COMMONWEALTH OF PENNSYLVANIA
BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

***En Banc* Hearings On Wholesale Electricity Markets**	)	**Docket No. M-2008-2066901**

REPLY COMMENTS OF THE ELECTRIC POWER SUPPLY ASSOCIATION

I. INTRODUCTION

The Electric Power Supply Association (EPSA)[1] respectfully submits these reply comments in response to the Pennsylvania Public Utility Commission's (Commission) *en banc* hearing on current trends in the wholesale electricity markets held on December 18, 2008, in the above-captioned docket. This was the third in a series of hearings on this topic following an initial hearing on October 23, 2008, and a subsequent hearing on November 6, 2008.

EPSA supports the Commission's efforts to understand the scope of issues currently facing the wholesale electric markets given the intertwined nature of wholesale and retail markets. This is particularly important in light of the challenges ahead in ensuring adequate investment in both existing and new infrastructure, as well as demand response and energy efficiency, so that reliable service remains available for all customers at a reasonable price reflective of economic realities.

[1] EPSA is the national trade association representing competitive power suppliers, including generators and marketers. These suppliers, who account for 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities serving global power markets. EPSA seeks to bring the benefits of competition to all power customers. The comments contained in this filing represent the position of EPSA as an organization, but not necessarily the views of any particular member with respect to any issue.

The Commission has heard a number of views on the status of wholesale competition over the three hearings to date. Some of the testimony presented, however, paints a picture inconsistent with the reality of the market place and the goals that certain mechanisms, such as the reliability pricing model (RPM) forward capacity market, were created to reach. EPSA would like to highlight a few points in response.

In particular, we believe that the PJM wholesale market is competitive, as has been stated repeatedly by the Independent Market Monitor (IMM) and producing just and reasonable prices as determined by the Federal Energy Regulatory Commission (FERC). RPM is working as it was intended – to provide a reliable electricity system by sending the signals required to keep existing generation online, promote demand response and incent new infrastructure investment where needed. While refinements are needed, and currently being discussed by stakeholders, the forward capacity market framework is sound. In this time of economic uncertainties, changing electricity demand projections and uncertainty over the shape of future environmental regulations, it is critical that sustainable energy policies are followed to ensure that the right long-term price signals are sent in order to provide reliable resources for the years to come.

It should also be noted that, as the Commission heard from former FERC Commissioner William Massey who testified on November 7, 2008, the support for competitive wholesale electricity markets is bipartisan and will likely continue into the next Administration. (Page 8) FERC commissioners have long recognized the substantial benefits of competitive wholesale markets and have

adopted policies to support and promote them; as was recently noted by FERC Chairman Joseph Kelliher, “If you look at the roots of competition policy on the electricity side, it is rooted in three federal laws that have been enacted over the past 25 years. Two were signed into law by Republican Presidents, one by a Democratic President; two were written by Democratic Congresses, and one by a Republican Congress. And every U.S. President since Jimmy Carter has either embraced or accepted competition as the basis for wholesale electricity regulation in the United States.”[2]

II. COMMENTS

A. The PJM Wholesale Market is Competitive

Some who testified in the last three hearings raised questions as to whether the PJM wholesale market is competitive. In considering this, it is important to remember that PJM is by definition an independently administered marketplace. PJM is a non-profit entity that has no stake in individual sales, trades or transmission access. PJM and its markets are regulated by FERC, which looks daily at the market functions to watch for potential market manipulation and ensure a well functioning, competitive marketplace. In addition, PJM has an IMM that has access to all PJM market information and reports to FERC on any possible violations.

As was heard in testimony given by the IMM on October 23, “Market results support the conclusion that prices in PJM are set, on average, by units

[2] Statement of Chairman Joeseph Kelliher on Wholesale Competition in RTOs Final Rule, in reference to FERC Rule 125 FERC ¶ 61,071, Docket Nos. RM07-19-000 and AD07-7-000 (October 16, 2008)

operating at, or close to, their marginal costs… I continue to conclude that the PJM Energy Market results are competitive and that the PJM Capacity Market results are competitive." (Page 11-12) FERC has similarly found that the PJM markets as currently structured are just and reasonable.[3]

While differing views were expressed regarding the benefits of PJM from some, it is important to note that a number of consumers do believe that the PJM markets lead to the best possible outcomes. This view was represented both by the testimony of the COMPETE Coalition on December 18, 2008, as well as by an October 20, 2008 letter sent to Governor Ed Rendell by a group of Pennsylvania electricity consumers and employers representing 1,387 facilities, 97,941 employees, and over $125 million in annual electricity costs as consumers of electricity.

