HOUSE RESOLUTION No. 100

TESTIMONY OF
J. MICHAEL LOVE
President and CEO
of the
Energy Association of Pennsylvania

Good afternoon, Mr. Chairman, and other members of the Committee. Thank you for the opportunity to address energy issues in Pennsylvania.

Much has happened since this Resolution was first proposed. Thanks to deregulation, the electric and gas energy users in Pennsylvania have received tangible, significant, economic savings. Electric prices have dropped considerably from where they were back during the total regulation days. Gas prices, which were at their peak, have dropped considerably, as well. Finally, Philadelphia Gas Works, through the hard work of its management and the PUC, has become more customer focused and there is a proactive addressing of historical problems.

Electric –Price

While many states including California, Vermont, Hawaii, Massachusetts, Louisiana, and Nevada have seen their electric rates go up or marginally decrease over the past five years, Pennsylvania has witnessed a giant drop in electric rates ranging from 16 -

20%. Certainly there would be few if any other products, services or government levies that could make this claim.

The historical comparison between two relatively large states, California and Pennsylvania, is worthy of your consideration. Five years ago, California's industrial rates were slightly more expensive than Pennsylvania's. Since that time, Pennsylvania's industrial rates have decreased by approximately 17% while California's industrial rates have increased by nearly 7%.

This gap has led to a situation wherein California's industrials pay over 50% more for their electricity than their counterparts in Pennsylvania. At a time of economic turmoil, this provides a significant incentive for companies to both stay and relocate in the Keystone state. This electricity savings means three things for this Commonwealth: Jobs, Jobs, Jobs.

Five years ago California residential electric ratepayers were paying slightly more than Pennsylvania ratepayers. Since then, both have seen rate reductions. California's has been 11% and yet Pennsylvania's has been a reduction of 20%.

Today, average Pennsylvania residential ratepayers not only pay less than they did five years ago, but also pay an average of $15.00 less per month, or $180 less per year, than if they lived in California.

Now as we all know, we have numerous residents who are on fixed incomes who have felt first-hand the pressures of increased costs for medicine, food and housing, but have experienced some relief deriving from reduced electric costs.

Another customer group that we need to discuss is the commercial class of customers. These restaurant owners, dry cleaning establishments, and "Ma & Pa" grocery stores have seen an effective 16% reduction in their electric rates over the past five years. Similar customers in California are being charged the same rates they were paying five years ago, which are 40% more than those charged in Pennsylvania.

Clearly the benefits of deregulation and competition have been aptly demonstrated in Pennsylvania. Whether one is on a fixed income or trying to earn a profit, Pennsylvania is a good place to live in terms of electric prices.

Electric Price – Future Stormclouds

While I have shown you positive financial savings resulting from deregulation, you need to be aware of the harmful and contradictory currents that arose from the state budget passed in June of this year.

Hidden within that budget were two tax increases on electricity. The first involves the revenue neutral reconciliation (RNR), a provision designed in the electric restructuring bill to require electric utilities to pick up any shortfall the state experienced in revenues due to restructuring.

This annual adjustment netted the state $150 million in additional revenues for tax year 2001-2002. However, this complicated assortment of measures that make up the RNR was scheduled to go down in 2002-2003 by $36.5 million and then stay at that level out into time. This $36.5 million-dollar reduction in taxes and a similar drop in electric rates going out into time was eliminated by the budget when it froze this vacillating rate and didn't permit the additional rate reduction to occur this year or in succeeding years.

In addition, to preventing a $36.5 million electric rate reduction, the new state budget seeks to move taxes from other industries over to electric utilities and thereby increase rates in the future by a couple hundred million dollars.

How, you may ask? In 1997 a number of companies in the water, telecommunications, transportation, gas and electric business sectors challenged a PURTA surcharge. The Department of Revenue estimates that these industries may be entitled to $350 million dollars in refunds, and they saw to it that any refunds paid out are immediately transformed and become surcharges on the gross receipts tax, a regressive tax charged only to electrics and local telecommunication providers.

Now, many would find the concept of a taxpayer legitimately seeking and achieving a refund, only to be gouged by a tax increase based upon their success (as well as the success of others) to be Machiavellian at best. In any event, if you are interested in continuing the downward spiral of electric prices, then you can assist by forbearance on using electric utilities and electric customers as a taxing vehicle.

Gas - Price

One of the catalysts of House Resolution 100 was the spike in natural gas prices that occurred in the winter of 2000-2001. Natural gas prices, which for the previous decades had settled into a range between $2 and $4 per million BTU, all of a sudden went up to $10-$11 per million BTU.

