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BEFORE THE

FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: :

PJM INTERCONNECTION, LLC : Docket Numbers

TECHNICAL CONFERENCE - COMPENSATION FOR : EL03-236-000

GENERATING UNITS SUBJECT TO LOCAL MARKET :

POWER MITIGATION IN BID-BASED MARKETS :

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Hearing Room 2C
Federal Energy Regulatory Commission
888 First Street, NE
Washington, D.C.

Thursday, February 5, 2004

The above-entitled matter came on for technical
conference, pursuant to notice, at 9:10 a.m.

BEFORE:

ALICE FERNENDEZ, presiding

OMTR

1 APPEARANCES:

2 JOHN MEYER, Reliant Resources

3 JONATHAN FALK, NERA/PPL

4 JOE BOWRING, PJM Market Monitor

5 FRANK WOLAK, ODEC

6 GINA CARRADO, Exelon

7 DOUG MILLER, Mirant

8 BILL FIELDS, Maryland Office of the Consumer Counsel

9 MARGIE PHILIPS, PSEG

10 PAT ALEXANDER, Dickstein Shapiro for Constellation

11 JAMES MELLODY, FirstEnergy

12 ROY SHANDER, Consultant

13 CRAIG ROACH, Boston Pacific

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P R O C E E D I N G S

(9:15 a.m.)

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3 MS. FERNANDEZ: Good morning. It looks like not
4 everyone is here. This is the second day of the technical
5 conference. Both the format for today's conference, and, I
6 think, some of the discussion, is going to be different than
7 what we had yesterday.

8 Yesterday's was a discussion of a lot of sort of
9 general policy issues. And while we did on occasion get
10 into discussions of specific cases, today is a discussion of
11 PJM's specific proposals, so we're going to focus both on
12 PJM's proposals, the alternative proposals, and if there are
13 other people who would have alternatives that they would
14 like to discuss, the purpose being, basically, at the end of
15 the day, to try and develop the record so that the
16 Commission can make a decision on what changes, I suppose,
17 if any, should be made to PJM's current market mitigation
18 measures.

19 So, today, we are going to get into some fairly
20 specific detail. If we start getting into discussions that
21 look like they may be more general, you may get asked
22 questions as to how this relates to specifics for PJM's
23 markets, because that is our objective today.

24 We're also going to have a more informal session
25 that we had yesterday. We're going to start out with Joe

1 Bowring, the PJM Market Monitor, Gina Carrod from Exelon,
2 Frank Wolak from ODEC, John Meyer from Reliant Resources,
3 and Jonathan Falk, representing PPL.

4 Basically, these are all the ones who handed in
5 comments with alternative proposals. We're going to first
6 sort of start out with a general discussion of that. We
7 have had other people who have asked to speak. We will have
8 an opportunity, once we run through that first part -- I
9 think we're kind of waiting to see how many seats we have
10 around the table, if we can have those people just come up.
11 If not, we'll make an opportunity for people to come up. If
12 others want to say something, everyone will have an
13 opportunity to speak.

14 This is being transcribed. We also will have the
15 opportunity for filing comments and reply comments, after
16 the conference, to help develop the record. We'll go over
17 that some more, once we go through at the end of the day, to
18 try to focus what should be included in these comments.

19 As I said, the basic objective of today's session
20 is to build a record, develop a record, explore alternatives
21 for the Commission to make a decision on what the specific
22 mitigation measures should be in PJM. Anything else?

23 (No response.)

24 MS. FERNANDEZ: With that, why don't we start
25 with Joe Bowring? Oh, one other thing: I think we've told

1 a number of the people that we're not doing overhead
2 PowerPoints today. We're asking people to try to keep their
3 opening remarks brief, but to basically go through and
4 describe what the alternative proposals are.

5 With that, why don't I turn it over to Joe
6 Bowring?

7 MR. BOWRING: Thanks. Tell me if I'm going too
8 long. What I wanted to do is spell out the position, the
9 proposal PJM has made with all its components.

10 Clearly, the purpose of local market power rules
11 is straightforward to prevent the exercise of local market
12 power. It's obviously more complicated and it gets more
13 complicated than that, very quickly.

14 A couple of basic points, though: The first is
15 that, based on our analysis of the actual data in PJM, the
16 current local market power rules do not result in non-
17 compensatory revenues. As indicated yesterday, there really
18 is no significant difference between net revenues of a unit
19 that's cost-capped 80 percent of the time, and one that's
20 cost-capped ten percent of the time.

21 Another general point is that we need to address
22 both existing units and local market power in load pockets
23 where there is no scarcity, as well as situations where
24 there may be scarcity or there is expected to be scarcity.

25 The basic rule in PJM is straightforward. People

1 are familiar enough with it now. We offer-cap only when
2 units are not taken in economic merit order. The rule
3 requires that we always pay the higher of market price or
4 cost, plus ten percent.

5 The impact of the rule so far has been that the
6 rules really have effectively prevented the exercise of
7 local market power. Delmarva Peninsula is an example.
8 There's a relatively small proportion of the units set that
9 are actually covered, and relatively small areas that are
10 covered.

11 The issue that's not addressed by the current
12 rules, and that we recognized in our filing, is the scarcity
13 issue. There are two broad approaches to dealing with that.

