

COMMONWEALTH OF PENNSYLVANIA
SENATE OF PENNSYLVANIA

PUBLIC HEARING ON ENERGY POLICY FOR PENNSYLVANIANS

BEFORE

ENVIRONMENTAL RESOURCES AND ENERGY COMMITTEE

SENATOR MARY JO WHITE, CHAIR
SENATOR EDWIN B. ERICKSON, VICE CHAIR
SENATOR RAPHAEL J. MUSTO, MINORITY CHAIR
SENATOR ANTHONY H. WILLIAMS

- and -

CONSUMER PROTECTION & PROFESSIONAL LICENSURE COMMITTEE:

SENATOR LISA M. BOSCOLA, MINORITY CHAIR
SENATOR EDWIN B. ERICKSON
SENATOR JOHN R. GORDNER
SENATOR MARY JO WHITE
SENATOR GERALD J. LaVALLE

Date : June 12, 2007, 10:00 a.m.

Place : North Office Building
Hearing Room No. 1
Harrisburg, Pennsylvania

By : Patricia M. Brown
Reporter - Notary Public

1 SPEAKERS:

2

3 ELECTRIC POWER GENERATION ASSOCIATION

4 DOUGLAS L. BIDEN, PRESIDENT

5

6 INDUSTRIAL ENERGY CONSUMERS OF PA

7 DAVID M. KLEPPINGER, ESQUIRE

8

9 ENERGY ASSOCIATION OF PENNSYLVANIA

10 J. MICHAEL LOVE, PRESIDENT AND CEO

11

12 RETAIL ENERGY SUPPLY ASSOCIATION

13 RICHARD RATHVON, VP, RELIANT ENERGY

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15 PJM INTERCONNECTION

16 MICHAEL J. KORMOS, SENIOR VP FOR RELIABILITY SERVICES

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1 SENATOR WHITE: Good morning. I'll call to
2 order this public hearing on energy policy in
3 Pennsylvania. This is a joint hearing of the
4 Senate Environmental Resources and Energy
5 Committee and the Committee on Consumer Protection
6 and Professional Licensure. Since I serve on both
7 committees, I should get two different signs.

8 Senator Tomlinson is unable to be with us
9 this morning, so I will chair the hearing in his
10 absence. This is, as usual on a Tuesday morning,
11 a very busy day; and we will I'm sure have people
12 coming in and out as they try to juggle their
13 multiple obligations, so I hope you will bear with
14 us.

15 All members will receive, of course, copies
16 of all the testimony and possibly even the video
17 presentation so that those who are not able to see
18 the entire presentation live will have access to
19 all the materials. I assure you of that. And
20 it's important enough that I know they will review
21 them.

22 So with that, let's begin with who's
23 testifying.

24 MR. HENDERSON: Our first witness is Doug
25 Biden, president of the Electric Power Generation

1 Association.

2 SENATOR WHITE: Also, as an opening remark, I
3 should note that I think we've given each witness
4 about thirty minutes, is that correct, Patrick?
5 We would hope if you can summarize your testimony
6 as opposed to reading it, that would be helpful
7 and leave time for questioning because I'm sure
8 that there will be some questions from the panel.
9 Thank you. Mr. Biden, good morning.

10 MR. BIDEN: Madam Chairman White,
11 distinguished members of the committee, and staff,
12 good morning. And thank you for granting the
13 Generation Association the opportunity to be with
14 you this morning to share its views on energy
15 policy for Pennsylvania, including its views on
16 the energy independence strategy of Governor
17 Rendell.

18 Since part of the governor's proposal
19 purports to amend part of the Competition Act of
20 1996, I thought it might be useful to start with
21 some of the more compelling reasons why we decided
22 to restructure the electric industry to begin
23 with.

24 The electric industry was restructured
25 primarily because the past regulatory system had

1 failed. When generation was subject to rate of
2 return regulation, retail electricity consumers
3 had absorbed huge rate increases due primarily to
4 construction cost overruns and power plant
5 operations that had no incentives to improve
6 efficiencies. Then there were the high costs
7 associated with PURPA plants, PURPA being the
8 Public Utilities Regulatory Policy Act when the
9 state entered the era of government mandated
10 resource planning.

11 Many of these above-market costs from the
12 past regulatory eras, of course, became stranded
13 costs; and utility rate payers are still paying
14 these stranded costs in most utility jurisdictions
15 today and will continue to do so until the utility
16 transition periods end.

17 Plainly, the good old days were not so good
18 for utility consumers. There were three main
19 goals of electric restructuring.

20 First, to shift the financial risks
21 associated with electric generation from captive
22 rate payers to generation investors who were best
23 able to handle those risks; and we've been very
24 successful in accomplishing that goal.

25 Utility rate payers are no longer exposed to

1 construction cost overruns, excess capacity, the
2 risk associated with forced outages. No utility
3 rate payer is currently exposed to those kinds of
4 risks.

5 The second goal was to provide market
6 incentives for generation owners to build and
7 operate plants more efficiently. Clearly we have
8 accomplished that goal.

9 And there have been tremendous improvement in
10 power plant efficiencies, and those efficiencies
11 have been documented in a number of studies that
12 have been done to date. One such study estimates
13 that just in the Mid Atlantic area alone,
14 consumers are now paying between four hundred and
15 thirty and 1.3 billion dollars less per year
16 compared to what they would have paid under
17 traditional rate of return regulations. The value
18 of increased nuclear output alone just to
19 Pennsylvania consumers is estimated at a hundred
20 and twenty-two million dollars per year and
21 rising.

22 The third goal of electric restructuring, to
23 promote competition and innovation in retail
24 markets. We've had mixed results. Certainly when
25 we first restructured, we did have some robust

1 competition in Pennsylvania. But in recent years
2 and as wholesale power prices rose above the
3 retail price caps, as you heard in last week's
4 hearing, retail competition has somewhat
5 floundered as you would expect in any market that
6 employs retail price caps. Also, demand response
7 and energy efficiency has been less than optimal
8 as you would expect in markets that employ retail
9 price caps.

10 We need to understand that retail price caps
11 are a direct subsidy to consumption of
12 electricity, and energy efficiency and demand
13 response will always be suboptimal as long as we
14 have retail price caps and consumers do not face
15 market-based rates.

16 However, once the retail price caps are
17 lifted and consumers begin to see market-based
18 rates, there's no reason for us to believe that
19 retail competition will not occur in Pennsylvania
20 and we will not begin to see the beginning at
21 least of effective demand response.

22 What's driving electricity prices? We
23 believe it's vitally important for all
24 Pennsylvanians and particularly your two
25 committees which play such a pivotal role in

1 energy policy to fully understand what's driving
2 electricity prices and how prices are determined
3 in the wholesale market.

4 As your committee knows, our members sell the
5 output from their power plants into the largest
6 and one of the most competitive power markets in
7 the United States. The core of the PJM market,
8 the spot market, is based upon a single price
9 clearing concept.

10 Generators offer quantities of electrical
11 electric power into the market for which they are
12 willing to sell. The lowest cost power plants are
13 dispatched first, and higher cost plants are
14 dispatched in economic merit order until all
15 demand is met.

16 All generators receive the highest price bid
17 that is needed to satisfy market demand. This is
18 what is known as the market clearing price. It's
19 the price that must be paid to meet any given
20 level of demand at any given time.

21 This uniform single price clearing market
22 used by PJM and every other organized electricity
23 market in the U.S. and indeed the world except for
24 one market provides a built-in mechanism to
25 provide the lowest competitive prices.

1 All of our power plants compete against one
2 another for running time on the basis of cost.
3 This provides a powerful incentive for all of our
4 plants to bid in at the lowest possible cost, and
5 that lowest possible cost is their short run
6 variable cost. So it provides constant pressure
7 on power plant owners to minimize their costs.

8 No one is going to bid in lower than that
9 cost because for every megawatt hour that they
10 generate, it would lose money. So everyone wants
11 to minimize their bid into the market in the hope
12 that their bid will be accepted because if they're
13 bid is not accepted they earn no revenue. They
14 also want to drive their costs lower in the hope
15 that higher bids will be accepted which will then
16 enable them to recover their fixed costs and
17 perhaps earn a profit.

18 We believe that this single price clearing
19 market is the institution most responsible for
20 most of the cost savings realized from electric
21 restructuring to date. That's why it's somewhat
22 distressing to us when we hear a tax on the single
23 price clearing market because we believe this
24 distracts policy makers away from the real market
25 fundamentals, the energy policy issues, and the

1 environmental issues that are currently driving
2 wholesale energy prices and will continue to do so
3 for the foreseeable future.

4 The table on Page 5 shows the type of fuel
5 used by the marginal units in PJM. These are the
6 plants that set the market clearing price over the
7 last three years. You can see that coal set the
8 market clearing price over seventy percent of the
9 hours in 2006. This means as a group, coal-fired
10 plants had the opportunity to try to recover their
11 fixed cost and to earn a profit in the remaining
12 thirty percent of the time when units burning
13 natural gas and petroleum set the price.

14 Natural gas plants set the market clearing
15 price over twenty-five percent of the hours. So
16 taken together, coal and natural gas plants set
17 the market clearing price in the PJM market last
18 year over ninety-five percent of the hours.

19 Obviously these fuels have a pronounced
20 effect on wholesale prices. The price of these
21 two pivotal fuels have increased markedly in PJM
22 and in fact worldwide in recent years as the table
23 on Page 6 demonstrates, and these are in dollars
24 per million BTU.

25 Delivered natural gas prices increased almost

1 fourfold between 1999 and 2005 before moderating
2 somewhat in 2006. Coal prices increased by
3 seventy-eight percent between 1999 and 2005, but
4 also moderated somewhat in 2006.

5 Despite these dramatic fuel price increases,
6 the average price of electricity generated in PJM
7 increased by only fifty-six percent between 1999
8 and 2006. And the average price declined last
9 year from its 2005 level by sixteen percent to
10 \$53.35 per megawatt hour. That's 5.3 cents per
11 kilowatt hour. We think that's a pretty good
12 performance given the run-up in wholesale fuel
13 prices.

14 The table at the bottom of Page 6 shows the
15 components of generation prices compared by the
16 market monitor of PJM. You can see from this
17 breakdown if you add up the components that more
18 than ninety-six percent of the average wholesale
19 price was comprised of fuel; seventy-six percent
20 environmental costs, other variable operating and
21 maintenance expenses and congestion costs.

22 Notably, only 2.9 percent of the average
23 wholesale price was contributed by generator
24 markup or profit. We believe this is remarkably
25 low for a capital intensive industry that

1 successfully met a record peak demand last year.

2 And when I say a record, PJM described its
3 peak demand that it met last year as a one in
4 thirty-five year event. In revealing this
5 breakdown at a recent PJM meeting, the PJM market
6 monitor described these results as very close to
7 perfect competition.

8 Regarding fuel supply issues, our fuel
9 concerns center primarily on natural gas.
10 Environmental policy issues at the federal,
11 regional, and state level forces ever greater
12 reliance on cleaner burning natural gas as a power
13 plant fuel, while national, state, and local
14 politics impede the expansion of supply of natural
15 gas.

16 These policy contradictions have resolved
17 themselves in debilitating rises in the price of
18 natural gas and have been implicated in the
19 destruction of at least three million
20 manufacturing jobs in this country just since
21 2000.

22 We urgently need new sources supply of
23 natural gas; and all public policy makers need to
24 understand that ample gas supplies, electric
25 prices, electric reliability, and retention of the

1 manufacturing jobs that we still have in this
2 country are all critical issues that are
3 inexplicably linked.

4 Environmental regulations impact not only
5 generators' capital and operating expenses, they
6 also affect choice of fuels and retirement
7 decisions. Now, I won't have time to go through
8 all the environmental issues in my prepared
9 testimony. The important point that I want to
10 make is that almost all of the major current and
11 expected environmental requirements will lead to
12 greater costs of coal-fired electricity as well as
13 greater use of expensive natural gas as a power
14 plant fuel.

15 So we must be certain as a matter of energy
16 and economic policy that proposed environmental
17 regulations balance environmental and economic
18 development goals, and we also must ensure that
19 regulations are supported by sound science along
20 the lines of the legislation introduced last year
21 or earlier this year by Senator Erickson.

22 I'd like now to talk about the procurement of
23 the electricity supply included in some of the
24 energy independence strategy legislation. There
25 appears in the presumption in the proposed

1 amendments to Title 66 that the cost of long-term
2 contracts will be lower than market. In reality,
3 long-term contracts can be higher or lower than
4 short-term market results.

5 Legislation passed last year in Delaware
6 required Delmarva Power and Light to solicit
7 supply under long-term contracts from generators.
8 They received bids from integrated gasification
9 combined cycle plants, I think a six hundred
10 megawatt plant; a bid from a six hundred megawatt
11 off-shore wind park; and also bids from gas-fired
12 capacity.

13 The bids from the IGCC plant came in as five
14 billion dollars. This was a twenty to twenty-five
15 year contract, five billion dollars above what
16 Delmarva estimated market costs would be. The
17 off-shore wind park was two billion dollars above
18 market, and the gas plant bids were roughly equal
19 to what Delmarva estimated market costs would be.
20 However, they saw no advantage for their customers
21 in entering into these long-term contracts because
22 of the generator built-in price clause escalations
23 to protect themselves against environmental and
24 fuel price escalation.

25 So the point I'm trying to make is long-term

1 contracts are no silver bullet. And to build in a
2 legislative preference for long-term contracts we
3 think is a mistake.

4 The other thing that this points out is all
5 new generation and particularly alternative
6 generation are not going to come in at the cost of
7 existing generation. It's all going to be more
8 expensive.

9 So be very careful about building into
10 generation any kind of legislation preference to
11 long-term contracts. We don't think it makes
12 sense, and we agree with the counsel offered to
13 the committee last week by Chairman Holland. If
14 you need to give advice and counsel to the Public
15 Utility Commission, paint with a broad brush.

16 We're also concerned about procurement
17 requirements that requires electric distribution
18 companies to enter into contracts with energy
19 efficiency and demand side resources instead of
20 electric generation facilities to meet any
21 increases in energy or peak demand.

22 If buying generation is necessary, it must be
23 purchased from alternative energy suppliers.
24 Distribution companies can enter into contracts
25 with non-alternative generation suppliers only

1 upon a determination by the Public Utility
2 Commission that such generation is needed to meet
3 reliability needs.

4 Certainly energy efficiency and demand side
5 resources must play an expanded role in meeting
6 future energy needs; and they will as retail price
7 caps expire and customers see market based rates,
8 as the recommendations of the PUC's demand side
9 working group are implemented, and as PJM more
10 aggressively markets its demand side resources
11 programs.

12 But this proposed procurement provision
13 appears designed to interfere with the market by
14 inappropriately substituting a preference for
15 demand side resources and alternative energy
16 resources and creating a special test that some
17 generation sources such as coal and nuclear must
18 pass before they can be included in capacity
19 plants.

20 I don't think I need to remind the members of
21 these committees that we cannot have anything
22 close to an affordable power supply without our
23 coal resources. And if Congress passes climate
24 change legislation, it's very likely that we are
25 going to need all the nuclear resources we can get

1 our hands on.

2 It doesn't make sense to build into
3 legislation language that discriminates
4 effectively against those two resources. We think
5 there are serious adverse implications for
6 reliability and consumer prices with the current
7 language in that legislation.