As I told you last winter, this was a true market aberration that did not repeat itself in the winter of 2001-2002. Predictions for this winter are again back in the historical

range of $3 to $4 per million BTU. This means slightly higher prices than last winter, but nowhere near the price hikes of the previous winter, 2000-2001.

The winter of 2000-2001 was an aberration due to multiple factors all impacting the natural gas market at once. These included an early cold snap, a failure to drill new gas wells nationwide because of low prices, a robust economy, storage facilities not being filled nationwide, even thought we were at full capacity in Pennsylvania, and some transportation deficiency problems in California.

One picture is worth a thousand words and the chart attached to the end of my testimony shows the trend of gas prices over a number of years. The unique nature of the gas price increase of 2000-2001 is clearly shown by the graph, as that price dwarfs the price paid in all other years. However, the heating season for 2002-2003 will witness prices that are significantly lower than those experienced in the winter 2000-2001 but more than what was experienced last year.

My second chart reflects the change occurring in the market today. The recent run-up in future prices is tracking two factors: First, a fall-off in drilling rigs by 4% due to low prices, and second, the likelihood of an invasion of Iraq and a disruption impacting oil prices. Both of these factors are acting as upward pressure on price.

Electric Transmission - Infrastructure

The absence of a transmission line infrastructure remains the single largest threat to price stability and reliability. Probably none of you can remember a large transmission line being built in Pennsylvania, or for that matter, anywhere else.

While we as a society love to focus on what type of generation is best -- coal or wind or gas or hydro or nuclear or oil – this singular focus is misplaced. Today what should be of primary concern is the lack of transmission infrastructure.

How bad is our transmission infrastructure? Bad! The minimal amount of investment going into transmission today is a drop in the bucket compared to historical levels. Investment in new transmission nationwide has dropped by more than $100 million a year for the past 25 years. Left unchanged, transmission lines will have a 4% increase in investment over the next decade, compared to a 25% increase in power consumption.

The costs to consumers from transmission bottlenecks is significantly over a hundred million dollars a year, and the cost is escalating as the demand for energy increases. The transmission facilities today need to be greatly expanded due to each of the following: (a) transmission today needs to bring cheaper power from generating, units both inside and outside a state's boundaries; (b) generation units, especially renewable sources, are located at great distances from load centers such as cities and industry; and (c) due to

increased security concerns regarding terrorist activities, there is a greater need for redundancy and alternative routes.

If you are interested in continuing the reductions in electric bills started in 1996, the transmission deficiencies must be addressed. If we as a nation want to provide greater levels of choice to customers while ensuring their energy accessibility and security, the transmission line bottlenecks need to be eliminated.

Philadelphia Gas Works

Turning to another matter: *the Philadelphia Gas Works and the PUC.* It is evident that the professional oversight of the PUC and the professional leaders hired by the Philadelphia Gas Works have made a significant positive difference to the gas customers of Philadelphia.

There are numerous examples of how the greater use of natural gas professionals, in management and in regulatory oversight, has made a positive difference. For example, in the past, customers contacting PGW experienced significant time delays and frustration in reaching customer assistance personnel. The percentage of calls answered within 30 seconds is a traditional PUC measurement of customer satisfaction. The PUC's insistence on improvement and the commitment of PGW personnel to improvement led to a remarkable turn-around: the company's call center consistently meets and exceeds the

PUC standard in which 80% of all calls receive a response within 30 seconds. This is a situation where what had been a problem is now a stellar PGW accomplishment.

Since customer/gas entity interface is even more important since 9/11, the PGW improvement is of aid to security concerns, as well. PGW management has actively been focusing on their infrastructure in a fashion which would have been foreign a few short years ago.

The PGW system was in need of some capital infusion so as to begin the process of addressing problems of old or small diameter cast iron pipe. The professionals at PGW and the PUC have made safety, reliability, and security watchwords at PGW, which is of significant value to the citizenry of Philadelphia.

I have been either a regulator or a participant in the energy industry for over 25 years, and I have never seen as much progress in one year by any entity, whether public or private, as I have witnessed at PGW over the past year.

