ANTICOMPETITIVE THREATS FROM PUBLIC UTILITIES: ARE SMALL BUSINESSES LOSING OUT?

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HOUSE OF REPRESENTATIVES

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WEDNESDAY, MAY 4, 2005

HOUSE OF REPRESENTATIVES
COMMITTEE ON SMALL BUSINESS
Washington, DC

The Committee met, pursuant to call, at 2:15 p.m. in Room 311, Canon House Office Building, Hon. Donald A. Manzullo [chairman of the Committee] presiding.

Present: Representatives Manzullo, Bartlett, Chabot, Akin, Fortenberry, Westmoreland, Velazquez, Lipinski, Christensen, Davis, Sanchez and Moore.

Chairman MANZULLO. Good afternoon, ladies and gentlemen. Today's hearing focuses on another part of a consistent theme raised from this podium.

Our Committee and small business advocates of every stripe worry about the health of the marketplace and certain actions by government that tip the scales in favor of one party over another. There have been many instances where the big guys and the well connected are protected at the expense of the entrepreneur or where the new entrant or small businessman is overlooked. We have fought against this many times in the past.

For instance, when our Committee learned that the Federal Government Printing Office was taking away work from the private sector we shut them down. We went after Federal Prison Industries for similar unfair practices. This even applies in the trade setting.

We have raised questions about government subsidized or government controlled entities winning U.S. Defense contracts. I have spoken out about Chinese state owned companies competing with U.S. companies that have private shareholders and face real market pressures which state controlled entities can avoid. It is a simple question of fairness.

Today the issue we confront is growing competition from service companies owned and controlled by investor owned utilities and some municipal owned utilities. The real worry we have here is not dissimilar to the other examples I mentioned. The utility companies in most every state have their rates fixed by public utility rate commissions, and they are essentially guaranteed a profit each year. Their costs are a public record. Their rates are fixed with a reasonable profit in mind.

This is a legacy of the very high priority we place on electrifying nearly every home in America and not unlike the universal service fund program we have devised for telephone services. While many might question the wisdom of these arrangements, they are a fact of life for every American.

Increasingly, the utility companies are creating subsidiaries and affiliate companies that provide other kinds of services apart from the basic power supply delivery. The diversity and scope of these services seems to grow each year. Companies owned and operated by these utilities sell plumbing and electrical services, home remodeling, vinyl siding, storm windows, subscription service contracts, appliance sales and rentals and many other services that range from home security systems to high-speed internet access. It is truly a growing phenomenon.

Like me, the witnesses here today are concerned that these new companies enjoy unique advantages because of their special status as instruments of a public utility. While direct subsidy from ratepayers is proscribed, there are many ways that these new entrants could get an unfair advantage.

For sure, they can obviously use the highly visible brand name developed over many years and paid for by the guaranteed profits. So too, many are able to avoid a lot of the pitfalls of finding start-up capital that others might face without the benefit of a successful and long-established parent. These are just a few of the concerns we hope to learn more about today.

If you do not see a witness from the public utility sector, they refused to participate in this hearing. We have other methods, including subpoenas, to get to the heart of this matter. We are very upset—very, very upset, extremely upset—with the special status that the public utilities have and the lists of customers are being used to disadvantage little people, those before us, those who have the integrity to show up and participate in the hearing.

I now recognize the Ranking Member, the gentlelady from New York, for her opening remarks.

All Members are reminded that following today's hearing they will have five business days to submit statements in writing or other supportive material that without objection will be made a part of the hearing transcript.

At the appropriate time following Mrs. Velazquez's opening statement I am going to recognize Congressman Tierney, who has a constituent that he wants to recognize.

Congresswoman Velazquez?[Chairman Manzullo's statement may be found in the appendix.]

Ms. VELAZQUEZ. Thank you, Mr. Chairman. There is no question that our nation's small businesses are facing a myriad of challenges today. Between skyrocketing health care, energy and gas prices to a growing budget deficit, there are significant barriers standing in the way only making it more difficult for small business owners to successfully run their business on a daily basis.

Not only do they have to deal with this additional cost, but small business traditionally face unfair competition from larger businesses. This competition has been particularly dominant in industries related to energy. Small firms consistently find themselves

living in the shadow of large public utility companies. That is why protections such as the Public Utility Holding Company Act, PUHCA, have been put into place.

Since its inception in 1935, PUHCA has acted as a firewall protecting small businesses from having to compete with monopolies within the public utility industry. PUHCA was created to eliminate unfair practices and other abuses by electricity and natural gas holding companies. By limiting the geographic scope of public utilities, state utility commissions were able to effectively regulate them.

However, regulation and protection is about to become significantly tougher. Two weeks ago the House passed an energy bill that did little, if anything, to help small firms. With today's national average price of gasoline at a record level of $2.24 a gallon, 42 cents higher than just a year ago, the situation is only getting worse.

Not only did the energy bill fail to relieve small businesses of the record high gasoline prices, but it also repealed PUHCA. Without the protections of PUHCA it will be difficult to regulate multi-state public utility holding companies. Utilities will be able to take liberties in regard to cross-subsidization that are currently prohibited.

The repeal of PUHCA gives utility companies a clear, competitive advantage. Not only will this wrongfully harm small businesses and consumers, but it will negatively impact the U.S. economy altogether. In the past, allowing public utility companies to break into unregulated areas has simply not worked.

Prior to the inception of PUHCA, 53 public utilities failed, creating significant economic disruption. Since its inception, not one PUHCA regulated utility has failed, and it has prohibited utilities from entering into unregulated endeavors, protecting small businesses and this nation's economy.

When the House passed the energy bill, not only did it repeal PUHCA, but it failed to offer any new safeguards. Clearly what we need now is strong protection for small firms. If the Bush Administration decides that public utility companies should be able to delve into this area then we need to ensure that protections are in place.

Democrats have been engaged on this issue in the past. Over the last two Congresses we wrote a letter to the chairman of the Energy and Commerce Committee asking them to ensure that protections are in place in these instances.

What is most upsetting is that we are sitting here weeks later to address a problem that could have been prevented if we had broached this subject before the energy bill came up in the House. Now the battle is even tougher as we try to ensure that a provision is offered in the Senate.

What we need now is a provision that offers protection to small businesses, one that will not allow the public utility companies to use ratepayer assets to pursue their own ventures, one that prohibits utilities from using an already branded name and using equipment already under their monopoly in order to provide additional services.

Clearly small businesses do not have the resources to compete with these unfair advantages. Not only do this nation's entrepreneurs deserve a level playing field, but they also deserve to be

protected. Without the protections offered under PUHCA, our nation's entrepreneurs and our economy will be teetering on the brink of yet another economic disruption.

With an economy still struggling to recover, we must ensure that a provision is offered in the Senate so our nation's small businesses can continue doing what they do best, creating jobs and stimulating economic growth.

Thank you, Mr. Chairman.

[Ranking Member Velazquez's statement may be found in the appendix.]

Chairman MANZULLO. Thank you.

Congressman Tierney?

Mr. TIERNEY. Thank you very much, Mr. Chairman and Ranking Member Velazquez. I appreciate this opportunity to introduce my friend, a member from my district on this.

Hugh Kelleher is the Executive Director of the Plumbing-Heating-Cooling Contractors Association of Greater Boston. He has great ties to my district, which is north of Boston, and helps out on a lot of different Committees from the Tree Committee on up in the community in which he lives.

He is also obviously the head of the Plumbing Contractors Association of Boston, but I found out from our conversations earlier that he is a former staff member here in Congress, having worked for Jim Shannon when he was a congressman here on the Ways and Means Committee, and he himself is a licensed master plumber and a small businessman who is now working with the Association.

Mr. Chairman, I understand that this hearing is going to deal with anti-competitive threats from public utility companies, and Mr. Kelleher has a compelling story to tell about what is going on in Massachusetts.

You mentioned in your opening remarks about the tipping of the scales, the big guys against the small people, the small regular people in America. I think that is what we are seeing more and more. Here with utilities we are dealing with monopolies that have friends in high places. Unfortunately, too often those friends in high places wage their influence here in Washington, and it is not always a good result for small businesses.

There are a number of ways we can deal with that. One is legislatively, and I am glad to see that this Committee is getting out in front of that. I commend you for that. Another is regulatory, but in both of those ways too often it is like a David and Goliath battle for small businesses.

There is a saving grace in our system, and that is of course the balance of powers and the fact that we have a judicial system that allows people to take recourse there if necessary. I talked to Mr. Kelleher earlier today and told him that I think that if we are not able to do things legislatively then certainly hopefully their national and state organizations might look at the Federal Trade Commission Act and our local FTC Acts like Massachusetts' Chapter 93[A] and try to get to the bottom of this by using those re-

sources against these unfair business practices. It will help them both prove their case and get some recourse for it.

I just want to thank you, both of you, and all the other Members of this Committee for the hard work that you are doing in this area and the fact that you regularly stand up for small businesses and do such a great job of it. I thank you for welcoming Mr. Kelleher here. I know you will give his testimony full consideration, and I appreciate the opportunity to come here today and introduce him.

Chairman MANZULLO. Thank you, Congressman Tierney.

Our first witness is Mike Martin, president of F.K. Everest, speaking on utility unfair competition and cross-subsidization.

Mike, you have to speak closely into the mike. Thank you.

The clock is timed for five minutes. It is right in front of Mr. Kelleher. That does not mean that the timing only applies to him. When it gets down to the yellow that is one minute. When it gets to the red you are out of time, okay?

We look forward to your testimony. The written statements of all the witnesses will be entered into the record without objection.

Please proceed, Mr. Martin. You have to turn on the mike there.

Mr. MARTIN. Sorry.

Chairman MANZULLO. All right. Start all over again. We will reset the clock. Go ahead.

STATEMENT OF MIKE MARTIN, PRESIDENT, F.K. EVEREST, INC.

Mr. MARTIN. Good afternoon, Chairman Manzullo and Members of the Committee. My name is Mike Martin. I am president of F.K. Everest Electrical Contracting, a firm headquartered in Fairmont, West Virginia. Our firm is a member of the National Electrical Contractors Association, and today I speak for myself and also on behalf of the entire association of 4,200 electrical contractors across the United States.

I have served as president of F.K. Everest since the year 2000. In that position I have had direct experience with problems of competing with utilities on a playing field that is anything but balanced. Prior to coming to F.K. Everest, between 1986 and 1996 I held several positions with Allegheny Power System, so I can truly speak to this issue from personal experience.

Here are some examples of the ways utilities can unbalance the competitive playing field in favor of their unregulated entities. One way a utility gains a competitive advantage is for its unregulated, non-utility entity is through the practice of incremental billing. When a normal business has to rent or purchase equipment or hire manpower it must do so at market rates.

However, an unregulated electric utility using the same equipment and manpower provided by its utility operations is billed only the incremental cost for the rental of the equipment instead of the fair market price. This constitutes a major unfair advantage for the utility's unregulated venture.

The utility will argue that billing at such incremental cost is not cross-subsidization because they are billing for all costs incurred for the additional use of that equipment or for the personnel.

Chairman MANZULLO. Mr. Martin, first of all I want you to take a sip of water, and I want you to relax, okay? We are going to add some time back to your clock again.

Are you all right? Is this your first time speaking before a congressional hearing?

Mr. MARTIN. Yes. Yes, sir.

Chairman MANZULLO. Okay. What I would like you to do is to go to the portion of the testimony that tells your story.

Mr. MARTIN. Sure.

Chairman MANZULLO. Then if there is time we can go back to the general picture. Is that okay with you?

Mr. MARTIN. That is great.

Chairman MANZULLO. All right.

Mr. MARTIN. Thank you very much, Mr. Chairman.

Chairman MANZULLO. We will tell you when to stop. Just ignore that timepiece, okay? Go ahead.

Mr. MARTIN. Okay. Addressing the issue of incremental cost, the utilities are customarily billing their non-regulated entities for incremental cost, which is just the additional cost for using that equipment or personnel and not the full market price of the use of that equipment.

However, while there are no additional costs to the utility, the non-regulated company has gained an unfair advantage. It is a benefit derived from the use of the utility property, and I feel that that difference between the market price and the incremental cost should remain in the regulated company to the benefit of the utility customers.

A specific example might be if a specialized piece of equipment is used by the non-regulated utility and it is used let us say 10 percent of the time. The utility may have purchased that again for themselves for 10 percent of the time, and they have to have it available to them 24 hours a day, seven days a week, in case of an emergency, but if the non-regulated side needed that piece of equipment and it is rented to them at the incremental cost, just the cost for demand power or to operate the equipment or the fuel or maintenance, there is an unfair advantage because while they are not directly subsidizing the non-regulated utility and the equipment is better utilized, the subsidiary has been given an unfair advantage by the below market rates.

If a contractor needs the same piece of equipment he has a couple options. One, he can purchase the equipment, and if he is only

using it 10 percent of the time he has to spread the full cost of that equipment over that 10 percent of the time he is using it, or he could go out and rent the equipment, and again he has to pay the full market price for that equipment. If the subsidiary chooses to use that equipment again for its competitive ventures it should be charged the full market price for that equipment.

Another item would be a non-regulated entity affiliated with the public utility benefits directly and substantially if it uses the name and logo of the public utility. It also benefits even for its inherent relationships whether it uses the actual name or logo. As soon as a sales representative tells a potential customer their relationship with a public utility they immediately gain from the name recognition and the goodwill of that public utility.

An independent contracting firm has to use its own money to advertise and to build its own business relationships. In our area, if you look in the yellow pages of the local telephone book you will see many advertisements for electrical contractors. However, you will not see any advertisements from a utility non-regulated business.

As a contractor, I would love to have mailings on a monthly basis, a postcard or a utility bill, mailed to all my current customers and potential customers on a monthly basis so when my salesperson makes a call to that customer they would immediately know who I am. Again, this is just another example of how the utilities gain, how their non-regulated entities gain from the utility business.

Another example would be upgrades involving customer owned and utility owned facilities. There was a local hospital who was upgrading their electrical facilities for future renovations, and it included their switchyard and some utility facilities within their switchyard. This particular service point was a critical point for the hospital. It could not be taken out of service, nor could it afford any interruptions.

