Commonwealth of Pennsylvania

Pennsylvania Public Utility Commission

En Banc Hearing

on the

Current & Future Wholesale Electricity Markets

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Testimony presented by:

Steve Elsea, Director of Energy Services

Leggett & Platt Inc.

I want to thank the Commission for the opportunity to share our perspective of the competitive electricity markets. My name is Steve Elsea and I am the Director of Energy Services for Leggett & Platt Incorporated.

I began my career with an investor-owned dual-fuel utility in Illinois in the pre-Three Mile Island era. I spent 22 years working for investor-owned utilities in Illinois, Kentucky and Ohio. The focus of my career was in marketing & customer services and I've personally conducted hundreds of energy efficiency audits for residential, business, institutional and industrial customers. Before I left the utility industry in 2000 I managed residential and commercial programs for American Electric Power (AEP). Later I owned an energy management company that focused on a demand response solution and consulted for municipal electric utilities in Ohio before I joined Leggett two years ago.

Leggett & Platt is a diversified manufacturer that conceives, designs and produces a broad variety of engineered components and products that can be found in virtually every home, office, retail store, and automobile. Leggett serves a broad suite of customers that comprises a "Who's Who" of U.S. manufacturers and retailers. In our 125 year history, our company has grown into 21 business units in more than 250 facilities located in 20 countries. About 75% of our facilities are located here in the United States. We operate two production plants in Pennsylvania; one in Berwick and the other in Wilkes-Barre.

As you can imagine, our production facilities and their respective hours of operation are very diverse. We have small assembly plants that operate one or two shifts a day five days a week to large 24x7 integrated production facilities where feed stock is turned into finished components.

As a large power user, Leggett believes that competitive energy markets are important. Competitive markets produce price transparency that provides end-use consumers more choices than those from the vertically integrated energy delivery construct. Competitive markets not only provide consumers the options that can mitigate price volatility but those markets also inherently improve reliability through regional transmission organizations on the supply-side and increase efficiency & technology options on the demand-side.

You've heard testimony in previous hearings that are contrary to these statements but I will take the next several minutes to explain our perspective.

First, let me say that I understand the positions of ALCOA, ELCON, PJMICC et al. These folks represent a class of customers of which Leggett is a part but we take exception to their opinions regarding the direction of organized electricity markets.

Prior to wholesale & retail deregulation in the days of the regulatory compact between utility and consumer cross-subsidization between billing determinants and even between rate classes served multiple purposes.

Often, however, that cross-subsidization had unintended consequences. For example, demand costs that were much lower than the cost-to-serve that marginal capacity reduced investments in technologies that specifically mitigated peak demand. The unintended consequence was lower utility system load factors and higher capital costs to meet new peaks in the entire electric supply-chain infrastructure. In the best case, those costs became imbedded in those kilowatt-hours aggregated within the time-of-use rate blocks that were typically spread around an entire season. In the worst case, every kWh regardless of TOU or seasonality subsidized the marginal cost of every new kW added to the system peak. This cross-subsidization created a need by utilities to establish energy efficiency rebates to promote behind-the-meter installations of technologies whose installed costs could not be supported by the average cost –let alone below average cost- price signals of subsidized tariffs; thus compounding the problem of cross-subsidization.

In my days at AEP before the emergence of organized markets, I found it curious that certain customers and customer classes -namely industrial customers- were among the most active participants lobbying for deregulation. They were experiencing rate increases never seen before, but the fact of the matter was that many high use high load factor customers were paying slightly above system lambda and well below the cost-to-serve. I couldn't imagine that in a deregulated environment that they could get a better deal.

As you know, competitive markets do not support the cross-subsidization between customer classes. The so-called 'average cost' to serve industrial customers is actually below-average cost so it is natural that a pre-deregulation subsidized group will experience increases upon the introduction of competition. This doesn't make the markets dysfunctional as has been suggested by some but it proves that price unbundling in a competitive, organized market works.

I said earlier that I understand the positions of ALCOA, ELCON, PJMICC an others. They are coming to the realization that the subsidized electricity costs south of 3¢ that they have been paying won't be in the cards in a competitive market. I'll use two examples from my personal experience.

First, when I began to consult with a 100 megawatt municipal utility in Ohio I reviewed their wholesale contract they had with my former employer, AEP. The muni was paying well below market prices after the phase-in to competition began in Ohio in January 2000. I noticed that there was a cancellation provision that would allow AEP to notify the muni of its intent to cancel before the automatic renewal date of January 1, 2001.

