

COMMONWEALTH OF PENNSYLVANIA
HOUSE OF REPRESENTATIVES

ENVIRONMENTAL RESOURCES AND ENERGY
COMMITTEE HEARING

STATE CAPITOL
MAJORITY CAUCUS ROOM
ROOM 140
HARRISBURG, PENNSYLVANIA

WEDNESDAY, JANUARY 20, 2010
1:05 P.M.

PRESENTATION ON HOUSE BILL 1909
COMMONWEALTH ENERGY PROCUREMENT
AND DEVELOPMENT AGENCY

BEFORE:

HONORABLE CAMILLE "BUD" GEORGE, MAJORITY CHAIRMAN
HONORABLE BRYAN BARBIN
HONORABLE MIKE CARROLL
HONORABLE EUGENE DePASQUALE
HONORABLE R. TED HARHAI
HONORABLE TOM HOUGHTON
HONORABLE DAVID R. KESSLER
HONORABLE TIM SEIP
HONORABLE JAMES WANSACZ
HONORABLE JOHN T. YUDICHAK
HONORABLE SCOTT E. HUTCHINSON, MINORITY CHAIRMAN
HONORABLE MATT GABLER
HONORABLE JEFFREY P. PYLE
HONORABLE DAVE REED
HONORABLE RANDY VULAKOVICH

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1 P R O C E E D I N G S

2 * * *

3 CHAIRMAN GEORGE: This meeting that has been
4 called for Wednesday, January 20, 2010, at 1 p.m.
5 will commence.

6 The Commonwealth of Pennsylvania is now
7 faced with an energy crisis as the rate caps expire
8 and utility prices skyrocket to record heights.
9 Combined with today's rising cost of food and fuel,
10 these electric rate hikes will place many
11 Pennsylvania residents in economic peril.

12 The Commonwealth's failed attempt at
13 electric deregulation and the competitive marketplace
14 now requires legislative action.

15 The "competitive" wholesale power market
16 exists in name only. This market, which is not
17 regulated at the State level and only loosely
18 overseen at the Federal level by the Federal Energy
19 Regulatory Commission, the F-E-R-C, is not
20 competitive at all.

21 To address this looming problem, I have
22 introduced House Bill 1909, creating the
23 Commonwealth Energy Procurement and Development
24 Agency, similar to House Bill 2791 of the 2007-2008
25 session.

1 This legislation will create a solution to
2 the problems surrounding deregulation by improving
3 the process of procuring electricity and protecting
4 Commonwealth citizens of their economic well-being.

5 I turn to my Co-Chairman, Chairman
6 Hutchinson, for a word.

7 REPRESENTATIVE HUTCHINSON: Thank you,
8 Mr. Chairman.

9 Thank you for holding this hearing today on
10 this, I will characterize as a controversial piece of
11 legislation.

12 But I'll just simply state something, that I
13 was on the phone with a colleague right before coming
14 to this meeting and sort of had to hurry him off the
15 phone. And I told him where I was going and what
16 subject area we were going to address, and although
17 he will remain nameless, I did ask him if I could use
18 his quote. And he said, "Okay, Hutch, go and fight
19 against the planned economy. It didn't work in the
20 USSR."

21 I thought that was a very valid quote, and I
22 look forward to this hearing today as we talk about
23 the power authority.

24 Thank you, Mr. Chairman.

25 CHAIRMAN GEORGE: I thank the gentleman.

1 And if we may, I would like to start at my
2 lower right with the gentleman, Representative
3 Houghton, to introduce each and every member as it
4 comes to from your left, and you can go.

5 Mr. Houghton.

6 REPRESENTATIVE HOUGHTON: Thank you,
7 Mr. Chairman.

8 Tom Houghton, southern Chester County,
9 the 13th District.

10 REPRESENTATIVE GABLER: Matt Gabler,
11 75th District, Clearfield and Elk Counties.

12 REPRESENTATIVE PYLE: Jeff Pyle,
13 60th Legislative, Armstrong and Indiana
14 Counties.

15 REPRESENTATIVE BARBIN: Bryan Barbin,
16 Cambria County.

17 REPRESENTATIVE WANSACZ: Jim Wansacz,
18 Lackawanna, Luzerne, Wyoming, and Susquehanna
19 Counties.

20 REPRESENTATIVE YUDICHAK: Good afternoon.
21 John Yudichak, Luzerne County.

22 REPRESENTATIVE KESSLER: Dave Kessler, Berks
23 County.

24 REPRESENTATIVE VULAKOVICH: Randy
25 Vulakovich, Allegheny County.

1 REPRESENTATIVE HUTCHINSON: Representative
2 Hutchinson, Venango and a portion of Butler
3 Counties.

4 CHAIRMAN GEORGE: Camille George, Clearfield
5 County.

6 REPRESENTATIVE SEIP: Tim Seip, representing
7 parts of Schuylkill and Berks, the Cabela's and
8 Yuengling district.

9 CHAIRMAN GEORGE: We have a distinguished
10 group of individuals testifying today. Nevertheless,
11 it is imperative that those presenting their
12 testimony keep their presentation within the allotted
13 time. Your complete testimony should be submitted
14 for the record.

15 All on this committee, including this
16 Chairman, have a tendency to pontificate during our
17 questioning period. I will make every effort to make
18 my questions clear and to the point, and I expect
19 each and all members to do the same.

20 Furthermore, I ask the testifiers to answer
21 the questions directly and not engage in deep
22 conversation.

23 Testifying first is Ray Landis, AARP
24 Pennsylvania, Advocacy Manager.

25 Welcome to the committee, Mr. Landis.

1 MR. LANDIS: Thank you, Chairman George. I
2 appreciate the opportunity to be here today.

3 AARP welcomes the opportunity to address the
4 Environmental Resources and Energy Committee and
5 thanks all the members for attending today's
6 hearing.

7 AARP supports House Bill 1909, the
8 Commonwealth Energy Procurement and Development Act,
9 and we support this legislation because it provides
10 mechanisms to mitigate electric price volatility and
11 limit future rate hikes, a crucial factor now that
12 electric rate caps are beginning to expire.

13 AARP is a national organization with offices
14 in every State, and we have seen the failure of
15 electric deregulation across the country. There is
16 no doubt that electric deregulation has failed to
17 produce the price cuts in retail competition its
18 supporters had predicted.

19 We have testified before this committee
20 numerous times in support of electric market reforms
21 that would have prevented the recent rate increases
22 for PPL customers.

23 Now, thanks to lower-than-expected fuel
24 prices, the rate increases that have taken effect
25 this year are not as extreme as may have been

1 predicted a few years back, yet increases of
2 30 percent for the almost 85 percent of retail PPL
3 customers who have not changed electric suppliers
4 remains a huge hit on family budgets and local
5 businesses, especially given the cold weather we have
6 experienced over the past month.

7 We have no doubt that many consumers and
8 business owners will be in for a rude awakening later
9 this month or early next month when they open their
10 bills that reflect this increase.

11 Now, we should not expect that retail
12 competition will bring down prices for consumers.
13 Texas is a great example of this.

14 Texas is a State that is often touted as a
15 deregulation success, but in looking at the
16 statistics on electric prices from Texas, it should
17 be noted that consumers pay far more for electricity
18 than those in neighboring States with similar fuel
19 mixes.

20 Our neighbors in Maryland have faced price
21 increases up to 70 percent, and the issue of
22 re-regulation is very much alive at the State Capitol
23 in Annapolis.

24 Pennsylvania has now allowed approximately
25 40 percent of its electric customers to suffer rate

1 increases with the expiration of rate caps, and we
2 have not taken any action to mitigate this
3 situation. But if the provisions of House Bill 1909
4 are passed into law, we have an opportunity to take a
5 step forward before the remaining 60 percent of
6 electric customers go through these rate increases
7 beginning on January 1, 2011.

8 The central provision of House Bill 1909
9 creates a new Commonwealth Power Agency with the
10 responsibility to procure power for default service
11 customers following least-cost portfolio planning
12 principles.

13 A power agency addresses one of the most
14 significant factors behind high prices in deregulated
15 electric markets; that is, the dysfunctional
16 wholesale market.

17 Power on the wholesale level is bought and
18 sold in a single price wholesale electricity auction
19 managed by the PJM Interconnection, a Regional
20 Transmission Organization.

21 The Federal Energy Regulatory Commission in
22 Washington, DC, has authority to oversee this market.
23 However, FERC has taken a hands-off approach to RTOs
24 that, according to numerous studies, allows market
25 operators to create complex rules that result in

1 windfall profits for generators and excessive prices
2 for consumers.

3 For example, a study conducted by the
4 American Public Power Association found that
5 generators in the PJM earned more than \$12 billion --
6 and that is billion with a "b" -- in excess earnings
7 over a 7-year period.

8 Although the wholesale market is under
9 Federal jurisdiction, the creation of a Commonwealth
10 Power Agency is an action that the State can take to
11 influence market prices.

12 The positive impact of a power agency has
13 already been shown in Illinois. A few years ago,
14 consumers in Illinois began to receive double-digit
15 increases in their electric bills, and an
16 investigation by the Attorney General of that State
17 found evidence of market abuses in the wholesale
18 electricity market.

19 The result was the passage of legislation
20 that established the Illinois Power Agency and a
21 \$1 billion refund for ratepayers over the next
22 5 years.

23 Today, even the President of the Illinois
24 Competitive Energy Association declares the power
25 authority a success in bringing down prices to

1 consumers.

2 As created by House Bill 1909, a
3 Commonwealth Power Agency would have the goal to
4 develop procurement plans to ensure adequate,
5 reliable, and affordable electric service at the
6 lowest cost over time for default service customers.

7 The agency would buy power under a
8 least-cost portfolio planning approach; it would
9 enter into long-term contracts, which would help
10 stabilize the rates and result in new generation; or
11 it could acquire and construct new power plants and
12 sell the output on a cost-of-service basis.

13 Unlike the PJM, the power agency would be
14 overseen by a board broadly representative of the
15 State's electricity ratepayers.

16 With a clear mission, transparent process,
17 and a representative board, AARP is confident that
18 the power agency would act in the best interests of
19 the State's consumers.

20 AARP believes there are two other key
21 provisions that will serve consumers in our State
22 that are contained in House Bill 1909.

23 First, it creates a Commonwealth Energy
24 Advocate to represent the interests of our State's
25 consumers before Federal agencies, including FERC, as

1 well as in the governance process at the PJM.

2 Many crucial policies which directly impact
3 rates in Pennsylvania are made before these bodies.
4 AARP supports having a strong consumer voice
5 representing our interests on matters that pertain to
6 electricity prices paid by consumers.

7 Second, House Bill 1909 would provide a
8 rebate from owners of generation in Pennsylvania that
9 were formerly owned by the public.

10 As a result of the deregulation law, most of
11 the State's power plants were sold off, many at
12 bargain-basement prices. As shown by the APPA report
13 mentioned above, the purchasers now earn excessive
14 profits through the dysfunctional wholesale market.

15 The rebate, which recognizes that the
16 deregulation law has netted windfalls for generators,
17 would be used to fund the power authority. A part of
18 the rebate will also be refunded to consumers to
19 offset their increased electricity bills.

20 AARP has advocated for the creation of a
21 Commonwealth Power Agency since 2007. Although the
22 price caps are now expired for some customers, it is
23 still not too late to take this important step.

24 Today, the Pennsylvania General Assembly has
25 an opportunity to pass legislation to create a power

1 agency with the obligation to act in the best
2 interests of the State's ratepayers, providing a
3 long-term check on electricity price volatility and
4 future rate increases.

5 At this difficult economic time, it is
6 critical that we work to lessen the impact of
7 electric rate hikes.

8 Thanks again for the opportunity to testify,
9 and I would be pleased to attempt to answer any
10 questions you may have.

11 CHAIRMAN GEORGE: I thank the gentleman.

12 Are there any questions from the members? I
13 would be happy to.

14 The gentleman from Indiana, Mr. Pyle.

15 REPRESENTATIVE PYLE: Thank you,
16 Mr. Chairman.

17 You said one thing that caught my curiosity:
18 AARP wants a strong Consumer Advocate for the
19 consumers of Pennsylvania. We already have a
20 Consumer Advocate. I don't know how this new
21 position would be any different.

22 Mr. Popowsky, every time I have called him,
23 he has helped my office and my constituents well. I
24 don't know why we would require another guy to do
25 what our Consumer Advocate is already doing.

1 MR. LANDIS: Mr. Popowsky performs an
2 admirable job in Pennsylvania---

3 REPRESENTATIVE PYLE: Right.

4 MR. LANDIS: ---and we are strongly
5 supportive of the Office of Consumer Advocate.

6 Now, we feel that this legislation would
7 enable another position to help advocate before FERC
8 and PJM, as another voice for the Commonwealth to
9 advocate before those bodies specifically, whereas
10 the Office of Consumer Advocate today has quite a
11 broad range of responsibilities, whether it's in
12 utilities, telephones -- all utilities.

13 So we feel that this would be an additional
14 voice, in addition to Mr. Popowsky, who we have the
15 utmost respect and admiration for in the job he does.

16 REPRESENTATIVE PYLE: Thank you,
17 Mr. Chairman.

18 CHAIRMAN GEORGE: I thank the gentleman.

19 Are there any other questions down front?
20 Are there any here?

21 Oh, by the way, my apologies. The
22 gentleman, Mr. Carroll, and the gentleman from York
23 have just joined the committee.

24 REPRESENTATIVE DePASQUALE: Thank you,
25 Mr. Chairman.

1 CHAIRMAN GEORGE: Welcome, gentlemen.

2 Are there any questions? Have you heard the
3 testimony?

4 Are there any questions up here?

5 I have one question, if you will, sir.

6 Have you heard from the AARP members who are
7 concerned about the increase in electric rates? I
8 know that many seniors did not receive a Social
9 Security cost-of-living increase this year. What are
10 your folks saying to you?

11 MR. LANDIS: I don't think there has been an
12 issue that has been of more concern and we have seen
13 a better response from our members when discussing
14 any issue in the past year.

15 When our members realized, our members that
16 live in PPL territory, realized that their bills were
17 increasing by 30 percent, there was a shock.

18 And we had a number of town hall meetings
19 across the State in the past year that the turnout
20 was tremendous. I believe, Mr. Chairman, we had one
21 up in your territory in Clearfield and had filled
22 every seat in the room with our members who did not
23 realize this was happening and, frankly, were shocked
24 at the idea that their electric bills could go up so
25 much.

1 And then combined with the difficult
2 economic situation, many of our members, facing a
3 situation where they, as you mentioned, did not
4 receive a Social Security cost-of-living increase
5 this year yet, are being asked to pay 30 percent more
6 on their electric bills. It means a very difficult
7 situation for them.

8 And they are looking for relief. They are
9 looking for some way to be able to afford this kind
10 of increase on their electric bills.

11 So I do not think there is an issue this
12 year that has generated more response from our
13 members than concerns about electric rate
14 increases.

15 CHAIRMAN GEORGE: The Chair thanks the
16 gentleman for the taking of his time to present his
17 testimony to this committee. Thank you very much.

18 MR. LANDIS: Thank you.

19 CHAIRMAN GEORGE: Now the Chair calls on
20 Steve Etsler, AK Steel Corporation. Come forward,
21 sir.

22 If you will, introduce yourself and your
23 companion.

24 MR. ETSLER: Okay. I am Steve Etsler. I am
25 the Manager of purchasing electric, natural gas, and

1 water at AK Steel, and I am currently serving as
2 Secretary of the Industrial Energy users group in
3 Pennsylvania.

4 MS. POLACEK: And I am Pamela Polacek with
5 McNees, Wallace & Nurick. We are counsel to
6 Industrial Energy Consumers of Pennsylvania.

7 CHAIRMAN GEORGE: Welcome.

8 You may proceed, sir.

9 MR. ETSLER: Thank you, sir.

10 Good afternoon, Chairman George,
11 Representative Hutchinson, and members of the
12 Environmental Resources and Energy Committee. We
13 appreciate the opportunity to testify before you
14 today.

15 My name is Steve Etsler, and I am testifying
16 on behalf of the Industrial Energy Consumers of
17 Pennsylvania, or IECPA for short.

18 I am the Manager of purchasing electric,
19 natural gas, and water for AK Steel Corporation,
20 which is a member of IECPA.

21 AK Steel is a leading producer of
22 flat-rolled carbon, stainless, and electrical steel
23 products, primarily for automotive, appliance,
24 construction, and electric power generation and
25 distribution markets.

1 Our company is headquartered in
2 West Chester, Ohio, and we operate a major specialty
3 steel plant in Butler, Pennsylvania. The Butler
4 plant employs more than 1,400 men and women.
5 AK Steel also has plants located in the States of
6 Ohio, Indiana, and Kentucky.

7 AK Steel is one of the largest producers in
8 the world of silicon-alloy electrical steels and is a
9 leading domestic producer of high-efficiency,
10 grain-oriented grades, which are produced at our
11 Butler plant. These special steels are used in the
12 manufacture of energy-efficient power generation and
13 distribution transformers.

14 As demand for our electrical steels has
15 increased in the United States and globally, AK Steel
16 has made targeted investments to help us meet the
17 demand.

18 We previously announced proposed capital
19 projects totaling \$180 million, most of which are
20 targeted for investment at Butler Works, to give
21 AK Steel the flexibility to increase production and
22 lower costs.

23 Part of this significant capital investment
24 is for the construction of a new 1.45 million-ton
25 capacity electric-arc furnace at Butler, which will

1 replace two existing older furnaces.

