THE P3 GROUP

RECEIVED

NOV 17 2008

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

November 17, 2008

James J. McNulty
Secretary
Pennsylvania Public Utility Commission Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
2nd Floor, Room-N201
Harrisburg , PA 17120

Dear Mr. McNulty:

Enclosed per your October 27, 2008 letter, are one original and ten copies of the PJM Power Providers Group (P3) reply comments to the November 6, 2008 Public Hearing on the Current and Future Wholesale Electricity Markets. Also enclosed is a copy on electronic format.

If you have any questions or concerns, please feel free to contact us.

Sincerely,

Diane L. Slifer

PJM Power Providers
1060 First Avenue, Suite 400
King of Prussia, PA 19406
(610) 768-8080

Before the Pennsylvania Public Utility Commission

RECEIVED

NOV 17 2008

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

	:	
November 6, 2008 *En Banc* Hearing	:	**Docket No.** M-2008-2066901
on Current and Future Wholesale Electricity Markets	:	
	:	
	:	

Reply Comments

of the PJM Power Providers Group

The PJM Power Providers Group ("P3") appreciates the opportunity to offer these comments regarding the second hearing on Current and Future Wholesale Electricity Markets held on November 6, 2008.[1] P3 applauds the Pennsylvania Public Utility Commission ("Commission") for holding hearings on the wholesale electricity market. The wholesale electricity markets serving Pennsylvania are the backbone of our economy and quality of life. The policies of the wholesale markets have a direct impact on the available supply of generation to meet the demands of consumers and the price they pay for that service. Fortunately, the wholesale markets in Pennsylvania are strong and delivering enormous value to Pennsylvania consumers.

Despite the claims of some who presented at the November 6th hearing, the PJM markets are working well, meeting their intended goals and serving the consumers of Pennsylvania effectively. While improvements can always be made and should certainly be explored, the PJM

[1] P3 is a non-profit organization dedicated to advancing federal, state and regional policies that promote properly designed and well-functioning electricity markets in the PJM region. Combined, P3's eleven member companies own over 75,000 megawatts of power and over 51,000 miles of transmission lines in the PJM region, serve nearly 12.2 million customers and employ over 55,000 people in the 14-state PJM region. The views expressed in this testimony do not necessarily reflect the views of individual P3 members. For more information on P3, visit www.p3powergroup.com.

market structure is fundamentally sound and producing value – a value that PJM estimates to be around $2.3 billion a year for the region.[2]

We will not reiterate the comments made in our October 23, 2008, testimony; rather we will address in these comments the specific misunderstandings, misstatements and misperceptions of the November 6, 2008 testimonies. Although there were many misunderstandings, misstatements and misperceptions presented on November 6, we will focus our attention in these reply comments on 8 specific issues.

1) PJM Markets Are Working Well

PJM's energy markets are watched carefully by PJM's Market Monitor and are consistently found to yield competitive results. As noted by the PJM Market Monitor, Dr. Joe Bowring, the markets are responding appropriately to market conditions. As he stated in his testimony on October 23, "Given higher fuel prices, higher electricity prices do not mean that there is something wrong with the wholesale power market. In a perfectly competitive market, changes in input prices will change the price of the final product. Nonetheless, all market participants need to be assured that markets are competitive and that higher prices are not the result of the exercise of market power. This includes energy markets, capacity markets and ancillary services markets. The ultimate test of a competitive market design is whether market participants invest in response to incentives endogenous to the competitive market design and not in reliance on the potential exercise of market power."[3]

Pennsylvania businesses (who did not testify on November 6) also find PJM markets to be working well and they encourage the Commission to support a competitive energy marketplace for the region. In an October 20, 2008 letter to Governor Rendell, 12 companies representing collectively 1387 facilities, 97,941 employees, and over $125 million in annual electricity costs as consumers of electricity in Pennsylvania, all supported the current competitive electricity market and noted that "all deserve the opportunity to continue to benefit from the choices derived from a well designed, competitive electricity market."[4] They noted that they "believe that regional competitive wholesale markets for electricity with independent oversight, as we have in the PJM marketplace, provide access to generation at the lowest available cost, promote transparency and reliability, enhance the nation's transmission infrastructure, and provide price

[2] http://www.pjm.com/documents/downloads/presentations/pjm-value-proposition.pdf.

