ENERGY AND PUBLIC UTILITIES COMMITTEE

Witness Form

Today's Date 10. 4. 07

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Testifying on Bill Number: SB221

Testifying AS (Mark One):

____ Proponent

✓ Opponent

____ Interested Party

Are you a Registered Lobbyist? ____ YES ✓ NO

Are you Submitting Written Testimony? ✓ YES ____ NO

Comments

Testimony for Anthony J. Alexander
Senate Bill 221
Thursday, October 4, 2007

Good afternoon, Chairman Schuler and Senators. I'm Tony Alexander, president and chief executive officer of FirstEnergy.

I appreciate the opportunity to share my thoughts on the changes taking place in Ohio's electricity market – and, more specifically, on some of the features of Senate Bill 221.

First, let me give you some background on FirstEnergy. We're a diversified energy company headquartered in Akron that owns seven electric utility operating companies. Our three Ohio utilities – Ohio Edison, The Illuminating Company and Toledo Edison – serve 2.1 million customers within a 10,900-square-mile service area. In fact, we serve nearly 45% of the state's investor-owned utility customers.

We have about 8,000 employees in Ohio and own $12 billion in assets here – including 89,000 miles of transmission and distribution lines, 643 substations, and more than one million square feet of office space.

We're also one of the state's largest taxpayers – with a total state and local tax bill of some $455 million last year. And, we spend nearly $700 million on goods and services with Ohio businesses each year.

Like any business, we face a wide array of challenges – but none bigger than what seems to be an ever-changing regulatory landscape that is making it even more difficult for us to continue to meet the energy needs of our customers.

As a company, we didn't spend a lot of time second-guessing Senate Bill 3 after it was signed into law in 1999. After all, it was what our customers demanded, because they know that competitive markets for electricity – like any other market – drive innovation, efficiency and investment and, over time, produce the lowest prices. Instead, we focused on preparing our business for the challenges of competitive markets described in the law.

For example, we doubled the size of our regulated wires business through a merger with GPU in 2001, and restructured our company to make it more adaptive and capable of competing. We separated our regulated and unregulated operations, and our generating plants are no longer owned by our utilities. Our competitive generation subsidiary increased the capacity of its fleet through investments in new generating facilities, upgrades at existing plants, and a generation swap with Duquesne Light Company. And it took steps to enhance the productivity and efficiency of our generating assets. In fact, since 1999, FirstEnergy has improved the productivity of its generating fleet by

27% and added about 1,600 megawatts of capacity. When major environmental upgrades are completed, our subsidiary will have invested about $6 billion through 2010 in its generating assets.

After spending billions of dollars restructuring our company and positioning it to be a successful competitor, we're now faced with legislation that would turn back the clock on competition and return Ohio to the failed policies of regulated generation rates.

Ironically, Ohio's largest manufacturers, who led the charge for electric competition back in the 1990s, are now strong advocates for a return to regulation. A decade ago, they claimed that regulated electricity prices created a competitive disadvantage for manufacturers. They now claim that, without a return to regulation, they will again be at a competitive disadvantage.

It doesn't make sense to change public policy every time large manufacturers, who already enjoy special privileges and subsidies, think "the grass is greener" on the other side of the regulatory fence… especially when electricity prices in Ohio haven't changed in years.

You've all heard the stories about price increases in Maryland and Illinois that followed about 10 years of price freezes. But what you haven't heard about are the increases in regulated states since 1997 – the 45% increase in Florida or 53% increase in Washington or 57% increase in Wisconsin or other double-digit increases that have occurred in regulated states throughout that period.

Customers in Ohio literally have already saved billions because their rates haven't changed – and future price adjustments will simply catch up with cost increases for fuel, environmental protection and other expenses that others have been paying all along.

While price increases affect both regulated and competitive states, it's clear that competitive markets, over time, will produce the lowest price for customers. This basic economic theory applies to all markets, it applies to electricity – and it is almost universally accepted among the nation's leading economists.

In fact, only two years ago, even the Ohio Manufacturers Association supported competitive markets for electricity in its official position on electric restructuring, and I quote: "Electric restructuring should be given additional time to develop because competition still provides the best long-term opportunity to obtain low-cost, reliable electricity."

And, a recent poll released by a coalition of commercial customers shows 84% of Ohioans supporting choice and competitive markets for electricity.

It's easy to understand why customers prefer competitive markets when you consider the ratemaking process under regulation.

