

**BEFORE THE PENNSYLVANIA
HOUSE DEMOCRATIC POLICY COMMITTEE**

Public Hearing regarding:

“Update on Electric Competition and Consumer Choice”

Testimony of

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Good morning Chairman Sturla, Chairman Daley, and members of the House Democratic Policy Committee. Thank you for the invitation to testify today. I am Terry Fitzpatrick, President and CEO of the Energy Association of Pennsylvania (EAP), a trade association formed by the electric and natural gas utilities operating in Pennsylvania. This morning I am commenting on behalf of EAP's electric utility members, which are also referred to as "electric distribution companies" (EDCs) under the Electricity Generation Customer Choice and Competition Act (Competition Act).¹

I commend you for holding this hearing. The Public Utility Commission (PUC) completed its investigation of the electric retail market last year. It concluded that the retail market was not as vibrant as it should be, and it developed new policies and made recommendations to the General Assembly regarding statutory changes. In addition, Senate Bill 1121 has now been introduced, which would make fundamental changes to the electric retail market, including significant modifications to the default supply service model. The issues raised by these proposals are important to the public interest, and it is appropriate for this Committee to examine them.

At the outset, it may be relevant to point out that I have had significant experience with competition in the utility industries, including electric competition. I began my career in the law bureau of the PUC, and in the 1980s worked on assignments to bring greater competition to the trucking, telephone, and natural gas industries. In 1996, as a lawyer on the staff in the Senate, I was part of the group that drafted the Competition Act. Shortly after that, I went into private law practice and represented electric utilities in the restructuring proceedings under the Act. From 1999

¹ 66 Pa.C.S. Section 2801 *et seq.*

to 2007, I served as a Commissioner at the PUC and participated in decisions implementing the Act.

The Competition Act of 1996

Prior to passage of the Competition Act in 1996, electric utilities in Pennsylvania were vertically integrated monopolies that provided all aspects of electric service. The chief purpose of the Competition Act was to allow customers to choose their supplier of electricity. In order to do that, the charges of electric utilities had to be “unbundled” into transmission, distribution, and generation charges. Along with this, the structure of the electric industry was changed, so that today it consists of three major players:

- **Electric generators** – they own power plants and compete to sell power in the wholesale market which is regulated by the Federal Energy Regulatory Commission (FERC). Many of these plants were owned by electric utilities prior to implementation of the Competition Act.
- **Electric generation suppliers (EGSs)** – they are licensed by the PUC to sell power in the electric retail market. While they are not “public utilities,” they are subject to some oversight by the PUC. However, their prices are market-based and not set by the Commission.
- **Electric distribution companies (EDCs)** (aka, electric utilities) – they own the electric distribution infrastructure (poles, wires, substations, etc.) and deliver power, interact with customers, and serve as the “default supplier” to customers who do not choose to purchase supplies from an EGS. They are subject to PUC regulation of their rates and service, including their default supply service. EDCs

may also own and operate electric transmission facilities, which are subject to FERC regulation.

This industry structure in Pennsylvania is similar, but not necessarily identical, to that of other states that have restructured their electric industries to allow competition and customer choice. Roughly half the states restructured their electric industries to allow customer choice in the mid to late 1990s, and the other half continue to have electric utilities that operate as vertically-integrated monopolies.

The evolution of default service under the Competition Act and Act 129 of 2008

In order to understand current public policy regarding default service in Pennsylvania, it is helpful to review the evolution of this policy since the passage of the Competition Act. As originally enacted, the Competition Act provided that if a customer does not choose an EGS, then the EDC or commission-approved alternative supplier “shall acquire electric energy at prevailing market prices to serve that customer.”² The Act also provided that the Commission shall adopt regulations at the end of the transition period (the multi-year period during which EDCs were recovering stranded generation costs and during which EDC generation rates were capped) to define the EDC’s obligation to acquire electricity for non-shopping customers.³ The Commission adopted regulations and a policy statement governing default service in 2007.⁴ In these two documents the Commission established a flexible approach for EDCs to procure energy for default service under the statutory “prevailing market price” standard. The

² 66 Pa.C.S. Section 2807 (e) (3) (repealed).

