

**BEFORE THE PENNSYLVANIA
HOUSE POLICY COMMITTEE**

Testimony of

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on

The Impact of State Mandated Energy Programs

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Good morning Chairman Reed and members of the Committee. Thank you for the opportunity to present testimony on the impact of state mandated energy programs. I am Terrance J. Fitzpatrick, President and CEO of the Energy Association of Pennsylvania (EAP), a trade association formed by the electric and natural gas distribution companies operating in Pennsylvania. I am offering this testimony on behalf of EAP's electric utility members¹ – also known as “electric distribution companies” (EDCs) – which are subject to mandates contained in the two laws I will discuss. These two laws are the Alternative Energy Portfolio Standards (AEPS) Act (Act 213) of 2004, and Act 129 of 2008 which amended the Public Utility Code.

The Committee is to be commended for holding this hearing. At the time of their passage, some advocates for both the AEPS Act and Act 129 argued that these laws would provide economic benefits for customers; however, it was always my belief that these laws were driven at least as much by environmental policy as economic policy. It serves the public interest for the Committee to examine how these laws are working, and whether any adjustments should be considered for the protection of customers.

I believe that my background in economic and environmental regulation is helpful in analyzing these issues. I began my career as a lawyer with the Public Utility Commission (PUC), serving there from 1981 to 1987. From 1988 to 1992, I was a member of the Pennsylvania Environmental Hearing Board, which involved presiding over cases and writing decisions on appeals from the actions of the Department of Environmental Resources. From 1995 to 1997, I was Counsel to the Environmental

¹ Citizens' Electric Company, Duquesne Light Company; Metropolitan Edison Company, *A FirstEnergy Company*; PECO Energy Company; Pennsylvania Electric Co., *A FirstEnergy Company*; Pennsylvania Power Co., *A FirstEnergy Company*; Pike County Light & Power Company; PPL Electric Utilities Corporation; UGI Electric Utilities, Inc.; Wellsboro Electric Company; and West Penn Power Company, *A FirstEnergy Company*.

Resources and Energy Committee in the Senate of Pennsylvania, and during that time I helped to write Pennsylvania's electricity competition law. From 1999 to 2007, I was a member of the PUC, serving as Chairman from 2003-2004.

Before discussing these laws, it is also important to recognize that EDCs are recovering the costs of implementing these laws from customers. EDCs are concerned, however, about the cumulative cost impact on customers from these programs in light of other important priorities, such as the need to modernize infrastructure and to maintain programs to assist low-income customers. While wholesale electricity prices have moderated in recent years, experience shows that it is dangerous to assume that this trend will continue indefinitely; therefore, it is important to periodically examine the cost-effectiveness of mandated energy programs.

The Alternative Portfolio Standards Act of 2004

Pennsylvania is among a group of 33 states that require some amount of electricity to come from renewable or alternative energy sources.² These states take a variety of approaches to which sources qualify, and what amount of electricity must come from these sources. There has also been substantial debate over a federal renewable portfolio standard, but Congress has not approved such a law.

The AEPS Act of 2004 required that electricity supplied to customers in Pennsylvania contain a specific percentage of electricity from alternative energy sources set out in the Act. This requirement began upon the expiration of rate caps in each EDC's service territory, and the percentage requirement increases over a fifteen year period to a maximum of 18% by the year 2021. The Act established two tiers of

² Dept. of Energy website at http://apps1.eere.energy.gov/states/maps/renewable_portfolio_states.cfm

resources, and the different types of resources compete within each tier, except for a set aside of .5% in tier 1 for solar photovoltaic sources. Suppliers of electricity – both EDCs who sell to non-shopping customers and competitive electric generation suppliers (EGSs) – comply with the Act by purchasing alternative energy credits which are issued for each megawatt hour (MWH) of electricity generated by these sources.

The AEPS Act also contained provisions regarding customer generators, including a requirement to allow “net metering” so that these customer generators would receive credits on their bill for electricity they supply to the grid.

Since rate caps of utilities serving most customers in Pennsylvania expired in 2010 and 2011, the bulk of the purchasing requirements of the AEPS Act have not taken effect. It is not possible to determine exactly how much this Act will cost customers when all of the requirements take effect over the next decade, but certain provisions of the Act are likely to increase customer costs.

First, the cost of alternative energy credits will be influenced by the cost of alternative compliance payments (ACPs), which were established at \$45 per credit for tier 1 sources other than solar, and at 200% of market value for solar credits, in amendments to the original AEPS Act contained in Act 35 of 2007. In later testimony, you will hear ideas for revamping alternative compliance payments, including changing the solar ACP to a fixed price that would increase certainty for developers, EDCs and consumers, which could reduce the cost to customers. Second, under the current net metering provisions of the Act, customer generators receive a credit against not just the generation portion of their bill, but also against the distribution and transmission portions of the bill. These “wires” costs do not go away, and other customers will end up

subsidizing the customer generators by picking up these wires costs. These additional subsidies to customer generators should be reconsidered.

