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January 9, 2009

James J. McNulty, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120

VIA HAND DELIVERY

RE: *En Banc* Hearings on Current And Future Wholesale Electricity Markets; Docket No. M-2008-2066901

Dear Secretary McNulty:

Please find enclosed the original and ten (10) copies, as well as an electronic version on diskette, of the Reply Comments of the Industrial Energy Consumers of Pennsylvania ("IECPA"), Duquesne Industrial Intervenors ("DII"), Met-Ed Industrial Users Group ("MEIUG"), Penelec Industrial Customer Alliance ("PICA"), Penn Power Users Group ("PPUG"), Philadelphia Area Industrial Energy Users Group ("PAIEUG"), PJM Industrial Customer Coalition ("PJMICC"), PP&L Industrial Customer Alliance ("PPLICA"), and West Penn Power Industrial Intervenors ("WPPII") to the December 18, 2008 *en banc* hearing.

Please date stamp the extra copy of this transmittal letter and Reply Comments and kindly return them for our filing purposes.

Very truly yours,

McNEES WALLACE & NURICK LLC

By Vasiliki Karandrikas
Vasiliki Karandrikas

Counsel to Industrial Energy Users of Pennsylvania, Duquesne Industrial Intervenors, Met-Ed Industrial Users Group, Penelec Industrial Customer Alliance, Penn Power Users Group, Philadelphia Area Industrial Energy Users Group, PJM Industrial Customer Coalition, PP&L Industrial Customer Alliance, and West Penn Power Industrial Intervenors

VK/sds
Enclosures

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Vice Chairman Tyrone J. Christy (via Hand Delivery)
Commissioner Robert F. Powelson (via Hand Delivery)
Commissioner Kim Pizzingrilli (via Hand Delivery)
Commissioner Wayne E. Gardner (via Hand Delivery)
Karen Oill Moury, Director of Operations (via Hand Delivery)
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

***En Banc* Hearings on Current And Future Wholesale Electricity Markets**	:	**Docket No. M-2008-2066901**

REPLY COMMENTS OF INDUSTRIAL ENERGY CONSUMERS OF PENNSYLVANIA, DUQUESNE INDUSTRIAL INTERVENORS, MET-ED INDUSTRIAL USERS GROUP, PENELEC INDUSTRIAL CUSTOMER ALLIANCE, PENN POWER USERS GROUP, PHILADELPHIA AREA INDUSTRIAL ENERGY USERS GROUP, PJM INDUSTRIAL CUSTOMER COALITION, PP&L INDUSTRIAL CUSTOMER ALLIANCE, AND WEST PENN POWER INDUSTRIAL INTERVENORS

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Dated: January 9, 2009

I. INTRODUCTION

Industrial Energy Consumers of Pennsylvania, Duquesne Industrial Intervenors, Met-Ed Industrial Users Group, Penelec Industrial Customer Alliance, Penn Power Users Group, Philadelphia Area Industrial Energy Users Group, PJM Industrial Customer Coalition, PP&L Industrial Customer Alliance, and West Penn Power Industrial Intervenors (collectively, "Industrial Customers") appreciate the opportunity to submit these Reply Comments. Industrial Customers commend the Pennsylvania Public Utility Commission ("PUC" or "Commission") for convening a series of special Public Hearings dedicated to the current and future state of wholesale electricity markets. The Commission's action underscores the critical link between the design and structure of the wholesale power market administered by PJM Interconnection, L.L.C. ("PJM"), and the retail prices paid by Pennsylvania ratepayers. The success of Pennsylvania's retail market hinges on a properly structured and properly designed wholesale power market. The current wholesale power market is neither.

Because the cost of electricity represents a significant operating cost for large commercial and industrial customers, Industrial Customers were among the early proponents of introducing properly structured competitive forces to the electric utility industry.[1] However, the restructuring movement has not stayed true to the initial goals of ensuring reliability and providing customer benefits, namely, lower cost power. Now, more than a decade later, the current PJM wholesale power market bears little resemblance to the market that Industrial Customers had envisioned. This "competitive" wholesale market is, in reality, nothing more than a set of administratively determined pricing mechanisms. Despite the rhetoric of the proponents of the current PJM market design, supporters of the current design are not "pro competition," while opponents of that design are not "anti-competition." Rather, Industrial Customers and

[1] See generally industrial customers' testimony before House and Senate representatives prior to restructuring.

others, such as Portland Cement Association, are seeking to replace the current administratively determined pricing mechanisms with alternatives that strike a better balance among the interests of all market participants and continue to ensure reliability.