The customer's representative who heard about this before the general public and was dealing with the customer had stressed to the customer that there had to be very strict, close cooperation between the contractor and the utility to achieve this work. He also went on to say the only way to assure that cooperation was for the utility to do work on both the customer owned and the utilities. In fact, he was in our office and mentioned that he was—

Chairman MANZULLO. Mike, go on to the college.

Mr. MARTIN. Sure. Okay. The local college—

Chairman MANZULLO. Is this not fun? Go ahead. Go ahead, please.

Mr. MARTIN. Yes. In this instance, the local college had a 10-year construction plan where they were going to be building some new buildings and remodeling and renovating some existing buildings. In this case it was a state owned college, and they received their service at a high voltage through a single metering point. From

that point to the individual buildings it went through the college owned facilities; not utility owned, but the college owned facilities.

Again the utility, through the utility practice, heard about the project before the general public did, had their foot in the door, talked with them and convinced the colleagues to single source the construction or upgrade these facilities directly to the public utility but through their non-regulated entity.

When we became aware of it and mentioned it to the National Electrical Contractors Association they challenged the project as a giveaway and the fact that in the State of West Virginia state agencies are to solicit bids for any projects over $25,000, and in this case they had not.

After challenging that issue all of a sudden the project became a utility owned facilities. The college turned the facilities over to the utility, and the utility upgraded them and put individual metering points at each service location. Therefore, it took the work away from the non-regulated side, and it became a utility property.

Chairman MANZULLO. Okay. I am going to halt you right there.

Mr. MARTIN. Sure.

[Mr. Martin's statement may be found in the appendix.]

Chairman MANZULLO. Are you doing all right?

Mr. MARTIN. I am doing okay. I apologize.

Chairman MANZULLO. You do not need to apologize. Have another sip of water, and then we will be back with a round of questions, okay?

Mr. MARTIN. Sure.

Chairman MANZULLO. Our next witness is Brian Harvey. Brian is from Laurel, Maryland. I think we met what, a couple months ago?

Mr. HARVEY. You met our president, Richard Dean.

Chairman MANZULLO. Okay.

Mr. HARVEY. Yes.

Chairman MANZULLO. In any case, from your company. That was one of the interesting stories that further peaked my interest in the subject.

Brian, we look forward to your testimony.

Mr. HARVEY. Thank you. Thank you, Mr. Chairman.

Chairman MANZULLO. If you see the clock there, we will follow regular order on the clock. I gave an exception to Mr. Martin because he needed some time to drink his water.

Go ahead.

STATEMENT OF BRIAN HARVEY, PRESIDENT, H&C INC.

Mr. HARVEY. Thank you, Mr. Chairman and Ranking Member Velazquez and all the other Members of the House Committee on Small Business.

I am here representing the Air Conditioning Contractors of America. We represent 5,000 local, state and national members. Most of our contractors are family owned and operated small businesses, and many of these businesses are in their second and third generation of family ownership.

My company in Laurel, Maryland, we have 25 employees. I am a second generation owner. My father started the business in 1969. We provide residential and commercial heating and air conditioning service throughout the State of Maryland. I am also a board member of the Maryland Alliance for Fair Competition and the past president of the National Capital Chapter of ACCA.

I first experienced unfair competition with a local utility company in July of 1994 when Baltimore Gas & Electric, BG&E, purchased one of my largest competitors. BG&E's acquisition of Maryland Environmental Systems created a 800 pound gorilla in the central Maryland heating and air conditioning contracting community.

Before purchasing Maryland Environmental Systems, our company had always had a good working relationship with BG&E and participated in many, if not all, of their contractor programs. Maryland Environmental Systems was a large, well-established, well-organized heating and air conditioning company. BG&E gave them an infusion of cash and allowed them to share in over one million residential and commercial electric customers and 600,000 gas customers.

Maryland Environmental Systems, which was renamed BG&E Home, gave BG&E immediate entry into the air conditioning contracting field. They provided the platform of established operating systems, trained personnel and contracting knowledge.

Almost immediately we saw former Maryland Environmental Systems employees driving around in BG&E trucks, trucks that were paid for with ratepayers' money. These trucks that were originally purchased by Baltimore Gas & Electric to provide Maryland ratepayers with gas and electric service were now being used by BG&E Home to install heating and air conditioning systems in direct competition to me.

The two companies began to share resources and consolidate overhead expenses. Needless to say, with plenty of cash and plenty of customers the company flourished. As an independent businessman, I find myself continually working harder to try and maintain market share. I do not get free trucks from the electric company. I have to pay for my trucks like every other business does.

When marketing to new customers I have to explain to them who my company is and why they should choose us to install their new furnace or air conditioner. BG&E Home never has to explain who they are because everyone gets an electric bill every month with the BG&E logo on it. No doubt, many of you have these in your own homes. You get the utility bill with the stuffer in there trying to sell you storm windows and plumbing repairs and what else.

The point is that the name has immediate and enormous name recognition. The utility's name is just a slam dunk with the consumer.

To give you an idea of how important that name is, a somewhat different scenario recently played out in the Washington metropolitan area. Washington Gas, which is a public utility like BG&E, decided to enter the air conditioning business. They did this by putting up $25 million along with a private venture capital fund who also put up $25 million to begin operations, so with a pool of $50 million they started purchasing privately owned air conditioning firms and consolidating them under one name.

They named the new company Primary Multicraft, a $50 million company with acquired HVAC contracting expertise, but with no identifiable history and no name recognition. They had almost the same business model as BG&E Home, yet they did not use the utility's trademark name. Two years later they filed Chapter 7, and they were out of business.

This shows the importance of the brand and what that means to the companies. Recently both Home Depot and Sears have enthusiastically entered the home air conditioning market. I do not like competing against two of the largest retailers in the country, but it is a fair fight. They have paid for their name recognition with their own resources and not with the ratepayers' money.

I do not want preferential treatment or more regulatory burdens, but I do want a fair playing field. Let the consumer decide for themselves. I am happy to compete with anybody, but a utility has a unique advantage over an independent business person, and it is really not fair.

Thank you for your time and attention.

[Mr. Harvey's statement may be found in the appendix.]

Chairman MANZULLO. Thank you.

Our next witness is Mr. Kelleher, who has already been introduced. Mr. Kelleher, we look forward to your testimony.

If the remainder of the witnesses would try to concentrate on the anecdotal stories that brought them here? We know the big picture. We want to know how it impacts you directly.

Mr. Kelleher?

STATEMENT OF HUGH KELLEHER, PLUMBING-HEATING-COOLING CONTRACTORS OF GREATER BOSTON

Mr. KELLEHER. Thank you, Congressman Manzullo, Ranking Member Velazquez, other Members of the Committee. Let me get right to the point, although I do just want to mention it is a great pleasure as a former congressional aid to be here in a meeting and actually be offered a seat.

The situation in my home state really began to take on added dimension when KeySpan moved up from New York. Each year they have been authorized by our state's energy regulatory agency to include in its rate structure a promotional budget line item.

That promotional budget line item costs the natural gas customers millions of dollars each year in Massachusetts, but if you peel back that line item to see what those millions of dollars are

spent on you find that much of it is being used to promote KeySpan's unregulated affiliated businesses.

What are those businesses? They include a large heating and air conditioning which competes directly against mom and pop contractors like the ones I represent.

Just to follow up on an earlier example, I can tell you that in Massachusetts we saw one utility company bid directly against an electrical contractor on a job. The utility company bid remarkably low. People wondered how they could even cover the cost of the materials. Naturally they won the job.

A few weeks later if you went out to that jobsite do you know what you saw? You saw the trucks. You saw the backhoes. You saw the workmen of that utility company. Now, I am sure that my friends who are electrical contractors would be very pleased if they could have the ratepayers covering the cost of salaries for their employees and making payments on their trucks.

How aggressive are the utility companies in terms of syphoning off assets to open up and support other unregulated business? I think the most extreme example that I have seen occurred when KeySpan came into our state and opened up a web based business called MyHomeKey.com.

One day I went to their website and discovered to my amazement that not only would this gas company affiliate send someone over to install a gas stove in direct competition to my business or a sink. Their website told me in fact that they would even be willing to come over and clean my drapes or have someone come by and cut my lawn. So much for the efficient delivery of natural gas.

Now, we do not know how much money was wasted while the utility company tried to get into the landscaping and drapery cleaning businesses, but each dollar spent on that ill-conceived business plan was absolutely a dollar which could have been spent either upgrading their unreliable gas delivery system or reducing the cost of natural gas.

One of the common models actually is the free equipment giveaway. A utility like KeySpan makes every effort to convert customers from other energy sources by giving away free equipment. Free equipment offers raise a couple of basic points. First of all, the consumer is paying through their gas or electric bill the cost of that free equipment. If the utility company stuck to its primary business, which is supposed to be the reliable, cost-efficient delivery of natural gas or electricity, prices could actually be lowered and their delivery systems could be improved.

The second problem is that these promotional giveaways have a highly negative effect on small business people. It is very difficult for a plumbing company to bid a job against a utility's affiliate when, as in the case of KeySpan, that affiliate has a whole warehouse full of boilers and furnaces which have been paid for by the ratepayers.

Before I conclude I just want you to imagine one scenario. You and I each run a business in the same town. We are competitors, but part of my business has access to hundreds of thousands of dollars of government approved subsidies. That part of my business has a special status which in fact grants me a profit, and I use that

profit and shift funds and resources over to the part of my business which competes directly against your business.

I can guarantee that over time no matter how well you run your business, no matter how well your employees are trained, no matter that you offer a truly market rate price, I will put you out of business. Now, this does not sound to me like the kind of economic model that made the American economy the greatest in the world.

What we are asking for in quick summary is that in conference with the Senate that your Committee work with representatives from Energy and Commerce, take a closer look at this issue. We are not asking for more regulation. All we are asking is that Congress actually create a firewall between the utility's regulated businesses and its unregulated affiliates.

Thank you very much.

[Mr. Kelleher's statement may be found in the appendix.]

Chairman MANZULLO. Before you end, you are speaking on behalf of yourself and on behalf of the?

Mr. KELLEHER. Plumbing-Heating-Cooling Contractors Association National. We represent thousands of plumbing and heating/cooling contractors from every state in the United States.

Chairman MANZULLO. Thank you, Mr. Kelleher.

Mr. KELLEHER. Thank you.

Chairman MANZULLO. Our next witness is Adam Peters, Research Fellow and Regulatory Counsel at the Progress & Freedom Foundation.

Mr. Peters, we look forward to your testimony.

STATEMENT OF ADAM PETERS, THE PROGRESS & FREEDOM FOUNDATION

Mr. PETERS. Thank you, Chairman and Members of the Committee. Thank you for the opportunity to speak to you today. My name is Adam Peters, and I am a Research Fellow and Regulatory Counsel for the Progress & Freedom Foundation, a think tank that studies the digital revolution and its implications for public policy.

Your hearing today is a timely one as public utilities increasingly are entering into new markets, including communications, which is my area of research. I have a lot of sympathy for regulators who must address the questions raised by utility entry into new markets. From a consumer welfare perspective, it may be efficient for a firm to expand into complementary markets. This may serve to increase competition in these markets, driving down prices and fostering innovation.

However, the incentive may also exist for a utility to cross-subsidize the activities of an affiliate through its rate base. Left undetected, this strategy may cripple competition in the unregulated market while additional costs are extracted from the rate base through higher monthly bills.

In addressing cost subsidization concerns, one tool regulators use to balance efficiency benefits with fair competition is the cost allocation method. Cost allocation is vital because it sets the competitive equilibrium in the market. To be sure, cost allocation issues can quickly devolve into an exercise in blackboard economics where competitors seek protection from competition and where one right answer is unattainable so the process essentially asks regulators to make a predictive judgment, but I do think it is the best one they have.

The balance between efficiency and fair competition is therefore more tenuous when the cost allocation is removed from the equation. For instance, literally dozens of municipalities are entering into the communication space, and these efforts are usually backed by municipally owned electric utilities.

In recent months this has become a highly contentious issue in a number of states. Municipal entrants in the communications markets may enjoy several artificial advantages over entrants from the private sector. They may be exempt from taxation. They can raise capital through the issuance of guaranteed tax exempt bonds. They may enjoy free access to utility poles and rights-of-way.

Finally, municipally owned utilities in many states are exempt from oversight by state commissions and are therefore immune from the cost allocation requirements that might otherwise apply to their privately owned counterparts. Under these circumstances, the right of cross-subsidization and market distortion is magnified.

For example, a recent study authored by my colleague, Tom Leonard, focused on three municipal entrants in Bristol, Virginia, Kutztown, Pennsylvania, and Ashland, Oregon. Dr. Leonard concluded that the three municipalities which offer broadband services in competition with private companies were unable to cover their costs without being subsidized. He estimated that the subsidies in these localities range from $350 per customer to over $1,000 per customer.

Now, admittedly it is quite possible and perhaps even likely that head-to-head competition between these entrants and a private competitor will apply downward pressure on prices in the short run, but the ability of the municipal entrant to tap into an endless stream of subsidies from their rate base may include both short run and long run costs.

The short run costs may include higher electric rates for taxes. The long run costs include the possibility of picking their own technology, creating entry barriers to new competition and predatory pricing, which would drive capital from the market.

Now, despite the foregoing care should be taken in my view before legislating new federal rules without a clear showing that there is a jurisdictional vacuum. Where investor owned public utilities are concerned, in my view state commissions are pretty well equipped to handle cross-subsidization concerns.

To be sure, the challenge of monitoring and regulating investor owned utilities is real, but most states to my knowledge have brought authority to protect consumers from unreasonable rates, including auditing authority and the power to investigate affiliate relationships.

Some states have in recent years adopted codes of conduct which govern regulated and non-regulated entities, and while municipal entry into communications raises another set of difficult policy questions I would likewise defer to the judgment of state and local officials and citizens in evaluating the need for these services in light of local conditions.

I want to thank the Committee once again for this opportunity and ask that my written remarks be made part of the record. I am happy to answer any questions later.

[Mr. Peters' statement may be found in the appendix.]

Chairman MANZULLO. Thank you very much.

Our next witness is Lynn Hargis, who is an energy attorney with Public Citizen. We look forward to your testimony.

