

**BEFORE THE PENNSYLVANIA
SENATE CONSUMER PROTECTION AND
PROFESSIONAL LICENSURE COMMITTEE**

Testimony of

**SONNY POPOWSKY
CONSUMER ADVOCATE OF PENNSYLVANIA**

**Regarding
Electric Rate Issues**

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**Office of Consumer Advocate
555 Walnut Street
Forum Place, 5th Floor
Harrisburg, PA 17101-1923
(717) 783-5048 Office
(717) 783-7152 Fax
Email: spopowsky@paoca.org
124741**

Senator Tomlinson, Senator Boscola, and Members of the Senate Consumer Protection and Professional Licensure 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. Thank you for inviting me to testify at this important and timely hearing regarding electric rates in Pennsylvania.

As the members of this Committee are well aware, we stand at a critical juncture in the history of the Pennsylvania electric utility industry. The generation rate caps that have protected most Pennsylvania consumers for more than a decade will all be completed by the end of this year. But those caps are coming off in a world that is much different from the one that many of us anticipated when the General Assembly passed the landmark Pennsylvania electric restructuring law in 1996.

I am pleased to state that, in 2008, the General Assembly took important steps that I believe will benefit Pennsylvania electric consumers in meeting their future electricity needs in a post-rate cap world. The General Assembly passed Act 129 of 2008, which addressed, among other matters, two important components of Pennsylvania's electric industry structure. First, the new law established mandatory energy efficiency and demand response requirements for each of our major electric utilities. Under these mandates, our electric utilities are required for the first time to take specific and quantifiable steps to help their customers save energy and thereby save money on their monthly electric bills. Second, Act 129 required our utilities to secure generation for their non-shopping customers "at the least cost to customers over time." Given the fact that most customers – at least most residential customers – continue to buy generation from their incumbent electric distribution company, this requirement will help to ensure that all Pennsylvania consumers have access to the lowest cost generation supplies from the wholesale

market. While Act 129 took these two important steps, I believe that more can be done at both the state and federal level to ensure that Pennsylvania consumers benefit from the changes we have implemented in the electric industry.

In the letter setting forth the purpose of this hearing, Senator Tomlinson identified a number of proposals that have been offered to assist Pennsylvania electric consumers during this critical period. As stated by Senator Tomlinson in his letter of March 26, 2010:

There has been a great deal of discussion about what additional tools could be made available to assist customers as we continue to phase out rate caps. Some of the options discussed have been for the Department of General Services to apply for membership in PJM, creation of a state power authority, purchasing at the municipal level through aggregation, or most recently the article reporting Philadelphia is interested in providing an energy cooperative.

I would note that each of the proposals identified by Senator Tomlinson is not an attempt to abandon or supplant the restructured electric market in Pennsylvania. Rather, these efforts represent attempts to enhance consumers' ability to benefit from the restructured market either by "eliminating the middle man" (in the case of the DGS/PJM proposal), finding strength in numbers (in the cases of the Philadelphia and general municipal aggregation programs), or supporting new entry and long term generation contracts (in the case of the Pennsylvania Power Authority).

In addressing these and other proposals, it is important to consider the reasons that Pennsylvania restructured its electric industry to begin with. 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. At the time of restructuring in 1996, Pennsylvania's

electric rates were well above the national average, particularly for certain utilities that had become involved in very costly nuclear generation construction programs. It was hoped that wholesale competition among generation owners would reduce the cost and price of generation, and that retail competition among suppliers would provide lower prices and a broader array of products to consumers. Just in case competition did not develop quickly and just in case prices did not go down, however, the restructuring law passed in 1996 contained a series of generation rate caps that originally were set to expire in 2005 but were later extended through settlements with most of our major utilities until the end of 2009 or 2010.

