating to; because if you look in
22 here locally, if you want to take the spin
23 that Brian gave and put it back in
24 Pennsylvania, we're looking at -- PP and L
25 came forward.

1 And we made an issue because of linemen,
2 linemen everybody understands. And we said
3 at that time, and I'm speaking from memory,
4 PP and L had 448 linemen, but yet they had
5 269 that were actually eligible for
6 retirement or at least age 50 and above
7 getting close, and I think they had 178 that
8 were eligible for retirement. And they had
9 absolutely no apprentices, none. Nobody was
10 in the system.

11 Well, since then, they've hired 55
12 apprentices, but we took a look at the
13 numbers that we had on the books. Well, they
14 also have 50 that are age 60 and above.

15 So what you're doing is going to replace
16 the people that are leaving, and now you have
17 this five-year window about people that are
18 coming forward, being able to be trained by
19 those qualified people and be fully competent
20 at the end of those five years. Well, now
21 they've come forward and now they're reducing
22 230 bargaining unit people at PP and L.

23 So I was talking to the business manager
24 as recently as today, and I said well, what
25 does that do with your apprentice program.

1 And he said well, the bumping process, the
2 displacements actually allows people who can
3 pass the test to be able to displace that
4 person who got hired as the apprentice
5 lineman.

6 So you've got 230 lost out at PP and L.
7 You've already got the announcement from
8 Allegheny that they're going to cut 10
9 percent of the work force or 600 people. I
10 know that's the utility workers.

11 I'm going to have a serious concern
12 about what that will do. They feel that
13 they're right now running minimally staffed.
14 The Keystone Report, if you're familiar with
15 that at all, the Keystone Report -- and
16 believe me, this was generated by a question
17 that came from Representative Tully at one of
18 the hearings I was at.

19 He asked me pointedly, he said are you
20 saying that the utilities are not in
21 compliance with the deregulation legislation,
22 and I had to plead ignorance and I said well,
23 could you be more specific.

24 He said we said that we would not slip
25 below the level of reliability as established

1 in 1996. And I said well, if you're asking
2 me my opinion, I'm telling you yes; but do I
3 have any facts to back that up, I've got to
4 tell you no. I mean, I'm on the inside
5 looking out.

6 So what the Keystone Research Department
7 did, the research organization, was they
8 actually took a look at the PUC filings and
9 found that PUC complaints have gone up
10 dramatically, that expenditures on O and M
11 has gone down, that those are the types of
12 things that we could actually take a look and
13 say conclusively yeah. And these are the
14 filings that the utilities actually file to
15 say what are you spending, where is it going,
16 what's your reliability factor

17 REPRESENTATIVE MANDERINO: If you know,
18 what does California prescribe as those kind
19 of standards?

20 I mean, as a lawmaker, I'm always leery
21 of telling somebody else's business whether
22 it's hospitals where people want us to put a
23 nurse to staff ratio. I mean, I'm much less
24 thinking that we know enough to tell somebody
25 how to staff their organization.

1 I think we're much more suited to tell
2 them this is the level of reliability that we
3 expect and give us the numbers to show that
4 you're meeting that and let the personnel
5 fall out where it may.

6 MR. MCCARTHY: And you're right,
7 historically, I think that's the way it's
8 always been with utility companies. Utility
9 companies for years and years, prior to
10 deregulation, operated under a cost of
11 service regulation. It was a built-in safety
12 net.

13 If you invest \$100 into your
14 infrastructure, we'll let you gain, you know,
15 11 percent profit on that investment. So
16 they were incented by that cost of service
17 regulation to ensure that they kept investing
18 in their infrastructure.

19 But I understand what you're saying,
20 because coming from the gas industry, I was
21 amazed the first time I started working with
22 the electric guys, and I said well, where's
23 your government oversight, where's your field
24 inspectors. They said what are you talking
25 about.

1 I said the gas industry in Massachusetts
2 has a representative from the Department of
3 Transportation that actually goes out and
4 makes sure the crews are abiding by the
5 regulations.

6 There's Federal regulations as to how
7 often they have to inspect their underground
8 piping. There's Federal regulations for
9 corrosion to keep it from rotting out. All
10 these were enacted obviously because of
11 serious problems in the past.

12 When we leave here today, especially
13 down here, I'll be driving over many of your
14 bridges. Bridge inspection criteria was
15 enacted in 1965 due to several major bridge
16 collapses. Similarly, people said they
17 should have local inspectors inspecting
18 bridges, they should ensure the reliability,
19 but nobody did.

20 People started lengthening it out,
21 people started lengthening it out, and they
22 had a serious collapse. And then the Federal
23 government stepped in and mandated exactly,
24 prescriptive bridge inspection standards.

25 And what California did, to answer your

1 direct question, I believe the legislature in
2 California law mandated that the PUC enact
3 reasonable inspection and maintenance
4 criteria, but I can only envision --

5 REPRESENTATIVE MANDERINO: They didn't
6 say you need to have this many linemen for
7 this much whatever, they said here's the
8 level of reliability. I don't know how you
9 would define it.

10 MR. MCCARTHY: What they did, they
11 actually -- the PUC then went out and, like I
12 say, adopted reasonable standards, what was
13 reasonable for the industry as a whole. They
14 took in a combination of standards in all of
15 the companies and adopted those, say a pole
16 would be -- and there are three levels.

17 They ensure that at least the
18 infrastructure -- they have like a patrol
19 standard once a year, and I don't think
20 that's unreasonable for a utility company to
21 have their infrastructure visited by a
22 person.