14 14

15 One has been termed scarcity pricing, and the
16 other is the auction. I think they are both designed to get
17 to the same place. I'm not sure exactly what is meant by
18 scarcity pricing. We can talk about that, obviously, but
19 PJM's proposal is to do an auction.

20 Before I get to that, I just wanted to mention
21 two other key parts of the local market power mitigation
22 proposal. One is that we implement a specific trigger for
23 when there is local market power.

24 The trigger recognizes that there is no magic
25 threshold above which market power cannot be exercised, and

1 below which it necessarily will be exercised, but we tried
2 to draw it in a conservative way, based on our experience,
3 and the proposed trigger is that if there are more than
4 three pivotal suppliers, that we would consider, based on an
5 analysis, ending the mitigation for local market power.

6 The final piece of the proposal is that post-1996
7 units be converted.

8 To go over the highlights of the specific
9 proposal regarding the auction, the first is that there has
10 to be a specific set of rules governing retirements.
11 Currently, PJM does not have a very specific set of rules.
12 PJM has been working on it since we highlighted it a few
13 months ago.

14 In fact, I suspect that in both PJM, as well as
15 elsewhere in the Northeast, that retirements are going to be
16 a significant issue over the next 12 to 18 months and
17 beyond. The essential point about the retirement issues is
18 that they have to address what happens if retirements are
19 likely to lead to reliability issues.

20 And, in addition, they have to ensure that market
21 power is not exercised in the form of physical withholding
22 by retirements. As part of the design, PJM would continue
23 to do ongoing evaluations of the need for capacity.

24 This is effectively what would define scarcity.
25 When the engineer in PJM, looking forward, determines that

1 an area will be short of capacity, either in the very near
2 term or the longer term, and the lookout is fairly
3 extensive, so the goal is to do it long-term, then the
4 beginning of the auction would be triggered.

5 One of the essential components in all of this,
6 as I mentioned briefly yesterday, is the rules governing the
7 auction have to be very tightly coordinated with the rules
8 governing transmission investment. Currently, PJM has in
9 place, a Commission-approved approach and set of thresholds
10 for addressing hedgeable congestion.

11 It essential that we don't run afoul of those.
12 For example, it's conceivable that we could run an auction,
13 generators could win, the result could still be congestion
14 in the load pocket and congestion that fails the hedgeable
15 tests. As a result, transmission will be built anyway.

16 It's essential that a global cost/benefit look be
17 taken, so that that doesn't occur. That's just one example
18 of the way in which those sets of rules could run afoul of
19 one another.

20 Very briefly on the auction, we're planning to
21 put out a more detailed document within the next ten days or
22 so in preparation for our next local meeting of PJM. In
23 effect, what people will be offering in, is, they would be
24 bidding for what we've termed a subsidy. That would be with
25 no pejorative connotation intended. It's an analytical

1 definition.

2 It would be an adder to the capacity market
3 payments; in fact, it would be a local capacity payment,
4 and, in addition, it would be an FTR component, that is, the
5 bidder would be offering a hedge against certain forms of
6 risk in the load pocket, basically against the difference
7 between the load pocket price and the external price.

8 There are a number of ways of evaluating it.
9 We've talked about this at some length as a group. One of
10 the key issues is the risk associated with that FTR piece.

11 The FTR piece has very nice properties. It
12 provides a very strong disincentive to exercise market
13 power, however, unless it's properly designed, it can also
14 have associated with it, fairly high levels of risk,
15 particularly for peakers.

16 For example, it might be the case that the price
17 of the load pocket is less than the marginal cost of the
18 peaker, in which case the peaker wouldn't provide a very
19 good hedge. Without going into all the details, what we've
20 come up with is a multi-part FTR where units would not be
21 required to bear the risk.

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1 We're still working on a few details; the biggest
2 challenge being how do I equate transmission that has a life
3 of 40 years against generation that would have a recovery of
4 five years or less. To listen to the people in the
5 investment community yesterday, they're almost implying you
6 know you almost had to recover it in one or two years before
7 they would invest in a load pocket. Those are the issues,
8 is how do we equate those fairly?

9 We developed this strategy in ERCOT actually for
10 RMR units. It was a requirement that the ISO come up with
11 an auction and that, if you didn't get enough bidders to
12 develop a transmission exit strategy, the transmission,
13 evaluated on its full annual cost will win out over the RMR
14 unit almost every time. Four out of four is what we got in
15 Texas and it's winning by margins 4-8 on an annualized
16 basis. But some of those cases are what we call the Texas
17 Valley; none of them are in highly congested municipal areas
18 like cities like New York or Dallas-Ft. Worth yet. Those
19 may present more challenges. Whether the new entry is
20 transmission or generation, it would be almost impossible,
21 and perhaps there we need to focus again a little further.
22 However, even in New York units are being proposed and might
23 be able to be financed if the revenue certainty is there.

24 I'm going to stop there and answer more questions
25 on it. I'm sure I'll get a few. Thank you.

1 MR. FALK: Thank you.

2 Yesterday, when we heard the New England ISO
3 market monitor say something is wrong when you have units
4 you need and the units can't make money, we don't have that
5 happening in other markets. There's something very odd
6 about it. Partly the notion that we will offer-cap these
7 units or we will impose a market power mitigation strategy
8 and then graft onto that a notion of getting enough capital
9 to keep units around or to solve scarcity problems should be
10 a clear sign that there's something wrong with whatever
11 you've chosen to do in mitigating market power.

