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## Energy in the Afermath of the 2003 Electricity Blackout - U.S. Speaker

David J. Manning

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## U.S. SPEAKER

*David J. Manning<sup>†</sup>*

MR. McILROY: Thank you, Garry.

Our next speaker has some PowerPoint presentations, and I am wondering if one of the Institute's technological gurus –

While we are bringing that up, I would describe our hybrid system as being a half pregnant system in that they say it is not regulated, but it sure is.

You are on the screen, David.

MR. MANNING: Yeah. I am almost on the screen. There we go. I've got a slide show. All right. Thank you very much. Did I just eat three minutes of my time?

Just very quickly, what's fascinating is that we are using this blackout as a launching pad for a discussion, and Garry and I, of course, know that we are really just supposed to be the initiators, and this conversation will come from this room. And, of course, I am also thrilled to see the legend himself, Professor King, with his bell. So I will do my best to honor that, but, just quick anecdotally, when that happened on the night of the fourteenth of August, it was a very hot day in New York City. For reasons I cannot explain, I was the only officer in the company that was actually at a station. I was in the City. I managed to get back to the building. We had a generator, at least one elevator ran slowly to get me to my office, and I was there manning the phones. And about 10 o'clock that night, this guy appeared at my door saying, "Mr. Manning, can I help?" He was the only employee that had one of those two jobs that he was supposed to be there in the event of an emergency, and I said, "Yes, you are to go to the operating room and wait there because – How

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<sup>†</sup> David J. Manning was elected Senior Vice President of Corporate Affairs of KeySpan Energy in April 1999. Mr. Manning is the Senior Officer reporting to the Chairman, with responsibility for Public Affairs, Government Relations, internal and external communications, community development and altruism, corporate brand strategy, and environmental policy and operations. Before joining KeySpan Energy, Mr. Manning had been President of the Canadian Association of Petroleum Producers (CAPP) since 1995. From 1993 to 1995, he was Deputy Minister of Energy for the Province of Alberta, Canada, the source of approximately 14 percent of U.S. natural gas demand. From 1988 to 1993, he was Senior International Trade Counsel for the Government of Alberta, based in New York City. Previously he was in the private practice of law in Alberta, Canada. Mr. Manning is eligible for admission to the New York Bar. Mr. Manning is past Chairman of the Brooklyn Chamber of Commerce, Vice Chairman of the Long Island Housing Partnership Board, and Coordinating Committee Co-chair of the current National Petroleum Council Natural Gas Study.

did you get here?" He drove. So what happened is we have 10,000 employees. We have 4000 fleet vehicles. We have a garage. I said, "I will be fine." I called downstairs.

Every vehicle had been stolen by employees. One of our little guys from New Jersey had taken the CEO's chauffeured car and driven out of the garage and headed home, and the Chairman happened to be at his home on Long Island, which was actually closer to the electric operation center. He drove down alleys and over parkland at the cross grass, got to the operation center, got in there, and was hanging over this young guy who had been on the job for six months and who controlled the control room. Understand the whole thing melted in nine seconds. It started, as you know, in Ohio. It went over the top through Canada, landed in New York as a last spot, but our entire system just started flashing red. Everything is green. There were lights all over. You know, it is the old 1950s control room. So here is the Chairman leaning over this guy. He said, "Mr. Catell, you will have to leave the room. I've got to do my job." And seriously, he was promoted three months later.

(Laughter.)

Young, early thirties. It was just one of those great moments.

In any event, my thesis is that we have a pretty dysfunctional system in North America on the electric side. I think that Ontario is a case in point. Ontario is facing fuel supply. Ontario is facing the political will and the lack of appetite for higher pricing. I think that's really where we face now.

Keyspan is not really known to many of you. It is a whole bunch of old utilities, which have been bought up and merged. When I came down from Canada five years ago, it was 2300 people. Now, as I said, it is about 10,000.<sup>1</sup> We have 30% or 40% of New York City's power supply. We also run some electric systems, and we sell a lot of gas.<sup>2</sup>

So what I just want to turn to is what's going to be driving this conversation now is not some great relationship between Canada and the U.S. – which has always been taken for granted, I would suggest, certainly on the U.S. side – it will be choice of fuel, cost of power, and the cost of energy.