Due to the close nexus between wholesale and retail prices, it is critical for the Commission to understand which wholesale market design and structure deficiencies contribute to Industrial Customers' dissatisfaction with the PJM power market and its resulting impact on retail prices. To this end, Industrial Customers' Reply Comments focus on responding to the assertions made by certain wholesale market participants during the Public Hearing held on December 18, 2008. Industrial Customers offer their perspective on the shortcomings of the wholesale market. If the administrative wholesale market mechanisms are modified, Pennsylvania's retail competition initiative can better meet the goals established in the Electricity Generation Customer Choice and Competition Act ("Competition Act"), and reliability can be fulfilled.

Failure to pursue a market design that brings competitive forces to bear when they can optimize efficiency for the betterment of customers will have dire consequences for business and industry in Pennsylvania. As the General Assembly determined in passing the Competition Act, "the cost of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in this Commonwealth."[2] Without steps to ensure that the wholesale power market in which Pennsylvania participates is producing just and reasonable electricity prices, the Commonwealth will be severely disadvantaged in its ability to compete in the national and international marketplace for industry and jobs. The current economic climate makes it even more essential for the Commission to ensure that the interests of

[2] 66 Pa.C.S. § 2802(6).

Pennsylvania ratepayers, including business and industry, are paramount in evaluating wholesale market design theories and results.

II. DESCRIPTION OF INDUSTRIAL CUSTOMERS

Industrial Energy Consumers of Pennsylvania ("IECPA") is an association of energy-intensive industrial companies operating facilities across Pennsylvania. IECPA's members annually consume in excess of 25% of the industrial electricity in Pennsylvania and employ approximately 75,000 workers at nearly 120 facilities across the Commonwealth. IECPA actively participated in the stakeholder process that led to the drafting of the Competition Act that established Pennsylvania's retail choice program and participated in many generic rulemakings initiated to implement the Competition Act.

Also sponsoring these Comments are coalitions of commercial and industrial customers receiving service from most of the Commonwealth's electric distribution companies: Duquesne Industrial Intervenors ("DII"); Met-Ed Industrial Users Group ("MEIUG"); Penelec Industrial Customer Alliance ("PICA"); Penn Power Users Group ("PPUG"); Philadelphia Area Industrial Energy Users Group ("PAIEUG"); PP&L Industrial Customer Alliance ("PPLICA"); and West Penn Power Industrial Intervenors ("WPPII").

PJM Industrial Customer Coalition ("PJMICC") is an ad hoc coalition consisting exclusively of large commercial and industrial end-users of electricity. PJMICC members operate manufacturing and institutional facilities throughout the expanded PJM footprint, which encompasses all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia, and the District of Columbia. Several PJMICC members also operate manufacturing and institutional facilities located in parts of Virginia and North Carolina encompassed by the PJM South region. PJMICC member companies consume more than 9.5 billion kilowatt-hours of electricity annually. Several PJMICC members are currently also voting participants of the PJM Members Committee and actively participate in the PJM Committee structure.

III. COMMENTS

Over the last three months, the Commission has collected testimony and comments from various stakeholders regarding the state of the current wholesale markets, including testimony by PJMICC, American Public Power Association ("APPA") and Electricity Consumers Resource Council ("ELCON") that advocate for alternative market designs. Since 1996 when the initial changes to the PJM wholesale market were proposed, there have been countless pleadings submitted to the Federal Energy Regulatory Commission ("FERC") and other bodies that explained legitimate objections to the various market design changes that have occurred to the energy and capacity markets (and other markets) that have disadvantaged customers. All of those documents are available to the Commission in reaching its determination regarding this investigation. Industrial Customers will not repeat those arguments here and will, instead, focus on correcting misstatements of the industrial community's positions and explaining why changes to the current market design are necessary to fulfill the goals of Pennsylvania's restructuring initiative.

