

**BEFORE THE PENNSYLVANIA HOUSE
MAJORITY POLICY COMMITTEE**

Representative Todd A. Eachus, Chairman

Testimony of

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CONSUMER ADVOCATE OF PENNSYLVANIA**

**Regarding
Electric Utility Rate Stabilization**

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Chairman Eachus and Members of the House Majority Policy Committee

My name is Sonny Popowsky. I have served as the Consumer Advocate of Pennsylvania since 1990, and I have worked at the Office of Consumer Advocate since 1979. As the statutory representative of Pennsylvania's electric utility consumers, I want to thank you for holding this important hearing and for inviting me to submit this testimony.

It is not an exaggeration to state that we stand here today at a critical crossroad in the history of the Pennsylvania electric industry. The stakes are high, not just for the electric utilities, but for the millions of Pennsylvania consumers whom they serve and for the economic and environmental health of the Commonwealth as a whole.

As the members of this Committee are well aware, the generation rate caps that have protected most Pennsylvania consumers from the winds of change in the electric industry will be coming off at the end of this decade. But they will be coming off in a world that is much different from the one that many of us expected when the General Assembly passed and Governor Ridge signed the landmark Pennsylvania electric restructuring law in 1996. The policies that we develop between now and 2010 may determine whether Pennsylvania has a crash landing, as has occurred in some of our neighboring states, and even here in the tiny service territory of Pike County Light & Power Company, or whether we continue on what has generally been a smooth path toward restructuring our electric industry in a reasonable and beneficial manner.

In 1996, Pennsylvania became one of the first states in the Nation to open the generation portion of its electric utilities to competition. This landmark legislation reflected a policy that competition, rather than regulation, would provide lower prices and improve service for that

portion of the electric industry -- electric generation -- that was not believed to be a natural monopoly and where competition could therefore take root.

I would hasten to add, however, that we did not deregulate our electric utilities. First of all, the distribution portion of the industry – the wires that carry electricity to our homes and businesses -- remained a monopoly service under the traditional regulated model. And, equally important from my view, even with respect to electric generation, our regulated utilities continued to serve as the “default provider” or “provider of last resort” so that all Pennsylvania consumers can continue to receive essential energy service even if they cannot or choose not to shop in the competitive retail market.

In fact, the vast majority of Pennsylvania electricity consumers – especially residential consumers – have continued to receive all of their retail electric service, both distribution and generation, from their local electric utility. In my mind, there is nothing wrong with that, as long as the utility provides customers with reliable service at reasonable prices. To the extent that a retail competitor can provide generation service that is better than the utility – that is, for example, less expensive or less environmentally harmful – then that is all the better. But retail competition is not an end in itself; it is one possible means to the end of reliable electric service at the lowest reasonable cost to consumers.

At the time of restructuring, the price that a utility could charge for its generation service was “capped” at a level that was equal to the regulated price that the utility had been charging for the generation portion of its service prior to restructuring. Under the statute, those caps were supposed to expire no later than 2005. Under a series of restructuring settlements, however, the caps for several of our major electric utilities were extended to around 2010. After these rate caps expire, the utilities are still obligated to provide default service, but they do so by acquiring

supply at “prevailing market prices” in the wholesale electricity markets and then recovering the costs from default customers.

The critical issue facing us now is how our electric utilities will meet the challenge of serving their customers at the end of the rate cap period. Fortunately, we now have some experience in Pennsylvania showing us how to provide service when rate caps expire and how not to provide such service.

In the case of Duquesne Light Company, whose residential customer rate cap expired in 2002, residential electricity prices are actually lower today than they were prior to restructuring in 1996. Duquesne has offered its residential customers a series of multi-year fixed price rates that have been based on the cost to Duquesne of purchasing a portfolio of generation resources through the competitive wholesale market. Duquesne is an example of a company that has done it right when it comes to providing stable reasonably priced service to customers even after the end of the rate cap period, and as a result, Duquesne residential customers have not been subject to the kind of wild price increases that have occurred in some of our surrounding states when their rate caps expired.

At the opposite extreme, we have the unfortunate recent experience of customers of the tiny Pike County Light & Power Company in the Milford and Matamoras areas of Pike County, Pennsylvania. When that Company’s rate cap was about to expire at the end of 2005, and the company went to market to obtain power for customers starting on January 1, 2006, their 4,200 customers were shocked to find out that the generation portion of their rates had increased by 129%, from 6.3 cents per kilowatthour to 14.4 cents, and that their overall bills were increased by 75.2%. Residential customers using 700 kilowatthours per month saw their monthly bills increase from \$75.50 to \$132.31. Pike is unique in that it is an affiliate of a New York utility

that obtains its power through the highly volatile, high cost New York wholesale market, rather than from the PJM market that serves most of the rest of Pennsylvania. The Pike wholesale market auction also was conducted at the worst possible time, in October 2005, when wholesale natural gas and electricity prices were soaring in response to Hurricanes Katrina and Rita on the Gulf Coast. In any case, for a number of reasons, we have learned from the Pike County experience how not to provide default service at the end of the rate cap period.