23 Today, with automated meter reading, you
24 know, you put that meter in with automated
25 meter readers and send that car down the

1 street. It's years and years before anybody
2 ever walks up to that house. They're doing
3 away with the meter readers. That's
4 technology. That's going to happen.

5 But those meters readers were the eyes
6 and ears of both the gas and the electric
7 companies out there. As they went around
8 reading their routes, they were trained to
9 uncover all these problems, you know, smell
10 for gas leaks, look at the crossarms on the
11 poles as they're walking along.

12 Today, it's the car going down the road
13 in the middle of the night because there's no
14 traffic, and it is more productive just
15 getting those readings, and that's it. They
16 expect the consumer to call it in.

17 So all these changes in the industry, I
18 don't believe that the regulators have kept
19 pace, you know, to pick it up on something
20 else. We say all right, the meter readers
21 are going through technology.

22 That's well and good, you know. That,
23 in theory, should give customers less
24 estimated bills, to get more accurate
25 readings, all these type of things that they

1 expect, but you have to look at what happens
2 when those meter readers are no longer out
3 there in the field. The customer is never
4 going to see a utility person unless they are
5 out in the front yard in the middle of the
6 night.

7 So I would think, and I can only
8 envision up in Massachusetts, trying to get
9 passed through the house and through the
10 senate a bill that says you have to inspect
11 your wooden poles every 10 years; every 15
12 years, you must drill them, you must do this
13 and do that. It would be amended so many
14 times.

15 But what they did in California enacted
16 was --

17 REPRESENTATIVE MANDERINO: Empowered
18 the
19 PUC.

20 MR. MCCARTHY: -- empowered the PUC and
21 said this is what we expect to ensure the
22 reliability of the system.

23 MR. SIMON: Well, if I could put a local
24 spin on it so we could understand it in
25 Pennsylvania, what's happened here in PA was

1 it's an uncertainty.

2 I've got sympathy for the utility
3 companies because it's a terrible time to be
4 a utility company because after '96, here in
5 Pennsylvania, you weren't quite sure what you
6 were going to have.

7 They themselves are struggling, most of
8 them, a lot of them sold their generations,
9 some of them didn't. Once you sell your
10 generation to a utility, that is really your
11 cash cow, and now you better replace that
12 with something that's going to be bringing
13 money back into the utility because your
14 capped on what you can charge for your
15 transmission and distribution costs.

16 So they therefore, I believe, my opinion
17 was, they were reluctant to spend money on an
18 industry they weren't sure they were keeping
19 because until they decided we're either going
20 to stay in generation, we're not going to
21 stay in generation, we're going to stay in
22 transmission, we're not going to stay in
23 transmission, we're going to move our
24 subsidies out, that's what we're going to do,
25 we're going to have our subsidiaries do that

1 business, they weren't sure what they were
2 going to spend money on.

3 So the Post study that Brian referenced,
4 and it's also in my testimony, in '99, the
5 GPU was held accountable because there was
6 major outages, especially over in New Jersey,
7 and GPU was held accountable to say hey,
8 you're not spending enough money, you don't
9 have enough infrastructure out there and
10 things built in to prevent a reliability
11 problem. And they came forward and
12 reluctantly said yes, and they went out and
13 repaired that.

14 So now when it came time for FirstEnergy
15 to take over GPU, first off, New Jersey
16 Public Service Commission or BPU over there
17 wouldn't even allow GPU to offer any early
18 outs or reduce their work force any further
19 until they could show that they were going to
20 be able to keep the reliability standards to
21 at least what they were at that time.

22 So when FirstEnergy bought GPU, the New
23 Jersey BPU stepped in and said you're not
24 offering any early outs over here not until
25 you can prove to us that you're going to be

1 able to maintain and run the company, not
2 only efficiently, but reliably.

3 And unfortunately, from our members
4 standpoint, ones in New Jersey weren't
5 offered that opportunity and ones in
6 Pennsylvania were because there's nobody
7 overseeing making sure that there's some kind
8 of standard that at least reliability is
9 being protected to some level. And that's
10 our concern

11 CHAIRMAN GANNON: I looked at this
12 report, and they have what they call regional
13 reliability counsel. This is a report from
14 the Pennsylvania Utility Commission. But in
15 looking at what they were talking about here
16 is mostly reliability in capacity and not so
17 much the reliability that you've been
18 referencing.

19 But when you were talking about the
20 meter reader reporting what he sees that's
21 out of line on his route and now relying on
22 the consumer, as a consumer, I'm not looking.

23 REPRESENTATIVE MANDERINO: I'm not
24 looking.

25 CHAIRMAN GANNON: All I know is I flip

1 the switch and the light goes on. And when I
2 flip the switch and the light doesn't go on
3 and everything else is okay, then I'm going
4 to call the utility whether it's because a
5 wooden cross member has snapped or something
6 like that. I'm not looking for those early
7 signs so I don't know what they are.

8 MR. MCCARTHY: If I could just add one
9 other quick comment in follow up on what Paul
10 was saying, and I don't know the details or
11 recall the details of the GPU FirstEnergy
12 merger, but many of the mergers that have
13 followed for the utility workers, in order to
14 get the deal done, the first thing utility
15 companies do is say hey, we'll freeze the
16 rates for the next five, eight years.

17 And everyone says that's a great thing
18 for consumers, they will have frozen
19 distribution rates. Now, that doesn't freeze
20 the commodity price, you know. That can go
21 up and down.

22 But now, think of this. In fairness to
23 the utility companies, we expect them to hold
24 the line on their distribution costs, to
25 maintain their system in the same level of

1 standard that they've been doing for maybe
2 eight years.