A. Industrial Customers Support Bypass or Reform of the Wholesale Markets as a Means To Allow Retail Competition in Pennsylvania To Achieve Anticipated Benefits.

A common theme in the testimony of certain wholesale market participants is the mischaracterization of Industrial Customers' position on wholesale power markets. Those market participants allege that Industrial Customers seek to return to the cost-of-service regulatory paradigm that existed prior to electric utility restructuring. The objective of this tactic is to avoid meaningful discussion about current flaws plaguing the PJM wholesale power market.

Contrary to these arguments, Industrial Customers believe that competition and market forces can be part of a functional wholesale power market, if properly structured to drive efficiency and reduce costs for the benefit of customers. Pennsylvania's restructuring initiative was undertaken with the central goal of reducing electricity costs for Pennsylvania consumers (in comparison to traditional regulation), while also maintaining reliability.[3] The ability of Pennsylvania to achieve its goals for retail competition is handicapped by the existing (and flawed) wholesale market design. Retail competition can co-exist with alternative wholesale market designs. Industrial Customers urge the PUC to pursue all available methods to reform the wholesale markets or, if necessary, bypass those markets to ensure that Pennsylvania's retail restructuring initiative is successful.

B. The Current Wholesale Market Design Does Not Enjoy Broad Customer Support.

According to FERC, the goal of electric utility restructuring was to provide "efficient, lower cost power to the [n]ation's electricity consumers."[4] In restructuring Pennsylvania's electric utility industry, the General Assembly recognized that "[r]ates for electricity in this Commonwealth are on average higher than the national average" and that the "cost of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in this Commonwealth."[5] The General Assembly determined that introducing greater competition in the electricity generation market was necessary to "protect this Commonwealth's ability to compete in the national and international marketplace for industry and jobs."[6] Thus, the measure of success of Pennsylvania's restructuring initiative is the

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[3] 66 Pa.C.S. §§ 2802(4) & (11).

[4] *See Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Service by Public Utilities*, FERC Stats. & Regs., Regs. Preambles, Jan. 1991-June 1996, ¶ 31, 036, p. 31,632, 61 Fed. Reg. 21,540 (1996), *aff'd sub nom. New York, et al. v. Federal Energy Regulatory Comm'n*, 535 U.S. 1 (2002) ("Order No. 888").

[5] 66 Pa.C.S. §§ 2802(4) & (6).

[6] 66 Pa.C.S. § 2802(7).

fulfillment of the Competition Act's core goals of lowering electricity rates and promoting economic development in the Commonwealth.

COMPETE Coalition ("COMPETE") claims that wholesale markets enjoy broad customer support, citing a letter to Governor Rendell signed by a several retailers and one industrial customer, Leggett & Platt, Inc. ("Leggett"), doing business in the Commonwealth.[7] In support of this claim, Wal-Mart Stores, Inc. ("Wal-Mart"), and Leggett testified that they favor competitive markets because they reward cost management initiatives, such as participation in demand response programs and implementation of energy efficiency and conservation measures. While the current wholesale market structure does provide these opportunities, Industrial Customers submit that these programs and measures do not address the underlying market design flaws that contribute to unjust and unreasonable rates. Stated differently, reformed wholesale market designs, as advocated by PJMICC, APPA, and others will still allow, if not enhance, Wal-Mart's, Leggett's, and others' opportunity to achieve their demand response and energy efficiency and conservation objectives. Correction of the flaws in the current wholesale market structure does not mean the elimination of the motivation and incentives of customers to pursue those objectives.

Although COMPETE purports to represent the view of Pennsylvania customers, it is important to note that customers make up only a small segment of COMPETE members. The majority of COMPETE members constitute generator interests. With due respect for the contributions that the actual customers in COMPETE may make to the Pennsylvania economy, the potential economic devastation for Pennsylvania's manufacturing base is immense, if rate caps are allowed to expire under the current wholesale market structure. IECPA members alone employ 75,000 Pennsylvania workers in stable jobs with family-sustaining wages. Unlike most

[7] *See* Testimony of William L. Massey on behalf of the COMPETE Coalition at 10 (Dec. 18, 2008).

of the retail industry, industrial operations are very energy-intensive and commonly run 24 hours a day, seven days a week. For large commercial and industrial customers, energy costs usually constitute a key driver of operating costs, after labor and raw material costs.