STATEMENT OF LYNN HARGIS, ON BEHALF OF PUBLIC CITIZEN

Ms. HARGIS. Thank you, Mr. Chairman, Ms. Ranking Member, Members of the Committee. Thank you very much most of all for having this hearing.

If the Public Utility Holding Company Act is actually repealed after 70 years we are going to have a Tsunami of problems with utility non-regulated affiliates not only for small businesses, though they will be very affected, but for all the rest of the country as well.

I would like to just point out one mistake in my testimony. In the last paragraph on the first page I said under PUHCA utilities could not go into non-utility business and companies had to give up their non-utility businesses.

I am afraid I bought sort of the other side, which is that PUHCA is already gone. It is not already gone, so that should say that under PUHCA utilities cannot go into non-utility businesses and companies have to give up their non-utility businesses.

Right now it comes as a surprise to a lot of people that oil companies cannot for example own public utilities. The minute PUHCA is gone they will be able to do that. We may not be able to reduce the oil prices immediately with a stroke of the pen, but with a stroke of the pen repealing PUHCA we absolutely can come up with an electricity/natural gas/oil cartel.

This is a matter of great, great importance and I really commend this Committee for taking a look at it. Just to quickly illustrate that PUHCA is still very much alive, this is from an international law firm whose clients deal power plants. It is called The Project Finance News Wire. It happens to be the distinguished law firm at which I worked for 17 years, but they do not in any way endorse what I am saying here today.

It has just a heading in this article, and it says, "The 1935 law called PUHCA requires overseas buyers acquiring U.S. utilities to shed their non-utility businesses." I do not know. I find that a lot of people do not realize right now that foreign companies cannot under PUHCA come in and acquire public utilities unless they happen to be public utility holding companies themselves, and that is only very recently.

It does not seem to bother anyone else, but I think it may bother small businesses that they are not only going to have to compete with huge American public utility holding companies, but also EON is a German pharmaceutical company who wants to buy American utilities. There are companies all over the world that want to do that, and the minute that PUHCA is gone they will be able to do that.

The other thing I wanted to show you happened after I wrote my testimony yesterday morning I am afraid, so this is very, very recent breaking news. We won a case at the Securities and Exchange Commission, and an Administrative Law Judge ruled that the American Electric Power/Central & Southwest Public Utility Holding Company merger should be denied under PUHCA because the main issue in that case was are Michigan and Texas in the same region of the United States.

Now, I have personal opinions as somebody who grew up in Texas on that, and I think probably most of you do as well. The judge found that they did not. The Court of Appeals had indicated this when they remanded the case along with a map showing AEP up here and Central & Southwest down here.

This still goes to the full Commission, but the point I am trying to make is there is nothing in the federal law, in any of the laws of the United States, that would stop this merger other than PUHCA. The FERC said oh, it looks great to us. They I think required them to get rid of 500 megawatts. That is like one merchant power plant. AEP has 30,000 megawatts.

The Department of Justice said this looks okay under the antitrust laws. The Federal Trade Commission said this looks okay to us under the antitrust laws, but they have repeatedly told the Congress in testimony that they do not have the kind of structural jurisdiction over utilities that PUHCA does.

So you are talking about an 800 pound gorilla. This is going to be an 800 million pound gorilla because they made it very clear that if PUHCA is gone not only can AEP acquire Central & Southwest; they can acquire the Southern Company, Entergy, Xcel, Excelon. In fact, we can have one big, happy public utility holding company that owns all the utilities in the United States. Prior to the enactment of PUHCA that is pretty much where they were headed.

Some of you may have seen on 60 Minutes the show Who Killed Montana Power Company. This is a 90-year-old electric utility in Montana, and as soon as utilities were allowed to purchase telecommunications businesses they jumped into that. They bought telecommunications businesses, and then they thought oh, let us get rid of this utility stuff—it is kind of boring—and so they did.

Unfortunately, the telecommunications business did not quite work out. They went bankrupt. In the meantime, Northwestern, which is a South Dakota utility who had bought some of those transmission and other utility facilities, had also gotten into telecommunications. They went bankrupt. In the meantime, Montana citizens found out they were having to pay really high prices to get power from their own former power plants that had been sold off to an unregulated business.

You know, whether you look at what happened before PUHCA in the 1920s or you look at what happens like with someone like Enron who got all sorts of exemptions from PUHCA today or whether you look at Montana Power—

Chairman MANZULLO. One thing I am not exempt from is the time.

Ms. HARGIS. I am sorry. I forgot to look.

Chairman MANZULLO. That is okay.

Ms. HARGIS. Thank you very much.
[Ms. Hargis' statement may be found in the appendix.]

Chairman MANZULLO. Thank you very much. Thank you for the excellent and very diverse testimony.
Let me try to weave something here, and perhaps you can help me. I think whoever wants to try to answer the question please feel free to go ahead with it.
Ms. Hargis, let me ask you this question. Are there any public utility companies that are not-for-profit in the country, municipally owned?

Ms. HARGIS. Well, municipally owned ones I assume.

Chairman MANZULLO. Okay. Do we see any indications that some municipally owned utilities are getting into the heating and air conditioning business? Does anybody have any knowledge of that?

Mr. KELLEHER. I cannot say I know.

Chairman MANZULLO. Because that would be one scenario with a group that is not-for-profit.

Ms. HARGIS. Right, but they are typically—I mean, they are creatures of the states, so the states could regulate that.

Chairman MANZULLO. Okay.

Ms. HARGIS. I think the big problem is when you get into interstate holding companies, owners of utilities where one single state cannot control what would be happening to the utilities.
That is why we had PUHCA because President Roosevelt had originally been governor of New York, and he found that no matter what he did he could not control New York electric rates because of the interstate holding companies.

Chairman MANZULLO. Okay. Let me go on to my second question then with regard to the public utility companies. How many of them or how many states actually regulate the rates, or are some states unregulated with regard to the rates?

Ms. HARGIS. All states regulate distribution rates. Some have deregulation in terms of power supply, which is wholesale rates are regulated or rather right now deregulated by the Federal Energy Regulatory Commission, and under the supremacy clause of the Constitution those costs have to be passed through so the states have very little choice. They have to pass through what the wholesale rates are.

Chairman MANZULLO. So the rate regulation, would it be fair to say, results in a built in profit margin for the utility?

Ms. HARGIS. They certainly have the ability to make a profit, you know, if they screw up their business. Usually rates are set at a certain level.

Chairman MANZULLO. Right.

Ms. HARGIS. If they indeed, you know, manage to make a profit at that level then to that extent it is built in, yes.

Chairman MANZULLO. But the purpose of setting the rate by the government, the state government, is to ensure that there is at least a reasonable rate of return so that the company stays in business.

Ms. HARGIS. Yes, sir.

Chairman MANZULLO. Therefore, the rate guarantees a profit.

Ms. HARGIS. As I say, if you operate efficiently enough to make a profit at that rate.

Chairman MANZULLO. Okay. Okay. Mr. Kelleher?

Mr. KELLEHER. I know that some of the research that I have done, the standard return on capital investment is about 10 percent. That is a guaranteed amount that the utility companies in our region are often able to maintain. They do have to invest some of their money obviously in improving their infrastructure.

Again, I am familiar with what happens in New England, but, as I said, I am here representing contractors all around the country.

Chairman MANZULLO. Okay. Now I can do the followup. So the objection is the fact that companies who are given a government guaranteed profit then can leverage those assets, which would be customer lists, name brand and just pure muscle based upon the size to the detriment of the little guys?

Mr. KELLEHER. Equipment, manpower.

Chairman MANZULLO. Okay. Is there anything illegal in that, Ms. Hargis? I think you are the only attorney on the panel, correct?

Ms. HARGIS. No. I do not think they are supposed to use business for—you know, you should certainly not use utility assets for non-regulated business.

It is illegal under the Holding Company Act for a holding company to do that, and that is why if you are a multi-state holding company they are very, very strictly regulated by the Securities and Exchange Commission, all of their financial interactions with the public utilities, for that very reason.

Chairman MANZULLO. What about, Mr. Harvey, it was in Baltimore. What is the name of the company?

Mr. HARVEY. Baltimore Gas & Electric.

Chairman MANZULLO. Okay. Do you know anything about that company, Ms. Hargis?

Ms. HARGIS. They have changed. They were a holding company, and in Constellation I think they spun that off. Now they may have merged with Pepco. I am sorry. They have been moving around pretty fast.

In terms of the parent company, if indeed it is in two states and no single state can regulate that utility then that is when PUHCA kicks in and the Securities and Exchange Commission does it.

Chairman MANZULLO. Mrs. Velazquez?

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Ms. Hargis, are small businesses throughout the economy likely to see a reduction in their electricity bills or rates as a result of the PUHCA repeal?

Ms. HARGIS. Absolutely not because what we are going to see is massive consolidation on the part of the utility holding companies, and that usually leads to higher rates.

Certainly there was a tremendous problem with higher rates back when PUHCA was originally passed, and also with the credit ratings both Standard & Poor's and Fitch's have said that PUHCA regulated utilities have much better credit ratings, and that decreases their cost of capital.

Ms. VELAZQUEZ. Will the energy bill and specifically the repeal of PUHCA do anything to improve electricity service and reliability? How will it reduce the likelihood of another blackout?

Ms. HARGIS. Well, I do not think it will at all because the reason that we are having so much problem right now is that the transmission system is being used for something that it was not designed for, which is to carry—everybody wants to go to the highest priced markets, and the system was not really designed for that, so that is what I think is causing the problem.

Ms. VELAZQUEZ. Mr. Kelleher, do you want to comment on that?

Mr. KELLEHER. One point I would like to make—

Ms. VELAZQUEZ. Sure.

Mr. KELLEHER. —is that we were discussing the role of the state regulatory agencies when they are supposed to be addressing these problems.

I cannot specifically guess as to what the impact might be in terms of blackouts or that kind of thing, but I do know that the state regulatory agencies in my area have absolutely failed to do adequate analysis of the rates in terms of the volume, the percentage of the rates that is actually being diverted to these unregulated businesses. That is bound to have an impact on the efficiency of the utility company.

Ms. VELAZQUEZ. Thank you. Ms. Hargis, what has happened to consumers in Kansas following Westar's attempt to become a home security company, and can you also discuss allegations that Westar attempted to illegally influence Members of Congress?

Ms. HARGIS. Well, what happened originally certainly was the same sort of situation, and I think Westar sort of used Montana Power as a model. The executives there were getting ready to sell off the utility assets and go instead into the home security business that they thought was going to be more profitable, but in fact was not. Again, I think there was a bankruptcy situation, or at least they had to sell it off.

What happened was they thought PUHCA would be repealed, but that was not enough. They also wanted to get out of the Investment Company Act, which would have kicked in for them when PUHCA was gone, and so the allegations were that they contributed a lot of money to get an exemption from the Investment Company Act.

Chairman MANZULLO. Mr. Kelleher, assuming that PUHCA is repealed are there any safeguards that could be implemented that would limit a public utility's ability to cross-subsidize?

Mr. KELLEHER. The group that I am here representing nationally, the plumbing and heating contractors, what we would be looking for would be some kind of compromise legislation were PUHCA repealed that would draw a line in the sand which would prevent in clear legislative language the cross-subsidization of the unregulated businesses.

The fact is this is needed nationally because I think if you go around to your various states I think the Members of this Committee, if you ask the small business people in your states are you having a problem like this the first answer is probably going to be yes.

The second problem is trying to deal with it on a state-by-state basis is virtually impossible. At local levels the utility companies maintain a massive amount of influence. It has been very difficult for small contractors, small business people to overcome that level of influence.

Ms. VELAZQUEZ. What about ring fencing? Would that protect small businesses?

Mr. KELLEHER. Yes. The term that has been used in the Energy Committee of ring fencing would in fact be an effective way to address this problem.

Essentially what that does, it prevents the regulated utility company from diverting its assets either directly over to an affiliate or, and this is another important point, to not allow that regulated utility company to pass its assets up to a holding company which then would be allowed to pass it back down to one of the unregulated affiliates.

The idea of ring fencing, which has been used in the Energy and Commerce Committee, would be one effective way to maintain the kind of separation that would prevent damage to small businesses.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman MANZULLO. Mr. Westmoreland?

Mr. WESTMORELAND. Thank you very much.

You know, when you talk about this I represented part of the great State of Georgia for a while, and I am in the construction business and so I understand and feel your pain and am familiar with what Atlanta Gas Light has done with their company and what Georgia Power and Southern Company has tried to do with several of the unregulated companies that they have had. They have all failed, to be honest with you.

In Georgia though we had a problem with our natural gas. We deregulated gas and had a problem with the marketing of that. We established some firewalls or some partitions there to keep some of these utility companies that wanted to offer gas service from using their regulated side to do the marketing on the gas side.

Does Maryland or any of the states that you all represent have any such firewalls as that to keep your public utilities from getting into the unregulated business? Evidently they do not, but have you approached the legislature about doing that?

Mr. HARVEY. I have testified in Annapolis for the last three years. It is better now than it used to be. It used to be if your power went out and you called the power company you would go to a phone tree, and they would say if you need a new air conditioner press nine. No kidding. It would get you over to the unregulated air conditioning company.

We are beyond that, but last time I was testifying in Annapolis BG&E Home had Constellation Energy's attorney there. How much did they pay for that? I do not know.

Mr. WESTMORELAND. One last question, Mr. Chairman.

Do you think that on the federal level there is something, a simple fix, that we could do that would not be as complicated as the PUHCA Act? I mean, is there something that you see that you all have in mind collectively that you could come up with that would be a simple fix to this?

Mr. KELLEHER. The answer, although many people here do have an appreciation for what PUHCA has done in the past, there are things that could be done. In this particular issue, put aside the other important issues that PUHCA deals with, but in terms of actually isolating this particular problem there would be language which could be crafted which would prevent this kind of improper cross-subsidization.

One final point. At the various levels of state operations there are codes of conduct which, for instance, in my state happen to have some language in there which would suggest the utility companies are not supposed to be involved in cross-subsidization.

The reality is though that these state regulatory agencies have often been dominated by former employees of utility companies and have been extremely sympathetic to the barrage of documentation that they have provided.

