

**COMMONWEALTH OF PENNSYLVANIA  
HOUSE CONSUMER AFFAIRS COMMITTEE**

**Senate Bill No. 168 - An Act Concerning Boroughs, and Revising, Amending  
and Consolidating the Law Relating To Boroughs**

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**PUBLIC HEARING TESTIMONY OF  
GARY A. NACE  
ON BEHALF OF  
BOROUGH OF EPHRATA**

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Good morning, Chairman Preston, Chairman Godshall, and members of the Consumer Affairs Committee. My name is Gary Nace, and I am the Borough Manager for the Borough of Ephrata in Lancaster County. On behalf of the Borough, I thank you for convening this public hearing and for the opportunity to provide testimony on Senate Bill 168, "An Act Concerning Boroughs, and Revising, Amending and Consolidating the Law Relating to the Boroughs."

Before discussing Senate Bill 168, I wanted to note that for most of the past thirty years I have served two Pennsylvania boroughs with municipal electric systems, including the last twenty years in Ephrata Borough. I am a past Vice President of the Pennsylvania Municipal Electric Association (PMEA) and am currently the Vice President of the Pennsylvania Municipal Power Agency (PMPA). I also hold the Pennsylvania seat on the Board of Trustees of American Municipal Power, Inc. (AMP), a Columbus, Ohio-based not-for-profit corporation offering power supply alternatives to its member municipal power systems. In addition to serving on the Board, I am a member of the Green Power Development, Hydro Power Projects, Power Supply and Generation, and Finance Committees of AMP.

Ephrata Borough Council believes Senate Bill 168 is of vital importance to the residents of Ephrata. Senate Bill 168 adds missing tools to the toolbox of Pennsylvania boroughs, like Ephrata, that seek to procure reasonably priced and reliable power for the benefit of their residents. Senate Bill 168 authorizes Pennsylvania boroughs to: (1) enter contracts with "take-or-pay" and "take-and-pay" provisions, as well as step-up power provisions; and (2) purchase power without engaging in a competitive bidding process. In the face of escalating wholesale power costs and an ever-changing and complex wholesale

market structure, Senate Bill 168 provides the flexibility to pursue innovative purchasing strategies, which are critical to Ephrata Borough's efforts to manage power costs on behalf of its residents, particularly in light of the recent economic downturn affecting our nation.

Ephrata Borough is one of thirty-five boroughs in Pennsylvania that own and operate municipal electric utilities for the benefit of their residents, businesses and local industry. As a public power agency, Ephrata Borough has successfully operated its electric utility since 1902 and provides significant value to its customers by:

- Offering consumer electric rates that historically have been priced on par with or slightly lower than rates offered by private sector suppliers;
- Offering stable consumer electric rates, which facilitates financial planning and budgeting by the Borough, as well as by local businesses and industry;
- Providing very high system reliability to its customers with interruption indexes below industry averages; and
- Reinvesting proceeds of the electric operation back into the Ephrata community.

Because Ephrata Borough has no electric generation equipment of its own, it must purchase power supply for its customers from the wholesale power market. The way that the Borough purchases power supply today differs dramatically from the approach taken in the past due to deregulation of the wholesale power market. From the mid-1960's until the late 1990's, Ephrata was captive to the investor-owned utility that provided transmission service to our area, and the wholesale electric rates we paid to that supplier were cost-based rates regulated by the Federal Energy Regulatory Commission. In the ten years following the federally mandated deregulation of the wholesale power market, the Borough

has experienced large increases in the cost and volatility of its electric power supply. For example, in 2004, the Borough's average delivered cost increased by 47% over costs from 2003. The cost of delivered electric power doubled again for 2009, representing a 200% increase over 2003 costs. Although increasing commodity prices have played a role in escalating wholesale power costs, changes in the design of the wholesale power market are the primary drivers of these large increases in the Borough's cost and volatility of purchased power. It is our opinion that, as a result of the current wholesale market structure, wholesale power prices will remain high and volatile for the foreseeable future and the Borough must pursue purchasing strategies that will minimize that price impact on its residents by returning to cost-based electric power for a significant portion of the Borough's energy supply portfolio to stabilize the power prices facing our residents.

To reduce the Borough's reliance on the wholesale power market, Ephrata Borough Council has chosen a long-term power supply strategy that involves the Borough joining with other public power municipalities, both within and outside of Pennsylvania, in constructing generating facilities to serve at least the baseload needs of the Borough and its customers. Ephrata Borough Council desires to diversify its power supply portfolio by purchasing modest amounts of capacity in multiple generation projects. In pursuit of this strategy, Ephrata Borough has become a member of AMP, a not-for-profit corporation with 128 municipal electric system members in six states, including 30 borough electric systems in Pennsylvania. AMP is the only member organization serving Pennsylvania boroughs that is currently building generation projects for its membership.

To date, Ephrata Borough Council has voted unanimously to participate in four generation projects spearheaded by AMP. However, the Borough of Ephrata and any other

Pennsylvania boroughs that were interested in participating in such projects have been precluded from doing so because they lack the express authority under Pennsylvania law to enter into contracts that include "take-or-pay" or "take-and-pay" provisions. Such provisions are required by financial institutions and capital markets to secure the lowest cost financing for the development of new generation projects.

A "take-and-pay" contract provision is commonly used for purchases from generating plants currently in service. Under this provision, a participating borough would be obligated to pay only for power contracted for and made available at a designated delivery point, whether or not the participant actually accepts delivery of such power. This type of provision has been used in the electric industry for approximately 30 years.