Act 129 of 2008 – EDC Energy Efficiency and Conservation Programs

The second law which mandates energy programs is Act 129 of 2008. Among other things, this law requires certain EDCs to implement energy efficiency and conservation programs to reduce energy consumption by 1% by May 2011, and 3% by May 2013. It requires reductions in peak demand of 4.5% in the 100 hours of highest usage by May 2013. EDCs filed Energy Efficiency and Conservation Plans (“EE&C Plans”) in August 2009 which detailed numerous programs aimed at meeting these mandates. The PUC approved the EE&C Plans, and implementation efforts began in 2010. Failure to meet the mandates could result in civil penalties ranging from not less than \$1,000,000 to \$20,000,000. Of the 26 states having energy efficiency resource standards, Pennsylvania is one of only two states which provide for civil penalties for failure to meet mandates. Act 129 also requires EDCs to install smart meters (meters capable of measuring things such as when electricity was used, not just the total amount used in a given period) throughout their service territories over a period not to exceed 15 years.

Act 129 allows EDCs to recover their implementation costs without filing a base rate case, but caps such recovery at 2% of the EDC’s 2006 total annual revenues for the law’s efficiency and demand response programs. The law specifically precludes EDCs from recovering the revenue they lose due to customer usage reductions,

although they can file a base rate case to set rates on a going forward basis that reflect the lower usage levels.

To understand Act 129, it is necessary to understand the background against which it was adopted. Three years ago, it appeared that electricity bills of customers might increase significantly – perhaps 50% or more – when rate caps expired for most electric customers in 2010 and 2011. The General Assembly adopted Act 129 legislation as a response to the expected increase in retail rates. These steep increases generally did not occur when the caps expired. In fact, some customers even saw their bills decrease, due to a drop in wholesale electricity prices at the beginning of the recession.

The anxiety underlying passage of Act 129 helps to explain some aspects of that law. At the outset, I recognize that almost everyone would agree that energy conservation should be encouraged, and that customers should be given the tools to conserve. However, some aspects of the way in which Act 129 seeks to achieve that goal might be questioned. First, the Act is onerous in that it threatens EDCs with substantial fines for failure to achieve usage reductions when it is customers, not EDCs, that use electricity. Depending upon the historical level of their bills and other factors, customers may have different levels of receptivity to conservation programs.

Second, offering these programs comes with a cost. Based upon the 2% cap on revenues, EAP calculates that the total cost of these programs will be just shy of a billion dollars. While the PUC must determine whether the benefits of the programs outweigh the costs, the calculation of benefits is complex and subjective.

Third, some parts of Act 129 are extremely specific and prescriptive. This approach contrasts with most provisions of the Public Utility Code, which are more general and allow the PUC to exercise expertise in filling in the details of regulation. Consider, for example, the language in the Code that public utility rates must be “just and reasonable.”³ The prescriptive approach in Act 129 creates problems because real-world conditions at the time a law is implemented often differ from perceptions at the time a law is passed.

Fourth, the process for measuring and verifying that the mandatory usage reductions have been achieved is complex and contentious, and creates uncertainty for purposes of determining compliance. The deemed savings attributed to programs may be modified over time as new studies are released and technology advances, but EDCs developed and filed plans to meet the statutory targets based on information and funding available to them earlier, at the time of filing. Determining compliance based on changing, uncertain standards is problematic in any regulatory setting and more so here because of the threat of civil penalties for failure to meet the targets.

I would call to your attention three specific issues under Act 129 that will be addressed in the testimony to follow mine. First, there is widespread recognition that the requirement to reduce peak demand for electricity in the 100 hours of greatest usage is a problem. Among other things, it is impossible to know in advance which hours will constitute the top 100 over the compliance period. This forces EDCs to incur additional costs to reduce the risk that they will be penalized for not meeting the 4.5% reduction target.

³ 66 Pa.C.S. Section 1301.

Second, the Act contains a “stick” (civil penalties) for failure to meet the usage reduction targets, but does not provide a “carrot” (benefits) for reductions beyond the targets. This could be addressed by allowing these excess reductions to count toward AEPS tier 1 requirements, which would reduce the cost to customers of complying with the AEPS Act. Third, the requirement to install smart meters for every customer, regardless of circumstances, might be questioned. Finally, consideration should be given to the role of EGSs in providing customers with time-of-use rates and other forms of dynamic pricing pursuant to Act 129.

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