When we have challenged codes of conduct, when we have charged violations of codes of conduct, we have not been very successful, which is why finding some language that everyone could agree on which would really put a ring or a firewall around this would really be the answer. Again, yes, this could be done, and I think it could be done fairly effectively.

Mr. WESTMORELAND. I would appreciate if you could get us that information. I think we would all appreciate if you could get us that information.

Mr. KELLEHER. We will do that. We will do that, Mr. Westmoreland. Thank you.

Chairman MANZULLO. Congressman Lipinski?

Mr. LIPINSKI. Thank you, Mr. Chairman. This is a very important issue obviously for all of you here and also important for me and I think all of us up here. I apologize for having to leave there for a little bit, but this is something we definitely—another area that we need to help the small businesses in.

Now, I never have quite as good of questions as Mr. Westmoreland because of his experience, but I want to sort of follow up on something, on what he was just asking Mr. Kelleher.

Do any of you question the possibility that cross-subsidization can actually be prevented? Do any of you? I know Mr. Kelleher had said he believes it can. Do any of you question that? Has this definitely happened at the state level? Have you seen problems in any states who have tried to stop it, but there are ways to get around the legal barriers that were set up?

Mr. Harvey?

Mr. HARVEY. If you were able to eliminate all the shared expenses of back office and overhead and all those things and totally separated the regulated side from the unregulated side they would still have the trademark. They would still have the name recognition, which it is just huge.

You know, I do not know if you can take that away. Certainly in Maryland we are trying to. We are actually trying to impose a royalty that they would have to pay to use that trademark.

Mr. LIPINSKI. Mr. Peters?

Mr. PETERS. I would just add, and maybe this is more a followup also to the previous question, that there really is no simple solution to this problem when you look at what a regulator needs to go through as I discussed in my testimony about the cost allocation method.

In certain circumstances it may be good for these utilities to move into complementary markets, but you have to balance those concerns against questions of fairness so in a market where you have a lot of competition already you can probably more adequately set a price based on the fair market value, but utilities entering into a market where there is not already a lot of competition you will probably want some of these efficiencies to be passed along to customers for lower prices.

On the communications sector, there is a new technology called broadband over power line. It is being deployed in Cincinnati. It is being tested in a lot of markets. I have no idea whether or not it is ever going to work out on a widespread basis, but as far from a consumer welfare perspective you want that sort of technology to go out in the market, but you also want to have these rules.

A lot of states do have cross-subsidization rules and conduct rules. I think a majority of the states actually have a lot of those rules in place. NARUC, the National Association of Regulatory Commissioners, I think in 1999-2000 studied the issue extensively, came up with codes of conduct. A lot of the states are implementing those codes, and it has taken time because in the last few years this is a new phenomenon.

I do have a lot of sympathy particularly in these behavioral questions and the use of a company's trademark and its logo. These are difficult issues, but I think that state regulators do have the resources. They are closer to the consumer and so I am not sure what a federal solution would actually bring to the table other than maybe a redundant set of regulations and some confusion.

Mr. KELLEHER. If I could just add, to disagree a bit, I think the codes of conduct so far have been proven to be extremely ineffective.

What we would be asking for, Mr. Lipinski, you asked can this be achieved. I think part of the answer would be to say that the unregulated businesses would have to be separately capitalized. They would have to have a different name. They would have to have different buildings. They would have to have different trucks. They would have to have different personnel, and they would have to have different logos.

By putting together that kind of system we can really make sure that the current ratepayers—remember, the ratepayers are actually bearing this cost, and it is an unnecessary additional fraction of their utility bill that is being used to compete against small businesses and put small businesses out of business.

Mr. LIPINSKI. Well, I have certainly heard from a number of small business owners in my district, and I look forward to working with you to figure out what we can do and get something done to stop this really unfair practice that is hurting our small business owners.

Thank you, Mr. Chairman.

Chairman MANZULLO. Thank you.

Mr. Fortenberry, we have been notified that we have a bunch of votes coming up in about 10 minutes, so if you could take that into consideration in asking your questions in fairness to everybody else? Thank you.

Mr. FORTENBERRY. Thank you, Mr. Chairman. That is a very polite way of saying hurry up, Jeff. I will heed your advice.

Actually, thank you all for your insightful testimony. This is a very important issue that I, being a member of city council in a small city and having bumped up into in a previous life a number of questions in this regard across the spectrum, but I did want to follow up with Mr. Peters. You preempted some of my questions.

Nonetheless, there is a big issue out there in the development of communications as to how utilities who have already taken on the process obviously of providing a quasi public good can use those efficiencies, to use your language, without unfairly stifling private competition, but actually promoting or helping to potentially partner with it so that consumer benefit can come about—greater consumer benefit can come about—through the use of these again quasi public goods.

Are there other examples out there particularly in the energy industry in which broadband has been piggybacked like that successfully without bumping up into the type of legitimate questions that you all have raised because of unfair subsidies of a public good? In other words, has the private market been allowed to partner, lease, in some way find new markets because of this public investment?

Mr. PETERS. I am not sure about other BPL. I am aware of I think Minnesota is looking at that as a WI-FI model for city-wide access. I think the city would help to deploy the network but then would bid it out to a private entity, so I think that is sort of the public/private model that you might be looking at.

It is a cleaner form I think of some of these controversial WI-FI networks that are in the news in Philadelphia and some other cities.

Mr. FORTENBERRY. So this is very underdeveloped I think is what you are saying?

Mr. PETERS. It is very, very recent.

Mr. FORTENBERRY. Okay.

Mr. PETERS. It is just, I mean, really the next few months.

Mr. FORTENBERRY. All right. Thank you.

Chairman MANZULLO. Mrs. Moore?

Ms. MOORE. Thank you, Mr. Chairman. I was just sitting here feeling frustrated because I did not hear one single—I did not read one single talking point about the repeal of PUHCA during the bankruptcy bill discussion, and I am really wondering if in fact these kinds of arguments, if this PUHCA was repealed inadvertently from drafting instructions or was there a lot of dialogue in Congress about the impact of repealing PUHCA. That is one question I have.

Another question that I have, and I am mindful of the time. What do small businesses or companies do now for emergencies, when someone has a gas explosion or electrical problem? I can see these larger companies contending that they need to maintain an operation in order to respond to the emergency. How does the small business community respond to those sort of contentions that they need to use whatever loopholes or have other holding companies so that they can respond to emergency situations?

Thank you.

Mr. KELLEHER. I could answer that as a gas fitter. We definitely believe that the utility companies, since they are providing the gas to a building, they are well suited to go in in an emergency situation. Contractors have no problem with that.

What we have a problem with is when someone goes out to read your gas meter and leaves a little ad behind that says call the gas company. We will come over and replace your boiler. That is what we have a problem with.

Ms. MOORE. And this repeal of PUHCA during the discussions of the bankruptcy bill, was there a lot of activity? Maybe the public member would have some knowledge of this.

Ms. HARGIS. Well, there has been a huge industry lobby trying to kill PUHCA since about 1935, actually 1934. It was the biggest legislative fight of FDR's first term, and it looks like they finally succeeded at least partly.

No. I mean, I wish the Financial Services Committees had looked at this because the bankruptcy situation—as somebody had pointed out, with the Southern Company they put all their deregulated businesses into Merit. Merit not only went bankrupt. It is now suing the Southern Company.

Xcel. They had three PUHCA regulated utilities, affiliates. They are doing just fine. They put all of theirs—they spun them off into NRG. NRG went bankrupt, pulling down the credit rating of all the rest of them. It is a terrific problem.

Even with Enron, you know, the SEC under PUHCA actually has jurisdiction over bankruptcy of public utilities so that ahead of the bankruptcy, the creditors, they can put the consumers. You know, with PUHCA gone that is gone as well, so it is a huge issue.

Chairman MANZULLO. Mr. Akin?

Mr. AKIN. Thank you, Mr. Chair. Just a quick question or two here for Mr. Harvey.

First of all, does the Baltimore Gas & Electric use its employees to perform non-utility work in central Maryland? Second of all, has your company lost jobs due to unfair competition from Baltimore Gas & Electric's unregulated utility?

Mr. HARVEY. They used to use utility employees. I do not know if they still are or not. I do not know if they are sharing back office personnel. We suspect they are, but that is kind of behind their closed doors. We do not have access to that.

We lose work to Baltimore Gas & Electric every day without a doubt. They are a force to be reckoned with in our marketplace.

Mr. AKIN. I have heard of this issue as a legislator. Probably even before I came to the Congress it was out there.

I guess my question was how common is it, and I assume probably there are areas or certain states where it may be more common compared to other places where we are not seeing that much. It is more sensitive. I am afraid they are going to do it rather than the fact that they are.

Mr. HARVEY. Right.

Mr. AKIN. Can anybody on the panel answer how much is this currently a problem and in what parts of the country?

Mr. MARTIN. It is occurring in West Virginia. We have had several instances where the utilities have gone out and bid on projects in fact where their price was artificially low because they are only paying that incremental cost and not the portion of the fixed cost everybody else has to share in.

Mr. AKIN. So you are saying it was common in West Virginia, and in Maryland there is some of it there. Anybody know about anywhere else?

Mr. KELLEHER. I think if you look around the country you are going to see it in a number of states. Michigan, for instance. The contractors in Michigan fought a very long battle to deal with this issue.

It is not just the large utility companies that are involved. I think if you go to some of these states you will find that some of the smaller regional companies are doing exactly the same thing. It is a national problem.

Mr. AKIN. Okay. Thank you. I think that answered my question. Thank you, Mr. Chairman.

Chairman MANZULLO. Thank you.

Mr. Davis?

Mr. DAVIS. Thank you very much, Mr. Chairman.

Mr. Martin, you mentioned in your testimony one specific problem with utility competition. Are you aware of any other instances of any other contractor groups where there have been similar problems?

Mr. MARTIN. Yes. There have been several different instances. I recall at a local prison changing out some electrical transformers where the utility was the low bidder and got that job. There was another one at a hospital, the same type of thing. It was changing out transformers.

One particular instance was a street lighting project in Charleston, West Virginia, and that one in fact was challenged in the court. Again, the utility was the low bidder. Their price was substantially lower than the next bidder. Again, it was challenged in the court, but the utility explained that they were not cross-subsidization because they were paying the full incremental or additional cost.

What they do not say is the fixed cost that a small business has to incur to have an office complex or the equipment sitting there being non-productive. We have to spread that across the times that we are productive and do have a job. Therefore, their cost is much less.

Mr. DAVIS. Has the West Virginia Public Service Commission been of any help?

Mr. MARTIN. No, they have not. Their focus seems to be more on the direct subsidization and not these indirect or hidden subsidies that are out there. They are looking at are they paying for these additional costs and making sure that the regulated side is not incurring any additional cost for the non-regulated side.

Chairman MANZULLO. Mr. Davis, if I could interrupt to let Mr. Chabot have an opportunity to ask a couple questions?

Mr. DAVIS. Okay.

Chairman MANZULLO. Is that okay with you?

Mr. DAVIS. Yes.

Chairman MANZULLO. Mr. Chabot?

Mr. CHABOT. Thank you very much. I will be brief.

Mr. Harvey, I might mention that the chairman of your association, Greg Lesgang, lives in my district. He came into my office and spoke with me—

Mr. HARVEY. Good.

Mr. CHABOT. —in Cincinnati this past week and had some suggested questions.

Mr. HARVEY. Good.

Mr. CHABOT. Most of those have already been asked by my colleagues, but I think this has been a very interesting hearing.

Let me ask. You talked in your testimony about the utility companies sharing resources and consolidating overhead with these unregulated businesses. Are you aware of these utilities sharing customer information or marketing data with unregulated businesses?

Mr. HARVEY. Yes. Yes. We have seen instances where, for instance, the gas company will be running gas lines to a neighborhood, and then the BG&E Home salesman will essentially immediately start canvassing those homeowners for what we call conversion.

Mr. CHABOT. Okay. What has been the immediate economic impact on your company specifically or on others in your association relative to the cross-subsidization?

Mr. HARVEY. We have seen a big impact on our business. It has really stymied a lot of our potential growth, and when you talk to the vendors and you look at how much equipment is sold in our area and where it is going, through which contractors, BG&E has a big piece of the pie.

Mr. CHABOT. Okay. Thank you very much.

I will yield back the balance of my time, Mr. Chairman. Thank you. I would like to commend the Chairman for getting around late. You handled this masterfully, I have to say.

Chairman MANZULLO. Well, we try to be fair.

First, I want to thank you all for coming. I guess one of the lingering questions here is whether or not once there is a relationship between a utility company and an extended service as it were whether or not when a phone call comes in that somebody's utilities are out does somebody get preferred? I guess that is one thing we will never know.

Mr. KELLEHER. No. That does happen. That is common in fact if a utility customer calls in and they have some kind of problem. In fact, as my colleague has mentioned, sometimes right on the phone tree there they will refer you over to their affiliated business. They will directly refer you over to their affiliated business.

That is a job that is being subsidized by the ratepayers, and it is a job that is not going to private business.

Chairman MANZULLO. Mr. Harvey?

Mr. HARVEY. Just another tactic is that they will finance the new installation and put it right on your gas bill or right on your electric bill.

Chairman MANZULLO. We have to go vote. This is a fascinating hearing. It sounds like this might be the beginning of some further inquiry here.

This is the Small Business Committee. We have absolutely no jurisdiction over what goes on in the bankruptcy and obviously under Energy and Commerce, but I guess it is the type of thing where it is a problem you are sort of living with now, but where are you going to be five years from now?

Is everything going to be Mr. Big? Will the ability to, for example, buy health care through a huge utility at lower rates because of your large company, will that make them more competitive as it were with the small mom and pop shop that cannot afford that type of break?

I do not have the answers to these, but I just want to let you know that we are open for more inquiry, and the record will be open for five days for people that want to submit statements.

This hearing is adjourned. Thank you.

[Whereupon, at 3:39 p.m. the Committee was adjourned.]

Statement of Donald A. Manzullo, Chairman
Committee on Small Business
United States House of Representatives
Washington, DC
May 4, 2005

Good afternoon, ladies and gentlemen. Today's hearing focuses on another part of a consistent theme raised from this podium. Our committee and small business advocates of every stripe worry about the health of the marketplace and certain actions by government that tip the scales in favor of one party over another. There have been many instances where the big guys and the well connected are protected at the expense of the entrepreneur; or where the new entrant or small businessman is overlooked. We have fought against this many times in the past.

