

Prepared Comments of
Robert F. Powelson
Chairman
Pennsylvania Public Utility Commission

before the

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Consumer Affairs Committee

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Pennsylvania Public Utility Commission
400 North Street
Harrisburg, Pennsylvania 17120
Telephone (717) 787-4301
<http://www.puc.state.pa.us>

Introduction

Chairman Godshall, Chairman Preston, and members of the Committee, I appreciate the opportunity to speak with you today to discuss the status of competitive electricity markets in Pennsylvania. This is a topic that I am passionate about and I look forward to updating you on the steps the Public Utility Commission (PUC) has taken to ensure the success of electric competition in the Commonwealth.

History of Electric Restructuring

First, I would like to provide a short history of the evolution of electric restructuring in Pennsylvania. In 1996, the Legislature passed the Electric Generation Customer Choice and Competition Act (Competition Act), making Pennsylvania one of the first states in the nation to open the generation portion of its electricity service to competition. This legislation represented a policy decision that competition, rather than regulation, more effectively controls the cost of generating electricity.¹ During this time, Pennsylvania's electric rates were 15 percent higher than the national average. Electric restructuring was designed to remedy this by lowering prices, improving service, and providing a greater array of product offerings for customers.

Prior to the Competition Act, Pennsylvania's electric marketplace was dominated by vertically-integrated utilities. During this time, the Pennsylvania utilities owned and operated all aspects of the electricity supply chain, from power generation, to

¹ See 66 Pa. C.S. § 2802(5).

transmission across the electric grid, to distribution to consumers' homes. In this monopoly environment, all costs incurred by the utilities that were deemed "reasonable" by the PUC were automatically passed along to ratepayers, with no incentives to reduce costs or improve efficiency. As long as the lights stayed on and the rates did not increase too quickly or significantly, construction overruns and the cost of other uneconomic decisions could be passed along to ratepayers. Since regulated utilities earned higher returns if their rate base grew, the incentive was to "gold-plate" the system. None of this was good for consumers.

The introduction of competition into the Pennsylvania's electric industry was designed to stop these unnecessarily high rates. In a restructured market, private suppliers compete to provide customers with the generation portion of their electricity service, while the regulated utility continues to distribute the electricity to customers' homes. This market structure is beneficial for customers because, in a competitive market, shareholders (and not ratepayers) are responsible for any poor business decisions made by the supplier. By requiring generators to compete for business, restructured markets encourage greater efficiency, increased innovation, and smarter investments, all of which keep costs down.

To implement electric restructuring, the Competition Act required utilities to unbundle their rates into separate generation, transmission and distribution charges. The Competition Act also mandated that utilities provide open access over their transmission and distribution systems to allow competitive suppliers to generate and sell electricity

directly to consumers. With the passage of the Competition Act, the generation of electricity is no longer regulated by the PUC. However, the Competition Act does require electric generation suppliers to obtain a license before doing business in Pennsylvania. In addition, while the PUC does not regulate the price of electric generation service, it does act as a “watchdog” with respect to the marketing and sales practices of competitive suppliers.² The PUC still continues to regulate the transmission and distribution of electricity within the Commonwealth.

The transition to a competitive market took place over several years. There was a concern that too quick a transition would harm utilities by preventing them from recovering their long-term investments made during the regulated environment. The Competition Act thus allowed utilities to recover the “stranded costs” they were expected to incur upon the shift to a competitive market. The Competition Act also capped generation rates for a period to protect consumers in case competition was slow to develop and prices failed to drop. The rate caps were originally set to expire no later than 2005, but were later extended until the end of 2009 or 2010. The last of the generation rate caps expired on December 31, 2010.

With the restructuring of the electric industry, if a customer does not choose an alternative generation supplier, a “default service provider” must supply electric generation service to that customer. In the current market, the default service provider is the local utility. Default suppliers must acquire the generation to supply this service in

² There is currently an ongoing proceeding wherein the PUC is establishing regulations for marketing and sales practices of competitive suppliers in Docket No. L-2010-2208332.

accordance with a Commission-approved plan. Pursuant to the law, default service must also be acquired in a way that results in “the least cost to consumers over time.”