3 We have one utility company in
4 Massachusetts that agreed for ten years to
5 freeze its rates. I testified in front of
6 the PUC. I said common sense tells you
7 something has to be less somewhere along the
8 line.

9 The company paid a premium for the other
10 company, they said we'll freeze our
11 distribution rates for ten years. Why are
12 you surprised when you have all these
13 problems. You're going to get less of
14 something somewhere along the line.

15 REPRESENTATIVE MANDERINO: That was the
16 restructuring debt. That was their savings.

17 MR. MCCARTHY: The economy is the scale.

18 CHAIRMAN GANNON: That's what the
19 trade-off was.

20 MR. MCCARTHY: Right.

21 CHAIRMAN GANNON: Let me ask you this
22 specific question. Does Pennsylvania
23 currently have prescriptive standards with
24 respect to the transmission and delivery?

25 MR. MCCARTHY: I don't believe so, but

1 I'll let Mr. Simon answer it.

2 MR. SIMON: Well, there were standards
3 established, and again, they're those
4 standards of '96.

5 CHAIRMAN GANNON: That are in the
6 deregulation?

7 MR. SIMON: That are in the deregulation
8 legislation.

9 What the PUC just came back with was
10 they are adopting at least a theory that was
11 given by their internal audit which came from
12 the Finance and Budget Committee to start to
13 establish -- what they were saying,
14 Representative Gannon, was that GPU, for
15 instance, would take an outage that might
16 happen in mid Pennsylvania, and because it
17 happened, they would now not count that
18 outage because they would take the whole
19 system.

20 Now, because of the duration and the
21 level, versus other utilities that weren't
22 taking that same opportunity, you weren't
23 getting the same reporting level.

24 And the deviation percentages were so
25 high that in order to be -- for you to show

1 that you were actually getting worse, I mean,
2 you had to be terrible.

3 So now they're taking a look at how
4 they're going to better report and do those
5 types of things which is a step in the right
6 direction.

7 CHAIRMAN GANNON: And they can do that
8 under current law. What I'm getting to is
9 they don't need any additional statutory
10 authority or direction to.

11 And I guess when they started this
12 monitoring, you could literally see if the
13 infrastructure was starting to decline
14 because you had a pretty quick handle on the
15 outages that were occurring, and that was an
16 indicator that the system was beginning to
17 fail in terms of getting power to that
18 consumer.

19 MR. MCCARTHY: That was their concern
20 apparently at the PUC. The data was coming
21 in, but by the time they compiled it or even
22 the length of time to report it, the damage
23 has already been done, the people have
24 already suffered.

25 So if they get the data on a daily

1 basis, by the time they compile it, they can
2 say hey, how come this one circuit out here
3 in Western, PA, is the one that's constantly
4 going out. So within two weeks, they can
5 call the utility company up on the carpet and
6 take a look at it.

7 We just had this summer here, 2002, a
8 different utility company had some massive
9 outages and continual outages north of Boston
10 in Medford, Massachusetts, with direct buried
11 cable, which I understand is a problem here
12 in some locations down in Pennsylvania, but
13 instantly, the PUC stepped forward and
14 ordered the utility company to hire an
15 independent consultant to step in and do an
16 assessment and give them a report by October
17 31st as to how we're going to solve this
18 problem in relevance to your whole
19 distribution system.

20 So I see more and more they're relying
21 on outside independent analysis of what the
22 distribution systems are. I think they're
23 beginning to realize that the utility
24 companies themselves are under tremendous
25 financial pressure and constraints so

1 something has to give sooner or later.

2 And we met many times with the CEO of
3 NSTAR in different forms, and two months
4 before that outage, we were at a public forum
5 and he basically said you know, you people
6 are full of baloney, we're maintaining our
7 system just as it's always been.

8 And I honestly don't think that he knew
9 how bad it was, because they had to brief him
10 with the independent report before it went
11 public because they were petrified, the
12 management team, as to what was going to
13 happen once he saw what it actually showed.

14 But the field workers are the first ones
15 to sense that the game has changed, that
16 something is different here, you know. We're
17 not getting called out like we used to,
18 they're not sending as many crews to respond
19 to the outages, we're now traveling 60 miles
20 instead of 20 miles to the call, to the
21 emergency call. The field people are the
22 first ones to really get a sense that
23 something has changed.

24 And it takes a while. As Paul said,
25 it's reliability of the distribution system.

1 Reporting was something the utility
2 companies, until most recently, kept very
3 closely guarded.

4 Because, you know, I started in '98
5 looking for data as to prove the utility
6 reliability, local distribution system, and
7 there really wasn't any. You would have to
8 go up there and spend years digging through
9 paper, reports, and things.

10 But because of the public outcry,
11 because the unions have collectively been
12 arguing it and they see it firsthand as to
13 what's going on, there are now more reports
14 at the legislative budget and finance here in
15 Pennsylvania. I read that up in
16 Massachusetts.

17 I think it's a great study. It's a
18 great vehicle. When you look at some of the
19 graphs as to outages, you can see some
20 companies in Pennsylvania, from going back
21 four years, every year, the number of outages
22 go up, up, up.

23 There's something wrong when the outages
24 -- every single year. You know, you could
25 have a bad storm, you could have a bad

1 season, but not every single year the outages
2 are going up, and the same companies are
3 investing in out of state power plants,
4 investing in foreign countries. You say hey,
5 something is going on here.

6 MR. SIMON: But please keep in mind, the
7 PUC doesn't oversee generation. The
8 generation now is deregulated.

9 MR. MCCARTHY: Right.

10 MR. SIMON: And the PUC has no say over
11 what they do. Other than the licensing
12 process in the state of Pennsylvania, nobody
13 is overseeing generation.

