

COMMONWEALTH OF PENNSYLVANIA
HOUSE OF REPRESENTATIVES
ENVIRONMENTAL RESOURCES AND ENERGY COMMITTEE

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PUBLIC HEARING IN RE: SPECIAL SESSION OF HOUSE BILL 54

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BEFORE: CAMILLE GEORGE, Chairman
SCOTT HUTCHINSON, Chairman
Scott Conklin, Joe Deklinski, Dave Reed,
Jeffrey Pyle, Members

HEARING: Wednesday, March 26, 2008
Commencing at 1:00 p.m.

LOCATION: Ramada Conference Center Altoona
18 Sheraton Drive
Altoona, PA 16601

WITNESSES: Aldie Warnock, Steve Feld, Richard Hudson,
Kevin Cadden, Frances Mansberger

Reporter: Cynthia Piro-Simpson

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I N D E X

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

OPENING REMARKS		
By Chairman George	3 -	6
TESTIMONY		
By Mr. Warnock	6 -	17
QUESTIONS	17 -	27
TESTIMONY		
By Mr. Feld	27 -	40
QUESTIONS	40 -	51
TESTIMONY		
By Mr. Hudson	52 -	59
QUESTIONS	60 -	64
TESTIMONY		
By Mr. Cadden	64 -	71
QUESTIONS	71 -	79
TESTIMONY		
By Ms. Mansberger	80 -	89
QUESTIONS	89 -	103
CLOSING REMARKS		
By Chairman George	103 -	104
CERTIFICATE		105

P R O C E E D I N G S

CHAIRMAN GEORGE:

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4 If you will, we first want to thank all
5 of you for being with us today. Of course, the
6 purpose of this hearing is to solicit testimony
7 identifying proactive policies that will protect
8 Pennsylvania from electric price volatility and
9 prevent soaring rate hikes before the new year, not
10 after. Of course, of particular interest is the
11 special session of House Bill 54 extending protection
12 to residential, commercial and industrial consumers
13 for a period of two years for each company that has
14 not completed its cost recovery period.

15 This is the second public hearing on the
16 special session of House Bill 54. Special Session
17 House Bill 54 allows the Legislature to move beyond
18 the basic utility restructuring and ensure reasonable
19 and stable rates, least cost procurement and system
20 reliability that include energy resource
21 diversification, distributive generator and load
22 management. It is incumbent on the General Assembly
23 to debate and to adopt proactive policies that will
24 protect our constituents from price volatility and
25 prevent soaring rate hikes before they occur, not

1 after.

2 I want to introduce our legislators that
3 are with us today. The gentleman from Armstrong, Mr.
4 Pyle.

5 REPRESENTATIVE PYLE:

6 Thank you, Mr. Chairman. State
7 Representative Jeff Pyle. I represent the 60th
8 Legislative District, Armstrong and Indiana Counties.

9 CHAIRMAN GEORGE:

10 The gentleman from Indiana, Mr. Reed.

11 REPRESENTATIVE REED:

12 Dave Reed, 62nd Legislative District,
13 Indiana County.

14 CHAIRMAN GEORGE:

15 And the Co-Chair's Executive Director,
16 Mr. Deklinski.

17 REPRESENTATIVE DEKLINSKI:

18 Joe Deklinski.

19 CHAIRMAN GEORGE:

20 And of course, my Co-Chair, the
21 gentleman, Scott Hutchison.

22 CHAIRMAN HUTCHINSON:

23 Representative Scott Hutchison, 64th
24 Legislative District, which includes all of Venango
25 County and a portion of Butler Counties. And I'm

1 pleased to be here. It's a very important topic that
2 we'll be addressing today and I thank the Chairman for
3 this series of hearings on this very vital subject
4 area.

5 CHAIRMAN GEORGE:

6 And then on my near left to my Executive
7 Director, the gentleman, Mr. Kuhn. And next to him,
8 of course, the gentleman, representative from Centre
9 County, the gentleman, Mr. Conklin.

10 REPRESENTATIVE CONKLIN:

11 Thank you, Mr. Chairman.

12 CHAIRMAN GEORGE:

13 And another individual who has been with
14 us for some years, and she's reminding me what her
15 name is. It's Jennifer Minnick. I can ask the
16 Chairman if he has any opening remarks.

17 CHAIRMAN HUTCHINSON:

18 Nothing further except thank you for this
19 opportunity to hear these people and their viewpoints
20 on this important subject.

21 CHAIRMAN GEORGE:

22 We have a full agenda this afternoon.
23 Consequently, it is imperative that those presenting
24 their testimony keep their presentation within the
25 allotted time. Your complete testimony should be

1 submitted for the record. David Hughes, the Executive
2 Director of Citizen Power, wanted to testify today,
3 but unfortunately cannot due to the funeral of a
4 neighbor and a close friend. We hope to hear from him
5 at a future hearing.

6 Before we begin, I would like to
7 recognize a gentleman, Tyrone Christy, Commissioner of
8 the Pennsylvania Public Utility Commission. Thank you
9 for being with us. I thank Commissioner Christy for
10 attending this hearing and testifying at our first
11 meeting in Harrisburg. Testifying first today is
12 Aldie Warnock, VP, External Affairs, Allegheny Energy,
13 Incorporated. Welcome, sir.

14 MR. WARNOCK:

15 Thank you, Mr. Chairman and Committee
16 members. This is my second time appearing before you,
17 and I appreciate you having me back. Most of all, Mr.
18 Chairman, thank you for actually coming out to the
19 western part of the state. I think it's good to get
20 across the state to get the perspectives. We actually
21 have service territory north of here, west of here and
22 south of here, and so you probably drove through it
23 coming this direction. As y'all can tell, I'm from
24 the southern portion of that territory with the
25 accent, but we appreciate you being here today.

1 I thought long and hard, Mr. Chairman,
2 about how to come and present this testimony today,
3 and what I tried to do was tried to do it in some
4 slides. So what I'd like to do, if you don't mind, is
5 actually walk you through the slide package that we
6 have and just make a couple of points. And Mr.
7 Chairman, I'll do my best to stay right on the time.

8 The first slide, and I think a very
9 important one, is obviously prices are going up on a
10 number of different issues, and I think what a lot of
11 people are not aware of is just how good electricity
12 prices have been for us if you take a look at how it
13 compares to other things from 1986 to 2006. And
14 electricity is actually low. I think the most
15 important point is, Mr. Chairman, is you're here
16 talking about rate cap extensions. A lot of people
17 don't even know they had rate caps the last ten years.
18 And so I think it's incumbent upon us no matter what
19 we do that we're going to have to do a great job of
20 education.

21 If I could flip over to the next page,
22 one of the other points that I think is brought up a
23 lot, Mr. Chairman and Committee members, is, well,
24 what about --- is this just in Pennsylvania because we
25 did deregulation or is it related to other parts of

1 the country? Is it because we're in an RTO, we're not
2 in an RTO?

3 If you'll take a look at that slide and
4 you'll look across, what you'll notice is that prices
5 are going up in all jurisdictions. It doesn't matter
6 if it's Georgia or Pennsylvania. It doesn't matter if
7 you're in PJM or you're just in your own state and you
8 operate under your different name. So I think it's
9 very important to realize that all prices are going
10 up. Now, my next question would be, which is where
11 I'd like to take this, is ultimately what's causing
12 those prices to go up.

13 Let's flip over to the next page. If
14 you'll take a look at what has happened to fuel costs
15 across the country, these are national numbers, you'll
16 notice that fuel costs are going up dramatically.
17 Coal alone is 43 percent, residual oil 220, natural
18 gas 193. In fact, if you look at coal just in our
19 region, it's 52 percent. So that's from PJM.

20 The interesting thing was we just went
21 through --- we faced this in Maryland, Mr. Chairman,
22 right exactly the same issue y'all are facing. Caps
23 were about to come off, and what do we do? Customers
24 will tell us, obviously, we don't want rate increases.
25 Nobody does. I don't want it in my home. My mom and

1 dad can't afford it any more than anybody else. But
2 the bottom line was once we showed them this slide and
3 they see what is happening to actual gas at the pump,
4 everybody realizes prices are going up and we had them
5 frozen here for a long time. It's been a great deal.
6 Unfortunately, we got to start moving onto the next
7 direction, but I think that will actually assist us in
8 the other thing that y'all are going to do in maybe
9 some of the conservation initiatives, and I'm going to
10 bring that up in just a minute.

11 The other one is --- it's huge if you'll
12 take a look at this, and this affects manufacturing,
13 it affects businesses in the state. Equipment prices
14 are going up dramatically. And first movers of these
15 different things, we all know that we need more
16 infrastructure in this country, whether it's
17 generation, transmission, distribution on our side of
18 the business, gas pipelines on the gas pipeline side.
19 If you take a look at China, they're building a plant
20 a month, a coal plant a month, and what's happening
21 with that is a lot of these equipment prices and
22 stuff, everything is going international. Our labor
23 is going international. We're actually having to
24 create schools right now both for our power plants and
25 transmission lines to actually train people out at the

1 site to try to have enough labor to actually build the
2 lines. So I think we got to watch labor prices, watch
3 equipment prices and make sure that we keep some up
4 here in the U.S. and not all of it go international on
5 us.

6 The next slide is a very cumbersome
7 slide, but if y'all will take the time with me, and
8 being in the business for 25 years, these next two
9 slides are the most fascinating slides I've ever seen
10 in my part of the business, so I'm going to try very
11 quickly to give you an update. We were talking about
12 what are we going to do, Mr. Chairman, to mitigate
13 prices. I will tell you that I'm nervous we're
14 heading for a crisis in the country. I think that
15 there is what I call the three-legged stool, trying to
16 balance reliability, trying to balance price and
17 trying to balance environmental stewardship. And
18 right now I think what we're going --- and our company
19 cares very much about the environment. We implement a
20 DSM, environmental programs and stuff and we want
21 others to do it, but we got to do it in a way to
22 understand what the fallout is going to be on price
23 and reliability.

24 The thing that I want to point out on
25 this chart, I'll be more than happy --- and this is

1 actually just updated. Y'all are the first group I
2 presented this to, and I'm presenting it to the
3 Democratic Governor's Association this coming Saturday
4 in Montana. This is a case that was done by a
5 technical group on how we can reduce carbon.
6 Everybody wants to reduce carbon and clean up the
7 environment. And these are the different --- the
8 colors are the different ways to do it. The white gap
9 is actually the number that's gone down from '07 to
10 '08 on what carbon output is going to be due to more
11 growth and more renewables, among other things. But
12 the actual colors make up how we do it, energy
13 efficiency, nuclear generation, renewables, electric
14 cars, different things that are there.

15 But a couple points that I want to make
16 on this chart. The colors that are there, the blue is
17 energy efficiency. What people don't realize on the
18 energy efficiency --- yes, we can bring it down. That
19 actually includes businesses leaving the U.S., because
20 prices are so high they're leaving the U.S. The other
21 thing that I think is important that is in here is if
22 you take where the two stars are to tell you where the
23 balance is, that's where the two current federal bills
24 are. Now, the color is what is technically feasible,
25 and this is done by an independent third party. The

1 stars are under what's technically feasible. So right
2 now, the disconnect is we're promoting legislation
3 where there is no technology to get us there. So I
4 think that's important.

5 So one of the things we've been
6 advocating --- and I raise this, Mr. Chairman, because
7 I think it's important, because we're nervous about
8 where prices are going. We're about to have a huge
9 price issue coming from this. And let me flip over to
10 the next page and show you what it means to prices.
11 If you take a look --- if we go get everything that's
12 technologically available and that we can actually do,
13 that includes some businesses leaving the U.S., prices
14 are only going to go up 45 percent under the carbon
15 legislation. If we don't do everything that's here
16 and we don't get all the conservation, we don't get
17 the clean coal and the natural --- the whole price
18 difference is gas. If we have to rely more on gas,
19 prices are going to go up 60 percent. I don't know
20 about you, but I can't afford that at home. So we've
21 got to balance these policies, and that's why it's so
22 important. And all we're doing is we're looking at
23 price mitigation and we look at balancing these.

24 And I don't know if you'll recently
25 heard, but DOE just cancelled FutureGen, and that was

1 supposed to be the one that was going to build all the
2 clean cars, because prices just went up on it too
3 high. And secondly, in Maryland, we're also --- I've
4 just spoken over there, in fact, to some of the
5 leadership. They've got a goal of 90 percent
6 reduction in carbon by 2050. If you shut down every
7 power plant, that's 30 percent. If you shut down
8 every car, that's 30 percent. And I'm still 30
9 percent short. So I'm saying I hope as a state in the
10 Commonwealth, we will actually balance those policies
11 so we can do that in a way, because we have some great
12 resources here and I hope we can use them in balance
13 so we don't have these huge prices as we go
14 environmental.

15 So Mr. Chairman, one of the ways that we
16 can actually --- and the Committee members, how can we
17 actually mitigate electricity prices? One, I want to
18 compliment you, Mr. Chairman, on your House Bill 2200.
19 I think that's a great first step. I think we, one,
20 have to make the public aware of what's going on.
21 We've got to educate them on the need to conserve
22 energy. And I think your program, we're trying to
23 find ways to expand cost effective demand response and
24 encourage energy efficiency. I hope the Senate
25 approves that bill and you get it moved forward.