PGW is operating under an approved settlement with the PA Public Utility Commission for its Gas Cost Recovery. The natural gas cost prices reflected in the approved settlement are in the historical range of $3 to $4 per million BTU. The market, however, is beginning to trend upward. This trend is driven by a variety of issues such as

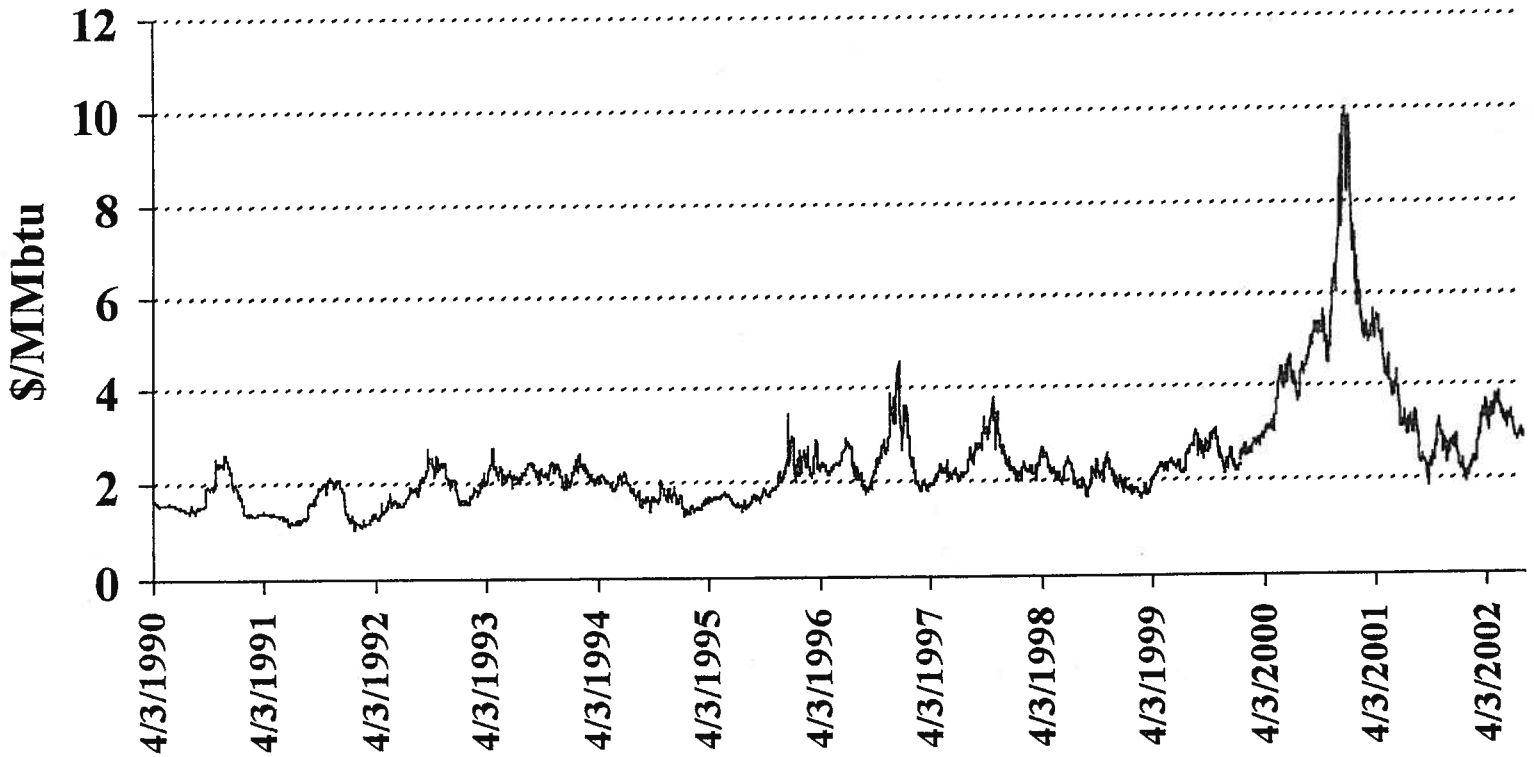
the global oil market, the continuing economic recovery in the U.S. energy industry business issues, and the recent drop in the amount of drilling rigs being used to find gas in the U.S. I again refer you to the second table which shows natural gas futures on an upward slope.

Thank you again for the opportunity to address these energy issues.

Natural Gas Prices

NYMEX Henry Hub Futures Daily Settlement Prices

April/90-Aug/02



AGA
American Gas Association

Future Natural Gas Prices

Weekly Closing Prices for January 2003 NYMEX Henry Hub Futures
March 15 - August 30, 2002
Source: Natural Gas Week