And I just want to get – all of which, of course, Ontario is the microcosm for those issues. Just a few quotes: "Power disruptions, outages cost the economy \$80 billion annually," says the DOE.<sup>3</sup> "Closing Ontario's coal-burning power generating stations will force the province to increase natural

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<sup>1</sup> Lucie P. Lawrence, *Case Study: Connecting the Energy of People - KeySpan Corporation Transforms HR Service & Delivery*, WORKINFO.COM, available at <http://www.workinfo.com/free/Downloads/271.htm>.

<sup>2</sup> KeySpan Corporate Info Index, [http://keyspansenergy.com/corpinfo/about/index\\_all.jsp](http://keyspansenergy.com/corpinfo/about/index_all.jsp) (last visited Oct. 30, 2005).

<sup>3</sup> Kristina Hamachi LaCommare & Joseph H. Eto, *Understanding The Cost of Power Interruptions to U.S. Electricity Consumers*, at xi (2004), available at [http://certs.lbl.gov/CERTS\\_P\\_Reliability.html](http://certs.lbl.gov/CERTS_P_Reliability.html).

gas-fired generation by five to eight times at a time when Canada's gas supply is dwindling . . ."<sup>4</sup> I wouldn't say that, but it certainly is an issue, as Garry pointed out.

"While there is a growing need for new capacity, investor-owned utilities are pursuing back-to-basics strategy: freeze out independent producers."<sup>5</sup> "The recent shift in expectations has been substantial enough and persistent enough to bias business investment decisions in favor of energy cost reduction."<sup>6</sup>

And, of course, most importantly of all, "Pat Wood, who has been at odds with many members of Congress over deregulation, said he would leave the Federal Energy Regulatory Commission (FERC)."<sup>7</sup> Pat spoke yesterday in Washington, D.C., and I was there. And he pointed out that the Baltic States and regions of Africa have managed to consolidate their electric systems, but we have been unable to do that in the United States.<sup>8</sup>

And the contrast, of course, with the natural gas industry, the telecoms, and the airlines, is very significant, and what I would suggest to you is that we will not have true continental integration until such time as we actually solve the deregulation puzzle.

Now, natural gas was a very different story. Natural gas, to start with, was not built like the electric system. We don't really have a power grid. We always talk about the power grid, so in a couple of great words you read occasionally, the morphology of the electric business – and I think that's a made up word, but I read it – and the physicality of the business is very different.

We clearly have got great cross-investment in the energy business, and always have. One of the largest oil and gas producers in the United States is based in CalGarry,<sup>9</sup> a group of the larger producers from CalGarry – in the Western Basin, of course, all come from the U.S.,<sup>10</sup> and the very high cost of

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<sup>4</sup> John Spears, *Big Chill Ahead for Ontario Energy*, TORONTO STAR, Feb. 24, 2004, available at [http://www.energyshop.com/es/contactus/big\\_chill\\_ahead.cfm](http://www.energyshop.com/es/contactus/big_chill_ahead.cfm).

<sup>5</sup> *Utilities' Focus on "Back-to-basics" Could Hurt Merchants*, ELECTRIC POWER DAILY, Apr. 5, 2005, at 1.

<sup>6</sup> Edmund L. Andrews, *Greenspan Expects High Price to Lead to More Fuel Supplies*, N.Y. TIMES, Apr. 6, 2005, at C7.

<sup>7</sup> *Change at Energy Agency*, N.Y. TIMES, Apr. 7, 2005, at C3.

<sup>8</sup> See generally *Renewable Energy Potential in Selected Countries*, Energy Sector Management Assistance Program, April 2005, available at [http://wbln0018.worldbank.org/esmap/site.nsf/files/070-05+RE+Potential+Final+P044440.pdf/\\$FILE/070-05+RE+Potential+Final+P044440.pdf](http://wbln0018.worldbank.org/esmap/site.nsf/files/070-05+RE+Potential+Final+P044440.pdf/$FILE/070-05+RE+Potential+Final+P044440.pdf).

<sup>9</sup> The company's name is EnCana, and is worth an estimated \$50 million in enterprise value. <http://www.encana.com> (last visited Nov. 17, 2005).

<sup>10</sup> See <http://www.devonenergy.com/> (last visited Nov. 17, 2005); see also <http://www.apachecorp.com/> (last visited Nov. 17, 2005).

eastern Canadian production offshore drilling has driven a lot of international investment.<sup>11</sup> So there has always been integration.