8 In the interest of time, I'll just move to
9 conclusion comments. As a nation, region, and
10 state, we face unprecedented challenges. We need
11 to invest billions of dollars in new generation
12 and environmental controls to meet a growing
13 demand for electric power and increasingly
14 stringent environmental standards.

15 If we're going to attract the investment and
16 innovation on the scale needed to meet our energy
17 security and environmental challenges, investors
18 must be assured that the rules of the market will
19 not be changed repeatedly and dramatically by
20 legislation or regulation.

21 At this critical time, Pennsylvania should
22 not adopt energy policy provisions that will cause
23 power plant investors to question their ability to
24 recover their long-term investment in new
25 capacity; and that includes the state through PEDAs

1 or any other mechanism entering the generation
2 industry or utilities getting back into the
3 generation industry.

4 Competitive generators will not make the
5 investment in new generation or in existing
6 generation if they think other generation sources
7 are going to be favored by state policy. Also, we
8 know that you have heard from a number of entities
9 that are not happy with market results.

10 Many of these same entities are the ones that
11 provided the primary political thrust for electric
12 restructuring to begin with, some large industrial
13 customers. Back then when imbedded costs were
14 higher than market costs, these customers wanted
15 market costs. Now that market costs are higher
16 than imbedded costs, they want imbedded cost.

17 This heads-we-win, tails-you-lose approach to
18 pricing of electricity can never work for a
19 capital intensive industry like ours where it
20 takes years to build new capacity that must last
21 for decades. It simply cannot work for us. And
22 more importantly, it cannot work for our
23 investors.

24 And with that, I'll close and take your
25 questions.

1 SENATOR WHITE: Thank you, Mr. Biden.

2 Questions? Senator Williams?

3 SENATOR WILLIAMS: Thank you, Madam Chairman.

4 First I have to apologize. I'm going to be

5 leaving after this.

6 I want everyone to know I'm appreciative that

7 we had this joint hearing because I think the

8 issues are very germane to the time in which we

9 live. I'd say fifty percent of what you commented

10 on today I can grasp and understand and in some

11 areas agree with.

12 I want to draw attention to one of the

13 central parts of market-based rates, based upon in

14 essence the cap lift perspective, that is, supply

15 and demand, and that naturally based pricing if

16 you will is generated by the marketplace. I can

17 tell you frankly I'm very concerned about that.

18 When I studied economics in school, there was

19 the first part called Introduction to Economics,

20 which introduced supply and demand which you

21 talked about. But there were some later courses

22 which talked about micro and macroeconomics which

23 talked about even though you may have supply and

24 demand, there are places where need will not be

25 met.

1 Electricity is not like sneakers and soda.
2 People can't survive without it. That's why it's
3 a utility. So while I can agree we should not
4 exclude natural resources and what Congress is
5 considering can be devastating to us, I think I
6 would like on your side to be conscience of the
7 fact that you talked about market-based rates.

8 What are we going to do about places that I
9 represent that simply will not be able to afford
10 the rate at which they will be charged to consume
11 electricity? There's no reality to that kind of
12 comment without understanding that there is a
13 compassion part to this process that your industry
14 has to respond to when you make comments that
15 relate to the whole industry or this particular
16 situation that we're confronted with.

17 I need to understand how it is that you think
18 we're going to resolve those categories in those
19 communities which will be excluded by a
20 natural-based or market-based prices.

21 MR. BIDEN: The questions that you ask are
22 good ones, and part of the problem that's going to
23 bring that issue into sharp focus is due to the
24 fact that we've had rate caps in place for so long
25 and there's going to be an element of shock when

1 those rate caps are suddenly removed.

2 But there are programs in place, and I think
3 you're aware of them, low income energy assistance
4 programs that are income based in terms of
5 determining eligibility. And those programs need
6 to be more fully funded, and we certainly support
7 that. But those are done through the utilities,
8 which we are not utilities.

9 But back to what I said initially. If we had
10 not restructured the industry and we had just gone
11 along with rate of return regulation, starting
12 with 1996, and if you just -- and we had incurred
13 these fuel costs increased or whether we hadn't,
14 if rates had gone up just with the consumer price
15 index which is right in the vicinity of 2.9
16 percent per year, between 1996 and the time that
17 these rate caps are expected to come off,
18 electricity rates would be forty percent higher
19 than they were in 1996. It's just that they would
20 have been felt. They would have been rolled in
21 more gradually, and customers could have adjusted
22 to them more easily.

23 However, in this case, because we kept the
24 rate caps on for so long, there's going to be this
25 sudden pinch; and that I think is going to be a

1 serious problem, particularly for the folks that
2 you're talking about.

3 SENATOR WILLIAMS: This is my last question
4 or comment. I'm not speaking simply of low income
5 people. I'm speaking of middle class people now.

6 Frankly, if you ever watch the news lately,
7 the gas issue is very germane and hot in this
8 country. Those are middle income people who are
9 complaining about the fact that we've raised the
10 cost of gas eighty cents a gallon within a year.

11 To suggest that we're not going to address
12 that -- forget rates. Lower income people are
13 obvious victims of this. But I mean, the
14 fundamental crux of the state sits at the part at
15 which you talk about; and that is market-based
16 pricing.

17 And I'm glad you brought your attention to
18 the two percent average rate. The difference
19 between the two percent -- as a matter of fact,
20 our legislators' income is based upon that.
21 That's the rate at which our pay increases every
22 two years, two percent or 2.5 percent. Not five,
23 ten, or fifteen.

24 We wouldn't have been able to pay our
25 electric bills based upon the natural

1 considerations that you're talking about
2 regardless of how modest they are because our 2.5
3 percent doesn't keep pace with that forty percent
4 over that ten year period of time.

5 And so you may not have an answer today, but
6 we're going to have to confront an answer. We're
7 talking about people who are not part of the
8 program.

9 And understand, a lot of what you're talking
10 I agree with. A lot of what you're talking I
11 agree with. But this fundamental consideration
12 has to be a part of any general consideration when
13 we move forward.

14 SENATOR WHITE: Thank you, Senator. Senator
15 Gordner, did you have a question?

16 SENATOR GORDNER: Thank you, Chairman White.
17 You indicated in your testimony that over the past
18 ten years, there's been nine thousand megawatts of
19 new capacity that's been built. What have the
20 sources of that been?

21 MR. BIDEN: Fuel sources?

22 SENATOR GORDNER: Yes.

23 MR. BIDEN: Most of it has been natural
24 gas-fired units. The capacity in Pennsylvania,
25 there was one five hundred and I think twenty-five

1 megawatt waste coal facility built by Reliant
2 Energy. Most of the rest has been natural gas
3 units.

4 SENATOR WHITE: Are those peak load pricing
5 units?

6 MR. BIDEN: Combined cycle plants which are
7 what we call intermediate load units and also
8 peaking units because at the time they were built,
9 there was a need for peaking capacity, not a need
10 for base load, and it was felt that we were going
11 to need plants that could cycle up and down in
12 response to changes in prices.

13 And also keep in mind, at the time the
14 decision that those plants were built, natural gas
15 prices were below three dollars per million BTU.
16 And the Natural Petroleum Council as late as
17 December of 1999 was saying that natural gas
18 prices would not go above three dollars per
19 million BTU through 2010, as late as December of
20 1999.

21 Now, that doesn't also discount the fact that
22 we're in the ozone transport region and we have
23 very stringent environmental standards to meet.
24 So the possibility of building new coal-fired
25 capacity, no one knew if they could build new coal

1 capacity and meet rapidly changing environmental
2 standards. Our plants had to meet four different
3 rounds of nitrogen oxide emission reduction
4 requirements within a ten-year period. The
5 uncertainty associated with that alone was enough
6 to make plants opt for natural gas.

7 SENATOR GORDNER: You spent some time in your
8 testimony talking about environmental issues and
9 obviously legislation and regulation and policy
10 adopted at the federal and state level. Obviously
11 we spent quite a bit of time over the past twelve
12 months or so on the mercury issue.

13 And again, just curious, obviously there was
14 some federal mercury regulations put in place; and
15 this administration decided to go beyond that.
16 What is the difference between the federal and the
17 state? What sort of difference has that made on
18 the coal facilities here in Pennsylvania?

19 MR. BIDEN: That could be the subject of --

20 SENATOR GORDNER: In two minutes or less. Is
21 the major issue the trading issue?

22 MR. BIDEN: That's by far the largest issue.
23 And not only is it going to present operating
24 problems for existing units, it's going to
25 seriously constrain and put limits on the choice

1 of future generating capacity because not only can
2 we not trade emission allowances -- and keep in
3 mind, we are the second largest generating state
4 in the nation and we are dependent on coal. And
5 we are by far the largest generating state within
6 PJM.

7 So this puts significant brakes on
8 Pennsylvania's economy and generation supply. But
9 just as importantly, we have no bank of allowances
10 to make room for future coal generation unless we
11 retire existing coal-fired generation. So that's
12 why I went to great pains to explain to the
13 committee the importance of that fuel in setting
14 the market clearing price.

15 SENATOR GORDNER: It's over sixty percent of
16 the time, right?

17 MR. BIDEN: Seventy.

18 SENATOR GORDNER: Seventy percent of the time
19 it sets the price?

20 MR. BIDEN: Yes, seventy percent of the time.

21 SENATOR GORDNER: I know at the hearing we
22 had last week, Chairman White and others mentioned
23 that those of us who have a number of coal
24 generating facilities in our district, obviously
25 these past regulations created problems.

1 And there's nothing in the governor's
2 proposal that provides any assistance or help that
3 I saw to these coal facilities that need help in
4 order to comply.

5 But it also discourages, from what I see, any
6 new generation from those facilities in the coming
7 years when. From what I understand, in the next
8 five years we really have to ramp up capacity in
9 order to meet demand.

10 MR. BIDEN: That's true. It seems clear to
11 us when we saw the governor's edged initiative
12 come out last year and in other things that we've
13 heard from the administration that they favor
14 integrated gasification combined cycle.

15 And, of course, we had a real life test in
16 the Delmarva solicitation. And we have also heard
17 from the investment community, although many of
18 the states have anointed the IGCC technology as
19 the preferred capacity source of the future as far
20 as coal is concerned. Unfortunately, the
21 investment community has not.

22 Most of the new coal-fired generating
23 capacity that is being built is super critical
24 coal-fired generating capacity. It is not IGCC.
25 Most investors are not willing to take the risk on

1 it at this point in time because its cost is so
2 much higher than super critical coal-fired
3 generating capacity.

4 Now, I do think that IGCC better lends itself
5 to carbon capture when, in fact -- and it's
6 important to remember that CC does not stand for
7 carbon capture. It stands for combining cycle.

8 We do not yet know what carbon capture is
9 going to cost. I know that Chairman Tomlinson had
10 been asking, What's it going to cost, How much
11 generating capacity are we going to lose as a
12 result of all these various environmental
13 initiatives.

14 Well, the estimates right now are if you put
15 carbon capturing on an existing plant, you're
16 going to lose twenty percent of that plant's
17 output at least, perhaps thirty percent. So that
18 effectively means that existing coal-fired power
19 plants are not going to be able to compete in the
20 market with carbon capture.

21 So obviously we have a lot of work to do with
22 carbon capture technology to make that more
23 effective and efficient if we want to keep the
24 existing fleet of coal-fired power plants
25 operating.

1 SENATOR WHITE: Senator Boscola?

2 SENATOR BOSCOLA: I just have basically a
3 simple question, I guess. Since 1996, from now
4 and going back to 1996, has your industry, has
5 anyone in your industry lost money, anybody went
6 under, lost money?

7 MR. BIDEN: Yes. We've had two members go
8 bankrupt. One has reorganized under Chapter 11.
9 One went completely out of existence and no longer
10 exists.

11 SENATOR BOSCOLA: Can you tell me who they
12 are?

13 MR. BIDEN: Merit Corporation and National
14 Energy and Gas Transmission. They're the ones
15 that are gone.

16 SENATOR BOSCOLA: Because, you know, I'm
17 looking at it from a consumer standpoint. When I
18 read reports, newspapers, things like that, it
19 seems like a lot of companies are making profit.
20 They're not hurting in any way, shape, or form
21 from 1996 till now.

22 So when the rate caps expire, why is there
23 this need to now put a thirty, forty percent price
24 tag, you know, a consumer tax on these
25 individuals? I don't get it. Is it to make more

1 of a profit, a tremendous profit, as opposed to
2 minimal profit?

3 MR. BIDEN: Can I just correct slightly what
4 you just said?

5 SENATOR BOSCOLA: Sure.

6 MR. BIDEN: This industry earlier this decade
7 lost two hundred billion dollars in market
8 captitalization because we overbuilt the market.

9 SENATOR BOSCOLA: You overbilled the market?

10 MR. BIDEN: We overbuilt the market.

11 SENATOR BOSCOLA: Okay.

12 MR. BIDEN: We had excess capacity just like
13 we had back in the 70's. However, the consumer
14 did not pick up any of the price tag for that.

15 SENATOR BOSCOLA: Okay.

16 MR. BIDEN: We effectively shifted the risk
17 from the consumer to the investor.

18 SENATOR BOSCOLA: Which you said is a good
19 thing.

20 MR. BIDEN: Well, yes, because not only did
21 the consumer not have to pay for excess capacity
22 like they did under rate of return regulation, but
23 they benefitted from lower prices earlier in the
24 decade because wholesale prices were lower.

25 SENATOR BOSCOLA: But with deregulation --

1 MR. BIDEN: Even now, admittedly now, some
2 companies who have made wise investments are
3 making money, sure. But not all generators are
4 making money; and, in fact, some of them are
5 losing money to this day.

6 But that's the wisdom of the market. The
7 companies that make good investments make profits.
8 The companies that do not lose money.

9 SENATOR BOSCOLA: Right. And I believe the
10 rate payer shouldn't pay for a bad investment
11 decision based on a company's bad decision when
12 somebody's making good decisions.

13 But I still have a hard time believing when
14 these companies are making profits, I mean, in
15 some instances, record profit, that all of a
16 sudden when the rate caps expire, the rates are
17 going up thirty, forty percent.

18 I mean, you said doing nothing is probably
19 the best way to go, don't overlegislate, try to
20 stay out of this. I get where you're coming from.
21 But doing nothing is never a plan, especially when
22 the rate caps come off.

23 There are a lot of middle class families.
24 I'm not just talking about poor families because
25 poor families get things from the federal

1 government, state government to handle their
2 bills, but not working class families. And
3 they're not going to be able to sustain this,
4 basically not only because of this but because
5 everything is going up in the country.

6 I would like your industry to be a partner
7 here and just do what's reasonable when the rate
8 caps expire, not get greedy or over excessive and
9 have extreme profits. All I'm asking for --
10 because if that happens, then I think the
11 legislature is going to come back and have to try
12 to do something which you don't really want them
13 to do.

14 But I'm asking this industry to be
15 responsible when those rate caps expire and not
16 say, Well, wow, they expired, all of a sudden
17 let's jack up the rates forty percent. I know
18 they want to make a bit of profit. I know that.
19 But at the expense of the people, it's not fair.