12 Because I couldn't have said it better than the
13 market monitor said yesterday. There's obviously something
14 with a system in which something is literally needed, it
15 must be provided, something of great value, but somehow the
16 market rules are set up so that it can't recover enough
17 money.

18 And, again, this goes partly to my comments from
19 yesterday: I'm not proposing unlimited access to all the
20 rents that every conceivable person could gain as a result
21 of their location. But there's certainly something wrong,
22 because in every other market that we have in the world, we
23 have the access to at least enough rents to keep you around
24 in a world where someone really wants to keep you around,
25 where your customers want to keep you around. They will

1 pony up enough to keep you around if they really want to
2 keep you around.

3 That's the fundamental problem we have here. The
4 fundamental problem we have with offer capping is that we
5 just don't know, Joe's statements to the contrary -- when he
6 says the rules he has prevent excess market power, as I said
7 in my original filing here, I still don't know why that's
8 the case. I still don't have any evidence that's the case.
9 I understand he's lowered bids a lot. I understand he's now
10 got to put this superstructure on for scarcity. But it's
11 just not clear to me that what he's actually stopped is
12 local market power. There hasn't been any actual
13 demonstration of that as opposed to simply quelling the
14 normal price signals of what a valuable plant creates in a
15 valuable location.

16 By the way, in the back today, my client has
17 printed out a summary of what we think is wrong with the
18 proposal. I'm just going to catch a couple of highlights of
19 what, referring specifically to what's in here.

20 As to the application of this post-1996 units, I
21 don't believe my client has any post-1996 units, but they
22 certainly oppose that as a rule if they adopt the rule here.
23 They don't want it as a rule elsewhere because, obviously,
24 the Wallingford unit is obviously in another area that's not
25 really covered here. But the reasoning behind it is exactly

1 the reasoning that we've discussed in that case. That's why
2 we don't think it should apply to post-1996 units anywhere.
3 So we don't think it should apply in PJM.

4 The final point is if we're going to live with
5 something like 10% offer caps, and essentially PPLs proposal
6 says Okay, look, we agree, for the vast majority of units,
7 for base-loaded units and maybe most mid-merit unit -- I
8 agree with John on this, the 10% offer cap doesn't have any
9 real effect. LMP is above that. That's, of course, a lot
10 of what Joe's evidence -- that this doesn't really matter.
11 Of course, when it's applied to inframarginal units, since
12 it doesn't have any effect on what they actually receive,
13 that's why it doesn't have any real impact on anybody's
14 revenues.

15 But that's not what we're really concerned with
16 here, that's not where all the problems are coming. The
17 problems are coming from the peaking units. Those are
18 exactly the units that aren't able to properly recover under
19 this plan.

20 If we're going to have to live with something
21 like that, all right, the PJM auction proposal is similar, I
22 think, to John's exit strategy. It says, sure, if there's a
23 load pocket where there is an inability for units to achieve
24 what they need, the units within the load pocket can ask for
25 an auction to auction off essentially that entire load

1 pocket to make what essentially is a local capacity payment
2 in which the size of that local capacity payment will be
3 determined by the market. The winner of that auction will
4 then agree to bid at 10% above its variable cost. That
5 won't matter any more, obviously. If that's what's so
6 important, that won't matter any more because they will
7 adjust their capacity bids to make up for that. Generation
8 can bid into that. Transmission projects again --
9 integrated, we agree with Joe that that's got to be
10 integrated with the regional transmission expansion process.
11 Loads could bid into that. And that would again solve this
12 problem.

13 If we've just decided that -- without, I think,
14 very good evidence and good evidence to the contrary -- for
15 example, in push bidding, that this is a problem that needs
16 to be at the top of our list and we're going to use various
17 other mechanisms to then correct the problems created by
18 this problem that we saw on the top of our list, something
19 like an auction proposal that the generators can call for as
20 well, in order to get the payments they need, then, in the
21 interim, if the incumbent wins the auction, they could, of
22 course, begin immediately. If the incumbent doesn't win the
23 auction, they ought to get payments over the period at least
24 equal to whatever the person who submitted the winning bid
25 gets to at least give them part of their exit strategy.

1 Essentially that's the PPL proposal.

2 MS. FERNANDEZ: I think I'm going to start by
3 trying to get some basic facts out and maybe some basic
4 positions. When we're talking about the cost capping in
5 PJM, how widely used is that?

6 MR. BOWRING: We've published a fair amount of
7 data on that. We're going to publish more in another month
8 or so. But basically it's measured by megawatts or units.
9 It's always less than 1%. There are some hour intervals
10 when there could be 30 units, but typically it's a
11 relatively small number of units, a relatively small number
12 of megawatts, also generally constrained, where it's
13 systematic to a very small number of load pockets.

14 MS. FERNANDEZ: In terms of Exelon's proposal,
15 we'd seem to be saying divide this up into several different
16 categories. If we did something like that, how many units
17 are, I guess, cost capped with unpredictable hours that
18 frequently do not run in merit and are cost capped at
19 unpredictable hours against predictable hours?