1 Support the development of new
2 infrastructure. I don't know about y'all, but we have
3 not, whether it's bridges or whether it's transmission
4 lines or generation, we're not building infrastructure
5 in the country. We need to do that. And no question,
6 my parents couldn't take it. I couldn't expect others
7 to do it. We need to get a phase-in plan to try to
8 mitigate these things, and that's for residential and
9 small commercial, to create stability.

10 My point on that is, though, Mr.
11 Chairman, and very important, Committee members, what
12 you turn the utilities into at that point in time is a
13 bank. I'm not a bank. And if you loan me money, Mr.
14 Chairman, you've got to have the cash flow to be able
15 to do that so you don't go bankrupt. Well, the same
16 thing for us. We've got to have enough revenue coming
17 in to offer that phase-in to be able to do it. So
18 it's very important that if you're going to make us
19 bankers, make us healthy enough to get a loan of that
20 money and get it back.

21 This is something, and I'll switch over
22 now, and this is how I've tried to address this bill
23 for you, Mr. Chairman, on the rate cap extension. We
24 can work on the phase-in. A rate cap extension will
25 kill Allegheny. It will put us in financial distress.

1 There is no way for two years we can go out and
2 purchase the power up here and only bring this much
3 in. It will cripple the company. More importantly,
4 just as I complimented you on the demand side
5 management energy efficiency, in Pennsylvania, to do
6 the smart metering, that project is going to cost us
7 \$140,000,000 to \$150,000,000 to do it. I can't do it
8 if we're distressed, and we can't do it financially.

9 So my point on that would be --- and just
10 so you know, we just got back from Wall Street. My
11 CEO actually is up there today and they said, until
12 the Pennsylvania legislation issue is resolved and the
13 rate cap extension, they're not investing a dollar in
14 the state for our company. They said, you're a good
15 company, but we've got to get this resolved. So I
16 want to be able to try to meet the goals and
17 objectives you've laid out in your House Bill on
18 energy efficiency and demand response. And what I
19 need is the opportunity to be able to have the money
20 to get these programs.

21 And the last thing I'd point out, a lot
22 of things I hear the utilities putting up, if we do
23 all this energy efficiency --- and let me just give
24 you an example in Maryland. This is where I'll leave
25 this. 2007-2008 we did a program, Energy Efficiency

1 Lighting, two bulbs to every home. When we did that,
2 that program was \$2,500,000 for us to do it. The
3 company did a thing called decoupling where you can
4 recover --- so we lose \$13,000,000 to \$15,000,000 on
5 that program over the life of the program if everybody
6 installs those two light bulbs. So companies are
7 losing revenue by just doing the energy efficiency,
8 and we're trying to invest the \$2,500,000.

9 And I'll give you my last example of the
10 best energy efficiency I've seen in the country. And
11 I think I've told you, Mr. Chairman and Committee,
12 I've worked in 38 states. And I would point you to
13 California, San Diego right after the crisis in 2000.
14 They showed prices signals in California, and I don't
15 know if y'all know this or not. As soon as the real
16 price went through, you know what happened? Usage
17 went like this (indicating). Federal government came
18 in about two months later and put price caps in, and
19 guess what happened to the usage? It shot straight
20 back up. They didn't see a profit, so all they did
21 was use power.

22 So my point is we've got to have a
23 balanced approach. We want to do these energy
24 efficiency things, do the right things for our
25 customers. We are concerned about where prices are

1 going. We want to help mitigate them. We need to be
2 financially healthy enough to mitigate them and be
3 able to implement the demand response programs under
4 2200.

5 So with that story, I'm finished. I
6 appreciate your time today. I appreciate you being
7 here. I'd be very happy to answer any questions.

8 CHAIRMAN GEORGE:

9 If you will, sir, I'd like to turn to my
10 right. This gentleman, Mr. Pyle has a question.

11 REPRESENTATIVE PYLE:

12 I think you, Mr. Chairman, and I thank
13 you, Mr. Warnock. It's good to see you.

14 MR. WARNOCK:

15 Yes, sir.

16 REPRESENTATIVE PYLE:

17 And you talk just fine.

18 MR. WARNOCK:

19 Thank you very much.

20 REPRESENTATIVE PYLE:

21 Question. You said one of the great
22 riddles here is balancing reliability with
23 environmental stewardship, and you also mentioned the
24 need for further infrastructural build-out. I visited
25 with some friends with Exelon out in Kennett Square.

1 They told me they anticipated over the next ten years
2 there will be a 43-percent increase above current
3 level for electrical demand. My question to you is
4 it's very hard to tell consumers their electrical is
5 going to go up 70 to 80 percent. However, in my
6 mind's eye, if we can balance that against building
7 more infrastructure, it's kind of justified. We're
8 addressing future needs. But has Allegheny got ---
9 and you are the service provider for my home area.
10 Has Allegheny got plans for building further
11 infrastructure?

12 MR. WARNOCK:

13 Obviously, we're already in the process
14 of trying to get some transmissions asked to be built
15 based on reliability. On the other --- we've actually
16 created a generation unit to look at building new
17 generation. The problem that we have, and I go back
18 to this balance of environmental stewardship, is
19 carbon legislation. We've built a lot of coal,
20 obviously. We're looking at renewables and we're
21 looking at everything. But right now at the current
22 time, with the carbon legislation hanging over our
23 heads and some of the things that are happening, it's
24 difficult to get a clear vision of what to do and how
25 much it's going to cost to be able to do those. So

1 the more certain we can get around the state and what
2 the environmental rules are going to be --- and
3 unfortunately, in this one, federal rules, because as
4 you know, we're probably going to have legislation on
5 carbon in '09. That's causing a big dilemma on
6 actually infrastructure being built. In fact, you're
7 actually seeing a lot of the coal companies turn down
8 infrastructure until that's resolved.

9 In the meantime, we were going to try to
10 look at gas, and we're still looking at gas in some
11 areas, but I'll give you an example. The RGGI Auction
12 in Maryland, we actually have to go out and buy
13 allowances. It's not cost effective for us to build
14 in Maryland, so we're looking at other jurisdictions
15 to build gas in. So again, balancing that
16 environmental stewardship with reliability and price.

17 REPRESENTATIVE PYLE:

18 One more question, Mr. Chairman.

19 MR. WARNOCK:

20 Yes, sir.

21 REPRESENTATIVE PYLE:

22 In your chart you depict carbon levels
23 that you say our technology has not yet caught up to.

24 MR. WARNOCK:

25 Right.

1 REPRESENTATIVE PYLE:

2 How far away are we from that?

3 MR. WARNOCK:

4 We met a couple years ago with Senator
5 Rockefeller from West Virginia. He believes we'll be
6 there in three to five years. There a lot of people
7 who think the price is going up and there are a lot of
8 people that are in that community who want prices to
9 go up. They think that will drive technology. But
10 I'm nervous about what it does to customers and
11 constituents at home. I'm a big believer in we've got
12 to find a way to retrofit existing plans, and that's
13 where our research dollars should go. The sooner we
14 can do that, the better, I think, on trying to get to
15 that point. And I think most companies want to try to
16 do that. It's just working out all the rules at the
17 state and the federal levels to make that happen and
18 continue to invest their research dollars. I think
19 we're five or ten years out on that.

20 REPRESENTATIVE PYLE:

21 Thanks, Mr. Chairman.

22 CHAIRMAN GEORGE:

23 Thanks. The gentleman, Mr. Reed.

24 REPRESENTATIVE REED:

25 Thank you, Mr. Chairman, and thank you

1 for your testimony again today. You mention on the
2 last line that the smart metering program implemented
3 from your company's perspective would be \$140,000,000
4 to \$150,000,000. What would that translate to to the
5 average residential customer? How much would they see
6 total impact in their bill?

7 MR. WARNOCK:

8 You know, I need to go back. There's two
9 parts to that, Representative. One of them would be
10 --- I need to go back and check the number. We've got
11 a little bit over 700,000 customers, but you got to
12 break that down. And I got to go back and see how it
13 applies to commercial, residential. But then
14 obviously, if they use the meters correctly, there
15 should be savings associated with the meters also.

16 REPRESENTATIVE REED:

17 That would be the second thing, if you
18 could get back to us on how long you would estimate it
19 would take the average consumer to recoup that cost
20 that they're going to have to share ---.

21 MR. WARNOCK:

22 I'll try to do that for you on both
23 residential and small commercial, because that will
24 make a difference based on the rate compliance.

25 REPRESENTATIVE REED:

1 The second question, you talked about and
2 we've heard a lot about phasing in the removal of the
3 rate caps. From your company's perspective, how would
4 you structure that phase-in?

5 MR. WARNOCK:

6 A lot of the stuff that we've actually
7 been working on now, the key for us is to try to have
8 enough revenue coming in so that we can try to do a
9 referral program. Most of the ones that --- the
10 previous experience that I've had is in Maryland where
11 we actually, and I mentioned this at our last
12 testimony on this hearing, we did a pre-phase-in
13 program, because there, they actually did not want to
14 have the spike issue that all of us are here today
15 working on. So we actually have 92 percent
16 participation right now in an opt-out program. At
17 Allegheny we're already through a settlement. We're
18 already raising rates a little bit at a time getting
19 there, but we're still going to have a jump when it
20 comes to that period.

21 So I think the key is here what I've
22 talked about so far and what I've heard is that people
23 talk about an opt-in program that the companies would
24 actually offer some type of deferral or credit card
25 program, we'd serve as a bank, to help do those

1 deferrals over that period of time. And the key for
2 us is having enough revenue coming in to be able to do
3 that loan that we're offering to those customers.
4 Right now we think probably we need around the 15
5 percent range to make that happen over that period of
6 time.

7 REPRESENTATIVE REED:

8 Thank you.

9 MR. WARNOCK:

10 Yes, sir.

11 CHAIRMAN GEORGE:

12 The gentleman, Mr. Conklin.

13 REPRESENTATIVE CONKLIN:

14 You were talking about here
15 infrastructure on your system for Allegheny. How old
16 is your infrastructure? When you're talking about
17 switching over, what type of costs do you foresee in
18 the future trying not only to keep your customers
19 satisfied, but also to have the money to keep doing
20 infrastructure?

21 MR. WARNOCK:

22 I think the first question,
23 Representative, would be just your current
24 infrastructure, most of your infrastructure is 20 to
25 30 years old if you think about the last time you

1 really had some new stuff that was built, and that's
2 no different than having an older car and you think
3 about the gas mileage on it and the upkeep and things
4 of that nature. So we obviously --- and we do have
5 upgrades on some of those, as you know.

6 But as a country, unfortunately, we
7 haven't done a lot in infrastructure. And quite
8 honestly, I've noticed this, Committee members and
9 Chairman. We're tending to be a reactive country.
10 That's why I'm excited about being in front of the
11 today. I hope we can be proactive. Because I don't
12 think we would have had Homeland Security had it not
13 been for 9/11.

14 I was asked by the Governor's
15 Association, who we spoke to the other day,
16 Representative, what's it going to take to get
17 infrastructure built? And unfortunately, I think
18 blackouts. And I hope that's not the case, because
19 nobody wants it in their backyard. And it's going to
20 take some states standing up, the companies included,
21 to say we need to get this done, to get more
22 infrastructure. Unfortunately, infrastructure in our
23 industry, and that's another reason why we've got to
24 be financially healthy. This is a very
25 capital-intensive industry. Power plants are a

1 billion dollars, half million to a billion dollars
2 depending on what you're building. Transmission lines
3 we're building right now, almost a billion dollars.
4 These things are not cheap. And you've got to go to
5 Wall Street and get the money to be able to make it
6 happen. And we have old infrastructure.

7 So I guess my comment to you would be at
8 least in our area, that's the reason we created a
9 generation group. We see the need to get generation
10 built. Depending on what the environmental
11 requirements are, that's going to be more and more
12 expensive. We have no idea what this technology is
13 going to cost us to clean up the plant and to build a
14 cleaner technology, but we need to get to it and get
15 to it fast.

16 REPRESENTATIVE CONKLIN:

17 Thank you.

18 CHAIRMAN GEORGE:

19 If I may, and I don't want you to take
20 this wrong. I've thought of your company as a very
21 fine company. I've been down in the General Assembly
22 for 34 years. And you talked about carbon, which
23 isn't the state's doing. It's the federal
24 government's doing. And I remember when you were the
25 cheapest utility in Pennsylvania sitting right

1 alongside Duquesne with nuclear and the most expensive
2 utility. You can take this as specific criticism, but
3 you know, 99 percent of the coal that you burned
4 wasn't from Pennsylvania. You brought it up the
5 Monongahela from West Virginia. So you sit there and
6 tell us that you know more about it, being in the
7 business field, maybe, than I would, but supply and
8 demand will have as much to do with price increasing
9 as anything else. And as long as we can make the
10 supply greater than the demand, it should in some way
11 formulate an idea for us where we can go.

12 So I suggest to you folks where they're
13 intending to build plants in Pennsylvania that we join
14 in and invest these monies in Pennsylvania, because my
15 big complaint, if you will, and I don't direct this to
16 you alone, but when the other companies sold their
17 plants, no longer were we rebuilding. We were buying
18 a lot of power. And I could go back and we could
19 argue, for how long did you exercise a right for long-
20 term contracts from the people who bought these
21 plants? Now, I also know that they want to bring
22 power, more power in from the west. And again, the
23 thing that I would say about Pennsylvania and where
24 you people are suffering as well as anyone is from the
25 emissions you put out in Pennsylvania isn't all of the

1 problem, because some of that problem is coming from
2 westerly to east on their plants.