In fact, today, the majority of Pennsylvania residential electricity consumers – even in areas where rate caps have expired – continue 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. The goal of electric restructuring was not to force customers to switch from their traditional electric utilities to other retail generation suppliers. Retail shopping for electricity is not an end in itself, but only one possible means to the end of providing reliable electricity service to all Pennsylvania consumers at reasonable and affordable prices.

Our recent experience in the PPL service territory, where approximately 330,000, or 27% of residential customers have switched to competitive suppliers since rate caps expired at the end of 2009, demonstrates that many customers are willing to shop for electricity where they can save a reasonable amount of money. Our experience also shows that there are a number of retail suppliers who are willing and able to offer such service if they can provide savings to customers and still make a profit.

It is important to recognize, however, that more than 70% of PPL residential customers are still buying their generation from PPL and, more importantly, the unique factors that gave rise to high residential shopping levels in PPL in 2010 are unlikely to be repeated when rate caps expire for our remaining electric utilities at the beginning of 2011. Specifically, as part of its one-year Competitive Bridge Program to serve customers in 2010, PPL purchased its default service generation supplies in six equal installments in 2007, 2008, and 2009. The default service price being charged by PPL in 2010 reflects the average cost of the wholesale purchases made during that period, which included two years of very high wholesale prices. By the time the PPL rate cap expired at the beginning of 2010, however, wholesale market prices were significantly lower than they were in 2007 and 2008. As a result, competitive retail marketers have been able to enter the PPL market and offer substantial savings to PPL residential customers. The typical PPL customer has been able to reduce the generation portion of their bill by about 10% by switching to an alternative supplier. I believe this is a very positive development, and my Office has helped to support this development through the publication and distribution of our highly popular Electric Shopping Guide, which provides residential consumers an up-to-date, apples-to-apples comparison of the rate offers that are available to them. But I also believe that the PPL experience in 2010 is not likely to repeat itself to the same extent when the remaining electric generation rate caps expire in the service territories of PECO, Met Ed, Penelec, and Allegheny Power (West Penn). That is because those utilities have been purchasing their generation supplies for the 2011 post-rate cap period at a time when wholesale prices are extremely low and will therefore be very hard to beat. Indeed, the same factors will arise in the PPL service territory in 2011, as I expect that PPL's own default service generation rates will decline significantly and PPL's new rate might be difficult to beat as well.

One way to address this potential loss of retail competition would be to increase the rates charged by the utilities above wholesale market levels. Such a solution, however, would be extraordinarily perverse, in my view, and would in any case be illegal under Act 129, which requires our utilities to provide default service to their customers at the least cost over time. The primary goal of our electric policy, I believe, should be to provide reliable service to all Pennsylvania consumers at the lowest reasonable cost, not simply to encourage retail switching at any cost.

It is in this context that I would turn to the proposals that have been made and that have been identified by Senator Tomlinson. As I noted above, each of those proposals works within the existing overall electric industry structure in an effort to bring greater benefits to Pennsylvania consumers. In particular, I would like to discuss the establishment of a Pennsylvania Power Authority, because that proposal could provide benefits in the wholesale as well as the retail markets that affect Pennsylvania electric rates.

Municipal Aggregation

On March 3, 2010, I had the opportunity to participate in a hearing before the Pennsylvania House Consumer Affairs Committee on draft legislation that would permit municipalities to provide “opt-out” aggregation service for residents and small businesses within their municipal boundaries. The principle behind municipal aggregation, which I believe has worked successfully in states such as Ohio and Massachusetts, is that a large aggregated group of customers is more likely to get a lower competitive price for electric generation than could be obtained by small individual users. Many individual low-use customers have neither the time nor the interest to shop for a small amount of electricity, and some marketers may not wish to

devote the resources necessary to advertise and sell a small amount of power to customers on an individual basis. By purchasing power on behalf of all of its residents and small business customers -- except for those customers who affirmatively choose to be removed from the aggregation pool -- a municipality could effectively obtain a volume discount for its customers at a rate that would be lower than the individual customers could obtain on their own.