2 At Butler Works, we are currently spending a
3 little over \$40 million annually for the purchase of
4 electricity to power our operations. When the rate
5 caps are removed at the end of 2010, we believe the
6 result will be a 50 percent or more increase in our
7 electric costs based on published forward pricing.

8 These increases that we project in 2010 and
9 2011 are consistent with the increases that IECPA
10 members in the PPL electric territory are seeing this
11 very month.

12 IECPA is a group of large industrial,
13 commercial, and manufacturing energy companies formed
14 for the purpose, amongst others, of ensuring that
15 adequate and reliable long-term supplies of
16 electricity are available in Pennsylvania at
17 reasonable costs.

18 IECPA members include 24 large industrials,
19 collectively employing over 43,000 Pennsylvanians.
20 IECPA members in the PPL territory have reported that
21 their electric supply costs will increase by 50 to
22 80 percent, and potentially more, due to the
23 expiration of PPL's rate caps.

24 Electricity consumption represents a
25 significant element of production and operating costs

1 for our members. For any customer, increases in this
2 range would be shocking. However, for our members,
3 the increases are even more significant due to the
4 large amount of electricity that we consume.

5 At a time when our national economy is
6 already under stress, allowing the electricity caps
7 in Pennsylvania to expire without a plan to mitigate
8 the short-term and long-term impacts of rate
9 increases on the manufacturing base in Pennsylvania
10 could be disastrous.

11 IECPA supports House Bill 1909. It is vital
12 for Pennsylvania to have an entity that can offer
13 electricity to new and existing customers at
14 reasonable rates.

15 The Commonwealth Energy Procurement and
16 Development Agency as proposed in House Bill 1909
17 would have the power and the obligation to offer
18 economic development power at cost-based rates to
19 businesses and industries, as well as meeting the
20 default service procurement needs of other customer
21 classes.

22 The agency has a number of tools available
23 to secure power at reasonable rates, including:

- 24 • The ability to enter into power purchase
25 agreements with new and existing

- 1 Pennsylvania-based power plants and
2 industrial cogen facilities;
- 3 • The ability to enter into long-term
4 purchase agreements to facilitate the
5 financing of new power plants and
6 cogeneration facilities; and
 - 7 • The ability to acquire ownership of or
8 ownership interests in new or existing
9 power plants or cogeneration facilities
10 through purchase or construction.

11 The economic development power would be
12 offered to customers that can demonstrate significant
13 contributions to the Commonwealth's economy by
14 satisfying criteria specified in the act and that are
15 willing to commit purchasing their supply needs from
16 the agency for a long period of time.

17 The agency would have the flexibility to
18 negotiate the rate and the commitment length for the
19 customer based on the generation resources it has
20 available or can obtain to meet the customers' needs.
21 The agency would send the power to the customer's
22 incumbent utility, which would then supply the
23 customer at a negotiated rate.

24 IECPA was and is a supporter of the
25 restructuring effort to introduce competitive

1 alternatives for generation supply to the traditional
2 bundled electric service.

3 Assuming that Pennsylvania's business and
4 industry remains competitive in the national and
5 international markets was one of the main
6 motivations for the adoption of the Electricity
7 Generation Customer Choice and Competition Act in
8 1996.

9 For example, the Declaration of Policy of
10 the 1996 act recognizes that "the cost of electricity
11 is an important factor in decisions made by business
12 concerning locating, expanding and retaining
13 facilities in this Commonwealth," end of quote.

14 "This Commonwealth must begin the transition
15 from regulation to greater competition in the
16 electricity generation market to benefit all classes
17 of customers and to protect this Commonwealth's
18 ability to compete in the national and international
19 market place for industry and jobs."

20 These statements and policy goals remain
21 important and as true today as they were in 1996, and
22 we urge the committee to keep them in mind as
23 Pennsylvania addresses the currently scheduled
24 expiration of electricity caps over the next
25 12 months.

1 If the rate caps are allowed to expire
2 without a plan to address the impact, there is a high
3 probability that customers' expectations of lower
4 prices due to restructuring efforts and the
5 correlating enhancement of our ability to compete in
6 the national and international marketplace due to
7 these lower prices will not be met in either the
8 short or the long term due to the wholesale market
9 design.

10 As IECPA members and others have explained
11 to the committee in testimony presented at various
12 hearings on rate cap expiration alternatives, the
13 Pennsylvania wholesale electricity market changed
14 significantly between 1996 and 2009, and these
15 changes do not benefit customers.

16 Quite simply, the wholesale market design is
17 inflating supply prices above what those prices
18 should be. Researchers at Carnegie Mellon University
19 have estimated that the market design increases
20 prices for customers by 1 to 2 cents per
21 kilowatt-hour.

22 For some manufacturers, a 1- or
23 2-cents-per-kilowatt-hour difference in electricity
24 pricing can be the deciding factor on whether a
25 facility remains open or is closed and with

1 production moving to a competitor or another
2 State.

3 In fact, IECPA member Alcoa idled its
4 Frederick, Maryland, facility when the rate caps
5 expired in that State, and the facility was exposed
6 to the full impact of this wholesale market
7 design.

8 While the General Assembly does not directly
9 control wholesale market design, the General Assembly
10 can examine alternatives to enable the Commonwealth's
11 largest users and largest employers to bypass the
12 pricing influences of the wholesale market.

13 Pennsylvania manufacturers are competing
14 against facilities and regions that do not have this
15 wholesale market design and in States that do not
16 have retail competition.

17 For companies with multi-State locations,
18 such as AK, decisions as to which of the facilities
19 will receive capital investments are critically
20 examined in terms of the impact of the future
21 competitiveness of the company.

22 Many IECPA members, including AK Steel, have
23 invested heavily in their Pennsylvania operations
24 over the years, in no small part because of the
25 expected experience of adequate supply of affordable

1 electricity to power our energy-intensive
2 operations.

3 Now, the anticipated sharp rise in electric
4 costs is changing the landscape on how our companies
5 may view Pennsylvania. Simply put, many Pennsylvania
6 manufacturing facilities are now at a competitive
7 disadvantage when it comes to capital investment
8 decisions.

9 IECPA members supported the original retail
10 industry restructuring initiative with the belief
11 that the market would develop to meet customer
12 desires and demands for electricity products on
13 reasonable rates, terms, and conditions.

14 Mr. Vic Sawicki of Air Products testified
15 before this committee in May 2009 regarding the
16 efforts that a group of IECPA members undertook to
17 obtain reasonable offers from the "competitive"
18 market prior to deciding to support the agency.

19 The group looked for a bilateral contract to
20 meet their needs for appropriate electricity rates
21 when the caps expire. They looked for arrangements
22 to obtain long-term price stability through contracts
23 with generation owners or developers at reasonable
24 rates that would still allow the suppliers to make a
25 fair profit. They requested pricing structures based

1 on the generation owner or developer's actual cost to
2 produce the power plus a reasonable profit.

3 These deals did not materialize, and the
4 pricing was linked to the expected profit that
5 generation could earn if all of its power were simply
6 sold in the PJM Locational Marginal Price, or LMP,
7 market. That is the wholesale market clearing price
8 for power in the short term or a "spot" market.

9 They also saw "take or pay" obligations that
10 are difficult for many companies to assume from the
11 financial accounting standpoint, because in some
12 instances, the entire contract liability must be
13 placed on the customers' books at the beginning of
14 the contract. Moreover, the contract implications of
15 those deals can be quite onerous.

16 In a nutshell, the IECPA members found that
17 a legitimate, negotiable, bilateral market is not
18 available to customers that fills their needs for
19 appropriate electricity rates, terms, and
20 conditions.

21 The power agency proposed in House Bill 1909
22 would be an alternative for customers that want a
23 long-term, cost-based supply service in exchange for
24 a commitment to purchase supply solely from the
25 agency.

1 The agency can accommodate the "take or pay"
2 requirements with the suppliers and generation owners
3 and also better bear the credit requirements of these
4 deals.

5 In exchange for the financing assistance,
6 the agency can request that the power plant owner
7 provide a portion of the output to the agency at
8 cost-based rates.

9 The agency could construct or purchase
10 generating facilities to meet customer-supply needs.
11 The agency would represent another alternative for
12 customers that can coexist with the ability of other
13 customers to access the anticipated retail markets
14 and to obtain generation supply from other suppliers
15 on a short-term basis without commitment to remain on
16 that service.

17 The agency can also provide benefits to
18 customers of all classes who are not served by the
19 authority through the implementation of construction
20 or investment strategies that would operate to
21 decrease the overall prices for all customers in the
22 PJM markets.

23 Overall, market prices could be reduced
24 under the PJM model if baseload generation plants and
25 efficient peaking generating units are sited

1 strategically in Pennsylvania to relieve transmission
2 constraints.

3 One of the alleged justifications of the PJM
4 energy market model was that it would send price
5 signals to indicate where and when generation units
6 are needed because the transmission system is
7 constrained or inefficient generation exists to serve
8 the load, with the results that new suppliers would
9 enter the market and relieve the constraint and
10 thereby drive down prices.

11 A traditional developer may not have the
12 motivation to build baseload generation or peaking
13 generation in constrained areas due to the devaluing
14 impact that it would have on other units within the
15 developer's existing generation fleet.

16 The agency, however, would have a much
17 different motivation and would build those units to
18 minimize costs both for its customers and for others
19 in Pennsylvania.

20 In other words, the agency would react to
21 concerns that prices are too high by increasing the
22 available supply, which under the PJM model would
23 decrease prices for everyone.

24 I have focused primarily on ways that the
25 agency could assist Pennsylvania in business and

1 industry. However, IECPA also fully supports the
2 initiatives of House Bill 1909 to advocate before
3 PJM, the Federal Energy Regulatory Commission,
4 Congress, and other Federal agencies for improvements
5 to the market design.

6 The creation of the Commonwealth Energy
7 Advocate to represent retail ratepayer interests in
8 those wholesale and Federal discussions are very
9 important steps to ensure that Pennsylvania's
10 interests are considered. In our view, despite our
11 efforts, customer interests are currently
12 underrepresented in these fora.

13 Finally, the creation of a power authority
14 or implementation of market design changes by the
15 Commonwealth Energy Advocate will take time.

16 Customers in the PPL territory will see
17 substantial increases this month. Customers in the
18 remaining portions of the Commonwealth will see
19 potentially disastrous effects from the exposure to
20 this flawed wholesale market on January 1, 2011.

21 As a result, the committee may need to
22 consider proposals such as rate cap extensions,
23 rebates, or other concepts to mitigate the imminent
24 increase while the agency and the Commonwealth Energy
25 Advocate are getting up and running.

1 IECPA appreciates the opportunity to provide
2 its views on House Bill 1909 and the potential
3 benefits of the Commonwealth Energy Procurement and
4 Development Agency, and I look forward to any
5 questions you may have.

6 CHAIRMAN GEORGE: I thank the gentleman for
7 his testimony.

8 I turn to our members for questions.

9 Mr. Carroll?

10 Mr. DePasquale?

11 Mr. Houghton?

12 Mr. Gabler?

13 REPRESENTATIVE GABLER: Thank you,
14 Mr. Chairman.

15 I wanted to focus a little bit on your
16 discussion of the economic development power
17 concept.

18 MR. ETSLER: Okay.

19 REPRESENTATIVE GABLER: And if my
20 understanding serves me well, basically the concept
21 would mean that the energy authority would offer
22 cheaper electric to an area or to customers that it
23 deems would be a strategic benefit for the workforce
24 in the Commonwealth.

25 MR. ETSLER: Correct.

1 REPRESENTATIVE GABLER: My question is, if
2 the authority, which is an arm of the State, is able
3 to offer cheaper power than the market would
4 otherwise provide to specific people or entities that
5 it picks, who makes up the difference?

6 I mean, you know, who ends up paying the
7 difference between the cheaper rate and the
8 acquisition rate?

9 MR. ETSLER: I think the concept that you
10 are talking about of rate subsidization is generally
11 a regulated concept. And in the unregulated markets,
12 supplies are procured and costs are set up for
13 specific deals based on the specific impact.

14 So that if in fact an economic development
15 deal is an advantage to the State because there are
16 1,400 jobs, some number of amount of taxes created,
17 et cetera, et cetera, then the Commonwealth goes and
18 finds that amount of power and creates the deal that
19 it takes to make it work. The idea there isn't a
20 subsidization necessarily where I have a bunch of
21 existing power and I'm talking about selling it and
22 then therefore have to make up the costs, if you
23 will, and then charge it to another class of
24 customers.

25 Again, economic development power is in some

1 ways a discussion of State benefit, and the analysis
2 that you would have to really spend some time on is
3 what benefit the State gets from the existence of
4 these facilities.

5 It's nothing that we don't face in our
6 business every day now. A new plant is offered to be
7 built in some place -- there was some discussion in
8 Ohio of new steel plants, and there was a discussion
9 of giving them property tax rebates and some of those
10 kinds of things that the existing steel makers didn't
11 get.

12 You know, so it's a fact of our corporate
13 lives now, and we learn to exist with it.

14 REPRESENTATIVE GABLER: So, I mean, I guess
15 what makes me a little bit uncomfortable is the idea
16 that we are going to have government-entity folks
17 that are making decisions about, you know,
18 essentially picking winners and losers.

19 And then the question becomes, you know, how
20 can the political entities that be that are trying
21 to, you know, spin one way or the other perhaps make
22 it such that, I mean, we always hear talk about
23 creating jobs or saving jobs. It seems to me to be
24 pretty easy to spin those numbers to tell a certain
25 story.

1 Is it really, you know, from a business
2 perspective, is that a level of trust that you would
3 rather put in the government as opposed to
4 elsewhere?

5 MR. ETSLER: I guess I would suggest that if
6 we were getting ready to make a large investment and
7 that tool was available, we would seriously consider
8 it. And I'll give you an example of the disadvantage
9 you would be at if you didn't have it.

10 There is a German manufacturer who is
11 building a steel facility in Alabama that is very
12 similar to our facility, and the State gave them a
13 guaranteed 1.2-cent kilowatt-hour rate for
14 30 years.

15 That plant is going in there. It will be a
16 couple thousand jobs in that plant in Alabama, and
17 the other States really couldn't compete because they
18 didn't make that offer.

19 So there are a lot of things that go into
20 making these decisions. Electricity is a key one
21 when you've got an electric melt shop. So I think
22 you would be at a big disadvantage if you didn't have
23 at least that tool in your toolkit.

24 CHAIRMAN GEORGE: Has the gentleman
25 concluded?

1 REPRESENTATIVE GABLER: Yes. That is all
2 for now. Thank you, Mr. Chairman.

3 CHAIRMAN GEORGE: The gentleman, Mr. Seip.

4 REPRESENTATIVE SEIP: Thank you,
5 Mr. Chairman.

6 Thank you for your testimony today.

7 One of the pieces of the testimony that
8 really captured my attention was the 43,000 employees
9 that are employed by the IECPA membership.

10 MR. ETSLER: The members.

11 REPRESENTATIVE SEIP: I'm just wondering if
12 you would be able to tell us what that translates
13 into in regard to payroll and financial impact across
14 the Commonwealth?

15 MR. ETSLER: Have you done those studies,
16 Pam?

17 MS. POLACEK: I'm not sure that we have
18 collected that information, but I can speak with
19 Ms. Mansberger to see if that's available to provide
20 to you.

21 REPRESENTATIVE SEIP: Yeah. I think that
22 that, you know, would---

23 MR. ETSLER: But it's large. Your comment
24 is that it's volumes. That is large, and certainly
25 there are multipliers with their ability to shop and

1 buy things, et cetera.

2 REPRESENTATIVE SEIP: And as you had said
3 here just to the prior questioner about the impact on
4 job locations and really choices that are made, I
5 guess, in the business world, there is a lot riding
6 on this legislation.

7 MR. ETSLER: Absolutely.

8 REPRESENTATIVE SEIP: I thank you again for
9 your testimony.

10 Thank you, Mr. Chairman.

11 CHAIRMAN GEORGE: I thank the gentleman.
12 Representative Pyle.

13 REPRESENTATIVE PYLE: Thank you,
14 Mr. Chairman.

15 Mr. Etsler, we're neighbors.

16 MR. ETSLER: Yes.

17 REPRESENTATIVE PYLE: I'm right across the
18 border from you, and I have a lot of folks working at
19 AK. I in fact am the child of a steelworker---

20 MR. ETSLER: There you go.

21 REPRESENTATIVE PYLE: ---and have many
22 cousins and whatnot still employed there.

23 Originally I was just going to ask one
24 question: Who is your energy supplier? I know PPL
25 is not in our territory.

1 MR. ETSLER: West Penn Power; Allegheny
2 Power Corporation---

3 REPRESENTATIVE PYLE: Allegheny Power?

4 MR. ETSLER: Through West Penn.

5 REPRESENTATIVE PYLE: Just for your piece of
6 mind, I have discussed this at length with them, and
7 I understand they were able to procure their power
8 for our region at a, I hesitate to say better, but
9 that is what it is, a better rate than our friends up
10 at PPL.

11 So I don't think the costs you are
12 projecting are going to be as profound as you are
13 seeing. But that is just FYI.

14 Mr. Chairman, I really wasn't going to ask
15 any questions, but the gentleman from Elk County
16 brought up an interesting question.

17 Now, pardon my simplicity of understanding,
18 but if you go to the PJM grid, the same as any other
19 home consumer, business, commercial, and say they are
20 selling, you know, a megawatt, and this is a dream,
21 but for 10 bucks. Okay? Just for example's sake.

22 This legislation would create a Consumer
23 Energy Advocate that would step in -- and this is
24 from my understanding -- and weigh out the importance
25 of the jobs at AK, which in our area are very

1 important, and then decide that you don't have to pay
2 \$10 to PJM, you should only pay \$8 or \$9. Who makes
3 up the extra 2 bucks?