Moreover, unlike the retail industry, industrial operations require costly capital investment and, therefore, long-term commitments to a local community. Due to the lack of a stable and predictable environment for electric power, large commercial and industrial customers are being forced to place such capital investments on hold. As Arthur K. Mann, Sr., Chairman of Donsco, Inc. ("Donsco"), testified: "We are currently looking to expand capacity in PA, spending $10,000,000 over four years. This expansion of production and jobs is now on hold because these investments have a 10 to twenty year[] life and the return on this investment depends greatly on what we will be paying for electric power."[8]

Due to the energy-intensive nature of their manufacturing processes, large commercial and industrial users of electricity are extremely sensitive to fluctuations in energy prices. Any price increases must be reflected in product pricing or offset by cost cuts elsewhere. Because Industrial Customers compete in a fiercely competitive global marketplace, and it is difficult to pass costs onto customers, the latter course of action is more likely. For example, David F. Ciarlone, Manager, Global Energy Services for Alcoa, Inc. ("Alcoa"), testified that the inability to obtain long-term, competitively priced power resulted in the shut down of Alcoa's aluminum smelter in Frederick, Maryland, and the loss of 700 well-paying jobs.[9] Similarly, local power price and supply issues in the Electric Reliability Council of Texas ("ERCOT") market have forced Alcoa to curtail production at its Rockdale, Texas smelter, resulting in the elimination of 820 jobs.

[8] Remarks by Arthur K. Mann, Sr., Chairman, Donsco, Inc. at 1 (Oct. 22, 2008).
[9] Testimony of David F. Ciarlone, Manager, Global Energy Services Alcoa, Inc. at 4 (Nov. 6. 2008).

With the potential expiration of rate caps in 2010, Alcoa is bracing itself for the impact of having its Lancaster Mill fully exposed to the flawed PJM market design. Alcoa expects the Lancaster Mill to suffer from a cost disadvantage that is entirely attributable to the current market design, which "is threatening the future of the Lancaster Mill."[10] Higher costs will make it difficult for the Lancaster Mill to compete with other Alcoa facilities located in regulated states or other countries with predictable and affordable electricity prices.[11] Why would industrials, like Alcoa, continue operating in Pennsylvania if a product can be produced more economically elsewhere?

PJM and other wholesale market participants have cited studies claiming that competitive power markets have produced customer benefits. However, as demonstrated by testimony presented by Donsco, Alcoa, and other industrial customers before this Commission and FERC, customers' real world experience does not match the academic studies cited by market proponents. Stable, predictable and affordable energy prices are critical to the Commonwealth's ability to attract, retain, and promote industry. As structured, the current market fails to provide Pennsylvania's manufacturing base with a sound platform for their businesses.

C. Market Signals Are Not Working To Encourage New Investment.

In defense of the current market design, a PSEG Energy Resources & Trade LLC ("PSEG") representative testified that, "[b]ecause people are not investing to the extent that may be desired by the Commission, or are not investing in certain types of plants at this time, does not mean the market signal is wrong."[12] During the hearing, PSEG's representative explained that investment is not occurring because prices are not high enough. Such comments, however,

[10] *Id.* at 6.

[11] *See* SNL Financial LLC, "Alcoa Secures Long-Term Power Deal with Hydro-Quebec, but Faces Downgrade" (Dec. 22, 2008) (announcing a long-term contract between Alcoa and Hydro-Quebec for 2,100 MW of power supply through 2040).

[12] Comments of Marji Philips on behalf of PSEG at 6 (Dec. 18, 2008).

ignore the fact that the implementation of the current design was based on FERC's theoretical view that the design would provide price signals for more "efficient and cost-effective construction and location of generation plants" than provided by cost-based regulation.[13]

In PJM, the adoption of the single-clearing price mechanism establishing a locational marginal price ("LMP") was intended to "send price signals that are likely to encourage efficient location of new generating resources, dispatch of new and existing generation resources, and expansion of the transmission system."[14] When the LMP scheme, along with the concepts of Financial Transmission Rights and scarcity pricing, were introduced in 1996/1997, PJMICC and other industrials actively opposed this market framework.[15] PJM's implementation of a new capacity market based on the Reliability Pricing Model ("RPM"), more than a decade after implementation of LMP, makes clear that PJM's market design has failed to achieve its intended objective. RPM validates large commercial and industrial customers' concerns with, and opposition to, the original market design.