20 MR. BOWRING: We have a grid which shows the
21 number of units by number of cost-capped hours and the
22 number of run hours. So, for example, if you're only
23 running five hours and you're cost-capped 90% of the time,
24 that's something different. If you're running 500 hours
25 and cost-capped 90% of the time -- but the numbers are down

1 pretty significantly for 2003 over 2002 -- what I was
2 planning on doing was, when this is over, submitting a
3 document which would spell out our position and include some
4 of that data. Much of that data, we can just include in
5 that document.

6 MS. FERNANDEZ: I think it would be helpful to
7 sort of identify what the scope of the problem is in PJM in
8 terms of -- because it also seems from the discussion that
9 the focus of the comment seems to be on the cost-capping of
10 peaking units.

11 MR. BOWRING: Just to be clear, the statement
12 that my compensation evidence is about non-peaking units is
13 not correct; it's about peaking units. What it shows is
14 that there's no significant difference in that revenue for
15 peaking units that are cost-capped 90% of the time as
16 opposed to 10% of the time across the run-out. It's fairly
17 constant. What that suggests -- and other recognized
18 yesterday as well -- is that net revenues are primarily a
19 function of aggregate market conditions. If we're in a long
20 situation or if you think the market rules are bad in the
21 aggregate market -- whatever the cause is, that's what's
22 driving net revenue in the load pockets, and it's not cost
23 capping.

24 MR. MEYER: I guess we would disagree. We
25 brought this to the attention of the Commission because we

1 had 20 peaking units which we didn't think were earning back
2 their money. Ten of those were sort of, I guess, marginal.
3 They were close enough. We didn't bring a lot of attention
4 to those, but 10 of them I think we filed at issue in this
5 docket. In those cases, 90% of their run hours were cost-
6 capped but we were not making, we feel, our money back. In
7 the interim, Joe has offered, and we accepted, a \$40
8 payment, which is much different than 10%. I'm trying to
9 think what 10% would be on those units, probably 16,000 heat
10 rate with \$5 gas, that's \$80, so that's roughly \$8 versus
11 \$40 compensation.

12 MR. BOWRING: So we're getting \$5 gas? I'm
13 kidding.

14 (Laughter.)

15 MR. MEYER: I'm from Texas. I'm estimating \$6
16 gas, whatever the case is. But the situation there, the
17 amazing thing to me that I mentioned yesterday, the usage we
18 were projecting -- and I'm not sure what PJM projected, but
19 the usage we projected actually went way down when we
20 increased the margin there, or the bid, by \$40. It's
21 increased roughly \$30, I guess, which told me that they
22 really didn't have market power in those hours that got
23 reduced anyway. It may have been my other units. Somebody
24 could point out that. I don't know which other units took
25 it. But obviously that particular unit could be relieved by

1 other units. Even if it was mine, obviously I didn't
2 exercise market power. It would have taken another bid.

3 MR. BOWRING: Can we talk about that for a
4 second? That point was made yesterday and it's --
5 particularly in this case, it's factually erroneous. As I
6 said in my testimony we expected cost-capping, offer-capping
7 in the West Met Ed load pocket to go down significantly
8 because the reason it was high in 2002 was based on a number
9 of transient transformer problems, one of them was hit by
10 lightning, there was a malfunction in another. And, in
11 fact, it isn't because they don't have market power, they
12 do, but because there was less need for generation in that
13 load pocket because the transformers were fixed.

14 MR. MEYER: It even begs the question that we
15 should have a competitive test that's more than a year or
16 five years in running such that in the hours that it's not a
17 problem, there's no issue there.

18 MR. O'NEILL: Is this an issue of the fact that
19 these are needed for reserves?

20 MR. MEYER: It's N minus 1 contingency for the
21 most part, at least the way I look at it. PJM, because you
22 shed load, you have a contingency; you overload other
23 elements and risk some load shedding.

24 MR. O'NEILL: These units essentially sit idle
25 until that contingency occurs?

1 MR. MEYER: You turn them on. Usually you have
2 to commit them.

3 MR. O'NEILL: To minimum load?

4 MR. MEYER: On a GT it's usually full out because
5 of the restrictions on air permits and general efficiency.
6 If it's minimum load on a CT, it's sort of hard to find. In
7 the older ones, you can probably go half-load; on the newer
8 ones, probably 70-80%.

9 MR. O'NEILL: So it's just not being dispatched
10 very often, is that the issue?

11 MR. MEYER: Some of them run 100 hours, some 200,
12 some 300.

13 MR. BOWRING: In 2003, the run hours are down
14 significantly from 2002.

15 MR. MEYER: So 300 hours or less?

16 MR. O'NEILL: So essentially they're there
17 because you need them for when the contingency happens.
18 Then you dispatch them to full capacity, right?

19 MR. BOWRING: They're there because that was part
20 of the way the system got planned. There are more units
21 there.

22 MR. O'NEILL: What would you do if John proposed
23 to retire them?

24 MR. BOWRING: If he proposed to retire all of
25 them, we would suggest a couple of alternatives: one is

1 that they be put up for sale and, second, if that didn't
2 work, to have an auction to address it which will include
3 all of the alternatives, transmission and DSN.