Today’s Competitive Marketplace

Though the transition has been gradual, we are clearly witnessing the benefits of electric competition in Pennsylvania. In 1996, Pennsylvania’s electricity prices were 15 percent higher than the national average, while today rates are hovering right around the national average. In 2009 and 2010, the years when the rate caps expired, Pennsylvania’s electric rates were 1 and 3 percent higher than the national average, respectively.³ This is an impressive reduction considering Pennsylvania only fully transitioned to a competitive market on December 31, 2010, when the last of the rate caps expired. It is also worth mentioning that in 2010, Pennsylvania’s electricity rates were lower than the rates of all the other Northeastern states, including Maryland, Delaware, New York, New Jersey, Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont.⁴

However, prices are only one measure of a successful competitive electricity market. The number of options available to consumers is an equally important determinant. Over the past few years, alternative electric generation suppliers in Pennsylvania have developed a variety of new and innovative products that benefit consumers. Competitive suppliers are offering short and long term contracts, fixed and

³ U.S. Energy Information Administration, *Average Retail Price of Electricity to Ultimate Customers: Total by End-Use Sector* (www.eia.gov/cneaf/electricity/epm/table5_3.html); *Table 8: Retail Sales, Revenue, and Average Retail Price by Sector, 1990 Through 2009* (www.eia.gov/cneaf/electricity/st_profiles/pennsylvania.html).

⁴ U.S. Energy Information Administration, *Average Retail Price of Electricity to Ultimate Customer by End-Use Sector, by State* (www.eia.gov/cneaf/electricity/epm/table5_6_b.html).

variable-rate offerings, as well as renewable energy options. One supplier even offers airline miles and hotel points for signing up for service.

Since the advent of electric competition, Pennsylvania has also seen the efficiency and reliability of its generation resources increase. Moreover, the Commonwealth has attracted over 8,500 megawatts of new generation and added over \$12 billion in capital investment as a result of electric competition.

Another indicator of the health of a competitive market is the number of customers shopping for an alternative generation supplier, as well as the number of suppliers making offers in the state. As of July 27, 2011, more than 1,261,897 customers have switched to an alternative supplier in Pennsylvania. In the PPL Electric Utilities territory (PPL) (the area that has seen the most shopping activity), 40 percent of customers, representing 68 percent of load, have chosen an alternative electric generation supplier. In addition, as of July 2011, there are over 50 suppliers making competitive offers in the state. In the PECO service territory alone, customers can choose from among 30 alternative generation suppliers.

By all reasonable benchmarks, Pennsylvania has made a successful transition to a competitive electricity market. Without a doubt, electric customers are benefiting from this transition. Moreover, across the nation, Pennsylvania has come to be viewed as an example of the positive effects of electric restructuring. Despite these successes, Pennsylvania should not be content with the *status quo*. The PUC is constantly working

to ensure the success of electric competition in the Commonwealth, and through these efforts, the PUC has witnessed firsthand that there is room for improvement.

Room for Improvement in the Competitive Market

Based on shopping statistics alone, consumers are not moving into the retail marketplace at a rate that one would expect in a well functioning market. Pennsylvania seems to have stabilized at approximately a 20 percent shopping rate. With the exception of Pike County Light and Power (which is a unique case), there is no service territory in the Commonwealth where even close to a majority of customers are being served by something other than the default service model offered by the electric distribution company.

While 40 percent of residential customers are shopping for an alternative generation supplier in the PPL territory, only 20 percent of customers are shopping in the PECO and Penn Power territories, 9 percent are shopping in the West Penn Power and Penelec territories, and only 4 percent are shopping in the MetEd territory. Indeed, the competitive market in these territories has not had as much time to develop as it has in the PPL region due to the timing of the expiration of the rate caps. However, the low shopping numbers in certain areas of the state are still a cause for concern.

In addition, while electric rates have decreased since 1996, Pennsylvania should not take for granted that these rates will continue to decline without increased efforts to foster the competitive marketplace. While electric competition has been a clear impetus

for rate reduction, the recent drop in electricity prices is not exclusively due to electric restructuring. In recent years, the economic downturn has reduced energy demand and thus energy prices. In addition, the price of natural gas, which is used to fuel many power plants, has dropped dramatically in recent years. While the reduced price of natural gas may be a longer term scenario with the discovery of the Marcellus Shale, should other economic factors change, electric rates may go up unless we take preventative measures to encourage greater electric competition in the Commonwealth.

Also, while the variety of product offerings has improved since restructuring, there are not as many innovative offerings in Pennsylvania as there are in other competitive markets. For example, in Texas, suppliers are not only offering consumers renewable options, but also prepaid energy plans and access to real-time energy consumption information. The PUC wants Pennsylvania to have an equally diverse portfolio of product offerings for its electric customers.