14 CHAIRMAN GANNON: I'm sensing the focus
15 of your testimony was pretty much with that
16 distribution infrastructure, and how do we
17 monitor that to see where companies are
18 beginning to show problems that, as you
19 pointed out, that management may not even be
20 aware of.

21 Everything seems fine, and now when you
22 do an analysis of it and you begin to get
23 some real-time reporting, you see recurring
24 problems in certain areas within the
25 company's system, and that relates back to

1 reliability, which comes back to maintenance,
2 and which comes back to inspection. And that
3 seems to be what I'm hearing.

4 MR. SIMON: Well, which goes back to my
5 answer. Take a look at other areas because
6 everybody is struggling with the same thing.

7 And I think the result of Massachusetts
8 taking a look at reliability was the
9 utilities had to hire people. They ended up
10 having to hire people because they just
11 simply didn't have enough to maintain the
12 reliability standard.

13 CHAIRMAN GANNON: One of my concerns
14 would be that there would be some view that
15 we could get some short-term savings by
16 cutting back on some of that stuff, that the
17 long-term -- when the CEO said we're going to
18 put \$1 billion into this now, what would it
19 have been a couple of years earlier, you
20 know, probably a lot less.

21 MR. MCCARTHY: The whole business in
22 Chicago was down for, you know, like a half a
23 day. What was the cost of that? Exactly. I
24 mean, sooner or later, you have to pay.

25 You can paint your house every three

1 years or you can not paint it, and you might
2 get to nine years, but sooner or later, now
3 you've got a lot of scrapping and priming and
4 everything else to do.

5 But I do have one other document I will
6 give you before I leave. It's some comments
7 by the Public Utility Commission up in
8 Massachusetts relevant to their reporting
9 criteria, and like I said, I think the new
10 report, the new criteria that the PUC here
11 has just adopted is a major step forward, but
12 I think you'll find it interesting reading.

13 And it cites the company, this LiveData,
14 that I have no interest in just other than
15 that they're the only company that I know of
16 that has software that allows utility
17 companies to electronically report their
18 outages.

19 And they talk about they can print out
20 reports in a variety of different ways for
21 anything. You could call them up tomorrow
22 and say I want the outage report for
23 Allegheny and out it comes so you can see
24 real time, first hand what the information is
25 available.

1 CHAIRMAN GANNON: Well, thank you very
2 much for appearing before the committee and
3 providing us with some very valuable -- oh,
4 I'm sorry. Do you have a question? I
5 apologize.

6 MS. MENDLOW: I will make it very
7 brief. What I would like to know is if you
8 could recommend a report that perhaps looks
9 at the issues involving the role of the
10 Federal Government and the states in dealing
11 with all of the issues that have been really
12 laid out here, because what I'm hearing over
13 everything is that these are not common to
14 Eastern Pennsylvania because basically you've
15 got a system where you are having to draw
16 energy resources from all over the continent,
17 and it's quite a remarkable system in terms
18 of distribution generation, and this is all
19 new to me, but as such, it also is a system
20 that in my mind requires some attention to
21 what states are experiencing and how they're
22 addressing it, and also to work hand in glove
23 with the Federal Government because of the
24 issue of interstate issues now.

25 And I was just wondering if you had seen

1 help this because it's really more than
2 inside of our state, and the Federal Energy
3 Reserve Commission wasn't very helpful.

4 But I think there is a report out there
5 that could probably define it for you, the
6 differences between responsibilities for the
7 Federal versus the state kind.

8 MS. MENDLOW: Okay. Thank you.

9 CHAIRMAN GANNON: Thank you very much,
10 Mr. McCarthy and Mr. Simon. We appreciate
11 it.

12 MR. SIMON: Thank you.

13 CHAIRMAN GANNON: Our next witness is
14 J. Michael Love, president and chief
15 executive officer of the Energy Association
16 of Pennsylvania.

17 Mr. Love why don't we take just like a
18 five-minute break for the benefit of our
19 stenographer.

20 MR. LOVE: That's fine. That's probably
21 a wise idea.

22 (Brief break.)

23 CHAIRMAN GANNON: As I said before, the
24 Judiciary Committee will reconvene. Our
25 witness is Mr. J. Michael Love, president and

1 CEO of the Energy Association of
2 Pennsylvania.

3 Welcome, Mr. Love, and you may proceed
4 when you are ready.

5 MR. LOVE: Thank you, Mr. Chairman.

6 I'm here representing the electric
7 distribution companies and most of the gas
8 distribution companies in the state of
9 Pennsylvania.

10 House Resolution No. 100, in March of
11 2001, was primarily about one consideration,
12 which was price. And I would like to take
13 you to the next to the last page of my
14 testimony so that you see why Representative
15 Gannon was concerned about price.

16 If you look at House Resolution 100,
17 which came out in March 20th of 2001, you can
18 see that natural gas prices were spiking to a
19 significant high versus what they were over
20 the last 12 years and which had been since.

21 I came before this committee last year
22 in November before the winter heating season
23 and said that from what we could tell, it
24 looked like it was going to drop. And it did
25 drop precipitously.

1 What I am trying to give you is a point
2 of reference that says here are 12 years
3 across the natural gas industry, relatively
4 stable prices all during that time except for
5 one isolated period.

6 Now, that still deals with questions
7 about affordability, and I'm going to talk
8 about that, and I'm going to talk about
9 California, and I'm going to talk about the
10 Philadelphia Gas Works because the second
11 consideration I saw in House Resolution 100
12 was are they providing good service, so I
13 addressed that as well, sir.

