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COMMONWEALTH OF PENNSYLVANIA

HOUSE OF REPRESENTATIVES

ENVIRONMENTAL RESOURCES & ENERGY COMMITTEE

COMFORT INN & CONFERENCE CENTER

699 RODI ROAD

PITTSBURGH, PENNSYLVANIA 15236

TUESDAY, JULY 22, 2008

BEFORE:

Representative Camille George, Chairman
Representative Scott Hutchinson, Co-Chairman
Representative David Levdansky
Representative John Hornaman
Representative Scott Conklin
Representative Kathy Rapp
Representative Jeffrey Pyle
Representative Dave Reed

Reported by: Amanda M. Murphy

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P R O C E E D I N G S

(1:00 o'clock p.m.)

MR. GEORGE: The time of 1 p.m. having arrived, the Environmental Resources and Energy Committee hearing on this Tuesday July 22, 2008 at 1 p.m. at the Comfort Inn Conference Center in Pittsburgh East will commence.

If I may to introduce those panelist legislators. The gentleman from Centre County at my far left, Mr. Conklin.

MR. CONKLIN: Thank you, Mr. Chairman. Scott Conklin from the western portion of Centre County, the 77th District.

MR. GEORGE: Next to him is a gentleman, Mr. Hornaman, from Erie.

MR. HORNAMAN: Thank you, Mr. Chairman. John Hornaman, 3rd District, Erie County.

MR. GEORGE: And to his right, a gentleman, Mr. Levdansky, from Allegheny County.

MR. LEVDANSKY: And Washington County as well. Thank you.

MR. GEORGE: And I'm Bud George from Clearfield County, and to my right is my co-chair, the gentleman, Mr. Hutchinson, from Venango County.

MR. HUTCHINSON: Thank you, Mr. Chairman.

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MR. GEORGE: And the lady on the right is Representative Rapp from Warren County.

MS. RAPP: Thank you, Mr. Chairman. Representative Kathy Rapp, 65th Legislative District, Warren, Forest, and four townships in McKean County.

MR. GEORGE: Okay. I thank the lady. I thank all the members for being present. The significance of our current crisis cannot be denied on this energy crisis.

Rising costs of food and fuel are just the tip of the iceberg for Pennsylvanians who will soon be faced with the rising cost of utility prices once the rate caps expire.

While all of the Commonwealth's residents will suffer, there can be no doubt that our middle and low income residents will fare the worst.

As you all know, I have never been a fan of deregulation, and I fear what lies ahead for all of us over the next couple of years; and I've been closely following the struggles of other states that have tried the costly experiment of deregulation, and I'm not at all heartened at what I see.

Most recently, the Wall Street Journal has reported that the people in Texas who are shopping for electricity today are paying up to 31 cents a kilowatt

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hour, which is four times what Allegheny Power customers pay here in the Commonwealth.

Why worry about Texas? Because the federal government once said that Texas is an example of successful deregulation. This is a warning to the people of Pennsylvania and to those of us in the legislature who must try to prevent an energy crisis here in the Commonwealth.

My hope is that with today's hearing, we will continue on the road to finding an answer to this problem before the problem becomes catastrophic.

I've asked our speakers here today to help steer us in the right direction by providing us with each of their unique points of view.

I'm going to ask those presenters to limit to the time that they were apprised of; and while answering questions, if at all possible, answer in the affirmative or negative, whichever your reply will be. I ask those members who will be interrogating or asking for answers to do the same.

I now turn to my co-chair, the gentleman, Mr. Hutchinson, for a few remarks.

MR. HUTCHINSON: Thank you, Mr. Chairman. I want to personally thank you for hosting this hearing and allowing us to delve into the big issues

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that are facing the Commonwealth of Pennsylvania as we address energy prices and increases of all sorts and try to steer our way to the future in a way that is both economically competitive as well as least harmful on the citizens and employers of Pennsylvania.

So I think it's important that we air these issues in public, and I thank you for hosting these forums to do just that; and I look forward to the informative session today. Thank you, Mr. Chairman.

MR. GEORGE: The gentleman testifying first here today is a gentleman, Mr. Jay Apt, executive director of the Carnegie Mellon University Electricity Industry Center at Carnegie Mellon University's Tepper School of Business where he is an associate research professor and the CMU Department of Engineering and Public Policy where he is a distinguished service professor. Will the gentleman step forward with his presentation. The Board and all thank you for your presence.

MR. APT: Thank you, Mr. Chairman. Thanks. It's good to see all of you, some of you again. I'm a professor, so I have a computer. It prevents me from forgetting things when I'm old.

Almost two years ago, the Team Pennsylvania Foundation, seeing what was lying ahead, asked us to

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perform a study to look at what the options might be for the Commonwealth after the rate caps came off.

This was based on our research, much of which is published in peer-reviewed academic journals. It resulted in this report that you have in front of you.

We're asked specifically to look at the competitive position that Pennsylvania has, specifically with respect to the industrial and the commercial customers.

So the study doesn't deal with residential customers, although we did a little bit of that. What I'm going to tell you today is some fundamentals, and then I'm just going to get on some of the recommendations that have been made for both near-term and medium-term work that the legislature can actually do.

So first and foremost, as the Chair alluded, there are 15 states that have restructured and have fully until competitions in the United States.

There's a couple of others that used to have it and report back; but when you talk to people, they're generally shocked because in the Northeast, they think that everything is restructured. Not so. And some states that have started down that path like Virginia backed off this year. But about 40 percent of all electricity in the U.S. is sold in restructured states. All right.

We are in one of those, as you know, and the market is made by a regional transmission organization called the PJM Interconnection Incorporated that covers the whole Mid-Atlantic area.

Now, some are monopoly structured states, and some are restructured states. The thing that I want you to know about the PJM area is that the demand for electric power is quite variable.

Last year, the lowest low day of the year was half the amount of generation that the highest day of the year was. In May usually every year there's about 70 billion kilowatts that is needed at PJM.

In August it can be double that. In fact, the load is so variable that only 15 percent of the generators in PJM, 15 percent of the generators only use 1 percent of the time, 100 hours a year.

That's to meet the peak demand, and we're getting more peak here as we're getting more air conditioning and so forth and so on. That situation is getting more intense.

What does that mean for you? Well, those generators that run only a few hours a year are very expensive. In a restructured state, when you have a uniform price option, electric prices are set by auctions every hour.

The price that every generator is paid is the price of the last bid that is excepted. If you're talking August 15 at 3 in the afternoon, a very expensive generator might be needed; and that last bid could come in at a dollar a kilowatt hour.

That's every generator, including in nuclear plants and coal plants. That's important when I talk about demand reduction. A little bit of demand reduction gets you off the hockey stick portion of that curve very quickly.

So that's a fundamental I want to talk about a little bit more. As the chair said, the caps are about to come off in most of the state; but they came off in Duquesne's territory in 2005 and in 2007.

Just because I'm a teacher and I ask my students this question all the time, I do division every month on my electric bill. My bill went up from 8 cents a kilowatt hour to about 13.2 cents a kilowatt hour in the transition time after the rate caps came off, and that's about what we're hearing is going to happen in the rest of the state. I don't know. That's 60 percent or so increase. I'm hearing 35 to 60 percent. This is what people worry about in the

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rest of the state.

Now, I'm over on my time. Because you have this report, and everybody here has the executive summary report, I'll just talk about some of the options that we talked about.

In the short term, what can you do? Pennsylvania has a gross receipt's tax of 5.9 percent on sales of electric power. 5.9 percent is not a fixed amount per kilowatt hour.

That means as the price goes up, the State will get a windfall. If rates increase 35 percent, tax revenues will go up 240 million dollars. That is both a chance and a pitfall.

You don't want to see it written in some of our friends' papers about that without doing something about it. The good news is you can use some of that windfall to offset some of the gross receipt's tax.

Now, it would cost about 750 million dollars of tax expenditures, but you could take out a third of the gross receipt's tax or the whole gross receipt's tax for a third of the consumers with the windfall that you're going to get.

So that's one thing you can do fairly quickly. The portion on exported electricity, if we export it, it's about 100 million dollars. That would remain

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unchanged.

The second thing you can do is a little bit Archean, but it's important. You know, if you go with an electric supplier that goes out of business or decides they don't want to supply power in the summer, you are switched back to the provider of the last resort. It's called POLR.

There's no notification. The provider of the last resort gets slapped with you with zero warning. That's pretty expensive. When we did a survey, we surveyed 60 or 70 different people for doing this report.

Everybody said that that risk premium added between two and ten percent to the cost of the electric power. One of our recommendations was for you folks to say, look, you can't switch to the provider of last resort with no warning.

You got to give them 30 days or something. That would help. You know, every little bit helps. There's no one single bullet that's going to do this. We just recommended a portfolio of things that makes some sense that you can do. That's one of them.

Now, let me come back to that hockey stick, the man reduction. If you get off that hockey stick, the right side of the curb where you get these

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generators that only run 100 hours a year, you really help yourself a lot.

Because of the structure of the markets and how we were talking about before the low cost generators and getting that same amount of money, a small amount of demand reduction can pay off very big; and these programs aren't free.

California spends a half a billion dollars a year on their demand reduction program, but they get about six billion dollars a year in savings.

We estimated that if Pennsylvania spent about, you know, we used a high-end and a low-end, 300 to 800 million on this program, the savings would be about 2 billion dollars a year. That is a very good cost.

You don't have to take the word of California. There's closer states that have done a good job. New York and Vermont have both done excellent demand response programs. That's medium term and easy to do it. It's not hard.

There's a lot of talk that I read in the papers about real time pricing and smart meters. That is a complimentary program to the kind of demand reduction that we were talking about.

By "demand reduction," I mean you can replace these things with compact fluorescent bulbs and give the Comfort Inn right here a subsidy to do that or a tax incentive to do it. That's demand reduction.

Smart meters and real time pricing are -- the Comfort Inn pays right now a flat fee. They don't pay that extra at 3:00 in the afternoon on August 15 that it costs.

If they pay that, they might replace these on their own with compact fluorescents or might not; but the kicker is that it's a billion, a billion and a half dollars for the smart meters, and you don't need to do it for everybody.

You can get a great deal of the gain with not all of the customers. My secretary, whose electric power bill is $30 a month, doesn't need a smart meter at the cost of $500; and we talk about that in here.

Then there's co-generations and microgrids. U.S. Steel Clairton Works does that the right way; but in general, co-generation can also get you off that hockey stick.

Mr. Chairman, there's a big impediment to that in Pennsylvania. If, let's say, the Clairton Works generates more power than it needs, it can't sell it to a shopping center down the street.

In some states, microgrids, as these kinds of things are called, in Pennsylvania they're illegal.

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Making them legal so that they don't violate exclusive service there for us could significantly reduce the demand for power.

Finally, Pennsylvania passed advanced energy portfolios standard some years ago, which has a lot of great provisions; and a lot of them are quite cost effective, waste coal, wind, and so forth.

There's one provision that we analyzed in here that I was frankly surprised as a card-carrying environmentalist, was not cost efficient. That is the requirement in the sunny state of Pennsylvania for 800 megawatts of solar power, which is almost 900 now.

Our calculations are that that would cost rate payers, Mr. Chairman, two and a half billion dollars between -- well, over the next decade, and that's 1.8 billion dollars more than the cost of the same amount of wind power, for example. They will raise the average bill by about five percent all by itself.

So that's my testimony. The rest is in our report, and I would be happy to answer questions; and I believe I stayed within my time limit.

MR. GEORGE: I thank the gentleman. If I may, joining us at this time on the other side of the young lady is the gentleman from Armstrong County, the gentleman Representative Pyle.

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MR. PYLE: Thank you, Mr. Chairman. Glad to be here.

MR. GEORGE: And to his right is the gentleman from Indiana County, the gentleman Representative Reed. Thanks for joining us. The gentleman will stand for questions, and at this time I'll start at the left.

MR. CONKLIN: Thank you, Mr. Chairman. You were talking a little bit about cost effectiveness with making energy along with we talked about the smart meters.

One of the things that we're talking about a lot which I'm glad to see is that some use of the coal reserves that we have in Pennsylvania by using carbines and carbon sequestration and some other techniques.

During your study, what type of return money-wise did you find that larger investments by using, say, the coal reserves that we have a couple hundred years of in the State of Pennsylvania would save?

MR. APT: Let's see. I'm supposed to answer yes or no. Let me answer a qualified yes. We didn't quantify that. We did talk about carbon capture sequestration.

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I don't see how we can get to a low-carb economy without carbon capture sequestration. This thing is positioned to do it well. I hope we take the lead rather than buying technology from Indiana or Texas. You got to be proactive about it. I'm sorry, Mr. Chairman. That wasn't a yes or a no.

MR. CONKLIN: No. That was the question I had. One of the concerns, not concerns, one of the things I'm glad to see is that we are going back to using that along with the other alternatives, but I was just asking you --

MR. APT: It isn't going to happen without a price on carbon. It will cost more than you could as a prudent regulator approve or a green ashy guy in a utility approve right now.

But in a carbon-constrained world, if there is a carbon price, $10, $35, whatever it happens to be, those things make a lot of sense.

MR. CONKLIN: Thank you, sir.

MR. GEORGE: Is the gentleman concluded?

MR. CONKLIN: Yes, sir.