But the power system was built differently. It was built as a hub and spoke, and it was built around these major markets and power plants, the grid, as it served a market. Market areas abutted, but they barely touched, and that's of course, where you have congestion. Interconnects are not being built due to uncertainty of load, regulatory, and financing issues. The Energy Policy Act of 2005 tries to address that.<sup>12</sup>

So we have got these long-term solutions of renewables, clean coal, natural gas, and LNG (Liquefied Natural Gas), and those issues are out there, and the opportunities are certainly out there. But the difficulty has been – the focus has been entirely in the U.S. on the generation side. It has not been on the transmission side.<sup>13</sup>

Now, of course, we are in a very different world from traditional carbon-based fuels. First you had a lot of coal. Then the nuclear days hit their glory. The hydro came through in a large way, and everything in the last ten years has been natural gas.<sup>14</sup> The technology evolved to cost-efficient, fuel-efficient combined-cycle natural gas fired plants.

Well, all of a sudden Goldman Sachs last week said the price of oil could hit \$105.<sup>15</sup> That's what they put as a ceiling projection, and we are going to hit 60 bucks this summer. All of our analysis on natural gas would indicate we are in a high gas environment now, and gas prices will actually increase, not decrease, in the summer, and everybody thinks that oil is going to go over 60 bucks this summer.<sup>16</sup>

And if oil is over 60 bucks, natural gas will continue to increase \$7 or \$8.<sup>17</sup> Understand we are working with technology here that was built in the \$2 gas market, and the \$1.50 gas market-period, when oil was \$11, \$12.<sup>18</sup>

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<sup>11</sup> See generally Charles B. Renfrew, *Programs From the 1992 Annual Meeting The Boundaries of Horizontal Restraints - - Communication and Cooperation Among Competitors: Intercompetitor Cooperation in the Petroleum Industry*, 61 ANTITRUST L.J. 559 (1993).

<sup>12</sup> *Energy Policy Act of 2005*, H.R. 6 (109th Cong. 1st Sess.), July 27, 2005, available at [http://www.ne.doe.gov/EPAct2005/hr6\\_textconfrept.pdf](http://www.ne.doe.gov/EPAct2005/hr6_textconfrept.pdf).

<sup>13</sup> *United States Department of Energy National Transmission Grid Study: Comments of American Superconductor* (Oct. 10, 2001), available at [http://www.amsuper.com/industryViews/files/AMSC\\_Initial\\_Comments\\_to\\_NTGS.pdf](http://www.amsuper.com/industryViews/files/AMSC_Initial_Comments_to_NTGS.pdf).

<sup>14</sup> Mark Morrison, *Natural Gas: Flameout Ahead?*, BUS. WK. ONLINE, Sept. 27, 2005, [http://www.businessweek.com/bwdaily/dnflash/sep2005/nf20050927\\_9413\\_db035.htm](http://www.businessweek.com/bwdaily/dnflash/sep2005/nf20050927_9413_db035.htm).

<sup>15</sup> Reuters, *Goldman Sachs: Oil Could Spike to \$105*, MSN MONEY, Mar. 31, 2005, available at <http://www.energybulletin.net/5017.html>.

<sup>16</sup> Matt Piotrowski, *Bank Predicts Oil to Average \$68 in '06*, OIL DAILY, Aug. 19, 2005.

<sup>17</sup> See Michael Brush, *Three Energy Companies the Insiders are Buying*, available at <http://moneycentral.msn.com/content/P125119.asp> (last visited Nov. 17, 2005).

<sup>18</sup> See *The price of oil - in context*, CBC NEWS ONLINE, Aug. 11, 2005, available at <http://www.cbc.ca/news/background/oil/>.

Even coal has doubled and tripled in price in the last six months in response to that. One of the little anecdotes is that there was some crisis at some of the coal plants because Wal-Mart, just before Christmas, was driving so much rail traffic with its container loads of Chinese goods that the railways got a better price. Their coal cars got parked to make way for the Wal-Mart trade.<sup>19</sup> So those are some of the variables we are seeing now. But my point very quickly, we are completely linked in terms of the gas transmission system.

How did it get there? Well, one of the ways it got there was that the gas business recognized that prices were too high. So it was forcing deregulation to get lower prices, and two of the biggest advocates on the U.S. side were Enron and Dynergy, who were spending \$30 to \$60 million a year on lobbying expenses alone to try and drive that deregulation.<sup>20</sup>

Well, when they took that same thesis into the power institutions, it got a little wonky.

