BEFORE THE PENNSYLVANIA HOUSE
CONSUMER AFFAIRS COMMITTEE

Representative Joseph Preston, Jr., Chairman

Testimony of

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Regarding
House Bill 1201

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Chairman Preston and Members of the House Consumer Affairs 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 participate.

As I stated in testimony that I presented to this Committee in March of this year, we stand at a critical crossroad in the history of the Pennsylvania electric industry. 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, or whether we continue on what has generally been a positive path toward restructuring our electric industry in a reasonable and beneficial manner.

The time has come, in my opinion, for the General Assembly to re-examine certain provisions of the 1996 Act in light of current realities. The General Assembly can wait until the rate caps for all our major utilities come off – as occurred in states like Maryland and Delaware and Illinois, where the respective state legislatures have had to react in crisis situations to public demands for legislative solutions after the fact. Or alternatively, the General Assembly can take another look at the 1996 Act as part of a comprehensive examination of the Commonwealth's energy policies at this time. Obviously, I believe it is better to act **before** the rate caps expire,

rather than **after.** It is also better to consider this issue as part of a comprehensive examination of the Commonwealth's energy policy.

I am extremely pleased, therefore, to participate in this hearing on House Bill 1201, which contains many elements of Governor Rendell's Energy Independence Strategy, including the critical issue of how to address the upcoming end of rate caps on a proactive rather than reactive basis. I would also commend to your attention House Bill 697, which was introduced earlier this year by Representative Chris Ross and 21 other members of the House of Representatives. As many of you recall, Representative Ross was a primary sponsor of the General Assembly's 2004 legislation that created the Alternative Energy Portfolio Standards Act that I believed then, and that I continue to believe, will help diversify Pennsylvania's energy resources to the long-run benefit of our electric consumers.

As I noted above, however, I think it is necessary to reconsider and amend certain provisions of the 1996 restructuring law in order to better protect consumers and support the economic well-being of the Commonwealth. When the Pennsylvania electric restructuring law was enacted in 1996, it was widely assumed that competition would drive down the price of generation (which is why we allowed our utilities to recover billions of dollars of stranded costs) and that the great majority of customers would flock to lower-priced competitive retail marketers (which is why we required that retail choice be phased in gradually over three years). Rate caps were implemented just in case rates did not go down as anticipated, in order to prevent utilities from charging **both** for stranded costs and for higher than expected generation rates. As it turned out, however, due in large part to high natural gas and other fossil fuel prices, and the manner in which wholesale prices are set in the PJM market, wholesale generation prices have increased

substantially in the last several years, while retail competition – particularly for residential customers – has been dormant, both in Pennsylvania and in most other restructured states.

Even in 1996, the General Assembly recognized that at least some consumers might not be able, or might not choose, to switch to alternative competitive generation suppliers. The 1996 Act therefore declared that each utility (or an alternative supplier designated by the PUC) must serve as the "Provider of Last Resort (POLR)" or "default service provider" for those customers who could not, or chose not, to receive generation service from an alternative supplier. Under the terms of the 1996 law, after the end of the rate cap "transition" period, the provider of last resort would be required to serve those customers by acquiring generation "at prevailing market prices" to serve those customers. This provision received relatively little attention in 1996 when the common assumption was that wholesale competition would drive down the cost of generation and that most customers would switch to retail competitors who would offer service at lower prices than the incumbent utilities. What we know now, however, is that the provider of last resort service has been, and is likely to continue to be, the predominant service -- at least for residential customers -- for the foreseeable future.

My concern is that the "prevailing market prices" standard in the 1996 law has been interpreted by the Pennsylvania Public Utility Commission in a manner that relies too heavily on short-term market conditions. In its recent Policy Statement and Order establishing regulations for post-rate cap provider of last resort service, the Commission has stated that default service providers should rely on a portfolio of short-term and spot purchases in the wholesale market; that the rates charged for this service must change at least every three months for residential customers and at least every month for large business customers; that long-term contracts for supply acquisition "should only be used when necessary and required for [Default Service

Provider] compliance with alternative energy requirements;" and that arms' length bilateral contracts are prohibited, except for very short-term emergency situations in which a wholesale contractor defaults on its contract. In addition, the Commission stated in its Rulemaking Order that the portion of the utility's portfolio that relies on shorter term contracts of one year or less and the spot market should "be gradually increased over time."