³ 66 Pa.C.S. Section 2807 (e) (2) (repealed).

⁴ *Final Rulemaking Order In Re: Electric Distribution Companies’ Obligation to Serve Retail Customers at the Conclusion of the Transition Period*, Dkt. No. L-00040169; *Final Policy Statement Order Re: Default Service and Retail Electric Markets*, Dkt. No. M-00072009 (both orders entered May 10, 2007).

Commission recognized that procurement strategies might change over time, and that procurement at the time the rate caps expired could focus more on price stability, while strategies for procurement in the future might be tied more closely to changes in wholesale power prices.

However, in Act 129 of 2008, the General Assembly amended the default service provisions of the Competition Act in a manner that limited the PUC's ability to make future changes to default service procurement in order to stimulate a more competitive retail market. At the time Act 129 was passed, it appeared that the upcoming expiration of rate caps in 2010-2011 could result in increases in customers' electric bills of fifty percent or more. Increases of this magnitude had occurred and caused economic and political upheaval in Maryland, Delaware, and in the service territory of Pike County Light & Power Co. in Pennsylvania following the devastation of energy infrastructure caused by Hurricanes Katrina and Rita in 2005. However, for the most part, these large increases did not come to pass in 2010-2011 due to a significant drop in wholesale electricity prices that was caused by the 2008 recession and by the development of natural gas resources from the Marcellus Shale.

Procedurally, Act 129 required filing and advance Commission approval of default service plans, and required the Commission to make specific findings in granting such approval.⁵ Substantively, Act 129 repealed the "prevailing market price" standard and required default service providers to purchase a "prudent mix" of spot market purchases, short-term contracts, and long-term contracts (i.e. four to twenty years) to achieve the goals of "adequate and reliable service" and "least cost to customers over

⁵ 66 Pa.C.S. Section 2807 (e) (3.6), (3.7).

time.”⁶ These amendments reflected concerns about the potential for higher electricity bills when rate caps expired, and made clear that the General Assembly envisioned a regulated model for default service intended to provide a reasonably competitive, stable price to customers who for whatever reason did not purchase their supplies from an EGS.

Finally, I will note here that although this result is not compelled by Act 129, under the model being followed today, electric utilities do not earn a profit on default service. In addition, Pennsylvania’s electric utilities have cooperated fully in the PUC’s implementation of the Competition Act and in the effort to inform customers of their right to choose an electricity supplier.

Evaluating the current electric retail market in Pennsylvania

With this background in mind, I will turn to the policy questions the General Assembly is facing today. How well has Pennsylvania’s electric competition program worked to date, and should the current model under which EDCs / electric utilities provide default service be changed in order to stimulate a more active retail market?

By most measures Pennsylvania’s electric retail market has worked well. There are a number of criteria to consider here:

- First, examining the most recent data from the Energy Information Administration,⁷ the average price for electricity in Pennsylvania at the end of 2013 was roughly the same as (less than one percent above) the national average. When the Competition Act was passed in 1996, the average electricity price in Pennsylvania was fifteen percent above the national

⁶ 66 Pa.C.S. Section 2807 (e) (3.2).

⁷ See EIA Electric Power Monthly, Feb. 2013 ed., available at www.eia.gov.

average. While this lowering of electricity prices in Pennsylvania relative to the national average may not be solely the result of allowing choice, it is one factor that suggests the program has been successful.

