

Prepared Testimony of
Robert F. Powelson
Chairman
Pennsylvania Public Utility Commission

before the

Pennsylvania House of Representatives
Consumer Affairs Committee

March 8, 2011



Pennsylvania Public Utility Commission
400 North Street
Harrisburg, Pennsylvania 17120
Telephone (717) 787-4301
<http://www.puc.state.pa.us>

Chairman Godshall, Chairman Preston, members of the Committee, I appreciate the opportunity to speak with you today to give you an overview of the responsibilities and key issues facing the Public Utility Commission.

The PUC regulates approximately 8,000 utilities in five sectors: (1) electricity; (2) natural gas; (3) telephone; (4) water and wastewater; and (5) transportation. The mission of the PUC is to balance the needs of consumers and utilities to ensure safe and reliable utility service; to educate consumers to make independent and informed utility choices; and to foster new technologies and competitive markets in an environmentally sound manner.

As the newly-appointed Chairman of the PUC, I am charged with ensuring the PUC carries out this mission, along with my fellow Commissioners. I look forward to taking on this challenge because, in my time as a Commissioner at the PUC, it has become readily apparent to me that the Commission is well-positioned to take on the issues that confront us.

The most important issues facing the PUC right now are (1) the recent transition to competitive electricity markets; (2) the development of the Marcellus Shale natural gas play; (3) concerns about pipeline safety; (4) the ongoing efforts to replace the state's aging utility infrastructure; and (5) the reorganization the PUC is currently undergoing. Today I will explain a bit about each one of these issues.

Background

First, I would like to begin with a little background about the PUC. The agency was created in 1937 by the General Assembly to regulate our state's public utilities. The PUC is lead by five Commissioners who are nominated by the Governor for staggered five-year terms. There are approximately 500 employees at the PUC. We are based in Harrisburg, but we have regional offices in Philadelphia, Pittsburgh, and Scranton. The PUC has a \$56 million budget and is funded by assessments on public utilities.

As I mentioned earlier, the PUC regulates utilities in five sectors. In the electricity sector, the PUC's major responsibilities include regulating electric distribution companies, fostering the development of competitive electricity markets, and monitoring market entry and the conduct of alternative suppliers. In the natural gas sector, the PUC is responsible for the safety of the Commonwealth's more than 40,000 miles of natural gas pipelines, as well as regulating rates for natural gas distribution companies. The PUC's responsibilities in the telecommunications sector include ensuring reasonable local rates and service quality and enforcing requirements accelerating the deployment of high-speed internet service. In the water and wastewater sector, the PUC regulates the rates and services of investor-owned water and wastewater companies, as well as the rates and services provided by municipal systems to customers outside their boundaries. In the transportation sector, the PUC enforces railroad and motor carrier safety laws and handles applications and rate filings of motor carriers that transport property, passengers, and household goods.

The PUC does not regulate cell phone providers, cable companies, internet service providers, long-distance telephone rates, school buses, municipalities, bottled water, rural electric cooperatives, or heating oil.

Electric Deregulation

Of all the issues the PUC faces in carrying out its statutory duties, some of the most noteworthy are those involved in the deregulation of our electric industry. As you may know, in 1996, the Legislature passed the Electric Generation Customer Choice and Competition Act because Pennsylvania's electric rates were 15 percent higher than the national average. The Act unbundled electric rates, set the framework for customers to choose their electric generation supplier, and capped electric generation rates to help ease the transition to the competitive market.

Over the past few years, the rate caps expired on a staggered basis throughout the state. On December 31, 2010, the last of the rate caps ended and now all Pennsylvanians are able to shop for their electric generation supplier. Thus far, more than 900,000 customers have switched to a competitive generation supplier in Pennsylvania. In the PPL Electric Utilities territory, 37 percent of customers, representing 33 percent of load, have chosen an alternative electric generation supplier. However, we still have a long way to go.

As the retail electricity market is structured right now, utilities are required to provide default service to consumers who choose not to shop for their electric generation supplier.

However, as long as default supply exists in its current form, we are never going to see robust shopping numbers in the Commonwealth. Too many people worry they will not know who to call when their power goes out, or are afraid that if they switch, they will offend their incumbent utility, with whom they have a longstanding relationship. In order to address this issue, the PUC will be launching a state-wide investigation into the state's retail electricity markets. The Commission's goal is to determine the elements of the current retail electricity markets that are working and the elements that are not working, including whether there are other models for providing default service that might provide customers with more options for their electric generation.

Encouraging and fostering competitive electricity markets in Pennsylvania is an important mission of the PUC. Without competition we will not have innovation, which is essential in this day of smart meter technology and renewable resources. More importantly, without competition, we will not have affordable rates.

