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WITNESS: ERIC M. MARKELL

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-072300** **Docket No. UG-072301**

THIRD EXHIBIT (NONCONFIDENTIAL) TO THE
PREFILED REBUTTAL TESTIMONY OF
ERIC M. MARKELL
ON BEHALF OF PUGET SOUND ENERGY, INC.

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Power, Coal & Natural Gas - Regulatory and Legal Developments

FERC warns of rising electricity prices for years to come

SNL EXTRA

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By Kathleen Hart

The steep increase in forward market prices for electricity being seen across the United States may be the beginning of a period of significantly higher electricity prices that will last for years, FERC warned June 19.

"We've seen this storm of high prices coming at us for several years on the horizon and it is about to hit, and I think it will be over us for quite a while," Commissioner Philip Moeller said. FERC staff presented an assessment of increasing costs in electricity markets, which provided the basis for an extensive discussion of policy ramifications during the open commission meeting June 19.

Looking forward, the report found that demand will continue to grow and the need for new capacity "will become ever more acute and ever more widespread." While higher prices themselves may discourage some power demand, a significant level of demand increase seems virtually inevitable, the report said, adding, "So will be the need to build more capacity."

The two major factors pushing the costs of electric generation higher are increased fuel costs and increased cost for new construction, according to the staff report, "Increasing Costs in Electric Markets." "These factors affect all parts of the country. That is, higher future prices are likely to affect all regions," it said.

The index of costs for the main inputs that go into building new power plants has almost doubled since 2003, with nuclear plant inputs rising even faster, the report said. Much of the cost increase results from rising global demand for basic materials. Steel, for example, is now more than twice as expensive as it was four years ago. In addition to pushing up construction costs, rising costs for iron and steel also will affect fuel prices for the power industry because natural gas wells and pipelines both use substantial amounts of steel.

The staff noted that costs are increasing for copper, nickel, zinc and aluminum, the four key metals that go into generators. Copper is up more than five times over the past four years. "Indeed, copper is now so valuable there are reports of copper thieves cutting live cables to steal the metal," the report said.

Kelliher points to 'hard realities' shaping FERC policy

"It is a pretty sobering assessment," FERC Chairman Joseph Kelliher said. "FERC regulatory policy must be based on reality, and the reality is that we're looking at continuing upward pressure on electricity prices." Higher capital costs for new power plants, higher construction costs, and higher fuel costs are going to continue for some time, which means electricity prices will be higher than Americans would prefer, he said

Kelliher outlined three realities that are shaping FERC policy. First, FERC and state utility commissions are regulating in a high-cost environment. Second, the U.S. needs massive investments in new generation, transmission and distribution. Third, the country is beginning to confront the need to take action on climate change.

Uncertainty about future carbon regulation is a key factor affecting the market, particularly coal generation. The debate over how to address CO_2 emissions has already affected how companies think about investments. The report noted that since January 2007, 50 coal plants have been canceled or postponed while only 26 remain under construction.

"Whatever the eventual result of the climate change debate, costs of producing power from both coal and natural gas are likely to increase. Moreover, as long as future climate change policy is unclear, market participants will have a considerable disincentive to invest in coal plants," the report said.

Moeller sees transmission as shoulder strategy

Given the range of uncertainty over the future of carbon policy in this country and the cost of a carbon cap-and-trade policy or a carbon tax, Moeller noted that people are moving toward renewables. While it's good to have more renewables on the grid, he pointed to challenges with the integration of wind resources because wind is not the same as baseload power. "If we go in recognizing the reliability consequences of that as policymakers, it's better than if we pretend it doesn't exist," he said.

"More transmission can help solve a lot of these problems, at least as a shoulder strategy because it comes at a disproportionately small price compared to the commodity price or the fuel price," Moeller said.

In addition, Moeller said consumers need more education about rising electricity costs and more tools to control their energy consumption. "The more consumers receive accurate price signals and the more they see the real cost of energy, the better they can adjust their demand," he said.

Kelly notes enthusiasm for demand resources

Commissioner Suedeen Kelly said rising prices underscore the importance of FERC's policies to improve renewable resources' access to transmission. She also said FERC needs to be careful not to provide incentives for transmission construction in a way that has the unintended consequence of raising the cost of transmission.

Kelly noted that there are other problems in the U.S. economy that compound the cost of building new electricity infrastructure, including the weak dollar, an economic slowdown, the prospect of inflation and tight credit. "It's not easy to build expensive long-lived assets today in a constrained and uncertain world, and frankly we see around the country that it's not appealing to the electric industry consumer," she said.

In response, states have canceled the construction of new power plants and issued standards for renewables and energy efficiency, she added "There is decreasing enthusiasm for building and an increased enthusiasm for demand side resources."

Spitzer highlights need for supply, not just demand resources

Commissioner Marc Spitzer argued that while demand response and other energy efficiency measures are good, a lack of sufficient electricity supply is not. "Demand response is great, but demand destruction that we've seen in certain segments of the U.S economy where jobs are lost and permanently exported is not a good thing," Spitzer said.

Spitzer said FERC must attempt to attack and solve the supply side as well as the demand side of the equation. "A recent phenomenon that is one of the consequences of the oil shock of 2008 is that folks are now talking about both conservation and supply at the same time," he said.

Noting that the upward pressure on retail rates is national in scope, Spitzer said that there are very few utilities that are not applying to state commissions for rate increases, in organized markets and in regions with vertically integrated utilities.

"I think we have a good story to tell in the area of natural gas, although again it's in reaction to the price increase," Spitzer said. "We've, in fact, seen an increase in production in natural gas wells."

Energy is the lifeblood of the American economy, and FERC has a mission "to ensure that investment in infrastructure for both electricity and natural gas will be forthcoming," Spitzer added.

EEI estimates $1 trillion needed for new infrastructure

"Today's staff report by FERC underscores the significant challenge facing U.S. utilities," Edison Electric Institute Executive Vice President David Owens said in a statement. "As utilities work to meet ever-growing electricity demand in an era of rising costs, they will have to replace aging infrastructure with new and more efficient technologies while also confronting the climate change imperative."

EEI and its members are committed to expanding "a full range of energy efficiency and demand-side options, along with the steadily growing integration of renewable energy sources," Owens said. "We are acutely aware of our responsibility to become more energy efficient, and to do more to equip our customers with the tools they need to manage their bills through a wiser and more efficient use of energy."

However, Owens noted that the commission report amplifies the preliminary findings of a Brattle Group report released in April by the Edison Foundation, which concluded that U.S. utilities likely will have to invest more than $1 trillion in new generation, transmission and distribution infrastructure by 2030, even after factoring in substantial improvements in energy efficiency.

Owens emphasized that there is no single solution to the challenge. "We are going to need all the resources we can muster as we continue what will become the largest electric industry infrastructure investment in many decades."