MR. GEORGE: I thank the gentleman. Gentleman Hornaman.

MR. HORNAMAN: Thank you, Mr. Chairman. Mr. Apt, if you feel that the solar mandate in the

AEPS is going to cost the consumer so much, and I think you mentioned that you felt that wind was a better alternative, what do you see then as the future of solar and the entire alternative energy package in the future of Pennsylvania?

MR. APT: I teach in a business school. I look at low-cost portions. When you're talking that amount of money, it's real money. Two and a half billion dollars over the next decade is some significant money.

There is plenty of solar energy in this country. There's of the order of 4,000 times more sunlight falls on the U.S. than we need in power.

The costs have not been going down the way that the solar folks want them to and still want them to. In these applications, it makes good sense.

To have an 800-megawatt solar requirement without the requirement to reevaluate whether the costs have come down as much as the advocates thought or the legislature thought from the past is I think is not a good idea.

MR. HORNAMAN: Thank you, and thank you, Mr. Chairman.

MR. GEORGE: Thank the gentleman, and gentleman, Mr. Levdansky.

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MR. LEVDANSKY: Thank you, Chairman George. Professor, I have just two questions just briefly. One is, here in Western Pennsylvania, at least in the Washington and Greene County sections of Pennsylvania, there has been a lot of discussion about a proposal by one of our utility generators to construct a power line across state and essentially to move the electricity that's generated here to the larger markets and to satisfy the demand on the east coast.

You mentioned earlier that Pennsylvania is an exporter of power. I would presume then that if that line were to be constructed there would be more generation that occurs in Pennsylvania being exported.

Do you have any thoughts as to what impact, if that line were to be approved and constructed, what might be the impact of that new power line that's going to wheel power to the east cost? What might the impact be on our electricity rates here in Southwestern Pennsylvania?

MR. APT: Yes. Any time that you have a transportation line, whether it's a railway for wheat or steel that connects a low-cost and a high-cost area, the prices in the high-cost area come down a little bit; and the prices in the low cost area go up a bit.

But, if the low cost area also happens to be a place that you're getting jobs out of generating the steel or the wheat or the electrical power, the net may be fine.

As part of this study, we were not asked to take a look at that, but in general you got to look at the whole picture. The number of jobs in Pennsylvania that the electric power generation transmission and distribution represent is huge.

We are the second largest generation state in the country. Behind who? I'm a professor. I got to quiz you.

MR. PYLE: Texas.

MR. APT: No. It's Florida as it turns out. It's amazing. It's not Texas. I thought it was Texas too. It's actually Florida. It surprised the heck out of me. Texas is No. 3. But it's a significant economic generator. So you got to look at the whole picture.

MR. LEVDANSKY: And one other more theoretical question. This is the economist coming out of me. The argument for the regulation is that government regulators are inefficient in allocating, you know, the government by its very nature ought not

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be about the business of regulating the free market because the free market is the best allocator of the factors of production; and it's far more efficient if you let the free market, you know, allocate the resources in the most efficient manner.

Is there any indication though that in Pennsylvania that the PUC -- which for decades and decades has essentially controlled the rate structure and therefore de facto has influenced the investment decision-makings of the electricity companies.

Is there any indication that that market hasn't worked given the fact that we generate more electricity than we need and we even export it?

MR. APT: That's a yes or no question. I got to answer that I guess. So I teach in business school. I believe in markets, but I have to answer that question no.

In the electric power industry, there are winners and losers from restructuring; and some of my best friends work at some of the winners, and some of them work at some of the losers.

On balance, one has to look at the prices to the consumers; and that wasn't part of this study, but we published it, and I would be happy to talk to you about it another time.

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MR. GEORGE: Gentleman concluded. I'll go to my co-chairman. I'll be last. Mr. Hutchinson.

MR. HUTCHINSON: Thank you. I guess the question I wanted to ask -- I started thinking about something else based on your -- okay. If we -- maybe this is -- maybe I shouldn't even be asking you this, but you did mention that cutting the gross receipt's tax is a viable strategy to reducing costs, and I agree with you wholeheartedly on that.

Unfortunately, some of the actions that the General Assembly took in the last couple weeks, they spent some of that ability to do that.

Be that as it may, I still think it's something that we should investigate further as we go forward. But the question that I -- you made a mention of the fact that we couldn't cut it for out of state -- I didn't understand -- or we shouldn't?

MR. APT: I didn't say you couldn't. It was the analysis that we did had that the same. Okay. Because that doesn't particular benefit Pennsylvania consumers.

MR. HUTCHINSON: But are we allowed to tax at different rates?

MR. APT: You got ten lawyers up there.

MR. HUTCHINSON: That's what I'm saying.

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I don't know if you're the right person to ask that.

MR. APT: I think the answer is yes because there are other states, Ohio, for example, that has a differential.

MR. HUTCHINSON: Okay. That's all I have for now. Thank you.

MR. GEORGE: I thank the gentleman. The lady, Ms. Rapp.

MS. RAPP: Thank you, Mr. Apt. I find your presentation very informative. You mentioned the cost of solar. Have you studied the impact of building more nuclear plants in Pennsylvania? Would that be --

MR. APT: Again, it depends on the price. I teach in a business school. If nuclear plants come in at an interesting capital cost, then CEOs will push for building. At the moment, it's on the edge.

Now, nuclear plants produce power 90 percent of the time. A solar plant in Pennsylvania would produce power 15 percent of the time.

Currently they're at about the same capital cost. That means that the solar plant is about six times more expensive for the cost of electricity than the nuclear facility.

Having said that, we're not seeing a lot of

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CEOs in Pennsylvania push for either one. I think that the costs of nuclear will decline as the first few are built, and I'm quite sure that there will be a half a dozen of them built fairly quickly between now and 2015, 2017. At that point the costs might be interesting.

MS. RAPP: I did see on the news last night that the governor of Texas is considering building nuclear plants for that state. Have you studied -- I have a hydropower plant in my district actually. Do you see -- is that feasible for Pennsylvania to look at hydropower and other parts of the state as well?

MR. APT: Of course the APS has a provision for low-head hydro, not to build any big dams and have them in the whole country since the Glen Canyon Dam and the collapse of the Grand Teton.

Low-head hydro and water wheels aren't sure, and that makes sense. Interestingly enough, the two pumped hydroelectric facilities in Pennsylvania, one south of Harrisburg and one up in Seneca, are used greatly for storing power that is generated by the nuclear plants and some of the coal plants when people don't want the electricity and would be used for wind also. Pumped hydro is a good idea when it can be

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brought in economically. It isn't cheep.

MS. RAPP: Right. Thank you very much.

MR. GEORGE: I thank the lady. The gentleman, Mr. Pyle.

MR. PYLE: No questions.

MR. GEORGE: The gentleman Mr. Reed.

MR. REED: (Indicating.)

MR. GEORGE: Finally, we're going a little long, but we're interested. Let me ask you just a couple of questions. You can answer yes or no. Have you ever attempted as a private citizen, residential, to be able to take advantage of deregulation by going along with another company?

MR. APT: Sure. I've switched two or three times.

MR. GEORGE: Did they accept you?

MR. APT: Sure. And one of them bounced me out in August about three years ago when they found that power was a little high, and they bounced me right back to Duquesne.

MR. GEORGE: Okay. Now, this committee -- at that time I voted against deregulation, not that that makes those who voted for it any less knowledgeable than myself, but we're concerned about the fact where it's supposed to save people money.

I want you to tell me because I believe you could have an answer. You've written about commercial and industrial rates. Can you tell me why the deregulated states at one time some of them were 50 percent higher than regulated states in regard to power, now those deregulated states are 70 to 75 percent higher than the regulated states? With your knowledge, can you tell me why that is when we were supposed to save money?

MR. APT: There are a bunch of reasons, and of course --

MR. GEORGE: Give me the most important reason because this is very important.

MR. APT: Most important is the structure of the uniform price option. At the high demand hours, everyone is receiving the bid of the last generator that you need.

We've got a number of generators that are pressed into service only a few hundred or even a few hours a year, very inefficient, very costly.

So everybody received it as that price during those hours. It's just the structure of an auction market. At the same time, those high-price generators are receiving only the cost of fuel. They're not receiving enough money to build new ones.

And so we're having a situation where the RTO has to pay side payments. PJM looks at the liability of pricing model at RPM to those generators to maybe get them to even stay open and possibly get them to build more PMOs.

MR. GEORGE: Sir, if you will, all the major utilities in Pennsylvania are the best of their generating stations, and I dare say under the objective of purchasing under the so-called option market, a lot of them are buying from utilities out of state that they invested with. Is that not true?

MR. APT: I don't know. I didn't look at who has invested with who.

MR. GEORGE: Well, they're not buying from Pennsylvania because the PJAM at the time it gave regulation were announcing 250 million dollars profit, and last year it was $2,480,000,000. Will you explain that in just about ten words to me.

MR. APT: Pennsylvania has a large number of base-load generators that are receiving the peaking price cost from not only Pennsylvania consumers but the sales that we make to Washington and Baltimore, and so our generators, our nuclear plants, are based on coal plants.

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Our receiving premiums for sales at the high-priced hours -- and let me remind you, we're getting more and more high-priced hours every year.

So, all right, those figures that you mentioned are coming from profits made on exports as well but also some in in-state profits. There's no denying that base-load generators are becoming much more profitable.

MR. GEORGE: Professor, I know you're concerned about industry, and so are we, all of us; but, again, as far as the residents where there are those of us that do not have an answer over oil prices, we certainly don't have an answer in what will happen if these rates continue to go up as it is suggested.

What do you believe we can do in regard to bringing about a more efficiency and greater value or necessity for residential shopping for electricity?

MR. APT: Get those high-priced generators off the grid by reducing demand. That's the best thing you can do right now.

MR. GEORGE: The Chairman and his Board thank you for taking time to come before the committee. Thank you very much, sir.

The next presenter will be the gentleman, Mr.

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Terrance Fitzpatrick, general counsel for Electric Power Generation Association. Good afternoon, sir. You all have a copy of this testimony. You may begin.

MR. FITZPATRICK: Good afternoon, Chairman George and Chairman Hutchinson and members of the committee. Thank you for giving me the opportunity to testify before you today on behalf of the Electric Power Generation Association regarding policies to respond to higher electricity prices.

I'm not going to read my entire testimony. I will try to paraphrase it and go through the important parts and rely on your questions at the end for things I might not cover.

Caps in the generation prices that are charged by utility serving 85 percent of the customers in the Commonwealth will expire at the beginning of 2010 and 2011, and it's likely that these customers are going to experience significant price increases. That's why we're here today.

The amount that each individual, any individual customers price increases will depend upon a couple of factors. What are the level of wholesale prices at the time? Because the utilities have to buy in the wholesale market.

The other factor is what is the level of the customers' utilities historic rates? Because if you have a low-cost utility now, you're more likely to see a significant increase as opposed to if you have a high-cost utility.

But the question you're asking in this hearing today is what should the General Assembly do about these upcoming price increases.

But just as a doctor must diagnose a medical problem before prescribing a treatment, the General Assembly must determine why electricity prices are increasing before enacting policies to address these increases.

My testimony can be summarized as follows. Electricity prices are rising throughout the country in both states that allow competition and in states that have retained traditional cost of service regulation because of increases in the cost of fuels used to generate electricity and in the cost of building new power plants.

Policies that make sense in light of this situation are those that help the customers make the transition to paying market prices; policies such as educating customers, giving customers options to phase in higher prices, encouraging conservation and reductions in peak demand and reviewing the adequacy of low-income assistance programs.

In my view, it is simply wrong to blame higher electricity prices on electricity competition, on PJMs wholesale pricing rules, or on generators of electricity.

Policies that are based on these mistaken beliefs, policies such as extending price controls, imposing new taxes on generators, creating new state bureaucracies to buy electricity and modifying federally regulated wholesale power contracts whenever market conditions change will leave PA in the wrong direction and will cause higher prices and less reliable service down the road.

So why are electricity prices rising? As I said, they're rising everywhere, not just in states that allow competition to supply electricity to customers.

The reasons for this are the increased cost of fuels and the increase cost of building new power plants. An article in USA Today a little over a month ago got it right on this, not that I believe everything I read in the newspaper; but in this case, I believe the article got it right.

The name of it was "Price Jolt: Electricity Bills Going Up, Up, Up," and it gave some examples of where prices are going up; and it mentioned six states.

Well, in five of those states, they have retained traditional regulation. Only one of those six that they talked about allow retail competition for electricity.

And the article concluded correctly that these increases are due to the higher cost of fuels and the higher costs of building power plants.

Now, I would like to refer you specifically to the chart that's at the end of my testimony because I think it tells a very -- it tells a very important story here.

This is a chart that was put together by Dr. Susan Tierney. She's a recognized expert in electricity issues, and she looked at what has happened to prices in the different states from 2000 to 2007; and she, as you can see, color-coded it nonrestructured state. Those are traditionally regulated states.

The blue states are restructured states or states that allow competition. Now, if competition and deregulation is causing higher prices, you would expect to see all the blue states gathered at the left part of this chart.

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You would expect to see the higher prices in all the restructured states, but that isn't what you see. You see a fairly random sprinkling of these states with high increases in traditionally regulated states as well as in restructured states.