Contrary to witnesses' claims, the lack of investment in response to escalating price signals strongly suggests that PJM's current market design is not functioning properly. However, rather than investigating the root causes of this dysfunction and introducing meaningful market reforms based on the findings of such an investigation, federal regulators continue to bless administrative fixes that purport to stimulate needed investment by digging ever deeper into customers' pockets. Although customers have paid and are expected to continue paying escalating prices for power supply, they are not realizing commensurate, dynamic efficiency benefits. Industrial Customers question, when, if ever, the revenue streams produced by LMP, RPM, and any future "administrative fixes" will be lucrative enough to fulfill generators' self-

[13] *New PJM Companies*, 107 FERC ¶ 61,271 at n.69 (June 17, 2004).
[14] *Pennsylvania-New Jersey-Maryland Interconnection*, 81 FERC ¶ 61,257 at p. 62,253 (Nov. 25, 1997).
[15] *See* Official Transcript of Proceedings at 218-222, *Pennsylvania-New Jersey-Maryland Interconnection*, Docket No. OA97-261-000, *et al.* (1997) *available at* www.ferc.gov; *see also id.* at 232-236; *id.* at 239-241.

imposed expectation of "sufficient" price signals to build new generation. Even more importantly, Industrial Customers question whether Pennsylvania employers, such as Alcoa and Donsco, will be able to survive until that day arrives.

D. The Current Market Design Creates a Disincentive To Build for Owners of Existing Generation.

PJM uses the single-clearing price mechanism in both the capacity and energy markets. The single-clearing price mechanism allows the highest offer accepted by PJM to establish the price paid to all suppliers, regardless of their marginal costs. As a result, suppliers with lower marginal costs realize returns that greatly exceed their marginal costs. For this reason, the single-clearing price mechanism inflates the ultimate cost to consumers because suppliers with lower marginal costs (*e.g.*, coal-fired or nuclear generation) receive the same price as suppliers with higher marginal costs (*e.g.*, gas-fired generation). The differential between the clearing price and marginal costs represents a unit's "inframarginal revenue."[16]

For all but the marginal units, increased market-clearing prices have yielded increased inframarginal revenues for generators. As natural gas prices increase, and natural gas-fired units continue to set the market-clearing price, baseload and mid-merit units stand to earn more inframarginal revenue while marginal units may not cover their fixed costs. Investment in newer, more efficient resources would tend to reduce single-clearing prices and, thus, shrink inframarginal revenue streams, to the detriment of existing generation owners. The great paradox of the prevailing market design theory is that the price signal to invest is eliminated when an investor responds to it. Existing generation owners would not be acting in their economic interest if they put capital at risk to decrease their inframarginal revenue streams. Such action would be akin to spending a fortune to retire the goose that lays the golden eggs.

[16] Statement of Robert A. Weishaar, Jr., on behalf of PJMICC at 3-4 (Nov. 6, 2008) ("Weishaar Statement").

The current market design creates a "disincentive to build" for any owners of existing generators that are collecting substantial inframarginal revenues. Industrial Customers recognize the benefits of enhanced productivity; however, these benefits are not being shared with customers.

