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## EPGA Remarks

Before the

PA House Consumer Affairs Committee

Regarding

Utility Procurement, Rate Caps and Price Mitigation Issues

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## Introduction

Chairman Preston, Chairman Godshall, distinguished members of the House Consumer Affairs Committee, good morning. My name is Doug Biden and I am President of the Electric Power Generation Association (EPGA). EPGA is a regional trade association of electric generating companies with headquarters in Harrisburg, Pennsylvania. Our member companies include:

AES Beaver Valley, LLC  
Allegheny Energy Supply  
Cogentrix Energy, Inc.  
Dynegy Inc.  
Edison Mission Group  
Exelon Generation  
FirstEnergy Generation Corp  
Mirant Corporation  
PPL Generation, LLC  
Reliant Energy  
Sunbury Generation, LP  
UGI Development Company

These companies own and operate more than 122,000 megawatts (MW) of electric generating capacity in the United States. Approximately half of this capacity is located in Pennsylvania and surrounding states. Our comments today represent the views of EPGA as an association of generating companies, not necessarily the views of any particular member company with respect to any specific issue.

At the outset, EPGA would like to express its appreciation to the Committee for the opportunity to present its views. The energy policy bills introduced to date advance both environmental and economic goals. In focusing on the issues of rate caps, mitigation and procurement, it seems clear that this Committee is primarily concerned about cost issues.

We have prepared our remarks in anticipation of that primary concern.

## Rate Caps

- Rate caps have benefited consumers in Pennsylvania. When adjusted for inflation, average retail electricity prices are 12% lower today than in 1996.

- However, we must acknowledge that rate caps have insulated consumers from the true cost of electricity, and are going to cause a tough adjustment when a decade- plus of changes in energy markets suddenly hit customers all at once.
- While retail price caps will have been in effect for 11-14 years by the end of this decade, wholesale prices have risen significantly, driven by a two to four fold increase in key generation fuel prices (see EPGA House Consumer Affairs Committee testimony of June 14, 2007).
- For comparative perspective, if electric prices increased by the same rate as the CPI since the Competition Act passed in 1996, electric rates would be almost 40% higher in 2010.
- And significant electricity price increases are not limited to states where customer choice has been implemented and rate caps established for a transition period. In fact, fully regulated states have also experienced significant price increases over the last decade. But the rate caps have prevented Pennsylvania consumers from seeing those price increases as early, thus allowing Pennsylvania electricity consumers to experience lower prices for a longer period of time.
- Rate caps subsidize the consumption of electricity. They also greatly limit participation in conservation and demand response programs because they prevent consumers from determining when they would be willing to accept the loss in production or comfort associated with a loss of electricity.
- The major factors that will influence electricity prices going forward are:
  - Fuel prices – the dominant influence.
  - The cost of complying with environmental regulations.
  - AEPS Implementation.
  - Demand response – voluntary customer programs that can economically reduce growth in peak demand.
  - Regulatory uncertainty and its impact on electric capacity investment.

### Price Mitigation Issues

- There is nothing the Pennsylvania General Assembly can do to address fuel prices which comprise 80-90% of the cost of generation and are determined by world, national and regional fuel markets.
- Many environmental requirements are determined at the federal level. However, when the state decides to go beyond federal requirements, as a matter of energy and economic policy, we must be certain that proposed regulations produce a meaningful public health benefit commensurate with the cost.
- The General Assembly already passed House Bill 1203 amending Act 213. The mandated renewable and alternative energy percentages have been established by law. The best way to implement the law is to allow generation developers to compete to supply the mandated 18% market share just as they do to supply the

remaining 82% of the market. This will assure that cost-effective alternative energy investments take place.