[3] Testimony of Dr. Joe Bowring before the Pennsylvania Public Utility Commission, October 23, 2008.

[4] October 20, 2008 letter to Governor Edward Rendell, http://www.competecoalition.com/files/Rendell%20Letter1008.pdf.

signals that promote sound investment decisions regarding generation (using renewable energy as well as more traditional sources), transmission, demand response, and energy efficiency."[5]

Both consumers, or at least some consumers, and the PJM Market Monitor agree, PJM markets are fundamentally sound and fulfilling their mission well. Again, improvements are always possible and desirable, but the core structure is yielding benefits and should not be disrupted.

2) Regulated Markets and Deregulated Markets Are Seeing Similar Price Increases.

As a result of higher fuel prices and higher construction costs, electricity prices are going up everywhere regardless of market structure. In fact, "[s]ince restructuring started in 1997, average retail rates in both restructured and non-restructured states have increased by approximately 31 percent." [6] It is a historical fact that other regions of the country have had lower electricity prices than Pennsylvania due to different labor costs, environmental standards, taxes and other factors. Restructuring in Pennsylvania has not changed that dynamic; however, it also has not exacerbated rate differences as was suggested at the hearing.

A recent analysis of this question by the Brattle Group offers a compelling conclusion: "Although retail restructuring has failed to live up to its high expectations, **the available facts do not support a conclusion that customers in restructured states would have been better off under traditional cost-of-service regulation, nor that customers would likely benefit from re-regulation**. . . . despite the superficial appeal of re-regulation in light of the sharp recent rate increases, we are concerned that such initiatives carry a substantial risk of being ineffective and more costly in the long-run."[7]

3) Businesses Continue to Expand in Pennsylvania

The suggestion was made at the November 6th hearing that electricity rates are driving businesses out of Pennsylvania and that electricity rates are rendering the Commonwealth uncompetitive. However, there is strong evidence that businesses remain interested in expanding in Pennsylvania and our electricity market structure is supporting meaningful economic development.

---

[5] Id.

[6] "Restructuring Revisited: What we can learn from retail-rate increases in structured and non-structured states," June 2007, *The Public Utilities Fortnightly.*

[7] Id.

On October 22, 2208 Governor Rendell helped break ground on a manufacturing facility in Clairton, Pennsylvania described as a "massive investment by the United States Steel Corporation that will create more than 600 construction jobs, ensure the company's continuing operations in Pennsylvania, and bring about environmental improvements in the region."[8] U.S. Steel is headquartered in Pittsburgh and plans to spend $1.2 billion on the project. While making this substantial investment in Pennsylvania, on November 11, 2008, U.S. Steel reported that it would put off its construction plans for a $450 million plant in Alabama.[9]

Last week, despite the economic slowdown, Governor Rendell announced on November 12, 2008 that a division of a global chemical company, Germany-based Wacker Chemical Corp., will locate its North American operations 67,000-square-foot facility, in the Lehigh Valley as part of a $16 million project that will create 32 high-paying jobs and retain 88 other positions.[10]

Since 2003, the Governor's Action Team "has completed 1,048 projects, resulting in commitments to create 111,495 new jobs and retain 257,892 existing positions. The Commonwealth has offered more than $2 billion in assistance for these projects, which will leverage more than $12.9 billion in additional investment."[11]

Moreover, as noted by 12 companies in Pennsylvania in an October 20, 2008 letter to Governor Rendell, a "well designed, competitive electricity market in Pennsylvania has supported the development of new clean generation resources in Pennsylvania like wind power which has increased from zero to almost 300 MW since 1997 and PJM has seen consumer demand response increase six-fold since 2000."[12]

---

[8] http://www.marketwatch.com/news/story/pennsylvania-governor-rendell-helps-break/story.aspx?guid=%7BD0F3AF34-350E-4F74-8232-76EBB1B4D774%7D&dist=hppr.

