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July 20, 2006

James J. McNulty, Esquire, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
P.O. Box 3265  
Harrisburg, Pennsylvania 17105-3265

**REPLY COMMENTS of THE ENERGY ASSOCIATION of PENNSYLVANIA  
RE: POLICIES TO MITIGATE POTENTIAL ELECTRICITY PRICE INCREASES  
DOCKET NO. M-00061957**

Dear Secretary McNulty:

Enclosed for filing at the above-referenced Docket, please find an original and fifteen (15) copies of the Reply Comments of the Energy Association of Pennsylvania.

Please do not hesitate to contact the undersigned with any questions.

Cordially,

A handwritten signature in black ink, appearing to read "Donna M. J. Clark", is written over the typed name.

Donna M. J. Clark  
Vice President and General Counsel

Enclosures

CC: Wendell F. Holland, Chairman  
James H. Cawley, Vice Chairman  
Bill Shane, Commissioner  
Kim Pizzingrilli, Commissioner  
Terrance J. Fitzpatrick, Commissioner  
Shane M. Rooney, Esquire (via electronic mail)



expensive peaking units have been the sole source of generation construction with 98% of new construction being gas fired generation and the remaining 2% renewables.

Over the past decade, electric demand has continued to grow and the only option to meet environmental laws was construction of natural gas and renewable generation. Yet, the Congress accelerated prohibitions on drilling for natural gas in nearly every energy action it took. In the Energy Policy Act of 2005, the Congress prohibited drilling in the Great Lakes. On numerous occasions, attempts to open up the Atlantic, Gulf, and Pacific coasts to more drilling were thwarted in the Congress. Therefore, as the demand for natural gas has increased and the ability to search for new areas of supplies frustrated, it is not surprising that natural gas prices have significantly increased over the last few years

Prices for natural gas at the Henry Hub were \$2.17 per MMBTU in July of 1998. In July of 2006, the price is \$6.29 per million BTU. This nearly 300% increase, while significant, is dwarfed by the \$10 to \$14 per million BTU range experienced in the recent months and years. These peaks, as high as 600% over 1998, have often made electricity generated from gas fired units very expensive to run. The good news for Pennsylvania consumers who remain subject to rate caps is that the increased generation costs have not been passed through as they would have been in a traditionally regulated vertically integrated utility. Unfortunately, the climb in natural gas prices is a reality and together with Locational Marginal Pricing (LPM) as applied in PJM, the overall increase in cost of energy in the marketplace is inescapable. As noted in the charts, Attachments A and B, generation via gas fired plants in the Mid-Atlantic Region has grown from 7% to 14%. This greater reliance upon an increasingly more expensive fuel type, and one which during many hours sets the market clearing price, has placed significant upward pressure on wholesale electric prices.

As a nation, we discouraged coal, nuclear and oil as generation resources and placed all our reliance on peaking units using natural gas and renewable resources. The Congress then impeded the development of these types of generation by temporarily eliminating the tax credits for renewables and prohibiting drilling over vast amounts of geographic area; thus creating a demand/supply imbalance. This policy void brings the industry, the Commission, and consumers to the present where we find ourselves the victims of inconsistent and at times non-existent national energy policy.

### **III. A Premature \$25 Million Advertising Campaign Is Not The Answer**

Penn Future has suggested that the Commission order a major statewide advertising campaign costing \$25 million or more. While the EDC's strongly believe in the value of consumer education as noted in their individual comments, the suggested dollar amount is both arbitrary and premature until we finalize where Pennsylvania is headed in terms of demand side response.

Demand response is but one example of where direction is needed. Goals for demand response should not be set without consideration of the costs necessary to achieve those goals and further adjusting rates to reflect those costs.

This Commission has traditionally determined the appropriate investment in demand side management. Are demand response investments justifiable regardless of cost and without cost effectiveness evaluation because of their inherent value?

Furthermore, how are we to measure value from demand side response? Is it a) a societal benefit test, b) an all ratepayer test, or is it c) the overall impact on rates test, or d) a deferral of generation goal, or e) a greater reliability goal? Before the industry launches an advertising program, a decision needs to be made as to why we are seeking to alter the energy

habits of consumers. As EEI demonstrated, electric use is often coupled with economic development. Is the message to cut back generally or to cut back at certain times?