4 MR. ETSLER: Now, I think the---

5 REPRESENTATIVE PYLE: I think that is where
6 Representative Gabler was going, but I kind of needed
7 it in western Pennsylvania.

8 MR. ETSLER: Right.

9 In terms of what we are proposing and what
10 the bill proposes for an advocate to go argue it at
11 PJM -- our quarrel with the PJM market design is the
12 dispatch model and how they award fees to the
13 generators based on not their costs of production but
14 on the market rate assessed by the bids that are
15 made.

16 Therefore, people can bid in, and in fact
17 what happens daily is that the more inefficient units
18 set the price because they are the ones that are on
19 the margin, so they set the price that everybody gets
20 paid.

21 And in fact under the regulated rates, it's
22 a cost-based rate, and if somebody happens -- like
23 West Penn Power -- happens to have some very good
24 power plants that run very well and have a good
25 operating record, they could be providing it cheaper

1 than that marginal pricing.

2 REPRESENTATIVE PYLE: I have a lot of those,
3 too.

4 MR. ETSLER: Yes.

5 REPRESENTATIVE PYLE: Yeah.

6 MR. ETSLER: So the argument is not so much,
7 again, is not so much a transfer of costs from one
8 person to another; it's a question of what price was
9 awarded to those generating facilities. And we think
10 that the market design, the way it exists now, is
11 higher priced awards than what would be awarded under
12 a standard cost of service allocation and
13 measurement.

14 MS. POLACEK: Perhaps if I can add to that.

15 The power agency in negotiating the rates is
16 going to look at the cost that it pays to either
17 purchase the power or to produce it and cover those
18 costs with those rates.

19 Now, the difference would be, if it's a
20 power plant that is owned by the power agency, rather
21 than putting the power into the PJM LMP market, which
22 would be giving them the 10 cents, they may find that
23 the actual cost to produce that power is only
24 7 cents. So AK Steel would get the 7-cent rate
25 rather than the 10-cent rate that the agency could

1 have taken and sold that into the PJM market for.

2 That is why we view it as not being a
3 subsidization issue, because they are covering the
4 costs of producing the power or procuring the power,
5 again, because they could be assisting developers in
6 obtaining financing, and in exchange, again with that
7 same power plant, they would be entitled to so many
8 megawatts at the 7 cents rather than the PJM
9 10 cents.

10 MR. ETSLER: Right.

11 REPRESENTATIVE PYLE: You just said
12 something that was a bit of a curve ball to me: If
13 the agency builds power plants? You are saying you
14 want the State to build power plants?

15 MS. POLACEK: The agency does have the
16 ability to construct power plants. That is in the
17 bill.

18 And again, they also, in terms of that, also
19 have the ability to not physically have the workers
20 do it but to RFP that, have someone else run them,
21 too.

22 MR. ETSLER: Right.

23 MS. POLACEK: That is in the bill.

24 MR. ETSLER: The advantage that we see with
25 this agency, really, is that you are creating a pool,

1 a big pool, and a supplier into the big pool does not
2 have the credit risk of an AK Steel, does have the
3 bonding and the high credit rating of the State
4 behind it, and those two things by itself can be a
5 very significant portion of the costs.

6 I mean, I have four plants that we buy on
7 the open market for today, and I can tell you that
8 the two States that are the lowest priced are in fact
9 Pennsylvania and Kentucky, and they are the two that
10 are not open.

11 REPRESENTATIVE PYLE: Okay.

12 MR. ETSLER: And a lot of that is because of
13 the credit risk, et cetera, that the smaller
14 producers that are now out there in those markets
15 have to take on when they take on a load like
16 ourselves or some other loads.

17 But when you're in a pool, you have
18 essentially aggregated yourself in a fashion that
19 might be more beneficial to them, too, in their
20 ability to get financing and their ability to carry
21 the cost of that plant.

22 REPRESENTATIVE PYLE: Thank you.

23 Mr. Chairman, I don't know if this question
24 is for them or for you, but who pays for building the
25 power plants?

1 CHAIRMAN GEORGE: Well, let me say this to
2 you---

3 REPRESENTATIVE PYLE: It's a legit
4 question.

5 CHAIRMAN GEORGE: As the gentleman could
6 have went on, we are trying to keep it a little
7 simpler.

8 REPRESENTATIVE PYLE: Sure.

9 CHAIRMAN GEORGE: It's very possible today
10 with the rate caps off that a power company can
11 generate their own power and buy it from themselves,
12 and we know not what they are paying or whether it's
13 competitive with the prices.

14 And the truth is that as far as the system
15 that we use today, it would have pleased me, after
16 the deregulation, if these billions of dollars in
17 stranded costs would have allowed them to build
18 plants in Pennsylvania, like Indiana and Clearfield
19 and Armstrong, rather than Ohio and Montana.

20 So I stand corrected that, yes, they could
21 build a power plant. But again, I would be happy to
22 see that the power would be adjusted and sold through
23 an entity such as this rather than a Federal Energy
24 Commission, and I'll get into that later.

25 Thank you for your good question.

1 REPRESENTATIVE PYLE: Thank you,
2 Mr. Chairman.

3 CHAIRMAN GEORGE: I call and I recognize the
4 gentleman, Mr. Yudichak, first, then I'll recognize
5 you, sir.

6 REPRESENTATIVE YUDICHAK: Thank you,
7 Mr. Chairman.

8 Thank you, Mr. Etsler.

9 First, let me thank you for doing business
10 in Pennsylvania and investing in Pennsylvania
11 workers. Forty-three thousand employees is a
12 significant presence in Pennsylvania.

13 I would like to build a timeline, and if you
14 could respond to some of my questions.

15 From your testimony, you referenced that the
16 24 members of your organization did support
17 deregulation back in 1996 as a noble effort to try to
18 make Pennsylvania more competitive when it came to
19 doing business. And that is what we are talking
20 about, and certainly your testimony is the cost of
21 doing business in Pennsylvania.

22 After deregulation occurred in some portions
23 of the Commonwealth, your organization did try to
24 work, and if my numbers are correct, you mentioned
25 that you buy about \$40 million in power just at the

1 Butler plant. The 23 other members, we are probably
2 talking about a billion-dollar customer, at least.

3 MR. ETSLER: Yes.

4 REPRESENTATIVE YUDICHAK: You were not, in
5 the current system, in the current system you were
6 not able to get competitive rates or what you feel
7 were competitive rates for doing business.

8 MR. ETSLER: Under the current system, we
9 are very happy with the rates we have and the supply
10 into Pennsylvania. Hence, we proposed a big
11 expansion to that plant.

12 And in fact our green-oriented steel that we
13 make there, we are the market leader in that, and we
14 would like to continue to be able to produce that
15 there and continue to sell.

16 And we all know that the mega-trans are such
17 that the infrastructure needs around the world are
18 increasing. People in other countries are trying to
19 build transmission systems, power systems, putting in
20 transformers, getting electricity to themselves, and
21 the green-oriented steels are the critical piece of
22 that.

23 So we feel, you know, strongly that we would
24 like to produce here. But what is going to happen is
25 our caps are -- we have not gotten to deregulation in

1 western Pennsylvania. Like I said, I have four other
2 plants in other States that have, but not here.

3 REPRESENTATIVE YUDICHAK: Sure.

4 MR. ETSLER: And here, the rates are very
5 good.

6 Now, when we go to deregulation, I will go
7 to the published standard rates probably, and those
8 are significantly higher.

9 REPRESENTATIVE YUDICHAK: And you referenced
10 the academic study at Carnegie Mellon University that
11 you think at least a 2-cent per kilowatt-hour that
12 that may increase.

13 MR. ETSLER: Yes.

14 REPRESENTATIVE YUDICHAK: But your testimony
15 today is really about your business model. It's not
16 about an academic study; it's not about a political
17 agenda.

18 MR. ETSLER: Absolutely.

19 REPRESENTATIVE YUDICHAK: It's about a
20 business model and how do you keep those 43,000
21 workers employed in a very competitive market.

22 MR. ETSLER: Sure.

23 REPRESENTATIVE YUDICHAK: So I wanted to run
24 through that, because I think it's very important
25 that we have someone before us that supported

1 deregulation, that thought it was a noble idea to try
2 to make the energy market more competitive in
3 Pennsylvania, but is telling us today, not from an
4 academic study, not from a political platform, but
5 from the hard core business world that it has failed
6 and the wholesale market that is going to be created
7 will not be beneficial to Pennsylvania companies in
8 terms of their economic competitiveness with other
9 States.

10 I mean, you referenced Alcoa, a member in
11 another State that has idled its plant in Maryland.

12 MR. ETSLER: Yes.

13 REPRESENTATIVE YUDICHAK: I mean, that's my
14 biggest concern, when very limited dollars in terms
15 of the Commonwealth's fiscal position in terms of
16 trying to create incentives, trying to create
17 additional jobs, I'm very concerned about the rate
18 caps coming off and making it harder to do
19 business.

20 The last question I have for you. I noticed
21 on the map where there have been States that have
22 suspended deregulation. One of them was Virginia,
23 and I don't know if you can speak to Virginia, if you
24 have plants there or if there are members of your
25 organization---

1 MR. ETSLER: I don't have plants there, but
2 we have members that have plants there. Yes.

3 REPRESENTATIVE YUDICHAK: And whether or not
4 if you can speak to that at all, because Virginia
5 continues, in all the business journals that I see,
6 continues to be ranked as one of the most
7 business-friendly States in the country.

8 I'm wondering if suspending that
9 deregulation or making changes as we are proposing
10 here today plays a role in that.

11 MR. ETSLER: I think so. I used to live in
12 Virginia.

13 I can tell you that part of the problem of
14 deregulation is the idea that transmission facilities
15 and generating facilities would be built that -- the
16 bottom line is, across the country, we are generation
17 short. That is the crux of the problem.

18 And the original intent was with natural gas
19 at \$2 an MCF, building a whole bunch of turbines that
20 were pretty cheap would create another market to coal
21 and nuclear plants, et cetera, that were very
22 expensive, and that they could be built fast, you
23 could put them along the right places in the grid,
24 and you would have a deregulated market.

25 In fact, natural gas has gone way up. It's

1 hard to get anything sited. Transmission is hard to
2 build.

3 Virginia is one of those States where the
4 population is in the northern part of the State, the
5 electricity is in the southern part of the State,
6 and it's very hard to move or get right-of-way to
7 build a transmission line, et cetera. You know some
8 of the problems you have with transmission lines
9 here.

10 So it sort of failed, because the idea was
11 that the plants and stuff available in the southern
12 part of the State or in the regions that were more
13 buildable could be moved up towards Washington, DC,
14 and the northern Virginia area, and that turned out
15 to be very, very difficult.

16 Not to say impossible. I believe that
17 ultimately they will get built as the public policy
18 needs to focus on that and get it done, but it
19 doesn't happen overnight.

20 REPRESENTATIVE YUDICHAK: Thank you.

21 Thank you, Mr. Chairman.

22 CHAIRMAN GEORGE: I thank the gentleman.

23 The gentleman, Mr. Barbin.

24 REPRESENTATIVE BARBIN: Thank you,

25 Mr. Chairman.

1 And thank you, Mr. Etsler, for your
2 testimony.

3 The most interesting part of your testimony
4 for me, because I still am looking at this as what is
5 our job here, and that is to try to make sure that we
6 keep as many jobs as we have and increase jobs if it
7 is possible, but we're in a recession. And what I
8 took out of your testimony is when rate caps come off
9 in States that are no longer regulated, that the cost
10 of doing business for a manufacturer becomes
11 substantially greater.

12 There is a statement in Mr. Christy's
13 testimony that it will provide that under the
14 Pennsylvania Competition Act, EDCs are no longer able
15 to offer meaningful industrial economic incentive
16 rates because of that statute.

17 Now, from my perspective, the best part
18 about this power authority is that you would be able,
19 even with just one person, you know, doing contracts,
20 to provide a lower rate for manufacturers that would
21 allow us to get over this recession.

22 If the only thing that we could do with this
23 act was to parallel what Illinois did, which was to
24 go out and put requests for proposals out for the
25 benefit of residential customers buying in bulk or

1 industrial purchasers buying in bulk, would that be a
2 valid reason to start the power authority, from your
3 perspective, of trying to save jobs?

4 MR. ETSLER: Right. Absolutely. That is
5 why we supported that and why we support the advocate
6 to go argue positions in front of the FERC, so that
7 Pennsylvania doesn't get disadvantaged in some PJM
8 regional hearing.

9 You know, all those things that, as you say,
10 you can do it with, not big -- I mean, you don't need
11 massive buildings full of people to do that kind of
12 thing.

13 And then the other thing that I think is
14 that the agency is a powerful tool, and smart people
15 will come up with ideas of how to best use the pool
16 in such fashion.

17 And I think we had a discussion about using
18 the gas under the Pennsylvania land that you own and
19 maybe paying somebody to use it to generate and
20 providing power at a slightly reduced price, or
21 whatever price that ends up being, to your own State
22 buildings, to economic development rates, you know,
23 those kinds of things.

24 I mean, I think that's a wonderful idea, and
25 I just think, like I say, that smart people with a

1 tool will come up with good ways to use it, and I
2 think that's great.

3 REPRESENTATIVE BARBIN: Is it
4 oversimplifying this matter to say that this would
5 parallel buying health-care insurance on a statewide
6 basis as opposed to a city-by-city basis?

7 MR. ETSLER: I think it's absolutely the
8 same thing. You are talking about a pool and you are
9 talking about using the credit rating of the State
10 and some other things that are going to help people
11 provide you at a lesser cost.

12 REPRESENTATIVE BARBIN: Thank you.

13 And thank you, Mr. Chairman. I have no
14 further questions.

15 CHAIRMAN GEORGE: Next, I call on the
16 gentleman, Representative Kessler.

17 REPRESENTATIVE KESSLER: Thank you,
18 Mr. Chairman.

19 You mentioned in your testimony that you
20 have plants located in Ohio, Indiana, and Kentucky.
21 And then you also mentioned in your testimony about a
22 possible 50-percent increase.

23 If you were to have a 50-percent increase or
24 even a 30-percent increase, how would those rates
25 compare to Ohio, Indiana, and Kentucky?

1 MR. ETSLER: Oh, my projections are that
2 this plant will be the highest-cost plant.

3 REPRESENTATIVE KESSLER: And then on page 5
4 you testified that for companies with multiple State
5 locations such as AK Steel, decisions as to which of
6 its facilities would receive capital investment are
7 critically examined in terms of the impacts to the
8 future competitiveness of the company.

9 Would you possibly have to consider moving
10 some production to some of these other States and
11 also possibly moving some jobs to the other States?

12 MR. ETSLER: The short answer is yes.

13 I believe that, you know, to say that we are
14 going to close down the plant tomorrow would be an
15 understatement, or an overstatement of the case. But
16 when you're a multi-State, multi-facility location,
17 the competition for capital, the competition for
18 schedule time, the competition for where things are
19 going to be produced, it goes on every day.

20 And for us, we move a lot of steel around
21 amongst the finishing plants. All these things go
22 into a model, and we change our production around.

23 There is a sister plant in Mansfield, Ohio,
24 that makes the same products, and right now, they are
25 working 4 weeks on and 4 weeks off because Butler is

1 working full.

2 It doesn't necessarily have to stay that
3 way.

4 REPRESENTATIVE KESSLER: Okay. Thank you.

5 CHAIRMAN GEORGE: Any other questioners?

6 Seeing none -- oh, the gentleman, Mr. Reed.
7 I apologize.

8 REPRESENTATIVE REED: That's all right.

9 I'll stand up here, if you don't mind, since
10 the podium is kind of blocking our view.

11 MR. ETSLER: Okay.

12 REPRESENTATIVE REED: At least we should
13 know who we're talking to.

14 If I'm correct, just in, you know, hearing
15 the correspondence from the folks that you represent,
16 the Industrial Energy Consumers of Pennsylvania, over
17 the last couple of years, in your testimony today
18 your primary concern is what the market is going to
19 look like after rate caps expire. Correct?

20 MR. ETSLER: Correct.

21 REPRESENTATIVE REED: Okay.

22 So, you know, your testimony today is kind
23 of predicated on the fact that rate caps are going to
24 expire, you are assuming prices are going to go up,
25 and you see this as a possible way of dealing with

1 that issue.

2 MR. ETSLER: Correct.

3 REPRESENTATIVE REED: Okay.

4 Now, as you state in your testimony,
5 originally, the group that you represent was in favor
6 of a deregulation of the market because you assumed
7 greater competition would bring prices down for the
8 companies that are a part of your association.
9 Correct?

10 MR. ETSLER: Right.

11 REPRESENTATIVE REED: Okay. And really what
12 you're looking for is price stability in the future.
13 You don't want to see prices go up. So it could be
14 through a Pennsylvania Power Authority, it could be
15 through the extension of rate caps, you know, a
16 number of different means to get to that goal.

17 MR. ETSLER: Correct.

18 REPRESENTATIVE REED: Okay.

19 Now, my only question for you is, you
20 represent a lot of very large companies in
21 Pennsylvania, and a lot of folks work for those
22 companies and those jobs are very important. And we
23 also represent a lot of consumers in Pennsylvania,
24 and if you're looking for a deal in essence from the
25 government that says that one of the chief raw

1 materials needed to produce your products is going to
2 have a price that is going to be frozen in time, are
3 the companies that you represent willing to freeze
4 their prices for consumers as well?

5 MR. ETSLER: I guess the short answer to
6 that, from our perspective, is not that we are
7 looking for frozen prices or something that is out of
8 the ordinary to what anybody else would get.