In working to encourage competition in Pennsylvania, the PUC has also witnessed some unintended consequences of electric restructuring that should be remedied. For example, customers have complained about the timeframe for switching between competitive suppliers or from a default supplier to a competitive supplier. Currently, switching suppliers takes between 16 and 45 days. This is problematic because customers often switch to get a particular rate to coincide with either heating or cooling seasons. Delay in switching causes customers not to receive all the benefits that drove their decision to switch suppliers. Plus, the longer it takes to change suppliers, the less

convenient the process is for customers, making it less likely customers will shop.

Unfortunately, this is a complicated issue that is not easily remedied because it involves not only PUC regulations, but also electric distribution company billing procedures and supplier enrollment policies designed to guard against the unauthorized transfer of customer accounts.

The PUC has also encountered problems with default service providers reconciling any over- or under-collection of rates due to customer switching. For example, at the end of last year, PPL experienced a substantial under-collection of the generation and transmission service charge portions of their bills for about 100 large commercial and industrial customers. Due to the significant migration of customers on these rate schedules to competitive suppliers, this under-collection was recouped from the very small group of customers remaining on default service, making the amount per customer extremely high. While this issue first arose in the PPL service territory, the PUC anticipates that similar problems will arise in other utility territories as the competitive market develops.

Another issue the PUC discovered is that, because of how default service providers procure their generation, it is almost impossible for them to provide accurate time-of-use rates for customers. With the future of the electric industry moving towards energy efficiency and smart grid technology, it is essential for customers to receive “smart rates” to back up the smart meter. However, default service providers are simply not equipped to provide these rates. Alternative suppliers, on the other hand, have the

flexibility to provide accurate price signals to customers. This is the perfect example of how the innovation and creativity of the competitive market will allow alternative generation suppliers to serve customers better than a default service provider.

Issues like these are hindering Pennsylvania from achieving its potential of a robust and fully competitive retail electricity market. While Pennsylvania's electric customers are currently experiencing a myriad of benefits from electric restructuring, these benefits will continue only as long as competition continues to thrive in Pennsylvania. The PUC must, therefore, remain steadfast in its commitment to increased competition, greater innovation, and lower prices in the electric market.

Retail Markets Investigation

It is with this goal in mind – increasing competition – that the PUC initiated a state-wide investigation into Pennsylvania's retail electricity markets on April 28, 2011. The purpose of this investigation is to make improvements to ensure that a properly functioning and workable competitive retail electricity market exists in the state. The investigation will determine the elements of the current retail electricity markets that are working and the elements that are not working, including whether there are other models for providing default service that might provide customers with more options for their electric generation.

The investigation is divided into two phases. Phase I of the investigation, which recently ended with an order issued by the PUC on July 28, 2011, assessed the status of

the current retail market and explored changes that should be made to allow customers to fully realize the benefits of competition. Phase II, which has just begun, will examine how to resolve the issues raised in Phase I and determine how to implement any necessary changes.

As part of Phase I, the PUC held an *en banc* hearing on June 8, 2011. At the hearing, the PUC offered interested parties the opportunity to discuss the topics raised in the investigation. Participants included electric distribution companies, electric generation suppliers, regulators, consumer advocates, and academics. Thirty-nine parties also filed written comments.

The PUC's review of the comments and testimony revealed that while some participants are relatively comfortable with the existing state of Pennsylvania's retail electric markets, there is a substantial countervailing opinion that the *status quo* contains both structural and operational impediments to a fully functioning, robust competitive marketplace. The overwhelming weight of the comments and testimony affirmed that the PUC must examine changes to Pennsylvania's retail electric market in order to improve the competitive landscape. Thus, in the order on Phase I of the investigation, the PUC concluded that Pennsylvania's current retail market requires changes to bring about the robust competitive market envisioned by the Legislature when it passed the Competition Act in 1996. The order also set forth the process for Phase II of the investigation, as well as the issues to be examined during that phase.

Phase II of the investigation will be conducted by the PUC's Office of Competitive Markets Oversight (OCMO). During this phase, OCMO will work with interested parties to produce reports for the PUC which will recommend changes to the existing retail model. OCMO's investigation will examine issues that fall in three broad categories.

The first category of issues involves changes that can be implemented by the PUC relatively quickly. These include, among other things, encouraging more uniformity among distribution utility practices, speeding up the supplier switching process, examining the quarterly Price-to-Compare (PTC) to determine if it discourages shopping, and placing the PTC and other shopping information on electric bills.