[9] "U.S. Steel Halts Plans for Alabama Plant," November 11, 2008, Tribune Review.

[10] November 12, 2008 Press Release, Governor Rendell at http://www.portal.state.pa.us/portal/server.pt?open=512&objID=2999&PageID=431162&mode=2&contentid=http://pubcontent.state.pa.us/publishedcontent/publish/global/news_releases/governor_s_office/news_releases/governor_rendell_says_global_chemical_company_to_locate_operations_in_lehigh_valley__create_32_jobs.html.

[11] November 12, 2008 Press Release, Governor Rendell at http://www.portal.state.pa.us/portal/server.pt?open=512&objID=2999&PageID=431162&mode=2&contentid=http://pubcontent.state.pa.us/publishedcontent/publish/global/news_releases/governor_s_office/news_releases/governor_rendell_says_global_chemical_company_to_locate_operations_in_lehigh_valley__create_32_jobs.html.

[12] October 20, 2008 letter to Governor Edward Rendell, http://www.competecoalition.com/files/Rendell%20Letter1008.pdf.

Clearly, there is another side to the story that was presented to the Commission on November 6 as businesses continue to expand and invest in Pennsylvania – empowered by the benefits of a competitive electricity market structure.

4) The Pennsylvania Commission Has Full Access to Confidential PJM Market Data.

Unfortunately, several testifiers on November 6, 2008, misrepresented the authority of the Commission to obtain confidential data. The Pennsylvania Commission, along with every other state regulatory body in the PJM footprint, has the right to review confidential PJM data provided certain procedures are followed. Pennsylvania has had this ability since 2004. The authority is spelled out in the PJM Operating Agreement section 18.17.4: "The Office of the Interconnection and/or the PJM Market Monitor shall disclose confidential information, otherwise required to be maintained in confidence pursuant to this Agreement, to an Authorized Commission" under certain conditions.[13]

As a case in point, recently, the Maryland Public Service Commission utilized its authority under this section and was granted its request by FERC.[14] On November 12, 2008, the Maryland Commission asked for a list of all the units that did not clear the most recent RPM auctions. State commissions in Virginia and the District of Columbia have similar requests to be authorized to review confidential data pending before FERC.

5) Single Market Clearing Price Auctions Are a Superior Means of Pricing Energy

Single market clearing prices markets are an economically prudent means of pricing any commodity and electricity is no different. These markets send exactly the right signals to producers and encourage those participating in the market to submit the lowest bids for their product. The market clears at the lowest price that satisfies all consumer demand. This method of pricing electricity, like any other commodity, has continually been proven effective.

Corn, soybeans, oil, iron ore, silver and gold are all traded with a single market clearing price auction because, like electricity, one unit of a product is like another, regardless of how it is produced. Corn trades for so many dollars a bushel regardless of what it cost any one farmer to produce that bushel because, to the market, a bushel is a bushel. Some farmers have lower costs, some have higher costs, but each faces the same market price. The single market clearing price in the electricity market is no different.

---

[13] PJM Operating Agreement, Section 18.17.4.

[14] FERC Docket No. EL07-56-006 and EL07-58-005, Letter Order issued November 6, 2008.

Moving to a system that would pay generators what they bid in pay-as-bid auctions would completely change bidding incentives and likely lead to higher prices over time. Specifically, in a pay as bid market, generators would be incented to submit bids that reflected their best guess as what the price will be for the most expensive needed resource, instead of bidding their marginal cost. Suddenly, under a pay as bid system, generators would play a game of "guess the clearing price" instead on focusing on reducing their cost of service.

The single market clearing price auction encourages companies to build new, inexpensive resources as it provides a signal to invest in resources that can produce energy for less than the 'price-setting' resources. Additionally, small generators are better positioned to compete equally with larger producers rather than being subjugated to pawns in a game were larger producers are trying to guess the clearing price. Moreover, demand response and energy efficiency are well equipped to compete in these auctions as they see similar price signals and can respond accordingly.