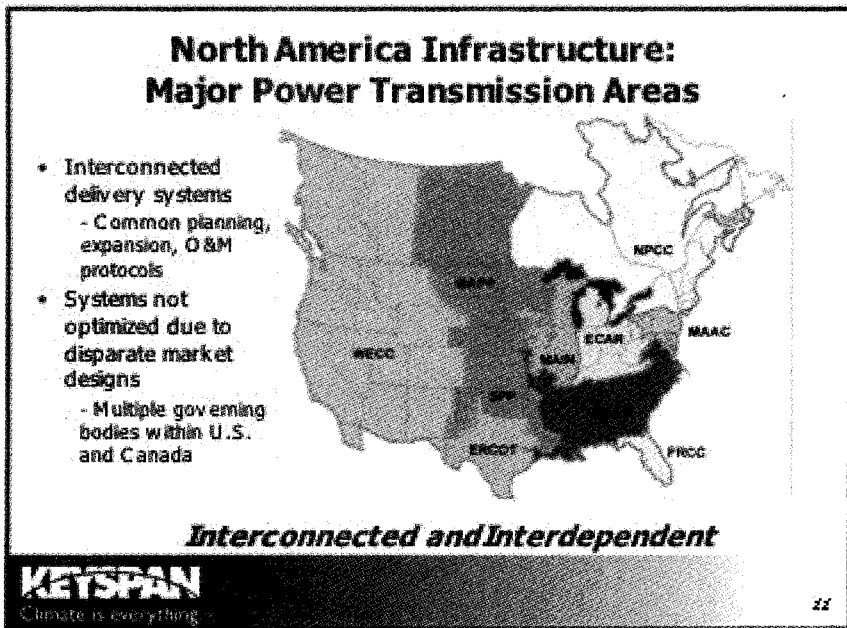
This slide is very important because it just shows what has happened now. The industrial component and the power component are so heavily dependent on natural gas because of the environmental agenda, that energy costs are going up dramatically.

So one of the key goals of deregulation would be to drive some choice of fuel, but you can't have a choice-of-fuel advantage unless there is a better power interconnection between the entire continental marketplace. This is another big challenge for the U.S. This is how the power grids are administered:

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<sup>19</sup> See generally Harvey Wasserman, *Our Fake Energy Crisis: What Really Happened in California*, 2001, available at <http://www.local.org/wasserman.html>.

<sup>20</sup> See generally *id.*



I love the fact that Texas is standing all by itself, as it likes to do. And what Pat Wood pointed out yesterday, the Mid-American Power Pool, the TIEL cluster, they had very little deregulation going on there, and there is very little grouping of their dispatch.<sup>21</sup>

Just interconnecting mid-America could drive substantial power efficiency. Most states are operating in a regional transmission organization or have an ISO, Independent System Operator, so that the lowest cost power runs first, and the higher cost comes on last, and those efficiency decisions are made in that system. Wood estimates there would be a 20% cost savings if you could achieve that in TIEL alone. So that's part of the challenge. About two-thirds of the U.S. states are not deregulated at all, and there is some form of deregulation on the power side in about a third of the states. And, of course, all of the capacity additions that we have seen in the last ten or fifteen years, noteworthily, are all natural gas powered, and, of course, natural gas is driving a lot of those prices.<sup>22</sup> Because of the shortage of time, I won't deal a great deal – at great length with this train here, but this shows

<sup>21</sup> See generally Interview by Lowell Bergman with Pat Wood, Chairman, Federal Regulatory Commission, in Berkley, CA (Mar. 26, 2001), available at <http://www.pbs.org/wgbh/pages/frontline/shows/blackout/interviews/wood.html>, [hereinafter Wood Interview].

<sup>22</sup> Natural Gas Demand, available at <http://www.naturalgas.org/business/demand.asp> (last visited Oct. 31, 2005).

you there has been, in fact, a regulatory progression of getting us toward deregulation, and, of course, let's think about why that was happening.

Everybody knew that energy was too expensive, and the gas industry got fairly aggressive with FERC, and the gas industry was really deregulated by the federal government. And it was deregulated also, of course, by the Canadian Government, and the regulator, as well, participated in that.<sup>23</sup> What you were able to do was you were able to, with long-term contracts, build this very long infrastructure and get that built out as the price disconnect between markets drove infrastructure. In 1991, we opened the Iroquois Pipeline, which in the U.S. is called "Iroquois."<sup>24</sup>

What happened was that our Chairman of Keyspan went to Texas back in the '70s, met a guy named Ken Lay. He had an embargo on any growth in the Northeast. The price was very expensive. He asked for a new pipe to get to the marketplace. Ken Lay said, "Fine, when you are ready, we will do it. Go back to Brooklyn, and don't bother me." So he went to Alberta and made a six-year effort and six-month construction phase to open a pipeline that raised the price of gas a buck in Alberta, and lowered the price of gas in Boston and New York, and that was the day the pipeline opened. So that was a good business case right there, even taking into account the tolls to move gas from Western Canada to New York City.

