Electric Power Generation Association

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Outline of Remarks Before House Republican Policy Committee
Re: State Power Agency - Doug Biden, President, EPGA

- I'd like to begin by focusing on the current state of the electric industry in PA – need to understand how we are doing to fully appreciate how a state agency may be counterproductive.

- PA is the second largest generating state in the nation (only Tx generates more power) and the largest electricity exporting state. 50,000+MW. Plants are engines of economic development: not just power plant jobs – fuel, fuel processing, rail, gas drilling, pipelines, steel, turbine manufacturers, environmental equipment, engineering and environmental services, insurance, etc.

- Developers, industry analysts and lenders are constantly focused on the political and regulatory climate of the state. Their eyes are on the risk of public policy reversals that could reduce the value of investments.

- We all hear a lot about the importance of energy independence and reducing energy imports. Yet, when it comes to electricity, PA is <u>the</u> leading exporter. Given that PJM runs a least-cost dispatch market, it is clear that PA's fleet of merchant power plants is among the low-cost producers.

- So, a first-order policy question arises – Now that we have made the transition to competitive electricity markets and witnessed the significant efficiency gains, is there something we have suddenly discovered that makes us reasonably expect that the electric power industry can be operated more efficiently or effectively by a government-run entity than by a privately-run competitive one? We submit the answer is an emphatic "no".

- Then, what is the driver behind the creation of a PA Power Agency? In reviewing the press release that announced last week's House Environmental Resources & Energy Committee hearing we find a number of glaring inaccuracies.

- Wholesale market is not broken.
  - According to PJM Independent Mkt Monitor (IMM), prices have consistently been found competitive – both energy and capacity market prices.
  - IMM net revenue analysis: new plants have not covered fixed costs for 10 yrs. If wholesale prices have been too low to cover fixed costs, policies based on mistaken notion that prices are "too high" are bound to be counterproductive.
  - Energy prices have tracked changes in fuel costs – mostly coal and gas.
  - When adjusted to remove the influence of higher fuel costs, wholesale prices have dropped by 41% over the past decade – reflects tremendous improvements in operation efficiency of plants due to competition.

- Contrary to assertions that no generating capacity has been built in PA, in fact more than 10,000 MW have been added in the past decade in the form of natural gas plants, waste coal, nuclear upgrades, hydro, biomass, methane and over 700 MW of wind. That's enough generation to power over 10 million homes. In addition, the latest PJM capacity market auction has attracted more than 1800 MW of demand response resources – the equivalent of 3 large power plants. PJM 2009 reserve margin = 30%; required reserve = 15%. No capacity shortage as claimed by IECPA and others.

- EPGA members have invested more than $12 billion in existing plants in PA in last decade and plan to invest $14 billion more in the next five (5) years.

- In our view, HB 1909, or similar legislation, creates a costly new power agency that will undermine far more efficient private investment and will increase rates.

- Electric competition has benefited consumers greatly by shifting to private investors the enormous risks of constructing, maintaining and operating power plants which cost many hundreds of millions of dollars, take years to build, and must serve customers for decades.

- This ill-conceived law would shift that tremendous risk back to Pennsylvania consumers/taxpayers along with the long term risk of high environmental compliance costs to meet increasingly stringent air and water quality standards.

- The frequent construction delays and cost overruns and pervasive poor plant performance in the 70s, 80s, and early 90s underscored that government-controlled entities cannot perform better than experienced private investors who compete daily, risk their own money and must control costs to make a profit. If investors make bad decisions, they bear the consequences. If government policymakers make bad decisions, electricity customers or taxpayers bear the consequences.

- For example, an audit in New York found that the NY Power Authority had lost several hundred million dollars from power plant projects because of poor planning, inaccurate cost estimates and repeated failure to consider less costly alternatives to generation self build.

- Generation acquisition or construction would require the state to raise billions of dollars at once, taking vital state funds from more critical programs when the state is confronting a multi-billion dollar deficit. And the state's ability to access lower cost financing does not produce lower rates as power plant construction, maintenance and operation costs and risks far exceed those for financing.

- Plus, under HB 1909, the state would have to actively manage a complex portfolio of generation assets, including hedging transmission congestion and fuel requirements, and managing outage risks, all of which require vast resources and highly skilled personnel.

- State-mandated long term contracts also do not guarantee lower rates. The PURPA (Public Utilities Regulatory Policies Act) debacle taught us that lesson as we saw consumers throughout the nation pay, and continue to pay, many billions of dollars for over-priced, multi-year contracts with power producers.

- There seems to be a misconception that a power agency would not participate in the wholesale market. On the contrary, power would likely be procured in the wholesale market or through bilateral contracts with pricing and terms determined by contracting parties' views of forward wholesale commodity prices/risks. Also, prices in Illinois have not fallen because of the IPA, but because PJM wholesale prices have dropped markedly in the past year.

- The discriminatory tax this legislation would apply to owners of certain plants is likely unlawful, and is certainly unwise. It would discourage building new plants, and would also discourage investments in existing plants that are necessary to maintain reliable supplies of electricity and to meet ever more stringent environmental requirements.

- Pennsylvania will need substantial investment in new power generation over the next decade to meet projected electricity needs and to replace aging facilities. Unfairly taxing generation companies discourages new generation investment in Pennsylvania, and gives a huge advantage to out-of-state generation companies putting existing and future jobs across the state in jeopardy.

- Additionally, imposing this tax will simply increase prices. Generators must incorporate all external risks/costs - including taxes, into their market prices - which will ultimately increase costs for consumers. If generators' costs go up, the cost of supplying wholesale electricity goes up and ultimately the cost to Pennsylvania consumers goes up. This is simple economics.

- PA no longer regulates generation (FERC does), but State decisions can have a profound effect on the value of generation investments and the future investment climate.

- Even before the current credit crunch there was an overriding need for regulatory stability in a world where political uncertainty had become the norm.

- That's why we ask you as policymakers to maintain your commitment to electricity competition, and help keep PA a place where promises are kept, and where those who have shifted their position based upon fuel price fluctuations or misleading claims about market failures are heard with a reasoned degree of skepticism.

- We respectfully submit that public policy decisions should be based upon sound principles that make sense for the long run, not on fluctuating fuel costs or inaccurate perceptions of how the evolving market has failed us.