- The best way to connect the wholesale and retail market and to encourage real economic demand response (DR) is to allow consumers to see real-time or at least market-based electricity prices.
- This doesn't mean real-time metering and real-time pricing needs to be imposed on all consumers. Economic research indicates that a relatively small fraction of the total electric load facing spot prices could be sufficient to connect the wholesale and retail markets and help moderate wholesale prices.
- Natural gas consumers have demonstrated remarkable conservation results since 2000 in response to higher prices. Electricity consumers will prove no less inventive once they are allowed to see market prices. After all, they are the same people.
- As the rate caps expire and retail competitors return to Pennsylvania, DR will be a relationship builder for retail suppliers, a critical piece of what it takes to be competitive.
- PJM is aggressively marketing its DR programs. During the recent August heat wave, customer reductions in the use of the electricity in the PJM market reached a record high of 1,945 megawatts – “the amount of power used by a mid-sized city.”
- In PJM's market, consumers can be paid the same amount for reducing demand for electricity as generators are paid for supplying electricity. EPGA believes these kinds of programs, in addition to utility and competitive retail supplier programs, will prove effective in reducing electricity prices by eliminating the need to run more expensive generating units.
- Political stability and regulatory certainty are among the most critical factors in deciding where and when to build capital-intensive new power plants. Currently, investors are very wary of state initiatives to re-regulate, adopt partial re-regulation measures, turn back to government-mandated resource planning, etc.
- As a nation, region and state, we face unprecedented challenges. We need to invest billions in new generation and environmental controls to meet a growing demand for electricity and increasingly stringent environmental standards.
- The Energy Information Administration estimates that we will need to invest over \$400 billion in new generation by 2030 if we are to ensure our energy security and address global climate change.
- If we are going to attract the investment and innovation on the scale needed to meet our energy security and environmental challenges, investors must be assured that the market rules will not be changed repeatedly or dramatically by legislation or regulation.

- This is why EPGA has stressed the need for a well-defined consistent competitive procurement process as allowed by the PaPUC default service regulations recently adopted by the Independent Regulatory Review Commission and the approach originally included in HB 1530.
- To ease the transition to market-based rates, EPGA could support the concept of a “phased ending” of the caps, or a “phasing in” of anticipated higher rates.
- Also to avoid the situation experienced by Baltimore Gas & Electric and Pike County Light & Power, utilities should be allowed to procure supply at staggered points in time prior to the expiration of rate caps to reduce the potential for transient fuel price spikes to have an exaggerated impact on retail rates. The PaPUC has recognized such an approach in its final rules for default service.
- EPGA supports customer education to inform customers about the transition to market prices, the potential for price increases, measures to help customers manage their energy consumption and offset price increases, including conservation and load management programs, time-of-use meters and rates, the Low Income Usage Reduction Program, and the availability of phase-in options.

### Utility Procurement

- EPGA continues to support the procurement approach and related language that was included in HB 1530 and voted out of the House by a margin of 200-2 (but later removed in the Senate).
- The procurement language in that bill was developed and supported by a broad coalition that included small business, wholesale and retail energy suppliers, manufacturers, electric distribution companies, labor and others.
- The procurement process provisions contained in HB 1530 allowed electric utilities and alternative suppliers the flexibility to purchase electricity supply through a variety of options including auctions, requests for proposal and bilateral contracts.
- It also allowed for a mix of long-term, short-term or spot market purchases, but did not mandate long-term contracts or allow them only for select generators.
- Head-to-head competition through open, transparent, competitive procurements will produce the lowest prices for consumers. This requires a process that allows all generators (and Demand Side Management (DSM) providers) to compete openly, fairly and equally.
- The state should not pick winners and losers and the procurement process should not be politicized.

- Portfolio management and government regulation under a non-competitive procurement methodology create market uncertainty, discouraging investment in new generation, eventually driving costs up.
- Certainly, alternative energy and DSM resources must play an increasing role in meeting future energy needs. And they will as rate caps expire and customers see market-based rates, and we begin to meet the mandated AEPS purchase requirements which includes energy efficiency and DSM resources. However, it is unrealistic and potentially costly to require electric utilities to meet all new demand growth with DSM and alternative energy alone.
- Traditional supply sources (e.g., coal, nuclear, natural gas) should not be required to meet a state-determined reliability test before they can be included in utility capacity plans. This will stifle future investment threatening reliability and price stability.
- Open competitive procurement continues to place the financial risks associated with generation on the investor rather than on the electric utility customers, preserving a significant consumer benefit of electric restructuring. These risks include construction cost overruns, operational problems that could shut down plants, and the cost of uneconomic electricity transactions.
- Robust competition between suppliers in the wholesale market has been the largest source of documented savings attributable to electric restructuring to date. Now generating plants have incentives to operate more efficiently than they ever operated under regulation. Any procurement provisions adopted by Pennsylvania should be consistent with the competitive principles of the wholesale market because it is the continued competition and demand response in that market that will provide the most dependable and recurring source of economic benefits for Pennsylvanians going forward.

Thank you