The second category includes examining the structure of the current default service model and determining what changes (if any) should be made to minimize its impact on the competitive retail market. The concern with the default service model is that customers are hesitant to leave their electric utility (who provides this service) because of the longstanding relationship they have with the company. It is often difficult for competitive suppliers to overcome this "status quo bias" and successfully break into the market. One of the commenters at the *en banc* hearing best summarized the problem: "[D]efault service is the provider of first resort, not the provider of last resort."⁵

⁵ *Investigation of Pennsylvania's Retail Electricity Market*, Docket No. I-2011-2237959, *En Banc* Hearing Testimony of James Steffes at 3 (June 8, 2011).

To address this issue, OCMO will examine the basic definition of default service, whether default service should remain a duty of the electric distribution company, the pricing and billing of current default service, the current default service procurement schedules, the prohibition on marketing default service, the practice of automatically assigning new customers to default service, and the possibility of an annual auction of customers on an opt-in basis, among other things.⁶

The third category of issues to be addressed by OCMO involves developing an aggressive consumer education project. This project is designed to inform consumers about Pennsylvania's retail electricity market and how to take advantage of competitive services. To this end, OCMO will explore the potential for a coordinated state-wide education campaign, which would include the PUC, electric distribution companies, and electric generation suppliers.

OCMO will address each of these categories through a series of technical conferences, the first of which will take place at the PUC on August 10, 2011 at 10:00 a.m. in Hearing Room 1. At the conclusion of the technical conferences, OCMO will submit reports to the PUC with recommended changes. The first report will include recommendations for intermediate changes and is due in December 2011, while the

⁶ The PUC is aware that some of the changes to the default service model that OCMO may consider fall outside of the PUC's statutory authority. However, clearly, the PUC will only act within the powers delegated to it by the Legislature. In undertaking this investigation, the PUC's goal is simply to examine all options for improving the competitive retail electric market in Pennsylvania. Based on our findings, the PUC will make the changes that fall within our statutory authority and may recommend to the Legislature additional changes for consideration.

second report will include recommendations for longer-term changes, and is due in the first quarter of 2012.

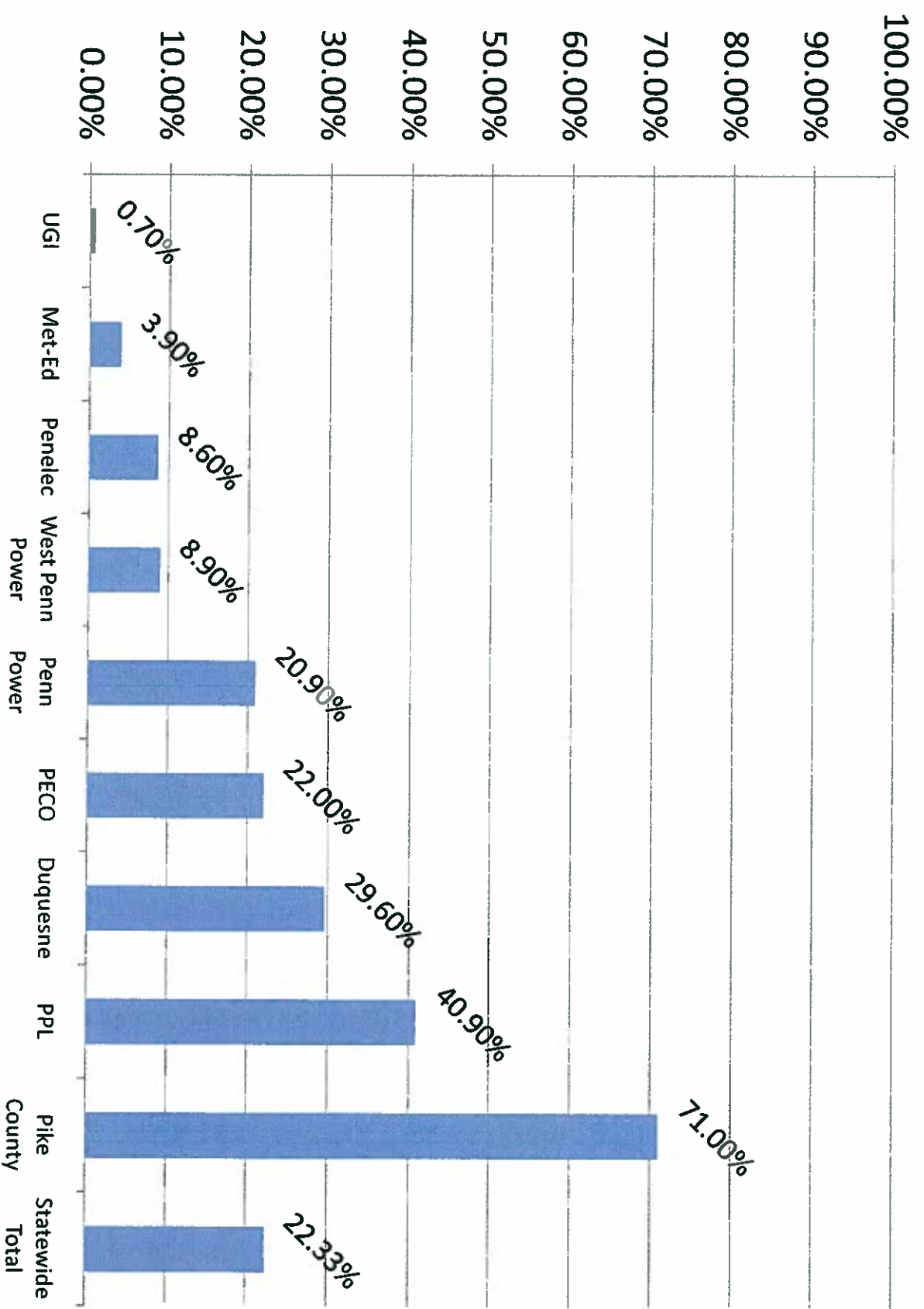
At the conclusion of the retail markets investigation, the PUC will evaluate the recommendations and will implement the changes it deems necessary to improve the competitive electricity market to the extent it has legislative authority to do so. In addition, for any changes that that PUC does not have authority to make, it may recommend statutory changes for the Legislature's consideration. The PUC takes very seriously its duty to carry out the legislative mandate set forth in the Competition Act, and it is with this mandate in mind that the PUC is leading this investigation. I am confident that by spring 2012, the PUC will have made significant strides in improving Pennsylvania's competitive electricity market as a result of this investigation.