Prior to 1996, Pennsylvania's electric marketplace was dominated by vertically-integrated monopolies. In this environment, all costs incurred by the companies that were deemed "reasonable" by the PUC were automatically passed along to ratepayers, with no incentives to reduce costs or improve efficiency. As long as the lights stayed on and the rates did not increase too quickly or significantly, construction overruns and the cost of other uneconomic decisions could be passed along to ratepayers. Since regulated utilities earned higher returns if their rate base grew, the incentive was to "gold-plate" the system. None of this was good for consumers.

The introduction of competition into the electric industry in Pennsylvania has put a stop to these unnecessarily high rates. Competitive markets impose less risk on consumers because shareholders are responsible for any poor business decisions instead of ratepayers. Competition provides incentives for greater efficiency of operations and drives innovation and smart investments, which keeps costs down. We have witnessed these benefits firsthand in Pennsylvania, with the increased efficiency and reliability of generation resources, the attraction of over 8,500 megawatts of new generation, and the addition of over \$12 billion in capital investment in our state.

These benefits will continue only as long as electric competition continues to thrive in Pennsylvania. It is with this goal in mind – of increasing competition – that the PUC will conduct its investigation into retail electricity markets and the existing model for default supply. I believe we are at a crossroads here and that Pennsylvania must take this opportunity to ensure that competitive electricity markets succeed in our state so consumers are able to experience the benefits.

Marcellus Shale

Another enormous opportunity for Pennsylvania is the Marcellus Shale natural gas play. The Marcellus Shale, which may be the second largest natural gas field in the world, is estimated to contain more than 489 trillion cubic feet of natural gas. If fully developed, it would provide a stable source of low-cost energy to consumers in Pennsylvania and across the nation.

It goes without saying that there is a lot of controversy surrounding the development of the Marcellus Shale natural gas. Parties have raised concerns about how it is extracted from the ground – through a process called hydraulic fracturing – and the impacts that process has on the environment. I am in full agreement that protections need to be in place to prevent harm to the environment and to the residents of Pennsylvania. However, I do not believe we have to choose between protecting the environment and the health of our citizens and developing the natural gas in Pennsylvania. I believe we have the ability to do both, meaning that Pennsylvania can approach this issue in a way that both protects our citizens and allows the natural gas industry to flourish in our state. The Marcellus Shale play represents a major opportunity for the Commonwealth of Pennsylvania to become a leader in natural gas production and this is not an opportunity we can afford to pass up.

Expanding natural gas development in the Marcellus Shale will produce additional jobs, generate increased government revenue, and provide stable, reliable supplies to help secure the state's energy future. Further developing this natural gas-rich region could create as many as 200,000 jobs and more than 18 billion cubic feet of clean-burning natural gas per day by 2020. In addition to direct job growth, increased development in the Marcellus Shale could create nearly \$19 billion in value added to the economy, benefiting other industries, including construction, engineering, finance, health care, education, manufacturing, and services. Local, state, and federal revenue from

exploration and production of the Marcellus Shale could be as high as \$2 billion over the next decade.

Natural gas produced from the Marcellus Shale formation is a clean-burning, Pennsylvania-based energy resource that can be safely extracted in an environmentally sound manner. The abundance of natural gas contained within the Marcellus Shale can energize Pennsylvania's economy and produce thousands of new jobs. Pennsylvania residents and municipalities are currently experiencing the direct economic benefits that are expected to continue as development of the Marcellus Shale formation expands.

Pipeline Safety

However, we cannot have a discussion about natural gas without discussing pipeline safety. With the increased development of the Marcellus Shale came a pipeline construction boom to help get the gas from the field to the interstate transmission system. Unlike most other state commissions, the PUC does not have jurisdiction over the safety of all gathering lines and intrastate transmission lines in the state. The PUC currently inspects certain pipelines under the U.S. Department of Transportation's pipeline safety program, which is administered by the Pipeline and Hazardous Materials Safety Administration (PHMSA). Through this program, the federal government pays the PUC to assume inspection and enforcement responsibility for the intrastate pipelines it has jurisdiction over pursuant to state law. However, Pennsylvania is one of only two of the 31 gas producing states without the jurisdictional authority required by PHMSA of state commissions (Alaska is the other).

Currently, there are two bills before the Pennsylvania Legislature (House Bill 344 and Senate Bill 325) that would remedy this issue by extending the PUC's pipeline safety jurisdiction to cover non-public utility pipelines in Pennsylvania consistent with federal law. Under these bills, the PUC would have jurisdiction over pipelines owned by cooperatives and municipalities, as well as those owned by propane, landfill gas, and natural gas pipeline operators. This legislation would give the PUC the power to conduct safety inspections of the pipelines, but it would not give the PUC economic jurisdiction over the pipelines or the ability to regulate these pipeline operators as public utilities. House Bill 344 would also increase fines for natural gas safety violations to federal amounts (from the current \$10,000 per violation per day/maximum \$500,000 to \$100,000/\$1,000,000).