University of Maryland Economist, Peter Cramton, in a whitepaper on this very subject takes direct issue with some of the statements presented before this Commission on November 6th. After reviewing the economic theories behind pay as bid markets and uniform clear pricing markets, he bluntly concludes, "Arguments that the uniform-price auction yields electricity prices that are systematically too high are incorrect."[15] Cramton then explains that his research suggests that a pay as bid model would increase consumer costs and drive smaller competitors out of the market – two outcomes that Pennsylvania should strive to avoid.

6) <u>FERC is Not Operating in a "Blind Spot"</u>

The Federal Energy Regulatory Commission ("FERC") is a bipartisan, well-balanced and reasonable governing body effectively implementing the nation's policies as articulated by Congress. FERC Commissioners have a unique national, geographical and long-term perspective.

FERC Commissioners have noted that competing markets yield value. Indeed, competitive wholesale markets enjoy strong bipartisan support from FERC. FERC Chairman Joseph Kelliher, a Republican appointee, has stated that "competition policy is best suited to address the hard realities we are facing today," and Commissioner Suedeen Kelly, a Democratic appointee, has referred to regional wholesale markets as a "real success story."

All five FERC Commissioners have again recently expressed strong support for competitive markets. As Chairman Kelliher recently stated: "Competition is national policy with respect to wholesale power markets, and has been for 25 years. Significantly, competition policy has

[15] http://www.cramton.umd.edu/papers2005-2009/cramton-stoft-clearing-price-markets.pdf

always been bipartisan. Competition became national policy through enactment of three significant federal laws. Two laws were crafted by a Democratic Congress, one by a Republican Congress. Two were signed into law by Republican Presidents, one by a Democratic President. Every President since Jimmy Carter has either embraced or accepted competition as national policy with respect to wholesale electricity markets. Since competition is settled national policy, our duty is clear – to promote effective wholesale competition and seek steady improvement in wholesale competition."[16]

As Commissioner Kelly noted in commenting on the passage of FERC Order 719, "I believe that many of the Final Rule's findings will promote competition in organized wholesale electric markets, thereby helping the Commission to fulfill our statutory mandate to ensure adequate and reliable service at just and reasonable rates." [17]

As Commissioner Spitzer has commented, "[s]ince the late 1970s, Congress has made clear that the optimal means to ensure just and reasonable rates for consumers is through use of competitive markets. However, we all agree that competition needs to be meaningful – which means that the markets must be properly designed and implemented. They also must be vigorously monitored to prevent, and punish, the exercise of market power or manipulation. Today's order establishes new rules that will ensure the organized wholesale markets remain competitive. These rules will also provide the Commission and others with additional means to monitor the nation's organized wholesale markets."[18]

Commissioner Wellinghoff noted that with the passage of FERC Order 719, FERC advances "the competitive functioning of our wholesale electric markets for the benefit of consumers."[19]

Commissioner Moeller stated that in reviewing the wholesale competitive markets for nearly the past two years and with the passage of FERC Order 719, FERC's "objective was to improve competition in organized markets and I believe that we've satisfied this goal."[20]

---

[16] FERC Docket Nos. RM07-19-000 and AD07-7-000, October 16, 2008, Statement by Chairman Joseph Kelliher.

[17] FERC Docket Nos. RM07-19-000 and AD07-7-000, October 16, 2008, Statement by Commissioner Suedeen Kelly.

[18] FERC Docket Nos. RM07-19-000 and AD07-7-000, October 16, 2008, Statement by Commissioner Marc Spitzer.

[19] FERC Docket Nos. RM07-19-000 and AD07-7-000, October 16, 2008, Statement by Commissioner Jon Wellinghoff.

[20] FERC Docket Nos. RM07-19-000 and AD07-7-000, October 16, 2008, Statement by Commissioner Philip Moeller.