14 But this is about price, and before I
15 start, I talk about California in my
16 testimony, which I'm not going to read and
17 keep this brief, but in the first three
18 pages, I talk about California.

19 And one thing you have to understand is
20 California is not about regulation or
21 deregulation. California is about, and to a
22 certain extent so is New York, about failing
23 to invest in the infrastructure, whether it
24 be generation or transmission.

25 In the state of California, they ran

1 badly because they did not invest, and this
2 committee should not find that surprising
3 because they didn't invest in a lot of things
4 in California.

5 They took their investment per student,
6 per school student, down so that they rank
7 now at the bottom of the barrel between
8 Louisiana and Mississippi. That's what
9 California has done.

10 So if you want to leave anything in your
11 mind about California, it is they have
12 blackouts both mentally and physically
13 because they did not invest --

14 REPRESENTATIVE MANDERINO: Just
15 propositions.

16 MR. LOVE: A lot of propositions, not
17 many prepositions.

18 REPRESENTATIVE MANDERINO: Think about
19 that the next time you want referendums and
20 initiatives.

21 MR. LOVE: So one thing you have to
22 understand about California is that.

23 Now, let's talk about price because I
24 talk about price in my testimony. California
25 versus us. Our industrial rates in the state

1 of Pennsylvania have been dropping. Theirs
2 have been going up.

3 Right now, if you own an industry out in
4 California, you're going to pay 50 percent
5 more than you are in the state of
6 Pennsylvania.

7 If you have a commercial establishment,
8 a small business, ma and pa grocery store,
9 dry cleaning, you're going to pay 40 percent
10 more in California than you are here.

11 Residential customers, in terms of
12 electricity, pay on average \$15 less per
13 month, \$180 per year less than they do out in
14 California.

15 California is an example of all that
16 could go wrong. They took the worst of
17 regulation and put it together with the worst
18 of deregulation, and that's what you got.

19 Now, Paul mentioned that when, quote,
20 price caps came off in California, rates went
21 up considerably. When a price cap came off
22 here in the city of Pittsburgh, rates went
23 down significantly.

24 I'm not here to tell you that when price
25 caps come off that rates are going to go up

1 or go down. It will probably depend upon the
2 company, but you can't look at just the price
3 cap. You look at Allegheny Energy, you have
4 some of the lowest rates anywhere in the
5 country.

6 So it's not always a question of where
7 the price caps are coming off or where the
8 increases are or are not. You have to
9 sometimes look at where it is compared to
10 everyone else.

11 But I think that one of the things that
12 you can be proud of in the state of
13 Pennsylvania is that when you look at what
14 we've enjoyed under our Pennsylvania
15 deregulatory scheme, we have seen, on the
16 electric side, significant rate reductions
17 over the last five years.

18 And I put it to each of you, I don't
19 think there's another industry, another
20 taxing authority, another service
21 organization that can say the same, that over
22 the last five years, they're paying less.

23 What does that do? Think about the
24 people with fixed incomes. Their cost of
25 electricity has gone down. The industries

1 that make jobs, they have had stable to
2 declining costs for five years. Commercial
3 establishments, anybody that's ever run a
4 small commercial establishment knows it's one
5 of the hardest things in the world to do,
6 costs going down.

7 So in Pennsylvania, because we've had
8 solid regulators, a good legislative
9 restructuring, and good people at the head of
10 utilities and their workers, we have a
11 marvelous accomplishment that we can be proud
12 of.

13 Again, House Resolution is about price,
14 and I heard you raise some concerns with some
15 of my fellow speakers about well, what's
16 going to happen in the next three to five
17 years. There's a storm cloud that I just
18 want to talk about, and this hits a little
19 bit close to home.

20 In the legislative budget that was
21 passed this past June, there were some
22 significant price increases that were levied
23 on the electric industry and the electric
24 consumers.

25 I talked about the electric

1 restructuring plans. That was an agreement
2 where utilities could recover some of their
3 stranded costs, consumers were assured rate
4 freezes, and the state was assured a level of
5 revenue of taxes like they were getting
6 under, quote, regulation.

7 That compact was broken in the last
8 legislative budget because that last formula
9 was about ready to drop rates by 36 and a
10 half million dollars.

11 That 36 and a half million rate
12 reduction did not occur because the rate that
13 it had been the previous year was frozen a
14 year early, and that rate reduction, which
15 would not only have been this year but every
16 subsequent year, was denied.

17 The second aspect that was in the budget
18 bill, a while ago, back in 1997, a bunch of
19 companies, telephone, electric, gas, water,
20 transportation, took some PURTA surcharges
21 that they had received and they challenged
22 them in court. We all as taxpayers have the
23 right to challenge when we think something is
24 wrong.

25 Well, it looks like that those various

1 entities are going the win against the state
2 that the surcharge apparently is illegal.
3 \$350 million, now that's a big hole, and I
4 understand where the state was pacing itself,
5 but a decision was made that we're going to
6 take that money, and when we refund it back,
7 we're going to make it a surcharge on
8 electric rates, gross receipts tax, a very
9 regressive tax, and we're going to force that
10 throughout the next year and a half.

11 That's big. 350 million is big. It's
12 big to the state; it's big to the rate
13 payers. I tell you this only in the sense of
14 saying to you that one of the dangers that we
15 face as an industry is there is a tendency
16 under regulation to try to find a way to use
17 that as a taxing vehicle because it does
18 touch everybody in the state.

19 And if we are, as House Resolution
20 properly does, raising concerns about price,
21 I'm just saying that we all have to look in
22 our own garden.