3 But I would say to you when you sold the
4 plants and deregulation, one of the worst things that
5 we allowed to happen under the PUC was you guys ate up
6 those stranded costs pretty quick, about
7 \$14,000,000,000 worth. I don't see any of it coming
8 back. So I would leave you with this, your utility
9 and all the rest. We're all receptive to hearing your
10 plan, that we can all work together, that we can make
11 something that is bad enough just a little bit easier
12 for the people that we want to serve. And I thank you
13 for your time and for your presentation. Thank you
14 very much.

15 MR. WARNOCK:

16 Thank you.

17 CHAIRMAN GEORGE:

18 Next is Steve Feld, Associate General
19 Counsel for FirstEnergy. Welcome Mr. Feld.

20 MR. FELD:

21 Good afternoon, Chairman, members of the
22 Committee. I'm Steve Feld and I'm the Associate
23 General Counsel for FirstEnergy Corp. We welcome this
24 opportunity to address the Committee today on Special
25 Session House Bill 54, which would extend the

1 generation rate caps for electric utilities for an
2 additional two years to 2013.

3 Although the FirstEnergy cannot support
4 this bill, we nonetheless urge the Legislature to pass
5 sound energy legislation this year. Changes in
6 electric rates will occur in the next several years,
7 and we need to have a sound energy policy in place in
8 Pennsylvania so that customers and utilities can
9 effectively plan for this expiration of those caps.

10 By way of background, FirstEnergy has
11 three operating companies in Pennsylvania: of course,
12 Penelec, whose service territory we're in today,
13 Metropolitan Edison Company and Pennsylvania Power
14 Company. Together they serve about 1,300,000
15 customers in 49 of the 67 counties in Pennsylvania.
16 Penn Power's rate caps expired at the end of 2006, and
17 its in its second competitive procurement process.
18 Penelec and Met-Ed's generation rate caps will expire
19 at the end of 2010, and their generation rates
20 generally haven't changed since 1986 and 1992
21 respectively.

22 Given that today's hearing is being held
23 in Penelec's service territory, I need to point out
24 that Penelec's generation rates are about the same as
25 what they were in 1986. That's 22 years ago. By the

1 time the existing rate caps expire at the --- of 2010,
2 these rates have remained stable for a quarter of a
3 century, and that's a very long time. In fact, the
4 overall Penelec rate is 35 percent less today than it
5 was in 1986 if you would adjust those rates for
6 inflation.

7 We do share the Legislature's concern
8 about the impact on customers when rate caps expire,
9 and we commend the Legislature, this Committee and the
10 administration for considering ways to mitigate
11 potential price increases. We believe that all
12 involved in this process, however, would benefit from
13 the common paraphrasing of a portion of the oath that
14 physicians state when they enter the medical
15 profession, that is, first do no harm. It's obvious
16 that electric energy is extremely important to the
17 physical and economic wellbeing of Pennsylvanians, and
18 we need to be thoughtful in dealing with these issues.
19 We should not adopt an appealing short-term political
20 solution that will result in serious adverse
21 consequences for customers and utilities over the
22 longer term. Instead, our attention should be focused
23 on real solutions that fix the problem over time.

24 My remarks today will address three
25 areas. First, I'll set the stage by focusing on how

1 electric restructuring in Pennsylvania got started and
2 why we're here today. Second, I'll discuss Special
3 Session House Bill 54 and explain why we do not
4 believe it provides a prudent framework for going
5 forward. And lastly, I'll propose a couple viable
6 alternatives that do provide a sound basis for
7 mitigating the impact.

8 Pennsylvania passed its electric
9 restructuring law in late 1996. Representative George
10 opposed that legislation, and as the Penn Power's
11 attorney who was very much involved in that
12 legislation, I can say that we were not particularly
13 enamored with it as well. But the law set the stage
14 for the generation of electricity to be sold at market
15 prices rather than determined in Public Utility
16 Commission rate hearings.

17 Under the pre-restructuring regulated
18 system, customers were subjected all through the '70s
19 and '80s to frequent and substantial rate increases as
20 utilities tried to recover the costs of new power
21 plant construction, fuel costs and environmental
22 expenditures. These costs were higher than anyone
23 anticipated because of double digit inflation, new
24 regulatory requirements for nuclear plants and other
25 costs. One of the prime factors behind restructuring

1 was the belief that utilities in a regulated system
2 simply did not have sufficient economic incentives to
3 build and operate their plants cost effectively and
4 efficiently.

5 Now, more than ten years later, we see
6 that this discipline of a competitive market, and its
7 discipline is an attempt to try to shift the risk of
8 the power plant construction operation from rate
9 payers to investors. The Pennsylvania restructuring
10 law, we believe, has done this. The risks in our
11 restructured industry are now borne by investors.
12 Customers no longer bear the risks of cost overruns or
13 lengthy outages. In addition, competition has
14 resulted in the more efficient operation of power
15 plants with fewer outages, more production and
16 reductions in operating costs.

17 The reasons for the anticipated increase
18 in electric prices after rate caps expire are not
19 difficult to understand. First, customers have not
20 experienced any of the effects of inflation because of
21 the length of time that generation rates have been
22 capped. Over the past 22 years, virtually every cost
23 associated with our business has gone up
24 substantially. The Consumer Price Index has nearly
25 doubled and the cost of gasoline has more than

1 tripled.

2 These increases affect every component of
3 the electric bill, from the cost of the fuel needed to
4 produce electricity to costs associated with the
5 maintaining and upgrading of Pennsylvania's electric
6 system. In the case of generation, coal prices have
7 tripled, natural gas prices have more than doubled and
8 uranium prices have gone up more than five-fold since
9 1986. From an infrastructure investment standpoint,
10 since 2003, steel prices have increased 60 percent,
11 aluminum has doubled, copper prices have nearly
12 quadrupled. These are all key items that we need to
13 maintain and build infrastructure for the electric
14 system.

15 While fuel prices and other operating
16 costs have continued to increase substantially, the
17 demand for electricity has also increased. The peak
18 demand for Penelec and Met-Ed have increased by 19
19 percent and 42 percent respectively from 1996 to 2006.
20 The average residential customer of Penelec used 13
21 percent more energy in 2006 than 1996. The average
22 Met-Ed residential customer uses 20 percent more
23 energy now than they did ten years ago.

24 This increased demand for electricity is
25 not surprising when you consider our increased

1 reliance on all kinds of electronic devices. And
2 also, the price for electricity has remained about the
3 same as it was 20 years ago. Customers simply have
4 little economic incentive to conserve or reduce their
5 peak usage because they see little financial benefit
6 to do so. The benefit of breakdowns to customers has
7 had the perverse effect of discouraging meaningful
8 energy conservation.

9 With regard to Special House Session 54,
10 this approach may appear to provide a magic elixir
11 that will alleviate the impact of rate cap expiration,
12 but it will only delay the inevitable and avoid a real
13 solution. In fact, it would produce significantly
14 adverse consequences for customers, electric utilities
15 and the competitive market.

16 Over the short term, customers no doubt
17 would benefit as they continue to pay the same
18 generation rates as they paid in 1986. However, if
19 rate caps are extended to 2013, the increase in rates
20 when those caps expire will even be greater than what
21 it will be in 2011. Two more years of inflation, fuel
22 costs increases, increased demand and environmental
23 costs will make the transition to market prices even
24 more dramatic. Further, appropriate incentives for
25 customers to use electricity more efficiently will

1 continue to be non-existent, just as they have been
2 for the last 20 years.

3 Pennsylvania House recently passed House
4 Bill 2200, which was just previously mentioned.
5 Chairman George was the primary sponsor. And that
6 bill provided for additional conservation and peak
7 load reduction. However, Representative George's hard
8 work in getting this bill passed will be fruitless if
9 these programs are unable to produce the reductions
10 envisioned. If generation rates continue at 1986
11 levels, customers who implement conservation measures
12 will not realize the savings that justify costs
13 incurred or the changes in lifestyle that are required
14 to achieve savings. The advanced metering mandated by
15 House Bill 2200 will also not produce its touted
16 benefits because rate caps prevent utilities from
17 adjusting rates in ways that encourage customers to
18 take advantage of this technology.

19 For electric utilities, extending rate
20 caps will have real and immediate financial
21 consequences that will jeopardize their very
22 existence. Met-Ed and Penelec sold their generation
23 plants to unrelated companies in the late 1990s as
24 encouraged by the restructuring law and approved by
25 the Public Utility Commission. Neither company owns

1 generation to supply its customers' needs. The
2 customers of Met-Ed and Penelec benefited from the
3 sale of generation because the proceeds were used to
4 directly reduce the amount of stranded costs that
5 customers were to pay to the tune of three quarters of
6 a billion dollars.

7 Because Met-Ed and Penelec do not own
8 power plants, they will be required to buy power from
9 the wholesale market to supply their customers' needs.
10 The cost of buying this power will be much, much
11 greater than the rate they can charge their customers
12 if the rate caps are extended. The difference between
13 what they will pay for power and what their customers
14 will pay the companies will be in the billions of
15 dollars for those two years. Neither company has the
16 money to fund that difference. Incurring these much
17 higher purchased power costs without a revenue stream
18 to pay for them would obviously damage the companies'
19 credit ratings and immediately jeopardize their
20 financial viability. No bank, no investor would loan
21 money to the companies in this amount without
22 assurance that it would be paid back. In fact, it is
23 doubtful that any power supplier would even enter into
24 a contract to supply these companies with wholesale
25 power without reasonable assurance that Met-Ed and

1 Penelec would be able to pay the full costs of such
2 power.

3 Another aspect of Special Session House
4 Bill 54 I the fact that the bill is unconstitutional
5 under longstanding, clear legal precedent. I do not
6 raise this as a threat, but merely to help ensure that
7 everyone is fully informed. The Supremacy Clause of
8 the United States Constitution has been interpreted
9 repeatedly and consistently that the rates set by the
10 Federal Energy Regulatory Commission for wholesale
11 power sales must be given binding effect by state
12 utility commissions in determining the rates charged
13 to retail customers. In other words, under this Filed
14 Rate Doctrine when Met-Ed and Penelec purchase
15 wholesale power in 2011 through a competitive
16 procurement process, they must be allowed to directly
17 pass through these costs to customers. The bill also
18 prevents this, and is therefore unconstitutional on
19 its face.

20 Without going into detail here, there are
21 also other constitutional deficiencies under the
22 Takings and Due Process Clauses. Again, I mention
23 this not as a threat, but to demonstrate that there
24 are other legal mitigation measures which I will
25 discuss later that are much more preferable to rate

1 cap extension legislation.

2 The third entity that would be adversely
3 affected by a rate cap extension will be the
4 competitive energy market. I defer to Mr. Hudson to
5 go into more detail on this issue, but an extension of
6 the rate caps will clearly make electric generation
7 suppliers unwilling to enter the Pennsylvania market,
8 because customers will be paying below market prices
9 for electricity. This means that suppliers will be
10 unwilling to sell their power to retail customers.
11 They simply would not be able to make money. Also,
12 companies that would be in the business of selling
13 energy conservation and load management products and
14 services will avoid Pennsylvania because they will not
15 be able to show prospective customers significant
16 savings that justify investments in energy reduction
17 measures. Finally, Pennsylvania will be forcing
18 potential investors in generation to look to other
19 states where they will be able to price their output
20 at market prices. The two-year rate cap extension
21 likely will cause a moratorium on any new commitments
22 to build new generation in Pennsylvania.

23 We do support legislation that offers
24 other types of mitigation. We support a phase-in of
25 the initial generation increase to help residential

1 and small commercial consumers moderate the impact on
2 their bills and encourage them to use energy more
3 wisely. A phase-in allows these customers to pay less
4 than the full amount of the initial increase for a few
5 years and then requires them to make up the difference
6 a couple years later. Depending on customer
7 participation and the amount of the increase, the
8 amount the companies will require to fund a phase-in
9 could be in the hundreds of millions or possibly
10 billions of dollars. Obviously, the full cost
11 recovery of these large amounts is essential to the
12 companies' financial viability.

13 Any phase-in plan needs to get customers
14 to the competitive market price in an appropriate time
15 frame. We believe that a time frame of no more than
16 three years to phase-in the initial generation rate
17 increase and then an additional three years to fully
18 recover deferred amounts and carrying charges is
19 appropriate. A longer phase-in period would continue
20 to insulate customers from the very real increases in
21 electric costs.

22 In order to implement a phase-in plan,
23 the companies will have to pay their wholesale
24 suppliers the full cost of obtaining power for their
25 customers even though customers who elect to phase-in

1 the increase will be paying the companies less than
2 the full cost of power. This amount, to put it in
3 perspective, of Met-Ed and Penelec's total debt at the
4 end of 2007 amounted to \$1,300,000,000. It is likely
5 that the amounts needed to fund the phase-in will
6 double Penelec and Met-Ed's debt as well as penalty
7 amounts of interest payments paid on that debt. As
8 long as the companies are able to fully recover these
9 costs in a reasonable period of time, we are willing
10 to temporarily incur these costs to give customers
11 options to deal with increases after the rate caps
12 expire.

13 Other measures to help mitigate the
14 increase include a variation of the phase-in plan,
15 which is giving customers the option to prepay a
16 portion of the increase for several years before the
17 rate caps expire and then to receive a credit with
18 interest once the new rates go into effect. This is
19 also known as a ramp-up plan, and as Aldie has
20 mentioned previously, has been very successful in
21 Western Maryland.