20 We're all in this together, whether you're a
21 business, a company, or a tax payer in this
22 Commonwealth, in this country. You know, you
23 can't -- what I'm asking the industry and you
24 because you're a leader here is to do what's
25 responsible for everybody, for your company

1 because you need to make a profit, but also for
2 the rate payers out there, that they are not going
3 to like this. And then the legislature will be
4 forced to do something.

5 SENATOR WHITE: Senator Musto has joined us.

6 SENATOR MUSTO: No questions.

7 SENATOR WHITE: Senator LaValle?

8 You touched on two issues close to my heart.
9 The one is generating capacity, and the second is
10 the price of natural gas. I think those are the
11 two big drivers in the foreseeable future on the
12 wholesale price market.

13 It disturbs me that DCNR has done everything
14 they can to discourage the drilling of natural gas
15 on state forest land and state-owned property,
16 while at the same time, they've come out recently
17 and proposed wind farms.

18 You know, the footprint of a natural gas well
19 compared to a wind farm is, you know, an ant
20 versus Godzilla. I think that we are really going
21 down the wrong road here.

22 The whole idea of a state having an energy
23 independence strategy likewise I think is a bit
24 silly. We're in a regional market. We're in a
25 national market. In some cases we're in a global

1 market. And to pretend that we can isolate
2 Pennsylvania or even insulate Pennsylvania from
3 what's happening in the rest of the energy markets
4 in PJM and elsewhere I think is wishful thinking.

5 And on the generating side, the governor's
6 proposal seems to say, Now here we have increase
7 in demand, We have decreasing generating
8 capability, And this gap is in the middle. And
9 the proposal is that we're going to close this gap
10 by conservation. In other words, people are
11 simply going to use less electricity. Do you
12 think that's realistic?

13 MR. BIDEN: I think it's realistic that
14 people are going to use less electricity once the
15 retail price caps expire and they see market-based
16 rates. I think it's realistic to expect that
17 demand respond on the part of load serving
18 entities, particularly competitive load serving
19 entities is going to be a large part of what it
20 takes to be competitive, particularly among
21 industrial or large commercial customers.

22 They're going to go to those customers and do
23 everything they can to save them money, including
24 selling their load back into the wholesale market
25 to help drive their costs down. All of those

1 things are going to happen.

2 The reason that they've been discouraged up
3 to this point is because we have had retail price
4 caps in place that in effect, you know,
5 discouraged that by directly, you know,
6 encouraging more consumption of electricity.

7 But is it reasonable to expect that we're
8 going to have a billion dollars a year in savings
9 as a result of what we see in there? We haven't
10 seen the data to back that up, so it's difficult
11 for us to ascertain whether or not that's a
12 reasonable expectation.

13 We see coming soon a possible capacity
14 shortage if we don't start putting iron in the
15 ground very soon. The reasons for that are, one,
16 regulatory uncertainty, not the least of which are
17 some of the state proposals that we've seen
18 throughout the wholesale market to re-regulate, to
19 go back to government mandated resource planning,
20 to try to put parts of the genie back into the
21 bottle. And we see some of that in these
22 legislative proposals here.

23 And there had been some market imperfections.
24 You heard mentioned last week of the RPM proposal
25 at PJM which are modifications to the capacity

1 market. We actually view that as a positive step,
2 and we think it will induce greater investment in
3 generation capacity. So we see those market
4 imperfections being addressed by PJM and that part
5 of it being addressed.

6 But when we see the states starting to pull
7 back from competitive markets, the investor takes
8 a very dim view of that. And just like the time
9 when we were trying to decide whether or not we
10 were going to, quote, deregulate generation,
11 investment in generation dried up. We have the
12 potential for that occurring here again today when
13 states are starting to try to decide whether or
14 not they want to go back to that regulated era.

15 SENATOR WHITE: I don't see that happening
16 here, but I'm interested in your comment where
17 you're saying that uncertainty about state
18 regulatory proposals for the future is deterring
19 the construction of new coal-fired power plants.
20 Is that what I'm hearing you saying?

21 MR. BIDEN: Well, it's that; and it's also
22 talk about getting the utilities back into the
23 generation business, talk about getting the state
24 back in the generation business. It's not just
25 here. It's occurring in Illinois too. Those are

1 two of the big states in PJM.

2 Investors are paying very close attention to
3 that, particularly when they just came through a
4 time earlier this decade when they lost so much
5 money investing in a generation business. People
6 look at the profits that we're making now,
7 forgetting that we need to built up cash reserves
8 to build the generating plants of the future.

9 SENATOR WHITE: Yes, it is a very capital
10 intensive business. Any other questions? Thank
11 you very much, Mr. Biden.

12 MR. BIDEN: Thank you.

13 MR. HENDERSON: Our next witness is David
14 Kleppinger on behalf of the Industrial Energy
15 Consumers of Pennsylvania.

16 SENATOR WHITE: Good morning. Proceed.

17 MR. KLEPPINGER: Good morning, Madam Chairman
18 and fellow Senators. On the behalf of the
19 Industrial Energy Consumers of Pennsylvania, we
20 express our appreciation for having this
21 opportunity to speak with you today on a critical
22 topic for the Commonwealth's future.

23 IECPA, as we are called, has been the primary
24 spokesperson for commercial and manufacturing
25 interests on electric and natural gas issues since

1 1981. We've been in the forefront of both
2 electric and natural gas restructuring and its
3 implementation throughout Pennsylvania.

4 We have twenty-four member companies. We
5 consume in excess of five and a half billion
6 kilowatt hours a year and over thirty-six million
7 MCF of natural gas.

8 We were asked to comment briefly on the
9 governor's energy independence proposal, and we
10 will do so. In one sense, we're appreciative of
11 the administration's recognition that energy
12 prices to consumers are critical to the economic
13 vitality of Pennsylvania.

14 One positive result of the proposal is that
15 it's heightened the debate as evidenced by this
16 hearing today and recognition that it has
17 motivated dialogue among consumers like I
18 represent, suppliers, electric distribution
19 companies, and others.

20 We're concerned as well with the
21 administration on the need for infrastructure
22 development and improvement that Mr. Biden had
23 previously commented today. While the package
24 does restore a potential solution in the ability
25 of electric distribution companies to enter

1 long-term contracts with industrial customers,
2 only time will tell if that ability will in fact
3 mitigate the pain of customers already
4 experiencing dramatic increases in western
5 Pennsylvania, primarily in the Duquesne Light
6 Company and Penn Power service territories.

7 Unfortunately, the package does not yet
8 provide meaningful mitigation opportunities to the
9 rate cap expiration in the eastern part of the
10 state on PPL, PECO, Met-Ed, Penelec, and West Penn
11 Power, those rate caps expiring in 2010 and 2011.
12 Absent a significant course correction, economic
13 development and employment in this state will
14 suffer upon rate cap expiration as we are exposed
15 to rather dramatic price increases.

16 Portions of the administration's proposal
17 would undeniably further increase prices, at least
18 in the short term with proposals like the systems
19 benefit charge that is being proposed on the
20 promise of lower prices in the future.

21 We have not yet seen the cost benefit support
22 for that analysis as the prior speaker had
23 indicated as to whether the long-term benefits
24 that are forecasted are real and would in fact
25 justify short-term price increments.

1 We are mindful however of the recent history
2 dating back to the Public Utility Regulatory
3 Policies Act of 1978 when we were promised
4 short-term pain for long-term benefit in the form
5 of non-utility generation contracts and projects
6 which have actually caused costs to increase in
7 Pennsylvania.

8 We also were assured over our objections when
9 FERC approved the locational marginal pricing
10 philosophy that would assure more competitive
11 markets and lower prices. And we were also
12 promised that the reliability pricing model on the
13 capacity side would assure us that capacity will
14 be built in the future and we would be paying more
15 prices, higher prices in the short term to assure
16 that.

17 Each of these initiatives, while championed
18 as producing lower prices and greater reliability,
19 at least for the time being have only resulted in
20 the assurance of higher prices. Thus you can
21 understand our skepticism related to a symptoms
22 benefit charge.

23 Nonetheless, if that charge is adopted, we
24 believe it does need to be capped for industrial
25 customers with a hard annual cap on a per-company

1 basis, as opposed to being a slide on a meter
2 basis or customer basis.

3 But if the governor's proposal doesn't solve
4 our problem, what does? I think we need to
5 recognize where the core of the problem and a
6 major component is.

7 Wholesale market prices dictate retail
8 pricing; and our wholesale market design, at least
9 in our view, has not been producing the just and
10 reasonable price results that are mandated by the
11 Federal Power Act. This is partially due to the
12 last bid in locational marginal price design, and
13 we encourage all our state delegations to
14 encourage Congress to have FERC rethink that
15 policy and also question its automatic granting of
16 market-based rate authority in conjunction with
17 that pricing model on the assumption that
18 competitive markets exist as opposed to a
19 demonstration that they in fact are there. We
20 need your help to effect that change on both the
21 federal and regional level.

22 That is a long-term solution however. And
23 absent that correction at the wholesale level,
24 what can we do at the state level as opposed to
25 just doing nothing?

1 First, I think we do need to acknowledge that
2 our abilities are limited somewhat in that the
3 control of our retail prices is in the hands of
4 the wholesale market. We also have to recognize
5 first that electricity is an extremely unique
6 commodity, one that's more unique than I think any
7 of us realized back in 1996 when the legislation
8 was passed.

9 You've heard talk already about the demand
10 side of this market, and IECPA is an absolute
11 proponent of demand side programs and demand side
12 management. However, I think we are kidding
13 ourselves if we think that the demand side on this
14 market will ever be a sufficient check on the
15 supply side. At the end of the day, all of us
16 want to be warm in the winter, cool in the summer,
17 and we want to manufacture our products.

18 While we can be paid for reducing our load,
19 we also don't make product when we reduce the
20 load, so that is not a long-term business
21 strategy, although it can be a cost minimization
22 strategy.

23 The market is extremely complex. We can only
24 scratch the surface of that complexity here today.
25 If I had an exhibit, there would be a mountain of

1 PJM's tariffs, manual, operating rules that are
2 probably approaching three feet thick at this
3 point.

4 There are always going to be multiple layers
5 in this commodity of political and regulatory
6 oversight at the state level and at the federal
7 level. We've already heard of the capital
8 intensity of this business, perhaps more so than
9 any other we know. It is a unique product in that
10 it is instantaneously produced and delivered and
11 consumed. There is not sufficient storage
12 capability for this particular commodity.

13 And despite the alleged competitiveness of
14 this business, we continue to have an extreme
15 concentration in ownership of generation. That
16 has not dissipated with the advent of competition
17 in this jurisdiction.

18 And we continue to have joint or affiliated
19 ownership of both the generation sources and the
20 delivery sources, namely transmission and
21 distribution. So there is still in essence
22 considerable vertical integration in this
23 business.

24 A second issue that I think will assist is to
25 allow our electric distribution utilities to

1 compete in this marketplace. We don't think the
2 current legislation that has been enacted
3 prohibits it, but proposed utilization of
4 long-term contracting capability by electric
5 distribution companies would assist in the
6 solution.

7 IECPA supports pending legislation like it's
8 been introduced within the last week at House Bill
9 1530 that would permit the distribution companies
10 to buy wholesale power and offer it to industrial
11 customers on long-term negotiated price contracts.
12 This could facilitate some immediate assistance in
13 western Pennsylvania where industrial customers
14 have already experienced the price cap expiration.

15 Third, we think the generation projects in
16 this Commonwealth if they are going to receive
17 assistance in the form of grants, low interest
18 loans, et cetera, should be assured that that
19 output is going to stay in this Commonwealth and
20 be priced on a reasonable basis as opposed to
21 dumping that power on the market on a locational
22 marginal price basis.

23 That doesn't cost our pricing problem if we
24 encourage generation to be constructed and then
25 simply allow it to be sold into the marketplace at

1 LMP earning no different return than maybe could
2 be earned by selling it locally on a long-term
3 contract.

4 Fourth, we need to explore other market
5 responsive opportunities in order to bypass the
6 LMP pricing structure and enable our indigenous
7 resources to stay in Pennsylvania and price them
8 to consumers at just and reasonable prices,
9 opposing alleged market returns and returning them
10 to reasonable returns.

11 Such market responsive opportunities can and
12 indeed will include things like self-generation at
13 industrial customers' sites, co-generation where
14 the operation is susceptible to the needs that
15 fits with the electric output.

16 I think we need to look at both public and
17 private power construction of low cost generation
18 and figure out how to price it on a cost-plus
19 basis as opposed to allowing it to be priced only
20 on a long-term LMP forecast basis or a short-term
21 LMP basis.

22 Fifth, I think we do need to continue to
23 facilitate meaningful demand response markets
24 where participants are properly rewarded for the
25 benefits they confer on the market price.

1 Sixth and finally, I think we should also be
2 looking at reducing or eliminating the tax burden
3 on energy consumers statewide. We have a
4 substantial gross receipts tax in this
5 Commonwealth, and we also have a revenue
6 reconciliation rider that is an outgrowth of the
7 1996 legislation that was locked in at one of the
8 highest levels that it needed to be.

9 These are price mitigation opportunities for
10 us that can and should be done within the next few
11 years with the long-term contract capability being
12 the only one on here that would be the immediate
13 short-term benefit.

14 I think it's time for many of us to take a
15 step back from what has happened over the last ten
16 years and what we have learned with energy
17 restructuring and, I think as Senator Boscola
18 said, figure out what should be done for the
19 benefit of everyone in the state as opposed to
20 perhaps one segment of this industry that may be
21 benefitting more than others today.

22 And I would entertain questions at this
23 point. Thank you.

24 SENATOR WHITE: Thank you, Mr. Kleppinger.
25 Questions, Senator Gordner?

1 SENATOR GORDNER: Thank you, Madam Chairman.

2 Just so I can get a better understanding, the
3 membership of your group, is it statewide or a
4 certain region?

5 MR. KLEPPINGER: It's a statewide group.

6 SENATOR GORDNER: So an example from the
7 north central, northeast part of the state,
8 members?

9 MR. KLEPPINGER: Northeast, Proctor and
10 Gamble is a member. Merc Company is a member in
11 the northeast part of the state.

12 SENATOR GORDNER: Just so --

13 MR. KLEPPINGER: BOC Gas is, Lindy.

14 SENATOR GORDNER: There's some legislation
15 being circulated, I know, by Senators Orie and
16 Senator Costa. Is that legislation being
17 circulated on your behalf, something that you're
18 supportive of?

19 MR. KLEPPINGER: Yes. That was the reference
20 to House Bill 1530 which provides the ability for
21 an electric distribution company to enter into
22 long-term contracts with industrial customers on a
23 negotiated price basis.

24 SENATOR GORDNER: I believe the utilities
25 have some concerns with regard to that. Are you

1 aware of what they are?

2 MR. KLEPPINGER: I have not had those
3 expressed to me yet. I would emphasize that the
4 proposed legislation is discretionary in nature.
5 It does not obligate an electric distribution
6 company to do that.

7 And I would also posit that the current
8 restructuring legislation at Section 2806-H
9 already provides the capability for this to occur,
10 and proposed legislation like House Bill 1530 just
11 makes that a little more clear.

12 The process that created the restructuring
13 legislation in 1996 was obviously done in a
14 different time. Interestingly, back then
15 consumers and utilities were sitting down together
16 and working on drafting that legislation with the
17 general assembly. That was a provision that was
18 jointly discussed among distribution companies and
19 consumers. The concern was that the distribution
20 companies at that time did have the desire to
21 remain in this market as a competitor and have the
22 ability to enter flexibly priced contracts.