9 The idea here is that we are looking -- we
10 are coming from -- the idea of a deregulation
11 essentially is what I consider a socialization of the
12 assets. People that have generating, extra
13 generating and the like, we are trying to find ways
14 to pool and support people that don't.

15 And in the prospect, some places that have
16 had pretty cheap rates, and we have some other places
17 that have some very, very expensive rates, and now
18 what we are talking about in taking the caps off and
19 the like is that it is all going to go to market. In
20 some places, it is going -- the market can
21 unfortunately change in prices, like overnight.

22 And I'm not saying we're looking for frozen
23 prices; we're just looking for reasonable prices.
24 And a 30- to 50-percent increase for going from
25 \$40 million to \$80 million in electric costs in a

1 year, or, you know, overnight basically for us in
2 western Pennsylvania, we don't think is exactly the
3 same situation as what you are describing.

4 Now, if you told me it was going to go up
5 3 percent a year for the next 4 years, we would have
6 lived with that for the last 10, because in fact
7 generation is getting more and more, electricity is
8 getting more and more expensive. And there are
9 places overseas and the like paying a lot of money
10 for a kilowatt-hour.

11 So we expect it to go up, and we can deal
12 with normal cost-of-living kinds of increases, but
13 it's the fly-up that we're trying to mitigate.

14 REPRESENTATIVE REED: I think we're all
15 trying to mitigate that.

16 MR. ETSLER: Yeah; I think so, too.

17 REPRESENTATIVE REED: And I guess from your
18 response, I am gathering that you would like
19 government perhaps maybe not to freeze prices but
20 restrict how much of an increase those prices can
21 be.

22 MR. ETSLER: I think that's fair.

23 We talked about support for the rate cap.
24 We talked about a support for a phased-in rate cap.
25 We're okay with that.

1 Now, we signed off on a rate case that
2 allowed West Penn, you know, reasonable rates to
3 recover their stranded costs in anticipation of this
4 open market.

5 We're not trying to be unreasonable about
6 these things. It's just a question of how fast it's
7 going to come at us, and in the business world
8 there's no doubt that we won't be raising the price
9 of steel 30 to 50 percent between the 31st of
10 December and the 1st of January.

11 REPRESENTATIVE REED: In fact, I guess my
12 last question would be---

13 CHAIRMAN GEORGE: You are limited to one
14 question. Now, let's make it a little bit more
15 directly, please.

16 REPRESENTATIVE REED: Okay. Can I have my
17 one final question?

18 CHAIRMAN GEORGE: You can indeed.

19 REPRESENTATIVE REED: Okay.

20 If you think it's fair enough for government
21 to restrict those types of price increases, is it
22 fair enough, because your companies are going to
23 benefit, very large companies are going to benefit
24 from those restrictions, that your company should be
25 under the same sorts of restrictions to the benefit

1 of the consumers of Pennsylvania?

2 MR. ETSLER: There's a fairly substantial
3 difference between the obligation to serve and the
4 monopoly franchise positions that the utilities have
5 and enjoyed for years over what the free market
6 companies have had to endure in other areas. So I
7 would say this is a different situation.

8 REPRESENTATIVE REED: Okay. So simply put,
9 no.

10 MR. ETSLER: Right.

11 REPRESENTATIVE REED: Thank you.

12 CHAIRMAN GEORGE: Are there any other
13 questioners?

14 You want another one, Mr. Pyle?

15 REPRESENTATIVE PYLE: No, Mr. Chairman.

16 Mr. Chairman, I just wanted to point out
17 that my colleague and dear working friend in Indiana,
18 his line of questioning should probably include, what
19 will this do to the price of baby goods, as my friend
20 became a father again last week. And I wanted to
21 mention that and congratulate him in public for the
22 birth of his daughter.

23 CHAIRMAN GEORGE: Did you say they just had
24 a baby?

25 REPRESENTATIVE PYLE: Yes, sir.

1 CHAIRMAN GEORGE: Then he should worry about
2 the cost of electricity.

3 If there is no other questioning, may I
4 thank you and the young lady for your testimony.

5 MR. ETSLER: Thank you.

6 CHAIRMAN GEORGE: We now call on the
7 gentleman, Mr. Popowsky.

8 Most of us are acquainted with this
9 gentleman. He is the Consumer Advocate of
10 Pennsylvania, their Director.

11 Welcome to the committee, Mr. Popowsky.

12 MR. POPOWSKY: Thank you, Chairman George,
13 Chairman Hutchinson, and members of the committee.

14 My name is Sonny Popowsky. I have served as
15 the Consumer Advocate of Pennsylvania since 1990, and
16 I have worked at the Office of Consumer Advocate
17 since 1979.

18 I would like to commend you,
19 Chairman George, and members of your staff and the
20 members of this committee for bringing this issue to
21 the General Assembly.

22 In my view, and the issue that I would like
23 to address, the primary question raised by this
24 legislative proposal and by this hearing is whether
25 market forces alone are sufficient to bring about the

1 new electric generation commitments that are
2 necessary to maintain the long-term reliability and
3 adequacy of our electric network at an economic and
4 affordable cost to all Pennsylvania consumers.

5 More specifically, the question is whether
6 the creation of a Pennsylvania Power Authority or
7 Agency would provide greater assurance to
8 Pennsylvania consumers that their future electric
9 generation requirements will be met in the most
10 reliable, economical, and environmentally sound
11 manner.

12 I believe that a Pennsylvania Power
13 Authority could provide substantial benefits to
14 Pennsylvania consumers, and I therefore urge this
15 committee, the General Assembly, and the Governor to
16 carefully consider the establishment of such an
17 agency through legislation.

18 First, I want to assure the members of the
19 committee that Pennsylvania is not the only State,
20 not the only one of the restructured States, in which
21 this question is being asked.

22 Just last month in a December 18, 2009,
23 letter to the Maryland Public Service Commission,
24 Maryland Governor Martin O'Malley called on the
25 Maryland Commission to "use its existing statutory

1 authority," which it has in Maryland, to order new
2 electric generation to be built in Maryland.

3 Governor O'Malley in his letter concluded
4 that, quote, "We can no longer afford to passively
5 wait for competitive energy prices or pay higher
6 incentives for merchant generation."

7 Governor O'Malley was particularly critical
8 of the capacity market in PJM, our interconnection
9 that serves both Pennsylvania and Maryland, that he
10 said has imposed billions of dollars on Maryland
11 consumers.

12 And if I could quote, it said, "From 2008 to
13 2013, it is estimated that Maryland ratepayers will
14 pay nearly \$5 billion in capacity charges to
15 incentivize the private sector to build new
16 generation -- enough to pay for seven new power
17 plants -- but no new baseload generation will be
18 built as a result of these incentives."

19 In Maryland, as many of you may recall, at
20 the end of 2005, their rate caps came off and
21 customers there were hit with rate increases of as
22 much as 72 percent.

23 As a result, the Maryland General Assembly
24 came back into session and passed a series of bills,
25 one of which did give the Maryland Commission the

1 explicit authority to order the construction of new
2 power plants.

3 The Maryland Commission also conducted a
4 series of studies which concluded, among other
5 things, that it "is not in the public interest to
6 continue to rely exclusively on market forces to
7 address Maryland's reliability concerns and the high
8 wholesale electricity prices Marylanders pay."

9 And the report that came out of the Maryland
10 Commission recommended that the utilities should
11 enter into long-term contracts with suppliers to
12 induce the construction of new capacity in Maryland.

13 And while the Commission in Maryland did not
14 recommend complete re-regulation in Maryland, the
15 Commission did conclude that the public interest
16 compels some re-regulation, or put another way, "that
17 the public interest is not served by de-regulation
18 that requires the Commission to wait passively for
19 market forces to deliver a reliable supply of
20 electricity at reasonable rates."

21 Nor is Pennsylvania the only State that is
22 considering or has established a power agency or
23 power authority.

24 There is legislation that was passed in the
25 Connecticut House, not in the Connecticut Senate, but

1 passed in the Connecticut House that would have
2 created a power authority.

3 And also, more importantly I think, even
4 without that power authority in Connecticut, which is
5 another one of the Eastern restructured electric
6 States, in Connecticut in 2008, the Connecticut
7 Commission determined that there was a need for more
8 generation. There was a need for power to maintain
9 reliability in New Haven and Bridgeport and
10 Fairfield, Connecticut.

11 And they actually directed, under their law,
12 they directed their utilities to go out and get bids
13 for new power plants, not ordering the utilities to
14 build the plants themselves or put them as they might
15 have done under traditional regulation, but to go
16 out, have a competitive procurement, and say, we need
17 these plants in these three areas in order to ensure
18 reliability and in order to keep our prices
19 reasonable.

20 In Illinois, the State Legislature did
21 create the Illinois Power Agency after enormous rate
22 increases occurred in that State after the rate caps
23 expired. That agency primarily is responsible for
24 developing procurement plans for customers to acquire
25 power, again, in the competitive market. The agency

1 also has the authority to assist in the development
2 of new plants if they are necessary.

3 In New Jersey, New Jersey issued a Master
4 Plan in 2008 that, like as in Maryland, concluded
5 that "We cannot continue to hope that market forces
6 alone will lead to the construction of new plants by
7 the market participants."

8 And as stated in the New Jersey report with
9 respect, again, to the method used by the PJM in the
10 capacity market, the concern was that that
11 reliability pricing model that is used by PJM, quote,
12 "does not target new plants, but instead spreads
13 capacity payments amongst all new and existing
14 plants."

15 "Paying all existing plants" -- and quoting
16 again from the New Jersey Master Plan -- "Paying all
17 existing plants a capacity price that PJM hopes to be
18 high enough to effectively encourage new plants will
19 cost electricity customers billions of dollars more
20 than a better-targeted effort."

21 So the thrust, the common thread of this
22 debate -- and we're not just talking about
23 Pennsylvania; we're talking about many of the
24 remaining deregulated States. And as the prior
25 witness pointed out, some States have completely gone

1 back to re-regulation -- re-regulation, like
2 Virginia.

3 But even those States that still rely on
4 competitive wholesale markets are taking steps, are
5 taking steps to make sure that new capacity is built,
6 that it is built when it is needed, and it is built
7 in an economical manner.

8 Again, not necessarily through traditional
9 utility ratemaking methods but through using
10 competitive procurement -- bringing people into the
11 competitive market, bringing people into Pennsylvania
12 to build the new plants that are needed. And that is
13 the kind of role that at least I foresee a State
14 power authority playing.

15 The short-term market system that we have in
16 place in Pennsylvania and in our surrounding PJM
17 States, in my view at least, has the unintended
18 consequence of overcompensating owners of existing
19 generation whose capital costs have already been paid
20 for through depreciation and stranded cost recovery
21 while providing inadequate incentives to new entrants
22 in the generation market.

23 The problem is that under the PJM pricing
24 scheme, where all generation is paid RPM auction
25 prices for capacity and the highest market clearing

1 prices are paid for energy, we have to overpay almost
2 everyone in order to try to get someone to build the
3 generation we need, yet we still do not have the
4 assurances that that adequate generation will be
5 built when and where it is needed.

6 And in my view, that is an area where a
7 Pennsylvania Power Authority could play a vital role.
8 That is to encourage and to help finance new
9 construction and long-term generation contracts that
10 would support Pennsylvania consumers and, while not
11 displacing the competitive generation market, would
12 supplement that market in a way that could produce
13 better reliability and lower costs for Pennsylvania
14 consumers.

15 Now, as you know, as we meet here today, we
16 are fortunate that the price impacts that we had
17 anticipated at the end of the rate caps just about a
18 year and a half ago are not as bad as we had feared.

19 Wholesale prices have come down, primarily,
20 I think, as a result of the recession. But it's not
21 clear, to me at least, that the kind of volatile
22 wholesale market and the reliance on short-term
23 wholesale market prices is a reasonable way to get
24 the new generation that we need here in Pennsylvania,
25 and one way to get some additional economic certainty

1 would be to establish something like the Pennsylvania
2 Power Authority to help finance and develop new
3 generation.

4 This is a critical time for the Pennsylvania
5 electric industry and our consumers. I want to thank
6 you again for inviting me to submit testimony on this
7 important issue, and I look forward to working with
8 all the members of this committee and the General
9 Assembly as you address this important concern.

10 Thank you.

11 CHAIRMAN GEORGE: I thank the gentleman for
12 his time and his presentation.

13 Are there any questions?

14 The gentleman, Mr. Carroll.

15 REPRESENTATIVE CARROLL: Thank you,
16 Mr. Chairman.

17 And Mr. Popowsky, I'm interested to learn if
18 you could share with me your thoughts on the
19 information that I have received related to energy
20 users who shopped around in the PPL service area.

21 As I understand it, somewhere in the
22 neighborhood of 15 or 20 percent of those users have
23 switched and shopped for their electricity and have,
24 as a result, saved on their monthly electric usage as
25 a result of their successful shopping.

1 Why do you think that that number is so low,
2 considering people have the capacity to save money if
3 they simply shop for a different energy supplier?

4 MR. POPOWSKY: I thought you were going to
5 ask why do I think that was such a high number.
6 That's a remarkable number, actually, in a short
7 period.

8 It's about 200,000 customers have shopped in
9 the PPL territory so far, and that's about the most
10 that we've seen in any of the States that have gone
11 to competitive retail markets. We have about
12 20 percent in Duquesne.

13 I think that we may get higher in the PPL
14 area, but -- in fact, I'm pretty sure we will get
15 higher -- but I still expect that the majority of
16 customers, the majority of residential customers,
17 will continue to be served by PPL.

18 And the important thing from my perspective
19 is that PPL, and all of our electric utilities,
20 continue or have an obligation to buy the lowest-cost
21 power to serve those customers even if they choose
22 not to shop.

23 REPRESENTATIVE CARROLL: And not just in the
24 PPL area. As I understood it, when the caps came off
25 in Pike County, there was a significant hike there.

1 I assume the folks in Pike County had the ability to
2 shop around as well.

3 MR. POPOWSKY: In Pike County, what we
4 actually did was we actually had an auction. Things
5 were so bad -- rates went up by 75 percent -- that we
6 actually had an auction to have a company come in and
7 take over the Pike County responsibility. And we did
8 get one successful bid from a competitive supplier,
9 Direct Energy, who actually is serving most of the
10 Pike County customers today.

11 Like I said, in Duquesne, it has been about
12 20 percent. In other States, even in Maryland where
13 they had a 72-percent rate increase, the number of
14 shoppers only got up to about 5 percent of the
15 residential customers.

16 REPRESENTATIVE CARROLL: To me, that's
17 shocking. It just seems to me that a residential
18 user, or a commercial user, for that matter, that has
19 the capacity to save a few dollars, and some
20 significant dollars in some caress, wouldn't take the
21 time and go through the exercise of finding an
22 alternative supplier.

23 MR. POPOWSKY: Like I said -- well, I think
24 the key is that you have to have suppliers who are
25 able to come in and beat the utility's price and

1 offer some significant savings. And we actually do
2 have that now in the PPL market, where customers are
3 able to save about 10 percent off of their generation
4 bill.

5 You have to remember, their overall rates
6 have gone up by 30 percent. They are seeing a
7 10-percent reduction in their generation bill, which
8 is about a 7-percent overall reduction. So those
9 customers are still seeing rate increases of more
10 than 20 percent.

11 But I agree. I actually do hope that more
12 customers, and our office, we publish a shopping
13 guide where we put out apples-to-apples information
14 on shopping. Our job is to try to get the
15 information out to customers, and then if customers
16 choose to switch, that's their prerogative. If they
17 choose not to, that's their right as well.

18 REPRESENTATIVE CARROLL: I just think that
19 it's probably a smart thing for folks to do. And for
20 those that are watching or listening, it really is
21 something that behooves them to move forward in that
22 direction, because there are real savings.

23 MR. POPOWSKY: Yes. At least for the year
24 2010, I would say PPL customers have, you know, a
25 good opportunity to save some money through the

1 retail market.

2 REPRESENTATIVE CARROLL: Thank you,
3 Mr. Chairman.

4 CHAIRMAN GEORGE: I thank the gentleman.
5 The gentleman, Mr. Pyle.

6 REPRESENTATIVE PYLE: Thank you,
7 Mr. Chairman.

8 Before my question, Mr. Popowsky, my
9 sincerest gratitude. I have sent many, many citizens
10 to your office, and you have helped each and every
11 one. So thank you.

12 MR. POPOWSKY: Thank you very much.

13 REPRESENTATIVE PYLE: My question: You
14 mentioned PJM and the model, and listening to the
15 discussion ensuing today, my question to you would
16 be, would we be better off to address basically the
17 functioning of PJM rather than, as a previous
18 testifier said, the State gets into the cost of
19 building power plants?

20 Which one would be -- thinking of last
21 year's budget, I'm trying to think, which is the
22 cheapest, most effective way to achieve what we want
23 to do?

24 MR. POPOWSKY: Well, PJM now consists
25 of, although originally PJM was

1 Pennsylvania-Jersey-Maryland, it has now got like
2 14 States. So we are one part of PJM.

3 And the industrial customers certainly have
4 participated at PJM. We have worked with them. But
5 again, it's only a small part of what we do and what
6 we can do, which is why I think in this bill we are
7 talking about a dedicated office that would spend all
8 of its time, all of its budget, addressing these
9 issues at the PJM.

10 It's a difficult process. It's a
11 stakeholder process with many groups -- transition
12 owners, generation owners, distribution companies --
13 so it's hard to get that done.

14 What we're talking about, at least what I'm
15 talking about here with the power authority is
16 actions that we can take at the State level that can
17 help bring those prices down.