For instance, when our committee learned that the Federal Government Printing Office was taking work away from the private sector, we shut them down. We went after Federal Prison Industries for similar unfair practices. This even applies in the trade setting. We have raised concerns about government-subsidized or government-controlled entities winning US Defense contracts. I have spoken out about Chinese state owned companies competing with US companies that have private shareholders and face real market pressures, which state controlled entities can avoid. It is a simple question of fairness.

Today the issue we confront is growing competition from service companies owned and controlled by Investor Owned Utilities and some Municipal Owned Utilities. The real worry we have here is not dissimilar to the other examples I mentioned. The utility companies in most every state have their rates fixed by public utility rate commissions, and they are essentially guaranteed a profit each year. Their costs are a

public record, and their rates are fixed with a reasonable profit in mind. This is a legacy of the very high priority we placed on electrifying nearly every home in America and not unlike the universal service fund program we have devised for telephone services. While many might question the wisdom of these arrangements, they are a fact of life for every American.

Increasingly, the utility companies are creating subsidiaries and affiliate companies that provide other kinds of services apart from the basic power supply delivery. The diversity and scope of these services seems to grow each year. Companies owned and operated by these utilities sell plumbing and electrical services, home remodeling, vinyl siding and storm windows, subscription service contracts, appliance sales and rentals and many other services that range from home security systems to high-speed Internet access. It is truly a growing phenomenon.

Like me, the witnesses here today are concerned that these new companies enjoy unique advantages because of their special status as instruments of a public utility. While direct subsidy from ratepayers is proscribed, there are many ways that these new entrants could get an unfair advantage. For sure, they can obviously use the highly visible brand name developed over many years and paid for by the guaranteed profits. So too, many are able to avoid many of the pitfalls of finding start up capital that others might face without the benefit of a successful and long established parent. These are just a few of the concerns we hope to learn more about today.

I now recognize the ranking member, the gentle lady from New York, for her opening remarks.

All Members are reminded that following today's hearing, they will have five business days to submit statement's in writing or other supporting materials that without objection will be made a part of the hearing transcript at the appropriate time.

DONALD A. MANZULLO, ILLINOIS
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States
House of Representatives
108th Congress
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

STATEMENT
of the
Honorable Nydia M. Velázquez, Ranking Member
House Committee on Small Business
The Hearing on "Anticompetitive Threats from Public Utilities:
Are Small Businesses Losing Out?"
May 4, 2005

Thank you Mr. Chairman.

There is no question that our nation's small businesses are facing a myriad of challenges today. Between skyrocketing healthcare, energy and gas prices to a growing budget deficit – there are significant barriers standing in their way, only making it more difficult for small business owners to successfully run their business on a daily basis.

Not only do they have to deal with these additional costs – but small businesses traditionally face unfair competition from larger businesses. This competition has been particularly dominant in industries related to energy – small firms consistently find themselves living in the shadow of large public utility companies.

That is why protections such as the Public Utility Holding Company Act (PUHCA) have been put into place. Since its inception in 1935, PUHCA has acted as a firewall – protecting small businesses from having to compete with monopolies within the public utility industry.

PUHCA was created to eliminate unfair practices and other abuses by electricity and natural gas holding companies. By limiting the geographic scope of public utilities, state utility commission was able to effectively regulate them. However, regulation and protection is about to become significantly tougher.

Two weeks ago, the House passed an energy bill that did little, if anything, to help small firms. With today's national average price of gasoline at record levels of $2.24 a gallon – 42 cents higher than just a year ago – the situation is only getting worse. Not only did the energy bill fail to relieve small businesses of the record high gasoline prices, but it also repealed PUHCA.

Without the protections of PUHCA, it will be difficult to regulate multi-state public utility holding companies. Utilities will be able to take liberties in regard to cross-subsidization that are currently prohibited.

The repeal of PUHCA gives utility companies a clear competitive advantage. Not only will this wrongfully harm small businesses and consumers – but it will negatively impact the U.S. economy altogether.

In the past, allowing public utility companies to break into unregulated areas has simply not worked. Prior to the inception of PUHCA – 53 public utilities failed, creating significant economic disruption. Since its inception, not one PUHCA regulated utility has failed and it has prohibited utilities from entering into unregulated endeavors – protecting small businesses and this nation's economy.

When the House passed the energy bill – not only did it repeal PUHCA but it failed to offer any new safeguards. Clearly what we need now is strong protections for small firms. If the Bush administration decides that public utility companies should be able to delve into these areas – then we need to ensure that protections are in place.

Democrats have been engaged on this issue in the past. Over the last two Congress' we wrote a letter to the Chairman of the Energy and Commerce Committee asking them to ensure that protections are in place in these instances.

What is most upsetting is that we are sitting here – weeks later – to address a problem that could have been prevented if we had broached this subject before the energy bill came up in the House.• Now, the battle is even tougher as we try to ensure that a provision is offered in the Senate.

What we need now is a provision that offers protections to small businesses. One that will not allow the public utility companies to use ratepayer assets to pursue their own ventures, one that prohibits utilities from using an already branded name, and using equipment already under their monopoly in order to provide additional services.

Clearly, small businesses do not have the resources to compete with these unfair advantages. Not only do this nation's entrepreneurs deserve a level playing field, but they also deserve to be protected.

Without the protections offered under PUHCA – our nation's entrepreneurs and our economy will be teetering on the brink of yet another economic disruption. With an economy still struggling to recover, we must ensure that a provision is offered in the Senate so our nation's small businesses can continue doing what they do best – creating jobs and stimulating economic growth.

Testimony of Mike Martin, President, F.K. Everest, Inc. before the House Committee on Small Business May 4, 2005 on the subject of Unfair Utility Competition and Cross-subsidization

Chairman Manzullo, Members of the Committee –

My name is Mike Martin. I am President of F.K. Everest, Inc., an electrical contracting firm headquartered in Fairmont, West Virginia. Our firm is a member of the National Electrical Contractors Association – NECA, and I speak today for myself and on behalf of our entire association membership of 4,200 electrical contractors across the nation. I have served as President of my company since 2000. In that position I have had direct experience with the problems of competing with utilities on a playing field that is decidedly anything but level.

However, I also have seen unfair competition from another perspective. Prior to coming to F.K. Everest, between 1986 and 1996 I served in several capacities as an employee of Allegheny Power Company. So I, truly, can speak to this issue from personal experience. Here are some examples of the ways utilities can unbalance the competitive playing field in favor of their unregulated subsidiaries.

Equipment rental – Incremental cost vs. Market price

One way a utility gains a competitive advantage for its un-regulated, non-utility subsidiaries is through the practice of incremental billing. When a normal business has to rent or purchase equipment or hire manpower it must do so at market rates.

However, an unregulated electric utility subsidiary, using the same equipment or manpower provided from its utility operations, is billed only the incremental cost for rental of equipment instead of the fair market price. This constitutes an major unfair advantage for the utility's unregulated venture. The utility will argue that such billing at an incremental cost rate is not cross-subsidization - because they are billing for all costs incurred for the additional use of the manpower or equipment by the non-regulated company.

However, while there may be no additional cost to the utility, the non-regulated company has gained an unfair advantage from the below-market rates at which rental or use of personnel is charged. A fair accounting for such transactions would be to bill the unregulated subsidiary at full current market rates. Any benefit derived from the use of utility property should remain in the regulated company for the benefit of the utility customers. Any other method of handling such transactions amounts to a hidden subsidy of the unregulated subsidiary at utility ratepayer expense.

A specific example might be a specialized piece of equipment which is used only 10% of the time, which the utility has purchased to have available 24 hours a day in case of an emergency. If a non-regulated subsidiary or sister company rents the equipment for an additional 10% of the time, the utility then bills it the incremental cost which is all costs incurred for the additional use (fuel, maintenance, and a pro-rated portion of the depreciation, etc.). While the regulated utility has not directly subsidized the non-regulated entity - and the equipment has been better utilized - nonetheless the utility subsidiary has been given an unfair advantage over its competitors gained from the regulated utility's assets.

If a contractor needs the same piece of equipment he has two options: he must (1) purchase the equipment and bill its total cost over the 10% of the time it is used, or (2) rent the equipment at the current market rates. If a utility subsidiary chooses to use the equipment or manpower of the utility in its competitive ventures, the difference between the incremental cost and market rental should accrue as a benefit to the utility customers. Their rates underwrote the base costs of the manpower or equipment, and any benefits should offset their costs, not go into the profits of the non-regulated entity.

The utility subsidiary gains the same unfair advantage from use of utility employees such as engineers, draftsmen, attorneys, etc. A contractor would have to either employ these professionals or pay the market rate to purchase their services, while the non-regulated entity is only billed the incremental cost for these services. Again, any advantage derived from the regulated utility's assets or employees should be used to the benefit of the utility's customers

Transfer of goodwill and name recognition

A non-regulated entity affiliated with a public utility benefits directly and substantially if it uses the name and logo of the parent utility in its competitive ventures. It also benefits from its inherent relationship whether it uses the actual name and logo of the utility or not. As soon as the sales representative tells the potential customer of their firm's relationship with utility they immediately gain from the name recognition and goodwill of the public utility.

An independent contracting firm has to spend its own money to advertise and build its business relationships. In our area the local telephone yellow pages have advertisements from many electrical contractors; however, there is not a single listing for the non-regulated utility entity. As a contractor, I would love to have a postcard or must-open envelope - like a utility bill - bearing my name and logo mailed monthly to all my current and potential customers, that would certainly assure that when I make a sales call the customer would immediately recognize my company. This accrued name recognition and goodwill, along with the implied strength of the utility, is just another way a private, unregulated utility subsidiary operates on a playing field tilted in its favor.

Upgrades involving both customer owned and utility owned facilities

Here is another example. A local hospital needed to upgrade its electrical facilities for a future expansion. The upgrade included a customer-owned switchyard and some utility-owned equipment located within the switchyard. The facility was a critical service point for the hospital, and could not be taken out of service nor could afford any interruptions. The utility's customer representative working for the non-regulated entity told the hospital that due to the critical nature of the work, there had to be close cooperation between the contractor for their facilities and the utility. He went on to say the only way to assure that "cooperation" was for the utility to perform all the work. This arm-twisting and bullying from the utility is also unfair competition.

Customer owned *or* utility owned facilities

A local college had begun a 10-year capital construction project involving construction of several new buildings and the renovation of others. The college received service at a high voltage through a single metering point. The college-owned facilities then stepped down the voltage and distributed the electrical service to the various campus

buildings. The college is state owned and is required by state code to solicit bids for construction projects over $25,000.

During the planning stage the utility convinced the college to single-source the electrical upgrades to them. Our contractors' association, NECA, challenged this project give-away, and filed a Freedom of Information Act Request with the college. An attorney for the utility advised the college to not disclose the engineering design, drawings and pricing. He said that "the information is considered a trade secret" and it "gives its users an opportunity to obtain business advantage over competitors."

After NECA's challenge to this violation of state bidding law, the utility took possession of the customer-owned facilities, upgraded the service and installed meters at each building as a public utility. This action bypassed the challenge and brought the college within the guidelines of the state law.

If this were public utility work the project would not be bid, and the design and pricing would not be protected as proprietary information from competitors. As non-utility unregulated work the project would need to be bid per the state bidding laws and the attorney would be correct in protecting the design and pricing. This is a prime example of how the regulated and non-regulated entities are not operating using "arms length" transactions.

These are just a few examples of the methods that utilities use to unfairly compete with private firms which do not hold their unique advantages. In light of the current interest in establishing a fair an effective energy policy, it is appropriate that this problem should be corrected. Small businesses face enough difficulty when competing in a fair and open marketplace. When they are faced with unfair competition from giant, well-known utility companies who are using size and recognition to give an advantage to their unregulated subsidiaries, these difficulties become insurmountable.

I hope this hearing sheds light on the extent and depth of these pervasive unfair practices and leads to a swift and simple solution. Thank you for allowing me this opportunity to testify before your Committee.

# # # #

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TESTIMONY ON ANTICOMPETITIVE THREATS FROM PUBLIC UTILITIES: ARE SMALL BUSINESSES LOSING OUT?

BEFORE THE

THE HOUSE COMMITTEE ON SMALL BUSINESS

SUBMITTED BY
BRIAN HARVEY, PRESIDENT
H & C HEATING AND COOLING, INCORPORATED
LAUREL, MARYLAND

MAY 4, 2005

Chairman Manzullo, Ranking Member Velázquez and members of the House Committee on Small Business, on behalf of the Air Conditioning Contractors of America (ACCA), thank you for providing me the opportunity to testify today on this very critical issue to ACCA's small business contractors. ACCA is the national non-profit trade association that represents the technical, educational and policy interests of the men and women who design, install, and maintain indoor environmental systems. We have over 50 federated chapters with nearly 5,000 local, state, and national members. Most of our contractor members are family-owned small businesses and many of these small businesses are in their second and third generation of family ownership.

In addition to being a member of ACCA, I am president of H & C Heating and Cooling, based in Laurel, Maryland and have 25 full-time employees working for the company. My heating and air conditioning company is a second-generation, family-owned and operated business and we've been in business since 1969. We provide residential and commercial heating air conditioning service to customers throughout

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central Maryland. I am also a board member of the Maryland Alliance for Fair Competition and past president of the National Capital Chapter of ACCA.

I first experienced unfair competition with a local utility company in July, 1994 when Baltimore Gas and Electric (BGE) purchased one of my largest competitors. BGE's acquisition of Maryland Environmental Systems created an 800 pound gorilla in the central Maryland heating and air conditioning contracting community. Before purchasing Maryland Environmental Systems, our company had always had a good working relationship with BGE and participated in many, if not all, of their contractor programs. Maryland Environmental Systems was a large, well established, well organized heating and air conditioning contractor. BGE gave them an infusion of cash and allowed them to share over 1,000,000 residential and business electric customers and 600,000 gas customers. Maryland Environmental Systems, which was renamed BGE Home, gave BGE an immediate entry into the air conditioning contracting field. They provided the platform of established operating systems, trained personnel, and contracting knowledge. Almost immediately we saw former Maryland Environmental Systems employees driving around in BGE trucks, trucks that were paid for with ratepayers' money. These trucks that were originally purchased by Baltimore Gas and Electric to provide the Maryland ratepayers with gas and electric service were now being used by BGE Home to install heating and air conditioning systems.