That has happened on the electric side. Many power utilities protect their turf. They also were very concerned about stranded costs, a real issue for costly infrastructure. But, that said, did you ever hear anybody from the tube industry talking about stranded cost when the transistor was invented? Probably not. So technologies have evolved. Many industries have been left behind. Some in the power industry said, "Not us. We will protect our turf. We will protect our investment. And Mr. Regulator, you have to protect us."

The other issue, which I think is very important, particularly in Ontario, here, East-West, Canada, and the U.S., is "native power." It is a wonderful expression. Native power relates to the fact that some of us have got great advantages in terms of affordable power and access to affordable power. The contracts for Niagara Falls are coming up soon.<sup>25</sup> Guess what? Niagara Falls on the New York side is controlled by the New York Power Authority. What a surprise. And the power, which, of course, has virtually no operating cost and virtually no fuel cost, drives power for jobs, drives all sorts of political

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<sup>23</sup> Patrick J. Hoey, *Is Further Deregulation of the Natural Gas Industry Beneficial*, THE CONFERENCE BOARD OF CANADA, Nov. 2005.

<sup>24</sup> <http://www.iroquois.com/new-Internet/igts/index.asp> (last visited Oct. 31, 2005).

<sup>25</sup> See New York Power Authority, *NYPA Files Application for a New License For the Niagara Project Reflecting Participation of Area Communities*, Aug. 18, 2005, available at <http://www.nypa.gov/press/2005/050818a.htm>.



opportunities that the state drives,<sup>26</sup> which, of course, some of the rest of us don't get access to.

It also has positioned hydro-power very well in a Kyoto world. Rely on energy, put all of its hydro assets for sale, very, very cheap power, of course, and they skunked – Brascan came in and skunked a lot of the American bidders and bid what we thought was an unusually high price.<sup>27</sup> But I think they were driven in large measure by what was evolving in Ontario.

And, of course, on the natural gas side, you had great advocates and great opportunities to lower prices and drive some costs out of the system. And the pipelines, which had harbored a lot of the rent in that whole system, were not nearly as savvy as the consumer was, and the producer, so I think deregulation moved forward. Then over on the electric side, you had the major utilities. You had the big native power producers, and you had the public and the federal power opportunities in the U.S. Bonneville Power was not about to give up any of their ground,<sup>28</sup> and the political leadership of the west that got this cheap, public power, was not about to yield.

So, where in the gas business you were trying to get to a lower cost environment, in the electric business, there was no guarantee, as Garry just pointed out, that you were going to get a lower cost because, quite frankly, the costs that were in many of the markets at that time weren't real. They were subsidized.<sup>29</sup> They were based on native power, like the advantage of hydro or nuclear where you had nukes, where you had very little fuel cost. So people had this expectation of lower power and, bingo, when dad went away, all of a sudden they were exposed to real costs, which, of course, is how the market works, and then the investment community rushes in, and they invest all that money and everything works. Of course, everything balances.

But what happened, of course, was the Ontario government got nervous, as Garry so aptly pointed out, and it didn't want to expose themselves to the wrath of the consumer. And on the U.S. side, the political leadership around the country who had watched Enron and Dynegy help move forward the gas deregulation, all of a sudden watched the Enron family blowup. All of a sudden, all of that opportunity for the markets was unclear because many had gotten pretty good prices out of the regulated world, and some of your best

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<sup>26</sup> See generally New York Power Authority, *Power Authority Benefits to Western New York*, available at <http://www.nypa.gov/about/Niagarafacts/wnybenefits.htm> (last visited Nov. 1, 2005).

<sup>27</sup> See *Brascan Closes \$874 Million Acquisition of Power Generating Stations in Upstate New York*, Sep. 28, 2004, available at <http://www.brascancorp.com/NewsRoom/2004/Sept28.htm> [hereinafter *Brascan Acquisition*].