The generation rate caps of different EDCs extinguish at different times. Further, the experience to date, as well as the EDC projections of price demonstrate that whether there is an increase in price and whether it is minimal or significant varies greatly depending on the market condition at the time, the generation mix, and the process used to determine the POLR load. There is no similarity among EDCs that would justify a statewide advertising campaign nor would such a campaign lead to long term permanent changes in energy usage. As demonstrated by the PECO comments in schedule 3, Allegheny Power comments at page 2, Duquesne comments at pages 7-8, First Energy comments at pages 3-5, PPL comments at pages 9-11, and UGI Utilities--Electric Division comments at page 2, the industry currently undertakes a significant expenditure of funds to encourage consumers to conserve.

The Commission is asked to recognize the value of the Keystone Energy Loan Program. This program launched in 2006 has already produced nearly \$2 million dollars in loans to replace inefficient heating systems and energy-wasting appliances. The loans have already been dispensed in forty-seven counties. All of the Association's members are promoting the program. Certain EDCs are currently helping to underwrite the loans for this program to ensure low cost loans for low income applicants. Recognizing these expenditures as eligible for rate recovery through LIURP or via other means would assure more conservation.

The Commission and the EDCs work together to promote energy efficiency and conservation for low income customers under the Low Income Usage Reduction Program (LIURP). Energy conservation supported through these efforts include 1) weatherization upgrades, 2) replacement of old, inefficient appliances with higher energy efficiency models, 3)

replacement of broken or inefficient heating and cooling equipment. The electric industry spent over \$18 million for LIURP during 2004 and was projected to spend nearly \$21 million in 2005<sup>1</sup>.

The 2004 Universal Services Report demonstrates that energy savings from LIURP expenditures in 2002 were forecasted at an estimated annual savings of \$141 for electric heat, \$42 for electric water heating, and \$90 for electric baseload<sup>2</sup>. The number of 2004 households assisted through LIURP was approximately 17,300<sup>3</sup>.

Expenditure of additional LIURP funds to assist more consumers and recognition of those funds in base rates would provide significant advantages over an advertising campaign which would have no quantifiable savings. A program to encourage smarter appliance purchases, at the point of sale, would most assuredly result in greater energy efficiency than some generalized ad campaign. For example, Pennsylvania is trailing California, New Jersey and New York in terms of energy star appliances saturation. A focused campaign is vastly superior to some general “spend some dollars” approach.

### Energy Star Qualified Appliances - Retail Sales 2005

Appliance Type	CA	MD	MI	NJ	NY	OH	PA	US
Air Conditioners	51.21%	<b>52.54%</b>	<b>55.22%</b>	<b>55.40%</b>	<b>57.56%</b>	<b>52.94%</b>	<b>54.74%</b>	52.12%
Clothes Washers	<b>41.40%</b>	<b>37.28%</b>	<b>37.69%</b>	<b>38.42%</b>	<b>38.05%</b>	34.94%	<b>36.45%</b>	36.45%
Dish Washers	<b>86.01%</b>	<b>84.14%</b>	<b>83.57%</b>	<b>84.93%</b>	<b>85.85%</b>	75.87%	79.48%	82.02%
Refrigerators	<b>43.16%</b>	<b>36.17%</b>	<b>34.22%</b>	<b>38.58%</b>	<b>38.14%</b>	25.41%	30.60%	32.93%

***Bold** indicates sales equal to or above the national average*

Source: Energy Star (Updated 6/8/2006) [www.energystar.gov](http://www.energystar.gov)

<sup>1</sup> 2004 Universal Service Programs & Collection Performance, page 38.

<sup>2</sup> Id, page 41.

<sup>3</sup> Id, page 39.

The Commission's focus should be on practical, achievable, and cost-effective policy actions that have been successful in other states. For example, the Commission could be a leading proponent of amending building codes to reflect greater energy efficiency. Adoption of DOE's IECC 2000 or ASHRAE 90.1-1999 would assist in addressing electricity demand in vastly superior ways than through an ad campaign.

If the Commission wants to focus on a regulatory issue, the design of CAP programs should be revisited. The current distinction between some electric CAP programs based upon a "percentage of income" with no usage restrictions, and other electric CAPs offering discounted rates based upon income yet mandating limits on energy usage does not provide a clear direction in terms of conservation. The latter is more conservation-oriented and more in keeping with the Alternative Energy Portfolio Act encouragement of energy efficiency and conservation.

Resources for conservation should be targeted to encourage the Keystone Help Loan Program, the LIURP programs by the various EDCs and to support CAP designs that encourage conservation. The Commission needs to set forth a guide-rail around desirable outcomes to be accomplished from demand side response programs. Targeted small expenditures can accomplish much more than a large, arbitrary \$25 million generalized ad campaign.

#### **IV. Regulatory Risk Is In The Marketplace**

The events in Maryland, the absence of a clear national or state energy policy, and regulatory alterations to the generation, transmission, and distribution landscape will necessarily raise the cost of investment. At present, the rules in Pennsylvania are not clear, and worse, existing implementation orders and policy statements are subject to change.