4 MR. O'NEILL: You wouldn't object if he proposed
5 to retire some of them?

6 MR. BOWRING: Right.

7 MR. O'NEILL: So there's excess capacity in the
8 load pocket?

9 MR. BOWRING: Yes.

10 MR. MEYER: As we define load pockets. I don't
11 think they lend the definition of load pockets -- for the
12 most part we were talking about yesterday New York City,
13 Dallas-Ft. Worth, Northern Illinois and I can't remember the
14 other ones discussed, but these are fairly small areas.

15 MR. BOWRING: And the economic results of those
16 units were not, in 2003, driven by cost capping. They
17 basically weren't economic very often and didn't run very
18 often, just like lots of other CTs in the system.

19 MR. PERLMAN: Could you address that question
20 Dick just brought up?

21 As I understand it, PJM may be in a different
22 circumstance, not having those relatively well-defined load
23 pockets like southwest Connecticut or New York City. Are
24 some of these units run off economy to maintain transmission
25 stability for power flowing through as opposed to serving

1 load in the load pocket? Is there anything different about
2 PJM than southwest Connecticut or New York City that we
3 should think about when we're considering this in the PJM
4 context?

5 MR. BOWRING: There are lots of significant
6 differences. Our load pockets are small, unlike southwest
7 Connecticut. I believe Bob said in New England, a third of
8 New England's load is a load pocket. In this case, we're
9 talking about a tiny, tiny load pocket compared to the ones
10 in New York or southwest Connecticut. In fact, as Bob
11 indicated yesterday, one of his primary problems is he
12 doesn't have CTs and load pockets, he has big steam units
13 that aren't a very effective way of managing constraints or
14 an effective way of managing short-term peaks. The CTs are.
15 So in this particular load pocket, it's relatively small,
16 most of the generation is owned by one owner, and it's CTs.

17 MR. MEYER: I would just add I don't think it's
18 due too much to flow-through power. Joe may be able to
19 correct me if I'm wrong, but most of these are fairly low-
20 voltage situations, 25- or 50-megawatts. It's not like
21 they're large units tied to the 500- or 230-grids.

22 MR. O'NEILL: These are all ICAP generators.

23 MR. MEYER: They have sold ICAP in the past.
24 Some of them still sell some amounts of ICAP. Of course,
25 the ICAP market's way down, too. That's one way you can do

1 it, don't have this much excess or have a different way to
2 pay for wanting to keep that unit around in capacity, as was
3 talked about yesterday.

4 One of the things we're going to address in ERCOT
5 -- and this may work here, too, I'm not sure -- because we
6 were proposed a solution sort of for not just these type but
7 quick start units in general -- is the quick start service
8 the ISO will buy, which is an operating reserve, and even
9 though we haven't identified it as purely localized like was
10 suggested yesterday, certainly the ISO would pick and choose
11 units I would hope in locations that made sense. If he did
12 that and picked them out of different merit, we haven't
13 probably figured out yet how to clear it because you may not
14 just go in a pyramid order stack if you pick and choose and
15 have enough to kind of cover different areas or regions and
16 you could regionalize quick start more. But again, if a
17 load pocket is extremely small, as I think in my case most
18 of the units would impact, it would still be the same issue.
19 How do you get an administrative payment, because you can't
20 have one bidder setting the price easily?

21 So somehow you've got to figure out what that
22 should be or how you're going to do it. But a quick start
23 service is really what Joe needs. You can almost wait hours
24 before you know you have different load conditions to commit
25 some and in other cases you have to commit them early.

1 Having run dispatching 10 years at HL&P, there are all sorts
2 of situations you can't predict but you always want to guard
3 against.

4 MR. O'NEILL: The steam units could participate
5 in the dispatch in the quick start by essentially starting
6 themselves up.

7 MR. MEYER: I don't think we're going to allow
8 steam units to participate.

9 MR. O'NEILL: If they're started up, why can't
10 they be part of the quick start?

11 MR. MEYER: We have another service called non-
12 spinning, if the ISO chooses to buy that.

13 MR. O'NEILL: If I'm a steam unit and I started
14 up and set myself at no load, why can't I then bid into the
15 quick start market?

16 MR. BOWRING: We don't have a quick start market;
17 we don't really have a need for it right now. We have more
18 than adequate spinning resources and we pay directly to
19 units to spin and be available and we make payments to both
20 steam units and CTs for spinning and being available. We
21 make separate payments to steam units that respond during
22 spinning events.

23 MR. MEYER: The idea, Dick -- I guess you could,
24 the idea is this would address more of the day-to-day
25 miscalculations of load forecasts, et cetera. Right now in

1 Texas we use something called non-spinning reserve, which
2 can be either quick start or units already on line that
3 haven't sold excess capacity.

4 MR. BOWRING: That's a different issue. That's
5 an aggregate market issue. The issue in the load pocket is
6 not about quick start.

7 MS. FERNANDEZ: In terms of PJM, this is the West
8 Med Ed load pocket. Are there other load pockets where
9 generators are mitigated many of the hours?

10 MR. BOWRING: The other principal one, which
11 isn't well known to you, which is the Delmarva Peninsula.
12 The geography of that has changed very significantly over
13 the last few years. In 2001, in fact, prices over virtually
14 the entire peninsula were raised because there was
15 congestion at Keene, which is a transformer bank in the
16 northern part of the Delmarva Peninsula. There have been,
17 as everyone knows, a lot of transmission upgrades. Ever
18 since then, they've substantially reduced the hours of
19 congestion and the degree of price separation and congestion
20 has become more local. But there are still units that run
21 significant hours cost-capped there.