Now, that very strongly suggests that competition is not causing the price increases, that there must be something else at work; and as I said earlier, I believe that something else is the higher cost of fuels used to generate electricity and the higher cost of building plants.

Now, just a couple numbers on these underlying costs that I'm talking about. From 2000 to 2007, the cost of building a new power plant in North American increased by 130 percent driven by increases in the prices of the different commodities, which I list in my testimony.

The cost of coal rose 56 percent between 2000 and 2007, and the price of natural gas rose 200 percent; and those are conservative numbers because the data that we looked at in 2008 indicates that spot market prices for those fuels have almost doubled in 2008. So the trend is definitely going up.

Now, in light of this, my so-called diagnosis of the problem, the things that we can do, are policies that would help to ease the transition of market prices.

Now, I understand the saying that it's a hard reality that Pennsylvania cannot control the global conditions, the surging demand for energy and for commodities in countries such as China and India that are driving up the underlying costs of producing electricity.

But Pennsylvania can help customers to adjust to these higher prices through phase-in programs, by helping customers conserve or reduce peak demand, and providing assistance to low-income customers.

I'm not going to go into a lot of details here. I think you had testimony on phase-in plans before. Basically, instead of customers taking an increase all at once, you try to spread it over a couple of years.

I would point out that with regard to encouraging conservation, reducing peak demand, and assisting low-income customers, the House has already taken some significant action in those regards with the passage of House Bill 2200 and with the passage Special Session House Bill 1, which is now Act 1 because it has been approved by the Senate and signed by the Governor.

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Let me respond to the claims that it's really flawed wholesale markets that are causing higher prices. Some argue that the reason prices are rising is because of the way PJM administers the wholesale market.

There's also sometimes the argument that the profits that are earned by some generators, and I would emphasize the word "some," prove that wholesale markets are not competitive. In my view, these arguments are not supported by the facts.

With regard to the single-price auction, I think there's a lot of misunderstanding about this. The first thing to understand is, the single-price auction is the way PJM goes about setting prices in the spot market.

Most electricity is not sold in the spot market, but that's not to say it isn't important. It is, because I think it sets the tone for the prices that are charged for other times of commodities in the wholesale market.

The single-price auction actually saves money for customers. It doesn't cost them money. And I believe it does that by encouraging all the generators to be very efficient in the way they run their power plants.

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As evidence of that -- and I think, Representative Levdansky, this responds to a question that you asked about, you know, can you prove to me that competition is more effective than regulation and encouraging efficiency.

When I was a lawyer at the PUC back in the 1980s, we had investigations at that time about why nuclear plants weren't running better, they were down all the time.

I think the data was they operated about 70 percent of the time on average. Now nuclear power plants run 95 percent of the time. That's the kind of efficiency that has been driven by competition.

It's not a criticism of regulators, because I was one, as a member of the PUC; but I don't think regulators can do what competition does to encourage efficiency.

Just one other fact I'm going to mention about the wholesale markets and the single-price option. There are seven regional transition organizations in the country.

All seven of them use the single-price auction. Some experimented with other alternatives such as a pay-as-bid approach where each generator bids in, tries to guess what the market-clearing price will be at bids in, but they dropped that because they found that it actually leads to higher prices, not lower.

The final point here, these are complicated issues, you know; and really, it's hard sometimes to understand these things. I think especially for elected officials to do that in light of the number of issues you have in front of you.

I would invite you to hear from PJM itself on these issues. PJM is coming under a lot of harsh criticism; and, frankly, I don't think it's warranted.

I can testify from my experience as a regulator that it is made up of a group of extraordinarily dedicated people who care deeply about keeping the lights on and about running competitive markets, and I think you benefit from hearing PJM's explanations to these concepts. Mr. Chairman, I'm not sure how much time I have left here --

MR. GEORGE: I would assume that you're pretty close, if you will.

MR. FITZPATRICK: I am. Thank you very much, Mr. Chairman.

MR. GEORGE: I thank you very much. You will stand for questioning?

MR. FITZPATRICK: Yes, sir.

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MR. GEORGE: We will start at the right. The gentleman from Indiana, Mr. Reed.

MR. REED: Thank you, Mr. Chairman. I have a couple questions for you. With your background on the PUC, especially of interest to me, you know, many folks have talked about the rate cap issue and the regulation issue as if, if Pennsylvania just never would have deregulated the electricity market, that consumers would not be paying a higher electricity prices today as opposed to ten years ago, that somehow, some way, the electricity prices would have been frozen back in 1996 and 1997, and we would never have to worry about electricity price increases again. Is that the case?

MR. FITZPATRICK: No. It certainly is not the case. Certainly, the chart I referred you to, Representative, would suggest that it's not the case.

Furthermore, the truth is, customers would have been paying more ever since those caps went into place. I can't say every year they necessarily would have; but on the whole, they clearly would have.

First of all, you can't assume the industry would be as efficient as it is, to come under competition. Furthermore, under regulation, the price of the fuel used in generating plants is passed through the customers with something called an energy cost rate. That's a pass through.

With the way fuel prices have gone up, all those fuel price increases would have been passed along to customers during these years. That is not happening with the caps in place.

So we would certainly be paying more for electricity. I think the proof of that too statistics from the Energy Information Administration back at the time the competition law was passed, Pennsylvania's average prices were 15 percent above the national average. Today they are two percent below the national average.

MR. REED: I think when you look at the CPI just for the last 10 or 15 years from the time we deregulated until the time when the price sort of goes up, you're looking at about a 40-percent inflation rate.

There exists a distinct possibility that had we not deregulated, that consumers could have ended up actually paying more higher electricity prices when this is all said and done than they will when the rate caps come off. Is that correct?

MR. FITZPATRICK: Yes. You would have to do the calculation about how much more they might pay, you know, every year with the fuel cost increases; but there is certainly no question that customers have derived tremendous benefits from those caps, and some customers frankly save money by shopping at different times too.

I know Professor Apt was asked about shopping. I was with the competitive supplier as well for a while and saved money off of the bill with my utilities. That's at least part of the savings.

MR. REED: When we look at the economics of electricity and the electricity markets, there's obviously two sides to it, supply and demand.

We tried to look at demand at the legislative level, the last couple years particularly, this past session; but on the supply side, you talked about the need to increase generation capabilities within Pennsylvania.

From your vantage point, will extending rate caps or entering into a re-regulated market encourage the investment necessary to increase the supply of electricity into the PJM?

MR. FITZPATRICK: No. It will hurt it, Representative. I think from the generation industry standpoint, there's two major sources of the uncertainty which really give you pause when you think about building a plant.

The more expensive the plant is, the more pause it will give you. One is the uncertainty hanging over the regulatory environment. You know, there's a lot of concern about high prices. Are we going to stick with competition, or are we going to try to re-regulate in some sense?

People who are thinking about putting their money on the table to build plants have to be concerned about that; and, you know, it's my hope that we can get through this debate that we're having in Pennsylvania and maintain a competitive market.

The other one that we haven't talked about here, it's another hard reality; and my testimony, frankly, is filled with hard realities, is that we really haven't talked about climate change.

There is going to be a price tag associated with that as well, and yet generators don't know exactly how that's going to break. The way that that's done is very important to your decisions on investments.

So that's something else, and that's probably a national -- that's an issue at the national level, but it's going to be very helpful if that issue is resolved in some way that provides some stability.

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MR. REED: One final question. You talked a little bit about PJM locational pricing and all seven of the other ISOs using similar pricing models, and I actually do agree with you.

I think it would be useful to have the PJM folks come before the committee to testify to hear a little bit more about how their system works and what their suggestions are for dealing with this issue in the future, but I believe that I read somewhere that California after the debacle that they've had a couple years back actually have been moving towards transitioning into a similar model that PJM uses. Is that correct?

MR. FITZPATRICK: That's exactly current, the California independent system operator. I'm not sure they have implemented it yet, but they decided that they're going to; and they're moving in that direction.

Again, they have tried other approaches, but experience has shown that this is the best -- despite some of the poplar opinions that are being voiced about this, they are moving in that direction.

MR. REED: Thank you, Mr. Chairman.

MR. GEORGE: I thank the gentleman, and the gentleman from Indiana or Armstrong, Mr. Pyle.

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MR. PYLE: I represent both of them, Mr. Chairman. You were right both times. Again, with my very rudimentary understanding, PJM and it's distribution purchasing systems, does our current fleet of power generating stations have the capacity and meet projected demand ten years from today?

MR. FITZPATRICK: I'm not sure that the projections necessarily go out ten years.

MR. PYLE: I've heard anything from 35 to 50 percent increase in electrical demands in ten years.

MR. FITZPATRICK: Well, that might be in the ballpark. I think the demand has been increasing about two percent a year, maybe just a little bit less than two percent.

Certainly demand is increasing, and I agree with some of the things Professor Apt said about the need to encourage conservation and particularly the need to encourage strategies that would reduce peak demand. I think those are very important, those types of pricing plans.

PJM has a planning process, and they have plants that are in the Q. They keep an eye on what is being added. I think generally we've done well with that. I think plants have come on board.

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There is a question about what kind of plants are we adding. I mean, at some point do we have to build nuclear plants, or you almost can't build coal plants anymore.

MR. PYLE: In your opinion, why is that?

MR. FITZPATRICK: Why can't you build coal plants?

MR. PYLE: Right.

MR. FITZPATRICK: It's the uncertainly with regard to climate change. I think you have difficulty getting financing for those plants. I think, you know, there was a widely publicized case in Kansas where the environmental regulator denied the permit for the plant because of climate change.

So it's difficult. There are still a few getting built, but the climate change debate has largely brought an end to building new base-load coal plants.

MR. PYLE: So despite this great wealth of coal right under our feet projected at a minimum of 250 years supply that we know of without discovering more, that advantage is distinctly moved to the side because of carbon capture and other environmental concerns; is that accurate?

MR. FITZPATRICK: I think the uncertainty

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has heard it in the near term. Now, I also agree with another thing Professor Apt said.

In the importance of finding out and working out the kinks in plants that would allow you to sequester the carbon from coal plants, I was disappointed frankly that the federal government withdrew their support from the future project because I think there's really a role for government there in seeing that those kinds of things can go forward.

It's very risky commercially for any individual company to take the risk of being the first to build that kind of plant because it hasn't been done on a large scale, but I really think we need to work through that and figure out a way to do it.

MR. PYLE: These plants that would, in fact, allow us to capitalize on Pennsylvania's great resources would require, by my understanding, similar to the first plant in Illinois where we had a great, great capital, would it be possible for our existing generators to build such a plant with rate caps extended or kept in place?

MR. FITZPATRICK: There's a lot of things that would have to be done before a plant like that could be built. So I want to give you a straight answer on that. But I will answer your question directly. Certainly things like rate caps make it even more difficult to move forward in that type of initiative.

MR. PYLE: Thank you, Mr. Chairman.

MR. GEORGE: I thank you, gentlemen. Representative Hutchinson?

MR. HUTCHINSON: Yes. Terry, thank you for your testimony. Thank you for addressing the previous testimony that talked about the efficiencies of a market versus PUC.

I wanted to push you one more time on that topic and ask, you talked about how the marketplace has played into more efficient operations of nuclear power plants, for example, and other power plants, you know, vast increases in efficiencies that we've seen.

Two other areas, if you could comment on, both the cost of construction for new power plants and whether a whole lot have been built, you know, the fact remains that or it seems to be that there are now much greater incentives to bring projects in on time and on budget for new building as well as I was curious about has there ever been a study similar to the chart that you showed us that matches states that have deregulated and where new power generation is being build. Has that ever been done? I guess both

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those things sort of overlap. If you could just comment on that.

MR. FITZPATRICK: I think in the restructured states, there's a good record of building power plants. One of the ideas of this to begin with was before the competition act was passed, there was a lot of unhappiness with how plants were built under the monopoly system; and the argument was, well, it's a monopoly, there's not enough incentive to be efficient and cost-effective in ways to do things.

One of the ideas of competition was to put that risk on investors instead of having it on the captive customers, and I think that has worked. Investors are stepping up, but investors are also going to be cautioned about what kind of a regulatory regime are we going to have down the road.

They can't just look at the way things are now. They have to think, well, I'm going to be a lot of years getting my money back for this plant, what's the government going to do a few years down the road. I think that illustrates the importance of a stable regulatory regime to try to keep the efficient system that we have.

MR. HUTCHINSON: The other quick question about has there been a study or matching of regulated

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states versus new power being built in the last ten years?

MR. FITZPATRICK: I'm not aware of anything like that, Representative. I'll go back and look; and if I see something, I'll let you know. I mean, plants can get built in either type of regime.

I also do think that the trend towards competition throughout the country has probably made everybody more efficient at building them, whether it's a merchant generator or whether it's a utility because now there's a baseline to compare the costs of a regulated utility and building because you know what a merchant generator does it for.

MR. HUTCHINSON: Thank you.

MR. GEORGE: If I may, and I say this just for honest inquiry because you probably know this, you were involved with the drafting of the stranded costs, were you not?

MR. FITZPATRICK: Yes.

MR. GEORGE: Just yes or no. I'm not trying to make -- I just want to make these members familiar in that I have a question that you should be concerned about.

MR. FITZPATRICK: I was involved in the drafting of the bill, Representative. We have a long history that has been interlocked on this, Representative.