The two companies began to share resources and consolidate overhead expenses. Needless to say, with plenty of cash and plenty of customers, the company

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flourished. As an independent businessman, I find myself continually working harder to try and maintain market share. I don't get "free" trucks from the electric company! I have to pay for my trucks like every other business. When marketing to new customers, I have to explain to them who my company is and why they should choose us to install their new furnace or air conditioning system. BGE Home never has to explain who they are because everyone gets an electric bill every month with the BGE logo on it. No doubt, many of you have seen similar advertisements for these services in your utility bills every month. In addition to the ads, BGE Home advertised on television commercials, newspaper ads, billboards and radio commercials. This 800 pound gorilla has run roughshod over the independent small business contractors and continues to leverage the Baltimore Gas and Electric name. A name that has enormous and immediate consumer recognition and a name that was paid for with ratepayers' money.

To give you an idea of how important the Baltimore Gas and Electric name is to BGE Home, a somewhat different scenario recently played out in the Washington, D.C. metropolitan market. Washington Gas, a public utility like BGE, decided to enter the air conditioning business. They did this by putting up $25 million along with a private venture capital fund who also put up $25 million to begin operations. With a pool of $50 million they started purchasing privately owned air conditioning firms and consolidating them under one name. They named this new company "Primary Multicraft", a $50 million company with acquired HVAC contracting expertise, but with no identifiable history and no name recognition. They had almost the same business model as BGE Home yet they did not use the Utility's Trademarked name and thus Primary Multicraft filed for Chapter

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7 bankruptcy protection within two years of their inception. This really shows how the ability to use a brand-recognized, household name like the utility companies have is so important. Recently both Home Depot and Sears have enthusiastically entered the home air conditioning market. While I certainly don't like competing with two of the largest retailers in the United States, at least it's a fair fight. They've paid for their name recognition with their own money, not with the ratepayer's money like BGE and other utilities that have a monopoly in a geographic area, like Maryland.

I want to be clear that I'm not asking for preferential treatment or more regulatory burdens; I just want a fair playing field to compete for business and let the consumer decide for themselves. I am happy to compete with any contractor for residential and commercial business, just as long as it is fair and my competitor isn't being subsidized by a utility that has a monopoly in a geographic area. This is not what capitalism and the free market is about and I hope that Congress will work with ACCA and the other organizations here to find a solution to this problem that is hurting small business contractors across the country.

Chairman Manzullo and Ranking Member Velázquez, thank you for your attention and the opportunity to present our views before the committee.

Plumbing-Heating-Cooling Contractors–National Association
Pride In Our Past–Faith In Our Future

WRITTEN TESTIMONY

OF

MR. HUGH KELLEHER
EXECUTIVE DIRECTOR
PHCC OF GREATER BOSTON
Danvers, MA

for the
Plumbing-Heating-Cooling Contractors--National Association

BEFORE THE
HOUSE COMMITTEE ON SMALL BUSINESS

May 4, 2005
2361 Rayburn House Office Building
House Committee on Small Business

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Thank you Chairman Manzullo, Ranking Member Velazquez, members of the Small Business Committee and other distinguished guests. It is a thrill for me to be here in Washington.

Anti-competitive threats from public utility companies are very real. I applaud the committee for taking the time to look into this issue, and to consider what might be done to correct the problem.

My name is Hugh Kelleher, and I am the Executive Director of the Plumbing-Heating-Cooling Contractors Association of Greater Boston. One thing that I believe you may find interesting is that while I now wear a jacket and tie to work, and have a desk job for our plumbing contractors' association in Boston, I spent years working on construction jobs, and then running my own business as a licensed master plumber.

It is a special honor for me to be here today, because when I was a very young man, before I became a plumber, I spent a couple of years right here in the Cannon Building, working as a congressional aide. As I think any former congressional aide would understand, it is a real pleasure to at last be in a hearing room, and to be offered a seat!

Mr. Chairman, I know of your own deep personal commitment, and of the commitment of other members of this committee, to the American small business sector. I've followed the work you have done in areas like manufacturing, and I want to applaud your efforts to make sure that our nation's manufacturing businesses are given a fair and level playing field.

The problem the committee is looking at today involves that same kind of search. It is a search for a fair set of rules for America's small businesses.

To the members of this Committee, I would say that no matter which state or district you come from, I can assure you that unfair utility competition is, in all likelihood, having a tangible, negative impact on small business people in your district.

What we hope to convey to you are the unfortunate ways in which utility companies have been using their monopoly positions and resources not only to damage small business, but also to drive up energy costs, and hurt their own customers.

This is not a glamorous issue, and at first it may be difficult to grasp.

Unfair competition can be described as an attempt by a utility to use its monopoly status to enter other business sectors.

At a time when all Americans are concerned with energy costs, here is one very unfortunate fact. Utility companies have been allowed to increase their rates beyond the true cost of the energy they provide. And in the process, they have done real harm to our system of private sector businesses.

An example: In our state, the largest gas utility, KeySpan (which is based in New York) has for years been authorized by our state's energy regulatory agency to include in its rate structure a

"promotional budget" line item. That "promotional budget" line item costs natural gas customers millions of dollars each year. But if you peel back that line item, to see what those millions of dollars are spent on, you find that much of it is used to promote KeySpan's unregulated affiliated businesses. And what are those businesses? They include a large heating and air conditioning company which competes directly against the small mom-and-pop contractors.

Imagine if you owned a utility and wanted to expand your operation and enter the construction business. The utility possesses massive resources, tangible assets such as trucks, equipment, and personnel. I can tell you that in Massachusetts we saw one utility company bid against an electrical contractor on a job. The utility company bid low, remarkably low. Private contractors estimated that the utility's bid price could barely pay for the real cost of the materials, never mind the cost of labor and equipment. Of course the utility company won the job.

A few weeks later, what did you see out on that job site? You saw trucks and backhoes from the government-regulated utility. You saw workmen from the government-regulated utility.

I am sure my friends who are electrical contractors would be pleased if they could have ratepayers covering the cost of salaries for their employees, and making the payments on their trucks.

How aggressive are the utility companies in terms of siphoning off assets to open up and support other, unregulated businesses? I think the most extreme example I've seen occurred when

KeySpan came into Massachusetts and opened up a web-based business called MyHomeKey.com. It appears they used rate-payer money to advertise this business in the papers, and on the radio. One day, I went to the web site, and discovered to my amazement that not only would this gas company affiliate send over someone to install a gas stove, or a sink. Their web site told me that they would even be willing to clean my drapes, or have someone come by and cut my lawn. So much for the efficient delivery of natural gas!

It was an ambitious business plan. But, like many efforts by utility companies who overreach, who fail to stick to their legitimate business – the reliable provision of energy at a fair cost – MyHomeKey became a ratepayer-subsidized business that failed.

We don't know how much money was wasted while the utility company tried to get into the landscaping and drapery cleaning business. But each dollar spent on that ill-conceived business plan was a dollar which could have been spent upgrading their unreliable gas delivery system – or reducing the cost of natural gas.

I am willing to bet that if you go back to your home state and do some research, you will find some variation of this process where one or more of the regulated utilities in your state are using rate-payer based funds to support "affiliated" unregulated businesses.

One of the common models, one we see in our state, is the "free equipment" offer. Hidden again in that standard "promotional" budget that gets approved by the state regulatory agency are millions of dollars used to get customers to convert their heating systems from other forms of

energy to natural gas. Put aside for a moment the important problem that there is not an adequate supply of natural gas – a fact that even Fed Chairman Greenspan has brought to the attention of the Congress. A utility like KeySpan is in effect arguing that, in a time of natural gas shortages, they should be allowed to use money collected from current customers, to create even further demand for natural gas.

In fact, those "promotional" dollars could have been spent upgrading the utility's gas delivery system, a system which during the past two winters has often failed to deliver adequate gas pressures and mixtures to homes and offices around Boston.

This kind of subsidized, "free equipment" program is not limited to KeySpan alone. Even in our state you can find other utility companies which use this approach to bring in new customers. But it is an example that raises two basic points.

First: The price the consumer is paying for this energy – in this case, natural gas – is higher than it needs to be. If the utility stuck to its primary business – the reliable, cost-efficient delivery of natural gas – prices could actually be lowered, and their delivery system could be improved.

And second, keep in mind that those promotional "give aways" (that cost burden put on current customers to lure in additional, future customers) -- those give-aways have a highly negative impact on small businesses, who are forced into a position of unfair competition when they have to bid jobs against a utility company which, in the case of KeySpan, has a whole warehouse of boilers and furnaces which have been paid for by ratepayers.

Think about the local plumber in your home town who works on your heating or air conditioning system. The next time you're talking to him, ask him if he can come over and install some "free" heating or air conditioning equipment. No contractor in my state, or yours, can afford to do that. But this is exactly what those ads in the newspapers are saying that the utility companies are able to do.

Sometimes elected officials ask me: If this is such a serious problem, why don't we hear complaints from more small business people?

My answer to that is: The plumber back in your home town is busy running his small business. You all know how small business people operate. I imagine that many of you have operated your own small businesses. Your local plumber or electrician's business is indeed being hurt by the local utility company's cross-subsidization practices. But most plumbers and air conditioning company owners are busy – hiring workers, bidding jobs, trying to get paid. Occasionally, a group of them will raise a few hundred dollars, and send someone like me, or one of the other representatives here today, down to Washington, or to the local statehouse. But it is a very difficult battle we face, and we know it.

Before I conclude, I would urge you to imagine this scenario. You and I each run similar businesses, in the same town. We are competitors. But my business has access to hundreds of thousands of dollars of government-approved subsidies. Part of my business has a special status, the government in fact guarantees that in that part of my business I will be assured a certain

profit. In fact, I am able to shift some of those profits and other resources over to the part of my business which competes against *your* business.

While you function as a true private business, I'm able to give away thousands of dollars of really expensive items. I am able to do special mailings to promote my business. I have trucks and workers I can send out to compete against you – and much of those costs can be covered through this other part of my business, the part that is guaranteed a profit, because of its special status with the government.

I can guarantee you that over time, no matter how well you run your business, no matter how well trained your employees, no matter that you offer truly fair, unsubsidized, market-rate prices – I will put you out of business. I will put you out of business, because standing behind me will be a huge government-regulated business which is ready to deposit checks into my account. Ready to send out its people to work in my business, ready to provide free advertising, and free equipment that I can use to drive you out of town.

This does not sound to me like the kind of economic model that made the American economy the greatest in the world.

But that this is exactly what's happening all over our country.

It is happening because utility companies are big, they are very big, and they are very influential. And yes, they are genuinely essential to the health of our economy. Utilities understandably

have a privileged position because we rely on them to provide key parts of our energy and communications infrastructure.

But unlike the small businesses represented here today from places like West Virginia and South Dakota and Maryland and Massachusetts, utility companies spend vast sums not only on their infrastructure. They spend large amounts on lobbyists, on lawyers, and accountants. Those accountants and lawyers often appear before state regulatory bodies which – you guessed it – are often staffed with people who formerly worked for the very utility companies which they are supposed to regulate.

Part of the difficulty, of course, is that many of the utilities – including ones like KeySpan – are privately-owned firms. They have stock-holders, who, in theory, could and should bear the responsibility for these unregulated business ventures.

Were the unregulated businesses of utility companies funded and operated solely through the use of private dollars, if they worked out of separate buildings, had separate names and had clearly delineated costs, then the small contractors of America would not be taking up your time today.

As contractors, we have absolutely no problem with the fundamental principal of competition in the context of our free enterprise system. We contractors are accustomed to working in a world of robust competition. All the plumbing companies I represent up in New England are in fact competitors with each other. But what none of us can accept is that our state and federal

governments have condoned – and might soon further enhance – a system of subsidies which is contrary to the spirit of American enterprise and competition.

Here is what we are asking for. That you, the members of the House Committee on Small Business, work with your congressional colleagues, particularly those on the Energy and Commerce Committee. Take a closer look at this problem, and then find a way to stop cross-subsidization.

Our industry has long been portrayed as seeking additional regulation. Nothing can be further from the truth. The plumbing and heating industry is on record as supporting repeal of the Public Utility Holding Company Act, or PUHCA. All we ask is that the repeal include some degree of consumer protections, and that Congress insure that there is a real firewall created between a utility's regulated business, and its unregulated affiliates. Don't let the repeal of PUHCA be an opportunity for the utilities to create more inefficiencies by allowing them to finance more plumbing, landscaping, and drapery cleaning businesses.

I do believe if ever there was an issue which deserved bi-partisan attention, and bi-partisan support – it would be this issue of unfair utility competition. The small business people who are being harmed come from both parties, and from every state. One hopes that most of us would agree it is just plain wrong in this great, free country to allow a huge governmentally-regulated business – typically a monopoly – to overcharge its customers, and then use its massive income stream to damage small, private businesses.

Mr. Chairman, once again, I thank you for the opportunity to appear before this Committee. I especially appreciate your comments in your letter to Energy and Commerce Committee Chairman Joe Barton, in which you have requested that this congress "work on the best method for ensuring fair competition and preventing improper cross-subsidization of utilities' unregulated activities by their regulated subsidiaries."

We hope that working with Chairman Barton – and perhaps in conference with the Senate – that the members of this congress can reach a legislative solution to this problem.

That is what the thousands of members of the Plumbing-Heating-Cooling Contractors Association have asked me to convey to you today. I thank you all for your time and attention.

Testimony of Adam Peters
Research Fellow and Regulatory Counsel, The Progress & Freedom Foundation
Before the House Small Business Committee
May 4, 2005

Good afternoon, Mr. Chairman and members of the Committee. Thank you for the opportunity to speak to you today about the anticompetitive threats posed by public utilities. My name is Adam Peters and I'm a research fellow and regulatory counsel for The Progress & Freedom Foundation (PFF), a market-oriented think tank that studies the digital revolution and its implications for public policy. Your hearing is a timely one, as public utilities increasingly are diversifying and entering into new markets, including communications. My comments today will focus initially on the broad competition issues raised by public utility entry into unregulated markets, and I will then discuss the recent and growing phenomena of municipal entry into communications.

