

**BEFORE THE PENNSYLVANIA
HOUSE CONSUMER AFFAIRS COMMITTEE**

Testimony of

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**Informational Meeting on the
State of Retail Competition in the
Electric Industry**

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Good afternoon Chairman Godshall, Chairman Preston, and members of the Consumer Affairs Committee. Thank you for the invitation to present comments regarding electric competition in Pennsylvania. 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 afternoon I am commenting on behalf of EAP's electric utility members, which are referred to as "electric distribution companies" (EDCs) under the Electricity Generation Customer Choice and Competition Act (Competition Act).¹

On behalf of EAP, I'd like to commend the Committee for holding this hearing today and on its efforts to improve utility service to consumers in Pennsylvania and enhance our energy delivery infrastructure. We applaud the Committee's consideration and approval of HB 1294 to authorize alternative ratemaking procedures and look forward to working with you to support moving that important legislation through the process. We also encourage the Committee to review existing state-mandated programs and costs to determine if the intended benefits of these programs can be achieved more cost-effectively.

Before I begin my comments, I would like to describe my background briefly. The effort to introduce competition to utility industries has been a major focus in my career. As a new lawyer in the Public Utility Commission (PUC) law bureau in the early 1980s, I worked on the initiative of then-Commissioner Cliff Jones to liberalize the entry standards within the trucking industry, and I later defended that policy in Commonwealth Court. Building on that experience, I was assigned to work on competition within the telephone industry resulting from the break-up of the Bell system by the federal

¹ 66 Pa.C.S. Section 2801 *et seq.*

government in 1984. Later, I worked on regulations that allowed large customers of natural gas utilities to purchase gas from competitive suppliers and transport the gas on the utilities' distributions systems. Finally, as a staffer in the Senate of Pennsylvania in the mid-1990s, I helped to draft the Competition Act. Following passage of that law in 1996, I represented electric utilities in proceedings to implement the law. In 1999, I was appointed to serve as a member of the PUC, and was involved in decisions implementing the Act until my departure in 2007.

To summarize my comments, I believe that electric competition is working in Pennsylvania. However, the issues surrounding competition are dynamic and complex, and the electric utility industry recognizes that there is room for improvement in current policies. The industry is committed to working with the General Assembly, with the PUC, and with other stakeholders to further refine these policies. The critical task before the Committee, the PUC and other stakeholders is to ensure that any modifications to Pennsylvania's default service model are undertaken based on consensus, clarity and the right public policy. It is important that all of the appropriate stakeholders are engaged in the process and that we ensure a smooth transition for all of those involved.

Shopping statistics published every quarter on the website of the Office of Consumer Advocate (OCA) provide some early indication of the extent of customer adaptation to the competitive retail marketplace.² At the same time, it's important to note that shopping numbers are only one indicator of the health of competitive markets. Switching statistics show that the amount of electricity purchased from competitive suppliers, known as Electric Generation Suppliers (EGSs), has increased substantially

² www.oca.state.pa.us. The Public Utility Commission also provides current shopping statistics on its "PowerSwitch" website, www.PAPowerSwitch.com.

over the past two years as the remaining caps on the generation rates charged by EDCs have expired throughout Pennsylvania. Since October 2009, the number of customers purchasing supplies of electricity from EGSs has increased from roughly 164,000 to over 1.1 million, and the amount of load purchased from EGSs has increased from 2,650 megawatts (MW) to 15,800 MW. This increase in shopping levels shows that the retail electricity market in Pennsylvania is active and continuing to develop.

The shopping statistics show that large consumers of electricity have become active in the market more quickly than smaller ones. It is not surprising that large business customers would be “early adapters” given that they are more sophisticated and sensitive to price differences due to the competitive pressures they face. It is also not surprising to me that residential customers would be slower to change – I recall from my experience in telecommunications competition that it took over a decade for a majority of customers to move away from the incumbent long-distance carrier after this service was opened to competition. This illustrates the need to continue the education process to help make customers comfortable with shopping.

In evaluating the shopping statistics, two factors should be kept in mind. First, while the Competition Act took effect a decade and a half ago, the retail market in Pennsylvania is still in its early stages in most areas of the Commonwealth because full competition did not begin until the generation rate caps of the EDCs serving most customers expired at the beginning of 2010 and 2011. The rate caps suppressed retail competition because EGSs generally could not purchase electricity in the wholesale market at a price low enough to attract customers to switch from the default service of

EDCs. The PUC is continuing to move forward with policies designed to further promote competition through the efforts of its Office of Competitive Market Oversight and its Retail Markets Working Group. In addition, the PUC has initiated an investigation of Pennsylvania's retail electricity market. EAP and its member EDCs are active participants in these efforts to further enhance competition.