A "take-or-pay" contract provision is commonly used in cases in which a not-for-profit membership corporation is financing and constructing a generating facility on behalf of its members. A participating borough would be obligated to pay only for its share of power from the generating facility that is the subject of the contract and to pay a minimum payment toward the debt service of the facility regardless of whether or not the facility is actually in operation. Take-or-pay provisions have been the standard for financing joint action agency generation projects across the nation for many years, and not surprisingly, project developers and bond holders must have assurances that all project participants have the express authority to enter such contracts.

Senate Bill 168 explicitly authorizes Pennsylvania boroughs, at their sole discretion, to enter into contracts with take-or-pay and take-and-pay provisions. This express authorization would provide assurance to project financiers and bond holders that such

contractual provisions are enforceable in Pennsylvania, thereby lowering financing costs and, consequently, power supply costs ultimately paid by the borough and its residents.

Unless there is a change in the Pennsylvania Borough Code to expressly authorize a borough electric system to enter into contracts with take-and-pay and take-or-pay provisions, Ephrata and other Pennsylvania boroughs are at a great disadvantage compared to their counterparts in other states where such legislative changes are already in place. In fact, Ephrata has been forced to forfeit the opportunity to participate in all of the AMP generation projects currently underway because the Pennsylvania Borough Code lacks the necessary language. This is a serious set-back for the electric supply strategy of Ephrata and represents the loss of significant savings for Borough customers over the 50 year or longer life of these projects.

Senate Bill 168 also authorizes Pennsylvania boroughs to agree to step-up power, again, at their sole discretion. The issue of step-up power arises in the event of a default by a municipality participating in conjunction with other municipalities in the development of a generating facility. Step-up power refers to the transfer of power and associated financial obligations from the defaulting municipality to non-defaulting municipalities on a pro rata basis. Senate Bill 168 limits the amount of step-up power that can be transferred to a non-defaulting borough to an increase of no more than 25% of that borough's original power allocation. It is important to note that anticipated favorable pricing of a project and the oversubscription of these projects will result in participating boroughs wanting as much step-up power as they can get if another community defaults. Step-up contractual provisions are another tool for reducing investor risk and gaining the lowest possible financing costs for generation projects.

In addition to authorizing Pennsylvania boroughs to enter contracts with take-and-pay, take-or-pay, and "step-up" provisions, Senate Bill 168 provides an explicit exemption from the competitive bidding requirement for acquisition of electric power supply. This change is needed to reflect the changed environment in which boroughs must now procure power supplies. The traditional competitive bidding process envisions receiving and opening written bids at a certain time and date, followed by the evaluation and awarding of bids over a number of days. In today's market, a borough may receive a number of responses at a prearranged time from suppliers offering "indicative prices," which are generally available for a period of a few *hours*. In other words, a borough council is expected to act the same day to execute the supply contract with the supplier that presents the most favorable offer. Thus, the traditional competitive bidding process has not only become outdated due to changes in the wholesale power market, but also presents a potential hindrance to boroughs attempting to shop for the best deal in this new marketplace.

Although Ephrata and other boroughs interpret the Pennsylvania Borough Code as already providing such an exemption from the competitive bidding process, the potential for differing interpretations of these provisions, however, indicates the need for clarity. By providing the explicit exemption from competitive bidding, Senate Bill 168 provides this needed clarity.

Skeptics of Senate Bill 168 have claimed that the proposed changes to the Pennsylvania Borough Code may not be good for Pennsylvania boroughs. It is important to remember that Senate Bill 168 is enabling legislation. It presents every borough operating an electric system with the choice to decide whether to participate in a joint generation

project by entering into a contract with take-or-pay or step-up provisions, or to forego the traditional competitive bidding process. Each borough should have the discretion to use these tools if it believes doing so is in the best interest of its residents.

I have also heard concerns expressed about the 50 year commitment that is typical of the contracts municipal electric systems execute to participate in joint generation projects. Some have indicated making commitments of that duration present too much risk to these boroughs. Pennsylvania boroughs regularly make similar long-term commitments for the benefit of our citizens in other aspects of borough operations. For example, Ephrata has been providing wastewater treatment services to Borough residents and to a number of surrounding municipalities for over 70 years and has a perpetual responsibility to continue doing so in the future. In performing these services, Ephrata has entered into long-term agreements for joint development of wastewater treatment facilities. In short, Pennsylvania boroughs have experience with assessing the risks and benefits of assuming long-term obligations for the benefit of their residents.

The 50-year term of these contracts is, in fact, an extremely desirable feature. Ephrata and other boroughs are hoping to participate in AMP's new hydroelectric generation projects. The electric power from these projects becomes particularly attractive during the last fifteen or twenty years of the contract, after all the debt has been repaid. At that point, it is similar to operating and maintaining a home after the mortgage has been paid in full. Public power communities are seeking the kind of stability and cost-based power prices offered by these long-term contracts.

I am pleased to report that the Pennsylvania State Association of Boroughs adopted a resolution at its Annual Conference this April endorsing Senate Bill 168 as explained in



the June 30, 2010 letter to Chairman Preston. The Pennsylvania Municipal Electric Association likewise endorsed Senate Bill 168 as evidenced in its August 2, 2010 letter to the Chairman. All interested parties have worked together and are supporting this much needed legislation.

Finally, it should be noted that among the first AMP projects that the boroughs may consider (if Senate Bill 168 is enacted) are hydroelectric generation projects. The green power provided from these proposed facilities should be available to those boroughs that desire renewable energy in their supply portfolios. As an aside, the turbines for these projects are being manufactured at Voith Hydro in York, Pennsylvania. It would be ironic if the Pennsylvania boroughs could not participate in these projects, which are contributing to the Commonwealth's economic development in other ways.

Thank you for the opportunity to express the support of Ephrata Borough for Senate Bill 168. I would be happy to answer any questions you may have.