While rising price signals are prompting generators to enhance productivity and, consequently, maximize inframarginal revenues from existing units, they are not creating an incentive to build new generation. Generators' efforts to maximize inframarginal revenues is meant to benefit their shareholders. They are not being invested in new, cleaner generation for the benefit of the customers that are footing the bill for these price signals. Thus, the single-clearing price mechanism motivates sellers to minimize costs and maximize profits for the benefit of their shareholders, not their customers.[17]

E. Fuel Prices Alone Cannot Be Blamed for Escalating LMPs.

PJM and certain market participants attempt to excuse higher energy prices on the basis of higher fuel costs and attempt to excuse "rate shock" on the basis of State-approved rate caps. It is difficult to reconcile such claims, however, with the fact that formerly integrated utilities are posting healthy profits while providing service at capped rates, and expect those earnings to increase dramatically when rate caps expire. For example, in a recent quarterly earnings report, PPL Electric Utilities, Inc. ("PPL"), stated that its earning for the first nine months of 2008 had dropped below those of 2007, but that "PPL's underlying fundamentals remain very strong" and that it projected earnings per share to increase from $2.00-$2.05 per share in 2008 to $3.60-$4.20 per share in 2010 with the expiration of its rate caps.[18]

Moreover, while increases in fuel costs correlate to increases in retail prices in all states, the fact remains that the current market design magnifies the effect for uncapped retail prices in

[17] Seller's ability to offer supply at "market-based" rates in the absence of fully functioning competition amplifies the price effect of the single-clearing price mechanism on consumers.
[18] Testimony of Sonny Popowsky, Consumer Advocate of Pennsylvania at 3 (Dec. 18, 2008).

retail access states. As highlighted in PJMICC's testimony, Allegheny Energy, Inc. ("Allegheny"), provides a good example of the interplay between retail and wholesale markets, and the magnifier effect that wholesale market design may have on retail prices.[19] Allegheny has affiliates that provide jurisdictional utility services in Maryland, where retail prices for large commercial and industrial customers are dependent on PJM's LMP-based market, and West Virginia, where cost-of-service regulation flows through actual costs and not the "magnifier effect" of the current wholesale market design. Figure 1 shows that costs to Maryland customers are now almost double what they are for an identical customer located across the West Virginia line, solely because Maryland customers are exposed to the single-clearing price design while West Virginia customers are not.

During the November 6, 2008, Public Hearing, Chairman Cawley expressed concern that the significant differences in retail prices between retail prices for West Virginia industrial customers and Maryland industrial customers were driven by cross-class subsidization in West Virginia, not by any relation to PJM market prices. Just to be clear, the difference is not attributable to cross-class subsidization.[20] Rather, the rate disparity is driven by state regulatory choices about exposing retail customers to wholesale market prices, and the rate disparity is relevant no matter which class a customer may be in.

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[19] Weishaar Statement at 1-2.

[20] Both major jurisdictional utilities in West Virginia, Allegheny Power and American Electric Power ("AEP"), have pursued full base rate cases within the last three years. Although rate of return differentials varied by class for both utilities, there is no evidence indicating that industrial customers are being uniformly subsidized in West Virginia. In fact, with respect to Allegheny Power, the Public Service Commission of West Virginia ("WVPSC") went to great lengths to explain that simply because rate of return differentials vary by class, that does not mean that a "subsidy" exists. Case Nos. 06-0960-E-42T & 06-1426-E-D, Monongahela Power Company and The Potomac Edison Company both dba Allegheny Power, May 22, 2007, Order, p. 51, n. 6. The WVPSC stated further "that a differential from the average rate of return may be cost justified." *Id.* In that case, the Commission Ordered that Allegheny Power implement a net base rate decrease (*id.* at Exhibit B), and in doing so, allocated that decrease in a manner that moderated rate of return differentials by class (*id.* at 59-60). In the recent AEP base rate case before the WVPSC, although the WVPSC ultimately approved a Joint Stipulation among the parties (Case No. 05-1278-E-PC-PW-42T, July 26, 2006, Order), the evidence indicated that the rate of return for the industrial class was in excess of the system average return, while the residential customer class rate of return was far below the system average return. *See, e.g.*, WVEUG Direct Testimony of Stephen J. Baron, pp. 9-11; AEP Supplemental Exhibit No. 5. The Joint Stipulation as approved moved all class rates of return closer to unity.

In West Virginia, both major electric utilities, Allegheny Power (through Monongahela Power Company) and American Electric Power (through Appalachian Power Company), maintain ownership of significant generation plant assets in service to their retail customers in West Virginia. Both utilities engage in purchases and sales in the wholesale power market, but retail customers receive the value of those sales of generation owned by the native utility. The effect is that West Virginia retail customers largely pay for generation supply based on the utilities' actual cost to produce the power to serve them. As a result, West Virginia utilities do not incur the same level of costs as utilities that must rely entirely on wholesale market-based prices for power.