22 In addition, we fully support new
23 customer education programs to give customers the
24 information they need to prepare for the increase and
25 to take advantage of conservation measures that will

1 help moderate the impact. Low income programs will
2 also be important to aid customers who have limited
3 ability to pay their bills. By 2011, we expect that
4 we will more than double the amount of assistance
5 through our utilities' low income program. These
6 programs combined with a properly implemented rate
7 phase-in plan and the choice of a ramp-up plan,
8 provide very appropriate and effective tools to deal
9 with the transition to market-based prices for
10 electricity.

11 In closing, we encourage the Legislature
12 to move expeditiously to adopt sound energy policy
13 legislation this year. Time is of the essence. While
14 the transition to market prices is several years away,
15 there is a need to finalize and implement procurement
16 plans and mitigation programs prior to rate caps
17 expiring so that customers and the companies can
18 effectively prepare for the expected price increases.

19 We look forward to continuing to work
20 with this Committee, the Legislature and the
21 administration to arrive at a positive resolution of
22 these issues. I am available for questions at your
23 convenience.

24 CHAIRMAN GEORGE:

25 Thank you very much. Are there any

1 questions to my right?

2 REPRESENTATIVE PYLE:

3 I'll hold my questions.

4 CHAIRMAN GEORGE:

5 You, Mr. Reed? I recognize the
6 gentleman. Please do.

7 REPRESENTATIVE REED:

8 Thank you, Mr. Chairman. Just two quick
9 questions. First, you talked about the number of
10 different factors that come into play when you look at
11 the rate jumps that we're looking at when the caps
12 come off depending on your service area and depending
13 on the year. You talked about increased demand. You
14 talked about natural inflation. You talked about
15 inflation associated with the cost of raw materials
16 used to generate the electricity as well.

17 One of the constant struggles we've found
18 in government is balancing our economic necessities
19 with our environmental responsibilities. And over the
20 last decade or so, there have been a number of
21 increased environmental regulations, both at the state
22 and federal level. How significant are those
23 environmental regulations going to be on determining
24 how high that rate cap --- that jump is going to be?

25 MR. FELD:

1 Well, to a large extent, it depends on
2 the federal carbon legislation. Currently our plants
3 that are in operation today generally have had ---
4 already invested in SO2 and scrubbers, NOx removal,
5 those kinds of particular removal, of course. Those
6 have been mandated under federal and state law for a
7 number of years and a lot of that has already been
8 implemented. The big hit that's going to be coming is
9 going to be the federal carbon legislation and what
10 impact of that we'll have. That will be significant.
11 When that occurs that will depend upon when those
12 productions would have to take place and what the
13 technology will be. So we can anticipate, and it
14 depend on whose estimate we want to believe, those
15 costs will be substantial. Again, when they occur
16 will largely be determined by probably this next
17 presidential election.

18 REPRESENTATIVE REED:

19 Second question, when you talk about ---
20 your company is in support of a phase-in strategy to
21 delay the rate shock that will occur when these caps
22 come off. You talked about as long as the companies
23 were able to fully recover the cost in a reasonable
24 period of time. What if legislation similar to this
25 were enacted and such a mediation strategy did not

1 allow companies to fully recover those costs in what
2 would be a reasonable amount of time? What would be
3 the impact on consumers? Some folks have talked about
4 rolling blackouts and other types of situations we can
5 get into in the future. From your perspective, what
6 would occur?

7 MR. FELD:

8 Well, it depends on the extent, of
9 course, of the non-recovery. To the extent --- we
10 have been fortunate over the last number of years,
11 five or six years, to put \$800,000,000 into the
12 Penelec electric distribution system. This year we've
13 got \$190,000,000 they expect to spend on that. To the
14 extent that money is not available, then obviously
15 it's not available and we can't do further
16 infrastructure improvements.

17 As I mentioned in my testimony, when you
18 go out into the market and you want to buy power from
19 bidders, there are a number of suppliers willing to
20 sell you the power. One thing require is sufficient
21 security so that they know that they will be able to
22 get paid. We would have a very great concern
23 depending on what happens with the legislation and
24 I'll say the PUC would implement it down the road that
25 if suppliers did not feel that we had financial

1 viability to pay the bills to the suppliers, then they
2 probably wouldn't even enter into a power supply
3 agreement with us, because there wouldn't be any
4 likelihood of them getting paid. And when that would
5 happen and whether that would happen, again, is a
6 matter of how fast, how much cash we would no longer
7 have to pay it.

8 CHAIRMAN GEORGE:

9 So reliability does become an issue?

10 MR. FELD:

11 Reliability would, because there would be
12 a huge cash crunch. I mean, we're talking about very
13 large dollar amounts here. The difference between
14 what Penelec customers currently pay for generation
15 and what the current market price is, it's a very
16 large number that we could not absorb and still stay
17 viable.

18 REPRESENTATIVE REED:

19 Thank you. And thank you, Mr. Chairman.

20 CHAIRMAN GEORGE:

21 Co-Chairman? Mr. Conklin?

22 REPRESENTATIVE CONKLIN:

23 I just have a quick question to ask. How
24 old is your infrastructure?

25 MR. FELD:

1 Ours is probably a little bit --- I'd say
2 between 20 and 40 years. And we've done substantial
3 upgrades in the last couple years, but there are ---
4 the fact that there are rate caps in place and no
5 increases in the distribution rates since 1986, it has
6 forced us to be a lot more efficient in what we are
7 doing, and at times there's not the cash available to
8 upgrade as fast as you'd like. And that's true with
9 all of the electric distribution companies in the
10 country. They've enjoyed stable rates, but the
11 investment in the infrastructure hasn't been there.
12 We've accelerated that in the last couple years
13 knowing that the infrastructure needs to be upgraded,
14 the poles, the wires, et cetera.

15 REPRESENTATIVE CONKLIN:

16 Excuse my not understanding a lot of
17 this, but are you --- are you the sole user of your
18 lines that FirstEnergy has or do you give space to
19 other energy companies?

20 MR. FELD:

21 The way the competition laws are set up
22 in Pennsylvania, anyone can supply the generation, the
23 electrons, and all we do is deliver it. Currently
24 there are very few suppliers that do supply to provide
25 electrons simply because they can't make money because

1 the price we're charging is under market.

2 REPRESENTATIVE CONKLIN:

3 I understand that. But when you do that,
4 do you charge the companies for the use of those
5 lines?

6 MR. FELD:

7 They are charged on --- no, we don't
8 charge those companies directly. They do pay PJM for
9 use of the transmission system.

10 REPRESENTATIVE CONKLIN:

11 I mean, some of it comes back when you
12 send out your service worker or whatever it is to
13 maintain the line? I'm just curious.

14 MR. FELD:

15 No. The separation into the three
16 components of the electric system is the distribution
17 line, which are the lower level lines along the
18 streets, then there's the transmission lines, which
19 are the ones that are on top towers and larger poles,
20 and then there's a generation function. The
21 suppliers, if they want to sell to one of our retail
22 customers, buy the generation or have their own
23 generation and they arrange transmission on the grid
24 through PJM and it's just delivered through our line.

25 REPRESENTATIVE CONKLIN:

1 Just one last question to try to --- the
2 question I asked wasn't helpful for everyone. When
3 you generate electricity, is FirstEnergy --- do you
4 buy your generation or do you own plant itself that
5 generates ---?

6 MR. FELD:

7 FirstEnergy Corporation owns some power
8 plants. It does not own enough power plants for the
9 capability to serve all seven of its utilities. We
10 operate in three states, and that's seven utilities.
11 In 2001 we bought GPU, which was a company that owned
12 Met-Ed and Penelec. GPU had already sold all of its
13 generation facilities to other companies, so when we
14 bought GPU, we bought a company that did not have
15 generation. And that's why Met-Ed and Penelec will
16 have to go to the market in 2011.

17 REPRESENTATIVE CONKLIN:

18 And just an odd question. If you're
19 buying generation, do the same stockholders --- the
20 existing stockholders of the distribution company also
21 would be the same stockholders of the generation
22 company as well?

23 MR. FELD:

24 In our case, we only have one set of
25 stockholders, and those are people who own stock in

1 FirstEnergy Corp. And all of the entities, our
2 generation company, our utilities and a small telecom
3 operation, all those companies are owned by
4 FirstEnergy Corp, one set of shareholders, and that's
5 the parent company, the ultimate parent company. So
6 there are no individual Penelec or Met-Ed
7 shareholders.

8 REPRESENTATIVE CONKLIN:

9 Thank you.

10 CHAIRMAN GEORGE:

11 Mr. Feld, I'm impressed with your
12 reasoning that we should do something to resolve this.
13 Probably three of the members on this panel were
14 around in 1998. They may have become somewhat
15 confused over nitpicking. It's hard to forget
16 something that we have listened to you say. You're
17 talking about maybe building power plants, and you
18 know, if I'm wrong, say so. Your company has invested
19 money in the last several years out of state. And
20 whether it's in an entirety or partial, you buy power
21 plants other places?

22 MR. FELD:

23 Yes. I would say we've also invested
24 money in our plant we own in Pennsylvania.

25 CHAIRMAN GEORGE:

1 I understand that, but you know what I'm
2 getting at. For example, when you sold the plant in
3 the community my young representative lived in, it was
4 estimated that the stranded cost was \$451,000,000 net.
5 Fortunately, for your selling it, you got over a
6 billion dollars for that plant. What happened to all
7 that money that you didn't utilize that for the supply
8 and demand? \$450,000,000,000 to a billion, that's
9 about \$600,000,000 profit on that and that alone. You
10 know, the one in my hometown it no longer is owned by
11 your corporation, but by another entity.

12 And again, my only argument is I want to
13 see you people prosper, but I want to make you aware
14 that all of the problems that we are facing aren't
15 yours alone. I blame the Legislature for passing that
16 deregulation. I've been around long enough to know
17 that the PUC had to work a month to go over all of the
18 sheets that their tractor trailer dumped off so they
19 could tell whether or not legitimately you were in
20 need of an increase. But I also go back to the day
21 where maybe I should have voted for it because I can
22 remember you had a mine up in Indiana called the
23 Holega (phonetic) Mine and you were getting more money
24 per ton for that coal than any utility because it was
25 your own mine.

1 So as I talked to one of the individuals
2 from your corporation, I'm waiting for you to come in
3 not just to say this is wrong, but to say to me and to
4 my fine members who are all open minded --- see, we
5 don't look at this as business people or Republicans
6 and Democrats. We believe that this alone, if it
7 isn't remediated, is going to destroy our economy in
8 Pennsylvania. Now, maybe you people down deep don't
9 like alternate energy, and I'm with you on some of
10 these things where these people are coming forth and
11 wanting to get into money, but again ---. I smiled
12 somewhat when you said you too were not as forceful or
13 as favorable to the deregulations, but George wasn't,
14 and I'm very grateful for your kind words. But again,
15 you're the guys that sold your power plants and you're
16 the guys that got the money. And I'm simply saying to
17 you I know eggs are up and I know gas is up and I know
18 everything is up, but again, this old boy knows that
19 what used to be a necessity now might be a luxury.

20 I don't know of any commodity that we
21 need more than electricity, and I know that many of
22 us, including myself, waste a lot of electricity. But
23 I'm not worried about whether I can waste it or not
24 waste it. We're worrying about that guy down there,
25 unfortunately, that you concern yourself about and

1 have worked with me on --- and I say, hey, look, we're
2 all in this together.

3 So I await you to come into our office so
4 I can get a meeting with my staff and my members so we
5 can resolve this matter, maybe not on the first
6 meeting, but in finalization, we can take the best out
7 of all worlds, not just yours.

8 MR. FELD:

9 Well, we would welcome the opportunity to
10 do that.

11 CHAIRMAN GEORGE:

12 Thank you for coming before us today.
13 The gentleman, Kevin Cadden. Oh, am I wrong? I'd
14 like the members of this fine Committee to meet this
15 guy. This guy worked for Governor Shapp. Isn't he an
16 old guy? Thank you both for appearing and you can
17 present your testimony. Do you want to pause a
18 minute? Can we take a couple minute break? Because I
19 want these legislators to hear what you're going to
20 say. Do you mind? Is that okay?

21 UNIDENTIFIED SPEAKER:

22 Okay, Mr. Chairman.

23 CHAIRMAN GEORGE:

24 Let's take five minutes.

25 SHORT BREAK TAKEN

1 CHAIRMAN GEORGE:

2 PA Chairman, Retail Energy Supply
3 Association. Accompanying him is Kevin Cadden. You
4 may now proceed.

5 MR. HUDSON:

6 Thank you, Mr. Chairman and members of
7 the Committee. Thanks for the opportunity to be here
8 today. I'm going to talk a little bit about our
9 association and some specific recommendations we have
10 on this issue of price increases and how to mitigate
11 current customers for this transition. Then Mr.
12 Cadden is going to give a little bit of history on his
13 experience being around in '96 when the Choice Act was
14 first passed.

15 I'm going to address basically three
16 things. First, I'd like to talk about the issue of
17 price increases and expand on what you've heard a
18 little and try to put the issue in perspective. I'm
19 also going to discuss some specific recommendations
20 for rate mitigation policies and how those can be
21 implemented so customers actually get a win-win
22 solution. And then finally I'm going to try to go off
23 script a little bit and address a couple of issues
24 that might come up later today when you hear from the
25 industrial community.