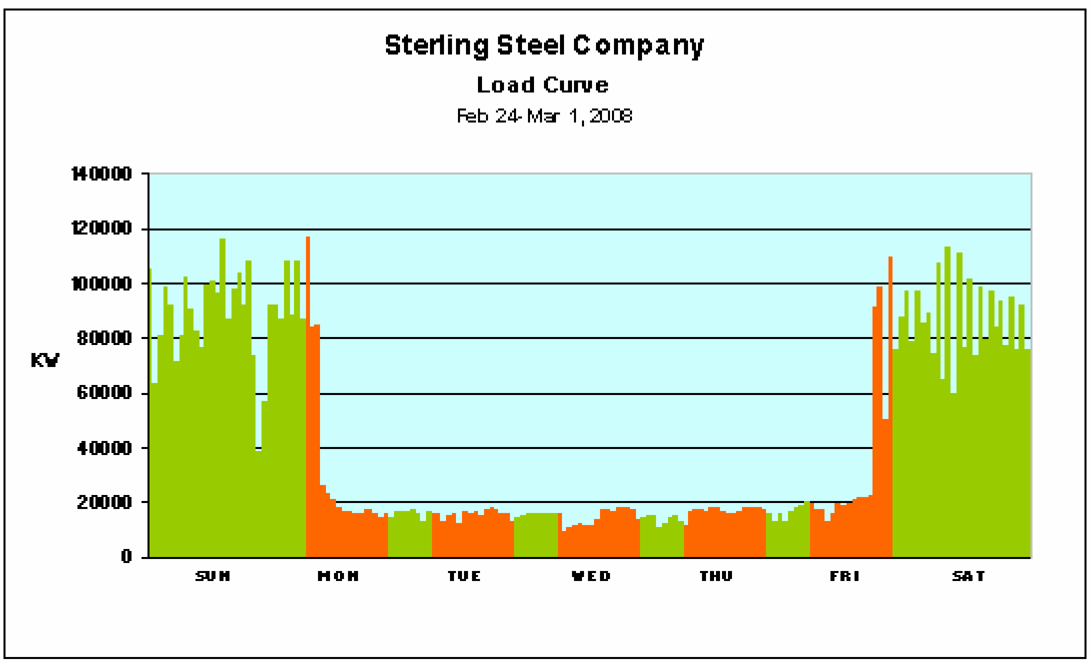
Upon such notification, the contract would expire at the end of the following calendar year. I suggested to the muni that AEP will probably be notifying them before year end to cancel this 20+ year old contract. The muni would then have 12 months to prepare for the inevitable increase. On queue, AEP faxed its intent to cancel on December 31, 2000. The muni began paying market prices on January 1, 2002.

Let me use Leggett as my last example. Leggett operates one of the largest electric arc furnaces (EAF) in the world at Sterling Steel Company located behind PJM. Prior to January 1, 2007 we paid 2.9¢ per kilowatt-hour at Sterling. This was a grandfathered deal we had with Commonwealth Edison.

ComEd exercised its cancellation clause in the Sterling contract as AEP had done with my muni client several years earlier. I understand why they did it and

I also understand the logical response by industrial customers and groups representing those customers to maintain the status quo. It is no wonder that customer surveys of industrial customers in regulated service areas versus industrials in competitive markets show a marketed difference. As a company that maximizes profits and has a focus on shareholder return, we understand the desire to minimize every controllable expense.

Now that we are paying market prices at Sterling we are responding to the price signals behind the Northern Illinois hub of PJM. Sterling operates a 15-megawatt rolling mill 7x24 and the 85 mW EAF –or melt shop- operates primarily on weekends.



In 2008, business increased for the steel ingots we produce from the melt shop operation. This made it necessary to extend the melt shop operation into the work week. Enter the PJM RPM. It became apparent that we had an incentive to manage around PJM's five coincident peaks. Operating the melt shop coincident with only one CP hour would cost approximately $700,000. Did we respond to this price signal? You better believe it.

Conversely, had our steel operation been located only 75 miles to the south behind MISO, we'd probably absorb the differences in hourly energy price and extend weekday operations without regard to system peaking conditions potentially contributing to new peaks and/or affecting the integrity of system reliability. I believe the RMP is a logical evolution toward valuing capacity. Is it perfect? No, but the absence of a capacity market translates into a subsidization between energy and capacity creating disincentives for supply-side investment and demand-response participation.

As an additional response to market price signals, we have enrolled 3 mW in the PJM Interruptible Load for Reliability (ILR) Program. Given the RPM price signals for the auction periods 2009-2010 and 2010-2011, we have also relocated a 2 mW standby generator from a closed facility in Arkansas to Sterling. During the due-diligence phase of transferring this idle asset, we only considered those Leggett facilities located behind RTOs/ISOs where capacity was valued. Again, the RPM was integral in that decision.

Lastly, improvements in technology and communications provide real-time access to energy usage data behind-the-meter and in the supply-side marketplace. Advanced metering, telecommunications and data processing are fundamental to the competitive marketplace by producing the price transparency on a real-time basis as well as providing the necessary coordination by the RTO for optimal grid reliability.

The market is moving supply-side options in renewable energy and demand-side options like advanced electricity storage into the consumer product mix. Consumers no longer need to be tethered to a specific electric generation mix but can shop for energy from wind farms to landfill gas-operated generation. We can supplant peak demand utilizing solar technology or smooth those peaks through the use of advanced battery storage systems. And just as importantly, the new electricity marketplace encourages increased consumer energy efficiency and conservation far beyond the "one-size-fits-all" model of yesteryear. Make no mistake about it. Competitive electricity markets are working.

I want to thank Judge Cocheres, Chairman Cawley and the other commissioners for giving us the opportunity to share our viewpoint.