The Regulators' Conundrum

Utility entry into unregulated or competitive markets puts regulators in an unenviable position. On the one hand, such entry may serve to increase competition in the unregulated market, driving down prices and fostering innovation. From a consumer welfare perspective, it may also be desirable for a firm to expand into complementary markets for reasons of efficiency. On the other hand, the incentive may exist for a utility to cross-subsidize the activities of an affiliate through its captive rate base. Left undetected, this strategy could cripple competition, entry and innovation in the unregulated market, while additional costs are extracted from the captive rate base through higher monthly bills.

Regulators must therefore try to balance the benefit of efficiency with fair competition through the use of a cost allocation formula. To be sure, cost allocation issues can quickly devolve into an exercise in blackboard economics, where competitors may seek protection from competition, and where the "right" answer is unattainable. So the process essentially asks regulators to make a predictive judgment, but it is the best one we have.

The chosen cost allocation formula is vital because it sets the equilibrium in the market. Take, for instance, the cost allocation issues presented by the deployment of broadband over powerline (BPL) technology. In theory, when offered by an electric company, the incremental costs for BPL infrastructure might be collected through the rates that consumers pay. But how much of the cost should be allocated to the regulated, electric side, and how much should be allocated to the competitive, broadband side? If the regulator allocates all the costs to the electric side, BPL looks like a viable platform. If costs are allocated to the broadband side, electric rates go down, but BPL may not be able to compete.

A World Without Cost Allocations: Municipal Entry into Communications

A recent PFF study notes that local governments entering the communications space are normally backed by municipally owned electric utilities. [1] According to the website for the American Public Power Association, it is estimated that out of the approximately 2,000 community-owned, public power utilities in the United States, 621 now offer broadband services such as cable modem service or DSL.

A number of explanations have been offered for the increasing number of municipal or state-owned communications systems. Many of these utilities have already paid off their embedded costs and have cash on hand to invest in new ventures. Communications services are an attractive "next step" because electric utilities may already own complementary facilities, including monitoring and metering equipment. Proponents typically argue that these systems will promote "universal service" or foster community development, including jobs and education. And, under a less generous view, it may be the case that some of those who operate these systems may be motivated to expand their operations in order to enhance their own power, prestige or tenure of employment.

Many municipal officials alternatively argue that broadband itself is a public utility, and make a public goods argument in favor of their entry. This argument fails to convince, however, and particularly in areas where broadband service is already available. A public good is generally defined as something that private markets will not provide because there is an externality and free-rider problem, given its non-excludability. But municipal broadband networks have few, if any, characteristics of a public good. Broadband connections involve both rivalrous consumption and excludability. These networks are private goods, and should be supplied by private entities, with the possible exception of high-cost, rural areas. Private firms have better incentives and are far more accountable to their "constituency" by holding down costs and making wise investments in technology.

Municipal entrants into communications markets may enjoy several artificial advantages over entrants from the private sector. They may be exempt from taxation. They can raise capital through the issuance of guaranteed, tax exempt bonds. They enjoy unfettered access to utility poles and rights-of-way. Finally, and of paramount importance here, municipal and state-owned utilities in many states are exempt from the antitrust laws and oversight by state utility commissions, and are therefore "immune" from the cost allocation requirements that otherwise apply to their privately owned counterparts.

Under these circumstances, the risk of cross-subsidization and its resulting market distortions is enhanced. For example, the study cited above, authored by PFF Senior Fellow Tom Lenard, focused on three municipally owned entrants - Bristol, Virginia; Kutztown, Pennsylvania; and Ashland, Oregon. Dr. Lenard concluded that the three

[1] Thomas M. Lenard, *Government Entry into the Telecom Business: Are the Benefits Commensurate with the Costs?* The Progress & Freedom Foundation (Feb. 2004).

municipalities, which offer broadband services in competition with one or more private companies, were unable to cover their costs without being subsidized. He estimated that the subsidies in these localities range from $350 per customer to over $1,000 per customer, excluding any capital costs.

While this study is anecdotal, it is quite possible (and perhaps even likely) that "head to head" competition between these municipal entrants and a private competitor will apply downward pressure on prices, at least in the short run. But the ability of the municipal entrant to tap into an endless stream of subsidies from their electric rate base includes both short run costs – through higher electric rates or taxes for other social programs – and potential long term costs, opening the door to predatory pricing, which would drive private capital from the market and result in supracompetitive prices.

It may seem a paradox, but the lifeblood of networks and innovation is capital - and capital goes where it is most welcome. Most of the economy works in this non-government mandatory way - and finds a way of serving all segments of the population, albeit in different ways. In communications, cellular telephone adoption is perhaps the best example of the free market model working. Cell phones started as a high cost, low use accessory for the well-off, and now have penetrated throughout society.

A Note About Institutions

In my view, and despite the ominous tone of the previous paragraphs, states are well-equipped to handle these cross-subsidization concerns, so care should be taken before legislating new rules without a clear showing that there is a jurisdictional vacuum. To be sure, the challenge of regulating investor-owned utilities through a cost allocation formula is real, but based upon my experience at the Colorado Public Utilities Commission (PUC), states have expansive authority in this area and the ability to address competitive harm. In Colorado, for instance, a utility must submit a cost assignment and allocation manual to the PUC for approval, which must include a listing of all regulated and unregulated divisions. The Commission may seek redress through a complaint proceeding. Most states, to my knowledge, have similarly broad authority to protect consumers from unreasonable rates, and are able to demand access to any and all pertinent information before adjusting rates.

While municipal entry is potentially more insidious, I would likewise defer to the judgment of state and local officials (and citizens!) in evaluating the necessity for new, publicly-funded communications services, in light of local market conditions. Notably, the federal government plays an additional role here through its provision of loans and grants to unserved rural areas through the Rural Utilities Service program.

Conclusion

My colleagues and I welcome new broadband entrants. We want to see many "pipes" into the home, beyond DSL and cable modem service. With careful oversight by the states, competitive entry by public utilities is part of this equation, a level playing

field between these entities and small businesses can exist, and consumers can benefit from the efficiencies and innovations these companies bring to the market.

I want to thank the Committee for this opportunity and ask that my written remarks be made part of the record. I am happy to answer any questions you may have.

Testimony of Lynn Hargis,
Energy Attorney, Public Citizen, Inc.
Before the House Small Business Committee

May 4, 2005

Good afternoon, Mr. Chairman and members of the Committee. Thank you for the opportunity to speak to you today about the anticompetitive threats posed to small businesses and others by the unregulated affiliates of public utilities.

Public utilities have always been regulated to some degree in exchange for their exclusive retail franchises to provide necessary electric and natural gas services to consumers. However, whenever such public utilities have been allowed to invest revenues from these captive utility customers in non-regulated affiliated businesses, substantial anticompetitive and other abuses have occurred. There is an enormous temptation for utilities to cross-subsidize these affiliate, non-utility businesses that are, almost by definition, riskier than the utility business.

This cross-subsidization of affiliates by utilities results in great potential harm to electric and natural gas consumers, who have to pay for such subsidies and for lower credit ratings from non-utility business failures, through higher utility bills. Such cross-subsidization also may provide an unfair business advantage to utility owners of such non-regulated businesses over non-regulated competitors, particularly small businesses.

Indeed, before restrictions were placed on huge utility holding companies to prevent such abuses by utility affiliates, the House of Representatives conducted a six year study that uncovered numerous instances of cross-subsidization of affiliates by utilities, along with accounting scams, excessive inter-affiliate fees, and many other abuses. The Federal Trade Commission also studied this utility affiliate problem and its investigation ultimately resulted in 101 volumes cataloguing similar problems. As a direct result, the Congress enacted the Public Utility Holding Company Act of 1935 (PUHCA) that effectively ended such affiliate cross-subsidization and other abuses by confining utility owners to the utility business.

Under PUHCA, utilities could not go into non-utility businesses and companies had to give up their non-utility businesses in order to acquire utilities. That is why today we do not see oil companies, investment banks, insurance companies, and others owning regulated public utilities. Without PUHCA, of course, that will quickly change.

After decades without utility affiliate abuses, the public and the Congress appear to have forgotten what led to enactment of PUHCA. In 1992, Congress exempted certain electric power generators and foreign utility companies from PUHCA. The Securities and Exchange Commission (SEC), which enforces PUHCA, began to flexibly increase its definition of what constituted "utility-related" businesses, thereby increasing the kinds of businesses that regulated utilities could enter. In 1996, Congress added telecommunications companies to those that public utility holding companies could own. Almost immediately, the same affiliate abuse problems began to recur.

For example, executives of the Montana Power Company, a 90-year old utility, immediately invested in telecommunications businesses. Viewing these as more lucrative than stodgy utilities, they decided to sell off the company's utility assets and keep the telecommunications business. Unfortunately for them, the latter rather quickly went bankrupt. Meanwhile, NorthWestern Corp, a South Dakota utility that had bought some of Montana Power's utility assets, also heavily invested in telecommunications, which led that company to declare bankruptcy. Today, the ratepayers of Montana are trying to buy back some of their utility assets and are paying high rates for power from their former, now deregulated, power plants.

Two large holding companies regulated under PUHCA, Southern Company and Xcel, sold or spun off their non-regulated businesses into Mirant and NRG, respectively, which shortly went bankrupt. Other utilities were forced to sell off non-regulated assets at cheap prices to restore their credit ratings, which Wall Street had dropped for the entire utility sector. Standard and Poor's and Fitch's credit ratings agencies reported in 2004 that PUHCA-regulated utilities have better credit ratings than non-regulated utilities.

Investment banks and private equity funds have bought up many of these deregulated "merchant" power plants, and undoubtedly plan to sell them at a large profit to huge public utilities. This will increase concentration of utility control and the anticompetitive advantages of such utility owners. Electricity and natural gas consumers will have to pay through higher rates for the profits which the investment banks, etc. intend to make off sale of such power plants. In addition, consolidation in utility ownership may effectively kill any true competition among utilities, let alone among utilities and small businesses.

The House energy bill repeals PUHCA, which will eliminate any structural restraints on the size or geographic spread of huge utility holding companies. Before PUHCA was passed, three holding companies owned nearly half of the utility assets in the United States. Once PUHCA is gone, we will probably see that level of concentration of utility control immediately recur.

Enron obtained numerous exemptions from PUHCA to allow it to engage in many of the affiliate abuses that are now the stuff of books, movies and court

records. Because of PUHCA, which was designed to protect State regulation over public utilities, Enron was limited to owning a regulated utility in only one state or having to submit to extensive SEC oversight under the statute. Without PUHCA, there will be no such constraints on either the number of utilities owned or on the financial transactions with affiliates by future bad utility actors like Enron.

All of these instances of utility affiliate abuses have the potential to harm those who desire to offer genuine competition to huge utility oligopolies in their non-utility businesses.

PUHCA enforcement has been described as "the most effective antitrust enforcement program in United States history." Seligman, "The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance," Northeastern University Press, 3rd Ed. 2003. Eliminating this powerful deterrent to public utility affiliate abuse will leave small businesses, as well as utility consumers and investors, and the national economy, once again at the mercy of giant utility holding companies.

CONCLUSION

In its last report on PUHCA to the Congress in 1995, then SEC Chairman Arthur Levitt stated that: "the conduct that gave rise to the Act has all but disappeared." Shortly thereafter came Enron, World Com, Tyco, AIG, etc. This committee should hold hearings to investigate whether certain recent PUHCA exemptions and the SEC's "flexible" enforcement of the Act have led to many of the problems discussed today, and whether full PUHCA repeal will lead to many more such problems.

Thank you for allowing me this opportunity to testify before your Committee.

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Written Statement of Alan H. Richardson,
President & CEO, American Public Power Association
To the House Small Business Committee

Anti-Competitive Threats from Public Utilities: Are Small Businesses Losing Out?

Wednesday, May 4, 2005

APPA is the national service organization representing the interests of the nation's more than 2,000 community-owned electric utilities that serve over 43 million Americans. The utilities include state public power agencies, municipal electric utilities, and special utility districts that provide electricity and other services to some of the nation's largest cities such as Los Angeles, Seattle, San Antonio, and Jacksonville, as well as some of its smallest towns. The vast majority of these utilities serve small and medium-sized communities, in 49 states, all but Hawaii. In fact, 75 percent of publicly-owned electric utilities are located in communities with populations of 10,000 people or less.

We commend the Committee for holding this hearing to examine the relationship between the Public Utility Holding Company Act (PUHCA) and protections for small businesses against abuses by affiliates of the utility corporations subject to PUHCA jurisdiction. At the same time, we are very concerned that today's hearing will partly be diverted by the red herring testimony of the Progress and Freedom Foundation (PFF), whose sole purpose for testifying

is to attack the provision of communications services by municipal utilities. The PFF statement is riddled with inaccuracies, half-truths, and false changes. In short, municipal electric systems providing advanced communications services do not cross-subsidize such services with electric revenues. In fact, most public power systems are precluded from cross-subsidizing any non-electric services with electric revenues under state or local law.

This statement will provide the Committee with a brief overview of why municipal electric utilities are providing communications services and the benefits to businesses and residents that accrue from those services. It will then discuss and refute unfounded arguments made against public power broadband services, including those asserted by the Progress and Freedom Foundation in its testimony to the Committee.

Brief Overview of Public Power Entry in to the Communications Marketplace

Many public power systems were established largely due to the failure of private utilities to provide electricity to smaller communities, which were viewed as unprofitable. In these cases, communities formed public power systems to do for themselves what they viewed to be of vital importance to their quality of life and economic prosperity. Today, public power systems are meeting the new demands of their communities by providing broadband services where such service is unavailable, is inadequate, or is too expensive.

Over 600 public power systems now provide some kind of advanced communications service, whether for internal or external purposes. This is a ten-

fold increase since Congress enacted the Telecommunications Act of 1996, and the number of public power systems providing or planning to provide services continues to increase. The services delivered by public power systems include high-speed Internet access, voice-over-Internet protocol (VoIP), cable television, and local and long distance telephony.

