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Before the

Consumer Affairs Committee

Pennsylvania House of Representatives

Public Hearing on

Municipal Electricity Aggregation

Legislation

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Testimony of

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Good morning Chairman Preston, Chairman Godshall, members of the Committee and thank you for the opportunity to present the views of the Electric Power Generation Association (EPGA) on the proposed municipal aggregation legislation. EPGA is a trade association of electric generating companies with headquarters in Harrisburg. Its members include AES Beaver Valley, Allegheny Energy Supply, Cogentrix Energy, Inc., Dynegy, Inc., Edison Mission Group, Exelon Generation, FirstEnergy Generation Corp., LS Power Associates, PPL Generation, RRI Energy, Inc., Sunbury Generation, Tenaska, Inc. and UGI Development Company. These companies own and operate approximately 139,000 megawatts of electric generating capacity in the U.S., more than half of which is located in Pennsylvania and surrounding states. These remarks are made on behalf of EPGA as an association of electric generating companies and may not represent the views of every member company with respect to any particular issue.

I'd like to begin by reviewing the goals of electric restructuring. We sometimes take it for granted that policymakers remember these goals and realize the progress we have made. But that's clearly not always the case, particularly during times when fuel costs push wholesale prices higher.

So it may be useful to review the goals of electric restructuring and the progress we've made in reaching those goals because it will help to put in perspective the significance and timeliness of the legislation we're discussing today.

There were three main goals of electric restructuring:

1. Shift the financial risks of construction, operation and ownership of generation from captive ratepayers to investors, who are positioned to manage those risks effectively;

2. Provide market incentives for generation owners to build and operate plants more efficiently; and

3. Promote competition and innovation in retail markets.

The shift of financial risks to investors has clearly occurred. In Pennsylvania, ratepayers no longer bear the financial burden of excess capacity, construction cost overruns, and forced outages that plagued many utilities in the traditional vertically integrated monopoly era. More than 10,000 MW of capacity have been added in PA in the past decade and consumers have not paid a penny for outages, construction delays or bad investments.

Tremendous improvements in operating efficiency were predicted by proponents of restructuring, and have been realized and documented in several economic studies. Increases in output at baseload nuclear and coal plants, increases in plant availability rates, reductions in forced outage rates, optimized maintenance practices, etc., have all benefited consumers.

Regarding the third goal of restructuring, it is premature to gauge the effectiveness of the PA Competition Act in creating retail competition where rate caps remain in place. Clearly, the caps have stifled retail competition, as price caps do in all markets. The caps have likewise restricted the development of demand response and energy efficiency investments.

However, retail competition has been promising in those EDC service territories where the rate caps have expired. The experience in the Duquesne Light and Penn Power territories has been promising and now in PPL's territory where nearly 45% of the total load has already switched to a competitive supplier, including more than 330,000 customers, the majority of which are residential.

But it's the small customers that we're really here to talk about today. Because even though overall shopping has been robust in those areas where rate caps have expired, and savings even for residential customers of 10% or more compared to default rates have been realized, the fact remains that, for a variety of reasons, many of which were not foreseen when the PA Competition Act was passed, the vast majority of residential and small commercial customers remain on utility default service even when real savings are being offered by alternative suppliers.

"Transaction costs" on both the supplier and the consumer side are a key component in a retailer's business model. Municipal aggregation can help reduce these costs for both market participants, thus reducing cost barriers and making the market more efficient.

Larger customers are proving by their actions that shopping is rewarding. For many smaller customers, acquiring the knowledge necessary to shop wisely is costly to obtain (at least in time) and the risks are unknown. And many small customers are opting not to try, thus foregoing potential savings.

For suppliers, the cost of educating small consumers, overcoming inertia and motivating them to switch can oftentimes exceed annual generation cost savings or service benefits they can provide.