In regulated environments, the process for setting rates is fairly straightforward: Utilities build costly new power plants or add environmental controls, and then prices are set to reflect the substantially higher costs of service created by these new investments. As a result, rates typically jump up significantly as utilities enter cycles of new construction, whether the costs of these investments result in prices higher than market prices or not.

I've been in this business now for some 35 years, starting as a tax accountant for Ohio Edison after graduating from The University of Akron. I worked my way up the ranks after earning my law degree at night school… and as the company's counsel I saw firsthand the impact of this cycle of new investments on rates.

And, we're in that cycle right now. For example, owners of generation in Ohio are spending, and will continue to spend, billions of dollars to meet new, more stringent environmental standards. At FirstEnergy alone, we'll be spending $1.8 billion over the next several years to meet these standards, and virtually every cost associated with our business – from coal and nuclear fuel to wire, poles and trucks – continues to increase dramatically. Also, other companies in the state, including AEP and Duke, have discussed plans to build new generating plants – and, of course, they have their own costly environmental additions to make.

In a regulated environment, these substantial new investments will significantly impact prices, as they did in the past. And instead of having shareholders bear the risks associated with these investments, those risks would be borne by customers on a utility-by-utility basis through the higher prices they pay.

In fact, the more an individual company has to spend because of its unique assets or the timing of its investments, the greater the price impact on that company's customers alone – and, of course, the greater the differences in prices within the state. It has happened in the past, and regulation will continue to create that disparity within Ohio. Only through competitive markets will prices essentially be the same throughout the state.

Re-regulation may sound like a good idea, when regulated rates appear to be lower than market prices – if for no other reason than current rate stabilization plans are holding prices essentially at 1990's levels. But if re-regulation becomes a reality in Ohio, we should expect significant increases in regulated rates to reflect the major investments all of the state's power producers have made and will be making to add new generation and to meet future environmental standards. And, in a couple of years, we will be back here again talking about how customers can avoid paying for these new investments, just as we were 10 years ago.

Reregulation and government mandates, controls and preferences are not the answer to Ohio's energy future. They failed in the past, and have been challenged in virtually every aspect since the early 1970s. Back then, the industry was faced with higher coal prices resulting from the Federal Coal Mine Health and Safety Act of 1969, the oil embargoes and double-digit inflation and interest rates that impacted the costs of generation plants then under construction, and all the other costs of providing utility services. The resulting changes in utility rates to reflect these costs led to demands for co-generation, "anyone but utility" construction for new plants, and customer choice.

Rather than relying on regulation and government mandates to meet our state's energy objectives, FirstEnergy believes that the competitive marketplace will deliver better products and prices and drive innovation and efficiency improvements. And customers should not be denied the opportunity to receive those benefits.

This push to change Ohio law should be driven by facts, not fear...

- Fear about price increases, which are inevitable under either a regulated or competitive system;

- Fear about a lack of new generation construction, even though Ohio has added 7,500 megawatts of new generation facilities since 1999, with little or no increase in price to customers; and

- Fear that competitive markets don't exist for electricity, which is simply not true.

In our region – which is overseen by the Midwest Independent System Operator – some 310 market participants clear more than $2.4 billion in wholesale energy transactions every month. I'd call that a fairly robust and mature market. In fact, a 2005 study by Cambridge Energy Research Associates found that wholesale competition has produced $34 billion in savings over a seven-year period for the nation's residential customers alone. And, retail markets will develop, as they have in every other area, when prices are no longer capped at artificially low rates.

At the same time, we know that "one size doesn't fit all." That's why we also believe the Public Utilities Commission of Ohio should have the flexibility and broader authority to approve, extend and expand upon rate plans developed by utilities if they offer a better opportunity for short-term price stability.

In addition, we support market-driven programs that encourage energy efficiency, demand response and the use of advanced energy resources. And, we support programs that encourage greater investment in Ohio's aging utility infrastructure.

You might think that, given this position, FirstEnergy would support Senate Bill 221 – but we don't.

The problem is that virtually every facet of this legislation offers very few details on how Ohio's utilities will be able to achieve the bill's stated goals, and it lacks the clarity needed to support the billions of dollars in investments our industry will require in the years ahead.

The bill's proponents would have us believe that the state's policy primarily supports competitive markets and customer choice. But the reality is, we simply can't get there the way the bill is currently written.

For example, Senate Bill 221 claims to offer a workable process that would enable utilities to use the competitive market to establish generation prices for customers who do not select alternative suppliers. But it is solely up to the PUCO to subjectively determine whether competitive markets exist – and whether customers can take advantage of them.