23 Let's talk about gas prices for a
24 second. I showed you the chart there in
25 which natural gas prices spiked up in 2001.

1 And, Representative, you were concerned about
2 that because you had constituents that were
3 probably screaming. Prices went up four or
4 five times what they normally had been.

5 Many factors, one was a robust economy.
6 The second one was a cold snap that was
7 early. The third one was that storage
8 facilities nationwide were not filled up like
9 we did in Pennsylvania.

10 We did it right in Pennsylvania, but we
11 are not alone, and they didn't do it right
12 elsewhere. And they had much lower storage
13 levels which were used up during the early
14 part of the season, and all of these things
15 came and culminated in terms of higher gas
16 rates during that one time.

17 It's a sad story about that one year.
18 But I told you when I came here last November
19 that we were going to see a significant
20 reduction, and we got back to that normal
21 range of just two to four dollars per million
22 BTUs. Back then, we got up as high as 11 or
23 12.

24 Now, you go well, that's fine, Mike, but
25 what's going to happen next year, our

1 constituents will be calling again maybe.
2 I've also shown you on the last sheet the
3 prediction of the futures that are going on
4 right now which again finds them in the
5 historical range between three and four
6 dollars.

7 There are a lot of factors that can
8 effect it. One of the reasons that this is
9 slightly escalated is for something that has
10 nothing to do with natural gas. It's the
11 potential for a war with Iraq and the
12 potential of that affecting oil prices thus
13 effecting natural gas prices.

14 I'm not saying that we shouldn't go to
15 war with Iraq. I'm not saying that we are
16 going to war with Iraq, but the fact that we
17 may has cast a specter, but it has only
18 bumped it a little bit. So it's still going
19 to be within the range of two to four dollars
20 per million BTUs as it stands now.

21 Now, obviously, there are other factors
22 such as terrorism and other things that could
23 impact. There are a lot of things that can
24 affect the price of energy, but what I'm
25 saying is if we look at the natural gas

1 prices and we look at the futures and we look
2 at what the PUC is using as a benchmark, it
3 looks like it is going to stay within the
4 historical range.

5 Now, one of the other things I think you
6 were probably hearing, Representative, was
7 concerns about, you know, I call up
8 Philadelphia Gas Works and I don't get an
9 answer. In fact, they had a horrible problem
10 that people would call and call and be on the
11 phone for 20 minutes, and they wouldn't get
12 responded to.

13 Well, you know, since they've now come
14 under the PUC jurisdiction, we have some PUC
15 commissioners that are very, very concerned
16 about that. In fact, they use it as an
17 indices to measure all the electric and gas
18 companies, and they said that this is not
19 acceptable.

20 So they made sure that Philadelphia Gas
21 Works and Philadelphia Gas Works management
22 made sure that they corrected because that is
23 one of the criteria that you have to have at
24 the PUC.

25 Now they enjoy better than the industry

1 requirement which is to answer at least 80
2 percent of the calls within 30 seconds. Now
3 that's quite a turn around from waiting 20
4 minutes, 15 minutes, and not getting an
5 answer to getting an answer within 30
6 seconds.

7 That is the difference between putting
8 professional gas management in place and
9 having them deal with professional
10 regulators.

11 And while sometimes we tend to always
12 focus on when things go wrong, this is an
13 example of where things have gone right.
14 Philadelphia Gas Works has worked strenuously
15 to take its level of response to the customer
16 and taken it above and beyond the requirement
17 of the PUC because that was at the PUC's
18 initiation and management of PGW's
19 initiation.

20 Now, another thing that they've been
21 dealing with, in the city of Philadelphia,
22 there are old cast-iron pipes and small-sized
23 pipe. Now, with the very changing needs of
24 Philadelphia and its growth in the Downtown,
25 et cetera, there's a need to replace a lot of

1 that gas pipeline, and Philadelphia Gas Works
2 has been doing that.

3 That's important from a lot of
4 standpoints. One of them is the potential
5 growth in the city of Philadelphia. Secondly
6 is the case of terrorism, to have enough
7 sized mains that you can route gas to other
8 parts of the city. And third is a safety
9 precaution, and the Philadelphia Gas Works
10 has been putting a lot of emphasis on
11 safety.

12 So they've been addressing both the
13 customer concerns, and they're now running
14 their operation like a professional gas
15 company.

16 I tried to briefly summarize my
17 testimony, but I want to just kind of go back
18 and make sure that we talk about a couple of
19 things.

20 I don't know. I sit here, Mr. Chairman,
21 as a person who was a former consumer
22 advocate. I was a former chairman of the
23 Public Utility Commission. I was the former
24 president chief operating officer of both the
25 gas and electric utility, served a million

1 customers in five states, and I'm saying to
2 you that no one can tell you, regardless of
3 their political stripe, about where prices
4 are going and our difficulties.

5 Long before many of you were born, I was
6 back as a commissioner in '79 and '83. And
7 back then, if you can believe it, we had
8 interest rates of 22 percent and everybody
9 told me that that's pretty much the way they
10 were going to stay.

11 And oil prices were jumping through the
12 roof, and everybody said well, those are
13 going to keep escalating, and people were
14 coming in for massive rate increases because
15 they were building big coal, nuclear, oil
16 stations.

17 You can't always know, but I think what
18 you can look at is if you look at the
19 testimony is that gas prices have maintained
20 relative stability.

21 The electric prices, California,
22 Massachusetts, Hawaii, Vermont, Louisiana,
23 whether it's regulated or deregulated, a lot
24 of them have seen price increases over the
25 last five years.

1 What you can be proud of is you have
2 seen rate reductions when your residential
3 voters, residential users, customers go home
4 every year with \$180 in their pocket versus
5 their counterparts in California. That's a
6 lot.