While I testified generally in support of this concept at the House Consumer Affairs hearing, I expressed a concern that the implementation of such a program at this time could impose additional costs on our utilities that have already begun to enter into contracts to procure power to serve their non-shopping customers for the post-rate cap period. In my view, any municipal aggregation program should be implemented in a way that complements, and does not undermine, our utilities' efforts to secure generation service at the least cost for their remaining customers. It would be unfair to the utilities, and costly to the remaining customers, if some or all of the utility's largest municipalities were to pull out of the utilities' generation service program en masse **after** the utility had secured generation to serve them. As such, I proposed in my testimony that if a municipal aggregation program is implemented in Pennsylvania, that the **timing** of such a program should be coordinated with the procurement schedule of the utilities that serve participating municipalities.

City of Philadelphia Ordinance

On March 11, 2010, a member of the Philadelphia City Council introduced an ordinance to create a Philadelphia Energy Authority. I have reviewed that ordinance, and I believe it is quite similar in intent to the draft municipal aggregation legislation that I just discussed. Under this ordinance, the new Energy Authority would be authorized to act as "an electric generation

supplier, electricity supplier, broker, arranger, aggregator or marketer of electricity or related services for sale to end-use consumers **utilizing the jurisdictional transmission and distribution facilities of an electric distribution company.**” I have emphasized the last clause of that provision because it makes clear that the proposal is **not** to create a municipally-owned electric distribution utility like the ones that currently operate in more than 30 Boroughs across Pennsylvania; nor would this ordinance create a retail electric cooperative, such as those that operate in several rural areas in the Commonwealth. Under this proposed ordinance, the existing electric distribution company – PECO – would continue to deliver the electricity to all the homes and businesses in the City of Philadelphia, but the new Energy Authority would acquire the generation to serve those customers. To that extent, it appears that this entity would serve in a role similar to the municipal aggregators established under the draft House legislation – that is, buying generation in bulk at the wholesale level and distributing that generation at retail to customers utilizing the regulated power lines of the local utility.

As in the case of the statewide municipal aggregation bill, I agree that there is strength in numbers and that an entity that buys generation in large volumes might be better able to acquire least cost resources than individual shopping customers, particularly residential customers. But again, it is important to note that PECO has already begun to acquire supplies to serve its default service customers beginning in 2011 under a PUC-approved least cost procurement program. While PECO and its wholesale suppliers recognize that individual customers will be free to switch to another supplier in the future, it was not envisioned at the time PECO’s plan was approved that all the customers in the largest municipality in the Company’s service territory would be buying their power elsewhere. That is why I believe that if a program like this were to be developed in Philadelphia or any other major municipality, it should be implemented and

scheduled in a way that does not impose additional costs on the utility or its remaining default service customers.

DGS Proposal to Join PJM

On September 24, 2009, and again on March 25, 2010, the Pennsylvania Department of General Services (DGS) gave presentations at meetings of the PJM Interconnection regarding efforts by the Commonwealth of Pennsylvania to become a member of PJM. As noted by DGS in those presentations, the Commonwealth of Pennsylvania spends over \$100 million per year on electricity and consumes more than one million megawatt hours of electricity annually through more than 4000 accounts located across the Commonwealth. Technically, DGS is seeking to become what is known in PJM as a “load serving entity”, or LSE, buying power directly in the wholesale market for its own use, and perhaps for sale to others for economic development purposes. In essence, DGS is seeking to “eliminate the middle man” by purchasing large amounts of electricity directly in the wholesale market, rather than purchasing power at retail either from an electric distribution company or from another licensed electric generation supplier (EGS) in Pennsylvania.