23 I think corporate philosophies have changed
24 since then, and that's understandable in some of
25 the electric distribution companies but not all of

1 them. And we have been approached by some of the
2 utilities that would like to have that clarified,
3 that they have the ability to engage in that kind
4 of a contract.

5 SENATOR GORDNER: Just a question for you. I
6 guess I made the assumption that your consumers,
7 the large industrial folks and the larger
8 commercial folks, actually were one of the
9 entities that actually had competition, maybe I'm
10 going back to the early days, because you have so
11 much demand there, that the utilities were
12 actually coming to you as compared with the small
13 residential folks to compete. Did that not
14 happen?

15 MR. KLEPPINGER: That did happen in the 1999
16 to 2001 time frame. There was a substantial
17 amount of industrial load that was purchasing
18 their power from alternative generation suppliers,
19 electric generation suppliers.

20 With the increases in natural gas prices and
21 thus the resulting increases in market prices at
22 LMP, those customers returned to their capped
23 rates that were negotiated during restructuring
24 cases.

25 SENATOR GORDNER: So you do not have multiple

1 utilities competing for your business at this
2 point?

3 MR. KLEPPINGER: Certainly not where any of
4 the rate caps were in place. In western
5 Pennsylvania where the rate caps are off, we will
6 and do receive proposals from more than one
7 entity, typically three or four at the most.

8 However, one of the difficulties is whenever
9 those proposals come back in terms of responses to
10 RFP's, they are all priced based on each entity's
11 best guess of where the LMP price curve is going
12 or where the natural gas curve is going. It has
13 no relation to the cost structure of the entity
14 other than what they're buying in the wholesale
15 market and then passing on to us.

16 That's one of the defects in this market in
17 that everything is being negotiated and contracted
18 on some LMP form basis as opposed to a longer term
19 contract that does not only look at LMP, it looks
20 at other cost structures.

21 SENATOR GORDNER: So you're not finding much
22 difference in price among those?

23 MR. KLEPPINGER: No.

24 SENATOR GORDNER: Thank you.

25 SENATOR WHITE: I have a question brought up

1 by something Mr. Biden said. He said that when
2 imbedded costs were higher than market costs, you
3 wanted market costs, and when the situation
4 shifted, you want the situation to shift. It
5 seems to me that the rules of the game are the
6 rules of the game and you pick your game and you
7 get in there and play it. Which do you want?

8 MR. KLEPPINGER: We want truly competitive
9 market prices. Unfortunately, the structure that
10 was adopted at the federal and regional level
11 after the 1996 legislation was passed in
12 Pennsylvania prevents us from doing that.

13 There's a little bit of a misstatement in
14 what Mr. Biden said in that when we promoted
15 competitive markets in the late eighties and early
16 nineties, we didn't have a market cost at all. We
17 had a difference between imbedded cost and we had
18 a marginal cost.

19 The marginal cost was set in the wholesale
20 market in PJM, not on a last-bid-in locational
21 marginal price basis. It was set on something
22 called split the savings. Once competition came
23 into place and the LMP model was adopted, the
24 rules of the game changed after the fact.

25 So the whole world has changed since the

1 adoption of the 1996 legislation in terms of the
2 effect of that wholesale price on the retail
3 market.

4 SENATOR WHITE: Of course, there's nothing we
5 can do about what FERC does. We have to look at
6 our own policies.

7 Senator Musto, did you have a question?

8 SENATOR MUSTO: Thank you, Madam Chairman.
9 Good morning.

10 MR. KLEPPINGER: Good morning.

11 SENATOR MUSTO: You have made reference to
12 legislation regarding long-term contracts.
13 Supporters claim there will be no rate
14 subsidization by other customers, yet the language
15 doesn't clarify how that would be prevented.

16 What language would you suggest to ensure
17 that residential and small business customers do
18 not end up subsidizing a special rate by large
19 users?

20 MR. KLEPPINGER: I would support language
21 that directly states what you said. Industrial
22 customers are not here looking for a subsidized
23 rate. What we're looking for are prices that
24 generators are willing to offer on a long-term
25 basis that provides them with their full cost

1 recovery and very healthy return on that. That
2 return may in fact be less in the short term than
3 the market would allow them to earn if they chase
4 the LMP.

5 Now, if you call that subsidy at all, it
6 would be a shareholder subsidy in the short term
7 in recognition, that it's better for this
8 Commonwealth to retain those industries and allow
9 reasonable returns to be earned that may be less
10 than market returns in the short term. Long term,
11 that may be a better strategy even for the
12 generation.

13 SENATOR WHITE: But, you know, I've been
14 asking the same question that Senator Musto just
15 asked. I keep coming back to one thing I do not
16 understand. You can currently enter these
17 long-term contracts with a competitive supplier.
18 The only thing we're talking about here is your
19 entering the same kind of contract with your
20 default supplier.

21 MR. KLEPPINGER: If they want to do that.

22 SENATOR WHITE: If they want to do it, sure.
23 Nobody's got a gun to your head.

24 My question is how is it you believe that
25 they can offer you lower prices from the

1 competitive suppliers when they're all buying
2 their power from the same generator?

3 MR. KLEPPINGER: Well, they may own their own
4 generation and chose to earn a lower return on
5 that generation in the short term than what they
6 may be able to earn on that generation currently
7 in the LMP construct.

8 SENATOR WHITE: Are we only talking about
9 providers of last resort that own their own
10 generation?

11 MR. KLEPPINGER: Well, that's certainly the
12 easiest way for it to be accomplished. They may
13 have access to other generation sources that are
14 an affiliate or something of that nature.

15 SENATOR WHITE: Okay. I still have some work
16 to do on that issue. Senator Boscola?

17 SENATOR BOSCOLA: On the systems benefit
18 charge, I appreciate that you said you're a little
19 skeptical because I've been asking the same things
20 of the systems benefit charge. I kind of think
21 that the short-term pain that we've talked about
22 is going to turn into long-term pain in the end.

23 I appreciate it because there's a couple
24 people in the testimony last week that also
25 pointed out the systems benefit charge, although

1 small, is something that we should all just be a
2 little leery of, so thank you.

3 SENATOR WHITE: Senator Musto, did you have
4 another question?

5 SENATOR MUSTO: Madam Chairman, I do not have
6 another question. But the message is the
7 legislature certainly wants to protect
8 manufacturing jobs here in Pennsylvania and
9 increase manufacturing jobs but we want to also be
10 sure that we do not unintentionally put other
11 customers at a disadvantage. So working together,
12 maybe we can craft some language that would
13 protect that smaller user.

14 MR. KLEPPINGER: Yes. We would agree with
15 that.

16 SENATOR WHITE: On the systems benefit
17 charge, would your organization be more supportive
18 of such a charge if the proceeds were to be used
19 for, say, infrastructure development or
20 guaranteeing the loans for new coal-fired
21 generating capacity, for transmission line
22 improvements, helping the grid so we can get
23 greater electric efficiency as opposed to where it
24 is now proposed to be spent?

25 MR. KLEPPINGER: At the end of the day, it

1 demonstrates that there is a positive cost benefit
2 and a good return on that type of systems benefit
3 charge. The kind of project you're proposing,
4 without seeing the study, would seem to me to be
5 the types of projects that are good for the
6 Commonwealth.

7 SENATOR WHITE: Thank you. Other questions?
8 Senator LaValle?

9 SENATOR LaVALLE: I don't have a question,
10 Madam Chairman. I just want to inform the members
11 if we support the cost of the legislation, my
12 district has a potential chance of a steel mill,
13 three quarters of a billion dollars' investment
14 that would include hundreds of steelworkers.
15 Without this legislation, the chances of getting
16 that are almost absolutely nil. So it's important
17 that we take a look at that. That may be rather
18 selfish. But to offer industrial users that
19 opportunity creates a situation beneficial to the
20 entire state.

21 SENATOR WHITE: Thank you, Senator. Thank
22 you very much.

23 MR. KLEPPINGER: Thank you.

24 MR. HENDERSON: Our next witness is J.
25 Michael Love, president and CEO of the Energy

1 Association of Pennsylvania.

2 SENATOR WHITE: Good morning, Mr. Love.

3 MR. LOVE: Good morning, Senator. Chairman
4 White, Chairman Boscola, it's an honor for me to
5 be here before two committees who have
6 demonstrated year in and year out a concern about
7 how we use electricity and what the price of
8 electricity is.

9 This is not the first time that I've appeared
10 before you, and you have been making inquiries
11 about where the price of energy is going for a
12 number of months preceding all the discussion
13 we're going to have today about certain bills.

14 I'd also congratulate you, Chairman White,
15 that your committee without dissent approved
16 Senate Bill 76 that was sponsored by Senators
17 Tomlinson, Boscola, Musto, Stout, and others which
18 for the first time sought to provide energy
19 assistance to the working poor under a specific
20 definitive set of circumstances.

21 It's your committees' continued need to
22 recognize that you need to balance the
23 affordability of electricity with the reality that
24 the government is not an unlimited source. That
25 is in essence going to get to the first point that

1 I want to raise with you.

2 When I was a child, I was taught to practice,
3 practice until you became good at something. And
4 I have the word practiced up there because the
5 problem that you have is that there are a lot of
6 concerns that impact the price of electricity and
7 impact the legislative involvement in the price of
8 electricity.

9 Obviously, as many of you have expressed,
10 you're very concerned about the price of
11 electricity; and you should be. But also
12 reliability is a factor. Affordability is a
13 factor. Conservation is a factor. Time of use
14 rates, smart meters are a factor. Infrastructure,
15 as Commissioner Fitzpatrick talked to you about
16 last week, is a factor. Competition, economic
17 development. What my predecessor, the speaker,
18 was talking about is exactly right. You were
19 talking about industrial development. That's
20 critical. Diversity of supply. You have all
21 helped pass the Alternative Energy Portfolio Act
22 that seeks to diversify supply.

23 The problem that I want to make sure that
24 we're all clear on is that these are not always
25 complimentary concerns, that you can't achieve

1 everything there. There is no silver bullet.

2 For example, new alternative energy sources
3 under the alternative energy portfolio standard,
4 wind, solar, we would all agree that that's
5 important and that should be brought on. But
6 here's the thing. Wind only works twenty-five
7 percent of the time, solar only fifteen percent.
8 Solar is twenty-five more expensive than wind.

9 Again, when you start saying, Well, we want
10 more than this and more than that, yes, you get
11 the diversity of supply but you don't get the
12 price break and you don't get to the reliability
13 if it's only working twenty-five to fifteen
14 percent of the time.

15 Speaking about reliability, that's where I
16 want to go first. I think you should be
17 congratulated in hindsight that when you passed
18 the Competition and Electric Generation
19 Deregulation Act, the word reliability appears
20 twenty times in that act, twenty times, because
21 you were very concerned that whatever you were
22 doing, you wanted to make sure that, you know,
23 hospitals, the schools, the homes, the businesses
24 would have the electricity.

25 And I would say in large measure because you

1 put such an emphasis on reliability is why the
2 electric distribution companies have dramatically
3 improved distribution reliability by putting in
4 significant amounts of technology to improve the
5 way that we deliver the power to the homes and
6 businesses in the Commonwealth.

7 Now, of concern to me is all of a sudden
8 we're going to get to the alternative energy
9 portfolio statute; and that appears, reliability
10 only appears once. So there it's almost like
11 we're sending the direction we want you to get
12 alternative energy, we want you to go out there
13 and contract for it; but it doesn't talk about is
14 it going to be reliable.

15 Then we get to the most recent legislation.
16 Senate Bill 715 which seeks to increase solar
17 percentages has no mention of reliability. And
18 Senate Bill 716 has only three mentions of
19 reliability as it relates to the electric utility
20 industry.

21 Since society needs electricity to run, I
22 think it is critical that we focus on reliability;
23 and for that reason, I turn to my first criticism
24 of 716, which is, in two very specific places I
25 believe it has procurement provisions that would

1 undermine the cost of reliability.

2 The entire language that appears in Section 3
3 has conflicting language on generation procurement
4 by electric distribution utilities. You asked us
5 to make sure that we purchase certain amounts of
6 long-term contracts, some in medium-term
7 contracts, some short term, some spot purchases;
8 make sure there's a diversity of supply; make sure
9 this, this, this. But nowhere does it appear the
10 words that we give one hoot about reliability.
11 That's a concern.

12 Having government planning as to when we go
13 into the procurement process is a process that can
14 never work, can't work. There's no way you can
15 write language enough to deal with all of the
16 situation.

17 For example, what should happen if a major
18 generating unit went down? That changes the
19 complexion of the purchases. What happens if
20 there's a Hurricane Katrina? There are a lot of
21 situations that can occur. You cannot procure all
22 situation in a marketplace.

23 The language that's currently in the
24 competition act is very solid, and it requires
25 electric utilities like ourselves to obtain

1 electric energy at prevailing market prices.
2 That's the broad brush that Chairman Holland was
3 talking to you about. And indeed, the PUC has
4 reinforced that approach; and that is in fact what
5 we do today.

6 Now, another procurement issue that's
7 associated with Senate Bill 716 that we have
8 problems with again is in Section 3 and
9 specifically on Pages 7 and 8. Here you have a
10 situation where we are for any increase, any
11 increase in the demand for energy or increase in
12 energy usage, we are supposed to first go to
13 demand side response which is defined as
14 volunteers who are willing to come up and curtail
15 their load. Secondly, if that's not enough, then
16 we're supposed to be using alternative sources.

17 I think you heard from Mr. Kleppinger and Mr.
18 Biden that you need to provide energy all the
19 time. You don't have the time to go around and
20 say, Well, do you want to help me out today;
21 Do you want to help me out today; How about you,
22 sir?

23 You know, we don't have time to go around and
24 ask for volunteers when power needs to be
25 presented instantaneously and we have to make

1 instantaneous suggestions. Nor can we though rely
2 on alternative energy sources that do not run
3 twenty-four, seven; do not run as base load. It's
4 just an unworkable solution.

5 And what's going to happen if that type of
6 legislation is required, we are not going to be
7 able to provide you the reliability you were so
8 concerned about in your competition act. Just not
9 going to work, especially in a time, you know, you
10 can't build nuclear units; coal units are said to
11 be a four letter word; and natural gas and diesel
12 are what, expensive and costly.

13 These two procurement provisions are at the
14 heart of our concern because neither one of them
15 seems to make practical sense in terms of trying
16 to run an energy business. We cannot go out and
17 make decision after decision when we are required
18 to deliver power instantaneously. We don't have
19 the situation where we store electricity. We have
20 not developed the technology to do that, so we do
21 have to make decisions.

22 And the context of talking about reliability
23 here, what I'm trying to talk to you about is in
24 essence generation reliability. I think my
25 companies have taken the steps necessary to

1 distribute energy efficiently and improve the
2 ability to do that according to the PUC
3 statistics.

4 What I'm now trying to make you are aware of
5 is generation reliability, and that is a very
6 significant issue and one where I keep pointing to
7 the fact that reliability needs to be up high in
8 your priorities.

9 We as an industry do not object to language
10 that permits long-term contracts between electric
11 distribution companies and industrial customers as
12 long as the contracts are voluntary and do not
13 require subsidization by other customers.