Conclusion

Encouraging and fostering competitive electricity markets in Pennsylvania are important missions of the PUC. Without competition we will not have innovation, which is essential in this day of smart meter technology and renewable resources. More importantly, without competition, we will not have affordable rates. While Pennsylvania has made significant progress in its transition to a competitive electricity market, there is still work to be done. Through the statewide retail markets investigation, the PUC is committed to ensuring the continued success of electric competition in Pennsylvania.

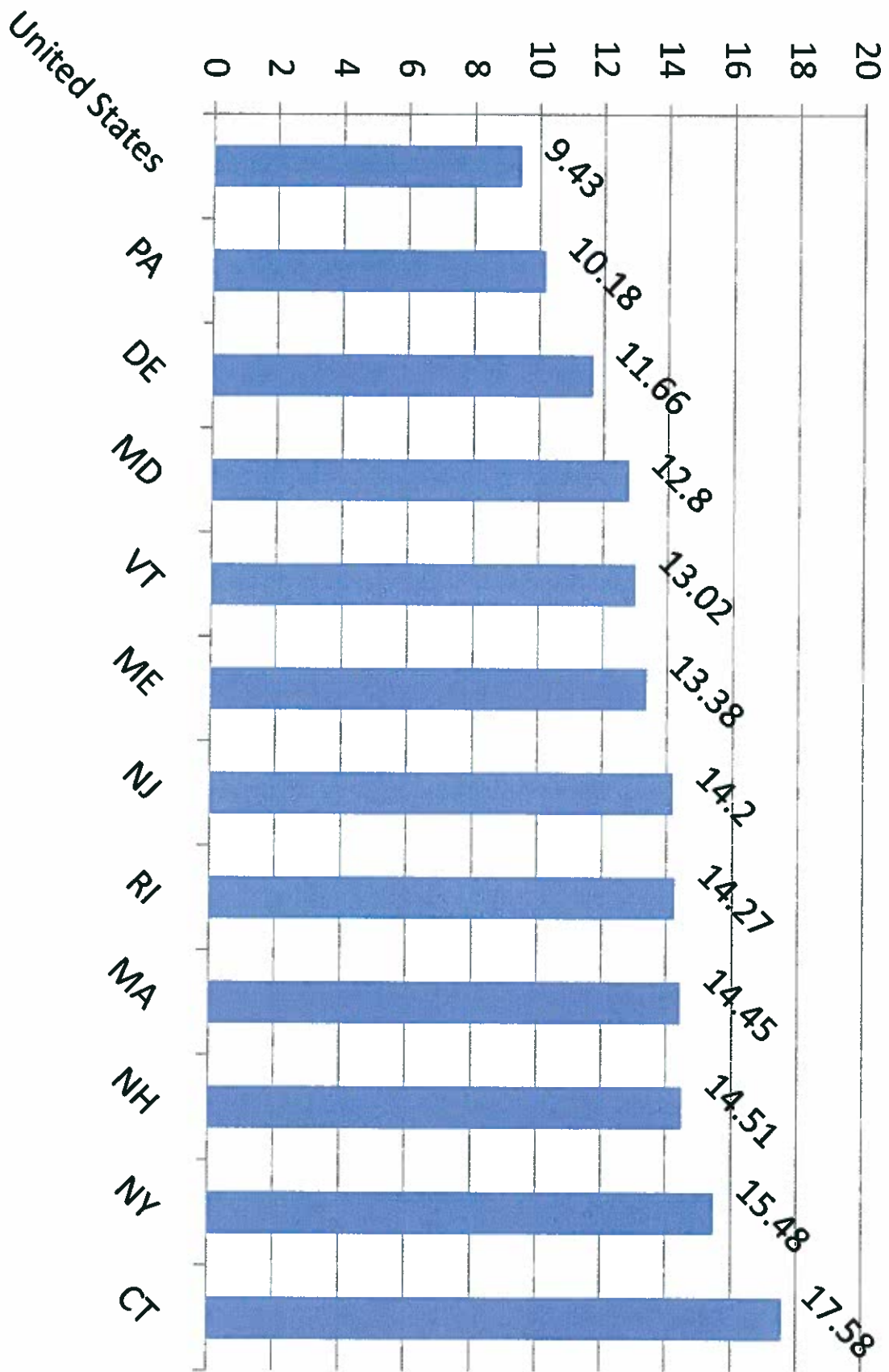
Thank you again for the opportunity to speak about this important issue. I am happy to answer any questions you may have.

Percentage of Customers Shopping per EDC Territory (as of July 27, 2011)



Cents/kWh

Retail Price of Electricity by State (2010)



Weekly PAPowerSwitch Update

Pennsylvania Public Utility Commission

www.PAPowerSwitch.com

CUSTOMERS SWITCHING TO AN ELECTRIC GENERATION SUPPLIER

WEDNESDAY, JULY 27, 2011

Electric Utility	Date Updated	Total Switching Customers			Residential Switching Customers			Commercial Switching Customers			Industrial Switching Customers		
