TESTIMONY OF

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of the

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BEFORE THE

House Consumer Affairs Committee

House Bills 2200 and 2201

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My name is Michael Love, and I am President and CEO of the Energy Association of Pennsylvania ("Association"), a trade association representing the electric and gas distribution utilities in the Commonwealth.

I have 30 years of experience in the utility industry including being a consumer advocate, a PUC Chairman and various utility positions culminating in President and Chief Operating Officer for a utility with nearly a million customers in 10 states.

Energy issues are complex and I congratulate this Committee for working on energy issues so diligently. Clearly, the overall direction of greater conservation and energy efficiency coupled with demand reduction as established in this legislation is the essential path for us to embark upon. The current reliance on natural gas for new generation is a very expensive proposition and we need to address that position through conservation and energy efficiency.

House bills 2200 and 2201 have many parts, and I, in the time allotted cannot possibly address all of the issues embodied in them. The individual electric companies will deal with some of the specifics of these two bills while I prepare the historical stage for you to understand the energy arena since the mid-1980's.

In the 1980's, many new large base load nuclear and coal units were being built by vertically integrated utilities which meant that the utilities owned generation, transmission and distribution facilities. Because of many factors these base load projects faced unexpected cost increases, and substantial delays in completion which combined to cause major rate increases.

Due to these rate increases, a number of steps were taken by this legislative body to address this situation. First, the legislature passed legislation that reduced any incentive to build base load units. Second, the Electricity Generation Customer Choice and Competition Act was passed to provide consumers choices in an emerging competitive market and to insulate consumers from bearing all of the financial risks of construction cost overruns, poor operating performance and forced plant outages. These risks of building and operating generation plants were transferred from consumers squarely onto the shoulders of the generators and their shareholders. Today, consumers, unlike the days of vertically integrated utilities, do not pay for the risks of construction or poor operation.

The Competition Act, while recognizing that a market-based system would provide the lowest prices also provided for a transition period during which consumers would have the benefit of capped rates. As those transition periods end for Pennsylvania, electric distribution companies' consumers will be exposed to a competitive market and prices will be inevitably higher for a number of reasons disclosed below.

The statistics of consumers shopping have fluctuated both up and down over the past ten years. Yet where rate caps are already off, there are robust offers from competitors of the local distribution companies. For example, in Northwestern Pennsylvania, a competitor is offering 10% off the generation rate of the local electric distribution company. In Pittsburgh, where residential rates are lower than 10 years ago, there are a number of competitors now that rate caps have been lifted.

Competition develops after the rate caps come off. These examples that I have provided you demonstrate the accuracy of this observation. With the rapid increase in fuel prices, no one can provide energy and capacity at the rates currently charged, where the rate caps still linger.

Third, and in addition to the Competition Act, increased environmental regulation, both on the federal and state levels, has culminated in an increased use of natural gas for electric generation because gas could meet the increased environmental requirements whereas coal could not. From 2002 through 2005 electric companies spent more than $21 billion to comply with federal environmental laws adopted to address health problems associated with air and water pollution. These costs have not yet been reflected in most electric rates.

Fourth AEPS legislation was enacted encouraging the development of alternative energy sources such as wind and solar. While the technology has and will continue to improve, the fact is that all of the alternative energy facilities provide generation less than 30% of the time leading to the need for back up reliability in the form of peaking facilities which are powered by natural gas. The regional electric grid relies on natural gas generators for back-up of alternative energy facilities to achieve the necessary reliability both here in Pennsylvania and indeed throughout the nation.

Due to the limitations on base load units the environmental regulations and the need to back up alternative energy projects, natural gas became the fuel of choice across the country. This substantial increase in demand for gas as a generating source led to gas prices tripling between 1999 and 2006. International forces increased the price of coal.

The increase in gas and coal prices has been felt in all states and in all energy markets. Coal sets the market price in PJM 75% of the time and natural gas 25% of the time. Rises in the fuel prices of these types of generation adds upward pressure to rates.

Higher electricity prices are occurring both in states that restructured their electric industries and in those that did not. The reality of conditions in today's global energy markets make it unlikely that low electricity prices will prevail in the future, in Pennsylvania or anywhere in the U.S. The average American has seen prices go up about a third over the past decade. The average Pennsylvanian has not. The price of power has been rising for several reasons. Fossil fuels – that is, natural gas, oil, and coal supplies, which together produce over 70 percent of the nation's power – have had significant price increases in the past few years after a period of comparative calm during the 1990s.

Electricity prices have risen more slowly than those of other goods and services. From 1999 to 2007, heating oil has increased over 300%; coal nearly 100% and natural gas prices have tripled. These fuel price increases are real and have occurred on both national and international markets.

In 1996, Pennsylvania was in the top 20 states in terms of above average electric prices. We were the twelfth most expensive. Today we are below the national average by 3 to 5%. In real comparable dollars we are even lower.

Compared to many other goods and services that we all depend upon in our daily lives, electricity is a bargain compared to historical or current data. When inflation is taken into account electric prices are about two thirds of what they were in the early 1980s.

Similarly as a percentage of gross national profit, the United States as a whole spends about two thirds less on electricity today than it did in the 1980s.

As I stated earlier conservation, energy efficiency and demand response are critical to the energy solution going forward. Competitive power markets have led to greater "demand response." On August 8th, 2007, for example, retail customers in the PJM region voluntarily reduced their demand by nearly 2,000 MW – an amount roughly equivalent in size to two large nuclear power plants, or enough to meet the needs of approximately 1.5 million homes – in response to real-time price signals in PJM's wholesale market. These customers were paid for the "resource" (reduced demand) that they provide to the system which in turn provides economic benefits to other consumers. Without this "demand response," other more expensive power supplies would have had to be dispatched, or PJM might have had to resort to involuntary disruptions of service to customers.

We as distribution companies are required to purchase power to meet our customer needs. We purchase electric generation that is governed by our customer needs as to time and amount and by our government mandates as to generation type and environmental requirements.

Those costs are established by the market place and by law. When we purchase such generation the costs we pay is exactly what is passed on to consumers. If cost recovery is denied two very unacceptable events occur, first there is governmental confiscation of the electric distribution company, second the true price signals, to enhance the impact of demand response, conservation and energy efficiency, are not sent to the consumer.

Electric prices in 2009-2011 will be impacted by the price increases resulting from the nationwide and worldwide increases in fuel costs that are occurring in all states and all nations. The impart of environmental mandates require the greater use of natural gas which further exacerbates the already significant impact of natural gas prices on electric prices.

Conservation, energy efficiency and demand response are the critical aspects of any energy policy. The existence of world markets and their corresponding impact on electric prices can only be addressed through greater reliance upon conservation, energy efficiency and demand response.

Pennsylvania history shows that consumers in the Commonwealth are paying less today than they were 10 years ago and that whatever Pennsylvania price increases lie in the future, it is no different than those currently being paid by consumers in other states today.

Thank you for your time.