14 The idea of two major corporate giants
15 sitting down to negotiate a contract is something
16 that, you know, let the buyer beware, let the
17 seller beware.

18 In addition, we support long-term contracts
19 for the acquisition of default service supply. We
20 cannot support, however, PEDAs being in the
21 purchase and sale of the energy business. And we
22 do so because unfortunately I sit here with thirty
23 years of experience. And I too remember
24 California, and California had a power authority
25 out buying and selling power. And that was a

1 disaster. It was a disaster because it put
2 electric rates through the roof and it made a
3 financial commitment on the state that they're
4 still coming out from. So I cannot in good
5 conscious say that I would recommend that.

6 What I do think we need to talk about is
7 conservation. I agree with what you've heard from
8 many speakers, that we have to address
9 conservation. Not as the cure all, not as the
10 only way, but as something that we have to face.

11 But here again, I don't want you to think
12 that there's some sort of silver bullet because in
13 terms of conservation, I want to point you to a
14 slide that's over here. One thing I think each
15 and every one of you know, that we as a
16 Commonwealth have an old housing stock.

17 Most of the people that live and vote in this
18 Commonwealth have older homes. Eighty percent of
19 the homes were built before 1979, before the first
20 energy crisis occurred.

21 And what do we know about those homes? We
22 know they weren't built with enough insulation.
23 They weren't built with windows that protect and
24 hold in energy, weren't build in with the doors,
25 weren't built with efficient appliances.

1 Basically energy was not a concern prior to
2 1979, yet we have eighty percent of our homes
3 according to the 2000 census that deals with the
4 issues squarely. You're not going to be able to
5 fix that with a smart meter. You're not going to
6 be able to fix that by changing out appliances.

7 What you're going to have to do is do the old
8 fashion block and tackle, which is you're going to
9 have to put insulation in, you're going to have to
10 put in an energy audit, you're going to have to
11 tune their appliances, find out where they're
12 leaking energy if we're going to make conservation
13 work.

14 I say that because the people that are out
15 there that are listening to us today, they want to
16 do their share. But for them to do their share,
17 to conserve, to help out, to lower their demand,
18 they have to have the ability to do it.

19 Right now, as my comments discuss, if you
20 want to get conservation or energy efficiency
21 help, good luck, because you've got to go
22 everywhere. We have programs in the electric and
23 gas industry that offer assistance in terms of
24 energy assistance.

25 There's a marvelous program at the

1 treasurer's office in terms of the Keystone Energy
2 Loan Program that is available to all customers.
3 There is grants given out by the DCED that they
4 get from the Department of Energy. There is
5 grants from DCED and DEP that are given out.

6 What are we doing? If we're going to say
7 conservation is important and you ask me to
8 address things more than just what the governor's
9 put forward, I say to you if we want to truly go
10 down the road of conservation and I think we must,
11 then can we kind of make it easy for the people
12 that are trying to find the information, trying to
13 find the assistance?

14 Doesn't it make more sense to follow what I
15 quote Senator Earll saying not too long ago, that
16 we have a tendency around here to create a bunch
17 of programs and then we end up having to fund them
18 all without stepping back and saying, is there a
19 way that we can do this more efficiently?

20 I agree and I put it up here that
21 conservation is one of the ways, but we should be
22 able to find a way to bring this all together
23 under one roof so that a customer can go there and
24 find out how they can best conserve so they can
25 deal with the issue. Because the only way they're

1 going to be able to take short-term steps to deal
2 with price increases, et cetera, is to turn to
3 conservation and weatherization and energy
4 efficiency.

5 Now, thankfully Senate Bill 716 in its
6 discussion of the systems benefits charge on Page
7 11 on Section 5, small i, F, talks about funding
8 for weatherization. But nowhere in the big talk
9 that we have -- we hear about solar. We hear
10 about smart meters. We hear about micro grids.
11 But nowhere do we talk about that provision which
12 in my estimation has to be enlarged.

13 People have told you about systems benefit
14 charges; and yes, they exist in places. Now, let
15 me tell you some of the good and some of the bad
16 because we need to hear this.

17 The bad aspect of it is that in our state if
18 you impose a systems benefit charge, people like
19 Dave Kleppinger's clients pay the sales tax and
20 then they pay a gross receipt tax. So you have a
21 tax on a tax on a tax. That's problematic, and
22 that doesn't help hold industry in this state.

23 In fact, one of the reasons our electric
24 rates are different from many of those states to
25 our south is because there are too many energy

1 taxes that are collected through the bills.

2 That's one of the big differentials.

3 Now, places where we have gone and done a
4 systems benefit surcharge, there are many. One of
5 the things they have done is they've said, all
6 right, we'll do that but we're going to allocate a
7 specific amount for increased weatherization and
8 increased supplements for lighting. Where? For
9 people who not only are poor but the working poor,
10 the very people you were trying to help out with
11 Senate Bill 76 that you all unanimously approved.

12 That's what's gone on, so those that reach a
13 hundred and seventy-five to two hundred percent of
14 the federal poverty level are the ones that are
15 given assistance, the very ones that you all
16 targeted in Senate Bill 76.

17 So again, it's not for me to suggest whether
18 you want to put on a new tax or not. But what I'm
19 trying to tell you are some of the good and some
20 of the bad from it.

21 Certainly I need to tell you, sadly, that
22 there is no silver bullet. There's no magic
23 elixir that's going to be able to save billions
24 and billions of dollars. That's just not going to
25 occur.

1 If it would occur, you have to believe that
2 the industrial clients that you heard from, you
3 have to believe that the generators Mr. Biden and
4 the companies I represent and the consumer
5 advocates that you heard from last week would have
6 all found such a solution.

7 Smart meters are not a new concept. I've
8 been in this business thirty years. Back in '78,
9 '79, we were talking about smart meters. Smart
10 meters were implemented, and I left and filed with
11 some of you and I'll make sure every one of you
12 get it, news clippings from Puget Sound,
13 Washington, which for the first time hundreds of
14 thousands of people were put on time-of-use rates
15 and smart meters. And they loved it at first, at
16 first. And then the bills started to arrive, and
17 the big savings that were predicted didn't occur.

18 What happened, what's the sad part of this
19 because conservation is part of the solution, is
20 disillusionment set in. They thought, Oh, another
21 story from our government, another story from
22 those electric utilities, because people were
23 changing their energy habits and seeing
24 forty-four-cent savings and seeing they have to
25 pay more and none of what was talked about was

1 anticipated.

2 Now, all right. You say, That was the state
3 of Washington. Let me take you to Page 9 in my
4 testimony and what's going on in terms of PPL.
5 What the companies in the state of Pennsylvania
6 have been doing have been trying to have pilots.

7 Why are we trying to have pilots? Because
8 we're cognizant that not all customers are alike.
9 What happened with PPL, and it's right there,
10 overall they had like three hundred and sixty-four
11 really committed conservationists who really
12 wanted to do something about their energy usage.
13 And indeed, about two-thirds of them, they saw a
14 savings. That savings was anywhere from two cents
15 for the summer to \$147.

16 Another third, and these are people really
17 committed to conservation, they saw their bills go
18 up from seven cents to \$65. It doesn't take a
19 genius to realize that the people that saw their
20 bills being more expensive quickly dropped out of
21 the program and didn't want to be curtailing their
22 demand anymore.

23 There is no silver bullet. There is no magic
24 elixir. When you start changing rate design
25 significantly as smart meters do, you have winners

1 and you have losers.

2 Now, should we change it? Let's talk about
3 that. You had Sonny here last week. He said, You
4 know what my residential customers want, They
5 don't want rates changing around the way PUC is
6 suggesting where they'll change quarterly, They at
7 best want to change annually. Well, hello. Are
8 we going to do it hourly? Will that make them
9 happy? Will we make them happy if we change it
10 monthly? Don't think so.

11 Heard from Mr. Kleppinger. He had an
12 opportunity as his clients did out in the western
13 side of the state to chose time-of-day,
14 time-of-use metering from smart meters; and they
15 chose not to take it. Why did they choose not to
16 take it? Because they need to know whatever the
17 definitive cost is for their product, it's going
18 to stay the same. They need that so they can
19 price their product the same.

20 Budget billing. We all know that we have a
21 lot of customers that love budget billing. We
22 know we hear from them.

23 So before we start opening up this Pandora's
24 box, let me just try to make sure that you realize
25 it's not a panacea, it's not sitting there, you

1 know, with a silver bullet or whatever. In other
2 words, you know, there's no magic elixir. I've
3 got it, and I'm sticking it in my bag. There's no
4 magic elixir that fixes these problems. The
5 choices are the ones that are there.

6 One of the things that has not been discussed
7 much and I set forth what has been alleged to be
8 the savings is that over half of these savings
9 come from something called micro grids.

10 Now, what are micro grids? The concept is
11 somehow a generating unit that would be
12 constructed to serve four customers outside the
13 reliability and safety concerns of the PUC. That
14 bothers me a lot in many ways.

15 Interestingly, those people don't have to
16 comply with the alternative energy portfolio
17 standards, so they don't have to buy their power
18 from there. They're not going to build a nuclear
19 plant. They're not going to build a coal plant.

20 So what are they going to buy? They're going
21 to build either a diesel plant or a natural gas
22 plant. Now, I don't know how that fits into
23 anybody's environmental scheme these days.

24 Indeed, one of the concerns that I have, one
25 of the most fervent worries I have is with wind,

1 with solar, with micro grids. All of them have to
2 be backed up by natural gas, the construction of
3 natural gas units. And what that's going to do is
4 drive up the price of natural gas, and then you're
5 going to have the chemical industry in here and
6 the fertilizer industry in here screaming about
7 the prices of gas going up so high. You need to
8 recognize that that is a significant risk that's
9 sitting there.

10 You've been very gracious in listening to me
11 as I go through these various points. I close
12 with the following. Conservation does work, but
13 don't oversell it. Demand side response does
14 work, but don't oversell it.

15 If you're truly concerned about people trying
16 to meet their energy bills, please understand this
17 is not the only industry you have to worry about.
18 Home heating bills from heating oil are probably
19 going to go up more than fifty percent this year.

20 Natural gas has gone up that much in the past
21 and may go up in the future. The models support
22 that.

23 The proposals in this bill as I outline on
24 Page 14 of my testimony all talk about increased
25 costs that are going to rise, that are being

1 imposed not by us, not by the marketplace, not by
2 the consumer advocate, the PUC, but by the
3 legislation. And I think that that's something to
4 be concerned about.

5 What I would ask you to be concerned about is
6 the very compassion that you demonstrated when you
7 considered Senate Bill 76 and the very compassion
8 that you demonstrated over the years, which is
9 there are people that are low income, middle
10 income sitting there with old housing stock.
11 That's who you have to address.

12 We aren't going to make step one down the
13 road of conservation unless and until we deal with
14 the old housing stock. I thank you for your
15 listening.

16 SENATOR WHITE: Thank you. Questions,
17 Senator Musto?

18 SENATOR MUSTO: Thank you, Madam Chairman.
19 According to your testimony, and I listened very
20 carefully, we should pack up and go home. But
21 that's not going to happen.

22 MR. LOVE: Nor am I suggesting it, Senator.

23 SENATOR MUSTO: I think you are. You've been
24 very critical of both, and I think your problem is
25 alternative energy use.

1 MR. LOVE: I think alternative energy use is
2 a fine example and part of both our state and
3 federal policy, something we're all committed to.
4 What I'm trying to say to you though is it can't
5 be the only answer. I believe what is good about
6 the bills is they push conservation which is also
7 in the alternative energy portfolio standard.

8 I'm saying you have to take major steps on
9 conservation, which means dealing with that old
10 housing stock; helping people with insulation;
11 helping people with greater efficiency around
12 their windows, their doors, their appliances. The
13 part of the bill that deals with the appliance
14 change-out is a marvelous idea.

15 What I'm simply saying is there's got to be
16 more of that. There's got to be conservation
17 that's true conservation, to get people to alter
18 their habits after you've altered their homes.

19 SENATOR MUSTO: I don't see where 715 and
20 Senate Bill 716 really, really interferes with the
21 production of energy by the major utilities.

22 MR. LOVE: I'm not saying that they interrupt
23 the production.

24 SENATOR MUSTO: You said the language of
25 Senate Bill 716 seeks to place unnecessary

1 restrictions on production of electricity. Now,
2 that is one statement that I disagree with you
3 fully. That is not our intention.

4 MR. LOVE: I'm sure it is not your intention,
5 but the point being is you seek to tie our hands
6 on how we are to deliver reliability and you
7 specify what type of units we can buy from or who
8 we have to get to converse. We can't do that in
9 an instantaneous environment.

10 And I'm sorry, Senator. I don't mean to be
11 disrespectful.

12 SENATOR MUSTO: And I don't for one minute
13 think that you are disrespectful. I really
14 appreciate your testimony and, of course, your
15 opinion; but I disagree with you. If Senate Bills
16 715 and 716 create such a problem for your
17 industry, I think we should sit down and talk
18 about it.

19 MR. LOVE: And I do too, Senator, because
20 what I praise 716 and 715 is laced with courage to
21 put these issues on the table and have a
22 discussion.

23 SENATOR MUSTO: Don't you think it's time to
24 put them on the table?

25 MR. LOVE: I couldn't agree with you more,

1 Senator. And I think as this committee has
2 demonstrated for the last couple years and the
3 governor demonstrated by putting out 716 and 715,
4 it is a problem we have to deal with. I'm saying
5 it has to be refined a little bit so it's more
6 directed to the average homeowner that's sitting
7 in the Commonwealth.

8 SENATOR MUSTO: Well, that's our objective, to
9 do that.

10 MR. LOVE: And Senator, I don't doubt for a
11 minute that that's your objective. And I'm just
12 trying to say that we'd be happy to work with you
13 because you're right, we have to have a dialogue.
14 I'm assuming that's why you wanted these hearings.

15 SENATOR MUSTO: Absolutely. Thank you.

16 SENATOR WHITE: Senator Boscola?

17 SENATOR BOSCOLA: Thank you. I really did
18 appreciate your testimony. I'm concerned about
19 our infrastructure too, probably more so than I
20 anticipated when these hearings first started. So
21 instead of doing nothing, right, is there any way
22 we can encourage the industry to reinvest their
23 profits into infrastructure?

24 When I look at Bethlehem Steel in my
25 district, one of the things you hear is they

1 didn't reinvest, didn't reinvest. Eventually we
2 lost that manufacturing giant. And obviously we
3 want to keep our companies intact, making profits.
4 We don't want to lose them, especially to
5 out-the-state companies.

6 But how do we encourage them to invest in
7 infrastructure? It's part of their responsibility
8 too. I mean, they're private enterprise. It's a
9 free market system.

10 MR. LOVE: Senator, I believe that the
11 electric distribution utilities have been
12 investing in the infrastructure. If you look at
13 the capital programs, you can go on various web
14 sites of the companies in terms of their press
15 releases. The magnitude of investment is
16 increasing, and the use of technology to make
17 reliability more affordable and more efficient has
18 been occurring all the time.

19 So I think the entities -- and I don't know
20 who we're speaking about that is not making
21 investment. But I will concur with you, and I
22 think one of the things the governor is trying to
23 do and I think you all are trying to do is we have
24 to be concerned when Mr. Kleppinger and his
25 clients say there may be jobs that could be lost

1 because of energy issues.