MR. GEORGE: Well, it's evident that you won because the prices have gone up considerably. So we're going to try to rectify that.

MR. FITZPATRICK: The prices would have gone up whether we --

MR. GEORGE: Let me say for the record, the way stranded costs were calculated ten years ago, they were based on natural gas price, were they not?

MR. FITZPATRICK: There's a link, yes, there is, sir.

MR. GEORGE: For the record, when my office asked if they were using natural gas instead of coal, my office were told by the PUC under regulation that they didn't expect new coal plants; and, believe me, that was long before Al Gore come out with the climate change, long before, ten years before.

MR. FITZPATRICK: But there were environmental restrictions that were still --

MR. GEORGE: Many of us members feel that if we're going to spend more money, we ought to be employing Pennsylvania -- we ought to be burning Pennsylvania coal. We ought to be doing a lot of things for Pennsylvania.

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Now, finally, my last question. At that time, the plant sitting in Indiana, Pennsylvania, the so-called stranded costs was $430,000,000. When the plant was sold, it sold for $1,260,000,000.

What happened to that money? $1,000,000,000, $700,000,000 profit, I hear utilities say we gave it back to the customers. Sir, it's like that rebate check. I haven't got mine, and I haven't got your rebate yet.

MR. FITZPATRICK: Well, you may be referring to a plant that was owned by First Energy. They were --

MR. GEORGE: It was sold to First Energy after the deregulation.

MR. FITZPATRICK: At the time -- and I know this. This is another part where our pasts interlock, Representative, because I was a lawyer for Met Ed and Pennelec back at the time of restructuring.

I remember very well arguing before Commonwealth Court with your colleague Counsel Ocko beside you there standing before the judges as well on this. But when GPU sold its plants --

MR. GEORGE: Sir, flattery won't get you anywhere. Just answer the question.

MR. FITZPATRICK: Representative, I know

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better than to flatter you and think I'm getting off the hook. At the time GPU sold its plants at the time of restructuring, the revenue from that was an offset to the stranded cost.

MR. GEORGE: I thank you. The next question, Mr. Levdansky.

MR. LEVDANSKY: Thank you, Mr. Chairman. Mr. Fitzpatrick, you point out the two, I mean, the factors that would drive electricity rates being the cost of the energy that they produce, that they purchase coal, you know, principally, and, you know, obviously the demand affects the price; but you also said that the cost of building a new power plant in North America went up, you know, 130 percent between 2000 and 2007. During that time frame, were there any new plants built in Pennsylvania?

MR. FITZPATRICK: Yes. Since the time the competition act was passed that there has been about 9,000 megawatts in new plants built in Pennsylvania.

MR. LEVDANSKY: And how many plants are we talking about?

MR. FITZPATRICK: I don't know if I can give you the exact number. I did look at this recently. Most of them have been natural gas fired plants. Some of them have been as big as -- if they're not 1,000 megawatts, they're close to it, which is a very big plant.

MR. LEVDANSKY: So 9,000 megawatts of new capacity have come on line in the period 2000 to 2007, and what is the total capacity of all the plants in Pennsylvania?

MR. FITZPATRICK: I don't recall that number, but I can get that to you.

MR. LEVDANSKY: Yes, if you could, because I'm not aware here -- I mean, are you aware of any new capacity that has been added here in Western Pennsylvania?

MR. FITZPATRICK: I do believe that some of them have been here. In particular, I think Reliant has built a 500 megawatt waste coal plant that's in Western PA. I forget the exact location of it. I think that's up around Cambria perhaps.

MR. REED: Mr. Chairman, that's actually in Seward. It's in my district. It came on I believe in 2004.

MR. HUTCHINSON: I have a natural gas in my district also.

MR. LEVDANSKY: How then do I explain, for example, here in Southwestern Pennsylvania with

Duquesne and Allegheny Energy that they built their coal -- largely coal fired plants -- I mean, I got a couple plants in my district that were built in the 1950s. I mean, these things have been paid for a long, long time ago.

So this idea that prices are going up, I don't understand why then in our area here in Southwestern Pennsylvania we have coal fired plants that are located really close to the coal fields, transportation cost by barge are minimal, that they are old plants that have essentially been paid off and yet -- and we're talking about, you know, with the caps coming off, that rates are going to escalate 30, 40, 50 percent.

I understand that the factors of production affect the price of the product, the cost of your capital, the cost of your labor, the cost of your raw materials, of all the factors of production. I can understand that; but, you know, you work for the industry now. You have the experience working for the PUC as well.

I guess my question to you is, what's the industry's profit margins in, say, the pre-deregulation period of 1996; and then what is the industry's, you know, profit margins and profit levels post deregulation?

MR. FITZPATRICK: Representative, I understand your question here, and you can correct me if I'm wrong; but some companies have built plants that are already paid for, why does the cost of new construction affect the pricing of those plants, if I'm understanding.

The reason for that is we went to a market. We wanted investors to be the ones to take the risk of building a new plant. So prices that are charged in the market over time, they must reflect the cost of building and running a new plant; or new plants will not get built because the incentives won't be there.

So it may be the case if you have a plant that's paid for and if you do a good job of running it, you have an opportunity to make some money on that.

At the time these decisions were made and we went with competition, nobody has a crystal ball where they can look far into the future and know with certainty what's going to happen. The price of construction and fuel has gone way up. That has pushed the market price up.

But if we start to unravel that, if we say it's unfair that some of these older plants get to charge these prices, I would just caution, we're going to have to unravel the whole thing; and we're going to have to answer the question, how are we going to build new plants now, because investors are going to do it under the market system.

But if we're going to go back and try to regulate those prices again, we're going to have to answer the question, well, how are we going to get new plants built now; and I think we're going to get back into some of the same old problems that led to this in the first place with monopolies building plants and inefficiencies.

MR. LEVDANSKY: I understand that the profit incentive has to be there to attract investment, to build the capacity. I understand that. My question to you is, let me rephrase it, what is the aggregate and relative profit margins of the electric generators pre-deregulation and post-deregulation?

MR. FITZPATRICK: There wasn't -- there were some merchant generators before deregulation, but it wasn't that extensive. You had some independent power producers, but they had long-term PURPA contracts. Other generation was owned by utility largely. That was the kind of industry structure you have.

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The truth is, Representative, I don't really spend time trying to find out what an aggregate industry profit measure is. Some companies are very profitable right now.

The ones that own base-load plants, particularly nuclear, and that run them well are profitable. But the other factor is generators have gone bankrupt since competition started.

If you made a bet back at the time of restructuring that natural gas was going to be the real killer technology, and a lot of people thought it was, you had a boom in building natural gas plants.

If you got into that very deeply, you took a bath when natural gas prices went up and then market prices went down in the early part of, say, 2000 and 2002 and 2003.

So, I mean, some of the members of our association, for example, have had financial difficulty. One member went bankrupt. Some even now are only marginally profitable. So to say that all generators are making a whole lot of money really is not an accurate representation.

MR. LEVDANSKY: I'm not saying that. I'm trying to find out. Let me ask you this as you're a former PUC regulator. The PUC looks at this and says, okay, these companies come in, they ask for a rate increase.

Now, why are they asking for it? Well, what is the cost of the coal and the transportation of the coal? What is the cost of their labor contacts with the IBEW? You know, what is the cost of borrowing capital?

And then the PUC has historically established an appropriate rate. That rate that they allow is based on an assumption of a certain amount of profits.

What would the PUC typically allow in a regulated environment? Is that structured or restructured? Because you kind of confused me with this restructured, nonstructured stuff. So what would the PUC in a -- we would call that nonrestructured?

MR. FITZPATRICK: Correct.

MR. LEVDANSKY: In a regulated -- how about I call it just regulated and deregulated?

MR. FITZPATRICK: That's fine.

MR. LEVDANSKY: In a regulated environment, what profit margin would the PUC typically allow a generator?

MR. FITZPATRICK: Well, that was always a bone of contention in rate cases because you got into a lot of testimony about how much risk there was.

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A return on equity might have been 15 percent, something around that; but it varied for different utilities, different time periods. You know, it's very difficult to compare -- cost of regulation is concerned about fairness.

Markets are concerned about efficiency. The decision to move to markets was made a little over a decade ago. The analysis that you're doing looking at cost, Representative, it does remind me of one thing that's in my testimony.

PJM, the market monitor, every year looks at the costs of building and running new power plants and compares that to the revenue that available to generators through the prices that are prevailing in the market.

Since the markets were started in 1999, over that period in general, in every year but one, the price of building and running a power plant was higher than the revenue that was available to generators.

Now, that situation is starting to turn around. You heard a little discussion about RPM. That is helping that situation; but if somebody thinks the wholesale prices are ripping consumers off, that net revenue analysis by the PJM market monitors suggests that it's not the case because the prices haven't generally been high enough to pay for the cost of building and running new power plants. And, again, we want investors to take that risk now. We don't want to put that on captive customers.

MR. LEVDANSKY: I understand. Just one quick final question. You said in the regulated environment, you're maybe looking at a 15-percent return on equity. When the rate caps come off in a couple years, any idea what you think the industry might average on return on equity might be?

MR. FITZPATRICK: I think it's going to vary widely by the companies based upon the mix of power plants that they have. For some I'm sure it will be high. For others, again, I expect that it won't be. Like any industry, there's probably going to be some that win and some that loose.

MR. LEVDANSKY: And a range?

MR. FITZPATRICK: Representative, I can't give that to you. Honestly, it isn't something I spend my time studying. I mean, I do spend my time studying whether market prices are competitive; and, again, PJM's market monitor looks at that as concluding consistently that prices are competitive. I don't spend my time looking at profit margins of generators.

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MR. LEVDANSKY: Okay. Thank you.

MR. GEORGE: Gentleman Mr. Hornaman?

MR. HORNAMAN: Nothing at this time, Mr. Chairman.

MR. GEORGE: Gentleman Mr. Conklin?

MR. CONKLIN: Mr. Chairman. You shouldn't give me enough time to sit here and play with a graph. You know, Mark Twain said it the best, "Lies, damned lies, and statistics." You're telling the truth. It's not about that.

By this, nine of the ten lowest paying customers are those in the regulated market, and the highest is, what, 50/50 between regulated and unregulated for the consumer.

MR. FITZPATRICK: Well, the ones that are congregated at the far right-hand margin --

MR. CONKLIN: I was only picking on your statistics. I just wanted to use them to play with you. Just a real quick question. I've asked this before. I still have to get my hands around this.

When you get the -- a generator gets the highest dollar value per peak hour no matter what the generation cost is?

MR. FITZPATRICK: Well, this is in my testimony, but I would just walk through this very briefly. When PJM runs an option in the spot market, it gets bids in; and it has demand, people who want to buy electricity, people who are willing -- companies that are willing to sell.

It takes the lowest -- and the way that this is structured now, companies bid in at their own marginal cost. So a nuclear plant has lower fuel costs than a natural gas plant. So its bids are going to reflect that.

So those are the low bids. They're fixed. You work your way to the more expensive types of generations to the point where the market clears where there's no more demand.

So the amount that the low-cost fuel generator gets is the market clearing price. It is what the highest bidder necessary to meet demand, it is their marginal cost that goes to all of the generators.

MR. CONKLIN: So basically at five o'clock the bid comes in at $14 a kilowatt or $10 a kilowatt to make it easy, for that five o'clock hour, everybody gets paid that $10 regardless whether it costs you a dollar and a half or $14?

MR. FITZPATRICK: That's correct. The alternative, as I said, is the pay as bid. Remember, we're in a market here. I mean, we're not forcing people to sell at their costs because we moved away from cost of service regulation.

So what that auction tries to do is how do we come up with what the market value of electricity is at that period, and that is the measure that is used to establish that.

Again, the alternative to that is a pay-as-bid system where generators don't have to bid based on their marginal cost. They can bid what they want to. It's a market.

Experience has shown they guess what the market-clearing price is going to be, and that leads to higher prices as opposed to a single price auction.

MR. CONKLIN: Sort of like selling a future market for oil?

MR. FITZPATRICK: I'm not an expert on that one, Representative, but I'll take your word for it.

MR. CONKLIN: Thank you.

MR. GEORGE: Mr. Fitzpatrick, are your utilities buying any power generators from outside of Pennsylvania?

MR. FITZPATRICK: Excuse me, sir?

MR. GEORGE: Are you buying power from any utilities that are located outside of

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Pennsylvania?

MR. FITZPATRICK: I represent the generators of electricity were no longer -- generation is no longer a utility service. Some of our members do own power plants in Pennsylvania. Some own power plants certainly in other states.

MR. GEORGE: But the truth is that most of your major have sold their power plants, have they not? GPU no longer owns their power plants, do they?

MR. FITZPATRICK: GPU is now --

MR. GEORGE: I don't think we need a story on do they or don't they.

MR. FITZPATRICK: There's isn't a GPU anymore.

MR. GEORGE: Well, I know what it is. I know what it is. Just like you have a power plant that bought a hydroelectric in Minnesota, isn't that not true?

MR. FITZPATRICK: I'm not familiar with that, Representative.

MR. GEORGE: I thank you for your patience and your presentation.

MR. FITZPATRICK: And I thank you for your patience as well. Thank you.

