

**TESTIMONY OF COMMISSIONER WAYNE E. GARDNER
ON BEHALF OF THE PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Before the Senate Consumer Protection and Professional Licensure Committee
April 12, 2010**

**Wayne E. Gardner, Commissioner
Public Utility Commission
Commonwealth of Pennsylvania
3rd Floor, Commonwealth Keystone Building
Harrisburg, PA 17105
(717) 787-1031**

Chairman Tomlinson, Chairman Boscola, and members of the Committee, I appreciate the opportunity to testify today on issues involving electric markets. The Commission has been working to provide customers with the tools they need as rate caps expire through programs that allow them to pre-pay as well as enhanced energy efficiency and conservation programs. But as we near the completion of the transition period where all Pennsylvania residents and employers will be paying market rates for their electric generation service, it is important we continue to be diligent. Also, allow me to add that my testimony today reflects my views and does not represent an official position of the Commission.

Department of General Services PJM Membership-

The Commonwealth of Pennsylvania's governmental facilities consume over 1 million MWh of electricity annually. The cost of supplying DGS' rate class will increase, generally, approximately 6% to 70% as rate caps expire depending on the facility's location within the state, and depending on the type of special economic development rate large commercial and institutional customers had prior to restructuring.¹ Given these circumstances, DGS' proposal to become a load serving entity (LSE) within PJM is reasonable. If any other large institutional consumer with this load size came to me for advice, I would recommend that they consider becoming a LSE or contract with a LSE to access the wholesale generation market directly and avoid the costs of a reseller.

I understand that DGS wishes to be granted various exemptions from the PJM Operating Agreement based on the Commonwealth's unique status as it relates to the doctrine of sovereign immunity, financial indemnification, and Commonwealth contract dispute resolution procedures. I do not know whether PJM's members committee will permit such exemptions. However, should PJM acquiesce to the exemptions and approve the LSE application, based on my office's communication with DGS, it plans to use a third party agent with the requisite market expertise to manage the intricacies of wholesale energy procurement in the PJM market. This includes procurement of long term, day ahead, spot, and numerous ancillary products as well as hedging and credit assessments of trading partners.

My advice to DGS would be to test the waters before jumping into a very volatile generation market. Rather than pledge the Commonwealth's credit to support this project, first contract with a LSE sufficiently large enough to have its own credit facilities and assess how much can be saved by such an arrangement.

¹ For example, prior to the expiration of rate caps, most customers were subject to a "declining block, demand based" rate structure. This meant that a high load factor customer would benefit from a lower overall rate, while a low load factor customer would pay a higher effective rate. In the post-rate cap world, if these customers stay on default service, they will be subject to a flat per kWh charge. So any realized rate increase could be driven by changes in rate design in addition to changes in actual generation costs.

State Power Authority, House Bill 1909-

Section 2804.1-D of the bill proposes to, “Conduct competitive procurement processes to procure the supply resources” and “Acquire or develop electric generation and cogeneration facilities in this Commonwealth, particularly facilities that use indigenous resources” to supply electricity to electric distribution companies for, “Default service customers” and “Eligible commercial and industrial customers.” This is a commendable goal, and I believe that the impetus behind it is to provide the lowest cost electric generation possible to the Commonwealth’s citizens and to encourage economic development within the state.

However, I believe that the costs of constructing generation facilities would be prohibitive. For example, over the latter half of this decade, the costs of constructing a coal plant in this region have risen dramatically. If the proposed Energy Authority had received approval to build using 2006 cost estimates and brought the plant in service a mere 2 years later, it, and the Commonwealth’s taxpayers, would have been responsible for cost overruns that could have amounted to up to 100%.