Also, the bill does not provide any context in which to establish prices, again leaving that up to the sole discretion of the Commission. Since the PUCO Chairman testified before you last week that the bill is "not necessarily cost-based," there is no basis upon which to determine what is just and reasonable. The bill also is silent as to how prices would be determined for utilities that don't own generation or must purchase power in the competitive market to meet all or part of their customers' loads.

In addition, the bill mandates efficiency and renewable measures, but excludes over 20% of the state's customers from participating – those served by municipal electric companies or RECs – and allows state and other governmental facilities and industrials to bypass the costs of these mandates. In fact, after these new costs are embedded in rates, only the customers who choose not to use or are denied access to the competitive market will be left to pay for the entire costs of these mandates.

Further, industrials can cut special deals, get "optimal cost" electricity from the state, obtain subsidies for distributed generation, avoid the cost of any new generation, and continue to enjoy the subsidies provided under regulated ratemaking. And, the costs of providing these options will be borne by the remaining residential and commercial customers.

The bill also proposes that all Ohio customers have access to so-called "smart meters" – also known as Advanced Metering Infrastructure or AMI. The problem with this proposal is two-fold. First, statewide deployment of AMI would cost more than $1 billion and result in the loss of more than 500 jobs. Second, the full benefits of these meters are only realized in truly competitive markets – not in a regulated environment that limits the options available to most customers.

Another costly proposal involves a target that, by 2025, 25% of the electricity sold under the standard service offer by electric distribution companies must come from advanced energy sources. In other words, only customers who are denied access to competitive markets would be required to pay for this mandate, and only electric distribution companies would be required to satisfy it.

Further, the bill narrowly defines advanced energy resources to include only certain types of nuclear and coal generation, and includes a mandate that at least half – or about 4,500 megawatts – must be from renewables, such as wind and solar power.

In Ohio, the wind doesn't always blow and the sun doesn't always shine. In fact, renewable sources of energy may be available less than one-third of the time, so the state may need to actually add more reliable forms of generation to support these renewable resources. The bill also misses a key advancement that must accompany any push for renewable resources, and that is energy storage. Without it, many of these options would make the overall electric system less reliable and more complex and costly to manage.

And, the cost of these renewable systems is significant. For example, the New Jersey Board of Public Utilities recently conducted an analysis of a renewable standard for solar power in that state. The BPU found that the state's 2% requirement for solar power – which would total nearly 2 million megawatt-hours per year – could cost as much as $11 billion by 2020. To put this into perspective, a similar 2% requirement in Ohio could cost about twice as much, based on our state's higher usage.

Further, in order to qualify as advanced energy sources, new coal-fired plants would be required to capture at least 80 percent of their carbon-dioxide emissions. However, most industry experts – including the ones we're working with at our Burger Plant to test carbon capture and sequestration – believe these technologies won't be commercially viable until 2025 or later. As a result, the bill would actually require an even greater investment in renewable energy, or substantially more nuclear capacity within Ohio.

This legislation raises serious constitutional and statutory issues involving the taking of private property by government, due process and the state claiming supremacy over generating assets that are under federal jurisdiction and involved in interstate commerce. I won't go through legal arguments point-by-point, because you'll be getting our perspective on these issues from other FirstEnergy representatives at future hearings. But my sense is the same as the Governor's, that there are "considerable legal obstacles to a full return to a regulated system" – yet that is what this legislation is attempting to do.

In closing, I don't think the road to lower prices and better service for Ohio's customers requires yet another major overhaul of our industry, with a price tag that could reach billions of dollars. Instead, I believe there is a common-sense path that addresses the concerns of the Governor, and is based upon essentially the same criteria that have been relied upon to deliver rate stabilization throughout Ohio.

- First, I recommend that the PUCO have the clear statutory authority to negotiate rate plans with utilities in ways that won't be overturned by the Ohio Supreme Court;

- Second, consistent with existing law, if these negotiations don't result in rate plan agreements, a competitive bid process for delivering the best generation price possible through the competitive marketplace for electricity should be used to establish the generation rate for customers who do not choose an alternative supplier; and

- Finally, to address the other components of the Governor's plan, the PUCO's statutory authority should be broadened to promote energy efficiency, demand response, renewable power and infrastructure improvements through variable rate mechanisms that provide adequate recovery for these and other societal programs.

We strongly believe these three recommendations would better serve our customers, and your constituents. Thank you for inviting me here today to share my thoughts on Senate Bill 221 and other key issues affecting Ohio's energy future. I will be pleased to answer your questions.