22 MS. FERNANDEZ: Are there other areas within PJM

23 --

24 MR. BOWRING: Those are the two primary ones.
25 There's another one we referred to as PECO North which Gina

1 is familiar with which is a tiny one. There are only a
2 couple of units involved.

3 MR. O'NEILL: Can I ask a question?

4 You have this cost plus 10% when you determine a
5 unit is out of merit. Out of merit is counter-factual and I
6 don't understand where it fits in the economic scheme that
7 would determine market power. It's my understanding that
8 out of merit generation comes from the algorithmic
9 development of dispatch algorithms. Why do you choose out
10 of merit as your criterion?

11 MR. BOWRING: Perhaps I haven't said it as
12 succinctly or accurately as I should have. It's not, in
13 fact, out of merit. It is not having been taken in merit.
14 So it's not a counter-factual. It's a simple test: were
15 they taken in merit?

16 MR. O'NEILL: In merit is when you don't have
17 transmission constraints. I assume that's a counter-
18 factual. The fact of the matter is that there are
19 transmission constraints.

20 MR. BOWRING: Remember, these are the first
21 baseline tests.

22 MR. O'NEILL: Why do we use it?

23 MR. BOWRING: I'm about to tell you.

24 (Laughter.)

25 MR. BOWRING: If one of John's CT's had offered

1 in at his cost and it was next in the dispatch order and was
2 taken and it was running, we wouldn't have a transmission
3 issue. That's point one.

4 MR. O'NEILL: But that dispatch is infeasible, it
5 can't happen.

6 MR. BOWRING: Absolutely not. It's absolutely
7 not infeasible. That unit can run whenever it wants, it's
8 not bottled, it's in the load pocket, it can run whenever
9 it's economic. There's nothing preventing it from running
10 when it's economic.

11 MR. MERONEY: Does some other unit run in its
12 place?

13 MR. BOWRING: Of course.

14 MR. MERONEY: Basically you satisfy the security
15 constraint but some other unit is run.

16 MR. BOWRING: Let's start with this: the system
17 is uncongested. We take units in merit order, what is the
18 next most expensive to run? If one of John's units is the
19 next most expensive to run, it runs. If it's not and, as
20 the result of the way load develops, we need a unit in that
21 load pocket, then first we see if he would be next in order
22 to meet the load.

23 If the current marginal unit is \$40 and his is
24 \$41, it would be taken in merit order and paid its offer.
25 However, if the current system price is \$40 and there's a

1 \$41 unit somewhere else and his are \$80 or \$100, then we
2 need him, he's not running in merit order and he's needed to
3 relieve the constraint, in which case he's cost-capped.

4 MR. O'NEILL: But the first instance where he's
5 declared out of merit is a counterfactual -- that is to say
6 that he's not out of merit if you would have considered the
7 real transmission constraints in the first place.

8 MR. MEYER: That's really our point. You need a
9 different competitive solution. There may be three or four
10 units out of merit that can solve our problem. And in my
11 opinion, and in many opinions -- not everyone's -- they form
12 a different competitive level for that load pocket.

13 MR. BOWRING: Let's just focus on that question
14 for a second. It is the case then that we do as John has
15 suggested, present a separate market if there's a
16 transmission constraint and only a subset of units can
17 resolve it. Then we look at that subset of units and form a
18 new merit order and take the cheapest merit order unit. But
19 when we do that, we are cost capping. Otherwise, as we've
20 seen, units that have the ability to exercise market power
21 will do it.

22 MR. MERONEY: Now you're cost capping, wouldn't
23 they be bidding under the assumption that it's going to be
24 cost capping, so whatever they're doing is not necessarily
25 market power? In other words, you can't conclude that from

1 that run.

2 MR. FALK: That's exactly my point. In a cost-
3 capping regime, when you know your bid is going to be cost
4 capped under certain conditions, that already changes what
5 you end up bidding, right? In a world with no cost capping,
6 if you make a high bid--

7 MR. O'NEILL: Why does it change what you bid?

8 MR. FALK: In a normal regimen with no cost
9 capping, if you make a bid, there's a chance you won't get
10 taken. You won't get taken. That's your offer, right? And
11 if you get taken, you get paid that or more, obviously, if
12 it turns out to be more. Cost capping almost gives you a
13 second bite at the apple, right? Because now I can bid
14 high, saying to myself of course if I bid high it's true I
15 might not get taken, but of course I know I'll get taken --
16 here's another chance to just get paid LMP anyway, right, if
17 that's above my cost. So no longer do I have to worry about
18 LMP as serving as a cap for me.

19 MR. BOWRING: We've seen people implement that
20 strategy. It's actually not a proper maximizing strategy,
21 but we have seen people implement it.

22 MR. O'NEILL: That strategy being?

23 MR. BOWRING: The strategy that's just described:
24 if you know you're going to be cost capped, cost plus 10%,
25 why not bid really high and hope you may set the price.

1 That simply doesn't work and it means you don't get taken if
2 you bid at what would otherwise have been a competitive
3 level. You don't get taken -- it might well have been a
4 margin. Frequently units are cost capped because they bid
5 in a non-competitive manner, perhaps under the same
6 assumptions that were just described.

