

Marcellus Shale En Banc Hearing on PUC Jurisdictional Issues

Docket No. I-2010-2163461

Testimony of Morgan O'Brien

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Chairman Cawley, and Commissioners, thank you for the opportunity to appear here today. My name is Morgan O'Brien. I am the President and CEO of Peoples Natural Gas Company. You have requested in setting out this hearing, responses to a number of very specific questions. I have chosen to address in my remarks the global opportunity that this energy source presents for this state and the people and businesses that reside here.

My beginning point is that in order for us to truly consider the best policy for overseeing the Marcellus Shale opportunity...we must all place our own self interests aside. Too many folks champion their own self interest in the name of Good Policy and paint their self interest needs as the priorities for all.

Second we must look at the forest and not the trees. And in this instance the forest is the "good of the state and its people". The trees are all of us, the regulators, the utilities, the drillers, the environmental agencies, the land owners, taxing bodies. We all have our important issues and important policy decisions that need careful and thoughtful answers. But before we answer all the questions, we need a view of what's best for the state. What end result are we all working to achieve?

And like many people in this country, we all assume someone, somewhere is working on designing that big picture answer. And as I sat here thinking about all of us trees and our issues and what views we would all have, I was struck by the fact that I'm not sure anyone is really looking at the big picture and really trying to design the vision of where we all need to go. I quickly went through my list of potential candidates as to who might be designing that big picture vision and I quickly eliminated most of us. And so we are all carefully looking at a bunch of very specific issues, whether they are regulatory, environmental or taxing policies, without the clear picture of where we need to be going or what we are trying to accomplish.

So I am here to today to respectfully challenge this commission to take ownership of designing that big picture view of what this opportunity should look like and describe as clearly as possible what we are all trying to

accomplish. This commission is probably without any question sitting in the best place to think through the complex issues this state has been dealing with in nearly all forms of energy. This commission has helped the legislature understand and navigate itself through the challenging rate cap expiration on the electric side. This commission has weighed in on and influenced the need for alternative energy support as well as the need for conservation to be entered into the energy equation for Pennsylvanians. This commission is currently focused on getting legislative support for the need to replace our aging infrastructure in the gas and waste water systems in this state.

Somebody a whole lot smarter than me once said, *“If you want to accomplish something you have never before accomplished you need to try something that you’ve never before attempted.”*

Those words strike a chord with what we really haven’t been able to accomplish here in Pennsylvania. We were fully regulated and prices were perceived high. We have deregulated the supply side of the equation and folks still see prices as both high and very volatile. And one of the lessons we’ve all learned is that you can’t fix the retail side of the equation without dealing with the wholesale side that feeds the retail business to customers. Competition is a fundamental business principal in this country. But competition hasn’t been able to overcome the poor design we find in the wholesale side of our current model.

I have had the good fortune of leading two special organizations, one on the electric side and now one on the natural gas side. So with some knowledge and experience with the issues of those businesses I believe we could dramatically change where people see Pennsylvania’s energy opportunities if we design that vision of where we want to go. And it needs to be today...right now. Businesses need certainty and clarity to make their long term plans and invest in long term assets.

I firmly believe we should not narrow our views so narrow that we see the Marcellus Shale opportunity defined by all of us in this room as the sum total of what economic development occurs in this state. That is, our vision

of this opportunity shouldn't be how to drill the most gas and then pipe the most gas off to the east coast as quickly and as efficiently as possible. But rather our vision should be how we use this huge gas development opportunity to create the largest amount of economic development as possible in this state.

While the Middle East is drilling huge amounts of oil for worldwide usage, the price of gasoline in some of those areas are a fraction of what gasoline sells throughout the world. For instance, in Kuwait City, gas at your local gas station is 25 cents a gallon. And similar pricing discounts can be found throughout the Middle East.

Imagine if the price of energy here in Pennsylvania was a fraction of what it was selling for in other parts of the U.S. Could we all imagine the impact that would have on manufacturers and industry wanting to locate their plants here in Pennsylvania? Imagine the jobs that would be brought to the state. Imagine the investment that would be made in this state.