MR. GEORGE: The Chair now calls on the

gentleman, David Hughes. Welcome, Mr. Hughes. You may proceed.

MR. HUGHES: Thank you. After listening to the previous presenters, it's going to take a lot of discipline to stick to what I was planning on saying.

There's so many -- I want to talk about every single thing they said. I'll try to just outline my testimony that you all have, I assume. I will refer to some of the charts and the testimony.

I'm David Hughes, executive director of Citizen Power. We're based in Pittsburgh. We have been an energy advocacy organization here for 11 years.

Some of us at the organization worked on these issues since the mid 1980s. Citizen Power, unlike a lot of organizations, happened to be right about electricity deregulation.

We were opposed to it in the beginning. It was a process that went down the track back in 1996, and nobody could stop it. We've since spent all of our resources dedicated to trying to make deregulation as consumer and as environmentally friendly as possible, but we never believed it could work; and pretty much everything we've predicted has come true.

We don't believe it ever will work, frankly.

I'm glad to have this opportunity here today, and I appreciate you having this hearing. We do want to present some recommendations to you and there in the latter part of my testimony, but the key is that we believe that the State and the legislature, in particular, should really return to cost of service regulation and not necessarily the old regime that was in place before but sort of a new paradigm that we'll recommend to you.

We urge you to end the regime of deregulation markets in Pennsylvania clearly and unequivocally. In other words, don't try any hybrid methods that people are looking at in other states because we guarantee you that just as we said deregulation wouldn't work, these hybrid methods will fail, too.

Eventually everybody will return to regulation whether it's Pennsylvania, whether it's another state or another country because electricity cannot be left to the volatility of the marketplace.

So I want to mention that deregulation was introduced and based on false promises and false premises. We were told that, you know, you let the prices be determined by the marketplace and the customers will get restrained prices through competition. That would be the quid pro quo. We would pay off restrained costs, and we would get lower rates.

Well, with the exception of temporarily regulated lower rates, we really haven't received quid pro quo as customers and residential rate payers that we were promised.

So let me talk briefly about a few myths of deregulation. The first one is that there are rate caps in place. I don't know about you, but to me a rate cap means that the rates are capped and they don't go up.

The rate caps only apply to transmission and distribution. They don't apply to generation. Throughout the deregulation process here in Pennsylvania for the last eight or nine years, the rates have gone up.

Generation rates have had built-in increases. So as a customer, I don't really see rate caps in the literal sense of the term "rate caps."

Secondly, we are told by deregulation proponents that prices would be higher without deregulation. We don't believe that's true. We don't believe that studies show that to be true, and I call your attention to Fig. 1 on Page 4 of my testimony.

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I think it's important to take a look at history here. If you look at that chart, you will see that rates starting back in 1990 and 1991 were declining in this state all the way through the onset of deregulation in 1999.

And of course the first -- the top two lines represent the two nuclear utilities that most of the investment in nuclear power by Peco and Duquesne Light.

The rates were declining and then continued to decline for the two big nuclear utilities when deregulation started. If you look at Duquesne Light, you'll see that they had a relatively sharp drop in 2002, and I will talk about that.

There isn't any evidence, credible evidence, and we can show that the studies that claim this are flawed, that will support the theory that rates would have gone up had we not deregulated.

The fact is they may not have gone up. They may have continued their downward track. There is no credible evidence that the rates would have increased even with the increased fuel costs because they would have been offset by a whole lot of depreciation going on in plants.

If you take a look at Fig. 2, you'll see that historically -- and, again, I want to emphasize people talk about certain periods, but you really got to look at the long run here.

Rates in Pennsylvania have always tracked above other states and particularly regulated states, and that track is continuing after deregulation; and of course our fear, as your fear is, that after the rate caps come off that that differential will really go crazy.

The other myth that we keep hearing about is that deregulation has succeeded, and a shining example of this is Duquesne Light. As a Duquesne Light customer for 62 years -- well, I didn't pay the bills for the first 25 years. I can tell you that the sort of arguments put out about Duquesne Light as the shining example of the success of deregulation are just not true.

I'll just touch on three of them. One is that you hear that customers switching has been robust in the Duquesne Light territory. And if you look at Fig. 3 on Page 6, you'll see that after the onset of deregulation, when there were offers coming into the market, customer switching went up in the early period; and then from 2001 on, it just continued to drop down.

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What you see in 2007/2008 is an offer by Dominion to provide electricity to Duquesne Light customers; and in the last six months of 2008, that line has started to go back down again.

So there really isn't any robust customer switching in the Duquesne Light territory. All the customers who are switched are provided power by Dominion.

There's no competition. I keep hearing this word about competition. There is no competition. Dominion supplies the power to all the customers who don't get their power from incoming utility.

Secondly, we hear that Duquesne Light's rates went down by 22 percent and that this was due to competition. First of all, the rates didn't go down by 22 percent. They went down by 14 percent by Duquesne's own publication.

And they went down not from competition. They went down because, first of all, Duquesne Light's customers paid off 50 percent of Duquesne Light's stranded costs, and then Duquesne Light sold their plants; and that paid off the 50 percent remaining of their stranded cost.

This wasn't competition that did this. So it's not like we got a big bargain here because our rates were already extremely high because of Duquesne Light's investment in nuclear plants.

We also hear that things are much better now and that competition is working and that deregulation is working because prices now are way lower than they were back in 1992.

If you look at the chart on Page 7, Fig. 4 on Page 7, it's true that prices are lower than they were in 1992. Prices were lower every year in Pennsylvania for Duquesne Light customers, for example, since 1992 because 1991 and 1992 were the years when Duquesne Light's investment in nuclear power where you had 1,000 percent cost overruns on two nuclear plants. That's when those costs went into the rates for us.

So those years were skewed way high because of those investments, and every year since their rates have come down. So to argue that rates are lower now than they were in 1992 because of competition belies the fact that they were lower in 1998 before competition than they were in 1992.

And then I just want to mention that you hear about rates have gone up because of construction costs and plants, and rates have gone up because of the price of natural gas.

My testimony talks about the second part of that, the natural gas part because we can show you, and we will show you, that really the price increases in Pennsylvania have not been because of the increases in the price of natural gas.

In fact, in the years when natural gas prices went down, Pennsylvania's prices continued to go up. The price increases here are connected to this LPM, this locational marginal pricing, in the PJM system.

That's really not based on anything more in our view, and we can support this, than profiteering by the utilities. The fact of the matter is that since deregulation, utilities in this state and other deregulated states have had record profits.

So we do have a set of recommendations here, and I want to say just one thing. We hope that this committee and this legislature will -- that there will be no concession that rates should go up or that they have to go up when the rate caps come off.

In fact, because Pennsylvania has a huge reserve margin of generating capacity, 60 percent above the load requirement in the state, rates should not go up in Pennsylvania even when the rate caps come off.

But if you go back to regulation, cost of service regulation, then the State will be able to

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reassert its authority to control prices and to make sure those prices are fair for something that is not a commodity, that is a public good, electricity. It's a vital service for the people of this state.

Finally, I just want to close by saying that we hope that the legislature will eventually implement a clear policy that electricity in this state is to be provided for the people of this state as a public good.

And I don't want to run through all these recommendations for you probably because I'm getting close to my time. I assume that's what you looking at your watch means.

But I will refer you to Page 16, and the immediate steps I think that the State could take, and we will advise that long-term contracts are not the answer because they can lock you into things that you will regret later just like they have in California.

We think that the State has authority already to do a lot to control prices, and Point No. 1 talks about that. We think the State needs to exercise -- to get the PUC to exercise its special powers and rights under the federal power act and take a more aggressive role with FERC about adequate service including aspects of physical and economic withholding that may be on the region of state under Section 207 of the FPA.

Secondly, we think you should direct the PUC to make generator financial operational and pricing information transparent by acquiring it from the generators under state law and by requesting disclosure from FERC pursuant to FPA Section 209(c) or by compelling disclosure by the federal court under FPA Section 201(g).

And we think importantly that -- we think the State should make a FERC determination of just and reasonable rates on a traditional cost-of-service basis.

In an examination of long term-term consumer impact, a condition of the Pennsylvania PUC putting into effect any retail rate based on wholesale price ranges using the information gleaned from the second point that I mentioned.

So we have a lot of recommendations. We're going to provide it to the committee and the legislature, and I really appreciate the opportunity to come here today and share our concerns with you.

MR. GEORGE: Thank you very much. Now, we're running a little late. I would ask that we can keep them short, and I'll turn to the gentleman, Mr.

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Reed.

MR. REED: Thank you, Mr. Chairman. I only have two questions. My first question is you talked about and you referred to Page 4, Figure 1, and you used that graph to exemplify the point that electricity rates were going down before deregulation occurred.

But when I look at that graph, that graph doesn't do anything to demonstrate electricity rates. It is based upon the Pennsylvania average monthly electricity bill, which is much, much different than rates.

Monthly bill can be impacted by the climate on any given year, a colder winter, a hotter summer, energy efficiency measures, environmental regulation that may be occurring.

It seems that you're proving a point using a graph that does not match the statistics that you're actually using. Can you explain that?

MR. HUGHES: Well, it's for 500 kilowatt hours usage. So it doesn't matter. What matters is what the customer uses. If the customer uses 500 kilowatt hours in 1992 -- and by the way, this chart is adjusted for inflation.

MR. REED: I'm sure it's adjusted for

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inflation, but this --

MR. HUGHES: If they use 500 kilowatt hours and it costs them more in 1992 and less in 1993, et cetera, all the way down, I think you can be pretty sure that that change is not necessarily all being caused by weather changes. I meant prices, the prices --

MR. REED: We're talking about two different things then.

MR. HUGHES: But they reflect rates.

MR. REED: Okay. So we were talking about two -- perhaps you just misspoke when you used the terminology a little earlier. My second question, when I look at your opening, you described your group as a group that we work to effect energy policies of PA and Ohio to protect low-income electricity consumers. Is that accurate?

MR. HUGHES: That's part of our mission.

MR. REED: I would assume a lot of folks that you look to represent are in rent-controlled apartments, and I guess my question to you would be, do you find that folks in rent-controlled apartments are more likely to shop for cheaper housing or folks who are not in rent-controlled apartments are more likely to seek cheaper housing sooner and more often?

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MR. HUGHES: We don't do real estate.

MR. REED: Well, the reason I ask that is because on Page 6, Figure 3, you seem to question -- or you don't seem to. You actually question whether folks are actually going to be willing or have been willing to shop for different electricity providers, and it would stand to reason that folks in a rent-controlled apartment similar to price occurring in electricity are going to be less apt to shop because you're going to get a similar price wherever you go.

But once you remove the rent control or in the case of electricity, once caps come off, folks are going to act far more quickly to shop for electricity.

So I guess my point -- it's more of a point and a comment rather than a question. I don't think you can evaluate the electricity shopping market based upon what has occurred because you don't have a market in place because the caps are still in place.

It would be like evaluating folks shopping for new housing under rent-controlled conditions. What you need to do is evaluate it on an open-market system where prices are going up and going up down and not as uniform across the board.

Like I said, it's more of a comment than a

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question; but I do think you cannot evaluate the true market until a true market actually exists. You're more predicting the future as opposed to a statement of fact of something that already has occurred. So thank you for your testimony. Mr. Chairman, thank you for the opportunity.

MR. GEORGE: The gentleman, Mr. Pyle?

MR. PYLE: No question, Mr. Chairman.

MR. GEORGE: Lady Representative Rapp.

MS. RAPP: Thank you, Mr. Chairman. Page 7 and continuing on Page 8 at the bottom there, you state "Pennsylvania's electricity supply is fueled by coal and nuclear. It does not rely on natural gas. The proportions of coal and nuclear relative to natural gas/oil in Pennsylvania's fuel mix have remained stable at 90 plus percent to 4 to 7 percent since the early 1990s. Like we see in other markets, rising electric prices are driven more my profiteering, which Pennsylvania can control, than by rising full costs." Do you believe that the price of natural gas is rising?

MR. HUGHES: Right now?

MS. RAPP: Yes.

MR. HUGHES: The price of natural gas has risen, yes, sure; but there were periods when it actually went down, and yet our price of electricity went up.

MS. RAPP: Right. So you agree then that right now the natural gas is rising?

MR. HUGHES: At this moment I don't know, but I know that in the last year and a half or so it has gone up.

MS. RAPP: So if we're looking at some of our plants generating electricity using natural gas, then doesn't it make sense to you that the price of the fuel of natural gas would be passed on.

MR. HUGHES: It would be, except that very little of the electricity that's used totally in the state is generated by natural gas. Almost 68 percent of it is nuclear and coal.

MS. RAPP: Right, but I think I did hear two of my colleagues say that they now have a natural gas plant in their district.

MR. HUGHES: They're probably peaking units. They're not base levels.

MS. RAPP: Right. Well, I guess my concern is that I'm kind of getting the attitude from you that you do not believe that electric companies should make a profit.

MR. HUGHES: I didn't say that. You

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couldn't be in the electricity business and not make a profit and pay off your investors and pay off your capital loans. No, I don't agree with that.

MS. RAPP: So you do then believe that electric companies should make a profit when they're seeing an increased cost to their fuels that they should be able to pass that on?

MR. HUGHES: Sure.