Consistency and direction should be the goal of the current investigation. The Association continues to encourage the Commission to put forth a set direction and provide consistent guidance on the difficult electric issues and then monitor how the market develops. Over the past year, the amount of regulatory risk suppliers have been exposed to, through PUC actions, has increased. This is especially true due to the aggregation pool the Commission created for Pike County. Suppliers may be concerned that the Commission would respond to “rate spike” concerns involving other Pennsylvania EDCs with a similar aggregation plan. There is no way to hedge regulatory risks associated with such an approach other than to build in extra margin on energy supplies. The end result could be more expensive POLR service throughout the Commonwealth. Regulatory risk can be handled by establishing the rules earlier and not after the fact.

**V. Some Factors are Beyond PUC Control Both in the Generation Rate Component and the Distribution Rate Component**

The Association has already discussed the significant increase in natural gas prices because increased demand has not been met with an increase in supply<sup>4</sup>. The impact of increased natural gas prices are widespread and not controllable in any one state. Generation costs have risen throughout the United States because of the rise in price of the underlying fuel costs.

While various commentators expressed displeasure with Locational Marginal Pricing (LMP), it is a wholesale pricing methodology and, is thus under FERC jurisdiction and not PUC jurisdiction. LMP is the price of the spot market which is only one of the wholesale markets. Spot markets encourage long-term bilateral contracts. An advantage with LMP has been the elimination of some of the \$1000 MWh peaks experienced in 1999-2000.

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<sup>4</sup> The Commission could encourage development through rate incentives to free up trapped gas.

Newer, tougher environmental restrictions impacting generation will be implemented in 2009 and will significantly increase the cost of electric generation from coal. Again, these environmental mandates originate outside the Commission and the magnitude of the increase in electricity cost is apparently not a chief concern of the agencies handling the rulemaking process for coal generation. This is amply demonstrated by the fact that those involved in electric generation, according to EEI, have spent \$24 billion between 2002-2005 to comply with Federal environmental laws; state and local rules drive the price tag even higher.

September 11, 2001 is another factor that could not have been envisioned in 1998 and has led to greater costs for EDCs and EGSs. It has hampered the site selection of generating facilities and has furthermore increased the cry of NIMBY.

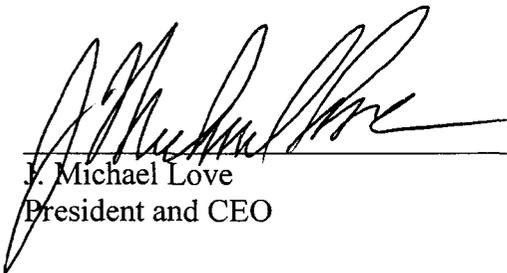
While the factors listed above have led to significant increases in electric generation rates, there have been other factors that contribute to increased electric distribution rates. Health costs have gone up by 185% in the last 20 years and nearly 100% in the last eight years alone. (EEI testimony) The steep rise in this cost component has impacted all businesses and has not spared the electric industry. Gasoline prices have also risen dramatically which again, impacts rates. Sarbanes-Oxley has moved costs to the forefront for purposes of expensing and billing. These costs which would in the past have been eligible for deferral reflects a Congressional preference for matching revenues and expenses in a reporting period, which again eliminates previous deferral options and requires that the price of energy has to be a full realistic price. Electric utilities like other businesses have experienced pension increases which again is an upward pressure on electric rates. All of these factors share a commonality, namely they all act to increase rates.

**VI. Conclusion**

Conservation and energy efficiency can be greatly assisted by using existing programs and funding their expansion. Only in this fashion does the Commission achieve a reality of KWH and KW saved. A premature expenditure of \$25 million in an ad campaign only increases rates further with no tangible benefits to consumers.

Natural gas prices are the largest component impacting the market. An imbalance of gas supply and demand is causing increases all over the country in both traditional and unregulated settings. Where gas prices will be when individual EDC rate caps end is not clear. It is clear, however, that unless the Commission has a way to influence Congress to open more land to drilling, gas prices will continue to be high and significantly so when compared to 1998. The rise in electricity prices due to natural gas generation should lead to customers changing their energy usage habits. The Commission can encourage a change in consumer behavior by cost-effective programs providing a tangible benefit.