1 First, on the issue of price increases,
2 you've heard a little bit today about the rising costs
3 of fuel, the rising cost of supply materials, and I
4 won't continue on the same line, but I would also like
5 to point you to an attachment to my testimony which
6 shows a list of about 27 business services,
7 commodities, like potatoes, orange juice, milk, et
8 cetera, ground beef, whose prices have increased
9 between 30 to as much as 70 percent over the last ten
10 years or so. So just to put the issue of electricity
11 price increases in a little bit of perspective, if
12 rate caps had been in place for the same time period
13 for everyday goods, we'd be bracing for the same level
14 of rate increases that we are now with respect to
15 electricity.

16 So looking at the issue through this
17 lens, especially considering that the cost of fuel has
18 skyrocketed in triple digit increases, and fuel, oil
19 and natural gas, et cetera, the cost of electricity
20 when the rate caps come off, considering that the caps
21 have been in place for more than a decade, is really
22 going to be more along the lines of the natural rate
23 of inflation. This isn't to say that we're trying to,
24 you know, sugarcoat the situation. Obviously, folks
25 are concerned, rightly so, with the rising cost of

1 energy. And we're not advocating a do nothing
2 approach to this issue by any means. RESA and its
3 member companies support sound policies that are
4 designed to help customers manage this transition to
5 market pricing.

6 As far as any specific recommendations, I
7 think it's important to note that compared to other
8 states, Pennsylvania is really already ahead of the
9 curve. Just last year, the Public Utility Commission
10 passed a series of Orders, regulations and policies
11 that govern how you fully secure supplies and set
12 rates when the rate caps expire. As part of that same
13 package of regulations, the Commission has policies
14 that encourage a utility to implement rate mitigation,
15 customer education, rate increase deferral and
16 prepayment plans as part of a comprehensive regulatory
17 issue.

18 And already two utilities, West Penn
19 Power and PPL, have followed the Commission's
20 advisement and filed rate mitigation programs for the
21 Commission's consideration. PPL, for example, has
22 proposed a proactive plan that will allow customers to
23 begin voluntarily prepaying their expected rate
24 increases. We believe that these programs, if
25 properly implemented, are a good, proactive way to

1 help mitigate the impact of the rate increases on
2 customers. And we would encourage the Committee to
3 consider rate mitigation legislation modeled after the
4 Commission's policies and the PPL plan to help
5 customers manage this transition.

6 While RESA supports these transitional
7 rate mitigation programs that would allow customers to
8 phase-in or prepay their rate increases, it's very
9 important that such programs be implemented in a
10 competitively neutral way, and that's a fancy buzz
11 word. What does that really mean? Basically, it
12 means that customers should be able to participate in
13 these utility structured programs whether they choose
14 to stay on the utility's generation service or they
15 choose to take advantage of potentially lower supply
16 offers from companies, like RESA members, competitive
17 suppliers.

18 Just as an example, if a utility offers
19 customers the option of paying a little extra on their
20 bill before the rate cap expires, then if the customer
21 leaves the utility service to shop with a company like
22 a RESA member, then the accrued balance of that
23 prepayment account should follow the customers. It's
24 just common sense. They paid into it. They should
25 get the money if they leave the utility service.

1 Competitive neutrality in concept is really a win-win
2 for customers because they receive the benefit of
3 participating in the structured utility rate
4 mitigation program and they can also take advantage of
5 potentially lower supply offers from the competitive
6 market. The Pennsylvania Public Utility Commission
7 began its most recent PPL rate mitigation plan for
8 recognizing the importance of competitive neutrality.

9 Moving on to the other issue that I'm
10 going to address is this concept that we call service
11 procurement. In addition to the impending rate caps
12 of this bill, Special Session House Bill 54, would as
13 part of their procurement plan, to enter into
14 long-term contracts to acquire a generation supply or
15 to build new generation capacity. Now, this would
16 shift an enormous amount of risk back on the customers
17 and would undo one of the core benefits of the
18 Electric Choice Act, which was to shift the risk onto
19 shareholders and away from customers.

20 Just ask yourself this question. If the
21 utility spends billions of dollars to build a new
22 plant or to buy the outfit of a plant through a long-
23 term contract, what happens when wholesale prices fall
24 below the cost of that plant or the cost of the output
25 of that plant? In such a situation, in a competitive

1 market, customers can and should be able to leave the
2 utility's generation service and take advantage of
3 those savings in the competitive market. But when
4 that happens, you're going to have an increasingly
5 fewer number of customers that the utility can recover
6 its generation costs from, and you're faced with the
7 issue of stranded costs all over again, which we've
8 already gone through the discussion of the
9 \$12,000,000,000 of stranded costs that Pennsylvania
10 consumers have already paid for. Let's not repeat
11 that same mistake.

12 Now, moving on, and finally, RESA
13 believes that empowering customers with greater
14 control over rising energy costs is really the most
15 effective and enduring rate mitigation strategy.
16 Competition has already led to significant benefits in
17 Pennsylvania. And turning to one of the issues that
18 may come up when we hear from the industrials a little
19 bit later today, there was a Carnegie Mellon
20 University study that was published a couple weeks ago
21 that tries to show that customers aren't receiving the
22 benefits of competition as promised under the Electric
23 Choice Act.

24 And first of all, I'd just like to say in
25 response to that, there are over 130,000 customers,

1 including myself, in the Duquesne Light service
2 territory that really don't need a fancy econometric
3 study to prove to them the benefit of the competitive
4 market. I myself am saving ten percent compared to
5 Duquesne Light's rate every month.

6 And turning to the specifics of the
7 study, it's important to point a couple key findings
8 of the study. Now, the authors of the study have
9 Ph.D.'s and letters behind their names that I don't
10 have, but I did take econometrics in college. And
11 there are a couple of interesting things going on in
12 that study. First, it failed to account for
13 competitive prices. It only looked at the utility's
14 default rate. This is like doing a study of, you
15 know, retail electronics and only comparing Circuit
16 City's prices to those of Best Buy and the other
17 suppliers that might be selling electronics, TVs, et
18 cetera over the Internet. So it's a very selective
19 study that ignores the potentially lower competitive
20 prices that companies like RESA members are providing
21 in competitive markets.

22 And second, the authors of the study
23 brush over key findings of their own study, which
24 showed a negative impact on prices if you combine the
25 effect of retail competition with the effect of

1 wholesale competition. You know, I just think it's
2 important that we set the record straight on that
3 study.

4 Now, turning back to what I was saying,
5 RESA believes that empowering customers with the
6 benefits of the competitive market is the most
7 enduring rate mitigation strategy. And on that note,
8 we are offering --- attached to my testimony is a set
9 of ideas modeled after successful programs in other
10 states that are designed to facilitate retail
11 competition, things like making sure customers have
12 access to data so they can shop, have all the
13 information they need to shop for electricity service,
14 making sure that competitive suppliers are on a level
15 playing field and the cards aren't stacked against
16 them when they're trying to compete. I won't discuss
17 the specifics of it, but I'm available to answer any
18 questions on these reasonable market enhancement
19 measures, should you have any. In conclusion, I would
20 just like to thank you again for the opportunity to
21 testify today. And I'll turn it over to Mr. Cadden.

22 CHAIRMAN GEORGE:

23 Thank you very much. Do you have any
24 questions for this gentleman? Gentleman,
25 Representative Pyle?

1 REPRESENTATIVE PYLE:

2 How are you doing, Richard?

3 MR. HUDSON:

4 Good.

5 REPRESENTATIVE PYLE:

6 Thank you, Mr. Chairman. You had
7 mentioned the PPL model for gradual rate phasing, and
8 I'm curious. A typical PPL customer, what percentage
9 will they see rate increase? How many years does this
10 increase take place and what is the eventual number
11 they're trying to reach based on these rates?

12 MR. HUDSON:

13 I'll be happy to provide you the
14 specifics of the program. I don't have the details at
15 the tip of my finger, but my understanding is the
16 residential customers, they've already done a couple
17 of the procurements for their 2010 service, and
18 they're projecting about a 30 to 40 percent increase.
19 And the proposal that's on the table is a prepayment
20 plan, the structured program. They would earn
21 interest on it. They would begin paying into the
22 program I believe as early as this year, July or
23 August of this year, and then they would pay into it
24 now through 2010. And then for two years after that,
25 the money that they had paid into the program would

1 come back to them. And I believe it's designed to
2 keep the actual real effect down to about 15 percent
3 for the person's second year after the rate has
4 expired.

5 REPRESENTATIVE PYLE:

6 How does this differ from the ramp-up
7 that we heard from the counsel for FirstEnergy, PPL's
8 program? Maybe I should ask Mr. Feld. I'm sorry.

9 MR. HUDSON:

10 I believe Mr. Feld was referring to a
11 similar concept, allowing, you know, customers to
12 prepay for their rate increases.

13 REPRESENTATIVE PYLE:

14 Thank you, Mr. Chairman.

15 CHAIRMAN GEORGE:

16 The gentleman, Mr. Reed? The gentleman,
17 Chairman?

18 CHAIRMAN HUTCHINSON:

19 Thank you. My question goes directly to
20 one of your recommendations where we might want to go.
21 And particularly, you talked about timely and
22 efficient access to customer usage data. Number one,
23 do you perceive to access to that information a
24 difficult thing at this point, parts of the state that
25 have been deregulated? Is access to that kind of sort

1 of hard to get at? And number two, if there were
2 mandated smart meter deployment throughout
3 Pennsylvania, how would that fit into the availability
4 of that kind of data?

5 MR. HUDSON:

6 Yes. This is a great question. You
7 know, first of all, I'd like to say that we do have a
8 very collaborative relationship with the utilities
9 that we supply our customers under, and you know, this
10 legislation is not to say that they are somehow
11 obstructing access to that currently, but you do have
12 different sets of rules in each utility, and we would
13 like to see uniformity to access to data. There are
14 all sorts of data elements that we need. There are
15 new data elements if the market changes. And we just
16 think having this Office Of Competitive Retail Market
17 Development at the Commission --- it's something that
18 has been implemented in New York and Connecticut and
19 Illinois recently to promote programs like, you know,
20 greater and more efficient access to data, would help
21 address problems if they do come up.

22 And to your question about smart meters,
23 without having that timely and efficient access to
24 customer usage data, you're not going to be able to
25 extract all the benefits that you otherwise could from

1 the deployment of the smart meter. So we're very
2 excited to see the Commonwealth move in the direction
3 of more advanced metering technology. It enables us
4 as competitive suppliers to offer customers much more
5 sophisticated products and services. But we need all
6 the data that those meters are capable of providing
7 and we need it in a very timely manner to be able to
8 deliver those benefits to customers.

9 CHAIRMAN HUTCHINSON:

10 Is there an issue with who owns those
11 meters? Does that fit into the question of which
12 direction we go?

13 MR. HUDSON:

14 It does. Currently in Pennsylvania, we
15 do not have what is called competitive metering. I
16 think, you know, if the Commonwealth is going to fully
17 embrace the idea of a competitive market, eventually
18 we should get to the point where, you know, it's
19 really the customer that owns the meter, not the
20 utility. And other suppliers, like the companies I
21 represent, can be that meter service provider.

22 We have that in other states and I think
23 that's part of the ultimate end state goal of having a
24 really effective competitive market, but we're not
25 there yet. It's going to take some time before we

1 move in that direction.

2 CHAIRMAN HUTCHINSON:

3 Thank you.

4 CHAIRMAN GEORGE:

5 Gentlemen, if there are no other
6 questions for this gentleman, we'll call on the
7 gentleman, Mr. Cadden.

8 MR. CADDEN:

9 Thank you, Mr. Chairman and members of
10 the Committee. As I said, thanks for inviting me here
11 today, and permit me to commend you on the leadership
12 as we face one of the most daunting times in the
13 planning of our energy future. The challenges we face
14 are enormous and the costs are frankly quite
15 astronomical.

16 By way of a background, I am a former
17 employee of the Pennsylvania Public Utility Commission
18 and the Federal Energy Regulatory Commission. And I
19 am here today on behalf of the RESA and Constellation
20 Energy Commodities Group. While I have been a
21 resident of Mclean, Virginia since 2001, I consider
22 myself first and foremost a Pennsylvanian. I still
23 have tickets to Penn State. I root for the Eagles.
24 It's good to be home.

25 First, it's important to understand where

1 we have been and where we are so we can make more
2 informed decisions. We must understand the past in
3 order to plan for the future. Many people hearken
4 back to the good old days when utilities had long-term
5 contracts and when price volatility was something that
6 we only read about in text books. Please understand
7 that the memories of the good old days of regulation
8 can be myopic and selective. The good old days were
9 not too good for customers, which is why policymakers
10 moved to promote competitive markets as an alternative
11 to inefficient regulation.

12 Former CEO of Wisconsin Power and Light
13 probably said it best. You know, he was quoted in
14 Forbes Magazine as saying this. To point out, the
15 utilities enjoyed in the past mandated rate increases
16 to cover all kinds of dumb investments plus an
17 allowable rate of return. As a result, he went on to
18 say, there was no rate base. It's the only industry
19 I've ever seen where you could increase your profits
20 by redecorating your office.

21 By the 1980s, it was clear that cost of
22 service regulation had brought customers poor
23 performance in terms of too much generation capacity
24 would always cost more than expected, generators that
25 were not available as much as they could be, declining

1 investments in the transmission grid that otherwise
2 would have broadened customer access to the low cost
3 resources and a culture that was resistant to new
4 technology.