7 When the businesses don't have to think
8 about energy costs rising through the roof,
9 if they can rely on electricity to be stable
10 or going down, it's a big plus in pricing
11 their product.

12 And so while many will focus on the
13 negatives that are going on, I would say to
14 you there is a tremendous amount of
15 positives, and I think it has a lot to do
16 with the people that have been regulating at
17 the PUC, the people that have been running
18 the utilities in the state, the workers that
19 work for those utilities. And the
20 legislative restructuring that went on that
21 you all passed.

22 So I'm here to tell you that I think
23 things have turned around significantly from
24 where they were in March of 2001, and I think
25 we can all take credit for that.

1 CHAIRMAN GANNON: Thank you, Mr. Love.
2 Any questions?

3 REPRESENTATIVE MANDERINO: Thank you.
4 Thank you for your remarks.

5 I want to go back to the chart that you
6 showed us at the beginning because I'm sure
7 it was meant to assure us that this fluke in
8 2001 was a fluke.

9 And having admitted already that my
10 knowledge of both the energy industry and
11 economics is fairly basic, this doesn't
12 reassure me at all.

13 This causes me concern because I look at
14 a 12-year history and say -- I mean, you gave
15 us three factors. We've had good economies
16 and bad economies in that 12 years. We've
17 had cold snaps and warm snaps or warm trends
18 during that 12 years.

19 The third factor you gave me was storage
20 levels, so that's something in your industry
21 that says to me okay, what was going on there
22 that they were so low, was it somehow
23 connected with, my recollection, the timing
24 and I don't know, I think nationwide because
25 we were starting to have that discussion in

1 Pennsylvania about natural gas deregulation,
2 and is this something that -- I guess I'm
3 trying to understand again why I should be
4 assured by this as compared to not concerned
5 that something was going on within the
6 industry that we need to understand to know
7 whether or not this is a one-time fluke or a
8 fluke of things to come as a regular basis
9 now that we have started along the path of
10 natural gas deregulation in this country.

11 MR. LOVE: All right. When we say along
12 the path of natural gas deregulation,
13 understand that we deregulated natural gas
14 back in the '70s and '80s. That's when
15 natural gas was deregulated at the well
16 site. That's when we deregulated the
17 pipelines.

18 What this state did in '99 and 2000 was
19 to offer the opportunity for people to come
20 in and compete against the retail natural gas
21 distribution.

22 REPRESENTATIVE MANDERINO: Right.

23 MR. LOVE: And you did have natural gas
24 people come in.

25 REPRESENTATIVE MANDERINO: Right, and

1 that's the part that I still have never
2 understood, because unlike electric
3 generation which can happen a million
4 different ways and there are all kinds of
5 factors, and I can see where you can get
6 price fluctuations whether your generating
7 nuclear, whether you're generating coal,
8 natural gas is natural gas is natural gas is
9 natural gas, so I never quite understood.

10 Again, I'm asking more to be educated.
11 I'm not at all trying to argue it. I realize
12 it might be coming across argumentatively,
13 but that's why I look at this having spiked
14 right at the time, and maybe it was just
15 coincidental, where we had made this change
16 at the retail level if that's what you want
17 to say, and so I'm just trying to -- maybe I
18 should ask a question.

19 Why were storage levels so low because
20 that doesn't seem to have been a historic
21 thing for 12 years?

22 MR. LOVE: A couple of things. First
23 off, what you're looking at here is not a
24 Pennsylvania price but is the national. So
25 whatever was happening in Pennsylvania was

1 not driving this. So let's put that aside.

2 Natural gas isn't always natural gas is
3 natural gas because natural gas sometimes
4 comes from sites down in Louisiana, sometimes
5 it comes from sites in the Midwest, sometimes
6 it comes from sites in Pennsylvania,
7 sometimes it comes from Canada.

8 REPRESENTATIVE MANDERINO: So there's
9 travel costs?

10 MR. LOVE: There are travel costs.
11 Thank you. And that does change.

12 Storage facilities, what happens with
13 storage facilities is you, in essence, make a
14 decision based on historical amounts to fill
15 up storage facilities to a certain amount.

16 Now, you can get stuck with it at the
17 end of the year. What happened is, remember
18 I said there was an early cold snap, and so
19 what happened is that the natural gas that
20 would usually be used for the winter, because
21 the pipelines were full, they had to pull
22 down the storage early, so that gas wasn't
23 around as it normally would have been for the
24 winter peaks, and that meant everybody went
25 scurrying as you do when something becomes

1 scarce, and that's what drove the price up.

2 It had nothing to do with Pennsylvania.
3 It was a national phenomena. And in fact, it
4 was fueled by some of the limitations that
5 were going on in California.

6 If you stripped out California alone
7 here, they would have been up at 15 to 20
8 dollars per million BTUs. So they're driving
9 this spike, and it was some of their actions
10 where they could not get gas in and people
11 started bidding it up just trying to get it,
12 people were make choices between generation
13 and residential use and commercial use.

14 That's what happens when you don't build
15 the infrastructure to get natural gas in
16 San Diego.

17 REPRESENTATIVE MANDERINO: So was part
18 of the problem, going back to the
19 infrastructure from electric deregulation,
20 the lack of investment in that?

21 MR. LOVE: The problem --

22 REPRESENTATIVE MANDERINO: I mean,
23 again, I'm really trying to understand it,
24 but I can't imagine that was the only early
25 cold snap we ever had, so something different

1 was going on here.

2 MR. LOVE: What I'm saying is if you
3 remember back then, we had probably the
4 biggest robust economy we ever had, so that
5 was high. We had an early cold snap.