Table 3-21 New entrant 20-year levelized fixed costs (By plant type (Dollars per installed MW-year))

	2005 20-Year Levelized Fixed Cost	2006 20-Year Levelized Fixed Cost	2007 20-Year Levelized Fixed Cost	2008 20-Year Levelized Fixed Cost	2009 20-Year Levelized Fixed Cost
CT	\$72,207	\$80,315	\$90,656	\$123,640	\$128,705
CC	\$93,549	\$99,230	\$143,600	\$171,361	\$173,174
CP	\$208,247	\$267,792	\$359,750	\$492,780	\$446,550

37 The MMU began evaluating fixed costs for all three technologies in 2005. In the following tables and figures, the 20-year levelized fixed costs from 2005 are used as a proxy for the preceding years.

38 Annual fixed costs may vary by location. The fixed costs presented here are associated with a location in the EMAAC LDA and are meant to serve as a baseline for comparison.

39 This analysis was performed for the MMU by Pasteris Energy, Inc. The annual costs were based on a 20-year project life, 50/50 debt-to-equity financing with a target internal rate of return (IRR) of 12 percent and a debt rate of 7 percent. For depreciation, the analysis assumed a 15-year modified accelerated cost-recovery schedule (MACRS) for the CT plant and 20-year MACRS for the CC and CP plants. A general annual rate of cost inflation of 2.5 percent was utilized in all calculations.

40 Installed capacity at an average Philadelphia ambient air temperature of 54 degrees F. during the study period of 1999 to 2009.

41 The figures in Table 3-21 represent the annual cost per MW per year if total costs were levelized over the 20-year life cycle of the plant. These fixed costs of construction are specific to the PJM Mid-Atlantic Region.

(Page 159, Monitoring Analytics 2009 State of the Market Report).

I am not convinced that it is in the public interest to place these potentially massive acquisition and or construction costs risks on Pennsylvania’s taxpayers. These types of costs and risks are best left to the competitive markets.

City of Philadelphia Energy Authority-

The City of Philadelphia's proposed Ordinance to form an energy authority under the Municipality Authority Act with the purpose of acting as a competitive electric generation supplier, as currently drafted, is not sufficiently specific for me to provide targeted comment. The Ordinance indicates that the City Authority would act as "an electric generation supplier, electricity supplier, broker, arranger, aggregator, or marketer of electricity or related services for sale to end-use customers." Currently the Municipal Authorities Act, 56 Pa. C. S. §§ 5601, *et seq.* provides for generation by steam facilities, but only authorizes municipal electric generation facilities if they are co-generating in relation to an incinerator, dam, water supply work, water distribution system, or sewage treatment plant. Electric power generated from such facilities is sold or distributed only on a sale-for-resale basis to one or more entities authorized to sell electric power to the public.

If the City of Philadelphia's goal in implementing this Ordinance is to manage the electricity bills of **City** facilities, co-generation and the Ordinance, as drafted, is one solution. Another solution would be to contract with a reputable and proven competitive supplier which has the technical expertise needed to procure wholesale energy supply and tailor that procurement to the needs of its customers, even a customer as unique as a municipal government.

If the City of Philadelphia's goal in implementing this Ordinance is to serve as a generation supplier to its residents, I would caution that trading in today's wholesale electric market requires technical expertise, financial skill, and enough liquidity to stay solvent when timing the market is not successful. I believe that the risks that wholesale electric market participants face are better left to the competitive electricity market. If this is the City's goal, working with a supplier experienced in competitive procurement and/or aggregation is key, otherwise all risks will fall on the City's taxpayers.

There are approximately 32 boroughs within the Commonwealth, such as Middletown Borough, that either produce or purchase bulk power supply for resale to their residents, so it has been proven, on a much smaller scale, that a municipal entity can successfully manage its residents' power needs.

As noted above in my comments regarding DGS, my advice to the City of Philadelphia would also be to test the waters before jumping into a very volatile generation market. Rather than pledge the City's credit to support this project, first contract with a LSE sufficiently large enough to have its own credit facilities and assess how much can be saved by such an arrangement.

Again, thank you for the opportunity to provide my thoughts on these very important topics. Through continued dialogue, we will continue to move forward in creating a competitive marketplace for electricity that produces the lowest price for consumers while providing options for different energy products as well as incentives to conserve energy.