The Commonwealth of Pennsylvania is certainly large enough to be an LSE, larger than many existing PJM members, and I agree that there could be benefits to the Commonwealth if it can aggregate and manage all of its loads through direct participation in the PJM wholesale markets. The problem is that, with the benefits of full PJM membership come certain financial and administrative obligations that would be difficult if not impossible for the Commonwealth to meet. Therefore, in its presentations to PJM, DGS straightforwardly set forth a number of requested amendments that would be required to the PJM Operating Agreement in order for the

Commonwealth of Pennsylvania to participate fully in the PJM markets. These amendments addressed issues such as funding of working capital and capital contributions, assessment for default payments, liability and indemnity issues, and dispute resolution procedures. Members of my staff and I attended these PJM presentations either in person or telephonically, and I think it is safe to say that the other PJM members who spoke up in those meetings were very concerned about the Commonwealth's request to amend the PJM Operating Agreement.

I believe it will be difficult for the Commonwealth to win the approvals needed to become a full-fledged member of PJM, but I support the goals that DGS expressed -- to reduce the Commonwealth's own substantial electricity bills and to promote economic development by taking a more proactive position in the PJM market. I would urge DGS to continue to explore alternative ways to meet those goals in the event that the PJM membership route is closed to it. It is possible that the Commonwealth can achieve many of those goals without becoming a full PJM member or load serving entity.

Pennsylvania Power Authority

The issue of creating a state power authority has been a topic of active discussion not just in Pennsylvania – where legislation has been introduced in the House of Representatives (HB 1909) – but in a number of other states which restructured their electric industries during the same period as Pennsylvania.

Most notably, after rate caps expired and massive rate increases occurred in Illinois, the state legislature enacted a law in 2007 that created the Illinois Power Agency, which was empowered to “develop electricity procurement plans to ensure adequate, reliable, efficient, and environmentally sustainable electric service at the lowest total cost over time, taking into

account any benefits of price stability.” The Illinois Power Agency has assumed the responsibility previously held by the state’s electric utilities to procure generation to serve residential and small commercial customers who have not shopped for electricity. With the assistance of a team of independent consultants, the Illinois Power Agency has conducted a series of successful procurement programs for portfolios of generation contracts to serve Illinois customers.

The proposed Pennsylvania legislation, House Bill 1909, would give this same role to a Pennsylvania Power Authority. That is, it would be the job of the independent power authority to obtain generation in the competitive wholesale markets to serve customers of each Pennsylvania electric distribution company at the least cost over time. The power would still be distributed by the local electric utilities, but those utilities would be relieved of the obligation to secure the generation (some of which might come from their own unregulated generation affiliates) to serve their non-shopping customers.

In addition to serving this generation procurement function, state power authorities have been proposed in some states to support the development of long-term contracts for generation, including contracts to construct new generating plants that can be used to serve retail customers. In May, 2009, for example, the Connecticut House of Representatives voted 135-3 to approve legislation to create the Connecticut Electric Authority. Under that proposed legislation, which did not move forward last year in the Connecticut Senate, a newly created Electric Authority would oversee the procurement of generation resources by Connecticut’s electric distribution companies and, where necessary, issue requests for proposals for the construction of new generating facilities. The Connecticut Electric Authority would also be empowered to provide financial assistance, including low interest loans, for the development of new generating

facilities, with the generation from those facilities being provided to Connecticut retail consumers on a cost of service basis.

Even prior to the introduction of the Connecticut Electric Authority bill, however, the Connecticut legislature passed a law in 2007, which required the state's distribution utilities to submit plans to the state public utility commission for the construction of new "peaking" generation to serve consumers in those parts of the state where the Commission determined that new generation was needed. Pursuant to that law, the utilities issued requests for proposals and the Connecticut utility commission issued an order on June 25, 2008, approving the construction of three new peaking facilities, totaling 678 megawatts, placed in strategic locations within the state where the need for such facilities had been demonstrated.

Significantly, the Connecticut legislation did not require the utilities themselves to construct the new generation that is required under that law. Instead, the plants were built under a competitive procurement process, once the need for new generation was established. While Connecticut law placed this obligation on the state public utility commission, I could envision a Pennsylvania Public Power Authority playing a similar role in the development of new generation facilities through competitive procurement processes.