> We 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 signals that promote sound investment decisions regarding generation (using renewable energy as well as more traditional sources), transmission, demand response, and energy efficiency.[4]

[3] Of note, the FERC Office of Enforcement's Division of Energy Market Oversight (DEMO) is responsible, among other things, for monitoring the functioning of the wholesale energy markets. To assess and ensure the ongoing competitiveness, fairness and efficiency of wholesale energy markets, DEMO's responsibilities include regular interface with the RTO/ISO Market Monitors; daily, real-time monitoring of developments in the electric, natural gas and related energy and financial markets; and, on-going analysis and reporting to the Commissioners and senior FERC staff on the energy markets. In addition, the FERC periodically holds formal technical conferences or other forums to review the functioning of the markets with the various market monitors. Most recently, in Docket No. AD08-9, the Commission invited senior management and market monitors from the jurisdictional RTOs/ISOs to provide a review of the current and future state of regional wholesale electricity markets. The technical conference was held on July 1, 2008, and PJM IMM Joe Bowring provided testimony which reviewed 1999 to current (including the most current capacity market clearing information for forward years).

[4] http://www.competecoalition.com/files/Rendell%20Letter1008.pdf

As has been consistently found by those charged with monitoring them, the independently administered and overseen PJM markets are competitive and providing real value to consumers. The competitive markets do so through lower generation costs, more efficient dispatch of generation, increased renewables development and improved access for demand response participation. In fact, PJM data reflects that, when adjusted for changes in fuel costs, wholesale prices have actually dropped by 23 percent over the past 10 years.[5] While no market is perfect, and continued improvements are, and should be made, PJM is a well functioning competitive system providing real benefits for consumers.

B. RPM Is Working to Provide a Reliable Regional System

Despite it being a result of an extensive settlement proceeding agreed to by the vast majority of stakeholders, RPM is today one of the most controversial elements of the PJM markets. It is important, however, to remember the context and goals for which it was developed. As described by PJM's Andrew Ott in testimony on October 23, 2008:

> In 2005, when PJM studied anticipated electricity demand growth and observed a significant lack in projected new generation investment, we saw a situation that would result in an unsafe gap between electricity demand and installed capacity – which would threaten electric reliability. In essence, a situation was developing where, without definitive action, an electricity shortage would have occurred that could result in widespread blackouts. Therefore, PJM asked for permission to reform its capacity market to help ensure grid reliability. (Page 8)

RPM was intended to ensure the reliable matching of supply and demand over the long-term at a level that would support the continued operation of necessary existing resources as well as investment in new resources. It was not

[5] Testimony of Andrew Ott on Behalf of PJM Interconnection, October 23, 2008, Pgs. 4-5.

intended to bring on unnecessary new generation resources at the expense of consumers for the sake of constructing new plants. If the demand levels could be met through continued operations of the current generation fleet, significant upgrades or uprates at existing plants, averted retirements and demand response, then RPM would do so.

RPM has, however, brought on significant investments with "9,986 MW of new resources, including a base-load coal plant, over 800 MW of renewable resources, and over 2,000 MW of new Demand Response resources... With the implementation of RPM, total load response in the capacity market has increased by over 3,500 MW, which is the equivalent of displacing the need to install 3 to 4 large base load generation plants."[6] Significant investment in existing resources also is occurring and is planned for the future.[7] For example, according to a PJM IMM report based on unit-specific offer cap submittals, which represents only a small subset of the resources offered into RPM, some generation owners have plans to spend $5.1 billion on existing units through the 2011/21012 delivery year.[8] Additionally, as Doug Biden, President of the Electric Power Generators Association (EPGA) testified on November 7, 2008, some EPGA members have plans to spend more than $14 billion in capital investments in the years 2008 through 2013. (Page 8)

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[6] Id., Pgs. 8-9.

[7] In his testimony on November 7, 2008, Electric Power Generators Association (EPGA) President Doug Biden highlighted the significant benefits this Commonwealth has enjoyed as a result of the market incenting generation performance improvements and additional investment of billions of dollars in generation. EPGA members alone have invested more than $12 billion in existing plants in Pennsylvania for environmental controls, capacity uprates, turbine upgrades and other miscellaneous capital expenditures to keep plants running. (Page 8)

[8] Analysis of APIR Investment and MW Added Under RPM: 2007-2011 RPM Auctions, Independent Market Monitor for PJM, September 2008

Despite the benefits of RPM and its current success in providing adequate resources, refinements are necessary to ensure continued reliability. The most critical element being discussed by stakeholders today is an update to the Cost of New Entry (CONE) values from the current level, which is based on data developed as far back as September 2004, to ensure that this central parameter in RPM reflects prevailing market conditions and economic realities. As many have noted, the impact of sharply rising construction costs due to global demand and the need to realistically factor this into the reliability and long-term planning equation is a critical issue that clearly pertains to, but also extends far beyond, the PJM region.