		#	%	% of Load	#	%	% of Load	#	%	% of Load	#	%	% of Load
Duquesne	7/23/11	173,388	29.6	61.3	152,668	29.1	32.7	20,042	32.5	76.2	678	58.6	93.6
Met-Ed	7/27/11	21,393	3.9	40.8	9,256	1.9	1.4	11,366	17.6	40.5	771	53.1	86.3
PECO	7/26/11	340,569	22.0	53.0	273,806	19.0	21.0	64,168	40.0	56.0	2,633	83.0	92.0
Penelec	7/27/11	50,574	8.6	47.4	29,189	5.8	2.1	20,452	24.8	43.3	933	57.2	88.8
Penn Power	7/27/11	33,415	20.9	55.0	28,406	20.3	14.3	4,855	24.7	63.0	154	63.4	95.4
Pike County	7/20/11	3,292	71.0	61.0	2,646	73.0	73.0	634	65.0	58.0	3	43.0	63.0
PPL	7/23/11	575,898	40.9	68.8	490,978	40.0	40.3	82,106	47.1	83.3	2,814	64.0	96.6
UGI	7/23/11	456	0.7	15.9	0.0	0.0	0.0	395	4.8	29.0	61	32.1	76.1
West Penn Power	7/27/11	62,912	8.9	42.8	43,589	7.1	1.8	19,209	20.2	51.2	114	89.1	83.5
Statewide Total	7/27/11	1,261,897	22.33 *	49.6**	1,030,538	20.7	20.7**	223,227	30.7	55.6**	8,161	60.4	86.1**

* Percentage based on the total number of customers of regulated electric utilities in Pennsylvania as of 12/31/10. (4,970,057 Residential + 680,045 Commercial/Industrial = 5,650,102 Total Customers).

** Percentage represents megawatt hours currently delivered by alternative suppliers.