7 MR. O'NEILL: You don't always know when you're
8 going to be cost capped.

9 MR. FALK: You don't.

10 MR. MEADE: Joe, you made a point early in your
11 presentation that currently there is no generation scarcity
12 in PJM. As I recall, you made that statement in various
13 reports before. Is there something sort of inherent in the
14 market design? I'm trying to remember all the ICAP rules in
15 particular that makes the fact that there is no generation
16 scarcity the usual outcome. I mean, is there something
17 about low LSE obligations under the ICAP program or
18 transmission expansion -- is there something about the PJM
19 rules that would make the lack of generation scarcity the
20 normal result?

21 MR. BOWRING: No, all you have to do is look to
22 1999 or 2001 to see that that's the case. We had exactly
23 the same set of rules in place, the same ICAP market, and we
24 had very high prices. So while it's understandable that
25 when we're in a down cycle those who would otherwise be

1 receiving higher revenues are not happy, it makes perfect
2 sense. It doesn't mean necessarily there's anything wrong
3 with the rules; that's not to say that we don't need to
4 continually look at the rules, we are involved in a thorough
5 review of the ICAP rules, for example, but scarcity in the
6 ICAP market looks different than scarcity in the energy
7 market.

8 MR. MEADE: I didn't put my question clearly.
9 Are you saying that in 1999 there was actually scarcity of
10 generation capacity and energy in the PJM market in some
11 areas?

12 MR. BOWRING: No, what I'm saying is that during
13 some hours we got close to the end of the supply curve in
14 energy, despite the fact that we had enough -- more than
15 enough capacity to meet our load obligation, which is the
16 expected peak load plus a reserve margin. Again, it's
17 important when you're thinking about generation shortages to
18 think somewhat differently about the capacity market than
19 the energy market. The capacity market, the demand for
20 capacity, is equal not only to expected peak load but that
21 plus a reserve margin. So one can be tight in the capacity
22 market, within say 1000 megawatts or so of the obligation,
23 but again the capacity market obligation takes account of
24 outage data and other things that are expected to happen and
25 you have forced outages and you have other events that

1 occur. And that's part of the reason why we were tight in
2 '99.

3 MS. CARRADO: I just wanted to add there was one
4 difference, that PJM has a deliverability test which says
5 that every generator can reach the load at any point in the
6 system. While that's not a perfect test, it's a planning
7 test, it's a snapshot per se. I think that is a difference
8 than they have in other areas.

9 MR. MEYER: I would like to point out that
10 obviously that's not a perfect test because if it was we
11 wouldn't have load pockets period. Therefore, you wouldn't
12 have any constraints in the system.

13 MR. MEAD: My question had to do with generation.
14 You defined a load pocket as an area where there's
15 transmission scarcity. My question had to do with was there
16 something in the rules of PJM that pretty much prevented
17 generation capacity scarcity or generation energy scarcity.

18 MR. MEYER: We hope resource adequacy markets
19 handle that problem. I guess ICAP, to the extent that it
20 can be filled, handles the problem. It's not going to be
21 generation short overall.

22 MR. WOLAK: I'd just argue, as you just said,
23 David, it would be the combination of the ICAP market with
24 the transmission expansion that says you've got to be able
25 to deliver capacity -- in an ICAP, you've got to buy, at

1 least, as Joe said, your planning reserves. So therefore in
2 theory there should never be generation scarcity and there
3 also shouldn't be local generation scarcity because of the
4 fact of the deliverability requirement.

5 But I also agree with John that that's probably
6 based on planning data, deliverability. So there would be
7 contingencies that arise that perhaps say that there would
8 be circumstances where you might have it. But I would
9 expect it to be an extremely low probability for exactly
10 that reason.

11 MR. MEAD: If I could just follow-up for a
12 second: does that deliverability test capture even the
13 small load pockets we've been talking about this morning?

14 MR. BOWRING: Remember, when you want -- I mean,
15 the deliverability test is applied to a generator, so if you
16 want to hook up a generator to the system and you want to be
17 a capacity resource, you have to meet the deliverability
18 test. That doesn't mean that you, unlike everyone else, are
19 going to be deliverable to certain load pockets during hours
20 when it's constrained. What it means is you would be
21 deliverable anywhere in PJM exactly as the current resources
22 are. The deliverability test -- Gina, I'm sorry.

23 MS. CARRADO: We're discussing -- one of the
24 things we proposed is that PJM needs to take a closer look
25 at deliverability or scarcity, especially with regard to

1 unit retirements. One thing the test does not do is look at
2 the age of the units, what their life span is and all that
3 and take a more proactive approach and look at these smaller
4 areas to say is there potentially a problem coming up.

5 MS. FERNANDEZ: I guess in terms of the
6 discussion and the deliverability test, looking the other
7 way, is this something you could solve in one of two ways:
8 one is through transmission planning to try and get at the
9 limited number of load pockets you have, and the other is
10 looking more specifically at the retirements of the units?

11 MS. CARRADO: Both.

12 MR. MEYER: In fact, we put that rule into place,
13 if your congestion costs in a region or load pocket exceed a
14 certain amount -- in ERCOT we're trying to put it in, I say;
15 we haven't got it passed yet. The ISO has to do a
16 transmission planning study to determine what would be the
17 fix. Then obviously you've got a cost-benefit analysis
18 you've got to go through just to see if you really want to
19 make that fix.