2 That's a problem we face nationwide, but we
3 also face it in the Commonwealth. He suggested
4 some. There are taxes that need to be peeled off.
5 There are the ability for us and they to negotiate
6 contracts. That is another step that is a
7 positive development, Senator Musto, in your bill.

8 There is, I think, recognition that in other
9 states they designate certain generating moves to
10 support major customers. And whether that's
11 something we can do, if they would get exempted
12 from the severe environmental regulations, maybe
13 they can have the generating units.

14 SENATOR BOSCOLA: I guess what I'm trying to
15 get at is we're talking about a systems benefit
16 charge. It is a new tax. You're saying what
17 would help peel off some existing taxes. I
18 understand that. Now you're talking about old
19 housing stock. Maybe we're better off in
20 investing in weatherization. And I know there's
21 no silver bullet and all these other things.

22 But if you had to choose, there's a systems
23 benefit charge out there, if it was used for
24 building infrastructure, is that better than using
25 it kind of on old housing inventory and

1 weatherization and all that kind of stuff?

2 I mean, we have to make choices here,
3 initially short-term solutions; but then the
4 longer-term solution is a little different
5 obviously. I mean, if we have a finite amount of
6 money, what do we do first? I mean, I think it
7 would be infrastructure. I mean, I'm really
8 concerned about reliability and the future.

9 And I understand where you're going here.
10 But when we have a small pot of money, where do we
11 go? Where do we go first?

12 MR. LOVE: As I understood, the small pot of
13 money would lead to eight hundred fifty million in
14 bonds; and that's not such a small pot of money.
15 And if I were to --

16 SENATOR BOSCOLA: Do you agree with that? Is
17 that the smartest way to use the systems benefit
18 charge, a thirty year, eight hundred and fifty
19 million debt?

20 MR. LOVE: No.

21 SENATOR BOSCOLA: So how would you use it?

22 MR. LOVE: Where I would use it is you
23 obviously want to get the average citizen in the
24 state to begin to address their energy needs.
25 Until you can start doing what I call basic

1 weatherization which is in Bill 716, you're not
2 going to be able to achieve much of anything.

3 If in your list of priorities, if holding
4 onto certain businesses are important, then it
5 strikes me that you give them incentives. If you
6 want to go down the road of demand side response
7 and that's what you find compelling, then we've
8 got to make sure that the enticements that we give
9 both business and residents are sufficient so
10 there's not the disillusionment that occurred in
11 Washington. Those would be the three areas that I
12 would focus on.

13 SENATOR BOSCOLA: Okay. I mean, you're very
14 direct and to the point; and I appreciate that.
15 And I've also heard the word conservation
16 mentioned so many times, it's like abracadabra,
17 poof, it's there, you know, it's magic.

18 I don't think people want to pay more for
19 using less. Isn't that what you were saying?

20 MR. LOVE: Well, the ultimate situation, I
21 would phrase it possibly a little differently, is
22 there is going to be an increase down the road.
23 What we're trying to do, I think what we're trying
24 to do, legislature, governor, us, is trying to
25 find a way that we can mitigate that.

1 And what we're trying to do here and what I'm
2 trying to say is which of these tools, which of
3 these choices most likely will mitigate.
4 Infrastructure improvement will mitigate.

5 You heard about some of the problems of the
6 marketplace not wanting to invest. Let me just
7 say, it's not only in Pennsylvania. Nobody's
8 building anything other than wind units and gas
9 units through the entire country, and that's a big
10 significant concern.

11 SENATOR BOSCOLA: All right.

12 MR. LOVE: You don't want to lose the
13 industry in Pennsylvania.

14 SENATOR WHITE: Mr. Love, we're running a
15 little behind schedule here. But I want to thank
16 you. I think your comments on weatherization, on
17 the demand side issues, and all the rest of it are
18 very helpful.

19 I just want to focus real quickly on two
20 issues. You indicated that you didn't think that
21 PEDA should be an energy authority in Pennsylvania
22 and buying and selling. When we asked the
23 administration why that provision was in this
24 whole mix and what their intent was for that, I
25 thought they said that this was simply so that

1 they could be a partner in certain types of
2 limited partnership arrangements.

3 I don't know why that's in there either, and
4 I don't know that there are very many people on
5 either of these committees that want to see the
6 state getting into fixing the energy prices and
7 getting into that market as well.

8 The one main piece that I want to ask you
9 about is how you obtain your electric energy.
10 Now, my understanding is that right now you buy it
11 at prevailing market prices and that the proposal
12 calls for a portfolio approach and a mix of ways.

13 It seems to me that that mix, that more
14 discretion puts more risk on you. The market
15 price is what the market price is. The rest of
16 this is, you know, amorphous. Is that why the
17 industry is -- I would think it would give you
18 more flexibility in how you purchase your electric
19 supply, but that also gives you a responsibility.

20 MR. LOVE: When we have the marketplace, we
21 have all the flexibility we need to choose. We
22 have to be cognizant of reliability. We have to
23 be cognizant of the distance of any generating
24 unit from the load we're seeking to serve and what
25 we're going to lose in terms of line losses.

1 If we have a generating unit that operates
2 sporadically, we have to take that into account in
3 our planning so that when it goes down, what do we
4 put in its place. We have to build natural
5 gas-fired units. Someone has to build them. We
6 have to buy them so that we can supplement
7 alternative energy.

8 SENATOR WHITE: And you're saying that's all
9 mixed up in the market price and at the end of the
10 day it's all in there?

11 MR. LOVE: The market prices are there. But
12 the point being, if the government then starts
13 saying, Well, we want to have you to certain
14 amount of long, a certain amount of medium, a
15 certain amount of short, and a certain amount of
16 spot, you don't require that of your own
17 procurement offices.

18 SENATOR WHITE: Is that what the bill is
19 saying, or are they simply saying that you should
20 consider a mix of --

21 MR. LOVE: Well, we already consider a mix.
22 I mean, we consider --

23 SENATOR WHITE: So you're saying it's
24 unnecessary?

25 MR. LOVE: It is unnecessary.

1 SENATOR WHITE: Okay.

2 MR. LOVE: And the fact that it becomes
3 embodied in the statute means we're all going to
4 be fighting over whether we've got enough long
5 term, enough medium term, enough short term,
6 enough spot, enough from this alternative source
7 or that. It's hardly something that is
8 productive.

9 SENATOR WHITE: Thank you. Senator LaValle,
10 did you have a question?

11 SENATOR LaVALLE: I already made a comment
12 about what it means to my district in southwestern
13 Pennsylvania. I was under the impression that
14 your members were opposed to any consideration of
15 the Orie/Costa legislation.

16 However, on Page 5 of your testimony you say
17 as an industry you don't object to that language
18 that would allow industrial, in my case, Duquesne
19 Light, provide what they consider a cheaper
20 approach to doing some of this business. You're
21 saying you're not opposed to it or your members
22 aren't opposed to it?

23 MR. LOVE: First of all, I can tell you
24 truthfully that Duquesne Light is one of the
25 sponsors assisting in Senator Orie's legislation.

1 SENATOR LaVALLE: I understand that.

2 MR. LOVE: As to some of the other members,
3 we got the legislation just before it went public;
4 and we're in the process of studying it.

5 What I am saying to you is this. If it comes
6 to voluntarily long-term contracts between
7 electric distribution utilities and major
8 industrial users, we don't have any opposition to
9 that, provided that there's not any subsidies,
10 which is exactly what the industrials have said as
11 well.

12 So, you know, everybody is looking at the
13 language; and everybody thinks the answer --

14 SENATOR LaVALLE: That's essentially what the
15 Orié/Costa legislation allows for. It is a
16 choice. It's not something anybody has to do. I
17 think that's how the legislation may be written.

18 MR. LOVE: Senator, I have a great amount of
19 respect for Senator Orié and a great amount of
20 respect for his staff who we're working with.
21 We're trying to understand what's being meant by
22 every provision in the statute before we say yes
23 or no. We just got it. It just came out.

24 What I'm saying to you as to the ultimate
25 goal that I think you're getting concerned with

1 and Senator Musto and the others is that you want
2 to have electric distribution companies be able to
3 negotiate on a volunteer basis without subsidy
4 contracts with major industrials. We don't have a
5 dispute on that.

6 SENATOR LaVALLE: Thank you.

7 SENATOR WHITE: Senator, thank you. Thank
8 you, Mr. Love.

9 MR. HENDERSON: Your next witness is Richard
10 Rathvon of Retail Energy Supply Association.

11 SENATOR WHITE: Good morning. It is still
12 morning. Good morning.

13 MR. RATHVON: Just under the wire. Good
14 morning, Madam Chairman and fellow Senators. My
15 name is Richard Rathvon. I am president of the
16 Retail Energy Supply Association, an industry
17 trade group; and I'm vice-president at Reliant
18 Energy.

19 SENATOR WHITE: This is small print. Did you
20 see this print?

21 MR. RATHVON: I did not. I had to increase
22 mine so I could read it.

23 SENATOR WHITE: Well, a suggestion for future
24 testimony submission would be change the font.
25 Thank you.

1 MR. RATHVON: Very good. Thank you. I'd
2 give you mine, but mine has a bunch of writing on
3 it.

4 SENATOR WHITE: I'll listen.

5 MR. RATHVON: My comments today represent the
6 views of RESA. First on behalf of RESA, I want to
7 express appreciation to both committees for the
8 opportunity to present our views regarding energy
9 policy for Pennsylvania.

10 As a brief background, the Retail Energy
11 Supply Association is a broad and diverse group of
12 energy suppliers devoted to promoting competitive
13 retail energy markets for all of Pennsylvania's
14 residential, commercial, and industrial customers.

15 These suppliers include, in addition to
16 Reliant, the following companies: Strategic
17 Energy, Direct Energy, Hess Corporation, Semptra
18 Energy, US Energy, Liberty Power, Con-Ed, and
19 Suez.

20 My company, Reliant Energy, serves almost two
21 million customers in the United States as well as
22 operates sixteen thousand megawatts of generation,
23 including seventeen generating plants in
24 Pennsylvania, totaling nearly six thousand
25 megawatts. Reliant has a regional office near

1 Pittsburgh and employs twelve hundred
2 Pennsylvanians across the Commonwealth.

3 In Pennsylvania, RESA's members serve
4 thousands of customers, including residential
5 homes; businesses; school and universities; sports
6 stadiums; and several city, township, and county
7 entities, but only in utility service territories
8 that have fully transitioned to a competitive
9 market.

10 RESA agrees with many of the goals put
11 forward by Governor Rendell for Pennsylvania's
12 energy future but does not agree that legislation
13 affecting Title 66 is necessary to accomplish
14 these goals. It is premature to determine that
15 the existing Title 66 has failed to produce
16 competitive electric markets.

17 The existing rate caps for most large
18 utilities continue through 2010, and robust
19 competition will likely not occur prior to the end
20 of these rate caps. The PUC has issued a set of
21 policy guidelines and default service rules that
22 will begin the transition towards competitive
23 markets and should be allowed to work.

24 It is the competitive market with customers
25 driving product choices and with customers driving

1 terms of contracts, with customers driving
2 competitive pricing and demand reduction and
3 energy efficiency. This competitive market must
4 be allowed to work; and if so allowed, will
5 produce long-term economic advantages for
6 consumers and this state.

7 Indeed RESA believes that the proposed
8 legislation at issue is fraught with unintended
9 consequences and would have a chilling effect on
10 if not outright destroy the progress toward a
11 competitive electric market.

12 Let me outline some of the possible
13 unintended consequences, first with regard to
14 utilities offering cost-based long-term contracts
15 for particular customers. If utilities are
16 permitted to offer cost-based long-term contracts
17 to large customers, an inordinate amount of risk
18 could be shifted to rate payers. The utility will
19 likely either be shifting some pricing risk, some
20 credit risk, or some environmental risk. Either
21 way, the rate payer, not the large customers,
22 would eventually see these additional costs in
23 unnecessarily higher utility rates.

24 In addition, smaller businesses and
25 residential customers will not get the full

1 advantage of a competitive market if certain large
2 customers are allowed to obtain special deals.

3 I have a letter from a big box retailer
4 recently sent to the governor that I brought with
5 me to share with you today. This letter implores
6 him to continue to develop policies that will
7 allow the benefits of competitive electric markets
8 to flow through to all Pennsylvanians.

9 Second, with regard to implementing a state
10 mandated procurement method which includes
11 long-term contracts as part of a portfolio,
12 consumers are forced to accept pricing based on a
13 mandated time line that can be above or below
14 market for extended periods of time. In a period
15 of declining prices, consumers will not be able to
16 take advantage of lower prices if the state has
17 them locked into long-term contracts.

18 In California, the state signed long-term
19 contracts, hoping to bring lower prices to
20 consumers. The market prices dropped soon after
21 the contracts were signed, and consumers were
22 still paying higher prices. Is the Commonwealth
23 ready to take on a possible unintended
24 consequence, that is, the responsibility of
25 outguessing the market?

1 In C&I markets that have deregulated in the
2 Pittsburgh area, as an example, if consumers want
3 a long-term contract, competitive suppliers were
4 there to provide it. The consumers make the
5 choice of when to lock in price and for how long,
6 over what term. It's not based on a regulatory
7 time line. Nothing today prevents any customer
8 from entering into long-term retail contracts for
9 retail supply.

10 Moreover, price signals can be muted under
11 long-term contracts. Consumers will base their
12 consumption decisions on distorted market prices,
13 and consumers won't conserve or invest in energy
14 efficiency or demand side management programs that
15 are a result of market prices or forces. Rather
16 than conserving energy, underbid demand may result
17 in the need for new power plants and transmission
18 lines, another unintended consequence.

19 Third, with regard to establishing micro
20 grids, while RESA agrees that easing restrictions
21 on the development of micro grids can be a useful
22 economic development tool to help industry manage
23 rising energy costs, we must ensure the micro grid
24 participants pay their fair share of system
25 reliability cost.

1 Fourth, with regard to extending the
2 authority of PEDA to include buying and selling
3 power, is the Commonwealth prepared to assume a
4 role perhaps more appropriately left for the
5 private sector? For example, is it really
6 prepared to assume the risks involved in getting
7 into the power trading business?

8 Does the state government have the risk
9 management skills for commodity trading or the
10 funds to hire experienced traders? How will the
11 state ensure the state personnel are adequately
12 supervised and will be held responsible for
13 inherent conflicts of interest between government
14 traders and competitive entity traders?

15 As another example, going back to California,
16 they hired consultants and traders and others
17 during its crisis with disastrous results.
18 Conflict of interest issues arose around traders
19 and consultants who were hired, and
20 second-guessing the government's choice of
21 consultants became headline news. Government
22 intervention can lead to unintended consequences.

23 Much has been said lately, both to you and in
24 the press about large industrial customers being
25 unable to procure electricity at prices that they

1 would like. They have threatened to take their
2 expansion plans elsewhere if they cannot obtain
3 electricity at below market prices.

4 RESA is sympathetic to their concerns, and
5 our members stand ready to work with industrial
6 customers and the general assembly to find
7 compromising solutions that do not sacrifice one
8 segment of the industry for another and that do
9 not sacrifice the framework and development of
10 competitive energy markets. It is in everyone's
11 best interest to see that all segments of the
12 market succeed.