MS. RAPP: I was a little concerned hearing your testimony that you thought differently, but thank you very much.

MR. GEORGE: Gentleman Mr. Hutchinson.

MR. HUTCHINSON: No questions.

MR. GEORGE: Gentleman Conklin.

MR. CONKLIN: Just very quickly. I want to ask the same question I ask a lot because maybe I'm a little slow. I'm not sure. Maybe you can try to explain to me again this peak hour pricing because I'm trying to get my hands around this. I've been asking this for about a year and a half.

Can you explain to me -- am I to understand that everyone that's involved in the market is basically in a consortium, that they're actually together; but they bid on the peak hour price together, and they work together, and then they get

paid that price? Is that what my understanding is?
MR. HUGHES: Yes. That's basically it. First of all, we're talking about the wholesale market. We're talking about PJM. PJM has this auction process to try to set prices that's based on the last unit where they accept the bid.
Whether that whole process is fair or not, it needs to be looked at frankly. I think there needs to be an investigation into that whole pricing mechanism at PJM.
But I think the more important -- and I think you're basically describing it accurately. The more important thing is that there is a whole lot of other evidence to show that there is no justification for the price increases that we've already experienced or that are being predicted when the caps come off in two years.
MR. CONKLIN: Thank you. You answered my question. Thank you.
MR. GEORGE: Mr. Hornaman?
MR. HORNAMAN: No question.
MR. GEORGE: Gentleman Mr. Levdansky.
MR. LEVDANSKY: Thank you, Mr. Chairman. Professor Apt pointed out in his earlier testimony that when the rate caps come off in Pennsylvania

consumers of electricity are going to see anywhere from a 70 to a 75-percent increase in their electric bills. That's pretty substantial.

The gentleman, Mr. Fitzpatrick, was testifying. I was trying to ascertain what the relative profits of the utility companies, the electric utility companies are in a regulated environment and in a deregulated environment.

Are you aware, have there been any studies done, you know, in Pennsylvania to your knowledge that have looked at the impact of regulation or deregulation or any national studies on looking at the impact of being an electric company in a regulated state versus a deregulated state and the impact on profits? Are you aware of any study that's --

MR. HUGHES: Well, I'm actually not aware of any study. I'm aware of the companies publicizing the fact that they've had record profits in the last two or three years including First Energy, but I'm not aware if they are, but we can do a search and see if there are.

MR. LEVDANSKY: That could be helpful. Finally, this genie is coming out of the bottle, so to speak. I mean, you know, the regulation is the law not with standing the fact that some of us opposed it when it was passed in the legislature back in the 1990s.

It is happening, but I think we're going to be looking to see what other states have done. Are there any other states that have dealt with the problem of rate caps coming off and deregulating the environment, any other states that have dealt with this challenge as well that you may suggest we look at for some guidance?

MR. HUGHES: Yes. There are a lot of states that have done that. Some of them have actually gone back to full cost of service regulation. Other states are moving in that direction.

Ohio just enacted legislation, Senate Bill 221, that sort of moves in the direction of going back to cost of service regulation. It gives the utilities the option to go back to cost of service regulation or to go to market.

I think for Pennsylvania you ought to take a look at what is going on in Maryland. I think they've done probably the most extensive investigation as to how to get out of this mess.

You'll see in my testimony, the people who engineered deregulation, and I don't mean just in Pennsylvania, but I mean across the country, they're very clever in how they put this together; and they spent a long time, and it's going to be very difficult to unwind it.

It might take as many years to unwind it as it took for them to get it back. I think the legislature really, in order to really do what is needed for the people of the State, has really got to make that move back to a system where the state asserts control over the vital necessities.

Anything short of that will lead to major problems; and I might mention, I never mentioned this, you keep hearing that you just let the market work, and it will perform its miracles, and you'll see what happens when the rate caps come off because we don't have a market now as Mr. Reed mentioned.

Well, we know what will happen with the rate caps came off and Duquesne Light. When the CTC come off the bill, customers switching continued to go down. Companies quit offering.

And you talk about having choices and what low rental people do in Section 8 housing. They're not going to make any choices because there are no choices to make.

There are no competitors, and nobody who supports deregulation can tell me what is going to happen to create competition to make people enter the market and give people choices.

What is going to happen to make that happen. No one can tell me, and now here we are nine years into this. How long are we going to wait for a fix?

MR. LEVDANSKY: Thank you.

MR. GEORGE: Sir, there are residents and customers here in Western Pennsylvania probably paying about ten cents a kilowatt.

MR. HUGHES: 13 cents.

MR. GEORGE: 13 cents. Well, again, there are some states such as Texas that are paying three to four times that. What do you think is going to happen if Western Pennsylvania's legislature doesn't act appropriately to contain this?

Sir, you know if you've been involved in the electric industry, anybody as old as you and I remembers when the electric companies used to offer you a better price when you were all electric, including electric heat. Now they're talking about the only way to save money is to use less power. Very quickly, give me your answer.

MR. HUGHES: Just having grown up here, I've watched Western Pennsylvania go from reliance on the steel industry to the collapse of that industry to

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an attempt to come out of that and build the kind of economy that benefits the people in this region, and I think in many ways we've made great strides; but we're still not out of that struggle.

And if what happened in Pike County and what happened in Illinois, Virginia, and Maryland happens here, it will be devastating for this region, for Western PA. We're sort of still treading water out here.

MR. GEORGE: For a little humor, I'm not worried about Maryland because Governor Ridge lives there. So I don't care how much he pays for electricity.

MR. HUGHES: Well, we can't afford the kind of --

MR. GEORGE: He's the one that passed deregulation. That's the reason I'm being somewhat silly about it.

MR. HUGHES: People have to understand that we don't -- it's frustrating for me because there's this assumption that there's going to be rate increases when the rate caps come off. It doesn't have to be the case.

MR. GEORGE: No, but some of them are predicting as much as 54 percent and up. In Pike

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County, it went up 71 percent.

MR. HUGHES: Well, this is the problem with deregulation. When the state gives up its ability to control prices, when you have a market situation where there's no competition and you still have monopolies in place, which is what is going to happen, then the prices can skyrocket.

MR. GEORGE: I would urge you to write to this committee and give us any of your ideas. We would be happy to look them over.

MR. HUGHES: Thank you very much.

MR. GEORGE: Thank you very much. The next individual who testifies, Mr. Ray Landis, advocacy manager at AARP Pennsylvania. Welcome to the committee.

MR. LANDIS: Thank you, and good afternoon, Chairman George, Chairman Hutchinson, members of the committee. Like the previous testifiers, I don't want to sit here and read my testimony. You all have it in front of you, but I do want to highlight especially the recommendations that AARP has for addressing the situation we encountered in Pennsylvania.

Just for the record, AARP is an advocacy organization, a nonprofit organization, with 1.9

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million members in Pennsylvania. I serve as the advocacy manager in our Harrisburg office.

You might ask what standing AARP has to comment on this situation and make the kind of recommendations we are making. We are a national organization, and we have state offices across the country and in deregulated states that have experienced the price shocks.

Our members have certainly expressed their outrage at these shocks and, frankly, their inability to afford the kind of price rises in electricity that they may have seen in states like Maryland and in Texas.

At that point, AARP at the national level has hired some experts in the electricity field and the utilities field who have worked on recommendations for other states and work with other organizations in coming up with these recommendations.

As I go on, I will talk about some of the recommendations that we have. One thing I did want to point out as we have talked about other states, like Representative Conklin, I had plenty of time there to examine the charts that Mr. Fitzpatrick had in his testimony and compare them with a chart that I included in our testimony.

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One thing I note on Mr. Fitzpatrick's chart that purports to show that there is a nix in the highest increases from states that there's a mix between regulated and deregulated states.

First, his chart discusses restructured states as opposed to deregulated states; and I note that he includes Delaware and Michigan as a nonrestructured state, and the chart that is presented in my testimony includes Michigan and Delaware as regulated states, excuse me, as deregulated states, which would indicate that most of the highest increases are from states that have been deregulated.

Also, I note on his charts that he includes the restructured -- includes Pennsylvania, Ohio, Virginia on his chart of restructured states.

Remember, those three states have had price caps that have restricted the possible increases in electric prices. So naturally they do fall at the bottom of his chart. So, again, it's a situation where you can do a lot things with figures.

AARP has been involved in doing things in other states and to keep states like Maryland like Delaware adopt midcourse corrections in their move for deregulation, and we've seen Ohio and Virginia actually pass some legislation; although, the AARP offices in those states do not feel that that legislation went far enough in reversing the price shocks that those states have experienced because of deregulation.

We feel in Pennsylvania that we have an opportunity to mitigate the price shocks that could come because of deregulation, and I would like to go through some of the recommendations that AARP has.

And, first, our primary recommendation is that we should not continue down the path that's set forth by the 1977 legislation.

We just don't feel that the experience of these other states has shown that the advantages of functioning in a competitive market benefit consumers; and, of course, we are a consumer organization. We've seen that the restructured markets have seen added cost, new middlemen, lost efficiencies and additional risk.

We wholeheartedly agree with the testimony from Mr. Apt that the provider of last resort service prices have been a disaster in other states.

Our consumer advocate of Pennsylvania, Sonny Popowski, has predicted an additional $1.55 billion in electricity costs should deregulation proceed as it is proceeding in Pennsylvania; and AARP believes that an

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alternative to the provider of last resort least cost portfolio planning should be adopted in Pennsylvania, and this is a provision in House Bill 12201, which AARP supports.

We do agree with some of the previous testifiers that the PGM situation is a big concern for Pennsylvania; and although this is out of our jurisdiction, out of your jurisdiction as state legislatures, we feel that the State could advocate before federal regulators and congress for investigation and reform of the wholesale markets as represented by PGM, and because they just have not produced just and reasonable rates.

We also believe that Pennsylvania should consider creating a state power authority as has been done in Illinois. It's one way that Pennsylvania can influence the wholesale markets, and we believe that the Illinois example is good because the authority that is created there has the authority to build power plants that could sell outputted rates based on cost of service rather than market prices and would procure power for the state's utility.

We also heard discussion in earlier testimony about smart meters or advanced meters. We have a serious concern about mandatory advanced meters, especially for older consumers.

We do not oppose the concept of advanced meters. They can save consumers money if consumers choose to use them; but by making them mandatory, we feel that they could jeopardize older consumers, especially those who are shut in at home and need to use heat in the winter and air conditioning in the summer for health reasons. So we just do not believe that that is a good policy that should be adapted by the State.

In regard to price caps, we, like Mr. Hughes in his testimony, do not believe that extending the price caps is the answer to all this.

We do believe that extending the price caps is a temporary solution, but we don't think it is the long-term solution to this problem; and we believe the legislature must do more than simply extending the price caps.

Finally, we do believe that in the face of increasing utility and electric prices that additional assistance must be extended to those who need it the most.

We strongly agree with the requirement and House Bill 2201 for programs to assist low-income customers and managing rate increases.

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We have been strong supporters of another bill that's before the House, House Bill 824, although this bill has been voted down by the Consumer Affairs Committee.

Finally, we believe that the State should contribute to the LIHEAP program so that the LIHEAP program could be restored to individuals at 175 percent of the poverty level instead of the current 150 percent level that Pennsylvanians are eligible for because the State does not currently contribute to the LIHEAP program.

Finally, there's little that we can do in Pennsylvania about the high price of gasoline or the cost of home-heating oil or natural gas for the winter as these prices continue to increase, but we can do something to mitigate this sharp price increase in electric rates that's going to be coming in if we don't do something before the end of 2009.

It is a situation where there's not a lot of public outcry about this right now. I'm sure that you're not getting a tremendous amount of calls to your district offices about electric rate increases.

I promise you that based on our experiences and other states like Maryland and Texas that have deregulated that should these price shocks decrease, that suddenly your phones will be ringing off the hook. Thanks, and I would be glad to answer any questions.

MR. GEORGE: Are there any questions to the right, the gentleman, Mr. Pyle?

MR. PYLE: I'm curious. We just heard from three different speakers about the aging fleet of coal and plants, and you're advocating establishing a state authority that has the ability to build electrical generation stations; is that correct?

MR. LANDIS: That is correct, yes.

MR. PYLE: I can't even guess what a generation station is going to cost, but I know we're well over a billion dollars easily. Where do you propose this construction money comes from should we vote for the authority you're advocating?

MR. LANDIS: We do not have a suggestion on where it would come from. In fact, we do not specifically advocate whether the State should indeed build these.

It would give the State the option to build them, but should the expense be too high --

MR. PYLE: It says here the authority would also have the authority to build power plants and would sell output rates based on cost of service.

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MR. LANDIS: It would give the State the authority if the State found that it would be economical to do so.

MR. PYLE: State billed, State owned, State operated public utilities; is that correct?

MR. LANDIS: That is what Illinois has authorized in the legislation that was signed in the fall, that it would authorize it, it would not require it; and that is our recommendation.

MR. PYLE: I'm not an electrical engineer or anything like that; but having a little bit of background in political science, that kind of goes a pretty good piece left. State-owned utilities, that's kind of like socialism, isn't it? Thank you, Mr. Chairman.

MR. GEORGE: Ms. Rapp?

MS. RAPP: I don't have anything.

MR. GEORGE: Gentleman Mr. Levdansky?

MR. LEVDANSKY: (Indicating.)