Public power systems are providing a wide array of advanced communications services in underserved areas using a wide variety of platforms – fiber-to-the-subscriber, broadband over power lines, hybrid fiber-coaxial, and wireless. They are also fostering a competitive marketplace where consumers are benefiting from the availability of advanced communications services that are the lifeblood of economic development and can support rich educational and employment opportunities, advanced health care, regional competitiveness, public safety, homeland security, and other benefits that contribute to a high quality of life.

Why Public Power Systems Are Providing Essential Broadband Services

Public power systems are providing essential broadband services because their businesses and residents have asked them to. Community demand for services is usually driven by the failure of the market to provide specific services at reasonable prices that the community needs to grow and prosper. In Scottsburg, Indiana, for example, the municipal electric utility deployed a wireless broadband network in order to prevent a Chrysler repair shop from leaving the town due to a lack of affordable broadband. Before pursuing this course of action, the local government first asked Verizon to provide the service. Verizon refused because the

town was too small for the company to justify the investment. Had the municipally-owned utility not provided the service, at least 60 jobs would have been lost.

Economic development also drives public power entry into the communications marketplace. The availability of affordable broadband service is critical to retaining existing businesses as well as attracting new businesses in today's highly competitive global marketplace. In many public power communities, business leaders and locally elected officials have approached the private sector about providing essential broadband services at affordable rates. In many cases, the private sector has responded that it did not have immediate plans to provide broadband service or upgrade existing services to meet the bandwidth needs of businesses and residents.

Smaller communities have two choices – wait until an incumbent provider decides to provide service, if it does so at all, or build the network themselves. Many APPA members have decided to deploy broadband networks because they understand that access to these advanced services helps retain and attract new businesses, creates new jobs, increases productivity, allows for telemedicine and telecommuting, and improves the quality of life for residents. These communities have recognized that if they waited for the private sector to provide affordable broadband service, they would fall behind and not be able to compete in today's information age.

The Many Benefits of Public Power Broadband

Many communities have decided to provide residents and businesses with critical broadband infrastructure because they recognize the growing importance of broadband for commerce, health care, education, and improved quality of life. Looking to the early pioneers of municipal broadband that have been models to other communities, they have seen the many benefits of providing access to an essential 21st century service. Some of the key benefits of municipally provided broadband service include lower prices, increased competitiveness in the communications marketplace, responsiveness to local needs, economic development, and universal access.

In many cities and towns across America, broadband service is too expensive for businesses and residents. In Iowa for example, the Iowa Utility Board has reported that many communities are charged up to $169 a month for one mega-bits-per-second DSL service.[1] However, in public power communities that are providing broadband service, consumers are paying lower rates for such service. In Manassas, Virginia, residents can get BPL service for $28.95 a month. In response to the presence of a third provider of broadband service (the City of Manassas in partnership with COMTek, a telecommunications and information systems technology company) both Comcast and Verizon lowered their prices in Manassas. Consequently, even those residents who have not switched to Manassas'

[1] See *Connecting the Public: The Truth About Municipal Broadband*, Media Access Project, Consumer Federation of America, Free Press available at http://www.mediaaccess.org/MunicipalBroadband_WhitePaper.pdf (citing http://www.iowatelecom.com/residential services/article.asp?id=220&PID&GPID).

BPL service have received a direct economic benefit in the form of lower prices from the incumbent providers from the introduction of a third provider.

The presence of municipal broadband providers has also resulted in a more competitive communications marketplace. Many public power broadband networks provide open access to other private sector providers. Competitive local exchange carriers and other competitive communications companies use municipal networks to deliver services to businesses and residents. In fact, the presence of a municipal provider can actually increase the number of competitive providers in a marketplace. An economic analysis by George Ford of Applied Economic Studies found that in Florida, localities that owned their own broadband networks had more competitive local exchange carriers in the marketplace than localities that did not have municipal broadband networks.[2] Rather than crowding out investment, as asserted by the opponents of municipal broadband, it appears that the presence of such a system actually increases the number of communications providers in the market.

In addition, municipal broadband providers are highly responsive to local needs. Residents can have a direct say about what types of services will be provided over broadband networks. Utility managers and locally elected officials are available to the public at open meetings to discuss their concerns and seek input on how to improve or expand service. Also, customer service is locally available to help individuals with setting up their service or fixing problems.

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[2] See George S. Ford, "Does Municipal Supply of Communications Crowd Out Private Investment? An Empirical Study," Applied Economic Studies (February 2005) at http://www.aestudies.com/.

Universal access is another benefit of municipal broadband. Public power systems providing broadband services ensure that all residents can receive such services – and at an affordable rate. Low-income neighborhoods are not passed by. Schools and hospitals are provided with significant bandwidth to enable rich multimedia applications that improve education and health care. For example, in Leesburg, Florida, public hospitals can send medical images such as MRIs and x-rays to doctors' offices in seconds over the city's optical network.

Economic development is yet another benefit of municipal broadband. As stated earlier, local governments recognize the importance of broadband for commerce, education, health care, and quality of life. The availability of affordable broadband helps retain and attract businesses, leading to more jobs and stimulation of the local economy. In Kutztown, Pennsylvania, Saucony Book Shop moved its business from Allentown, Pennsylvania, because of the borough's fiber-to-the-subscriber network. Paisley & Company bath shop also moved to Kutztown, opening a shop downtown and advertising its products online. In Provo, Utah, Riverwoods Medical Imaging Center employs state-of-the-art software to deliver hundreds of digital images to doctors quickly over the Internet. Without the bandwidth available over Provo's fiber network, Riverwoods would not have been able to provide its digital imaging services.

Campaigns Waged by Opponents of Municipal Broadband Against Public Power and Other Municipal Providers

Just as there was fierce opposition from private enterprise to publicly owned electric utilities 125 years ago, today there is fierce opposition to publicly owned broadband networks from private enterprise. Opponents of municipal broadband have used a variety of tactics to undermine, discredit, or block the deployment of broadband by public power systems. Threatened by the prospect of a public provider that is responsive to community needs and charges affordable rates, large telephone and cable companies, many of which have no plans to provide service themselves, have aggressively pushed for legislation in state legislatures across the country that would either prohibit municipalities from providing broadband services or significantly limit their ability to do so by erecting barriers to entry.

In addition to pushing for anti-municipal broadband legislation at the state level, incumbent telephone and cable companies have utilized a variety of tactics to undermine and discredit community-owned broadband networks. Working with corporate-funded think tanks, opponents have maligned municipal broadband projects, asserting they are destined to fail, are subsidized by taxpayers, and/or crowd out private investment with little to no empirical basis for such assertions. In communities where local governments have asked their citizens to vote to go forward with projects, incumbent providers have spent significant amounts of money on anti-municipal broadband campaigns with the knowledge that municipal governments are legally precluded from spending any funds to promote projects. For example, in the tri-cities area of St. Charles, Batavia, and Geneva, Illinois, the *Kane County Chronicle* (IL) reported that Comcast and SBC

spent over $300,000 on mailers, push-surveys, full-page newspaper ads, and local radio spots full of misinformation on municipal broadband projects.[3]

Arguments Made Against Municipal Broadband

As was briefly discussed above, opponents of municipal broadband have asserted a variety of arguments for why local governments should not provide broadband service. Many of these arguments aver that municipalities have an unfair advantage because of their position as both competitive providers and regulators of services and that public entry is contrary to "level playing field" principles. A closer look at these arguments reveals these claims are false.

One common argument made by opponents of municipal broadband is that localities cross-subsidize communications services at the expense of electric rate payers. The Progress and Freedom Foundation (PFF) testimony asserted this very argument and cited the municipally owned electric utility in Bristol, Virginia, as an example of a public power system doing so. The PFF assertion is completely unfounded and ignores the fact that state and local enterprise laws prohibit municipal electric utilities from cross-subsidizing communications and other services with electric revenues. In Virginia, for example, state law prevents municipal electric utilities from cross subsidizing telecommunications revenues with revenues from other services.[4]

Such an argument is also disingenuous when the private sector is free to engage in cross-subsidization and routinely does so. Predatory pricing by

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[3] See http://www.kcchronicle.com/SportsSection [illegible].php.
[4] VA. Code Ann. § 56-265:4:4.

incumbents in communities with municipal broadband networks is regional cross-subsidization. They are subsidizing service to the residents of those communities where competition exists at the expense of customers in localities that do not have community-owned broadband networks.

The opponents of public power broadband also argue that localities providing such service are competing against the private sector companies they regulate. This assertion is quite misleading. Municipalities do not, and cannot, favor their own municipal service entities. Municipalities do not regulate telecommunications service providers or Internet access providers. Such regulation occurs at the federal and state levels, and even there, it is disappearing rapidly. Municipalities do issue franchises to cable operators, but cable franchising is governed by detailed federal standards, and when municipalities provide cable services themselves, they typically assume regulatory burdens that are as extensive, or more extensive, than those of the private sector.

Municipalities also manage public rights of way and other public facilities. But federal and most state laws require municipalities to act in a nondiscriminatory, competitively-neutral manner. In short, the premise underlying this myth – that municipalities have power to regulate in favor their own services – is simply false.

Another common argument made by the opponents of municipal broadband is that localities have an unfair advantage against private sector communications providers because they do not pay taxes. It is true that public power systems are treated the same way as other governmental and non-profit

entities under federal and state tax law – they do not pay income taxes because they do not earn profits. At the local level, public power utilities are routinely required to make payments in lieu of taxes to the local government that are often higher in amount than what investor owned electric utilities pay in taxes. Evidence in Florida and other states indicates that the same is likely true of the payments made to local governments by public power broadband systems and private sector communications providers. Furthermore, public power utilities do not have access to the wide variety of tax benefits, such as accelerated depreciation and investment tax credits, available to the private sector. In Florida, for example, Bell South paid an effective state/local tax rate of 3.4% and Verizon paid 3.6%. Florida's municipal electric utilities paid an effective rate of 14.6%.[5] It is difficult to see how private providers can complain about the tax exempt status of public power systems that pay more to state and local governments than these private providers do.

Yet another claim made against municipal broadband is that localities have access to low-cost financing. The use of tax-exempt financing is a perfectly legitimate practice for pubic improvement projects. However, in today's market, tax-exempt financing is not always available and comes with many onerous burdens. While there is some advantage to tax-exempt financing, it may not be terribly significant because incumbent cable and telephone companies have access to the best commercial rates.

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[5] See "The Case for Municipal Broadband in Florida: Why Barriers to Entry Stifle Economic Development, Disadvantage School Children, and Worsen Health Care," Florida Municipal Electric Association (citing FMEA and FCC ARMIS 43-03 (2003)).

Conclusion

Public power systems throughout the country are meeting their communities' needs by providing access to affordable broadband services. Recognizing the importance of broadband for commerce, health care, education, and improved quality of life, underserved communities are constructing their own networks to compete and thrive in today's information age. Many benefits accrue from community-owned communications systems including lower prices for consumers, increased competitiveness in the marketplace, responsiveness to local needs, universal access, and economic development. In spite of the obvious benefits of municipal broadband, incumbent telephone and cable companies have opposed such projects, pushing for legislation at the state level to prevent municipalities from providing broadband. Rather than work with local governments to provide service or acknowledge that municipalities that choose to provide broadband have legitimate reasons to do so, incumbent private providers, most of which are very large businesses, assert disingenuous claims and unsubstantiated arguments.

As this committee further examines the anti-competitive practices of investor owned electric utilities that impact small businesses, APPA hopes it will recognize that public power systems are quite distinct from investor-owned utilities. Public power systems are non-profit public entities that cannot and do not cross-subsidize their communications services with electric revenues. In

addition, municipal electric utilities have an excellent relationship with the small businesses they provide electric and broadband services to. Small businesses, in fact, benefit from community owned broadband networks that provide them with affordable access to an essential service needed by businesses to compete in today's information age.

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RESIDENTIAL - COMMERCIAL - INDUSTRIAL

May 7, 2005

The Honorable Donald A. Manzullo
2361 Rayburn House Office Building
Washington, DC 20515-6315

Dear Mr. Chairman,

I would like to thank you for the opportunity to testify before the House Committee on Small Business during the hearing entitled "***Anticompetitive Threats from Public Utilities: Are Small Businesses Losing Out?***" This being my first exposure to this process and not knowing exactly what to expect, I appreciate your kindness and understanding. Although my presentation was not polished, the issues of which I spoke are very real and threatening to small businesses.

The problem of utility cross-subsidization is not being properly addressed by the state utility commissions especially when it creates an unfair competitive advantage for the unregulated utility subsidiaries. The West Virginia Public Service Commission has ruled when a public utility performs non-utility construction projects, the pricing terms must not only cover the incremental cost of such work but must also result in a profit over and above such incremental costs. *National Electrical Contractors' Association v. Appalachian Power Company and Monongahela Power Company, Case No. 00-1841-E-C (2002).*

In another example the Circuit Court of Kanawha County, West Virginia had a similar finding. In the *Civil Action No. 02-C-1109 City of Charleston vs. Bayliss & Ramey, Inc. and Appalachian Power Company (APCO)* the court states under its "Conclusions of Law" that "There is no legal prohibition or impediment preventing APCO from bidding on and performing non-utility construction work so long as its pricing terms and conditions make a contribution over and above its incremental costs."

Both governing bodies above were protecting the utility customers from incurring any additional costs, but neither addressed the unfair advantage the utility gained in performing non-utility construction when using utility assets and resources.

Expenses of a business can be divided into two categories, variable costs and fixed costs. The 'incremental cost' of the utility would be classified as variable costs and would vary in relationship to the volume of work performed. Fixed costs are generally the costs a company would incur regardless of the volume of work they perform. (administrative cost, office space, cost of capital equipment, etc.) By using the utility's

equipment, manpower and other resources, the non-regulated subsidiary avoids incurring these fixed costs thus gaining a competitive advantage.

I encourage the House Committee on Small Business to support and push for Federal regulation to prevent unfair competition from unregulated utility affiliates. It is the only way to uniformly protect the small businesses of our great nation.

Sincerely,

J. Mike Martin

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cc: Bob White – NECA
Steve Allred – WV-Ohio Valley Chapter, NECA