18 For example, if we know that in eastern
19 Pennsylvania, let us say, prices are very high and
20 there's a need for capacity, rather than just sit
21 here and wait for somebody to come in and say, "Oh,
22 okay, I'll relieve that concern," we could have the
23 power authority go out and enter into a long-term
24 contract with a generator, a developer to build that
25 plant, and then provide the power at cost to

1 Pennsylvania consumers. So I think we can do both.

2 And actually the way I read the bill, that
3 is the preferred approach. That is not -- the
4 authority could, as I see it, almost as a last resort
5 do its own construction. But the first preference,
6 as I read the bill, is that initially they would go
7 out and look for competitive developers to come in,
8 and they would help finance that.

9 And then there is, as I read the bill, it
10 says the authority can build, can construct, but only
11 if, and then it has a list of requirements that must
12 be met before they could do their own construction.

13 So I think that the combination of those --
14 that is continuing advocacy at PJM and helping to
15 develop new generation where it is needed in
16 Pennsylvania -- is the best combination.

17 REPRESENTATIVE PYLE: Can I follow that up,
18 Mr. Chairman?

19 You had mentioned something earlier of
20 interest to me. I know and I think you probably know
21 that consumer consumption of electricity is projected
22 to grow by about 1 percent a year over the next 10.
23 I think that's a general, you know, rule of thumb.

24 You mentioned baseload to handle this, and
25 what the tenets of this bill allow is for the State

1 to enter into the building of power plants.

2 Is it fair to say the State would build,
3 own, operate, and transmit the electricity? Is that
4 the gist of it?

5 MR. POPOWSKY: Well, like I said, I think
6 that is almost the last resort, that what the State
7 Authority would be able, as in several of the other
8 States that I have talked about, would be able to
9 have competitive procurements to bring developers
10 into Pennsylvania to build plants when and where they
11 are needed.

12 It would be more of a financing and
13 development tool rather than as a State Authority
14 that would actually construct its own and transmit
15 its own power.

16 REPRESENTATIVE PYLE: And you are definitely
17 referencing not peak plants but base plants.

18 MR. POPOWSKY: It could be either. It could
19 be either.

20 Like I said, in Connecticut, the plants that
21 were built, the plants that were needed were peaking
22 units. But in Maryland, they are talking about
23 construction of more baseload units that could
24 operate a much greater percentage of the time.

25 REPRESENTATIVE PYLE: More consistent.

1 MR. POPOWSKY: That's right.

2 REPRESENTATIVE PYLE: Yeah; a more
3 consistent supply.

4 I thank the gentleman.

5 Mr. Chairman, can I offer something for the
6 record?

7 CHAIRMAN GEORGE: Feel free to do so.

8 REPRESENTATIVE PYLE: Thank you,
9 Mr. Chairman.

10 I'm aware that the Maryland House of
11 Delegates refused to move the legislation as
12 described. In fact, I have friends who are in the
13 Maryland House of Delegates who have relayed to me
14 that they have made it clear to the Governor they
15 will not move the legislation requested, and I'm just
16 wondering, why would we, you know?

17 MR. POPOWSKY: Oh, no, there is more than
18 one -- the legislation that I referenced was actually
19 passed in 2006 and '07.

20 In addition, last year, Governor O'Malley
21 proposed basically a re-regulation, and one of the
22 Houses passed it, the other House absolutely refused.

23 So you are right, they are not going to
24 re-regulate in Maryland. So the legislation that I
25 was talking about was legislation that was actually

1 passed in 2006 and 2007 that gave the Commission the
2 authority to order construction of new generation.
3 That was passed.

4 What was not passed was an effort to bring
5 back the old plants and re-regulate them, and I do
6 not think that is what is being proposed here
7 either.

8 REPRESENTATIVE PYLE: Thank you.

9 MR. POPOWSKY: Sure.

10 CHAIRMAN GEORGE: Now, we are running a
11 little late, so I'm going to limit to one question,
12 unless you think it's so important, then you can ask
13 for another one.

14 The gentleman, Mr. Gabler.

15 REPRESENTATIVE GABLER: Thank you,
16 Mr. Chairman.

17 I had a question or two pertaining to
18 Maryland, but I think my colleague from Armstrong
19 County covered that pretty well.

20 So I would like to go into one, just one
21 question that I don't think necessarily has been
22 covered in the testimony yet. But my understanding
23 of the proposed bill is that it would levy a tax of
24 \$46,355 per megawatt on the power plants in this
25 State to fund the proposed new power authority.

1 From a consumer perspective, do you think
2 that this would, you know, this additional cost on
3 our ratepayers is something that would be okay?

4 MR. POPOWSKY: I think actually there are
5 two functions for that tax or fee. One would be
6 actually, a lot of it would actually be used for
7 rebates to consumers. So certainly the consumers
8 would be better off if they could get the rebates
9 rather than pay higher rates for the generation.

10 In terms of whether or not that tax would be
11 flowed through to consumers, I think it would depend
12 on how it was implemented. And as I read it, it
13 would be implemented not on the electric generation
14 itself, which is how the market prices are set, but
15 on the capacity cost.

16 It is quite possible that those costs -- and
17 this is for existing units, not new units -- it is
18 quite possible that those capacity costs would not be
19 reflected in the market clearing price for capacity,
20 because that price is set by the cost of new
21 entrants.

22 It's a complicated point, but I think that
23 is why if the tax is only applied to existing
24 physical generators in Pennsylvania and if it's
25 applied on a megawatt basis rather than

1 megawatt-hour, I think it is quite possible that that
2 price cost would not be passed on to consumers. But
3 if it were, I would have the concern that you have
4 raised.

5 REPRESENTATIVE GABLER: Mr. Chairman, if I
6 could just briefly follow up?

7 CHAIRMAN GEORGE: Absolutely.

8 REPRESENTATIVE GABLER: First, I would just
9 like to, I'm not an attorney, but it sounds like that
10 could trigger a uniformity clause problem, depending
11 on how that may be structured. And like I said, not
12 being an attorney, I would just like to throw that
13 out there.

14 But also my concern is with levying that tax
15 and then having the power authority, which also, as
16 my colleague from Armstrong County referenced, there
17 is a question about how the power authority could get
18 involved in constructing new power plants, that
19 sounds to me like that is essentially putting the
20 risk involved in construction.

21 You know, it's a large capital investment.
22 It's kind of a risky venture that normally, at least
23 in the current system, investors bear that risk. Now
24 we are putting this on to a tax and an authority of
25 the State.

1 If this authority gets involved in building
2 new power plants, wouldn't that essentially be
3 putting an arm of the State, and thereby, in the
4 larger picture, taxpayers, at risk for these
5 investments?

6 MR. POPOWSKY: Well, like I said, I think if
7 what we were talking about was an authority that was
8 just going to come in and build power plants and sell
9 them, I think that would be a concern.

10 Again, like I said, there are two parts to
11 that portion of the bill. The first part says that
12 the authority could help finance and develop, much
13 like other Commonwealth agencies, could help finance
14 and develop competitive providers to come in and
15 build those plants at their risk.

16 And that is why I pointed out what happened
17 in Connecticut. It wasn't the State that actually
18 built the plants. It was the State Commission that
19 ordered the companies to acquire the plants or to
20 require the construction of plants.

21 So I think the way it's done is very
22 important to the point that you have raised, which
23 is, again, as in Connecticut and as I believe what
24 they are talking about in Maryland is to have
25 competitive procurement so that the developer would

1 bear the risk of the plant.

2 The agency would serve the purpose of
3 saying, hey, this is where we need the plant; this is
4 why we need it; now let's get some competitors to
5 come in and compete to build it.

6 REPRESENTATIVE GABLER: Thank you very much.

7 And thank you, Mr. Chairman, for your
8 indulgence.

9 CHAIRMAN GEORGE: I thank the gentleman.

10 Are there any other questions?

11 My Co-Chairman, Mr. Hutchinson.

12 REPRESENTATIVE HUTCHINSON: Thank you.

13 I did want to go down that line with the
14 generation tax, but I think that was covered well.
15 Because I, too, am concerned that on top of the
16 mandated, high-priced energy that we have already
17 mandated the companies to purchase, and many in the
18 General Assembly want to increase those mandated
19 percentages, to pile a tax on top of that I think
20 would be very counterproductive.

21 But I'll go to another line of questioning,
22 and that is, several of our testifiers previous to
23 you talked about the importance of having somebody
24 advocate at the Federal level, specifically to FERC
25 and other Federal authorities.

1 I wanted to know, is the ability to advocate
2 to FERC and other Federal authorities within your
3 purview today, and have you done so in your capacity
4 as Consumer Advocate?

5 MR. POPOWSKY: The answer to both of those
6 questions is yes.

7 As you know, our office is responsible for
8 electric, gas, telephone, water, wastewater, several
9 hundred utilities within Pennsylvania.

10 On the electric side, we spend the great
11 majority of our time here on the electric rate cases,
12 the default service cases, the smart meter cases, the
13 Act 129 conservation cases. In addition, we do try
14 to participate at FERC alongside the industrials to
15 the extent we can and at PJM.

16 What I would say is my understanding is the
17 purpose of this act would be to establish a dedicated
18 office whose sole responsibility would be to
19 represent Pennsylvania consumers before FERC and the
20 PJM, because I can assure you that the utilities and
21 the generators have a lot of full-time folks there
22 doing that.

23 REPRESENTATIVE HUTCHINSON: The only other
24 thing I wanted to ask you about, it has been -- you
25 know, I guess there is debate in Pennsylvania over

1 whether we do have a competitive marketplace. Many,
2 including the market monitoring unit that was PJM,
3 had looked at PJM, and they say that we do have a
4 very robust competitive marketplace in Pennsylvania.

5 Do you agree with that assessment, and if
6 not, where do you see a difference between what that
7 independent group said?

8 MR. POPOWSKY: I would have to go back and
9 check. Certainly he has held many times that the
10 energy market, the daily energy market, is
11 competitive. And there are a lot of people bidding
12 into the energy market every hour of every day.

13 The capacity market, which is more what I
14 was talking about, is more problematic. And it's not
15 so much of a competitive market as an administrative
16 construct that is run by PJM.

17 And I do think that there are serious
18 questions as to whether or not that is a fully
19 competitive market. And I believe that, and I would
20 have to go back and check, but to see whether the
21 market monitor has said that the capacity market is
22 fully competitive.

23 But I think that's the biggest concern,
24 which is, if you want somebody to build new capacity,
25 the effect of that is actually to lower the capacity

1 price for all the other units.

2 So to the extent that you are sending sort
3 of mixed signals, what we really need to do is to try
4 to -- so it may not be, to the existing companies, it
5 may not even be to their advantage necessarily to
6 build new generation exactly when and where it is
7 needed.

8 So what we would like to do is be able to
9 get more new competitors in, and what the new
10 competitors have testified consistently, the new
11 generators, is that the PJM short-term market alone
12 is not enough to justify, to enable them to get into
13 the market and build the kind of long-term capacity
14 that we need, and that they need long-term contracts
15 in order to come in and compete.

16 And the ability to generate these types of
17 long-term contracts is where I could see the
18 Pennsylvania Power Authority serving a purpose, so.

19 REPRESENTATIVE HUTCHINSON: Thank you.

20 CHAIRMAN GEORGE: Mr. Popowsky, if I could
21 sum this up with one question.

22 I have heard the questioners ask about the
23 10 percent, heard them ask about whether the Federal
24 Government, through FEMA, could do this better, and
25 whether or not taxing these industries that are

1 seriously thinking about leaving Pennsylvania because
2 they can't afford the raw product of electricity.
3 Isn't it true, or in your opinion am I not close, in
4 that FEMA, the PJM, and all of those are responsible
5 for the higher costs of the electricity?

6 And let me just finish this up by saying, if
7 it wasn't inflated and to start with the inflation,
8 supposedly it would go to building plants across
9 Pennsylvania, which would take this stranded-cost
10 money and create employment in Pennsylvania rather
11 than letting these companies go out of State to
12 procure the energy rather than in Pennsylvania.

13 So to sum it up, the inflated wholesale
14 price comes from the shopping of the utilities rather
15 than worrying about the 10 percent that the consumer
16 could derive. Am I right? Yes or no?

17 MR. POPOWSKY: That's a hard question to say
18 yes or no.

19 I think that the structure of some of the
20 PJM markets, the structure of the market results, in
21 my opinion, in paying too much to some generators and
22 not enough to others. And what we want to do is
23 restructure the market or to do things at the State
24 level, like they are doing in Connecticut and they
25 are talking about in Maryland, they are doing it in

1 Delaware, in a way that will help bring that into
2 balance so that we could put pressure on to give the
3 right incentives to the new generators without
4 overcompensating the existing generators who already
5 recovered all those stranded costs.

6 CHAIRMAN GEORGE: But again, wasn't the
7 excessive pricing supposedly to help with the
8 creation of additional facilities for the generation
9 of power, and that is why these guys have been going
10 into 1-year contracts rather than 2 and 3, even when
11 the price was acceptable. That is why we got higher
12 pricing today.

13 MR. POPOWSKY: Yes. I would agree that the
14 reliance on the short-term prices and the pressure to
15 go to these short-term prices I think increases rates
16 rather than reduces them.

17 CHAIRMAN GEORGE: I thank you very much for
18 your testimony. Thank you very much.

19 MR. POPOWSKY: Thank you.

20 CHAIRMAN GEORGE: And to put this all in
21 the proper perspective, I am pleased to offer to
22 those here today the next testifier, which will be
23 Tyrone Christy, the Vice Chairman of the
24 Public Utility Commission.

25 Welcome, Mr. Commissioner.

1 COMMISSIONER CHRISTY: Thank you,
2 Chairman George and Chairman Hutchinson and members
3 of the committee. I very much appreciate the
4 opportunity to be here today.

5 And at the outset, let me state that the
6 testimony that I'm about to present today represents
7 my views and not necessarily those of the Commission.

8 Before I get into my presentation, I just
9 want to hit on one of the hot topics that was just
10 being discussed.

11 In my viewpoint, one of the benefits of
12 having a power agency is the ability to be able to
13 issue a long-term contract so that private industry
14 can build these facilities and build them under
15 performance-based contracts.

16 We did this in 1985, and it was the first
17 wave of how we broke the monopoly and introduced real
18 deregulation in the marketplace. We simply issued a
19 long-term contract, and developers went out and
20 raised the money on their own. They developed the
21 plants, they built the plants, they operated the
22 plants, and they only get paid when they produce
23 power.

24 And it would be my hope that a power agency
25 would develop those similar types of provisions, that

1 we would make sure that we're issuing long-term
2 contracts and we're shifting the risk to third
3 parties under performance-based contracts, because
4 I think the market is very capable of handling
5 that.

6 I have a fairly long presentation, so I'm
7 going to just jump into it real quick.

8 I want to step back and take a look at where
9 we were in 1996 and 1997. And if you look on page 3,
10 these are some of the projections of where the energy
11 market would be in 2010 and beyond. And as you note
12 here, the rate was projected to be \$31 per
13 megawatt-hour and 3.1 cents a kilowatt-hour.

14 There were other projections that were made
15 at the time as well. One Commissioner at the time
16 had his numbers in the 3.9- to 4-cent range.

17 Now, we know those numbers haven't quite
18 worked out. If you look at the PPL default service
19 rate today for residential customers, it's over
20 10 cents a kilowatt-hour.

21 If you back out some gross receipts tax and
22 also maybe back out some rounding for ancillary
23 services, maybe you get down in the 8 1/2-, 9-cent
24 range. But still, it's a tripling of where we
25 thought the prices were going to be.

1 On page 4, I wanted to show everyone what
2 Pennsylvania was facing in June of 2008 when the
3 economy was running at full speed, before we ran into
4 the recession. And what this table reflects is where
5 the rates would have gone in Pennsylvania based upon
6 market prices that existed at that time.

7 So if the caps were to be lifted at that
8 moment and we replaced it with market prices, these
9 were the rates that would have resulted for
10 Pennsylvania consumers. And it basically worked out
11 to be about an 89-percent increase across the board
12 in Pennsylvania.

13 On page 5, what I tried to do here is to
14 break that down, that 89-percent increase, into
15 dollar terms and what that would have meant to
16 Pennsylvania. And the bottom line is that it had
17 a potential impact of over \$12 billion to
18 consumers. And again, to put that into perspective,
19 that is almost half of the entire Pennsylvania
20 budget.

21 Now, the good news, as we go to page 6, is
22 that the economy is in terrible shape, power demand
23 is down, and gas prices have fallen. And so today,
24 if we look at where the rates are, I think we have a
25 much more favorable picture.

1 But still, if you take the rates today,
2 looking at, say, January 2010, we're looking at a
3 20-, 22-percent increase across the board in
4 Pennsylvania.

5 I think the important thing to note here is
6 that we have a very volatile situation in power
7 prices now, and my concern is that the mechanics of
8 how those prices were looking in June of 2008, those
9 mechanics, they have not gone away, they still exist,
10 and I think we need to pay attention to that.

11 On page, I guess that is page 7, even though
12 we have good news for -- and I hate to say "good
13 news." Power prices are up, but they are not as bad
14 as June 2008. But even in today's depressed economy,
15 if you take a look at what the rates are looking like
16 for the really large users of power, it is not a
17 pretty scene. These are the Alcoas of the world, the
18 AK Steels.

19 What really hurts these guys is, the energy
20 costs are a very, very big part of their operating
21 costs, and what this chart reflects is the increases
22 that these large users of power are expected to see
23 when rate caps come off.