MR. GEORGE: Gentleman Mr. Hornaman?

MR. HORNAMAN: (Indicating.)

MR. GEORGE: Mr. Conklin?

MR. CONKLIN: Nothing.

MR. GEORGE: Let me just say this. You're advocating, yet you're saying you can't do this

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and you can't do that, and it would be temporary; and you're saying something ought to be done just a few short months to 2009. Why wouldn't a rate cap for a year to two years give us an opportunity, for example, to put a tax on all of this that's coming from out of state so that we could build power plants?

Now, again, we didn't get the answer, but the truth is that there are generating entities in Pennsylvania that has bought the coal fire plant in Illinois, a hydroelectric in Minnesota, one in Vancouver.

I'm just saying, that's right, we ought to generate more, but should we not also because the problem I have -- and when you say the people aren't screaming, maybe it's up to the AARP to go out there and tell them really the dire consequences.

You know, we talk about gasoline. You can tell people a way to save money is don't drive, but you can't tell them to turn off their electricity or a heart or a breathing machine and that kind of matter.

So, you know, what do you do with these seniors that are absolutely held hostage? We've done things on heat, and we've done things on LIHEAP; but the fact remains, there is absolutely before us no other procedure to take up other than what we're trying to do.

MR. LANDIS: Let me clarify. We do not think rate caps are the long-term solution. We certainly do not oppose, in fact, would support, a temporary continuation of the rate caps until this long-term solution is put into place; but we just don't see that doing only extending the rate caps and doing nothing else is a permanent decision.

MR. GEORGE: That clarifies it a great deal more than your answer to one of the other individuals. I thank you very much for your testimony. Oh, the gentleman Mr. Levdansky, do you --

MR. LEVDANSKY: Yes. Thank you, Mr. Chairman. Mr. Landis, I just had my -- I didn't have a question, but one of my colleagues made some reference to some sort of "ism," and I just wanted to clarify a little bit.

Regarding your suggestion that Pennsylvania should consider creating a state power authority, that may not be as absurd as maybe some think at first glance.

I just think that, you know, there's a lot of people in Pennsylvania who purchased their electricity for their homes through rural electric associations.

I guess for whatever reason, the private

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distribution market didn't work; and so, you know, little local community-based associations were formed to purchase power and distribute it to customers.

So, I mean, there's a case of, you know, formation of kind of like some sort of governmental co-op to provide electricity. I know in Central Pennsylvania there's a short line railroad run by an organization called Sedacoff (phonetic). It's a consortium of local governments in Central Pennsylvania that run a railroad. One of my colleagues here I think to the left referred to this as socialism. It's actually quite the contrary.

It's a government agency competing in the free market. You know, it's government capitalism, if you'll call it that. So I think it's an intriguing idea.

It's probably something most of us in government would prefer not to do, but it is really -- you know, I think it does point to the idea that we need to get a better handle on what is going on out in the marketplace, you know, what are the relative profits; and sometimes the only way to get real information about the market is if you're running a business yourself.

So, again, while some think it's a little bit absurd, other states are taking a look at it; and it's not the fear of an "ism" I think we should all have.

MR. LANDIS: One note. You might check with your colleagues who represent the Chambersburg area. Chambersburg has a public power authority for their community, and the reports that we have heard from our members in the Chambersburg area is that they are pleased with us.

MR. LEVDANSKY: The public authorities provide water to people. They provide sewage to people. So there are comparable models there, but thank you, Mr. Chairman.

MR. GEORGE: I thank you gentlemen. I thank you for your testimony, and now we call on the gentleman, Tyrone J. Christy, commissioner of the Pennsylvania Public Utility Commission.

MR. CHRISTY: Thank you, Chairman George, Chairman Hutchinson, members of the committee. I very much appreciate the invite to be here today.

Now, I'm going to deviate a little bit from my prepared script here just to show you one particular chart that I think all of you would find very interesting.

This is a chart that I'm taking from the Web site of Pennsylvania Power and Light 2007, and basically it says that in 2007, 94 percent of our own generation output is expected to be produced at a fuel cost of approximately $16 a megawatt hour or less. That's 1.6 cents a kilowatt hour.

We're halfway through the solicitations for the new rates that will take effect in 2010 for PP&L, and those rates are at 10.8 cents a kilowatt hour right now; and in all likelihood, given the rise in power prices over the past three or four months, that 10.8-cent number may be even higher.

So when you look at the actual cost of generating power, according to the generation owner themselves at 1.6 cents a kilowatt hour, and consumers are being charged 10.8 cents a kilowatt hour, you just have to step back and say, okay, what is going on here, is this a reasonable rate for consumers to pay, are these just reasonable rates, is the market working fine, are there issue with retail competition that we need to take a look at. So that's one issue I just wanted to point out before I began here.

At the outset, I would like to emphasize that my testimony represents my personal views and not those of the commission as a whole.

In my view, the upcoming increases to electricity cost represent the most serious challenge to Pennsylvania in many years. I appeared before you five months ago and painted a dire picture of where we were headed.

Today I can report that things have only gotten worse. Natural gas prices which are a substantial driver for the pricing of electricity at PJM have increased significantly over the last five months.

If you look at a strip of power in January 30 of this year, 12-month strip, the price of that power was 6.92 cents per kilowatt hour. On June 27 last month, the price of that strip of power was 9.76 cents. There was an increase of about 41 percent.

These rises in natural gas prices are going to cost us some real heartache next winter for home heating purposes as well. Electricity prices are headed up absent of some fundamental changes to the way that electric distribution companies are procuring power to serve their customers after rate caps expire.

The 96 Competition Act was passed on the basis that it would lead to lower rates for consumers. Since the lower rates that were promised have not materialized, it's important to take a look at what has happened.

Pennsylvania is not alone with this issue.

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Many other states that have elected to take the route of deregulation have experienced similar problems with significant rises in electricity costs.

Many are scrabbling to figure out what went wrong and what direction they should take forward. Chairman George, you mentioned the problems in Texas, and there's also some similar situations in Montana, Maryland, Delaware, New Jersey. All of these states are struggling with these issues.

In my opinion, the lower rates that were promised have not materialized because the competition act ended the regulation of retail generation rates, and instead there is now a reliance on a newly created wholesale power market.

This new wholesale power market has been set up with a series of artificial pricing structures that are resulting in prices awarded to generation participates that have little relationship to the cost of producing power. This PP&L chart that I showed you I think is a small example of that.

PJM, which oversees this market, has basically two primary pricing mechanisms for the establishment of energy and capacity; and both of these pricing mechanisms is as a result of prices that bear no relationship to the cost of producing power.

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All generators are paid the same price. Under PJM single market clearing price, all generators are paid rates based on highest cost unit at any given time.

For example, let's assume that you have a load of 10,000 megawatts on your system and 9,999 megawatts low-cost coal-fired generation are offered at 2.5 cents a kilowatt hour.

If just 1 megawatt of gas-fire generation at 10 cents per kilowatt hour is needed, all 10,000 megawatts are paid to 10 cents despite the fact that the 9,999 megawatts is willing to sell to power 2.5 cents a kilowatt hour.

In Pennsylvania, over 90 percent of our energy needs are met with low-cost nuclear facilities. Yet these coal and nuclear power plants are paid high prices based upon natural gas prices, approximately 30 to 35 percent of the time.

On the capacity side, PJM has an RPM pricing mechanism for capacity that in theory is supposed to provide incentives for the construction of new power plants.

However, all insistent generators are paid this credit when only a small amount of new resources have actually been added. It is estimated that over

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26 billion dollars will be transferred to these generators over the PJM footprint over a four, five-year period with some estimating as little as actually 1,000 or 2,000 megawatts of actual new facilities being added.

This is cause for great concern of us at the public utility commission. Just recently we joined a number of other states and consumers and filed a complaint at FERC asking them to take a serious look at this capacity procurement mechanism and weigh in on the matter.

Those who continue to believe that we should continue to rely solely on this wholesale fire market to control prices must understand that this market is broken and is not producing competitive prices.

There's no meaningful check on prices for power in Pennsylvania. Consumer protection and oversight is absent in PA's competition experiment. It has been replaced with the blind reliance on the market to deliver just and reasonable rates.

The second consideration that I have regarding deregulation and why it has perhaps failed to produce lower rates is related to Pennsylvania's insistence that power supply to the EDCs generally must come from third parties or other marketers of power.

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This is a result in layers of new participants who in many cases simply add cost to the price of delivering power and additional risks to be in place on the cost of service.

The ability of an EDC to buy power direct from generating waves to save on power cost has been essentially removed from consideration. This is a mistake.

By way of further explanation, my descending statement issued in conjunction with the commission's decision in West Penn Power's case last week is attached to my testimony.

Instead of commission adopting an actively managed portfolio designed to obtain the lowest reasonable rate on a long-term basis including direct purchases from individual generating plants, West Penn will simply be soliciting a series of short-term, 3-to-29 a month full requirement contracts.

These full requirement contract plans ensure that only large power aggregators would be able to bid, plus adding unnecessary layers of cost to the rates paid by West Penn consumers.

According to the judge in the case and by many participants in the case -- and this is a quote of the judge, "The goal for default service under the competition act was not to provide residential customers with the lowest reasonable and most stable rates on a long-term basis. Instead, the statute requires that energy be acquired at the prevailing be acquired at the prevailing market prices."

In my opinion, the elevation of the goal of obtaining prevailing market prices over obtaining the lowest reasonable rates for Pennsylvania consumers is in my view very alarming.

Stated another way, I believe we're promoting competition to say we have competition even though the competitive wholesale market exists in name only, and we are denying the consumers the opportunity to buy power directly.

Prior to 1996 it used to be an obligation of electric utilities to engage least-cost planning, look for the lowest cost source of generation.

Today there is no oversight over capacity additions needed to serve Pennsylvania's customers. In my view this needs to be corrected.

Since 1996, over 90 percent of the new generated capacity added to Pennsylvania has been natural gas fire, which only exacerbates the high PJM marginal energy prices and frankly drives up the cost of natural gas needed for home heating. I think there was a reason why we didn't feel to use the restriction act in 1978. That was lifted I believe in the early 1990s.

We should ensure that the economy in Pennsylvania is strengthening through the use of Pennsylvania resources. The construction of base-load units fueled by coal or coal waste would create jobs in this struggling economy.

As we sit here today, I am personally aware of over 1,000 megawatts of fully permitted waste coal fire development plants that are at risk of failure because the policies discouraging long-term contracts.

These facilities represent over four billion dollars worth of investment, thousands of jobs, while producing power under performance-based contracts at rates that are less than any of the results from the solicitations that I've seen under default service.

These fire-plants need long-term contracts, and we need policies to encourage the long-term contracts. Not to divulge too much about the rates that they're offering, but in general terms, anywhere from six and a half to seven and a half cents per kilowatt hour spread out over a 20-year period is the rates that these facilities have been willing to offer.

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But these are the kind of facilities that might help to reduce gas off the market and which might reduce the prices that the other generators are marketing or making under the PJM program.

EDC should be required to issue competitive solicitation for new generating plants. That would provide the power directly to consumers with no markup by aggregators, contractual rates that bear a reasonable relationship to the cost of producing power.

In addition to issuing the RFPs for the construction of new power plants, owners of existing units should be encouraged to voluntarily agree to sell power to consumers under long-term contracts by rates that bear reasonable relationship to cost.

Such arrangements could be to the benefit of generating units themselves because they would remove a level of uncertainty to which a merchant generator is exposed.

The fact that we have legally divested the backbone of our generation fleet in fire sell prices in 1996 in an effort to accelerate competition complicates any quick solutions here.

Despite the fact that in Pennsylvania the rate payers pay for the capital costs of these utility power plants first through rate base treatment and then through 12 billion dollars in stranded cost payments, rate payers will not receive the benefits of low-cost power like other states such as West Virginia and Kentucky, which have remained regulated.

Instead of paying costs based upon rates, based upon fully depreciated units, rate payers will be forced to pay market rates for these powers.

A good example of how this could have worked for Pennsylvania is to take a look at West Virginia's experience, which remains regulated.

Last year an affiliate of Allegheny Energy sought a rate increase in West Virginia for the increased cost of full of the power plant. They were granted the increase for the full price increases, but they received offsetting reduction for the plants being depreciated.

The bottom line is they actually received the rate decrease. The rates in West Virginia hasn't gone up in 20 years, and they're not expected to dramatically rise.

So full prices are rising, and there's going to be some increases. That's inevitable, but nothing like we're experiencing here in the deregulated market of Pennsylvania.

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Once the rate caps come off here, the rates for Allegheny Energy are going to sore because of the way these market prices have been set.

In Maryland where there's deregulation and where Allegheny also operates, once the rate caps came off there, the industrial rates are double what they are in West Virginia, which, again, stayed regulated.

So we don't have to look at many charts other than maybe just look in our backyard here and see what is going on between regulated and nonregulated. Take a look at our co-ops in Pennsylvania, and look at the stability rates that they have as they were being regulated; and I think the conclusions are fairly clear.

So where does this bring us? Well, in addition to changing the framework under which EDC has procured power to serve to customers after rate caps expire, there are a couple of other concepts that deserve some consideration.

First, considerations should be given to creating a Pennsylvania power authority with the authority to contract for the construction of new power plants to serve Pennsylvania.