Respectfully submitted,



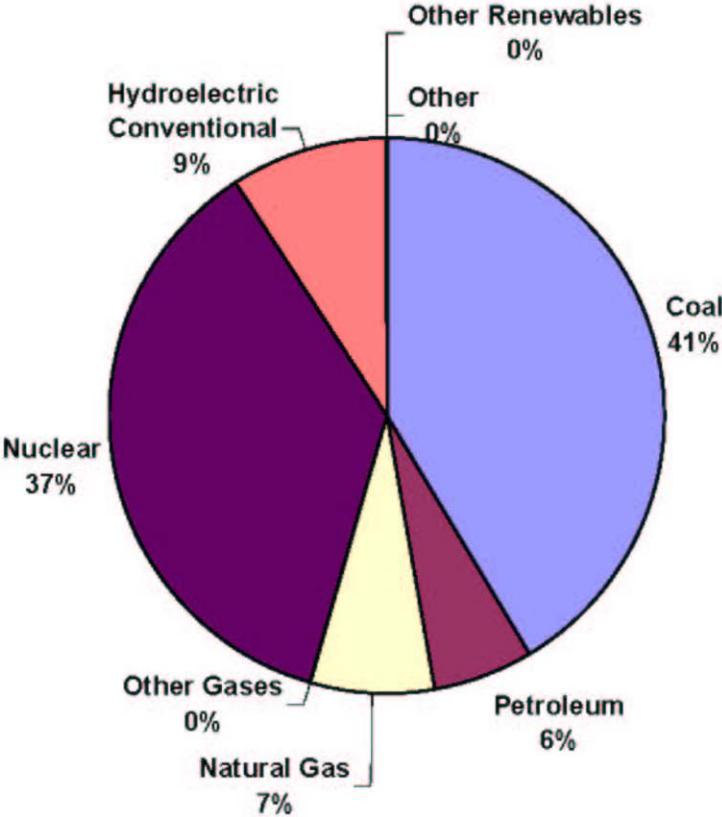
J. Michael Love  
President and CEO



Donna M. J. Clark  
Vice President and General Counsel

Date: July 20, 2006

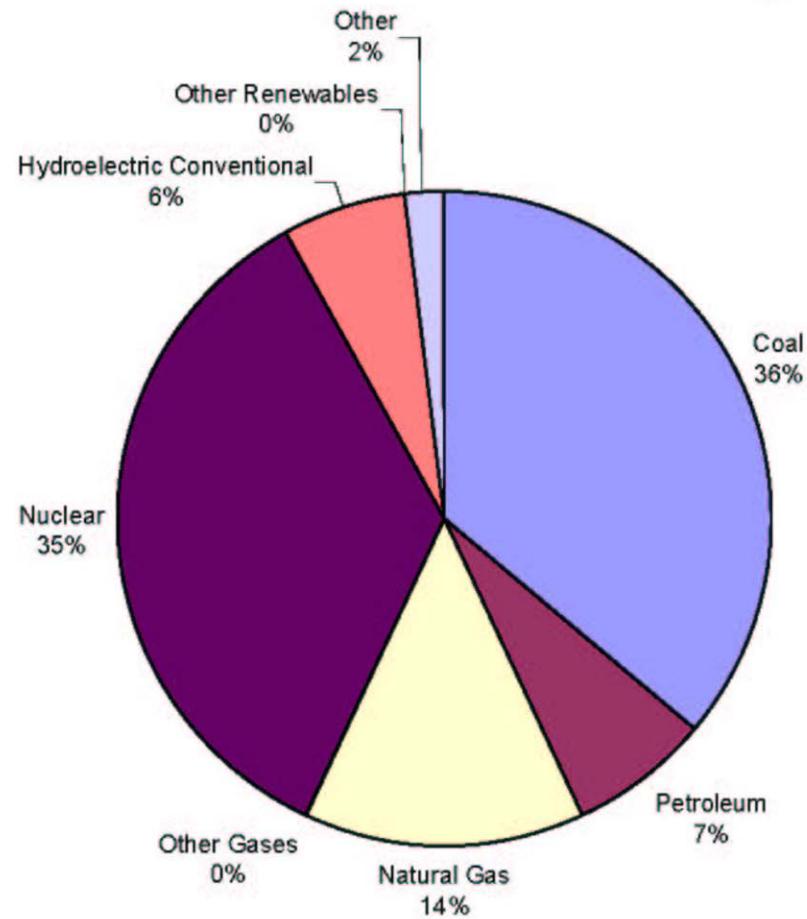
**Mid-Atlantic Region  
Electric Utilities Fuel Mix to Generate Electricity - 1998**



Data Source: U.S. Department of Energy, Energy Information Administration

# Attachment B

**Mid-Atlantic Region  
Electric Utilities' Fuel Mix to Generate Electricity - 2006**



Data Source: US Dept. of Energy, Energy Information Administration