In Maryland, by contrast, customers of the same utility no longer have access to cost-based generation, which is owned by the same holding company that owns generation across the line in West Virginia. Instead, Maryland customers must purchase power at market-based prices, even though the actual energy and capacity used to serve them may be coming from the same generators that are being used to serve customers in West Virginia. The West Virginia-Maryland comparison controls for a number of variables, and effectively isolates the key variable driving price disparities - i.e., whether or not a customer is directly exposed to prices that are determined by wholesale market design. Customers that are exposed fully to wholesale market prices (such as those in Maryland) are consistently paying higher prices than those that are not so exposed (such as those in West Virginia), regardless of the class that they are in.[21] Thus, the example is one of the few that can effectively isolate a sufficient number of variables to illustrate the impact of the PJM market structure on retail prices.

The West Virginia-Maryland comparison, using actual customers and real-world results,

[21] *This likewise holds true for customers on the Allegheny Power system in Pennsylvania receiving service from* West Penn Power Company in comparison to customers receiving service from Allegheny Power in West Virginia through Monongahela Power Company and The Potomac Edison Company-West Virginia.

demonstrates that increased fuel prices alone cannot explain the upward trend in LMPs. To the contrary, the comparison provides compelling evidence that PJM's LMP market design is a contributing factor to increasing retail prices in jurisdictions where neither rate caps nor cost-of-service regulation are in place.

F. The Commission Should Seize Upon the Opportunity To Explore Alternative Market Designs.

The object of the Competition Act, which the Commission is charged with implementing, is "*to benefit all classes of customers and to protect this Commonwealth's ability to compete in* the national and international marketplace for industry and jobs."[22] If rate caps expire, however, and Pennsylvania customers are exposed more directly to market forces, Pennsylvania's capability to realize the objectives of the Competition Act is in serious jeopardy. Instead of lower prices expected through operation of market forces, Pennsylvania retail customers in certain areas are beginning to experience the sting of the high prices produced by PJM's LMP-based market. Put simply, Pennsylvania is on course to have a retail market in which electric service will not be available to customers on "reasonable terms and conditions" as expected by the Competition Act's framers.[23]

The Commission is now at an important juncture. The Commission must decide whether to halt all debate and accept the LMP/RPM construct as the "right" platform for the continued evolution of the PJM wholesale market, or explore on its own (and urge FERC to explore) potential alternatives that produce a more customer-focused mix of competition and regulation. These alternatives include the Alternative Market Design Proposal advocated by PJMICC,[24] Portland Cement Association, and other commercial and industrial customer groups, as well as

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[22] 66 Pa.C.S. § 2802(7).
[23] 66 Pa.C.S. § 2802(9) ("Electric service is essential to...orderly economic development, and electric service should be available to all customers on reasonable terms and conditions.") (emphasis added).
[24] Weishaar Statement at 5.

the proposal developed by APPA.[25] Industrial Customers respectfully submit that the decision is clear: the status quo cannot be accepted as the indisputable "correct" answer to competitive market design. Moreover, time is of the essence because the cost of doing nothing now exceeds the cost of taking action.

[25] *See* Statement of Susan Kelly, Vice President of Policy Analysis and General Counsel, American Public Power Association at 11-12 (Nov. 6, 2008).

IV. CONCLUSION

WHEREFORE, Industrial Energy Consumers of Pennsylvania, Duquesne Industrial Intervenors, Met-Ed Industrial Users Group, Penelec Industrial Customer Alliance, Penn Power Users Group, Philadelphia Area Industrial Energy Users Group, PJM Industrial Customer Coalition, PP&L Industrial Customer Alliance, and West Penn Power Industrial Intervenors respectfully request that the Pennsylvania Public Utility Commission consider and adopt, as appropriate, the foregoing Reply Comments, and act expeditiously to actively explore (and encourage the Federal Energy Regulatory Commission to actively explore) alternative market designs such as those proposed by PJM Industrial Customer Coalition and American Public Power Association.

Respectfully submitted,

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Date: January 9, 2009