<sup>28</sup> See generally Kenneth W. Costello, *Toward Accountability and Efficiency: Reform of The Bonneville Power Administration*. REASON PUBLIC POLICY INSTITUTE, Apr. 1992, available at <http://www.rppi.org/privatization/ps138.html>.

<sup>29</sup> See generally *id.*

advocates, Dynergy and Enron, were basically profoundly embarrassed over their relationship with California and elsewhere, and the major utilities were, of course, advocating for their own worlds as opposed to a broader world.<sup>30</sup>

And in steps Pat Wood, the Chairman of FERC, who says, “There is a better way. This is a much more efficient way to do business. We are going to open up the system. We are going to get the grids to cooperate. We are going to build an infrastructure between all these different pods, and everything will be better. The right efficient market decisions will be made, and lower prices will prevail.”<sup>31</sup> And, of course, Pat Wood has just announced his retirement. So I think what happens here is that we’ve got a very different mechanical structure. We have got great desire and appetite for hydro-power from Eastern Canada into the U.S., but we don’t have a way to drive the rent out of the transmission system to get it there. We have great opportunities for efficiency across the U.S. and trans-border, but you can’t build the wires because you can’t figure out who is going to make the money off that easily. It is also very difficult to site.

In the gas business, Section 7 of the Natural Gas Act gives the federal government, FERC, the opportunity with eminent domain to put facilities where they direct that they go.<sup>32</sup> That doesn’t exist on the electric side. States preside over electric infrastructure.<sup>33</sup> The federal government presides over interstate – just as it does in Canada over inter-provincial<sup>34</sup> – natural gas infrastructure.<sup>35</sup>

So you have some mechanical differences. You have some philosophical differences. You have some regulatory differences, and the unfortunate thing is now we are in a situation where we really need to get good at this because if oil is going to be 60 bucks – and a lot of the industry is still in some parts running on oil – the gas-power industry and natural gas is going to be \$8, \$9, \$10 possibly, and that has a profound impact on energy prices and power prices.

So there is a very different approach. The U.S. marketplace, of course, would love to get a piece of that, and that’s ultimately going to be driving this as cost because I think what’s going to happen soon is the consumer is going to start to wake up. When you are driving that Suburban up to the gas

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<sup>30</sup> Mark Martin, California System was Easy Pickings Enron Helped Build market, then Exploited Weakness, SAN FRANCISCO CHRONICLE, Feb. 3, 2002 at A1.

<sup>31</sup> See Wood Interview, *supra* note 21.

<sup>32</sup> See *The Market Under Regulation*, The Natural Gas Organization, <http://www.naturalgas.org/regulation/market.asp> (last visited Nov. 1, 2005).

<sup>33</sup> See Status of State Electric Industry Restructuring Activity as of February 2003, *available at* [http://www.eia.doe.gov/cneaf/electricity/chg\\_str/restructure.pdf](http://www.eia.doe.gov/cneaf/electricity/chg_str/restructure.pdf).

<sup>34</sup> <http://www.oeb.gov.on.ca/html/en/abouttheoeb/whatwedo.htm> (last visited Nov. 1, 2005).

<sup>35</sup> *What FERC Does*, <http://www.ferc.gov/about/ferc-does.asp> (last visited Nov. 1, 2005).

pump at \$3 a gallon and it is costing you \$100 a week to gas up, I think we are now heading into a period of awareness, greater awareness in the energy business. The good news for us is that it has always been focused at the pumps. No one has been critical yet of companies like us who have some pretty high prices, but I do think that the disease is going to drive us into that kind of a conversation.

As I indicated, Brascan walked right under the noses of a bunch of American firms and paid a lot of money for about seventy different hydro assets in upstate New York.<sup>36</sup> There is a good example of somebody who was thinking more long-term. You will see that in the text, the bidders on the U.S. side, such as Keyspan, were much more focused on earnings per share and some near-term horizons. Brascan obviously took a longer-term view, and we are prepared to take a lower return based on their understanding.

And I show you at the end here another case study, we actually operate a state utility so that the utility is seen to be the state. It only happens – I can't come up with another example of this, so here the power supply to the three million people on Long Island are all served by the State of New York, and it is operated by Keyspan.<sup>37</sup>

So, you say Ontario has had a couple of political considerations in their evolution; New York is really no different.

Thank you very much.

MR. McILROY: Well, thank you very much, David.  
(Applause.)

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<sup>36</sup> See Brascan Acquisition, *supra* note 27.

<sup>37</sup> <http://www.keyspanenergy.com> (last visited Nov. 1, 2005).