My concerns with the reliance on short-term wholesale markets and short-term prices for default service are three-fold. First, I believe that most customers prefer stability and predictability in their utility rates. Though consumers understand that utility rates are subject to change, it is difficult for households (or businesses) to budget for essential utility service when rates can change substantially every month or every three months without warning. Second, I am concerned that limiting the portfolio of resources that utilities can rely upon might prevent utilities from serving their customers at the lowest overall cost on a long-term basis. Finally, I believe that long-term contracts may be necessary to bring new resources to Pennsylvania – and to the regional wholesale market – that are needed to prevent the continued upward spiral in wholesale prices that has stricken other nearby states when their retail rate caps expired.

I would note in this regard that we do have experience in Pennsylvania with one major utility – Duquesne Light Company -- whose rate cap expired in 2002 and which has successfully met its default service obligation to residential customers at rates that are still 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 a bilateral contract with its affiliate, which in turn has purchased a portfolio of generation resources in the wholesale markets. In my opinion, Duquesne has had the most successful post-rate cap transition for residential customers in Pennsylvania, if not the Nation, yet the Duquesne

methodology would be effectively prohibited under the Commission's newly proposed regulations.

At the same time, we have heard from potential generation suppliers, such as Duke Energy, which has expressed interest in building a coal gasification plant in Pennsylvania with integrated carbon capture and sequestration, but has stated that "the risks associated with such projects make their implementation impractical in the absence of long-term power purchase agreements." In my opinion, this is exactly the kind of project that we need in Pennsylvania to support our long-term energy needs in an economic and environmentally sound manner. And, more to the point, this is exactly the type of contract that our utilities should be considering for inclusion in the portfolio of resources that they utilize to serve their POLR customers. Total reliance on short-term wholesale transactions is not producing the kind of new market entry that we need to provide stable and reasonable prices in the wholesale market.

This brings me back to House Bill 1201 and House Bill 697. Both of those bills would replace the "prevailing market prices" language in the current law with a requirement that utilities acquire a portfolio of resources for their default service customers that is designed to "produce the lowest reasonable rates on a long-term basis." Under both of those bills the utility portfolio would reflect "a diversity of supply-side and demand-side resources, a diversity of fuel types and a prudent mix of long-term, short-term and spot-market purchases." In other words, under this legislation, it would be the utility's goal – it would be the utility's job – to seek out the best deals for the utility's default service customers. The utility would then be permitted to recover the costs of that service from those customers.

While both bills encourage the inclusion of long-term contracts as part of the utilities' portfolio, I would note that House Bill 1201 limits long-term contracts to "newly constructed or

proposed to be constructed" alternative energy facilities or resources determined by the Commission to be required for reliability. In this regard, I would respectfully urge the Committee to consider the more flexible approach of House Bill 697, which does not place any restrictions on the types of resources that can be the subject of long-term contracts. I believe that decision should be within the discretion of the utility, subject to approval of the Commission.

My Office has been calling for a portfolio approach to default service – including both long-term and short-term contracts – in comments and testimony that we have filed since at least 2004. It may be too optimistic to expect that our utilities can now negotiate long-term contracts that will bring new generation plants on line by 2010, but it is important nonetheless to begin the process of ensuring that our utilities are in the business of meeting the long-term needs of their customers at the lowest reasonable cost. I would also add that when it comes to demand-side resources, such as conservation and energy efficiency, these resources can be added much more quickly and, if we begin to develop such resources immediately, this could have a beneficial impact on wholesale and retail prices even sooner. That is why I am particularly pleased that House Bill 1201 and the Governor's Energy Independence Strategy emphasize the benefits of cost-effective energy efficiency and other demand-side resources as the first line of defense for our utility default service suppliers to meet additional energy demands in the future. There is no question that the cheapest kilowatt-hour of electricity is the one that isn't used, and that there are great untapped energy efficiency resources that should be considered, and indeed should be given priority, in our utilities' resource portfolios. 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 (that set the market clearing price for all generation used in that

hour) do not need to be operated. Finally, the benefits of 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 federal and international level. If we take steps now to reduce our carbon dioxide and other greenhouse gas emissions, then I believe we will be able to avoid even greater costs for electric utility consumers in the future.

I would like to assure you that the Pennsylvania General Assembly is not unique in trying to address these issues in a manner that seeks a long-term solution to some of the unanticipated consequences of electric restructuring. What is somewhat unusual is that you are trying to address these issues **before** a crisis develops such as has occurred in other nearby states.

Thus, in 2006, after Delaware electricity customers were hit with a 59% rate increase, the Delaware legislature passed the "Electric Utility Retail Customer Supply Act of 2006" which declared that, as of May 1, 2006, "it is the policy of the State that Electric Distribution Companies subject to the oversight of the Commission and as part of their obligation to be Standard Offer Service Suppliers shall engage in Integrated Resource Planning for the purpose of evaluating and diversifying their electric supply options, efficiently and at the lowest cost to their customers." In order to meet the new "lowest cost" standard in the 2006 Act, the Delaware electric utilities were given authority to "enter into short- and long-term contracts for the procurement of power… own and operate facilities for the generation of electric power… build generation and transmission facilities… and make investments in Demand-Side resources."

