TESTIMONY BEFORE THE HOUSE ENVIRONMENTAL RESOURCES & ENERGY COMMITTEE

ON BEHALF OF THE
INDUSTRIAL ENERGY CONSUMERS OF PENNSYLVANIA
(IECPA)

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RE

HOUSE BILL 1909 OF 2009/2010 SESSION

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Secretary of the
Industrial Energy Consumers of Pennsylvania

Good afternoon Chairman George, Representative Hutchinson and members of the Environmental Resources and Energy Committee. We appreciate the opportunity to testify before you today.

My name is Steve Etsler and I am testifying today on behalf of the Industrial Energy Consumers of Pennsylvania or IECPA. I am **Manager Purchasing Electric Natural Gas and Water** for AK Steel Corporation, which is a member of IECPA. AK Steel is a leading producer of flat-rolled carbon, stainless and electrical steel products, primarily for automotive, appliance, construction and electrical power generation and distribution markets. Our company is headquartered in West Chester, Ohio and we operate a major specialty steel plant in Butler, Pennsylvania. The Butler plant employs more than 1,400 men and women. AK Steel also has plants located in the states of Ohio, Indiana and Kentucky.

AK Steel is one of the largest producers in the world of silicon-alloy electrical steels and is the leading domestic producer of the high-efficiency, grain oriented grades, which are produced at our Butler plant. These special steels are used in the manufacture of energy-efficient power generation and distribution transformers.

As demand for our electrical steels has increased in the U.S. and globally, AK Steel has made targeted capital investments to help us meet the demand. We previously announced proposed capital projects totaling $180 million, most of which is targeted for investment at Butler Works, to give AK Steel the flexibility to increase production and lower costs. Part of this significant capital investment is for construction of a new, 1.45 million ton-capacity Electric Arc Furnace at Butler which will replace two existing, older furnaces.

At Butler Works, we currently spend over $40 million annually for the purchase of electricity to power our operations. When rate caps are removed at the end of 2010, we believe that the result could be a 50% or more increase in our electric costs, based on published forward pricing

The increases that we project in 2011 are consistent with the increases that IECPA members in the PPL Electric territory are seeing this very month. IECPA is a group of large industrial, commercial and manufacturing energy consumers, formed for the purpose, among others, of ensuring that adequate and reliable long term supplies of electricity are available in Pennsylvania at reasonable costs. IECPA members include 24 large industrials collectively employing over 43,000 Pennsylvanians. IECPA members in the PPL territory have reported that their electric supply costs will increase by 50 to 80 percent, and potentially more, due to the expiration of PPL's rate cap. Electricity consumption represents a significant element of production and operating costs for our members. For any customer, increases in this range would be shocking; however, for our members, the increases are even more significant due to the large amount of electricity that we consume. At a time when our national economy is already under stress, allowing the electricity rate caps in Pennsylvania to expire without a plan to mitigate the short term and long term impacts of the rate increases on the manufacturing base in Pennsylvania could be disastrous.

IECPA supports House Bill 1909. It is vital for Pennsylvania to have an entity that can offer electricity to new and existing manufacturers at reasonable rates. The Commonwealth Energy Procurement and Development Agency as proposed in House Bill 1909 would have the power and the obligation to offer economic development power at cost-based rates to businesses and industries,

as well as meeting the default service procurement needs of other customer classes. The Agency has a number of tools available to secure power at reasonable rates, including:

- The ability to enter into power purchase agreements with new and existing Pennsylvania-based power plants and industrial cogeneration facilities;
- The ability to enter into long-term power purchase agreements to facilitate the financing of new power plants and cogeneration facilities; and
- The ability to acquire ownership of or ownership interests in new or existing power plants or cogeneration facilities through purchase or construction.

The economic development power would be offered to customers that can demonstrate significant contributions to the Commonwealth's economy by satisfying criteria specified in the Act, and that are willing to commit to purchase their supply needs from the Agency for a long period of time. The Agency would have the flexibility to negotiate the rate and the commitment length with the customer based on the generation resources it has available or can obtain to meet the customer's needs. The Agency would send the power to the customer's incumbent utility, which would then supply the customer at the negotiated rate.

IECPA was, and is, a supporter of the restructuring effort to introduce competitive alternatives for the generation supply portion of the traditional bundled electric service. Assuring that Pennsylvania's business and industry remains competitive in the national and international markets was one of the main motivations for the adoption of the Electricity Generation Customer Choice and Competition Act in 1996. For example, the declaration of policy of the 1996 Act recognizes that "the cost of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in this Commonwealth" and "this Commonwealth must begin the transition from regulation to greater competition in the electricity

generation market to benefit all classes of customers and to protect this Commonwealth's ability to compete in the national and international market place for industry and jobs."[1] These statements and policy goals remain as important and true today as they were in 1996, and we urge the Committee to keep them in mind as Pennsylvania addresses the currently-scheduled expiration of electricity rate caps over the next twelve months.