The second factor to keep in mind when evaluating retail electric shopping statistics is that the amount of shopping is affected by statutory policies regarding "default service" for non-shopping customers, and these policies are not designed solely to stimulate shopping. 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."³ The Act also provided that the PUC shall adopt regulations to govern default service in the period after the generation rate caps of the EDCs expired.⁴ In 2007, following an exhaustive multi-year process involving hearings and consideration of written comments, the Commission adopted regulations and a policy statement governing default service. Taken together, these two documents sought to establish a flexible policy recognizing that the procurement strategies for default service should evolve over time. Specifically, the Commission recognized that these strategies should emphasize price stability for customers when the rate caps expired, and that future default service plans should tie default service prices more closely to changes in wholesale prices in order to stimulate a more active retail market.

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

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

In 2008, the General Assembly approved Act 129, which, among other things, amended the default service provisions of the Competition Act. These amendments reflected concerns about the potential for higher electricity bills at the time rate caps expired, and made clear that the General Assembly envisioned a regulated model for default service. 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 to achieve the goals of “adequate and reliable service” and “least cost to customers over time.”⁶

Under the above provisions of Act 129, the PUC retains flexibility to determine what constitutes a prudent mix of purchases in light of market conditions, and may consider the impact of a purchasing strategy on the development of retail competition. In that sense, Act 129 is consistent with the development of retail competition. However, the General Assembly made clear in Act 129 that it envisions default service as a regulated service, not a deregulated one, and that competitive procurement processes must be used with a goal of providing low, stable prices to customers over time. Stated differently, default service is more than just a stop-gap service designed to promote shopping; it provides a “safety net” for customers who cannot shop or choose not to shop. In addition, Act 129 applies to any default supplier, whether an EDC or a Commission-approved default supplier.

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

⁶ 66 Pa.C.S. Section 2807 (e) (3.2).

In the FirstEnergy – Allegheny merger proceeding before the PUC last year,⁷ Direct Energy proposed that the merger should only be approved if the EDCs owned by the merged company exited the default supplier role. Direct proposed that the PUC appoint an alternative default supplier that would procure all of its electricity for default service customers in the wholesale spot market, and the alternative default supplier would auction the default service customers to EGSs unless the customers opted out of the auction process. The PUC denied the Direct proposal, and instead opened an investigation of Pennsylvania’s retail electricity market.⁸

EDCs have a strong interest in assuring that any significant changes to default service policies are “done right,” because they have invested substantial time and resources into developing and implementing the current policies for default service. EDCs participated in the Commission’s proceedings to adopt default service regulations, and in the legislative process leading up to enactment of Act 129. EDCs have sought and obtained PUC approval of default service plans, often after administrative litigation on these plans. They have expended resources developing and implementing customer education programs, billing system changes, and purchasing strategies based upon these plans. Moreover, the current default service policies appear to enjoy public acceptance and support a stable regulatory environment that is conducive to attracting investment.

Pennsylvania’s EDCs are open to consideration of different models for default service. Under a strong majority of the PUC-approved default service plans, EDCs simply pass along to customers the actual cost of providing default service, without

⁷ *Joint Application of West Penn Power Co. d/b/a Allegheny Power and FirstEnergy Corp.*, Docket No. A-2010-2176520.

⁸ *Investigation of Pennsylvania’s Retail Electricity Market*, Docket No. I-2011-22337952

profit. Accordingly, for EDCs following this model, continuing to provide default service is not critical to their long-term business interests but a stable, well-structured marketplace is.

Significant changes to current default service policies, such as adoption of a model under which EDCs are removed from the role of default service provider and default service prices are deregulated, are likely to require legislative changes to the Competition Act and Act 129. EAP does not object to consideration of other models if the General Assembly wishes to place more emphasis on encouraging customers to shop for electricity. However, EAP believes any consideration of other models should be adopted through a deliberate, consensus-based process, and should reflect a balanced approach that focuses on the needs of customers and recognizes the multiple purposes served by default service.

Thank you for allowing me to provide comments, and I would be happy to answer your questions.