5 Customers paid for this inefficiency in
6 their monthly bills. Between 1970 and 1985,
7 residential rates more than tripled and commercial
8 rates quadrupled. Investors also shared in the pain.
9 Between 1985 and 1992, there were \$22,000,000,000 in
10 write-offs at nuclear plants. Industrial customers
11 were building their own generators as a way to bypass
12 their local utilities.

13 These disturbing developments prompted
14 the move to competitive markets by Congress, some
15 states and the minds of enlightened regulators. The
16 evidence was clear that traditional regulation was not
17 working, and technological innovations in generation
18 and transmission rendered invalid the premise that
19 electricity production was a natural monopoly. Moving
20 to competition was the right thing to do then and it
21 remains the right public policy today. As the
22 Chairman of the Fed said, markets aggregate diffuse
23 information more effectively and set prices more
24 efficiently than any central planner could. The
25 result is more competitive for a business to produce,

1 at the least cost, the goods and services our citizens
2 value most. In sum, the competitive markets enable
3 the nation to meet the challenges we face with
4 efficiency, fuel diversity, technological ingenuity
5 and new investment. Monopoly and old-fashioned
6 economic controls will stifle these creative forces.

7 Prior to the Electric Choice Act of 1996,
8 Pennsylvania electric utilities were vertically
9 integrated monopolies. That is, they were responsible
10 not only for the distribution and transmission of
11 electricity, but also for the generation of the power
12 they sold to their customers. Some of that generation
13 that had been built or purchased by our electric
14 utilities was very expensive and uneconomical, and
15 this in turn led to a great disparity at least among
16 some utilities.

17 I remember attending a public input
18 hearing in Pittsburgh a number of years ago trying to
19 explain to the customers why rates on one side of the
20 street were double than the rates on the other side of
21 the street. It's not an easy concept to explain to a
22 customer. When we completed the restructuring process
23 in Pennsylvania, we granted, as Representative George
24 said earlier, about \$12,000,000,000 in stranded costs,
25 of which \$2,500,000,000 can be fairly attributed to

1 costly long-term contracts with non-utility
2 generation.

3 While we in Pennsylvania were imposing
4 price caps, California went to market almost
5 immediately. The California Commission, as all of you
6 said earlier, was part of the market, if memory
7 serves, with all the utilities to buy on the
8 short-term market without an opportunity to recover
9 costs. So as their costs were rising, the customer
10 was paying a frozen rate. That drove one utility into
11 bankruptcy, PSE&G, and two companies came very close
12 to it.

13 Then the California Commission said, gee,
14 we're going to abandon the spot market purchasing
15 plan. We're going to go to long term contracts and
16 what happened then we all bought long-term contracts.
17 What happened then, as with all long-term contracts,
18 first of all, they weren't credit worthy, so they had
19 to create independent entities, I believe it was the
20 LADPW, Los Angeles Department of Public Water, to
21 enter into these long-term contracts because the
22 companies were not credit worthy. When they did this,
23 all on long-term contracts, those contracts all of a
24 sudden no more --- were no longer efficient. They
25 could get a better rate and they could get a better

1 price by buying it a different way. I guess what I'm
2 trying to say is that those customers are now locked
3 into some of these long-term contracts with higher
4 rates, and I don't think that's the right way to go.

5 I would now like to turn my attention to
6 the issue of how we can help customers manage their
7 way through this process. While Mr. Hudson has
8 provided specific suggestions on rate mitigation, I
9 thought I would focus on the policy goal, which is
10 reasonably priced, reliable service for customers.
11 How do we do this? How do we make the electric market
12 work for customers? We do this, in my view, by
13 encouraging investment in infrastructure and creating
14 balanced market rules that encourage competitive
15 market development.

16 We have underinvested in the grid for 20
17 years. Frankly speaking, we are living on our great
18 grandparents' largesse. It is estimated by the DOE
19 that we are almost \$1,000,000,000,000 underinvested in
20 energy infrastructure. This comes at a time when
21 prices for everything have been increasing, coal 33
22 percent, gas 300 percent, steel 50 percent, labor
23 costs have doubled. Electric utility use in the
24 United States is projected to grow more than twice as
25 fast as the committed resources over the next ten

1 years according to NERC.

2 Competitive markets can and will be the
3 best way to encourage investment in new generation and
4 transmission infrastructure. In my view, the best
5 mitigation strategy is a successful competitive
6 market, which will give customers more options over
7 controlling their energy costs. While the state has
8 very little to do with the wholesale market, you
9 absolutely control the retail market, and I would
10 encourage you to take steps to make sure that the
11 market works for customers. Specifically, I would
12 suggest that you create an Office of Retail Market
13 Development within the Commission to promote and
14 implement a variety of measures to stimulate customer
15 shopping and new market entry by competitive
16 suppliers. And I have listed a number of them in my
17 testimony. Illinois and Connecticut have passed
18 similar bills to promote their retail market.

19 A secure energy future requires a
20 fiscally disciplined process where the customers'
21 interests are the guiding factor and where, in fact,
22 risks can be shared. But we don't have to put those
23 risks on the backs of customers. The economic
24 slowdown of 2000 was the first time in history where
25 customers did not bear the costs. Investors did.

1 Sadly, they lost billions. The captive customers were
2 spared.

3 One of the principal reasons people visit
4 Washington, D.C. is to tour the monuments. It's one
5 of the few things to do in Washington that's free.
6 Trust me. We have the obelisk, the Washington
7 Memorial. We have a well to the temperance unit. One
8 of the nicest monuments out there is the tribute to
9 Teddy Roosevelt. It's only accessible north on the GW
10 Parkway on Roosevelt Island. On that island there's a
11 statue of Teddy along with a number of his famous
12 quotes. One of the best ones that I think is out
13 there is that he says that order without liberty and
14 liberty without order are equally destructive.

15 We have tried both approaches in electric
16 regulations, and customers suffered the consequences.
17 We can, however, have liberty with order. You can
18 ensure this by continuing down the market approach
19 that the Pennsylvania Legislature created ten years
20 ago and by encouraging investment in infrastructure
21 and creating balanced market rules. Thank you, Mr.
22 Chairman. I'll be happy to answer any questions.

23 CHAIRMAN GEORGE:

24 Gentlemen, are there any questions for
25 the gentleman? Mr. Chairman?

1 CHAIRMAN HUTCHINSON:

2 My only question is you talked about
3 encouraging investment in infrastructure. Do you
4 believe that competition itself is enough to do that
5 or are there additional steps the state can do to make
6 that happen?

7 MR. CADDEN:

8 Yes, sir, I do believe. I do believe
9 that the marketplace is doing that. A number of years
10 ago, about three years ago the Federal Energy
11 Regulatory Commission devised a pricing plan for
12 capacity cost for something called RPM. Since that
13 time, 10,000 megawatts were in cue. Do we need more?
14 Yes. One of the things that a number of people have
15 spoken earlier about this, when we talked about this,
16 when the General Assembly talks about this, when
17 Congress talks about this, when the regulators talk
18 about this, when you're adding this Wall Street gets
19 scared, there's a premium associated with Wall Street
20 being afraid of what we do.

21 CHAIRMAN HUTCHINSON:

22 Thank you.

23 CHAIRMAN GEORGE:

24 The gentleman --- Mr. Reed. My apology.

25 REPRESENTATIVE REED:

1 Just real quick. As we've dealt with
2 this issue in the last couple months, some folks have
3 been very easily --- said that deregulation on
4 electricity in Pennsylvania has been a disaster, that
5 it has failed. In your opinion, can we even evaluate
6 whether it's been successful or not until the rate
7 caps come off and we have a truly competitive market,
8 and if not, when, at what point in the future can we
9 have a true evaluation whether the deregulation of the
10 electricity market has been successful or not?

11 MR. CADDEN:

12 I believe that the market has been
13 successful so far, and I believe as we move forward it
14 will only get better. Let's look at the old the
15 telephone constraint, and I can remember the days. I
16 was working before Shapp, before Johnny Green opened
17 up the telephone industry. I remember the industry
18 executives telling me we can't have a recorder on a
19 machine. It will blow out the network. We can't have
20 touch tone dialing. It will blow out the network.
21 When you open up a market, it brings us a lot of new
22 things. And I expect a number of you have
23 Blackberries. This was an old fashioned telephone
24 business. Blackberries, voice mail, call waiting,
25 call forwarding, none of those things, in my view,

1 would have been available.

2 I believe as this market develops, you'll
3 see a lot of new things. When you passed the smart
4 metering, I think that will provide the customers a
5 myriad of opportunities to save money on their
6 electric bill. And it will only take a small amount
7 of people to participate and to be in a program to
8 drive the prices down for everyone else. I think
9 those are good things, that we're doing a good job,
10 and I encourage us to stay the course.

11 MR. HUDSON:

12 I can expand on that. You know, I think
13 there's actually evidence today in Pennsylvania that
14 retail competition is providing enormous benefit. In
15 my testimony, I didn't go over this, but there's this
16 school consortium that my company, Strategic Energy,
17 has worked with since --- they were our very first
18 customer that came up in 1997 right after the Choice
19 Act was passed, and we saved the schools in Western
20 Pennsylvania over \$30,000,000 over the last ten years
21 or so. And just a few weeks ago, the City of
22 Pittsburgh, Allegheny County and other area
23 organizations formed a purchasing pool and took their
24 supply, their demand up to bid and got a fixed price
25 offer. Unfortunately, it wasn't us, but someone won

1 that load. And there's \$1,400,000 through that
2 program.

3 And even though the market, it still
4 isn't fully developed for residential customers in
5 Western Pennsylvania, where the rate caps have come
6 off, we do have a couple competitive suppliers in the
7 market providing ten percent off offers, as I
8 mentioned earlier. You know, I'm one of those
9 customers that saves money. So I think there's a lot
10 of evidence that the market is working.

11 REPRESENTATIVE REED:

12 One of the focal points that people
13 recite is the percentage of residential customers
14 actually shopping for electricity providers today.
15 Now, my assumption would be that when the caps come
16 off, that percentage is going to increase rather
17 dramatically. Would that be your assumption as well?
18 Because there does not seem to be a whole lot of
19 incentive right now to shop around with the rate caps.

20 MR. HUDSON:

21 Well, certainly right now in the utility
22 service areas where rate caps are still in place,
23 there is no way that a competitive market is going to
24 develop unless the wholesale market prices were to
25 decline, you know, dramatically, which isn't likely to

1 happen. So as rate caps do come off and we have
2 market pricing, it's important that you get the
3 procurement plan right and make sure that the
4 procurement plan is market responsive so we don't
5 repeat the mistakes of having long-term contracts,
6 long-term fixed price rates in place, which makes it
7 very risky for new suppliers to come into the market.

8 So as those rate caps do come off, you
9 get the market going right, you know, the shopping
10 takes place in the residential market, small business
11 market --- you can look to New York. They've
12 implemented some of the programs we've talked about
13 today. And the New York Commission found that the
14 very programs that were recommended for Pennsylvania
15 contributed to a significant increase in residential
16 customer shopping and market entry by new residential
17 suppliers.

18 CHAIRMAN GEORGE:

19 The gentleman, Mr. Conklin?

20 REPRESENTATIVE CONKLIN:

21 No questions. Thank you.

22 CHAIRMAN GEORGE:

23 Thank you very much. Just one question,
24 if I may. I read this testimony along with the others
25 that we tend to review every bit of them again and

1 again and again ---. It isn't because I'm older or
2 been here longer, but we've gone through this, in
3 fact, 10 or 12 years before that in the House. We
4 were faced with a situation involving the PUC and such
5 where we didn't know what was going to happen. That's
6 when the federal government passed a law that said if,
7 in fact, you generate in any way, the excess of your
8 generation has to be purchased by the local entity who
9 is providing. Am I right or wrong?

10 MR. HUDSON:

11 Absolutely, Mr. Chairman.

12 CHAIRMAN GEORGE:

13 Okay. So now what I'm saying to you is
14 with the fact and the knowledge we know, naturally
15 these companies have to protect their investors, and
16 they have invested in the entities outside of the
17 state. And I would say buying power from them
18 benefits them two ways. First, they can furnish and
19 then they can make basically their rate --- or their
20 investors a profit margin commensurate with that
21 utility they're buying it from. So they're generating
22 and things like that. These companies will have to
23 buy off of what they're generating new, even though
24 they don't have to pay any other price higher than
25 what they're paying.

1 So don't you think it would be incumbent
2 on all of these people to start investing some of
3 these dollars in Pennsylvania where we again --- see,
4 I'm not concerned when you tell me about what gas is.
5 There isn't anybody who doesn't know what gas is. I
6 had a trucker call me this morning. They wanted to go
7 on strike. When I was in the Navy, fuel oil was nine
8 cents a gallon. Now it's \$4.29. Now, there isn't a
9 legislator here that doesn't get calls from
10 constituents saying, help me, I don't have money for
11 fuel, or about the LIHEAP. What do you think is going
12 to happen if I dare be that impulsive? When the rate
13 cap comes off, do you think that the prices aren't
14 going up?

15 MR. CADDEN:

16 That's where the prices are going to go
17 up ---.

18 CHAIRMAN GEORGE:

19 That's exactly right. And you know, what
20 bothers me is if you think that the price of gas and
21 the price of iron and the price of this and that is
22 high now, what do you think is going to happen when
23 the rates go up?

