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Testimony Before the

Pennsylvania

House Consumer Protection Committee

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On

Energy Policy Legislation

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EPGA TESTIMONY BEFORE THE HOUSE CONSUMER AFFAIRS COMMITTEE
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The Electric Power Generation Association (EPGA) is a regional trade association of electric generating companies with headquarters in Harrisburg, Pennsylvania. Its members include AES Beaver Valley, LLC, Allegheny Energy Supply, Cogentrix Energy Inc., Dynegy Inc., Edison Mission Group, Exelon Generation, FirstEnergy Generation Corp, LS Power Associates L.P., Mirant Corporation, PPL Generation, Reliant Energy, Sunbury Generation LP and UGI Development Company. These companies own and operate more than 141,000 megawatts of electric generating capacity, more than half of which is located in the mid-Atlantic region.

The following comments represent the views of EPGA as an Association of generating companies, not necessarily the views of any particular member company with respect to any specific issue.

EPGA commends the Committee Chairs and sponsors for holding this hearing and tackling some very difficult and complex issues with potentially far-reaching implications for our industry and the overall health of the Commonwealth's economy.

With limited time available we will focus today on the issues of most importance to the generation industry, but we will be happy to answer any questions the committee may have on other issues not specifically addressed in our testimony.

General Comments

- It is critically important for the General Assembly to set balanced, realistic policies regarding Pennsylvania's energy future. The General Assembly's decisions today can affect significantly the landscape for electricity prices and infrastructure in the Commonwealth for years to come.

- Wholesale electricity prices are increasing for the same reasons that other energy prices are increasing – rising global demand for fuels and infrastructure spurred by rapid growth in China and other developing countries, coupled with ever more stringent environmental requirements.

- Even though electricity prices are increasing due to these global factors, consumers benefit from competitive markets and competitive procurement of generation supplies in many ways. For instance, Pennsylvania has benefited from the increased operating efficiency of the generation industry as a result of competition. For example, nuclear plants now operate over 90% of the time, up from roughly 70% before wholesale competition began to take hold. The increased operating efficiency of these plants holds down overall electricity prices and minimizes the need to add new generation sources.

- Other consumer benefits include reduced consumer exposure to risks of building and operating generation, avoiding the possibility of future "stranded costs" incurred by utilities to build generation or enter into long-term contracts for supply, encouraging greater energy efficiency and responsive consumer demand, lowering overall investment needs and providing environmental benefits, and greater development of renewable generation.

- Consumers in the Commonwealth will be best served by legislation supporting competitive markets and competitive procurement of electricity supplies. It would be a significant mistake to return to the past and authorize regulators to take charge of these fundamental choices.

Procurement Provisions

- Political stability and regulatory certainty are among the most critical factors in deciding where and when to build capital-intensive new power plants. Specifically, new plants can cost in the range of $1,000 to $3,500 per kilowatt, which translates into investments ranging from hundreds of millions to several billions of dollars for a new natural gas, coal, or nuclear plant.

- We face unprecedented challenges – there is a need to invest billions to maintain existing generation, and to add new generation and environmental controls to meet the growing demand for electricity and increasingly stringent environmental standards. In addition, increases in global demand for energy have led to large increases in the price of fuels and of the materials, like steel, used to build energy infrastructure.

- In this region, electricity use continues to grow, and the balance between supply and demand is tightening. It is projected that new supply will be needed in the next couple of years. In order to invest in new plants, including renewable energy projects, generators must have the opportunity to earn adequate returns in the wholesale power market.

- Although it is important to allow customers the option of phasing in higher prices, consumers must ultimately see and respond to these higher prices. Only when customers are considering the true price of electricity supply will competition, energy efficiency and demand side management really begin to take hold.

- If we are going to attract the investment and innovation on the scale needed to meet our energy security and environmental challenges, investors must be assured that the market rules will not be changed dramatically by legislation or regulations. This is why EPGA has repeatedly stressed the need for a procurement process that is well defined, competitive, consistent, and predictable.

- EPGA supports a workable framework for competitive procurement that may include auctions, requests for proposals, spot-market purchases and (at the discretion of the default service provider) bilateral contracts.

- HB 2201 allows the default service provider to enter into long-term contracts of 20 years for up to 20% of projected default service load. Long-term contracts with alternative energy suppliers are not to be counted toward the 20% limitation on the default supplier's total procurement. Further, the Commission may permit a waiver of the 20% limitation on long-term contracts if the Commission makes a judgment that doing so would contribute to lower cost service for default customers. The Commission may also order a default service provider to sign long term contracts for all of its projected load. And the Commission, by waivers, can likely order such long term contracts without going through a competitive procurement process.

- Mandating the amount of utility long term contracts could lead to unintended consequences and greater problems. The more reliance placed on these contracts, the greater the potential problems. In addition, granting the Commission the authority to order long term contracts for an indefinite amount of default service load effectively allows it to pick winners and losers in the market.

- Entered into voluntarily by competitive entities, long term contracts may provide stability and certainty. However, mandated utility long term contracts will undermine the competitive market and lead to higher prices. This statement is supported by experience here in Pennsylvania. Long term contracts between utilities and independent power producers compelled by the federal Public Utilities Regulatory Policies Act became one of the largest categories of utility stranded costs (i.e., above market costs) under the electric competition law.

- Events currently taking place in Delaware, which amended its law to allow the state to mandate long term contracts, also illustrate the potential problems. The state tentatively directed a utility to enter into a long term contract with an off-shore wind project, but the responsible state agencies are now deadlocked on whether to go ahead with the project because of its cost. It is estimated that the project will initially cost residential customers from $13 to $22 more per month than market purchases. The state is now considering spreading that cost to all customers – even those that buy electricity from a competitive supplier – through a "wires charge" that is identical to the charge that Delaware used to collect utility stranded costs during the transition to competition a few years ago.

- In addition, we must keep in mind that the default service provider would be signing long-term contracts to serve customers who are free to leave default service at any time for a lower-cost offer from a competitive supplier. So, what happens when the cost of long-term default service contracts becomes higher than the wholesale market price? The default service provider could face the economically and politically unpalatable prospect of imposing the high cost of above-market long-term contracts on a shrinking default service customer base.

- Finally, EPGA suggests that the Commission be required to approve the results of any competitive procurement process not more than two business days after successful bids are selected. The current language allows for ten days which will produce higher bids from generators than would otherwise obtain with a shorter approval period because of wholesale market risks. In addition, a ten day review period may reduce the number of bidders.

Helping Customers make the Transition from Capped Prices

- By the time generation rate caps expire in most of the state at the end of this decade they will have been in effect for 14 years. While rate caps have provided temporary benefits to consumers in Pennsylvania, we must acknowledge that by insulating consumers from the true cost of electricity, they have failed to prepare customers for a new era of higher electricity prices. However, if prompt action is taken, there are options to help customers through the transition.

- EPGA supports customer education and low income energy assistance programs, as well as providing customers with options for controlling their use of electricity, such as time-of-use pricing, and the necessary meters and other technology.

- To ease the transition to market-based rates EPGA supports the concept of phasing in anticipated higher rates over a reasonable period that should not exceed 3 – 5 years. We also agree with the provision that allows the phase-in period to begin prior to the expiration of the generation rate caps. Full cost recovery should be allowed under these programs.

- Experience with programs such as this suggests that unless they are done on an "opt out" basis, participation will be minimal. Because of this, we suggest that you give serious consideration to authorizing utilities to implement competitively neutral "opt out" phase in programs. Large commercial and industrial customers should be excluded from these programs because they are in a better position to manage their costs.

Thank you for considering our testimony, and I would be happy to answer your questions.