What my Office has consistently recommended to the PUC and what we are recommending to the General Assembly as well, is that our electric distribution utilities should be required to provide their post-rate cap generation service through a portfolio of resources. In our view, the utilities should be starting now to develop a portfolio of resources to serve their default customers when the rate caps expire in 2010. That portfolio should include both long-term and short-term contracts, both renewable and non-renewable resources, and both supply-side and demand side resources. The inclusion of long-term contracts in the portfolio is important as a means of assuring some rate stability, and might be particularly appropriate and necessary to support construction of new renewable and advanced energy resources as embodied in the General Assembly's Alternative Energy Portfolio Standards legislation as well as resources needed to maintain reliability and fuel diversity. What we cannot do is simply wait until 2010 and then roll the dice as we did in Pike County and hope for a good price in a single auction. We also should not rely solely on volatile short-term or spot prices that will leave customers not knowing what their electric bills will look like from one month to the next.

The Public Utility Commission recently issued an Advance Notice of Final Rulemaking and proposed Policy Statement in which it encouraged a portfolio approach where each utility would establish a procurement plan with the goal of meeting its default service obligation "at the

lowest reasonable long-term costs.” My Office fully supported that goal, but some parties filed Comments in that proceeding, suggesting that this goal is impermissible and inconsistent with the Electric Restructuring Act, which provides that the default service provider must acquire its resources “at prevailing market prices.” The Commission’s proposed final regulations maintain the requirement for a portfolio approach, but remove the language that the goal is to provide default service “at the lowest reasonable long-term costs.”

I would submit that there is nothing wrong with a requirement that service must be provided at the “lowest reasonable long-term costs.” In fact, I would be surprised if any member of this Committee or the General Assembly did not agree that this is the appropriate goal for the well-being of our consumers and for the Commonwealth as a whole.

Fortunately, this issue is addressed in the legislation proposed by Governor Rendell as part of his recently announced Energy Independence Strategy. This issue is also addressed in a bill (HB 697) that was introduced earlier this year by Representative Ross and co-sponsored by 21 other representatives. Both pieces of legislation would make it clear that our electric utilities should be securing a portfolio of resources that is designed to produce the lowest reasonable rates on a long-term basis. This would be done by procuring contracts of varying lengths for both renewable and non-renewable generation as well as for demand resources, such as conservation and energy efficiency.

It has been argued by some parties that if our utilities provide stable reasonably priced generation service to their customers, then customers will be less likely to shop for other retail suppliers. My answer to that argument is “so what?” Again, the goal of electric restructuring was not to force customers to leave their utility and shop for retail generation service. I believe the goal was to provide customers with the best means of receiving reliable service at reasonable

prices. It is important to recognize that, even if a customer purchases electric generation from their local retail utility, that utility is now purchasing its generation from a competitive wholesale market. That was not true prior to restructuring.

Because of our reliance on wholesale markets, however, it is now even more important from my perspective that we do whatever we can to ensure that the wholesale markets from which our utilities are purchasing their resources are truly competitive and that those markets provide adequate generation at reasonable prices. Wholesale prices are much higher today than we anticipated when electric restructuring began in 1996. That is largely a result of high natural gas and other fossil fuel prices, and the manner in which wholesale prices are set in the competitive PJM market in which most of our utilities buy their power. As a region and as a Nation, we have grown to rely too heavily on electric generation that is fueled by natural gas. That is one of the reasons that I supported the General Assembly's efforts to encourage the development of new renewable and other advanced resources through the passage of Pennsylvania's Alternative Energy Portfolio Standards Act in 2004. That is also one of the reasons that I support the focus in Governor Rendell's new Energy Independence Strategy on conservation and energy efficiency measures. There is simply no question that the cheapest kilowatthour of electricity is the one that isn't used. To the extent consumers can be encouraged to reduce unnecessary electric usage it not only reduces those customers' bills, but it also reduces the overall cost of electricity for all customers in the wholesale market because the most expensive generating sources do not need to be used. Finally, the benefits of both non-fossil fuel burning renewable resources and conservation and energy efficiency will be even greater when we are faced with what I believe are the inevitable impacts of global climate change regulation at the state, federal and international level. If we take steps now to reduce our carbon dioxide and

other greenhouse gas emissions, then we are not only doing the right thing for the environment, but I believe we are also avoiding even greater costs for electric utility consumers in the future.

As I mentioned at the beginning of my testimony, these are challenging times for the Pennsylvania electric industry and its customers. I want to thank you again for inviting me to submit testimony on these important issues and I look forward to working with the members of the General Assembly as you address these concerns.

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