24 And if we could just take one or two as an
25 example, West Penn, which is where AK Steel is

1 located, if the caps were to come off today, they
2 could be looking at an 86.4-percent increase. And if
3 they're already paying \$40 million for power, well,
4 that's, you know, a \$70, \$75 million increase.

5 This is a big concern of mine. For these
6 large industrials, they are not like Walmart where
7 energy prices might be 1 or 2 percent of their
8 operating costs and their competition is the Target
9 down the street. These are industrials that energy
10 is a big part of their operating costs, and they are
11 competing against energy prices in other States as
12 well as other production facilities that might be
13 located outside the country.

14 Page 8 is a chart just showing some of the
15 increases that I think we've all seen in various
16 press journals about the increases that have occurred
17 in Pennsylvania as well as a couple of other States.

18 Moving on to page 9, I thought this was an
19 important chart to show everyone. It's not just
20 Pennsylvania that is experiencing an increase in
21 prices. The rate of change in what we call choice
22 States or restructured States operating in an RTO
23 versus the rates with regulated States that are
24 operating in an RTO, the rate of increase is much
25 higher.

1 Prior to deregulation in this country, prior
2 to the Enron pushing the concept, the difference
3 between regulated and unregulated or choice and
4 regulated was about 2 cents. Now that difference has
5 grown to be about 4 cents. And I think it's
6 important to note that this chart includes
7 Pennsylvania rates -- our rates are still capped, so
8 our rates kind of bring down the prices for the
9 choice States.

10 There are many States that adopted
11 deregulation, but because of these movement in
12 prices, they have moved away from this type of
13 approach. Look at Virginia; look at Ohio; look at
14 Michigan, Montana, California. Illinois just formed
15 a power authority. Maryland, the Maryland Governor
16 is calling upon the PUC to order new plants to be
17 built.

18 So I'm not aware of any State that is
19 regulated that is saying, boy, I really like what is
20 going on in these deregulated States; I need to adopt
21 that kind of provision. So I think Pennsylvania is
22 increasingly becoming a unique State in its movement
23 down this particular path.

24 Page 10, I think, is a very good chart to
25 show how power rates look right in our own backyard.

1 If you look at Allegheny Power, they operate in
2 West Virginia, Maryland, and in Pennsylvania. And
3 West Virginia is regulated, Maryland is deregulated,
4 and Pennsylvania will soon be deregulated for the
5 West Penn power customers.

6 So what this chart shows is that in 1998 in
7 West Virginia, the rates were around 3 cents. Today,
8 they are under 4 cents. But look at where the rates
9 were for Maryland in 1998 and look at where they are
10 today, almost 7 cents a kilowatt-hour.

11 And again, if you look at Pennsylvania where
12 there's a large industrial like AK Steel, they are
13 just right around 4 cents. The rate projection
14 for them is to be somewhere over 7 cents a
15 kilowatt-hour.

16 So there's a dramatic difference looking at
17 one company that operates in three States right in
18 our backyard, the difference between regulated and
19 unregulated.

20 Page 11, if you could. So what has happened
21 here? Well, I think to understand where we are, you
22 have to really dig into the mechanics of how energy
23 is priced in this new market and how it is supplied
24 to customers, and there really are two components to
25 this.

1 The first component is the wholesale market,
2 and as I note here, the market has changed
3 dramatically from the way the market was structured
4 in 1996.

5 And then number two, we have to take a look
6 at how the default service works. And at the PUC, we
7 have been relying upon the full-requirements approach
8 versus an active portfolio managed approach for
9 default service, and I think that has added some risk
10 premium that makes prices a little bit higher.

11 Page 12, to hit a couple of points on the
12 wholesale power market. We now have what is called
13 the Single Market Clearing Price. This is where
14 basically if you have a load of 10,000 megawatts --
15 or excuse me; a load of 9,999 megawatts using coal
16 and then you add 1 more megawatt needed to round out
17 the demand and it's natural gas, well, everybody gets
18 natural gas prices.

19 And in Pennsylvania, this doesn't quite work
20 to our advantage, because over 90 percent of our
21 energy comes from coal and nuclear facilities, yet
22 natural-gas-fired generation is on the margin
23 approximately 20 percent of the time.

24 A good graphical chart showing this impact
25 is on page 13. And I would note at the bottom there,

1 this is with one of our utilities in Pennsylvania,
2 one of the unregulated affiliates of a Pennsylvania
3 utility, PPL.

4 In 2007, the cost of over 94 percent of
5 their generation was \$16 per megawatt-hour. That is
6 1.6 cents a kilowatt-hour. But since these units
7 benefit from the Single Market Clearing Price, they
8 receive many, many multiples on top of this
9 particular cost-based number.

10 Now, this Single Market Clearing Price did
11 not exist in 1996. It was primarily a cost-based
12 exchange, where you look at somebody who was long
13 power, you look at his cost, and then somebody with
14 short power, you look at his next incremental cost.
15 You would split the difference, and that is how the
16 market used to work.

17 There is another component on page 14 where
18 this starts that is related to the wholesale power
19 market, and that's the capacity costs. And before I
20 get into that, I just wanted to show that in
21 Pennsylvania, we have spent nearly \$12 billion on
22 stranded costs to pay for the cost of the generation
23 that was determined to be uneconomical.

24 So we have basically paid off what was
25 determined to be uneconomical. But if you turn to

1 page 15, just when you thought the mortgage was paid
2 off, it doesn't go away.

3 PJM has a capacity cost formula -- it is
4 called RPM -- and Sonny Popowsky touched a little bit
5 on that particular provision. But it works very
6 similar to the Single Market Clearing Price. But
7 Pennsylvania is being basically hit with additional
8 capacity costs now, and it reached over \$2 billion in
9 the year 2009 and 2010.

10 Now, we are still paying stranded costs, but
11 we're also paying these capacity costs on top of it
12 under the roles that have been set up within PJM.

13 The other part of the mechanics of how our
14 rates are affected is related to what we do on
15 default service, and there are basically two
16 approaches.

17 And we have been relying primarily on the
18 first approach, and that is called the
19 full-requirements approach. This is where a bidder
20 is required to bid fixed prices 1 to 2 years in
21 advance and accept responsibility for unknown level
22 of customer demand.

23 What this does, in my opinion, is it adds a
24 substantial risk premium to the product. We don't do
25 this in natural gas. We don't ask gas suppliers to

1 give us a fixed price 2 years in advance and meet an
2 unknown level of demand. If we did, our gas prices
3 would be through the ceiling.

4 The other approach, which I greatly prefer,
5 is the active portfolio management. That's where you
6 would use defined block purchases so suppliers knew
7 exactly what they were bidding on -- a 24 by 7
8 product, as an example, say 50 megawatts in this
9 particular year, and then you layer spot market
10 purchases on top of it to round out the consumer
11 loads. This greatly reduces the supplier risk and,
12 at the end of the day, greatly reduces the prices to
13 consumers.

14 And a good chart to show this is on page 17.
15 This is a chart showing PPL, which we use the
16 full-requirements approach in order to get the most
17 recent default service program for our consumers.
18 And as I mentioned, the numbers are just over
19 10 cents a kilowatt-hour.

20 But take a look at Citizens and Wellsboro.
21 These are two tiny little utilities. Their default
22 service prices are in the 7- to 8-cent range, and
23 Citizens and Wellsboro use the active portfolio
24 management approach. Now, those numbers are, what,
25 20, 30 percent less than PPL's default service price.

1 Now, the interesting thing to note here is
2 that the default prices for Citizens/Wellsboro are so
3 attractive that I think we have little, if any,
4 shopping. But with PPL, since we have these higher
5 rates, which in my opinion are artificially high, it
6 is easy for people to shop to go get a 10-percent
7 discount.

8 And so what concerns me at times is that
9 proponents of retail choice will point to PPL and
10 say, wow, look how successful we are; look how many
11 suppliers we are, and you can get a discount off of
12 that 10-percent rate.

13 Well, to me, the measure of successful
14 competition is not how many people shop, but are
15 consumers getting the lowest possible rate, and I
16 think we need to be looking at more of the active
17 portfolio management.

18 Page 18. You know, as I mentioned, the
19 owners of generation are receiving, in some cases,
20 many multiples of their actual cost of generation,
21 and it doesn't take a lot to realize who is making
22 the money in this market.

23 And CMU out of Pittsburgh has done a lot of
24 different studies in this regard, and their main
25 conclusion is that "restructuring has been beneficial

1 to companies that restructured, but the benefits have
2 not reached consumers."

3 And, you know, as I look at it, because of
4 the new market design, the power plants that we
5 determined have little value in 1996 are now worth
6 many billions more, and this value is now in the
7 hands of private companies and unregulated
8 affiliates of our electric distribution companies,
9 even though Pennsylvania ratepayers fully paid for
10 these plants.

11 One of the best examples, I think, is
12 Three Mile Island, which was sold for or was valued
13 at \$23 million -- not \$23 billion but \$23 million.
14 And so now as we have to buy power from the market,
15 the value of that power is much higher than based
16 upon \$23 million.

17 Page 19. I would like to hit just some of
18 the common myths and misconceptions of the benefits
19 of competition.

20 I think we're not being fair by considering
21 that in some of the cases with the utilities, that
22 rates were at their peak in 1996 because of the
23 nuclear build-out program.

24 And I think it is fair to say that you can
25 make an argument that rates would have declined under

1 regulation as the generation plants depreciated.

2 It's like once you pay off your mortgage --
3 I just paid mine off last week. I went from \$1,200 a
4 month; now I'm down to \$300. And you pay off your
5 plant and you would hope that you would get lower
6 prices.

7 And the reason you build nuclear power
8 plants is they are expensive. These are
9 multibillion-dollar plants, and you build them for
10 the long-term benefit of getting low-cost energy
11 supply.

12 And I think if we take a look at Duquesne
13 Light as an example, the rates were headed down on
14 their own, because over time the depreciation would
15 have kicked in and it is very possible that consumers
16 would have had much lower rates.

17 Probably the biggest concern I have with the
18 Competition Act is that EDCs are no longer able to
19 offer meaningful industrial economic incentive rates
20 as a tool to attract and retain industry in
21 Pennsylvania. This inability to offer special
22 economic development rates puts Pennsylvania at a
23 competitive disadvantage to the regulated States that
24 aggressively use this tool to lure businesses into
25 their States.

1 So whether you like deregulation or you hate
2 it, the reality is that that special economic tool is
3 no longer available to us, and I think we need to
4 find ways to solve that problem.

5 I think we have also got to recognize that
6 consumers now are exposed to a heightened level of
7 volatility, and I think we also need to be honest
8 about what's the true measure of success of
9 competition. Is it how many marketers exist or how
10 many people shop, but is it maybe more of how many
11 customers are getting lower rates and more stable
12 rates?

13 Finally, I guess I'll talk about the reason
14 I'm here -- why a Commonwealth Power Agency?

15 You know, we talked about the need to issue
16 long-term contracts. People are not going to build a
17 new nuclear power plant without a long-term contract.
18 They are not going to build a new coal-fired plant
19 without a long-term contract.

20 As Larry Kellerman of Goldman Sachs, they
21 run some energy companies, and I would like to just
22 repeat one of his quotes here:

23 "Lack of forward visibility of capacity
24 values and revenue streams makes the financing of any
25 new merchant project both challenging and more

1 expensive, if not impossible in a capital raising
2 environment such as the one we are in."

3 As I mentioned, in 1985 we realized that if
4 we wanted to get private companies to build projects,
5 they needed the long-term contract, and we have got
6 some wonderful facilities operating in Pennsylvania
7 as a result.

8 The other thing that I might mention from
9 Goldman Sachs and from Mr. Kellerman was in a private
10 conversation he indicated to me that, you know, for a
11 State to simply rely upon this wholesale power market
12 for just and reasonable rates, he goes, you're just
13 setting yourself up for some disappointment, and
14 certainly at a minimum, some real volatility.

15 So again, why a Commonwealth Power Agency?
16 Well, I think a power agency can issue those
17 competitive solicitations such as RFPs for third
18 parties to build and operate new facilities under
19 performance-based contracts where risk is shifted to
20 third parties.

21 With long-term contracts, better pricing is
22 available because of lower interest rates and less
23 equity needed to finance the projects.
24 Capital-intensive facilities with low-running energy
25 costs can once again get built.

1 And I would like to just point out one other
2 aspect of why I think this is reasonable.

3 You know, just last week at the Commission,
4 we voted -- I was in the minority -- but we voted to
5 approve a \$1.2 billion transmission line. This was a
6 line that was determined to be needed by PJM. And so
7 now an exclusive contract is given to a utility to
8 build it on a cost-of-return basis with a premium
9 return on the equity because a need was determined
10 for this particular transmission line.

11 But here, I think what we're talking about
12 in this power agency is looking at that same need but
13 actually conducting competitive solicitations to let
14 third parties build these power plants under
15 performance-based contracts. I think that's a good
16 model to meet consumer needs to help drive power
17 prices down.

18 But I would be more than happy to answer any
19 questions. I have thrown a lot of material at you, a
20 lot of charts and graphs. So I'll just keep quiet
21 now and listen to the questions. Thank you.

22 CHAIRMAN GEORGE: The gentleman,
23 Mr. Wansacz.

24 REPRESENTATIVE WANSACZ: Thank you,
25 Chairman George.

1 And thank you for your testimony.

2 I'm just getting a little bit confused about
3 everything that is going on, so I hope you could
4 clarify this a little bit.

5 Currently, it's my assumption that
6 Pennsylvania power plants already produced more
7 energy than we currently have demand in Pennsylvania.
8 Am I correct with that?

9 COMMISSIONER CHRISTY: I think that's
10 generally correct. I think we export about
11 30 percent. We export 30-percent power to other
12 States, yes.

13 REPRESENTATIVE WANSACZ: A concern that I
14 have is we keep talking about building these new
15 energy plants as a possible solution. But you
16 mention here, and it has always been under my
17 assumption and you do mention that a company that is
18 the most inefficient drives up the cost, and that is
19 what we end up paying anyway.

20 So if we do nothing to address these
21 companies that are inefficient, are we ever going to,
22 even if we build new efficient power plants, we are
23 still going to be paying the higher rate. Am I
24 correct?

25 COMMISSIONER CHRISTY: Yes. Yes, you are.

1 There's a, and I don't blame the generation
2 community, but there is just not a real incentive for
3 them to go out and build another new efficient
4 generating unit beside one of their existing units.

5 When you do that, you cannibalize your
6 pricing, and I think that is the challenge that we
7 have as regulators, how do we balance making sure
8 that everybody gets enough rates to be profitable at
9 their generation plant but at the same time provide
10 stability for consumers with the next level of power
11 generation facilities.

12 REPRESENTATIVE WANSACZ: And I agree. So
13 what can we do that would say to these companies that
14 are inefficient -- maybe they're not even in
15 Pennsylvania, because we're buying off the grid,
16 correct? They could be in other States?

17 COMMISSIONER CHRISTY: Yeah. The PJM grid
18 covers multiple States, so it looks at the most
19 expensive unit running, regardless of which State
20 that it's in.

21 REPRESENTATIVE WANSACZ: So I'm saying, is
22 that really looking -- I'm trying to look at this and
23 solve the problem. I'm in the PPL territory where
24 the rates have gone up, and I understand that people
25 are concerned about this. And, you know, even though

1 it's 10 percent less when you go to somebody else,
2 you are still talking a 20-percent rate increase.

3 Is it our responsibility or is it the
4 Federal responsibility on the PJM to say that they
5 must do something to either change the rules so that
6 we can maybe bid more competitively or make these
7 power plants that are not, that are, as you said,
8 being cash cows, so to speak -- they are not making
9 any improvements, because why would they; they are
10 making money.

11 COMMISSIONER CHRISTY: The---

12 REPRESENTATIVE WANSACZ: What do we do, what
13 do we do to change that atmosphere?

14 COMMISSIONER CHRISTY: Right.

15 REPRESENTATIVE WANSACZ: Because no matter
16 what we do, we can build the most efficient power
17 plant tomorrow, and we're still going to be paying
18 the highest rate of the most inefficient plant.

19 COMMISSIONER CHRISTY: You know, I certainly
20 have proposed, as I'll call it, the 10-run Little
21 League mercy rule, that when gas separates from coal,
22 and so when you have a coal-fired unit, it is running
23 at 2 cents, and now gas goes up to 10, at what point
24 is it reasonable to ask that coal-fired plant to have
25 something less than 10 cents a kilowatt-hour? Can't

1 we put some kind of cap on it to control it?

2 But in the existing framework of the makeup
3 of the Federal Energy Regulatory Commission, I just
4 don't think that that kind of a solution is going to
5 be acceptable. And so with a Pennsylvania Power
6 Agency, this is an agency that is designed to try to
7 compete with that framework, to try to build the next
8 most efficient unit and place it in a right location
9 within the PJM grid to help minimize those big price
10 increases that might occur by running those
11 inefficient power plants.

12 You try to bring more efficient units; you
13 try to get the efficient units off of the margin to
14 drive down prices for everyone.

15 REPRESENTATIVE WANSACZ: Thank you.

16 COMMISSIONER CHRISTY: Thank you.

17 REPRESENTATIVE WANSACZ: Thank you,
18 Mr. Chairman.

19 CHAIRMAN GEORGE: Has the gentleman
20 concluded? I thank the gentleman.

21 Mr. Barbin.

22 REPRESENTATIVE BARBIN: Thank you,
23 Mr. Chairman.

24 And thank you, Commissioner Christy, for
25 your testimony today.

1 The thing that seems to me to be the issue
2 people really want to know how we are going to do
3 something about it in the Legislature is, how do we
4 affect the default rates when the rate caps go off,
5 and how do we help the industrial customers that no
6 longer can have a specialized rate? How do we help
7 those people under existing law?