7) RPM is Supporting Substantial New Investment in PJM and has Reversed Declining Reserve Margins

While we will not repeat our October 23 statements on RPM, we find it noteworthy that not a single witness at the November 6 hearing could refute the fact that the Reliability Pricing Model (RPM) has reversed the trend of declining reserve margins in PJM and has led to substantial increases in new resources including a significant increase in demand response. While some may question the price of capacity in RPM, it is hard to dispute that RPM is working as intended and dramatically improving the reliability of the PJM region. Specifically, 14,500 MW of resources are available in PJM that would not have been available without RPM. PJM's declining reserve margins have reversed as a result of RPM, and consumers in PJM have a renewed confidence that there will be an adequate supply of power to meet their future needs. Moreover, PJM's Market Monitor has reviewed every capacity auction held to date at several different levels and concluded that the auctions have been competitive and that prices are reflective of the actual cost of capacity in PJM.[21]

8) The Current Competitive Market Encourages Renewable Energy Development

While renewable energy development does occur in areas that do not have functioning competitive wholesale markets, there is no doubt that renewable projects are more viable in wholesale markets such as PJM's and the Midwest ISO's. Renewable resources can participate in both energy and capacity markets and specific accommodations have been made to promote participation from intermittent resources such as wind. Indeed, over 300 MWs of wind have cleared recent capacity auctions and in the most recent auction, a solar resource cleared for the first time ever.

As noted in our October 23, 2008 testimony, for these and other reasons, PennFuture concluded:

> The PJM-operated market is an incredible asset to wind energy development in Pennsylvania and the entire PJM region. Thanks to the PJM market, Pennsylvania will enjoy more new investments in renewable energy. These investments will create a virtuous circle of grid capacity, energy resource diversity and environmental improvement. That all adds up to better electricity prices and more reliability for our consumers too. [22]

[21] http://www.pjm.com/markets/market-monitor/downloads/mmu-reports/bowring-dec-pjm-answer-to-rpm-buyers.pdf, at paragraph 9.

[22] http://www.pennfuture.org/media_e3_detail.aspx?MediaID=938.

Similarly, the American Wind Energy Association (AWEA) passed a resolution in February strongly supporting the "preservation and expansion of competitive regional wholesale electricity markets." Drawing on experiences from the United State and Europe, AWEA found development of wind power easier in areas with competitive wholesale electricity markets.

This Commonwealth has forged a very aggressive renewable energy policy and, with the recent passage of HB 2200, will need every available tool in order to meet the demand response, energy efficiency and alternative energy goals of this Commonwealth. A market structure, such as PJM's, that is based on a predictable capacity mechanism and a liquid energy market provides an ideal if not optimal foundation from which to pursue these goals.

In summary, over the long term, P3 firmly believes that properly designed and well functioning wholesale markets will provide the most effective means of giving Pennsylvania consumers access to a reliable supply of power at the lowest available costs. Consumers will be best served in the long run by a market that relies on competition, not regulation.

P3 appreciate the opportunity to offer reply comments in this proceeding and refute the numerous misrepresentations that were made at the November 6 en banc hearing. Pennsylvania should be extremely proud of the work that has been done to date and should always look for ways to improve the markets to the benefit of consumers. Pennsylvania's markets are viable, efficient and strong. The challenge before this Commission is how to improve them – not how to dismantle them as suggested by some at the hearing.

From: Origin ID: KPDA (610) 768-8080
Diane Sifer
PJM Power Providers Group
1060 First Avenue
Suite 400
King of Prussia, PA 19406

FedEx Express

E

JCLS111208/28/23

Ship Date: 17NOV08
ActWgt: 1.0 LB
CAD: 2653176/INET8091
Account#: S *********

Delivery Address Bar Code

SHIP TO: (717) 772-7777 BILL SENDER
James J. McNulty, Secretary
PA Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor Rm N201
Harrisburg, PA 17120

Ref # P3 Reply Comments 11/6/08 Hng
Invoice #
PO #
Dept #

TUE - 18NOV A1
TRK# 0201 7961 1890 5213 **PRIORITY OVERNIGHT**

17120
PA-US
MDT

EM MDTA

TO: MCNULTY, J. PUC (MCNULTY,
Agency: PUC
Floor:
External Carrier: FedEx

796118905213

11/18/2008 9:26:42 AM

245
0
FZ

CMPC

pments Only