24 MR. CADDEN:

25 It will be higher, sir.

1 CHAIRMAN GEORGE:

2 Okay. With that, I leave you with my
3 very sincere thank you. We await a considerate effort
4 for all that hear me to work with us so that we make
5 sure that that group of people, especially that at one
6 time it was considered a luxury today, it's a
7 necessity, and where they'll be able to pay their
8 bills knowing that gas is more and oil is more and
9 eggs are more and butter is more. It is a scary
10 situation. I can sit at your side and tell you about
11 figures. You know, it's too bad about figures,
12 because some times they'll lie or at least they're
13 misrepresented, not that I doubt your veracity, but
14 I'm saying that we are in a situation where all of us
15 are scared about what's going to happen.

16 And we want the Pennsylvania utilities to
17 continue to prosper, but we want them to prosper in
18 Pennsylvania where they're burning our coal and
19 employing our people and buying the power from
20 Pennsylvania. At least, I do, and I can almost bet so
21 do the rest. Thank you for your time and coming
22 before us. Thank you very much.

23 Now, with the fact that the gentleman Mr.
24 Messer cannot be with us, I would wonder if Frances
25 Mansberger would come forward with her few minutes to

1 enlighten us, please.

2 MS. MANSBERGER:

3 Good afternoon. Thank you for allowing
4 me to present the Industrial Energy Consumers'
5 perspective on the issue. Mr. Messer called me
6 yesterday afternoon and said, see you bright and early
7 tomorrow morning. And last evening at ten minutes to
8 nine, I received a phone call that Mr. Messer had had
9 an emergency surgery. We are not able to ascertain
10 what the problem was, but we do regret that he is not
11 able to be with you.

12 I'm Frances Mansberger. I am simply and
13 clearly just the administrator of the Industrial
14 Energy Consumers Association, have been since 1981
15 when they were born. I am not an engineer. I am not
16 a large energy purchaser. So if you'll excuse me, I
17 will not be able to answer the very technical
18 questions at the end of this presentation, but will be
19 happy to take any questions you might have back to the
20 membership and report. The membership is always
21 available to meet with you individually or as a group.

22 If I may, and for Mr. Messer and the
23 Industrial Energy Consumers of Pennsylvania --- Mr.
24 Messer, by the way, is the Vice President of Linde
25 Energy Services. And it was formally called BOC

1 Gases. The Linde Energy Services company is a
2 subsidiary of the Linde Group, which manufacturers
3 atmospheric gases at three locations in Pennsylvania.
4 Linde Energy Services procures electricity and
5 operates within the PJM Interconnection wholesale
6 markets to deliver power to their individual
7 manufacturing facilities in deregulated markets. His
8 subsidiary was created to mitigate a small portion of
9 the substantial price increases that have occurred in
10 the deregulated elective market across the United
11 States.

12 To introduce you to the Industrial Energy
13 Consumers, I'd like to ask you to put on a different
14 consumer hat, because the residential and the small
15 commercials purchase energy one way and use a lesser
16 amount of energy than we do. Our 24 member companies
17 are obviously large commercial and industrial
18 consumers of electricity and natural gas. Our 24
19 companies employ 42,000 people. The testimony that
20 you have says 41,000, but I had a late person
21 yesterday that gave me revised figures. There were
22 42,000 workers in the Commonwealth of Pennsylvania.
23 We consume 6,000,000,000 kilowatt-hours of purchased
24 energy in Pennsylvania. That does not include any
25 energy that we are co-generating at our own facilities

1 and energy that we are reusing at our own facilities.

2 Some of the facilities, for instance, one
3 of the facilities reuses some of their steam to power
4 some of their other equipment within their facilities.
5 So we are doing everything we can to conserve and use
6 energy efficiently within our own manufacturing
7 processes. We also consume 36,000,000 MCF of gas.
8 Members anticipate a cost increase of \$120,000,000 to
9 \$180,000,000 annually starting in 2010 and 2011.

10 IECPA is here today to make the following
11 remarks and to address the following issues. IECPA
12 supports the approval of Special Session House Bill 54
13 to extend rate caps through January 1st, 2013. We
14 suggest the submission of five suggestions for future
15 initiatives to create cost plus reasonable return
16 electric prices in the Commonwealth. We promote a
17 discussion of the rationale for rate cap extension as
18 an interim step to provide the opportunity to develop
19 just and reasonable electric price solutions post
20 January 1, 2013.

21 IECPA requests for state legislators to
22 encourage a Congressional Order to FERC to reform
23 three wholesale pricing mechanisms, locational
24 marginal pricing, LMP, reliability pricing model, RMP
25 (sic), and FERC testing for market based rate

1 authority. The inability for PJM consumers to
2 continue the wealth transfer to suppliers in an amount
3 exceeding \$37,300,000,000 by 2011, that's
4 \$11,000,000,000 in stranded costs and \$26,300,000,000
5 in RPM. IECPA members expect further cost increases
6 of \$120,000,000 to \$180,000,000 per year when rate
7 caps expire. Current and projected electric market
8 conditions, including selected companies' stated
9 earnings in deregulated markets are something we'd
10 like to look at.

11 IECPA has five suggestions. May we
12 suggest the following initiative that can be evaluated
13 and developed by extending the current rate caps?
14 First, all generation product receiving Commonwealth
15 assistance of any form, expedited siting, funding or
16 tax incentives and so forth should be required to sell
17 their output on a cost plus reasonable return basis
18 rather than on the flawed LMP pricing model. New
19 generation construction projects should be approved on
20 a cost plus basis, and existing generation sources
21 should be encouraged to contract on a cost plus basis.

22 New initiatives are needed to encourage
23 customer self generation and co-generation.
24 Demand/response markets further development to ensure
25 participants are properly rewarded for the benefits

1 provided in price reduction while also providing a
2 meaningful check against supply side pricing. Energy
3 consumer tax burdens should be reduced or eliminated
4 going forward, including the gross receipts tax and
5 the revenue neutral reconciliation. Market reforms at
6 the federal level need to be communicated and
7 implemented to modify or eliminate the administrative
8 pricing mechanisms like the LMP system and RPM.

9 Regarding federal reforms in the
10 wholesale electric market, there are three federal
11 reforms for the wholesale market to provide just and
12 reasonable rates at the retail level. As relates to
13 LMP, locational marginal pricing, PJM's market design
14 pays the highest accepted bid by a generator to all
15 accepted bids, the market clearing price. Generators
16 receive the LMP clearing price regardless of their own
17 marginal cost or bid. Based on generating units,
18 nuclear coal, et cetera can receive substantial
19 revenues under this model.

20 LMP did not exist when Pennsylvania
21 enacted the restructuring legislation in 1996. PJM
22 changed from a split the savings approach to a bid
23 based approach in 1997 over the objection of
24 industrial customers. Bid based approach was
25 originally based on average cost bids, but converted

1 to today's margin price bid in 1999, RPM. The LMP
2 pricing model was designed in part to send price
3 signals for the need and location of new generation
4 and demand response. When this did not occur, PJM
5 implemented another administrative pricing mechanism,
6 RPM, to accomplish this purpose.

7 The first three-year period of RPM
8 auction generated an increase of about \$450,000,000
9 for Duquesne Light leading to a request to leave PJM.
10 Note that the supply is greater than load in this
11 particular region, and one would not expect these
12 customers to pay more to encourage generation
13 construction. PJM end users will spend about
14 \$26,300,000,000 under the RPM model from 6/1/07
15 through 5/31/11. For this payment, consumers will
16 receive a net increase of only 2,400 megawatts of new
17 in the ground generation. RPM also ensured continued
18 operation of 3,200 megawatts of the worst performing
19 units on the system, which had been designated for
20 retirement. \$26,300,000,000 could have constructed up
21 to 40,000 megawatts of new combustion turbine plants,
22 9,000 megawatts of clean coal generation or 14 PATH
23 transmission projects, market based rate authority.

24 FERC meets its duty under the Federal
25 Power Act by relying on a flawed market based rate

1 authority regime. FERC uses a truncated screening
2 process to review requests from wholesale generators
3 and other market participants to sell energy, capacity
4 and ancillary services at market based --- quote,
5 market based rates. FERC does not examine that rates
6 strike a just and reasonable balance between
7 shareholders and ratepayers.

8 LMP pricing system has upside/downside
9 incentives. Why would generators incur the capital
10 investment risk to build new generation if the Act
11 reduces the rate of return on their existing assets?
12 A just and reasonable discussion. The law requires
13 that rates be just and reasonable. Pennsylvania
14 consumers will have paid utilities over
15 \$11,000,000,000 for so-called stranded costs for
16 uneconomic generating resources in the restructuring
17 legislation. RPM will transfer another
18 \$26,000,000,000 from consumers to suppliers.

19 In addition to this wealth transfer, the
20 rate caps may have provided benefits by avoiding the
21 past reach to customers of cost decreases. Declining
22 rate base as investment in nuclear facilities was
23 recovered. Coal price declines in the late 1990 ---
24 coal prices only increased recently, and cost declined
25 in utility cost of capital.

1 PPL Corporation, for instance,
2 shareholders' total return on investments was over 254
3 percent from 2003 to 2007. Earnings per share are
4 projected to increase by 35 percent in 2010 due to
5 higher forward energy and capacity prices. On
6 Allegheny Energy shareholders' investment increased by
7 623 percent from 2003 to 2007. Company projects pre-
8 taxed income to increase seven-fold from 2007 to 2010.

9 IECPA appreciates the opportunity to
10 testify before the Committee on this important topic.
11 If we are going to continue to have a strong
12 manufacturing and industrial base in the Commonwealth
13 providing good jobs to Pennsylvania residents, the
14 Legislature must have the fortitude to tackle the
15 complex but important issue of ensuring that
16 Pennsylvania businesses pay reasonable electricity
17 rates.

18 IECPA specifically requests the
19 following: approval of House Bill 54 to provide
20 sufficient time to draft a permanent statewide
21 solution with an intent to include all customers in
22 the Greater Pittsburgh area, including those who are
23 already in a deregulated market, pursuit of active
24 reform by the Commonwealth that the federal level to
25 eliminate the administrative pricing mechanism like

1 the LPM system and the RPM and move to a cost plus
2 reasonable return basis, development of other
3 opportunities to bypass the LMP system and ensure that
4 Pennsylvania's consumers provide just and --- pardon
5 me, Pennsylvania resources provide just and reasonable
6 prices, generation construction, parenthesis,
7 generation construction on a cost plus basis,
8 initiative for customers to self generate or
9 co-generate, et cetera, support to develop meaningful
10 demand response markets where participants are
11 properly awarded for the price reductions conferred in
12 the market and initiatives to reduce or eliminate the
13 tax burden on energy consumers. For example, the
14 Gross Receipts and the Revenue Neutral Reconciliation.

15 Generation plant owners and retail
16 electric suppliers will promote the planned
17 progression for a fully deregulated market for most of
18 Pennsylvania during 2010 and 2011. A significant
19 portion of their argument is the benefit of shifting
20 power plant construction cost risk from end use
21 customers to the individual entities building these
22 plants.

23 Industrial customers are here today to
24 state that all end use customers have already assumed
25 that risk. As I discussed previously, PJM

1 interconnection customers will pay approximately
2 \$26,300,000,000 for the promise of new generating
3 plant construction. To date, a net increase of only
4 2,400 megawatts of new generation plant construction
5 has been committed. This is an extremely poor return
6 on the investment by all end use customers and should
7 counter the argument that risk will not be shifted to
8 customers. It already been shifted to customers.
9 Thank you very much.

10 CHAIRMAN GEORGE:

11 I thank the lady. Will there any
12 questions for the lady?

13 MS. MANSBERGER:

14 The lady doesn't --- well, the lady will
15 try to answer questions, but knowing full well ---.

16 CHAIRMAN GEORGE:

17 Representative Reed?

18 MS. MANSBERGER:

19 Please, Mr. Reed.

20 REPRESENTATIVE REED:

21 It will be more than fine if you just got
22 back with us and the Chairman with any questions that
23 you may not be able to answer. To begin with, I do
24 appreciate your recognition that elimination or
25 phasing out of the Gross Receipts Tax should be part

1 of a mitigation strategy along with some of the
2 phase-in plans that we've heard from earlier today.
3 That's been something pushed by a number of
4 legislators as something that the legislators can do
5 pretty quickly and pretty directly through the
6 budgetary process to have immediate impact on consumer
7 electricity bills.

8 A couple of the questions I have. The
9 first one goes back to the first tenet of your five
10 suggestions on the last page of the testimony that you
11 just covered where you talked about the approval of HB
12 54 to provide sufficient time to draft a permanent
13 statewide solution with intent to include all
14 customers in the Greater Pittsburgh region. I
15 understand the first part. I'm not sure if I
16 understand the actual intent of the second part. Are
17 you putting rate caps back on the systems that have
18 already seen them removed?

19 MS. MANSBERGER:

20 No. But we are hoping that we can
21 include those in the discussion of what happened or
22 happens to those customers. We have some of our
23 plants in that area that either are competing with
24 some of the plants just outside that area or plants
25 that are manufacturing the same product in the east

1 and the west and they're not have having comparable
2 rates, as I understand it. So we're not advocating
3 re-regulating. That is not in our thought process.
4 But we are trying to find some way to help some of our
5 members in the Pittsburgh area who have already seen
6 significant rate increases because the caps have come
7 off. And I think that we would be happy to have
8 someone get in touch with you. I'm not purchasing the
9 energy. I just can't give you the specifics, and I
10 apologize for that.