8 You know, is it possible under existing law
9 to provide an industrial customer such as AK Steel
10 with a beneficial rate that other regulated States
11 can provide? Can we do that under existing law?

12 COMMISSIONER CHRISTY: No. Under the
13 Lloyd decision, cross-subsidization is no longer
14 possible.

15 And again, I think this goes to my point,
16 that whether you like deregulation or you hate it,
17 the reality is that we don't have that special
18 economic tool available to us anymore to help keep
19 industry in Pennsylvania, let alone to try to attract
20 industry to Pennsylvania.

21 And there is no simple solution here, unless
22 someone has an interesting idea other than a power
23 agency to be a new entity to try to aggregate new
24 sources and spread that power at cost to entities
25 like the industrials, the residential, and the

1 commercial customers on an equal basis to help
2 stabilize their power prices.

3 REPRESENTATIVE BARBIN: All right.

4 And it would be fair then to say that the
5 same thing applies to residential customers. Under
6 current law, the PUC cannot order active portfolio
7 management as a way of reducing the residential rate
8 increases that are happening because the rate caps
9 are coming off. Is that true?

10 COMMISSIONER CHRISTY: Well, I think we
11 could, and we have certainly blessed the
12 Citizens/Wellsboro approach. But we need to---

13 REPRESENTATIVE BARBIN: No; I mean under
14 existing law, are you able as the PUC to order active
15 portfolio management so that the residential rate
16 increases that have occurred with PPL and will occur
17 in the west, where I'm from, next year, is there
18 anything today you can do without a Pennsylvania
19 Power Authority to reduce those rate increases?

20 COMMISSIONER CHRISTY: No. The
21 solicitations have already taken place, and for the
22 most part, we have adopted the full-requirements
23 approach.

24 But in the future, if we wanted, if we had
25 the willpower, I think we could do this under

1 Act 129. I think we could do it under Act 129.

2 REPRESENTATIVE BARBIN: Okay.

3 And would it be a good idea to consider, you
4 know, one of the things that had been suggested by
5 the utilities themselves, which is to look at
6 municipal aggregation, which would allow
7 municipalities by contract to purchase in bulk,
8 thereby allowing their residents to get a bulk rate
9 as opposed to, you know, an individual rate?

10 COMMISSIONER CHRISTY: I think it's a
11 possibility that they may get better rates by buying
12 in bulk under an aggregation approach, but that
13 remains to be seen. It depends who they contract
14 for, that third party, what kind of profit markup.
15 But it's a possibility, yes.

16 REPRESENTATIVE BARBIN: Thank you for your
17 testimony.

18 Thank you, Mr. Chairman. I am concluded.

19 CHAIRMAN GEORGE: The Chair thanks the
20 gentleman.

21 Are there any other questions?

22 The gentleman, Mr. Hutchinson.

23 REPRESENTATIVE HUTCHINSON: Thank you.

24 I just wanted to go to something you
25 mentioned a couple of times about the ability or the

1 power of Pennsylvania to use lower electric rates in
2 targeted instances as an economic development tool.
3 And I guess the thing that worries me, and this came
4 up a little bit earlier with some of the previous
5 questioning, and that is, you know, we heard an
6 example today of, I think you said Georgia that had
7 an astoundingly low rate for a new plant to be built
8 there.

9 If Pennsylvania were in the position to do
10 something like that, why would that be fair to
11 subsidize a new company to come to Pennsylvania when
12 you have existing customers, already huge users, that
13 would be a direct competitor for them, and meanwhile,
14 the new competitor gets these obscenely low rates and
15 the existing person, existing company, their
16 competitor, has to pay higher rates?

17 There's a basic unfairness there, and I
18 don't know how you resolve that, you know, if you're
19 helping one competitor over another with their
20 electric rates.

21 COMMISSIONER CHRISTY: You know, that's a
22 very valid point that you make. And one aspect of
23 the power agency that I like is that all the entities
24 that opt in to it, they all get equal access to that
25 power that is acquired, and it's delivered to those

1 customers at cost.

2 So anybody that wants in will get the same
3 power price, whether you're industrial, commercial,
4 or residential. So I think the agency takes care of
5 that situation.

6 But I think I could also make the argument
7 -- and this is just me personally speaking. You
8 know, I'm from Butler, and the sting of watching a
9 Pullman-Standard close down in the early 1980s, with
10 2,000 jobs being lost and families being decimated --
11 the business community just was really, really hurt
12 -- I probably would vote to pay a little bit higher
13 in my residential bill if I could keep the jobs in my
14 community. But that's just me personally, and I
15 understand the fairness issue.

16 But I think the agency does take care of
17 that issue by making it a level that everyone gets
18 the power at the same cost.

19 REPRESENTATIVE HUTCHINSON: But to take it a
20 step further, just on the industrial side, the
21 authority offers this very low rate to woo a new
22 industrial customer. Other competitor-type companies
23 say, yeah, we want that rate, too, which you say
24 would happen. They take that rate. The new company
25 never really gets off the ground, and meanwhile, the

1 old company is locked into those very low rates
2 forever. Who is going to make up the difference?

3 Because essentially the power that, you
4 know, the bulk amount that probably made that
5 somewhat possible is no longer going to be bought
6 because the new person never got off the ground, and
7 meanwhile, I guess you could even say it could be
8 used as a bait-and-switch thing. How do you stop
9 that?

10 COMMISSIONER CHRISTY: Yeah. I guess, let's
11 just take a hypothetical that the power authority
12 signs a contract with XYZ supplier for 4 cents a
13 kilowatt-hour. It would make that 4-cent power
14 available to everybody who is part of the power
15 agency. There would be no discrimination amongst the
16 industrials, no discrimination to residential or
17 commercial. And if there was a new entity that came
18 to Pennsylvania saying, I am building my facility and
19 I would like to be part of this procurement, they
20 would be in. And then if they left, the remaining
21 members would be the ones that would be able to get
22 that cheap power at that point in time.

23 I think that is how it would work.

24 REPRESENTATIVE HUTCHINSON: But economically
25 it wouldn't work if the authority in itself, you

1 know, contracted for buying X kilowatt-hours and
2 meanwhile those were never used. So somebody is
3 going to have to pick up the bag, I guess, for a
4 large customer that didn't materialize. That is what
5 I'm saying. And how does that get resolved?

6 COMMISSIONER CHRISTY: I guess if the power
7 agency bought power at 10 cents and the market moved
8 down to 5, I think the remaining people that are in
9 that procurement program would have to eat that
10 difference as part of the power agency.

11 REPRESENTATIVE HUTCHINSON: Thank you.

12 CHAIRMAN GEORGE: I'm going to recognize one
13 more witness. It will be Mr. Kessler. But I am
14 going to ask to jump ahead of him, because I wouldn't
15 want to miss this opportunity of, in a nice way,
16 challenging my colleague and Co-Chairman in that he
17 is worried about some new company that we would help,
18 and my concern is just opposite in that every
19 company that existed at the time of deregulation, you
20 know better than both of us, benefited by the lowest
21 one receiving about \$500 million in stranded costs,
22 and one of them as much as \$3 billion in stranded
23 costs.

24 And if we were to look into the matter of
25 why, and with the PJM and the pricing where one

1 company can buy it at so much and then another
2 company 2 months later has to pay so much more and
3 yet another company a little later so much more,
4 in the end, they all get the same amount, do they
5 not?

6 COMMISSIONER CHRISTY: I believe so.

7 CHAIRMAN GEORGE: They certainly do. So I
8 would like to really challenge and someday at a
9 better time say, what are we trying to do?

10 A minute ago someone said should the State
11 have anything to do with this organization of an
12 entity. It was the State that caused the problem
13 that we have now.

14 For example, under the Competition Act, the
15 utility generation was either sold or transferred to
16 unregulated affiliates, was it not?

17 COMMISSIONER CHRISTY: I would say for the
18 most part, it was transferred to unregulated
19 affiliates. There were a couple of utilities that
20 actually sold off their generation. But there were
21 definitely some that kept the generation an
22 unregulated affiliate.

23 CHAIRMAN GEORGE: And there haven't been
24 any plants built in Pennsylvania since 1998, have
25 there?

1 COMMISSIONER CHRISTY: There have been some
2 gas plants built.

3 CHAIRMAN GEORGE: Yes.

4 COMMISSIONER CHRISTY: But that was early on
5 in the deregulation mania.

6 But since the early part of 2000, we have
7 had some wind, but that is driven primarily by
8 government tax credits as well as Alternative
9 Energy Portfolio Standard credits. We have had
10 maybe, I think, about 400 megawatts onward to
11 700 megawatts.

12 But to my knowledge, we have only had one
13 baseload power plant built. That was the Seward
14 waste coal plant that came into operation---

15 CHAIRMAN GEORGE: Well, sir, that was an
16 existing facility that was operating with plain coal
17 instead of used coal.

18 COMMISSIONER CHRISTY: That was, I believe,
19 a retrofit addition to the Seward Power Plant.

20 CHAIRMAN GEORGE: Now I'll turn to the
21 gentleman, Mr. Kessler, for a final question.

22 REPRESENTATIVE KESSLER: Thank you.

23 In almost any business, in order for
24 consumers to buy bulk, you need competition. Would
25 you say there's enough competition in this industry

1 to create bulk buying?

2 COMMISSIONER CHRISTY: I think the short
3 answer is no, because I don't believe that we have
4 the right elements of a competitive market with the
5 Single Market Clearing Price being a pricing
6 mechanism where generators basically can just sit
7 back in just knowing that there's some more expensive
8 unit out there that is going to set the price for
9 them.

10 It's not like they compete against each
11 other. So in that sense, I don't believe that we
12 have the full realm of competition.

13 REPRESENTATIVE KESSLER: Thank you.

14 COMMISSIONER CHRISTY: Thank you.

15 CHAIRMAN GEORGE: If the gentleman has
16 concluded, let me say that I'm very grateful to you;
17 the gentleman, Mr. Landis; the gentleman, Mr. Etsler;
18 and the gentleman, Mr. Popowsky, for coming before
19 this committee.

20 I'm most grateful for those of you that
21 share our interest, and my gratitude to these
22 members. I'm very proud of this committee and its
23 members.

24 Regardless of what our position
25 philosophically may be, we try to get to the bottom

1 of all of this, and we are going to continue and
2 press forward so that the consumer and the business
3 facilities that are encouraged to pull out of
4 Pennsylvania stay in Pennsylvania where they are
5 needed.

6 So without any further ado, I thank all of
7 you.

8 We have a pamphlet, the "*Failed Experiment*."
9 If you don't have it, get your copy. It's redundant,
10 but it's the only thing I have ever written, so that
11 is why I want you to have it.

12 (For pamphlet, see attached.)

13 CHAIRMAN GEORGE: If there is no other
14 business before this committee, this committee stands
15 adjourned.

16

17 (The hearing concluded at 3:20 p.m.)

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1 I hereby certify that the proceedings and
2 evidence are contained fully and accurately in the
3 notes taken by me on the within proceedings and that
4 this is a correct transcript of the same.

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Debra B. Miller, Reporter

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FAILED EXPERIMENT:

**Deregulated Electric Market, Its Problems, and Why We Need the
Commonwealth Energy Procurement and Development Agency
(HB 1909)**

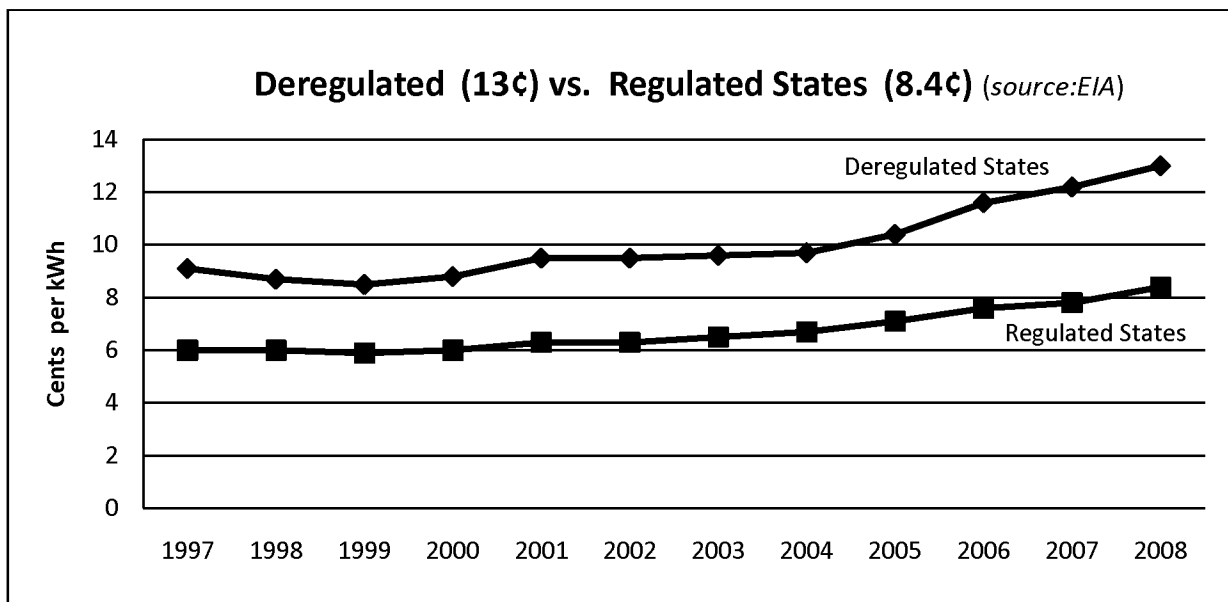


**A REPORT BY CHAIRMAN CAMILLE "BUD" GEORGE
HOUSE ENVIRONMENTAL RESOURCES AND ENERGY COMMITTEE**

DEREGULATION IN PENNSYLVANIA

In 1996 Pennsylvania enacted the Electricity Generation Customer Choice and Competition Act, which deregulated electricity generation. The premise was that customers should be able to choose their generation supplier and that competition among generators would lower prices. Generation costs comprise 60% to 80% of consumers' utility bills. The Act allowed the utilities to recover stranded costs and required that the rates be capped during this recovery period.

In 2005, the rate caps for the Pike County Light & Power Company expired. The result of the auction to provide supply to retail customers showed a shocking increase of 129% in generation rates and 79% in overall rates. The rate caps for most of the utilities (PPL, PECO, Allegheny, Met Ed, Penelec) expire in 2010 and 2011. Although the current severe down-turn in the economy may dampen the rise in post-rate cap prices, Pennsylvania must brace itself for significant rate hikes once the economy recovers. Efforts to extend the rate caps have failed.

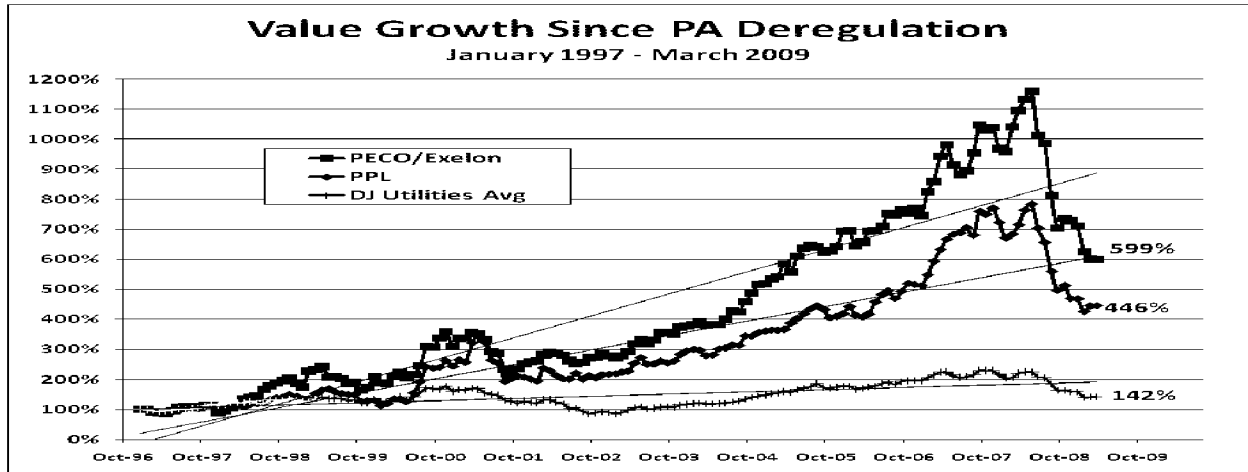


The last decade has shown that deregulation of the generation market has failed. Despite the promise of lower prices, the average rates for deregulated states are 54% higher than the rates for regulated states. A 1¢ per kWh increase in rates means \$5 million to \$10 million in annual operating costs for a Pennsylvania steel manufacturer; the impact on larger manufacturers may be even greater. A 1¢ increase also represents \$1.5 billion in costs to Pennsylvania consumers.

[Note: The wholesale market for power trades and auctions in Pennsylvania is operated by a not-for-profit entity called the PJM Interconnection, a Regional Transmission Organization that serves 12 states and the District of Columbia. PJM is regulated by the Federal Energy Regulatory Commission. Rates for transmission and distribution remain regulated.]