In Maryland, after customers of Baltimore Gas & Electric Company were informed of a 72% rate increase, the Maryland legislature passed emergency legislation in June 2006 that revised its utilities' obligation to provide standard offer service. Under the original Maryland restructuring law, the utilities were required to provide standard offer service for residential and

small commercial customers at "market price." Under the 2006 Act, the utilities are now obligated to "obtain the best price for residential and small commercial customers in light of market conditions at the time of procurement and the need to protect these customers from excessive price increases." Maryland utilities may now be required by the Commission to supply service through "a portfolio of blended wholesale supply contracts of short, medium, or long terms and other appropriate electricity products and strategies, as needed to meet demand in a cost-effective manner."

Rhode Island, like Pennsylvania, passed its original electricity restructuring law in 1996. The 1996 Rhode Island law included a series of findings, such as that "greater competition in the electricity industry would stimulate economic growth" and that "it is in the public interest to promote competition in the electricity industry." In June 2006, however, the Rhode Island legislature enacted "The Comprehensive Energy Conservation, Efficiency and Affordability Act of 2006." This legislation contained a new set of findings, including that: "while utility restructuring has brought some benefits, notably in transmission and distribution costs and more efficient use of generating capacities, it has not resulted in competitive markets for residential and small commercial industrial customers, lower overall prices, or greater diversification of energy resources used for electrical generation" and that "it is a necessary move beyond basic utility restructuring in order to secure for Rhode Island, to the maximum extent reasonably feasible, the benefits of reasonable and stable rates, least-cost procurement, and system reliability that includes energy resource diversification, distributed generation, and load management." In order to meet those goals, the Rhode Island legislation required each utility to submit an annual supply plan that "shall be consistent with the purposes of least-cost procurement."

In Maine, the state restructuring law was amended in 2006 to authorize the establishment of "various contract lengths and terms" for the purpose of "providing over a reasonable time period the lowest price for standard-offer service." The 2006 law specifically authorized the Maine Commission to direct investor-owned utilities to "enter into long-term contracts" for capacity resources, and further required the Commission to adopt "a long-term plan for electric resource adequacy for this State to ensure grid reliability and the provision or availability of electricity to consumers at the lowest cost."

And finally, in just the last two weeks, the Connecticut legislature passed, and the Governor signed into law, a major amendment to that state's electric restructuring law. Under the new law, Connecticut's regulated electric distribution companies must submit a plan to build new peaking generation to serve the state's growing peak load needs on a cost of service basis. The distribution companies are also required to develop a comprehensive plan for "the procurement of energy resources, including, but not limited to, conventional and renewable generating facilities, energy efficiency, load management, demand response, combined heat and power facilities, distributed generation and other emerging energy technologies to meet the projected requirements of their customers in a manner that minimizes the cost of such resources to customers over time and maximizes consumer benefits consistent with the state's environmental goals and standards."

I cite these very recent state efforts to show that in the Mid-Atlantic and New England states that were in the forefront of electric restructuring in the late 1990's, there is a growing realization that wholesale and retail market forces alone are not producing the kind of stable and reasonably priced generation service that is necessary to support the economic well-being of these regions. These states have now placed an obligation on their retail utilities to utilize the

competitive wholesale markets more wisely by securing a least-cost portfolio of long-term and short-term supply resources and demand resources. These states have established policies to govern the procurement of essential electric service for their non-shopping retail customers that are intended to support the development of wholesale markets that will meet their customers' and their states' long-term needs. Customers in each of those states are still free to choose competitive retail suppliers to the extent that those suppliers can provide lower-priced service or provide some other value, such as "green" electricity. But the goal is not to promote retail shopping for the sake of retail shopping. Rather, it is to encourage utilities to offer customers the lowest priced, reliable generation service that they are capable of providing, and then permit retail competitors to try to beat those prices or offer some other benefit to customers that will encourage them to switch.

We have a choice in Pennsylvania. We can do nothing, and hope that "prevailing market prices" in 2010 are favorable to Pennsylvania consumers, and that resources will be adequate to sustain the Pennsylvania economy. Or we can begin to take proactive steps, such as those contained in House Bill 1201, House Bill 697, and the Governor's Energy Independence Strategy, to at least try to protect customers and to support the development of the supply and demand resources that could help to ensure adequate service at reasonable prices.

As I mentioned at the beginning of my testimony, this is a critical time 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 your Committee and the General Assembly as you address these extraordinary concerns.

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