13 The simple fact of the matter is that these
14 large customers want retail prices that are below
15 prevailing market. RESA cannot afford to sell
16 their product below cost. More importantly,
17 traditional utilities cannot afford to sell
18 electricity below cost either.

19 Therefore, we believe that these large
20 customers in the final analysis are asking for a
21 subsidy at the expense of other customers. As
22 part of energy policy, the Commonwealth should not
23 allow favorable deals only for certain customers.
24 Rather, if the real issue is an economic
25 development issue which may include favorable

1 treatment of certain business segments based on
2 sound policies, then let's shed light on this
3 issue and encourage open discussion aimed at
4 problem solving.

5 It is a robust competitive electric
6 marketplace that will provide all consumers with
7 the products and services that best meet their
8 individual needs. If a long-term contract is
9 desired, the competitive market can provide it
10 today. Any other variations in products or term
11 are provided today in the competitive energy
12 markets.

13 And if there's truly no cross-subsidization,
14 if the intent is not to be looking for an
15 opportunity to buy electricity at below prevailing
16 market rates, then why do the industrial customers
17 need to contract directly with the regulated
18 utility?

19 The utilities could provide today through a
20 competitive retail affiliate the long-term
21 contracts they believe are needed. As an example,
22 Duquesne Light has such an affiliate. Why doesn't
23 this work today?

24 Moreover, there are inherent dangers if the
25 regulated utility is allowed to provide long-term

1 contracts. Consumers will bear a number of risks
2 if the utilities contract directly with industrial
3 customers.

4 For example, to name a few, there are credit
5 costs, unit contingency costs, capacity charges,
6 and other PJM requirements. PJM is making
7 progress in its transition to fully competitive
8 electric markets, but the opportunities for
9 customers to experience full retail choice will
10 not occur until the rate caps expire in 2011.

11 In 1997, the Commonwealth allowed competitive
12 retailers to come into the market and compete for
13 consumers' business. However, as part of the
14 restructuring process, rate caps were put in place
15 to act as a ceiling on prices, some not expiring
16 until 2011.

17 Had electricity prices remained stable or
18 declined, new competitors would have been able to
19 come into the market and provide prices lower than
20 the rate caps. And initially many competitive
21 sellers did come into the market.

22 However, when prices for natural gas and
23 coal, and as you heard was the underlying fuels
24 used to generate electricity in Pennsylvania,
25 increased significantly, the price of power

1 increased to levels higher than the rate caps.

2 Since 2000, the price of natural gas has
3 risen more than two hundred fifty percent; the
4 price of a barrel of oil, eighty percent; and the
5 price of coal, approximately fifty-five percent.

6 We have learned that regardless of the
7 state's regulatory status, whether restructured or
8 traditional, the cost of the underlying fuel
9 commodity will drive electricity prices.

10 Traditional regulation provides no immunity
11 from the effect of fuel increases. For example,
12 between 2000 and 2005, many fully regulated states
13 experienced a significant increase in states:
14 forty-nine percent in Oklahoma, thirty-seven
15 percent in Georgia, sixty-seven percent in
16 Louisiana, fifty-three percent in Mississippi, and
17 forty-three percent in Colorado.

18 RESA encourages Pennsylvania policy makers to
19 allow the advancement of competitive markets to
20 continue under the existing choice law. Over the
21 long term, properly structured competitive markets
22 will prove to deliver more value than regulated
23 monopoly service. The competitive market is the
24 best pathway to deliver innovative products that
25 allow consumers to meet their unique individual

1 needs and reduce consumption, thus helping the
2 environment. Thank you.

3 SENATOR WHITE: Questions? Well, I have a
4 couple.

5 If I'm hearing you correctly, you're saying
6 that our competitive program hasn't really had a
7 chance to develop because the price caps have been
8 on. But are you suggesting that we do nothing and
9 just stay the course and wait and see what
10 happens?

11 Because I think there's some discomfort with
12 that, you know, simply waiting until the price
13 caps come off and then see if the prices go nuts.
14 That's sort of not the approach that a legislative
15 likes to take. On the other hand, I understand
16 that some of the things that are being proposed
17 here are perhaps counterproductive.

18 I am convinced that the best way to get
19 electric costs down over the long haul is with
20 strong competitive markets. I don't want to do
21 anything in this legislation that destroys or
22 hampers or hinders those markets.

23 But what do you think we should do to avoid
24 the kind of political sticker shock that we are
25 all concerned about? Or do you think PUC has

1 already gone there with default service?

2 MR. RATHVON: Well, the PUC has proceedings
3 underway to address mitigation plans and how to
4 deal with those issues; and they're authorized to
5 deal with that. You know, we believe that they
6 are addressing that issue.

7 Should legislators stand by and just watch?
8 We're not suggesting that. You know, we think
9 there's a role to play. We need to keep an eye on
10 the energy markets, the wholesale energy markets,
11 as an example that was discussed earlier.

12 We believe the wholesale markets are
13 competitive, and the PJM market monitor has so
14 stated over the past two or three years. But that
15 doesn't mean take your eye off the ball. You must
16 keep your eye on the ball.

17 We're commenting on some of the provisions in
18 the amendments to Title 66 that we don't believe
19 work and we believe are counterproductive. But we
20 stand ready to work with all policy makers as well
21 as the industrial groups and other customer groups
22 to try to deal with some of the issues.

23 Energy management and energy conservation I
24 think is another approach that should be widely
25 encouraged, probably through competitive market

1 forces as well as part of that structure as a way
2 to address the increasing customer costs.

3 SENATOR WHITE: We're hearing numbers like
4 high of three percent for residential
5 conservation. That's not going to buy us a lot of
6 slack.

7 MR. RATHVON: Energy conservation and demand
8 reduction cannot be the only solution. Renewable
9 cannot be the only solution. What we want to be a
10 part of is helping solve some of these issues.

11 Again, other people have testified. There's
12 not a silver bullet. It's not simple. It's
13 complex. There are many moving parts.

14 A competitive marketplace though has to be
15 part of that solution, and that's what my trade
16 association stands on fervently. But that doesn't
17 mean we're asking you to not do anything or to
18 take the eye off the ball.

19 SENATOR WHITE: But you seem to be saying
20 that in these long-term contracts with the large
21 industrial, there's no way the default provider
22 can offer a below market price without subsidizing
23 it from somewhere. And where do they subsidize
24 it? Well, the only other thing they've got is a
25 huge pool of residential and commercial customers.

1 MR. RATHVON: Well, couple that with the
2 rules allow them to have an unregulated subsidiary
3 to compete with us on a level playing field where
4 the market rules are established. Why isn't that
5 good enough, back to your point?

6 SENATOR WHITE: I don't know. That's a good
7 question. I should have ask it. Thank you. Any
8 other questions? Thank you very much.

9 MR. HENDERSON: Your next witness is Michael
10 Kormos, senior VP for Reliability Services for PJM
11 Interconnection.

12 SENATOR WHITE: You're our first afternoon
13 witness.

14 MR. KORMOS: Good afternoon, Ma'am Chairman
15 and fellow committee members.

16 As said, my name is Michael Kormos. I'm
17 senior vice-president for Reliability Services at
18 PJM. And in that role at PJM, I have
19 responsibilities for the real-time operations, the
20 planning, IT, security, as well as the regional
21 integration groups in PJM. I want to thank you
22 for the opportunity to discuss before this
23 committee some of the issues. I believe you've
24 heard about PJM. I'll try to summarize my written
25 comments at a very high level.

1 SENATOR WHITE: If you would, please, because
2 there's a lot in here about the history of PJM.
3 And I think while the committee is familiar with
4 it, I was not until maybe a couple years ago. I
5 didn't know the grid existed. I have been very
6 impressed with what I learned about PJM.

7 I happen to think we participate in one of
8 the finest and most progressive and reliable grids
9 in the country. But I'd like to hear your take
10 mainly on some of the testimony you heard today
11 and what you think the impacts would be.

12 MR. KORMOS: I would. Thank you very much.
13 Again, I would like to discuss again, you know,
14 just basically who we are, what we are, how we
15 deal with short-term reliability, and how that's
16 raised some of the issues about how we've
17 implemented wholesale markets in protecting
18 reliability, how we do long-term planning, and how
19 the things like the capacity construct that has
20 recently been done is involved in that. So I'll
21 try to go through that fairly quickly and then
22 look forward to your questions at the end of it.

23 Again, for those of you not familiar with
24 PJM, we are the regional transmission operator for
25 one of the largest power systems in the world.

1 We're located and headquartered in Valley Forge,
2 Pennsylvania. We have five hundred and sixty
3 people in Valley Forge.

4 I wanted to stress that we are the operator
5 of the grid. We don't own any assets. We don't
6 own any transmission assets. We do not own any
7 generation assets. We take no position in the
8 markets that we operate. We take no title to the
9 power that is bought and sold and traded in our
10 markets. We are truly independent in that nature.

11 Our peak load is fairly large at a hundred
12 and forty-four thousand or a little over a hundred
13 and forty-four thousand, five hundred megawatts.
14 The capacity we have dedicated to serve that load
15 is a hundred and sixty-four thousand megawatts,
16 and we've billed out over twenty-two billion
17 dollars a year in the energy market itself.

18 But all that being said, our main
19 responsibility is to provide a platform for the
20 Commonwealth's buyers and sellers of electricity
21 to be able to enact in a fair, equitable,
22 non-discriminatory manner at the wholesale level
23 to ultimately fulfill whatever retail policies
24 that have been directed by the states.

25 We are a regional transmission operator under

1 the FERC authority, invested through FERC on the
2 short-and long-term reliability as well as open
3 access. We're also the responsible party for the
4 majority of the mandatory reliability requirements
5 that are now or are going to be in place later
6 this month. That is mainly ours.

7 As I mentioned, we do have a long history
8 dating back to 1927 although we have changed and
9 flowed with the industry and with technology.
10 Currently we hire an independent organization with
11 an independent board of managers, ultimately
12 responsible for the policies of our company.

13 But we do have a very extensive stakeholder
14 process with over four hundred members, many of
15 them who have testified in front of you today,
16 participating in the stakeholder process.

17 To just talk a little bit about how we
18 maintain short-term reliability and the tools we
19 use to do that, and again, going back to the
20 problem Mr. Kleppinger highlighted very well, our
21 product, our commodity is fairly unique in that it
22 is basically bought and sold, generated and
23 consumed instantaneously and it actually travels
24 along the delivery mechanism, the transmission
25 system, at the speed of light. And therefore we

1 have some very unique characteristics which causes
2 differences in this market than maybe you would
3 see in some other commodity kinds of markets.

4 Now, in order to do this, we do in fact
5 monitor the system in real time. We get over
6 sixty thousand pieces of data literally every
7 three to four seconds that we use to evaluate the
8 grid to make sure the grid is in a continuous
9 state of reliability by comparing it to actual
10 limits that we have developed for this system.

11 But that's not good enough because, again,
12 any major constraint could cause the system to
13 come out of balance. And again, if we use a
14 facility, a line, or a generator, the flows
15 redistribute themselves instantaneously. So
16 because of that, we have to basically do
17 contingency analysis.

18 What we look at is we simulate over four
19 thousand different events that could happen on our
20 grid and we analyze what the redistributed flows
21 would look like. And again, we are literally
22 doing this in real time every thirty seconds. And
23 on those four thousand different scenarios, we
24 then again make sure that the resultant flows are
25 again within the prescribed reliability limits so

1 that no matter what would happen with the grid,
2 the grid would still be at a safe place.

3 To do that, we use something called a least
4 cost security constrained economic dispatch. What
5 that entails is economic dispatch is basically
6 looking at running the cheapest unit that is
7 available based on the bids that we have received
8 through the wholesale market and basically
9 dispatching for the next instant what the most
10 efficient resource we have available.

11 The difficulty is though that the
12 transmission grid cannot always accommodate
13 delivering where that generator is located on the
14 grid to the load that is needed is wishing to
15 consume that energy.

16 And so when those events happen, and they
17 happen fairly consistently on our grid, we're
18 required to do security constrained economic
19 dispatch. So we not only look at the price of the
20 unit but we look at its physical effect. We look
21 at the effect it has on the transmission system,
22 and we then come up with the most cost effective.
23 It may not be the cheapest unit, but it's the
24 cheapest unit respecting all limits on the system.

25 The reason I mention that is, is when I

1 discuss locational marginal pricing which I know
2 has been brought up many times, that market
3 pricing mechanism is very much tied to this
4 dispatch. And straight to straight economic
5 dispatch is what we've dispatched since 1927,
6 including as Mr. Kleppinger mentioned, going back
7 to split savings. And we've always kept that; and
8 again, our market design has continued to keep
9 that on.

10 I'll jump real quickly to the long-term
11 reliability process. We have a regional
12 transmission expansion plan. We've had one since
13 1999; and again, it is planning that has looked at
14 the entire region. We've had some very recent
15 changes to that plan though within the last year
16 that I want to highlight.

17 First, we've moved from a five-year plan to a
18 fifteen-year plan, very much like some of the
19 issues this committee is looking at. And
20 understanding some of the longer term issues that
21 the industry is looking at, we have looked at
22 fifteen years' worth of information going forward
23 in our planning process.

24 We did this for two reasons, one to
25 accommodate potential projects that are going to

1 require longer than fifteen years or longer than
2 five years to actually build and construct,
3 particularly backbone transmission facilities, but
4 as well to put information out there for those
5 other people making investments on the grid, again
6 on a longer term investment, and wish to
7 understand what our view fifteen years from now
8 may potentially look like.

9 We also now under FERC regulations and under
10 their request look at economics for the first
11 time. Prior to that we simply looked at
12 reliability. We are now looking at economic
13 constraints as I discussed because in fact we do
14 see situations where the most efficient resource,
15 the cheapest resource is not being dispatched
16 because the transmission system cannot accommodate
17 it.

18 We are now starting to quantify that cost,
19 look at potential transmission solutions that
20 could alleviate that, and do the cost benefit
21 analysis to see if in fact it may be worthwhile to
22 make investments in the transmission grid on an
23 economic basis as well as reliability basis.

24 Some of the facts since 1999, our board has
25 authorized over 4.2 billion dollars of

1 infrastructure investment in PJM. Over three and
2 a half billion dollars of that have been for
3 reliability needs. The other seven hundred
4 million of that was basically paid for by
5 generation wishing to interconnect to our grid.

6 We are getting ready to approve the 2007
7 plan. And in the 2007 plan, we are looking at
8 approximately three billion dollars additional
9 investment in infrastructure at predominantly two
10 major backbone facilities, one that is in fact
11 originating in Pennsylvania, in the northeast part
12 of Pennsylvania, and going into northeast New
13 Jersey. Those projects will hopefully be approved
14 later this month by our board.

15 As part of that process, we also have a very
16 efficient interconnection process. And again, the
17 process is meant to basically look not only at
18 transmission but look the generation that is
19 requested to site. And therefore we have fairly
20 -- as Mr. Kleppinger said, we do have mounds of
21 rules and procedures to again provide
22 non-discriminatory access to the generation that
23 wishes to interconnect and be studied.