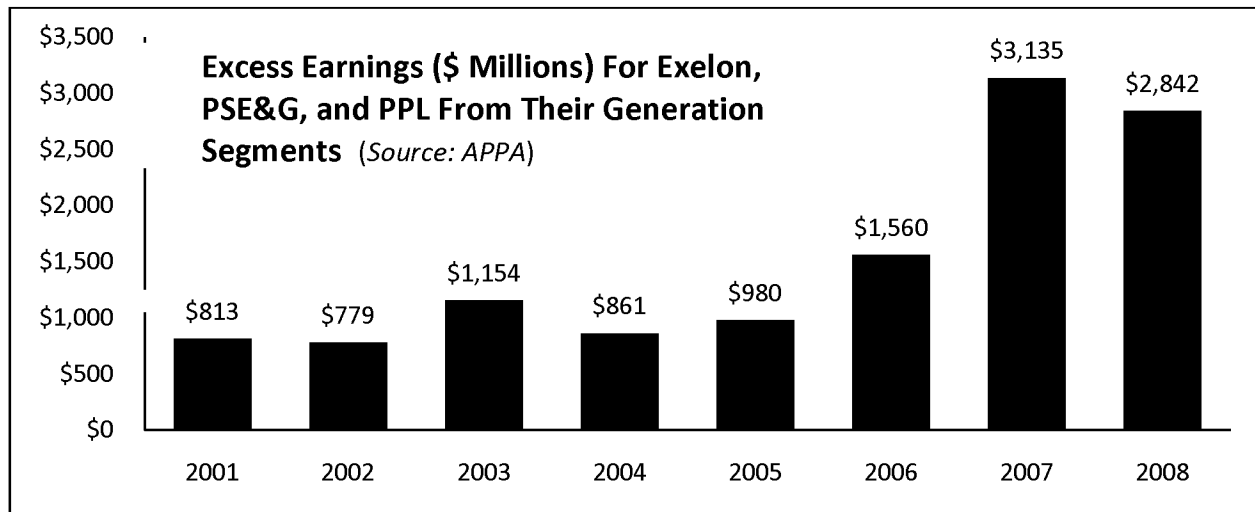
A WINDFALL FOR A FEW POWER COMPANIES

Not surprisingly, profits of the utilities with generation affiliates soared. PPL's stock value (taking into account stock splits and dividends) rose nearly 800% from 1998 to 2008; for PECO, nearly 1150%. In comparison, Dow Jones Avg. for Utilities increased about 225% for the period.



(Source: IECPA)

According to a study by the American Public Power Association, from 2001 to 2008, the return on equity by the generation segments of Exelon, PSE&G and PPL in the PJM territory (the wholesale market covering Pennsylvania) exceeded the return on equity by the regulated generation companies by a total of 12.1 billion dollars. Of those \$12 billion, about \$6 billion were generated between 2007 to 2008 by those three companies' generators. The \$12.1 billion in excess earnings translate to about \$20 billion in cost (accounting for tax) to consumers and represent millions of dollars in compensation to the company executives.



THE FLAWED MARKET

Deregulation has been bad for consumers, and no regulated states are following the path of deregulation. The wholesale market governing Pennsylvania is dominated by a few large utilities and Wall Street traders. Poorly regulated by the federal government, the market uses pricing schemes that shock the conscience. For example, in a pricing scheme called "single market clearing price," the price is set by the *highest* price bid by the most expensive--typically natural gas--generation that is necessary to meet the demand. This means that the least efficient generating unit sets the price, and all other generating units get paid the price that the least efficient unit bid, rather than their actual bids. Although 93% of power in Pennsylvania comes from cheap coal and nuclear generation, natural gas sets the clearing price for all generation 25% of the time, resulting in a windfall for nuclear and coal-fired generating facilities.

"For example, assume that the system load is 10,000 MW, and 9,999 MW of low cost nuclear or coal-fired generation is offered at 2.5 cents per kWh. If 1 MW of gas-fired generation is needed to meet the full load of 10,000 at a bid price of 10 cents per kWh, then all bids would be paid the 10 cents even though 99.9% of the generation offered was bid at 2.5 cents." --PUC Vice Chair Tyrone Christy

This may be fair for a new power plant with high recovery costs, but it is highway robbery when it comes to the formerly regulated large utilities that now own plants that have already been paid for by ratepayers and bought by the utility affiliate for pennies on the dollar; under deregulation, Three Mile Island Unit 1, now worth about \$1.5 billion, was bought by a utility affiliate for a net price of \$25 million.

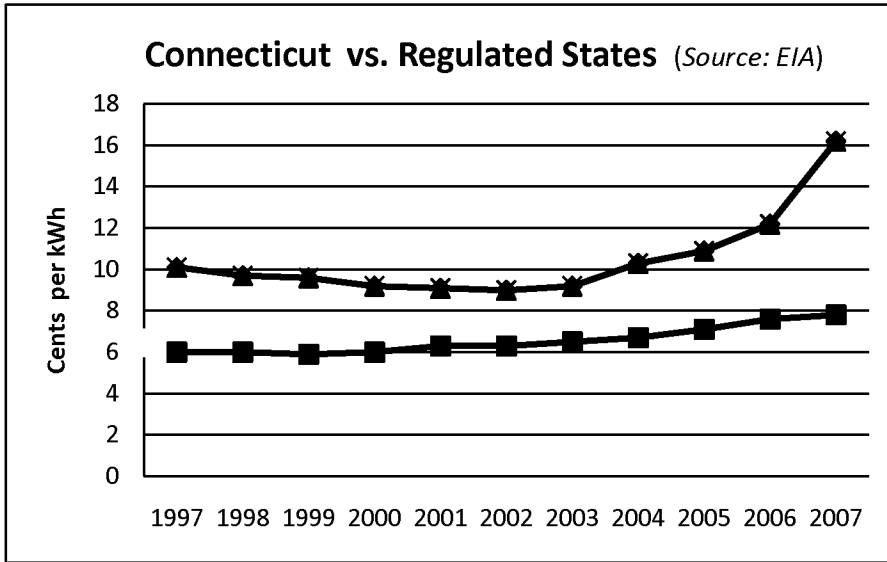
And what about the enormous capacity payments, called Reliability Pricing Model (RPM), imposed by PJM that are supposed to incentivize new base-load generation to ease congestion and to lower market prices, but failed to do so. PJM admits this failure to spur new baseload generation, but it claims that the failure is due to insufficient incentives, not the flawed scheme of RPM.

Generators owned by or affiliated with the six largest Pennsylvania utilities were paid over 3.5 billion dollars in capacity payments for years 2008 – 2010 as *incentives* to build new generation, but only 277 MW of low-cost baseload generation (nuclear, hydro, coal) are being built.

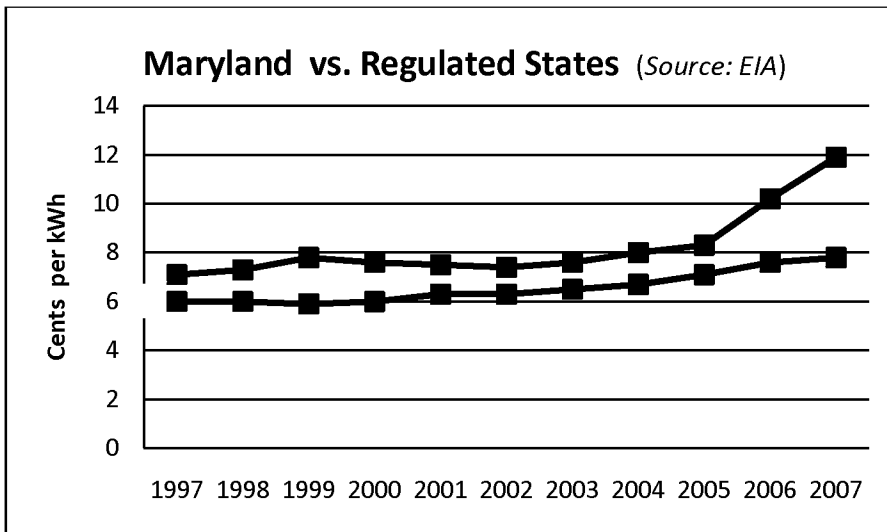
The capacity prices have risen from \$5.73 to \$111.93 per MW under the RPM scheme, which also correlates to the sharp increase in excess earnings by the power companies. These overpayments are outrageous, given that Pennsylvania produces more power than it needs, yet imports electricity from other states because its generators export 33% of the total output to other states.

WHAT AWAITS PENNSYLVANIA AFTER THE RATE CAPS: A Look at Our Neighbors

Other states with deregulated generation experienced great price shocks after the rate caps expired. Due to the severe recession, the rates in Pennsylvania may not immediately increase as drastically as feared upon expiration of the rate caps, but they will increase drastically--40% to 100% or more--once the economy recovers.



In 2006 generation rates in Connecticut increased by 25% to 72%. The Attorney General stated: "The conclusion is inescapable that electric deregulation has failed...." The governor called for a new Department of Energy that will take over policy making authority from the Department of Public Utility Control.



After the rate cap expiration in 2006, BG&E proposed a 72% rate increase for its customers in Maryland. Later that year, the governor lost re-election, and the board of public service commission overseeing the utilities was entirely replaced. Maryland is currently reviewing options for re-regulation.

In Delaware, rates increased 59% for residents after the rate caps expired. Occidental Chemical closed a major chlor-alkali facility in Delaware in November 2005, citing high electricity costs as the primary factor. Delaware is reviewing options to address the problem. New Jersey and New York have rates that are about 63% and 80%, respectively, higher than the average rates in the regulated states.

PENNSYLVANIA BUSINESSES AND JOBS ARE AT RISK

In the near future, Pennsylvania will face rate hikes that will shock the economy across all sectors, from our elderly citizens with fixed incomes and low-income residents to large manufacturers who provide desperately needed jobs.

Once the economy recovers, Pennsylvania must brace for post-cap rate hikes of 30% to 100% for residential customers, 40% to 120% for commercial customers, and 50% to 140% for industrial customers. Even with the recession and the historically low fuel costs, PPL's auctions for the year 2010 have shown an ominous 30% increase in rates.

In particular, electricity costs represent a significant portion of operating costs for many Pennsylvania manufacturers, as much as 70% in some cases. Pennsylvania Public Utility Commission Vice Chairman Christy testified that Signature Aluminum closed its plant in western Pennsylvania due in part to rising electricity costs and that AK Steel in Butler is reconsidering its expansion plan.

Alcoa closed its Maryland plant with 600 employees paying an average annual wage of \$55,000, solely due to electric rate increases. It is now deeply concerned about the impact of the increased rates in Pennsylvania for its Lancaster plant.

BOTTOM LINE: The current market structure endangers Pennsylvania businesses and jobs.

In July 2009, Pennsylvania lost about 500 factory jobs that came with the Carlisle Tire & Wheel to Tennessee, or more specifically, to the attractive electric rates offered by the Tennessee Valley Authority. Tennessee's offer trumped a \$6.9 million package in tax credits, loans and grants from Governor Rendell. Governor Rendell's spokesman said, "We don't have that same ability to offer [the attractive power costs that] Tennessee does".

Allegheny Power, along with 17 other generation companies in the deregulated state of Maryland, told the Alcoa plant in Maryland that it has to pay 350% more than the global average for electricity.

"We have facilities in 19 states around the country, and Pennsylvania has the highest power rates...." *Douglas Kittenbrink, Executive Vice President, Allegheny Technologies, in a press conference to announce its cancellation of its planned capital investments in Pennsylvania*

"Competition has not lowered U.S. industrial electricity prices" *Jay Apt, Carnegie Mellon Electricity Industry Center.*

A SOLUTION: HB 1909

THE COMMONWEALTH ENERGY PROCUREMENT AND DEVELOPMENT AGENCY

Because the wholesale market is under the federal jurisdiction, states' options are limited, but an independent public power agency can greatly mitigate some of the market flaws.

SINGLE MISSION:

To procure low-cost power for those Pennsylvania citizens who choose not to shop for power and for businesses that choose the Agency as the supplier.

TASKS:

1. Procure Electricity: The Agency would buy default supply for residents and businesses using a portfolio procurement approach; such an approach has allowed the Illinois Power Agency and the rural cooperatives in Pennsylvania to buy power cheaper than what the utilities offer.

2. Assist Private Development: The Agency could lower rates by helping to develop new plants through entering into long-term purchase agreements with private plant developers. Today the utilities refuse to enter into long-term contracts that are necessary for these developers to finance their construction because their generation affiliates make exorbitant profits from the short-term wholesale market and do not want competition in generation; in other words, abuse of market power.

3. Build or Acquire Generation: The agency could acquire or construct baseload generation, taking advantage of Pennsylvania's rich indigenous resources, and sell power to customers on a cost basis. The Agency could offer cheaper rates to manufacturers and businesses to attract and retain jobs in Pennsylvania. The construction would be financed by revenue bonds that would be backed solely by the Agency's revenue streams and assets. They

would not be backed by tax pledges or the full faith and credit of the Commonwealth.

OPERATION:

The Agency would be run by a five-member board, consisting of representatives from AARP, industrial energy users, farmers, the office of consumer advocate, and the office of small business advocate. The board would hire staff and consultants with expertise in energy procurement and development to accomplish its mission. The Agency would be financed by rebates from large generators formerly owned by the utilities based on the overpayments they continue to receive at the market.

IN COMPARISON:

1. Illinois Power Agency. After post-cap rate hikes stirred public outrage, Illinois sued the power companies for rebates and, as part of the settlement, established a non-profit public power procurement agency with the power to build new generation. Thus far, it has exercised only its power to procure supply from the wholesale market using a portfolio procurement approach. With only one staff and a team of consultants, IPA recently held an auction at which it procured power supply for all residential customers at rates that were 7.5% lower than the prior rates.

2. Connecticut Electric Authority. Following similar post-cap rate hikes and public outrage, the Connecticut House of Representatives overwhelmingly passed a measure establishing a state power authority with broad powers.

MYTHS AND FACTS

"...consumers in states with markets administered by RTOs [deregulated markets] continue to pay higher electric rates than consumers living in non-RTO [regulated] states. Fossil fuel costs, in particular natural gas costs, do not explain the differential between electricity prices in RTO and non-RTO states." 2008 report by McCullough Research

A presentation for PPL investors bluntly showed that its capacity profits could be increased by decreasing its capacity reserve margin. In short, generators have every incentive to create a congested market and to increase prices in order to reap higher capacity payments.

MYTH: Higher prices are due to the rise in fuel costs.

FACT: Fuel costs are not responsible for high prices.

The rise in fuel costs does not explain the higher costs, as there are several instances where natural gas costs and wholesale electricity prices have shown trends in opposite directions. Rather, these high prices are explained by the interplay between high fuel costs and the single market clearing price methodology, as discussed earlier. If the fuel price increases were the sole reason for higher prices, then the parent corporations of the generators could not make so much profit.

MYTH: The market would lower prices.

FACT: The evidence proves that the generation market with its flaws inflates, not reduces, price; moreover, ratepayers still pay for the risks.

Post-deregulation electric rates have been consistently much higher--54%--than the rates in regulated states. This demonstrates the point that while private companies are better at making *profits*, that does not necessarily translate into cost-savings for consumers. The benefits from any efficiency gains that generators may have made under deregulation have not flowed back to consumers, but rather to shareholders. Furthermore, ratepayers still bear the risks under deregulation because the generators build risk premiums into their rates.

MYTH: The Agency lacks the technical expertise.

FACT: The Agency would acquire the necessary expertise through its consultants.

Consultants would provide the Agency with prudent advice on the procurement decisions based on statistical analysis and the risk parameters establish by the Agency. The rural cooperatives in Pennsylvania, Duquesne, Citizens' and Wellsboro, UGI, as well as the Illinois Power Agency, successfully use the available outside resources and advice to maximize the benefit for their consumers.

MYTHS AND FACTS

Currently, no large utilities procure default supply using an actively managed portfolio approach to get the most savings, an approach successfully used by the rural electric cooperatives, utilities like Duquesne, and the Illinois Power Agency. Such an approach allows these entities to exploit favorable market conditions by buying blocks of power at different times, using a mix of short-term contracts, long-term contracts, and spot market purchases. Under that approach, power supply for one month or season would rarely be purchased all at once.

"The [market] resembles that of an oligopoly, where there are only a few firms supplying all or most of the output, than a truly competitive marketplace."
-Rose and Meeusen Report

MYTH: The Agency would eliminate customer choice.

FACT: The Agency supports customer choice.

The Agency's procured supply would not be imposed on unwilling customers. The Agency would procure power only for default service customers who do not shop for power and are given POLR (providers of last resort) supply by their utility companies and for those businesses willing to take supply on negotiated terms and conditions from the Agency. Large utilities in turn have abdicated their duties to provide low-cost power to POLR customers and, rather than actively-managing the costs for ratepayers through a portfolio management approach, they have contracted this obligation to third-party contractors who add another layer of profit to the cost of generation. Customers will still have the opportunity to shop with competitive suppliers.

MYTH: The Agency would negatively impact competition.

FACT: The Agency would promote competition within the wholesale market that currently lacks true competition.

About 87% of low-cost baseload generation (nuclear, coal, hydro) is owned by five companies, which own about 75% of all generation. Four of those companies (PPL, Exelon, FirstEnergy and Allegheny) own electric distribution companies in Pennsylvania. In short, these utility companies often buy power from themselves through their affiliates, undercutting any meaningful competition. These companies also own substantial transmission assets and are influential members of PJM that governs the wholesale market, deciding where and when to site new generation. By fostering new private generation development, the Agency would cure the abuse of market power by the incumbent utilities that refuse to enter into long term contracts with these developers. If supply is still inadequate to relieve congestion and produce competitive rates, then the Agency could build or acquire generation through its revenue bonds. New generation would mean true competition, lower prices and less congestion.

FAILED EXPERIMENT:

**Deregulated Electric Market, Its Problems, and Why We Need the
Commonwealth Energy Procurement and Development Agency
(HB 1909)**

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