If the rate caps are allowed to expire without a plan to address the impact, there is a high probability that customers' expectations of lower prices due to the restructuring efforts, and the correlating enhancement of our ability to compete in the national and international marketplace due to those lower prices, will not be met in either the short term or the long term due to the wholesale market design. As IECPA members and others have explained to the Committee in testimony presented at previous hearings on rate cap expiration alternatives, the Pennsylvania wholesale electricity market changed significantly between 1996 and 2009, and those changes do not benefit customers. Quite simply, the wholesale market design is inflating supply prices above what those prices should be. Researchers at Carnegie Mellon University have estimated that the market design increases prices for consumers by 1 to 2 cents per kilowatt-hour. For some manufacturers a 1 or 2 cents per kilowatt-hour difference in electricity pricing can be the deciding factor on whether a facility remains open or is closed, with production moving to a competitor or another state. In fact, IECPA member Alcoa idled its Frederick, Maryland facility when the rate caps expired in that state and the facility was exposed to the full impact of this wholesale market design.

While the General Assembly does not directly control the wholesale market design, the General Assembly can examine alternatives to enable the Commonwealth's largest users (and largest employers) to bypass the pricing influences of that wholesale market. Pennsylvania

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1 66 Pa. C.S. § 2802(7) & (8)

manufacturers are competing against facilities and regions that do not have this wholesale market design and in states that do not have retail competition.

For companies with multi-state locations, such as AK Steel, decisions as to which of its facilities will receive capital investment are critically examined in terms of the impact to the future competitiveness of the company.

Many IECPA members, including AK Steel, have invested heavily in their Pennsylvania operations over the years, in no small part because of the expected existence of an adequate supply of affordable electricity to power our energy-intensive operations. Now, the anticipated sharp rise in electric costs is changing the landscape for how our companies may view Pennsylvania.

Simply put, many Pennsylvania manufacturing facilities are now at a competitive disadvantage when it comes to capital investment decisions.

IECPA members supported the original retail industry restructuring initiative with the belief that the market would develop to meet customers' desires and demands for electricity products on reasonable rates, terms and conditions. Mr. Vic Sawicki of Air Products testified before this Committee in May 2009 regarding the efforts that a group of IECPA members undertook to obtain reasonable offers from the "competitive" market prior to deciding to support the Agency. The group looked for a bilateral contract to meet their needs for appropriate electricity rates when the caps expire. They looked for arrangements to obtain long term price stability through contracts with generation owners or developers at reasonable rates that would still allow the suppliers to make a fair profit. They requested pricing structures based on the generation owner or developer's actual cost to produce the power, plus a reasonable profit. Those deals did not materialize, and the pricing was linked to the expected profit that the generation could earn if all of its power were simply sold in the

PJM Locational Marginal Price (or LMP), that is the wholesale market clearing price for power in the short term "spot" market. They also saw "take or pay" obligations that are difficult for many companies to assume from a financial accounting standpoint, because, in some instances, the entire contract liability must be placed on the customer's books at the beginning of the contract. Moreover, the credit implications of those deals can be quite onerous. In a nutshell, the IECPA members found that a legitimate, negotiable, bilateral market is not available to customers that fills their needs for appropriate electricity rates, terms and conditions.

The Power Agency proposed in House Bill 1909 could be an alternative for customers that want a long-term, cost-based supply service in exchange for a commitment to purchase supply solely from the Agency. The Agency can accommodate the take or pay arrangements with the suppliers and generation owners, and also better bear the credit requirements of these deals. In exchange for financing assistance, the Agency can request that the power plant owner provide a portion of the output to the Agency at cost-based rates. The Agency could construct or purchase generating facilities to meet the customers' supply needs. The Agency would represent another alternative for customers that can coexist with the ability of other customers to access the anticipated retail markets to obtain generation supply from other suppliers on a shorter-term basis, without a commitment to remain on the service.

The Agency also can provide benefits to customers of all classes who are not served by the authority through the implementation of construction or investment strategies that would operate to decrease the overall prices for all customers in the PJM markets. Overall market prices could be reduced under the PJM model if baseload generation plants and efficient peaking generation units are sited strategically in Pennsylvania to relieve transmission constraints. One of the alleged justifications for the PJM energy market model was that it would send price signals to indicate where

and when generation units are needed because the transmission system is constrained or insufficient generation exists to serve the load in the area, with the result that new suppliers would enter the market to relieve the constraint and thereby drive down prices. A traditional developer may not have the motivation to build baseload generation or peaking generation in constrained areas due to the devaluing impact it would have on other units within the developer's existing generation fleet. The Agency, however, would have a different motivation - to build those units to minimize cost both for its customers and for others in Pennsylvania. In other words, the Agency would react to concerns that prices are too high by increasing the available supply, which under the PJM model, will decrease prices for everyone.

I have focused primarily on the ways that the Agency could assist Pennsylvania in business and industry. However, IECPA also fully supports initiatives in House Bill 1909 to advocate before PJM, the Federal Energy Regulatory Commission, Congress and other federal agencies for improvements to the market design. The creation of the Commonwealth Energy Advocate to represent retail ratepayer interests in those wholesale and federal discussions is a very important step to ensure that Pennsylvania's interests are considered. In our view, despite our efforts, customer interests are currently underrepresented in these fora.

Finally, the creation of a power authority or implementation of market design changes by the Commonwealth Energy Advocate will take time. Customers in the PPL territory will see substantial increases this month. Customers in the remaining portions of the Commonwealth will see the potentially disastrous effects of the exposure to this flawed wholesale market on January 1, 2011. As a result, the Committee may need to consider proposals such as a rate cap extension, rebates or other concepts to mitigate the imminent increase while the Agency and the Commonwealth Energy Advocate get up and running.

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IECPA appreciates the opportunity to provide its views on House Bill 1909 and the potential benefits of a Commonwealth Energy Procurement and Development Agency. I look forward to any questions that you may have.