6 It's really what people would call in
7 the industry the imperfect storm, and it is
8 in the sense that all these things happened
9 at once.

10 True, there have been cold snaps in the
11 past. There had been robust economies in the
12 past. There had been storage facilities in
13 the past. Never had they all come together,
14 coupled with the California problem which was
15 the largest state in the union not having
16 built sufficient natural gas pipelines into
17 their state, all of a sudden having a
18 shortage, and leading to the price being
19 driven up by a lot of people.

20 So what I guess I'm trying to say to you
21 is if you look at, take the last five years,
22 you know, if prices are right there in that
23 range, and there is this one spike, and if I
24 tell you that natural gas ineffectively --
25 the largest price factor in natural gas is

1 the price that's paid from the well head plus
2 the transportation costs, that represents
3 about 80 to 90 percent of the costs of the
4 bill that you get from Equitable Gas or
5 Philadelphia Phil Gas Works, that's what went
6 up, and it went up for factors way outside of
7 Pennsylvania.

8 REPRESENTATIVE MANDERINO: I guess my
9 final question then is what role is there for
10 government different than what it is today to
11 assure that the infrastructure is there such
12 that we don't have to experience that again.

13 MR. LOVE: Well, I'm going to go at that
14 from two ways. You asked the question.
15 Whether it's electric transmission or gas
16 transmission, there is a feeling that many
17 people just don't want it in their backyard.

18 Sadly, we're going to have to build more
19 infrastructure, terrorists or no terrorists,
20 because we have not invested in the
21 transmission structure. And I talk about
22 that in my testimony.

23 People always talk about generation and
24 people talk about local distribution, but
25 that one big aspect in between, transmission,

1 whether it be electric or gas, is where we
2 have to focus.

3 That's where the Federal Energy
4 Regulatory Commission has recognized this,
5 and they're trying to address it. And I'm
6 just saying that that's where we're going to
7 have to put our emphasis in the future.

8 But I'll give you something that you can
9 help with. What I see in here and what I see
10 in your community is a lot of concern about
11 your constituents.

12 Now, I'm going to give you kind of a
13 story of what happens when we get two
14 government entities that want to work
15 together but aren't, and how it impacts the
16 customers.

17 This past year, the state of
18 Pennsylvania, like other states, gets LIHEAP
19 money from the Federal Government to use for
20 those who can least afford electricity and
21 gas.

22 Last year, that program closed on March
23 27th or March 29th, I can't remember which
24 one. The PUC has a program where they
25 basically don't allow winter terminations

1 prior to April 1st.

2 What happens is a lot of people get
3 behind in their bills, they can't pay, turn
4 offs go through the roof in the month of
5 April. 20,000 people get terminated.

6 The really sad thing is that the
7 Department of Welfare had \$5.8 million that
8 they didn't distribute to people that could
9 have saved them the process of being turned
10 off in April.

11 So one of the things that I would hope
12 that you would get involved with is making
13 sure that the period by which LIHEAP funds
14 are distributed relates to when the PUC has
15 its winter terminations, and the fact that
16 someone owes something, they don't have to be
17 terminated or threatened to be terminated
18 before they get funds available.

19 It's something that we're fighting for.
20 It might seem strange that we are, but we
21 are, and I would welcome this committee's
22 fight with that in trying to just get the
23 Department of Public Works and the PUC to
24 work together so that we don't have people
25 being turned off in the first week of April

1 when there are funds available as late as the
2 end of March. Just, it's not right.

3 REPRESENTATIVE MANDERINO: Thank you.

4 Thank you, Mr. Chairman.

5 CHAIRMAN GANNON: Thank you very much
6 Mr. Love for appearing before the committee
7 and sharing this information with us. It has
8 been very helpful.

9 And I think just to echo your comments
10 about Philadelphia Gas Works, from our visits
11 with them and speaking with the people who
12 run that operation and also our site visit, I
13 think that they have done a lot to turn that
14 around, and that's probably indicative of the
15 dramatic decrease in the number of complaints
16 that we're getting from their customers in
17 the area of service and operation.

18 MR. LOVE: I was very impressed when I
19 saw in the PUC statistics that keep track of
20 this that their complaints have leveled off,
21 and the ones that have gone so far as to be
22 formal complaints have dropped down to next
23 to nothing.

24 Thank you very much.

25 CHAIRMAN GANNON: Thank you, sir.

1 Any other business to be brought before
2 the committee?

3 With that, this hearing is adjourned.
4 I'm sorry, I reverse myself.

5 We have some written testimony which is
6 submitted as part of the record from
7 Mr. David E. Callahan of the American
8 Petroleum Institute.

9 The Public Utility Commission has
10 submitted material to the committee. It's a
11 number of charts and other information which
12 will be available to any committee member who
13 wishes to see it. We'll distribute a summary
14 of those charts to the committee members so
15 they can see what's available and what they
16 might want to see.

17 And also testimony from Carol
18 Pennington, acting small business advocate
19 with the Office of Small Business Advocate.

20 And with that, if there is no other
21 business to be brought before the committee,
22 this hearing is adjourned.

23 Thank you.

24 (At 3:20 p.m., the hearing was
25 adjourned.)

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REPORTER'S CERTIFICATE

I, Christine A. Bird, do hereby certify
the foregoing pages are a true and correct
transcription of my stenographic notes taken at
the above-captioned Hearing on Thursday,
September 5, 2002.

A handwritten signature in cursive script that reads "Christine A. Bird". The signature is written over a horizontal dashed line.

Christine A. Bird, Reporter