



House of Representatives
Commonwealth of Pennsylvania

M E M O R A N D U M

DATE: September 19, 2008

TO: All Republican Members

FROM: Robert Godshall, Republican Chairman
Committee on Consumer Affairs

SUBJECT: Generation Rate Caps – Frequently Asked Questions (FAQ)

Given the considerable focus that the generation rate cap issue is receiving by the General Assembly, I thought it may be helpful for you to have some straightforward, basic information concerning this issue.

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Why did Pennsylvania deregulate the electricity markets?

Beginning in 1992, the Federal government recognized that introducing competition into the “monopoly” electric markets was something that could produce better results for consumers. As such, it opened wholesale energy markets to competition, allowing generators to be given full access to national transmission systems to transport electricity to buyers. Approximately one year later, when a small township in western Pennsylvania attempted to buy less expensive electricity for its residents from another generator, it was denied that opportunity because Pennsylvania law did not allow for customer choice.

Over the next three years, Pennsylvania’s electric rates continued to climb, placing them significantly higher than the national average. So in 1996, The General Assembly, in responding to peoples’ request to “break up the monopolies” of the electric generators and distributors, enacted the Electric Generation Customer Choice and Competition Act (Act 138 of 1996). The goal was simple: if there are less expensive alternatives, let retail customers choose them.

Why isn't there more competition in Pennsylvania right now?

There isn't more competition in most of Pennsylvania currently because caps on utility generation prices are still in place for 85% of the customers in the Commonwealth. Competitive retail suppliers cannot compete with the capped, below-market charges of these utilities. Significant levels of competition have developed in areas where the caps have expired. For example, roughly 50% of the total electric load is purchased from competitive suppliers in the service territories of Duquesne Light Co. and Pennsylvania Power Company, whose generation rate caps have already expired.

Why were the generation rates capped 1996?

The caps were intended to protect consumers during the transition to full competition -- that is, while utilities were still collecting "stranded costs" from customers. ("Stranded costs" were generation-related costs that utilities were recovering under regulation, but they might not be able to recover once competition began.) Specifically, the caps were designed to prevent utilities from shifting costs to remaining customers as some customers migrated to competitive suppliers.

Why is the cost of electricity anticipated to increase?

70% – 80% of a consumer's electric bill reflects the cost of generating the electricity that is used by the consumer, and more than 75% of the cost to generate electricity is driven on the costs of fuels. Since the generation rate caps were enacted, fuel oil has increased over 180%, natural gas and unleaded gasoline – approximately 140%, and the costs for coal have increased over 50%.

Can we extend the generation rate caps?

Extending the generation rate caps would likely result in legal action, since the U.S. Supreme Court has ruled that states may not set retail electricity prices that deny recovery of wholesale power costs authorized by the Federal Energy Regulatory Commission. Additionally, continuing the caps would only exacerbate the difference between the current market value for electricity and the capped rates, which would result in even larger increases for consumers in the future.

What can be done to "mitigate" the increases in electric bills once the rate caps expire?

There are several components to mitigating increases in the cost of electricity:

1. **Energy Efficiency** – Energy efficiency investments often are the most cost-effective means of reducing electricity bills.
2. **Demand Side Response** – Reducing usage or shifting load from periods when demand and prices for electricity are high, to periods when demand and prices are low, can have an effective impact on reducing overall energy costs.
3. **Rate Mitigation Programs** – Allowing consumers to phase-in or to pre-pay on the coming increases in electricity bills will assist in transitioning from capped generation rates.

4. **Updated Low-Income Programs** – Adjusting low-income programs to reflect the changing electricity costs will be important to ensure that consumers will be able to afford basic utility service.
5. **Encourage Competition** – Identifying barriers to the development of retail electricity markets to ensure a healthy competitive marketplace that delivers the highest quality service at the lowest cost.
6. **Consumer Education** – Educating consumers is the most effective way to ensure that mitigation strategies work. Consumers must be informed of opportunities to reduce electricity usage, have knowledge of pending rate increases and utility mitigation programs, have information on shopping for electricity, and know where to get assistance to maintain service.
7. **Electricity Procurement** – Requiring electric distribution companies to purchase electricity at the “lowest reasonable rates over the long term” through Public Utility Commission (PUC) approved procurement portfolios will ensure that consumers are getting the best rates. Under current law, utilities simply must buy electricity at “prevailing market prices.”

How can some electric companies be making substantial profits under the existing generation rate caps?

Some electric holding companies own both an electric utility (or utilities) and a generation company. In these situations, the utility is subject to state regulation by the PUC, the generation company is subject to federal jurisdiction over the wholesale market, and the relationship between the two affiliates is governed by a code of conduct. While the utility may be subject to a retail rate cap, the generation company can offer its output into the competitive wholesale market at market-based prices. Some of these generation companies are profitable currently for a number of reasons -- they are operating their plants efficiently, their plants were built when costs were lower and the plants may be depreciated, and their fuel costs may be lower than average compared to other competitors.

What is the difference between regulation and deregulation?

In regulated states, customers do not have a choice of suppliers and electric utilities continue to operate as a monopoly providing all aspects of electric service -- distribution, transmission, and generation. These monopolies are subject to cost of service regulation, and customers bear some of the risk when these utilities build new generating plants. In deregulated states, customers can choose among the utility and competitive suppliers to buy electricity, and the utility has a monopoly only over the distribution and transmission functions. Investors, not customers, bear the risks of building new plants in deregulated states.

Are electric rates lower in regulated states?

In general, yes, but this discrepancy existed for years before Pennsylvania and other states moved to allow competition, so regulation is not the cause of the lower rates. States with lower rates have lower costs generally (for example, wages are lower) and they tend to rely heavily on coal-fired generating plants or hydroelectric power, while states that allow competition tend to rely more heavily on natural gas plants. The cost of natural gas rose more than the cost of coal in recent years, although the cost of coal has also risen very rapidly within the past year. States that rely heavily on coal are now experiencing significant rate increases because of higher coal costs.

What is the difference between an electric distribution company and an electric generation supplier?

An "electric distribution company" or "EDC" is a public utility and it has a monopoly over the local distribution network. It also sells electricity to customers as the "default supplier" or "provider of last resort." An "electric generation supplier" or "EGS," sometimes referred to as a "competitive supplier," sells electricity supplies to retail customers in competition with other suppliers. EGSs are licensed by the PUC, but they are not classified as "public utilities," and the prices they offer are not regulated by the PUC.

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As always, if you have any questions, please do not hesitate to let me know.