I strongly support the passage of a gas safety bill so the public can have the maximum confidence in the soundness and integrity of these systems. Although I believe the natural gas transportation network in Pennsylvania is very safe, the recent tragic events in Allentown and Philadelphia have highlighted that we can never take too many precautions.

Aging Infrastructure

That brings me to another main objective of the PUC, which is to address the problem of aging utility infrastructure in the state. Similar to roads and bridges, regular use of utility infrastructure also causes wear and tear on infrastructure systems, requiring replacement. Unlike the roads and bridges we see every day, we cannot see the

deterioration of underground pipes and wires that have delivered services to our homes for generations. Here in Pennsylvania, much of our utility infrastructure – including gas pipelines, electric transmission and distribution systems, and wastewater collection systems – is over 70 years old. Because replacing this infrastructure is extremely expensive, it could take many years for utilities to make these replacements in an affordable manner.

Pennsylvania has largely addressed this issue for the water industry with the Distribution System Improvement Charge (DSIC). Implemented in 1997, the DSIC is an automatic adjustment charge that enables water companies to recover certain infrastructure improvement costs between base rate cases through a quarterly surcharge on customers' bills. The DSIC ensures the least possible rate impact on customers by evenly spreading out over time the cost of replacing and enhancing Pennsylvania's water system. Pennsylvania was the first state in the nation to enact and use the DSIC, and since that time, it has become a national "best practice."

Over the past ten years, the DSIC has had substantial impact on accelerating water infrastructure replacement in Pennsylvania. Prior to the DSIC, Pennsylvania American Water Company (PAWC) projected that it would take about 225 years to upgrade its entire system. With DSIC, the projected amount of time for upgrades to the PAWC distribution system is about 117 years – a timeframe that more closely matches the expected service life of the system.

Given the success Pennsylvania has had with the water DSIC, I believe the next step is to expand the DSIC, or a similar ratemaking mechanism, to other sectors of the utility industry, such as the electric, wastewater, and natural gas sectors. Currently, there are approximately 11,000 miles of cast iron, steel, and even a small portion of wooden natural gas pipes in Pennsylvania that have reached or are reaching the end of their useful lives. If left in place, these facilities will continue to deteriorate.

Natural gas companies spend millions every year repairing, replacing and maintaining the pipelines. The process for recouping the cost of making these upgrades is insufficient and causes unnecessary delays. To solve this problem, the General Assembly should approve a natural gas DSIC that would allow gas companies to recoup the revenue needed to upgrade and improve the pipelines in a timely manner.

The DSIC saves costs, not only in reducing frequency of rate cases, but by incenting flexibility in capital investment incurred to replace aging infrastructure. This would allow natural gas companies the flexibility to perform safety upgrades to the pipelines without a lengthy process to approve the rates necessary to make that large capital investment, and would encourage companies to replace pipelines under an expedited schedule. A natural gas DSIC would also help create hundreds of jobs — utility positions and pipeline contractors — needed to support the infrastructure replacement program. The same reasoning applies to the infrastructure for other energy sectors, which is why I believe it is necessary for the Legislature to authorize a

wastewater Collection System Infrastructure Charge (CSIC), as well as a natural gas DSIC.

Reorganization

The final issue that I want to update you on today is the reorganization that the PUC is undergoing. Act 129 of 2008 afforded the PUC greater flexibility to change our agency structure. Given the many changes in the regulatory landscape since the implementation of the PUC's existing structure, we decided it would be helpful to reconsider how our agency is organized. The goal is to align the Commission to best allow it to meet the duties delegated to us by the General Assembly, thereby enabling the agency to address the regulatory challenges we face in a more effective and efficient manner.

The PUC Commissioners recently presented a new organizational chart to all staff members that continues the functions and responsibilities currently undertaken by the PUC, but realigns them for greater efficiency and effectiveness moving forward. Some of the major changes include: (1) incorporating strategy and planning functions within a new Executive Director position that will also oversee the agency's communications, legislative, and judicial functions; (2) centralizing administrative and personnel functions; (3) maintaining bureaus with regulatory functions under the Director of Operations; (4) consolidating technical staff within one bureau; and (5) more clearly separating the agency's prosecutory and advisory functions.

We have recently held employee forums to address any questions or concerns staff members may have about the reorganization. I am very optimistic that the changes we will make during the reorganization will lead to a more efficient and effective PUC.

Conclusion

As you can see, the PUC has a variety of important issues to address over the coming year. While I stress to the Committee that the issues we face are significant, the foresight that has been demonstrated by both the Legislature and the Commission is to be commended.

Thank you again for inviting me here to speak today. I welcome the opportunity to answer any questions you may have and to meet with you at anytime to further discuss these issues.