Opt-out municipal aggregation can significantly lower these customer acquisition costs for suppliers, thus increasing the number of suppliers desiring to serve such customers. And by alleviating most of the effort associated with the screening and selection process, the aggregator enables its small customers to take service from a competitive supplier at little or no transaction cost to those small customers.

Thus, the municipal aggregator can help "jump start" the market by bringing the benefits of retail competition to more small customers sooner and increasing the number of suppliers willing and able to serve small customers.

In addition to lower transaction costs there are other benefits to municipal aggregation:

- Creates greater bargaining power for smaller customers – when it comes to bargaining for the price and terms of service, bigger is usually better. So aggregation can enable residential and small business customers to participate in the competitive market on a more equal footing with larger customers in negotiating lower prices.

- Greater sophistication – in addition to creating larger, more attractive customers, municipal aggregation transforms relatively uninformed consumers with little time and few resources into more sophisticated buyers. Municipalities routinely negotiate contracts on behalf of their citizens for services such as trash collection and cable TV. They can similarly acquire the expertise necessary to negotiate favorable terms for electricity service.
- Ability to enter into longer term agreements – Municipal aggregators have been willing and able to enter into longer term agreements (up to 3-5 yrs.) with suppliers which offer potentially significant advantages for consumers because they create a more dependable revenue stream for generators and retail suppliers, who may be willing to lower prices in exchange for long-term income security.

The economic advantage of municipal aggregation can be clearly demonstrated with a residential customer example. A customer with an all electric home and electric bills of $300 or more per month has a powerful incentive to learn about his or her options and shop for the best terms because they can save hundreds of dollars per year. Customers with oil or gas heat where the generation portion of their bill is, for example, only $30 per month, can only save $3 per month or $36 per year if the potential savings are 10%.

One can readily appreciate why many such customers will not invest the time and resources to realize such small savings. However, for a municipality or combination of municipalities of just 100,000 participants who aggregate these customers, a savings of "only"

$36 per customer translates into $3.6 million that remain in the local community to be saved or spent on other goods and services, much of which will benefit that same local community.

With the passage of this bill, elected officials of local government will be able to capture the benefits of competitive electricity markets for their residents and small businesses by providing them with the ability to shop for the best price and for other value added services. We think they can bring a lot of value to the table as market participants.

Obviously, this bill is not a "silver bullet." It can't overcome rapidly escalating fuel prices like we experienced during much of the last decade. But it can be another significant tool at our disposal to help put competitive markets to work for the benefit of consumers.

Although EPGA is supportive of the goals of municipal aggregation legislation, we do have a few questions and concerns:

- Safeguards will be needed for wholesale suppliers of existing default service that did not price the considerable risk of retail load migration away from default service attributable to municipal aggregation. A transition period will be needed for such suppliers.
- There is no definition of "small commercial customer" in the bill. This should probably be standardized to avoid confusion.
- One of the goals of municipal aggregation legislation is to encourage entry of more buyers <u>and</u> sellers into the market. This goal would be thwarted if aggregation devolved into only one or two entities in effect acting as monopoly providers. In that case we

could have less entry by retail suppliers and an aggregator so large it could over time potentially act like a monopoly supplier.

One might reasonably ask why EPGA cares about municipal aggregation legislation. After all, our members own and operate power plants and sell power into the competitive wholesale market. We are going to sell that power to the EDCs and competitive suppliers whether the load is aggregated or not. That's certainly true.

As generators we have delivered on our end of the restructuring deal by assuming investment risks and producing efficiencies in the wholesale market.

But the job won't be complete unless and until we can assure that all consumers are benefiting from electric competition and will continue to benefit on an ongoing basis. We firmly believe that the best way to assure that outcome is to have robust competition at the retail as well as the wholesale level. And the competitive retail market will work best with active participation by all consumers, large and small.

The introduction of this opt-out municipal aggregation legislation takes a significant step in drawing more small customers into the market. We commend Chairman Preston and the bill's co-sponsors for their insight and leadership on behalf of consumers that this legislation represents.

Thank you.