24 And in fact, since 1999, we have studied over
25 a hundred and eighty thousand megawatts of

1 generation requests. Obviously only a fraction of
2 that is actually interconnected. We have had a
3 hundred and fifty-seven projects proceed to
4 actually interconnect onto the grid for a little
5 over nineteen thousand megawatts of new generation
6 capacity since 1999.

7 We have specifically tried to address some of
8 the needs for renewable resources and some of the
9 smaller resources. We have specific
10 interconnection procedures for units that are less
11 than twenty megawatts so that they have
12 standardized interconnection procedures to connect
13 to anywhere in PJM. We also have procedures that
14 fast track, units that are less than two megawatts
15 to again try to facilitate some of their potential
16 unique needs that they have.

17 You've heard some testimony about the type of
18 generation interconnecting, and I think at least
19 in this case there is some better news on that
20 front. It is true over the last couple of years,
21 ninety-five percent of the generation wishing to
22 interconnect to PJM was natural gas.
23 Predominantly, most of it was. That has changed
24 though within the last year or two, in the last
25 couple queues, which are where they make their

1 requests.

2 If you look at the last two queues, right now
3 gas is only about thirty percent of the new
4 requests, wind is twenty-five percent of the
5 requests, coal is twenty-five percent of the
6 requests, and nuclear is fifteen percent with the
7 rest being made up predominately of other types of
8 renewables.

9 And again, we do believe that the
10 interconnection has accommodated a lot of the wind
11 and other renewables. Through 2006, we've
12 actually processed interconnection requests that
13 included nineteen thousand, five hundred megawatts
14 of wind requests, four hundred ten megawatts of
15 methane, four hundred megawatts of biomass, and
16 twelve hundred megawatts of hydro.

17 So again, hopefully that planning process is
18 providing them the information to make their
19 decisions should they choose to invest. It is
20 also giving us insight into where the potential
21 new generation is located so we can plan the
22 transmission accordingly.

23 A little bit about the market design. And
24 again, as I mentioned, the market design is fairly
25 deliberate. I would like to just remind everybody

1 locational marginal pricing has been around for
2 ten years. And I realize it has become an issue
3 in the last year or so. As prices have gone
4 higher, location marginal prices garner more
5 discussion. But the fact of the matter was, it
6 received a lot of debate early in the process in
7 the formation of PJM in 1997.

8 A little history again on why we ultimately
9 chose locational marginal pricing over some of the
10 other auction methods. And again, assuming it's a
11 given that at least on the wholesale level we are
12 moving to competitive markets, there's
13 predominately two choices you can look at as to
14 how you do pricing in the wholesale market.

15 The first was a marginal clearing price such
16 as locational marginal pricing. The second is
17 pay-as-bid pricing mechanism where people
18 basically offer a bid and they are paid that bid.
19 There was a lot of analysis done.

20 I'm not an economist and don't claim to be
21 one. But from what we gathered from that, at the
22 end of the day, they would argue that the results
23 should produce the same result whether you pay as
24 bid or whether you do a marginal clearing price if
25 the information is evenly weighted between the two

1 methods.

2 When we looked at our industry and the
3 uniqueness of our industry, and again, going back
4 to even those that were paid a bid, they would not
5 simply bid cost. Again, they are profits for the
6 companies. They would look to bid what they
7 expect the marginal price to be.

8 With the mechanics of the electric industry
9 and the volatility of our industry, the concern
10 became which market mechanism would allow the most
11 efficient resources to actually run; and that's
12 what we went back to conserve, that at the end of
13 the day we wanted to make sure that whichever
14 method we picked, the most efficient resources
15 were running.

16 Now, how they were contracted for, how they
17 were paid for, whether they were done through spot
18 prices or long prices, how those rates were
19 ultimately passed on to the retail customers was
20 sort of not the point. What we wanted to assure
21 is the most efficient resources are running.
22 Pricing hopefully then would follow in pricing
23 them.

24 The issue to pay as bid is you become very
25 concerned that people would be chasing the

1 marginal price and may bid less than what the
2 marginal price would have been. And in fact,
3 maybe there was some benefit to that then to those
4 that paid for that. But in fact they could also
5 bid more.

6 And the concern was if they bid more and they
7 guessed wrong, we would in fact not run those
8 units and would run less efficient units instead.
9 And because of the nature of the transparency of
10 the information that was available, the volume of
11 the information that was available, we felt that
12 it was much more likely that the right units would
13 run under the clearing price versus that, as well
14 it was very much tied in to, as I talked about,
15 security constrained economic dispatch.

16 Locational marginal pricing is simply an
17 extension of security constrained economic
18 dispatch. It simply prices the units as we
19 dispatch them. The units that are on the side of
20 the constant that we wish to bring, their prices
21 are higher. For those where we have excess
22 generation and we don't want more generation, the
23 prices are lower. And that is the intent of
24 locational pricing.

25 There are other areas of the country that

1 have experimented with other types of options.
2 California and Texas come to mind. And I would
3 suggest that if you looked at their history, they
4 were not successful; and in fact, they have moved
5 to locational pricing.

6 And as previous speakers have testified,
7 right now all organizational markets are pretty
8 much using the form of locational marginal
9 pricing.

10 I also want to touch on --

11 SENATOR WHITE: Was that a FERC requirement
12 to go with that?

13 MR. KORMOS: It was not a FERC requirement,
14 but ultimately it was debated and a subject of
15 hearing at FERC. It was a contentious issue in
16 the FERC proceedings, and ultimately it was
17 approved by FERC.

18 Moving on to capacity margins, I believe you
19 heard a little bit about reliability pricing, the
20 reliability pricing RPM market. Again, the
21 history of PJM is we've always had a capacity
22 market. One of the things, there is mitigation in
23 our market because market power, there are price
24 caps in our market power. And because the energy
25 market itself is not allowed to go and rise to

1 whatever level it would ultimately need, there has
2 always been a feeling that capacity market still
3 needed to exist at PJM.

4 The prior capacity market treated capacity
5 sort of unilaterally again, without regard to
6 where it was physically located and ignored the
7 realities of the fact that, again, much like
8 energy capacity has value based on where it's
9 located.

10 What we actually saw was significant
11 retirements and other investment in areas of our
12 system where we least could afford to lose those
13 units. And in fact, we've had to sign what's
14 called reliability must run contracts to certain
15 units to keep them from retiring. We have also
16 used DOD order to keep the concerned units on line
17 because we could not allow them to retire, even
18 though from a market perspective they would have.

19 Because of that, we elected to go through the
20 reliability pricing market. And again, it was a
21 very contentious issue. I don't want to downplay
22 that. Ultimately, the belief is paying the
23 locational difference and paying generation more
24 to invest in areas where they are more valuable is
25 ultimately the better price signal to be sending

1 for the long term, hopefully to drive that
2 investment and as well to give ourselves an
3 alternative to compare versus making either
4 transmission investments or demand side
5 investments, truly trying to provide the price
6 transparency.

7 To sort of wrap it up, again, I would hope at
8 the end of this you can look at PJM as providing a
9 wealth of information. And we did provide a
10 couple things for you. We did provide a brochure
11 on the regional transmission expansion plan. We
12 also provided the actual transmission expansion
13 plan itself which is the fairly lengthy document
14 that you have. This is the 2006. In this, there
15 is a section entirely on Pennsylvania.

16 I know there was a question in particular
17 about what units are interconnected. Every unit
18 that has gone through our queue in Pennsylvania is
19 listed in there. It is listed as what its current
20 status is, what its capacity is, and what fuel it
21 is primarily driven on that.

22 Also, the transmission upgrades in the state
23 of Pennsylvania are in there. So I would offer
24 that. There are also things like the market
25 monitoring report that's been mentioned as well

1 that we could provide to you that again may
2 hopefully provide some better information.

3 I would also -- again, I know some of you
4 have had an opportunity to visit PJM. And we
5 would welcome anybody. If you're in the Valley
6 Forge area and can stop by, we would love for you
7 to stop to by and give you the tour of the
8 facility as well as discuss anything further on
9 some of the issues that we have.

10 SENATOR WHITE: I thought about suggesting
11 that to the committee because it's not that far
12 from here. I have visited the training unit of
13 PP&L to see how they price and trade their power,
14 and it's amazing. And this, of course, would be
15 much, much larger, much more interesting.

16 Senator Boscola, do you have a question?

17 SENATOR BOSCOLA: Senator Tomlinson did have
18 us at PJM. I can tell you I was impressed. I
19 hold my head up high when we talk PJM and electric
20 reliability. Thank you for all you do.

21 SENATOR WHITE: Senator Musto?

22 SENATOR MUSTO: Thank you.

23 FERC has required PJM to institute an
24 economic planning component in its regional
25 transmission expansion planning process.

1 MR. KORMOS: Yes.

2 SENATOR MUSTO: And you also state -- this is
3 just for the information of the members and
4 myself. You stated, PJM's board has authorized
5 more than 4.2 billion of transmission upgrades and
6 additions. What happens if the board does not
7 authorize the amount requested?

8 MR. KORMOS: The transmission owners
9 themselves always have the option of proceeding
10 and going to the states to get the facilities
11 sited anyway and making the investments. The
12 board approval obviously provides at least an
13 independent assessment as to whether it was a
14 worthwhile investment and does provide them a
15 little bit of the availability of being in a
16 regional plan.

17 There are, particularly on the rate side,
18 some issues that FERC has the ability to recover,
19 potentially giving incentives for that. So there
20 is value in the board approving it, but it's not
21 required.

22 As a matter of fact, the board approving
23 anything in the plan is simply just the first
24 step. Ultimately the transmission owners need to
25 bring it before the states. The states need to

1 see the public need and need ultimately to site
2 the facilities and ultimately at the end of the
3 day then, recover the costs associated with that.

4 SENATOR MUSTO: Is this an extra layer in the
5 process?

6 MR. KORMOS: It may be an extra layer. I
7 don't view it as a bureaucracy layer. Again,
8 hopefully it is looked at as an independent layer
9 with an independent assessment.

10 And again, we do look at our ability to
11 provide you information. We have met with a
12 number of the states; and our message has always
13 been, We really want to understand what
14 information you need from us in order for you to
15 make your decision, whether it's, you know, the
16 policy on the retail side or whether it's
17 ultimately siting infrastructure. That's really
18 what we view our role to be.

19 SENATOR MUSTO: Your decision, the decision
20 of the board, is not binding?

21 MR. KORMOS: No. It's binding on the
22 transmission owners to make a good faith effort to
23 get it sited.

24 SENATOR MUSTO: Thank you.

25 SENATOR WHITE: On the transmission side, the

1 governor's proposing a systems benefit charge
2 which essentially is a tax on people's electric
3 bills across all classes of use. And then he
4 wants to use the proceeds of that to create this
5 huge bond issue that's going to be spent on all
6 kinds of good things and not very specific.

7 I asked Sonny Popowsky, the consumer
8 advocate, to get us a listing of what states had
9 systems benefit charges and how they spent them;
10 and we got it. Now I'd like it in more detail.
11 I'm going to ask, if he can't do it, I'm going to
12 get more detail. Do you have that detail?

13 MR. KORMOS: I would imagine we can get that
14 information for you.

15 SENATOR WHITE: I would like to see it.
16 Almost all of them who have a systems benefit
17 charge use some of it for low income and energy
18 assistance type programs. But after that, then
19 they sort of diverge into alternative energy and a
20 lot of other things.

21 It seems to me, if we're going to have a
22 systems benefit charge that truly benefits the
23 system, then it should be focused on improving
24 transmission infrastructure and perhaps generating
25 infrastructure. And to me, that's a worthwhile

1 investment; and I think I would be willing to ask
2 and I would be willing to pay as a consumer a
3 small additional fee to assure that the capacity
4 is going to be there and the transmission capacity
5 is there.

6 I had asked at an appropriations hearing,
7 asked one of the PUC commissioners if congestion
8 on the grid was a significant price inhibitor or
9 price raiser; and I got the answer yes. Would you
10 agree with that statement?

11 MR. KORMOS: Yes, I would.

12 SENATOR WHITE: So if we could reduce
13 congestion on the grid with the systems benefit
14 charge, the customer would ultimately possibly see
15 a reduction in price. Would you agree with that
16 statement?

17 MR. KORMOS: And I think by reducing the
18 congestion on transmission, you do afford access
19 to cheaper resources; and that is what the
20 congestion is showing.

21 And again, I would offer, we are trying to
22 get that information out there to make those
23 decisions, for that information to make those
24 decisions, whether it's through infrastructure
25 investments that we do through the normal

1 transmission rate design or the systems benefit
2 charge. We would welcome trying to get you the
3 information you need to make your decision where
4 to best spend the money.

5 SENATOR WHITE: I would be very interested in
6 seeing that information because I think that's
7 perhaps a worthwhile area to look at. We may get
8 a lot more bang for our buck there than we will
9 get out of some of the -- while I'm not ruling out
10 demand side issues, I think they're a good thing
11 to do; but I think we don't want to overstate the
12 savings there and oversell it.

13 Unless there's a really good price trigger
14 mechanism there, I don't see families
15 significantly changing their family behavior, you
16 know, doing their laundry at two a.m. or something
17 if they're going to save fifty cents a month. I
18 mean, that's just not going to happen. People
19 have routines. Family have routines. And while
20 you can persuade them that it's a good thing to do
21 certain things, to try to conserve or recycle or
22 whatever, there is a breaking point there where
23 behavior is not going to change significantly
24 enough to have an impact on the overall cost of
25 electricity in the Commonwealth.

1 I would be very interested in seeing whatever
2 you have on systems benefit charges as well as
3 anything you could give us as to what the impact
4 would be.

5 One other small question. I also suggested
6 at one point that perhaps we could use this to
7 guarantee loans or something like that for
8 generating capacity. And the industrial
9 representative, as I recall, said, Well, if you're
10 going to give state money and grants to these
11 firms to set up new generating capacity here, we
12 want to be sure that generating capacity stays in
13 Pennsylvania. Can you do that?

14 MR. KORMOS: No, I don't think PJM can do
15 that. I mean, obviously contractually, if it's a
16 covenant of the loan that they're receiving that
17 they need to enter into a long-term agreement with
18 somebody in the Commonwealth, I think that would
19 be in your jurisdiction. I think once it reaches
20 the wholesale market and if it's allowed to reach
21 the wholesale market, no, at that point it can
22 cross state lines.

23 SENATOR WHITE: I don't see us setting up new
24 generating capacity to be a captive supplier to a
25 particular industry. That's beyond the pale. So

1 it seems to me once it's on the grid, it's --

2 MR. KORMOS: It's on the grid.

3 SENATOR WHITE: Any other questions? Thank
4 you very much.

5 MR. KORMOS: Thank you.

6 SENATOR WHITE: Thanks, everyone, for your
7 attention and attendance. This is the second in a
8 series of hearings. We may hold more. Obviously
9 this is a very complicated issue, and we have
10 several pieces of legislation to review and
11 several good ideas that have come out of these
12 hearings. So thank you very much for attending.

13 (The proceeding concluded at 12:40 p.m.)

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1 I hereby certify that the proceedings and
2 evidence are contained fully and accurately in the
3 notes taken by me on the within proceedings, and
4 that this copy is a correct transcript of the
5 same.

6 Dated at Wormleysburg, Pennsylvania, this
7 20th day of June 2007.

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Patricia M. Brown
Reporter - Notary Public

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