11 REPRESENTATIVE REED:

12 That's quite all right. My second
13 question is, and you can correct me if I'm wrong.
14 When deregulation initially occurred, I was actually
15 in college at that time, so I wasn't in the
16 Legislature at that time, but weren't the industrials
17 part of the push to deregulate the electricity market?

18 MS. MANSBERGER:

19 We definitely were at that point, but
20 that was over ten years ago and certainly the whole
21 world has changed. Everyone sat at that table at that
22 time and we really fully believed that in exchange for
23 rate caps, the utilities got their stranded costs, and
24 if all things were kept on an --- even as we're moving
25 forward with inflation, that it would not have been a

1 problem. Today the whole world is different and how
2 we're doing things are different, and we need to
3 seriously take a look at what we can do to make the
4 law acceptable to both the utilities and the
5 consumers.

6 Members of the Industrial Energy
7 Consumers have said on many occasions that they do not
8 object to and would like to promote the utilities
9 making a fair and just and reasonable rate of return,
10 just as we expect to do that, but when caps come off,
11 we feel that we are competitively disadvantaged by the
12 increases in the energy prices.

13 REPRESENTATIVE REED:

14 I would have to assume that when you
15 pushed for the deregulation of the electricity market,
16 your members pushed that on the premise that you were
17 going to save them money, and that you're now against
18 that decision because you believe that in the end, it
19 has ended up costing or will cost your members
20 additional money. So in essence, what is happening is
21 you're making a decision purely based upon the cost to
22 your individual companies, which I can understand, but
23 is that a fair assessment of why your position has
24 changed? You thought it was going to save money. Now
25 you don't think it's going to save you money, so the

1 position has flip-flopped. I mean, in the end, isn't
2 that what it boils down to?

3 MS. MANSBERGER:

4 It's part of it. The other part of it
5 we're struggling to keep our jobs in Pennsylvania.
6 We're struggling within our own companies to keep
7 production in Pennsylvania. And within our own major
8 companies, they, for instance, and I use their name
9 here today because it's coming to mind, is --- Proctor
10 and Gamble can send their production to the south or
11 the west or overseas or wherever, and they fight
12 within their own company to be able to get the
13 production. Energy is a big part of their production
14 costs. Our companies, like Mr. Messer, anywhere from
15 50 to 70 percent of their manufactured product, their
16 cost for their manufactured product is energy, so
17 naturally ---.

18 REPRESENTATIVE REED:

19 I think when you look at it, energy is a
20 big part of our entire economy nowadays more than it
21 used to be. Just two final questions. Number one,
22 you're promoting the extension of rate caps on the
23 products sold by the utilities. How many of your
24 companies have capped the rates they charge for the
25 products they produce?

1 MS. MANSBERGER:

2 Well, let's put it this way. They're
3 selling their products on a global market.

4 REPRESENTATIVE REED:

5 On a free market.

6 MS. MANSBERGER:

7 On a free market and a global market.

8 REPRESENTATIVE REED:

9 Second, I guess more it'll conclude my
10 question, but as the Chairman has pointed out many
11 times throughout my time on this Committee, him and I
12 come from different generations. His experiences
13 growing up are a little bit different than mine, but I
14 did grow up in the world in Indiana County, and my
15 parents' home is in a rural electric coop. And it was
16 even in the '80s and '90s not an unfamiliar sight that
17 there were weeks, one, two, even months, about two and
18 a half three weeks, where we went without electricity
19 because of major snow storms. And when that would
20 occur in our home, luckily we had a wood burner. We
21 heated the house with the wood burner.

22 But in today's day and age, I find that
23 even with folks calling my district office, if the
24 electricity is out for a couple of hours, folks are
25 flipping out like it's the end of the world. So our

1 definition of reliability within our own residential
2 usage has changed a great deal. Just in the last
3 couple decades, I can only imagine going back you know
4 three, four or five decades ago. Could you tell me a
5 little bit about how much of an impact an unreliable
6 electricity system would have on large industrial
7 consumers? How much of a concern is that for you?

8 MS. MANSBERGER:

9 It's absolutely a concern. And at many
10 plants we have back up generation that we can use, and
11 have invested in seeing that their product continues
12 to move. There are some manufacturers, like PPG,
13 float glass plants, that you just can't stop that in
14 the middle of production. So it is very disconcerting
15 to our members not to have reliable electricity, and
16 we are trying to do within our own companies what we
17 need to do and invest within our own companies to see
18 that we stay online and continue to be able to
19 manufacture our products.

20 And I'd like to go back to something else
21 that you said. You said many, many years ago when you
22 were a young man. And Mr. George and I had the
23 discussion this morning that Mr. George has been here
24 since '74 and I've been working this legislative
25 process since 1970. So for once, I have some

1 longevity over Mr. George. But nevertheless, I now
2 currently live in the Met-Ed territory and by the way,
3 they do a fine job when they are finally able to get
4 to our house to put the energy back on, but I
5 currently live one mile away from my closest neighbor.
6 You have to go through the woods three quarters of a
7 mile to get into where the house is. Two winters ago,
8 I had two huge trees across my driveway and we had to
9 use heat, wood heat to heat our total electric house.

10 People need to get over it. You know,
11 just because you don't have electricity for a little
12 while doesn't, in my opinion, impact the residential
13 consumer as badly as we think we have become so
14 instantaneously gratified that we can't even allow
15 utility companies --- now I'm talking for them, so I
16 hope they give me a gold star. So we can't even allow
17 a utility company a couple of days to come and cut up
18 trees and things? We all want reliability and there
19 are things that we need to do for reliability, but
20 people that are calling you because their power is off
21 for two hours or even one day need to get over it.
22 This is petty.

23 REPRESENTATIVE REED:

24 Well, I would venture to guess that your
25 members' companies would be pretty upset if their

1 power was off for one or two days. And I think we
2 need to make sure as legislators that we take into
3 account the small guy as well as the large guy when we
4 talk about reliability. But in the end, we all
5 believe, and I think most of the members of this
6 Committee believe we need to find a successful
7 mediation strategy ---

8 MS. MANSBERGER:

9 We do too.

10 REPRESENTATIVE REED:

11 --- to help at least minimize the impact
12 of the rate shock that comes with the caps being
13 removed. But in the end, we also want to make sure we
14 do it in a responsible manner that does not impact
15 reliability for our small consumers who may live out
16 in the rural poor sections of Pennsylvania as well as
17 large industrial consumers that want to make sure that
18 they can remain competitive in the global market. So
19 thank you for your testimony today and thank you, Mr.
20 Chairman.

21 MS. MANSBERGER:

22 My final comment, Mr. Reed, is that when
23 we are in dire need of energy, the industrials do
24 curtail. So I want you to know that we do curtail our
25 manufacturing. And there have been times when we have

1 been ordered to curtail during the Casey
2 Administration and other times, curtail our
3 manufacturing so we have enough energy for the
4 residential.

5 REPRESENTATIVE REED:

6 Okay. I just asked you how important
7 reliability was, and you told me it's very important,
8 and you said reliability is not an issue. That's
9 something we've got to ---.

10 MS. MANSBERGER:

11 I didn't say reliability isn't an issue.
12 I said we are doing things within our own plants to
13 ensure that we have reliability through other methods.
14 Okay. Thank you.

15 CHAIRMAN GEORGE:

16 The gentleman, Mr. Conklin?

17 REPRESENTATIVE CONKLIN:

18 Could you please tell me what the LPM and
19 the PKM and all these --- great, great testimony, but
20 I have no idea ---.

21 MS. MANSBERGER:

22 We are actually putting together a paper
23 so that you understand all these things, just a
24 definition paper. But I'll ask the utilities, too,
25 because they are good and I don't want to misspeak.

1 As I best understand LPM, locational marginal pricing
2 is --- everybody help me. You know this better than
3 I. Like I said, I'm not an energy purchaser. As I
4 understand locational marginal pricing as a staff
5 person and not as a huge energy purchaser, as Mr.
6 George makes his --- because of a FERC Order, Mr.
7 George can produce energy at two cents, and Mr. Kuhn
8 at three cents and you're at four cents, and you all
9 come in. Under locational marginal pricing, everybody
10 gets four cents for that block of power. Now, that's
11 as I understand it, and I will allow the utilities to
12 further explain that to you because as I said, I do
13 not deal with that. But everybody gets the highest
14 price.

15 REPRESENTATIVE CONKLIN:

16 So your understanding is no matter what
17 the generation price is, you get the highest price?

18 MS. MANSBERGER:

19 That's my understanding. May I ask for
20 any ---?

21 MR. CADDEN:

22 Do you want some help here?

23 MS. MANSBERGER:

24 Yes.

25 REPRESENTATIVE CONKLIN:

1 I'm sorry. I didn't mean ---.

2 MS. MANSBERGER:

3 On those issues, it's important that you
4 understand them. And we're all friends even though
5 we're opponents. Go ahead.

6 MR. HUDSON:

7 I'm not an expert on this by any means,
8 but ---.

9 MS. MANSBERGER:

10 Oh, boy, you're good.

11 MR. HUDSON:

12 There's a lot of discussion about the
13 purported power feed of the single area price auction
14 system at FERC. But the way it was explained to me is
15 I'm a generator and I produce power at two cents, and
16 my neighbor who is a generator, maybe they're a
17 natural gas unit. They can produce it at five cents
18 per kilowatt hour. We have the alternative, which is
19 pay as bid. I bid my two cents, he bids his five
20 cents. And what's to keep me --- I know that a few
21 times the five cents generator could have to come
22 online. What's to keep me, the two cent guy, from
23 submitting my bid, even though I know my cost is only
24 two cents, from submitting it at five cents?

25 REPRESENTATIVE CONKLIN:

1 And that's how it's done?

2 MR. HUDSON:

3 Right. But that's the reason for the
4 single area price, because when you have the single
5 area price, the highest priced unit sets the price for
6 that hour. There's no incentive for anyone to bid
7 more than their actual marginal cost, the marginal
8 cost, the cost to produce ---.

9 BRIEF INTERRUPTION

10 REPRESENTATIVE CONKLIN:

11 And what letters --- this is on behalf of
12 PJM ---?

13 MS. MANSBERGER:

14 Pennsylvania, Jersey, Maryland
15 Interconnection. PJM is the interconnection.

16 MR. HUDSON:

17 It's a regional and it's a not-for-profit
18 entity that's set up to oversee the reliable dispatch
19 of generators. You've got all these generators out
20 here who submit bids. They run a fancy, you know,
21 economic model to determine what the order dispatch in
22 the generation unit should be. So base load coal unit
23 is told to send out their power first, and you've got
24 the natural gas unit during peak times that comes
25 online. You've got maybe an oil carrier unit that

1 comes online after that. So they oversee that
2 process.

3 REPRESENTATIVE CONKLIN:

4 So basically, they market --- if you're a
5 coal generation plant, they put you online with
6 natural gas and oil generation plants, you're
7 making ---?

8 MR. HUDSON:

9 Well, I'm not sure that necessarily ---.

10 REPRESENTATIVE CONKLIN:

11 I'm just trying to ---.

12 MS. MANSBERGER:

13 It could be.

14 MR. HUDSON:

15 In certain hours, they getting paid ---
16 only the coal plants, and the coal plants set the
17 clearing price, whatever the price is, five cents, but
18 then there are going to be hours in which they have
19 the gas unit set the price, because they're needed to
20 come online. And that's going to be higher.

21 REPRESENTATIVE CONKLIN:

22 One last question before I get my
23 microphone shut off on me. Now, I'm going to try one
24 more time to get my arms around it. If you own the
25 generation plant and I'm selling my electricity to the

1 lady, how do I get paid from her and how do I pay you
2 for generation? I'm just a private entity ---.

3 MR. HUDSON:

4 Well, you have the distribution
5 companies. They're still recovering the costs of
6 their system from every customer as regulated. And me
7 as a supplier, I have access to their line. If I
8 serve the customer, the customer is still paying for
9 this line through their regulated distribution rate.
10 I am a competitive supplier and I'm paying the
11 distribution rate on behalf of the customer. The
12 customer still pays that. It's still regulated by the
13 Public Utility Commission. But the generation
14 component is deregulated and the prices are dictated
15 by the market.

16 REPRESENTATIVE CONKLIN:

17 Thank you.

18 MS. MANSBERGER:

19 Yes, and it's not --- it will not be
20 industrial based. I just thought for you folks it
21 would be good if you had a sheet that told you what
22 the terminology meant, and we're going to be putting
23 that together.

24 CHAIRMAN GEORGE:

25 I want to thank the lady for taking this

1 opportunity.

2 MS. MANSBERGER:

3 Thank you.

4 CHAIRMAN GEORGE:

5 I want to thank, if I may, all the
6 presenters who have come a long way with their
7 accompaniment. I want to thank those who have honored
8 us with coming in to listen, and last but not least, I
9 want to thank these legislators that have the best
10 interests of their constituency and Pennsylvania
11 residents at heart. Thank you all. Without any
12 further notice, may I have an adjournment?

13 REPRESENTATIVE PYLE:

14 So moved.

15

16 * * * * *

17 MEETING CONCLUDED AT 3:30 P.M.

18 * * * * *

19

20

21

22

23

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25