Let us take a moment and imagine the industries that would be drawn here. The high technology, the leading manufacturing, and other industries that were required large amounts of energy.

Contrast that with the do nothing strategy. If we just allow this opportunity to take the course it is headed down and don't do anything we will have drilled it and piped to the east coast to provide those areas more supply of gas than they would have otherwise seen. Which means if we do nothing the price of gas will be lower in New York, Baltimore, Boston and other large east coast towns. And we will have created meaningful jobs to drill the wells and meaningful jobs to expand our current pipe system to move the gas east. But that's it. End of economic development story here.

As I'm sure you have heard from various legislators and other leaders in this state, there is a strong push to take advantage of this new supply opportunity. There is talk of having school buses and state vehicles converting into natural gas fueled vehicles. There is more talk having natural gas filling stations throughout the state. And I support all of those initiatives. But I believe there is an even bigger opportunity here.

Now as I began my testimony, I stated that I believe the wholesale markets are broken or at least not functioning very well. And clearly this is more of an issue in the electric markets. Now to address that issue, let's assume for "our new vision" we disregard those wholesale markets and design our own.

Attached to my testimony are two tables that show an estimate of what the price of Marcellus gas need to sell for in order to achieve a 10% IRR and a 15% IRR for the drilling company. This is based upon average Marcellus shale drilling costs. So what you can see is that a fair return can be achieved from this drilling and still produce a very attractive price.

Also attached to my testimony is the resulting electric prices under those various return scenarios if a new combined cycle gas power plant were built and entered into a contract providing the gas drillers those stated returns and providing the power plant owner the same return as the driller in each instance.

The resulting pricing derived with a 10 percent IRR for both the driller and the power plant owner is \$4.95 per mcf price for natural gas and the price electricity would be \$49.95 per mwh. And if you increase the IRR to 15% the price of gas is \$5.40 per mcf and the price of electricity is \$52.20 per mwh.

10% IRR	15% IRR
\$4.95 mcf	\$5.40 mcf
\$49.95 mwh	\$52.20 mwh

This feels both powerful and compelling. Imagine going out and marketing these prices in Pennsylvania to our existing industries as well as to new ones for the next 20 years. We would not only offering prices that no other state could match but also offering certainty and completely removing the

volatility that typically is a bigger issue than the price for making investments. Truly imagine that for a moment.

Imagine all of the jobs that this engine would be creating here in this state. Try to imagine that.

What my analysis shows is that if we wanted to guarantee long term price stability for both natural gas and electricity this Marcellus Gas opportunity provides us a means of doing that.

So let's go back to my first fundamental principal of doing what's right for Pennsylvanians by placing all of our self interest outside this room and outside this mission of finding our vision for the future. And let's combine it with the statement "If you want to accomplish something you have never before accomplished you need to try something that you've never before attempted."

So rather than choosing an existing party in this case as to who should be benefitting from this possible vision, let's create something that we haven't done here before. Let's create an entity whose sole purpose is to ensure that the economic vision of this becomes a reality for our state.

For lack of broader thinking on my part, let's create a state wide power authority who champions this concept. Its purpose would be to own the gas wells and power plant assets to offer energy to targeted customer groups. Alternatively the same opportunity could be achieved by entering into long term contracts with current owners of wells and power plants.

Imagine the potential economic impact of this state having a Power Authority that could offer natural gas at \$4.95 per MCF for the next 20 years and offer electricity for \$49.95 per mwh for a 20 year period while the Power Authority or whatever entity you felt made the most sense earned fair return on its investments.

Now take this opportunity of offering low prices to Pennsylvanians and expand to it the possibility of placing distributed electric generation strategically throughout the commonwealth. With a low cost fuel source, these assets become very compelling resources. We could not only have

a huge economic development opportunity with lower prices but also provide a more secure delivery of electricity by minimizing the potential for power interruption. Such a combination would be compelling for technology and research companies which require higher forms of reliability.

And we could begin a blueprint of what the future design of electric generation without the large power plant footprints but rather smaller distributed generation assets closer to the customers.

Imagine all of that.....and more.

“If you want to accomplish something you have never before accomplished you need to try something that you’ve never before attempted.”

Thank you for this opportunity today.