Such an authority should also be authorized to pursue litigation lobbying efforts at the federal level as part of an aggressive effort to challenge PJM and FERC decisions.

We had a good discussion here about the power authority and how it would work. Let me describe to you how I think the power authority would work.

They would not be state-owned facilities. They would not be state-operated facilities. Rather, a competitive solicitation would be issued, and performance-based contracts would be sought or a private industry is a step forward to build these facilities that are long-term contracts where they take all the risk for the development of the facility, all the risk of financing the facility; and all the State has to do is issue the long-term contract.

There will be no state financing involved, no state risk other than stepping up and making a long-term commitment, which many of these very, very capital intensive facilities need in order to secure their financing.

Second, we need to really get off the ball here and enact some legislation for aggressive conservation. Something like HB2200 is an excellent start to getting that very, very important program in place.

As an example, compact production bulbs is

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such low hanging proof for everyone across the state. I installed them in my own home, and I think I'm saving $20, $25 a month. The payback is less than six months.

Can you imagine what we could do in Pennsylvania if everybody would be encouraged to use these type of light bulbs. I think we would dramatically reduce the demand for electricity.

A third consideration should be given to restricting or eliminating the ability to shop, at least for residential customers. Few residential customers are shopping, and those that are are only seeing modest savings.

Simply having the ability to shop I think creates risks for suppliers which cost money to the consumers. All these options deserve consideration.

The extending of rate caps also deserves consideration. While rate caps could provide much needed short-term relief, fundamental change to the regulatory framework as I've discussed are what's really needed here.

In conclusion, I commend Chairman George, Chairman Hutchinson, and members of this committee for addressing these difficult, serious issues.

These are not easy problems to solve given the fact that we have legally divested the backbone of our low-cost generation from the unregulated market.

Solutions here are very complex and may take time; and, quite frankly, the silver door to immediate relief may be very challenging. Thank you, and I welcome any questions.

MR. GEORGE: Are there any questions for the gentleman? Mr. Hutchinson? One question.

MR. HUTCHINSON: Thank you for your testimony. You made a quick remark about looking at co-ops which are still regulated prices. How are they regulated?

MR. CHRISTY: Well, the co-ops basically own their generation. They did not divest their generation.

MR. HUTCHINSON: But they're not regulated?

MR. CHRISTY: Well, they regulate themselves. They own interest in like the Susquehanna Nuclear Power Plant. They get power from hydroelectric facilities up in New York.

They've got their own conservation and demand management program. They basically work as a co-op with the membership involved in the decision-making process.

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MR. HUTCHINSON: I just think the terminology, they are not regulated. I mean, there are reasons that they're prices may not be going up as fast, but it's not because they're under some regulatory scheme by a central body.

So the other point I wanted to ask you about. You said that the rate payers were paying for generation three times, and I can't find it here; but you said they paid for it originally, and then they paid for it through the stranded cost, and now they'll pay for it again.

Isn't it fair to say that the part that was not paid off under regulation, that is -- the stranded cost was the additional. You know, things were not completely paid off when we switched from a regulated regime to a deregulated regime.

So the margin remaining is what has been being paid for for the last ten plus, you know, ten or so years. So really it's not like they paid for it three times.

Now, I would argue that the third time you're talking about is actually how we would pay for future new generations. That's what I would argue, but I'm not going to get into that now; but I just want to clarify about the stranded cost portion, what we're talking about.

We're talking about paying the remaining cost of generation built prior to deregulation. Is that --

MR. CHRISTY: Yes, I agree with your characterization of that. The only place that there might be a little double-counting here would be on receiving the stranded costs and receiving a newly developed and issued RPM credit.

So the generation owners would receive stranded costs as well as the RPM credit, and in that sense I think there is a little bit of double-dipping but certainly not a triple.

MR. GEORGE: In your professional opinion, after serving as you do and watching deregulation, if it's not working, did you know of anywhere in the United States where that has taken place, where it has worked in bringing about residential rates much cheaper for the ordinary class of people that we concern ourselves about?

MR. CHRISTY: No, I'm not familiar with that. In fact, when I traveled a bit with my fellow commissioners across the country, those that have chosen to stay regulated just say, wow, you really have the tiger by the tail here, don't you; and we say, yes, we do have a challenge, yes.

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MR. GEORGE: Prior to you presenting, there was a witness that insisted that the generation in Pennsylvania has not kept pace and also the long-term contracts is not the answer.

The fact is that you're not going the get investors today to invest in a newer power plant if there isn't any guaranty that they're going to be able to establish long-term customers. Isn't that right?

MR. CHRISTY: In order to get these incredibly expensive solar fuel-fired facilities built, they really need the certainty of a long-term contract.

We could sit here and wait for the market to get higher, higher and higher; and eventually the risk or the prices will be so high that somebody would step forward and maybe take that risk, but it will be too late by then.

MR. GEORGE: You've given testimony about the PJM and a great percentage, almost 80 percent, of their power is not really being utilized and the fact that the one percent that is purchased at a higher rate per kilowatt, that structure gives all the loans that we're producing in much less the same ten cents a kilowatt.

MR. CHRISTY: Yes.

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MR. GEORGE: Shouldn't there be legislation that does something about that, or should we tax the PJM or better than that, those entities that are providing power to PJM?

MR. CHRISTY: Yes. I think there are two parts of that question or two questions there. The first part, unfortunately these wholesale power rates are overseen by the Federal Energy Regulatory Commission; and we at the Pennsylvania Public Utility Commission have no jurisdiction over these rates.

So we're simply reduced to file a complaint and/or intervening in proceedings before the Federal Energy Regulatory Commission, and basically we have done so but have not done very well.

The second part of that question is regarding the reliability pricing model where all these existing generators are used as capacity credit and in some circumstances a double-dipping.

The question is, is it maybe improper to try to claw back some of that tax that is basically being placed on the consumers of power from this RPM capacity credit, which, as I mentioned, will pay over 26 billion dollars; but very, very little new generation has actually been added. So I think there's some logic to possibly clawing back some of that RPM credit if there is a legal mechanism.

MR. GEORGE: One final question. What happened to the 14 billion dollars that the utilities benefited by in regard to this deregulation? Where did that money go? Someone told me they gave it back to their customers. Where did it go?

MR. CHRISTY: I would garner to say that probably the majority went to the shareholders. When you look at the 12 million stranded cost, a portion of that is related to long-term contracts that they signed; but a good portion of it is related to the stranded cost of the remaining investment.

One of the problems that I see from -- in 1996 there are good intentions. Everybody wanted this to work out. As I step back and look at it, I think what happened here was that we developed a standard of natural gas-fired combustion turbine using natural gas at $2.50 and said this is the price of power, anything above that is stranded cost.

We took a snapshot at a moment of time and said the gas prices will be $2.50 forever, and so all those coal and nuclear power plants that we paid billions to build were determined to be stranded, not economical, because at that one moment in time natural gas was the way to go. That's the bet that we made,

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and it was the wrong bet.

MR. GEORGE: I thank you. Anyone else? The gentleman Mr. Hornaman?

MR. HORNAMAN: Thank you, Mr. Chairman. I would just like to -- as one of those people who owns a total electric home and who was pulled into this back in the 1970s when the advertising was a dollar a day, $32 a month you could do it all, and as the years went on, we paid, and we paid, I am now a promoter of what Mr. Christy and Professor Apt mentioned earlier. A lot can be done on the demand side.

We have discovered ourselves in our own home by moving to a high-efficiency electric heat pump, in fact, one that up in Erie County they didn't really know if it was really going to work in our climate or not. It really did.

Compact fluorescent bulbs, energy efficient appliances, I'm paying less now than I paid 12 years ago for my electric. It can be done.

Now, senior citizens are being hit hard on this, and they probably can't invest their fixed incomes as much into a new heat pump or another electric source.

But if people who can afford demand side investments like this, do it. Then everyone will benefit. The seniors will benefit because, again, as mentioned, if we reduce that peak demand, the prices will come down for everyone including the senior citizens.

So based on what I've heard today and my own experience, I think demand side is certainly in the short run; and down the road in the future also, I think we can get a very quick reduction in rates if we promote this and push it. Thank you, Mr. Chairman.

MR. GEORGE: I thank the gentleman. Mr. Conklin?

MR. CONKLIN: No, thank you, Mr. Chairman.

MR. GEORGE: Mr. Levdansky?

MR. LEVDANSKY: Thank you, Mr. Chairman. Mr. Christy, I just want to make sure I understand how procurement works under the present environment that we have in this state.

The way I understand it -- I need to understand this so I can better understand one of your recommendations. It doesn't work such that a distribution company has to go to PJM to buy the electricity that they in turn then distribute out to their customers.

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MR. CHRISTY: The EDC will issue -- and without a number of different techniques here. In general terms, the EDC will issue a solicitation or default service to the customers that you would like to shop.

So basically you have these either unregulated affiliates with generation, with retail marketing arms. They will then bid into these programs, and where PJM prices come into play is that that's the only transparent market that we have to figure out where power prices are.

So it serves as a benchmark on our index from which everybody uses as a guide to actually bid into these short-term solicitations.

The suppliers who bid into this are oftentimes required to bid in and take the risk of an unknown number of megawatts of supply service, which just pass risk and uncertainty; and they have to make, in general terms, a fixed price proposal.

So there's risk that they assume. There's all their infrastructure that they assume. There's administration that they assume, and it's just an extra layer on the cost that I think help accelerate the prices that we're seeing under retail competition.

As an example, in the PP&L case, the power prices are coming in at 10.87 a kilowatt hour for default service in 2010; but when those solicitations were awarded, if you looked at a strip of power, it was about like seven cents a kilowatt hour. So we have like three, almost four, kilowatt cents an hour for this third-party related risk in the administration.

Now not all of it is completely blamed on the third parties. There's some cost involved in aggregating this power and levering it to the EDC. Some of that is going to be incurred by the EDC as well but not to the extent that I think we're seeing in these solicitations. So I think there's an opportunity to perhaps reduce the cost for Pennsylvanians.

MR. LEVDANSKY: Okay. But you're suggesting those to permitting the EDCs to engage, correct me if I'm wrong, in a long-term contract directly with the generator?

MR. CHRISTY: Correct.

MR. LEVDANSKY: Is that what Duquesne Light is looking for permission to do here in Western Pennsylvania?

MR. CHRISTY: I don't think I can really comment too much upon what Duquesne is thinking.

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MR. LEVDANSKY: Okay. Because they've expressed a desire to pull out of PJM. I mean, they're very concerned about the rates because Duquesne Light is now not a generator. They sold off all their plants. So they're simply a distribution company.

In speaking with them, my understanding of their position is they want to be able to go out and negotiate a long-term contract with the generator and not have to go through this whole PJM process.

MR. CHRISTY: I think I know what you're talking about. They have pulled out of PJM, and they are no longer a member of PJM because they did not like the structure of the pricing mechanism that was put into place at PJM, particularly the reliability pricing model which when it was adopted the projection at that time was that it might cost about a tenth of a penny a kilowatt hour.

Well, the prices came in about ten times that level; and as a result, Duquesne already made commitments under fuller supply and fixed rates.

Now, all of a sudden, being hit with this unexpected large increase under RPM and them asking the question, well, what are we getting for this RPM, I think that was -- and they can speak for themselves, but I think that was the primary reason that I said, we really don't want anymore to be a part of this PJM. So they joined the Midwest system of organization.

I think they have tried in the past to adopt strategies of actually trying to do a purchase of a plant and dedicating that plant back to consumers under some long-term rates, let there be stability; and, quite frankly, I think there's a lot of merit in that because, again, we're cutting out the aggregator, and we're buying direct, and they're now getting it directly to consumers.

MR. LEVDANSKY: Mr. Christy, just in closing, I want to thank you for your testimony and for your thoughtful recommendations.

I appreciate it, as I appreciate the testimony from the diverse group of people that we had giving testimony today; and I wanted to commend the Chairman for coming here to Allegheny County, to Western Pennsylvania, to have this hearing because the reality that we're looking at, it's going to be sticker shock. It's going to be rate shock for my constituents and for all the residents here in Southwestern Pennsylvania.

When these rate caps come off in two years, they're going to be actually shocked and not just

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individual homeowners; but businesses, small and large, are also going to be faced with significant rate increases, and I'm concerned about, you know, that impact to our economy.

We can't control -- as state legislators, we can't do anything to control the price of gasoline. That's a worldwide phenomenon.

Some things we have no control over, but we do have some ability to deal with this problem that we're looking at two years from now.

So your testimony and that of others has been very helpful; and, again, I want to thank the Chairman for coming to Western Pennsylvania and focusing some attention on it both for the benefit of the public and the members as well. Thank you, Mr. Chairman.

MR. GEORGE: I thank the gentleman. Commissioner, we thank you for your presentation. As Mr. Levdansky said, we thank all of those that participated. Your comments were diverse, but that's what this democracy is all about.

I thank the news media, the PCN, the reporter; and we'll go from here to the next meeting, and hopefully before we've concluded our sessions we'll have an idea that will justify the ends to the means. Thank you very much. This meeting is adjourned.

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(Public hearing concluded at 3:37 o'clock p.m.)

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C E R T I F I C A T I O N

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Amanda M. Murphy
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