In Maryland, generation rate caps expired at the end of 2005, leading to extremely high and controversial electric rate increases in that state, including a 72% proposed rate increase for customers of Baltimore Gas & Electric Company. The Maryland legislature passed a number of bills in 2006 and 2007 to address these issues. One of those bills gave the Maryland Public Service Commission the explicit authority to "require or allow an investor-owned electric company to construct, acquire, or lease, and operate, its own generating facilities." That legislation also required the Maryland Commission to investigate and report on several matters

related to the restructuring of the electricity markets. One of the primary concerns to be addressed was the fact that, despite the massive rate increases that had occurred in Maryland, there was little evidence that adequate new electric generation was being built to serve the state's future energy needs. In December 2007, the Maryland Public Service Commission issued an Interim Report to the Maryland General Assembly stating that, while the status quo in the electric generation market was "lucrative for existing generators" it "is not in the public interest to continue to rely exclusively on market forces to address Maryland's reliability concerns and the high wholesale electricity prices Marylanders pay." The report recommended that the Commission should pursue the option of "directing utilities in the state to enter into long-term contracts to induce the supply of new electricity in Maryland."

The common thread in these and several other restructured states is the concern that the short-term wholesale generation markets on which these states have relied to establish retail prices may not be up to the task of supporting the development of the new resources they will need to ensure their long-term economic health and security. That is, there is a growing concern that short-term market forces alone will be insufficient to produce new generation resources that are needed to serve these states in a reliable, economic and environmentally sustainable manner. It is in this context, in my view, that a state power authority can play a role in helping to ensure that such resources are developed on a timely basis and that they are utilized to serve a state's consumers in the most beneficial manner.

In my opinion, the primary benefit of a state power authority in Pennsylvania would be to supplement the short term price signals that are provided in today's PJM market and provide explicit support for long term contracts that are needed to bring new entrants and new resources to serve Pennsylvania consumers in the future. The short-term market system that we have in

place today in Pennsylvania and our surrounding PJM states, in my view, results in over-compensating owners of existing generation whose capital costs have already been paid for through depreciation and stranded cost recovery, while providing inadequate incentives to new entrants in the generation market. The problem is that, under the PJM pricing scheme, where all generation is paid the highest market clearing price for energy and capacity, we have to overpay almost **everyone** in order to try to get **someone** to build the generation we need. Yet we still have no assurance that adequate new generation will be built.

In my view, this is where a Pennsylvania Power Authority could play a vital role in the future. One purpose of the Pennsylvania Power Authority would be to encourage and help to finance new construction and long-term generation contracts that might not result from the unfettered operation of short-term wholesale markets. This could be done by the Authority on a stand-alone basis or as part of the default service procurement function to provide generation to Pennsylvania customers who continue to receive generation service from their electric distribution companies.

As this Committee meets here today, we are fortunate that wholesale energy prices have declined significantly from the extraordinarily high levels of just two years ago. As a result, it now appears that the rate increases that most Pennsylvania electricity consumers will face when the remaining rate caps expire at the end of 2010 will not be nearly as high as we had previously feared. This is a very welcome development for which we can all be grateful, but I believe it is primarily a result of our recent severe economic downturn, rather than the development of new generation resources that have driven down the cost of electricity through economic forces.

While the current drop in energy prices is a relief for many Pennsylvania consumers, the question remains whether the type of volatile short-term market that we have seen in recent years

will support long-term investments that are required to meet our future needs. It can take many years to plan and build some types of new generating plants, yet we have no way of knowing what the short-term wholesale market prices will be when those plants come on line, let alone during their decades of future operations. This is one reason, in my opinion, that we need long term contracts to provide at least some economic certainty to developers of new electric generation, particularly new market entrants. As I noted above, this is the area where I think a Pennsylvania Power Authority could provide the most significant benefit.

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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