- Second, the level of activity in the retail market has increased substantially since rate caps expired in most of Pennsylvania in 2010 - 2011. According to shopping statistics published on the website of the Office of Consumer Advocate, five years ago there were 167,000 customers purchasing supplies from EGSs. Today, the PUC's "Powerswitch" website indicates that the number of customers who have switched to an EGS has grown to 2,205,000 – thirteen times the number of switching customers five years ago. Roughly two-thirds of the total electric load in Pennsylvania is now purchased from EGSs. For residential customers, the group slowest to adapt to shopping, 30-44% are now purchasing from EGSs in the service areas of the seven largest electric utilities. However, while recognizing this success, it is important to also note that in the service territories of some smaller electric utilities,⁸ EGSs are not making offers to residential customers, so default service is the customers' only option.
- Finally, in an assessment sponsored by EGSs of the competitiveness of electric choice programs in the states and provinces of the U.S. and Canada, Pennsylvania's program was ranked third best for the residential sector and fourth best for the commercial and industrial sector.⁹ Both programs were

⁸ UGI Electric, Citizens Electric, and Wellsboro Electric.

⁹ *Annual Baseline Assessment of Choice in Canada and the United States*, (pp. 11, 16), available at <http://www.competecoalition.com/files/ABACCUS-2012.pdf>.

described as “Good.” Pennsylvania also ranked first in the number of retail suppliers (EGSs) making offers to residential customers, and third in the number of products available to residential customers.

All of these factors point to the conclusion that Pennsylvania’s retail electric market has been reasonably successful. This does not necessarily mean that further policy changes to encourage development of the market should not be adopted, only that such changes should be considered in a careful and deliberative process.

Senate Bill 1121 and whether to change default service policy

Should the current default service model be changed to encourage greater levels of participation in the retail market, either by changing the way that electric utilities procure power for default service in the wholesale market, or by removing utilities from the default supplier role, as in Senate Bill 1121?

The tenor of my remarks here will be consistent with EAP’s comments to the PUC in the electric retail market investigation. Electric utilities do not earn a return for providing default service, accordingly, neither keeping customers on that service nor continuing to provide the service are essential to their business interests. Moreover, we do not believe there is necessarily a “right” or “wrong” answer to the issue of whether additional policies to promote greater levels of participation in the market should be adopted. Addressing the issue involves a legislative judgment about the proper purpose of default service: should it be designed as a reasonably attractive, viable option for customers who do not choose to purchase from EGSs in the market, or should it be a temporary, stop-gap service with the expectation that customers will participate in the retail market by purchasing from EGSs?

If the General Assembly wants to move toward a new default service model, this may be a good time to make such a change. The development of the Marcellus Shale has contributed to relatively low, stable wholesale electricity prices that could not be foreseen or imagined five years ago. In such an environment, it is easier to transition customers to a new model. It is also true that customers will likely have competitive options to provide price stability, by choosing to sign contracts with EGSs that lock in prices for a year or more, even though wholesale market conditions may change in the future. Relying on the marketplace to provide this stability requires customers to take responsibility for comparing and choosing among EGS service offerings. This highlights the importance of educating customers if significant policy changes are made to eliminate or significantly change the nature of default service.

With respect to Senate Bill 1121, the legislation would end EDC-provided default service effective June 2015 and replace it with EGS-provided “next generation default service,” a product that is designed to reflect current wholesale market prices and that customers may remain on for a maximum of two months. Customers remaining on EDC-provided default service in June 2015 would be assigned to an EGS pursuant to a PUC-administered competitive assignment process. EGSs who wish to participate in the process to serve customers must submit bids and agree to pay \$100 per customer to the Commonwealth’s General Fund, \$50 to each customer enrolled, and \$2 to the PUC to provide funding for a customer education program. In addition, claims may be filed with the Commission by wholesale suppliers and other entities seeking reimbursement for “transition costs” caused by the shift from EDC-provided default service to next generation default service in June 2015.

Consistent with my comments above, EAP is neutral on the major policy issues raised by this bill regarding ending EDC-provided default service, assigning remaining default service customers to EGSs, or requiring EGSs to make payments to the General Fund to participate in the assignment process. Senate Bill 1121 is a complex piece of legislation, and if the bill moves forward, it is likely that EAP and its members will seek modifications to other aspects of the bill. EAP is currently working with its EDC members to identify the full scope of changes we believe may be necessary to the legislation.

Thank you for the opportunity to testify, and I would be happy to answer questions.