While there have been some recent reports of moderate declines in project-related costs, the fact remains that costs associated with power plant construction have increased significantly in recent years and should be properly reflected in CONE values to promote efficient pricing in the PJM capacity market. For example, the recently updated IHS CERA Power Capital Costs Index (PCCI), which tracks the costs of building coal, gas, wind and nuclear power plants, reflects that costs have increased 124 percent since 2000, with only a modest 3 percent decrease over the last six months. In other words, a power plant that cost $1 billion in 2000 would, on average, cost $2.24 billion today.[9]

Since the inception of RPM, some have argued that customers are paying excessive amounts for capacity and have questioned whether prices are just and reasonable or sending the appropriate signals for investment. A net revenue

[9] IHS CERA Press Release issued December 17, 2008 is available at: http://press.ihs.com/article_display.cfm?article_id=3953

analysis by the IMM, however, reflects that generators have generally not earned sufficient revenue to recover the fixed costs of building new plants. The analysis shows that new peaking, mid-merit and baseload pulverized coal plants have recovered only 43%, 61% and 71%, respectively, of their annualized fixed cost over the last 9 years.[10] This situation harmed reliability in Pennsylvania and the mid-Atlantic region and was one of the main impetuses for PJM's request in 2005 to change to what ultimately became the RPM forward capacity market. The historic lack of sufficient cost recovery for generators, combined with the rising costs in recent years for new generation construction, demonstrates a need to ensure that the "right" prices are established to ensure proper (and sufficient) market response from generation and demand response resources to meet future demand.

C. Sustainable Policies Are Necessary

The present electricity infrastructure investment climate is one of the most tumultuous in recent memory. The current challenges in the financial and capital markets are well known, as is the uncertainty as to the form and timing of federal climate change regulation. These elements are compounded by increases in the key input materials for construction, as outlined above, as well as the changing electricity demand picture where, after years of forecasting skyrocketing demand, current data points to a significant slowing and possibly even decreasing demand in selected areas. Added to this are the uncertainties for the existing electricity

[10] Testimony of Joseph E. Bowring, Independent Market Monitor for PJM, before the Pennsylvania PUC, Public Hearing on the Current and Future Wholesale Electricity Markets, October 23, 2008, pgs. 7-11.

system due to the promising development of plug-in hybrid electric vehicles, increased energy efficiency, continued expansion of intermittent renewables and more wide spread demand response. These combined factors create a staggering set of challenges for future electricity infrastructure investment.

It is in this uncertain setting that it is more important then ever for stable, long-term policies that support a competitive environment for the development of future resource needs. A competitive environment, such as is found in the PJM markets, provides the most choices, the greatest opportunity for innovation and the most cost effective resources at the lowest risk for consumers today as well as over the long-term. As FERC Chairman Joseph Kelliher said recently at a July 2008 FERC technical conference on the status of wholesale markets, "competition policy is best suited to address the hard realities we are confronting today."[11] While it is often most difficult to pursue stable policies in a challenging time and politically-charged environment, it is at such times that leadership is most necessary.

III. CONCLUSION

EPSA applauds the Commission for its initiative in holding these three informational hearings and appreciates the opportunity to provide comments. EPSA strongly believes that, as the Commission reviews Pennsylvania's electricity markets, the clearest way forward is to allow the competitive markets in place in PJM to continue to meet the resource needs for Pennsylvania

[11] FERC Review of Wholesale Electric Markets, Docket No. AD08-9-000, Technical Conference July 1, 2008, Tr. at 3

consumers and all those in the footprint. While not perfect, these markets have largely met their intended purposes of ensuring adequate supply at a reasonable price to allow for sustainable investment. RPM has considerably enhanced reliability for customers through additional electricity generation, the realization of demand response, and a continued trend in the reversal of planned retirement of older generating facilities. Continuing to refine the promising framework in place in the energy and capacity markets will provide consumers efficient, sustainable and reliable electricity supply.

Respectfully Submitted,

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