20 But the problem -- I really worried about this a
21 little bit. When we went to markets in the old days of the
22 control areas, vertical utilities, it was pretty obvious how
23 they managed congestion. They looked at all sides of
24 simultaneously. They managed to congest themselves. When
25 we went to a lot of the wholesale market -- the more and

1 more robust it gets, we still look at reliability as can I
2 fix the unit, can I get both units to turn on when I get
3 into enough contingency situations? Obviously the answer
4 usually in all these cases is yes.

5 What's bothering me a lot is we don't operate
6 exactly like it's planned. We operate it by having those
7 units not turned on a lot of the time to handle more than N-
8 1 contingencies and moving a lot of power over the lines.
9 Therefore, we take different risks.

10 If we have a number of outages hit all at once,
11 we have a big problem. I think we all know what that can
12 lead to. The next day we can solve it easy, just turn on
13 the units that were missing that day. But that day we can't
14 solve it unless we solve it up front. I just believe we
15 need to take a lot harder look at sending proper price
16 signals and building enough transmission that these big load
17 pockets, particularly big load pockets, are solved if they
18 can be solved and turned back into pure market. That's
19 really what our push is.

20 The smaller load pockets it gets a little
21 tougher. If it's just transformers a lot of times, I think
22 it ought to be handled pretty easily and we need to stay on,
23 I think, people to solve these load pocket dilemmas if you
24 put a transformer on and it solves it. There is a cost-
25 benefit issue, which one is more expensive? But if you

1 mitigate it down to a real low level, you'll never really
2 know which one is most expensive, and I think that's where
3 we are today.

4 MR. FALK: I agree with that. I fully support
5 integrating this with the transmission expansion process,
6 because you can't have this run on a different track and
7 then, at some point later on, someone goes oh, I've solved
8 that load pocket, didn't I tell you? So the integration of
9 that and the use of good economics to try and figure out how
10 to expand transmission, I have to say personally -- I don't
11 even know if I'm speaking for PPL here because I haven't
12 discussed it with them really, but the notion of whether
13 transmission expansion can happen in much more than a highly
14 command and control from the top holistic view of the whole
15 market, I'm sort of agnostic about. I don't have a great
16 view of whether or not the markets can come together and
17 expand transmission in an efficient fashion. But having
18 said that, whatever is done, it's got to know what else is
19 going on with the rest of the problems so they can all be
20 solved together.

21 MR. BOWRING: I would just add briefly PJM has
22 the hedgeable/non-hedgeable test. Part of the reason for
23 developing an auction is to ensure that we don't build
24 transmission if it's more expensive than building
25 generation, even if the result continues to be congestion.

1 If you look at it over the right timeframe, the life of the
2 transmission asset, for example, it may well be that
3 competitive generation auctions will result in lower costs
4 to the load pocket even if some congestion remains, then
5 building the transmission line. That's part of the purpose
6 of it. It may well be there's some cheap transmission
7 fixes, in which case they should be put in place. That's
8 part of an ongoing process.

9 MR. PERLMAN: My question was, Joe, you had
10 mentioned before, this is a depressed environment in some
11 senses for generation revenues. In that case, a few of the
12 same units that John has in the same location wouldn't be
13 dispatched at all and we wouldn't get any revenue. But
14 Jonathan and John's point is they are where they are,
15 they're necessary, shouldn't the value in some way be
16 recognized, notwithstanding the fact that it may be a
17 depressed market for generation in general. Should that
18 value be recognized in some fashion beyond the 10% to make
19 sure that there's compensatory payment, notwithstanding any
20 other circumstance that we're looking at in the market in
21 general. Should there be a focus on those units because
22 they're necessary and must be maintained to support
23 reliability regardless of the other market power concerns we
24 might have?

25 MR. BOWRING: I think it's an interesting

1 question. I think that in fact those units aren't more
2 necessary for the system than other units. Every unit in
3 the system is necessary for reliability, particularly when
4 we're close to our aggregate capacity requirements. To say
5 that we should be creating a special class of units in load
6 pockets that are compensated in a different way I think is
7 something you have to be careful about. Nonetheless, it is
8 appropriate if it's more expensive to build there and the
9 fuel costs more, that may cost more and the people pay more
10 for it. The prices should reflect the real cost of
11 generating power. They shouldn't reflect market power. And
12 I expect the outcome of auctions will be that in some cases
13 both the fixed and variable costs are going to be higher in
14 some of the load pockets and the price will reflect that and
15 that's appropriate.

16 MR. FALK: I guess where we differ is the
17 question of whether it also ought to affect the cost of the
18 next best alternative. If it affects their own costs,
19 which is exactly what he was talking about there, I have no
20 dispute that it's got to reflect at a minimum its own costs.
21 That's inarguable.

22 The question is whether it ought to reflect the
23 next best alternative. How are you telling people where to
24 put the next plant? How are you telling loads where to
25 locate? You're actually -- if it's needed for a local

1 market power reason, it is more valuable, it's not just it
2 happens to be there. Sure, they all contribute to system
3 reliability but you wouldn't turn on a unit out of merit if
4 it didn't provide something else to the system. You're not
5 just signaling to that unit, all right?

6 The local market power problem I understand. If
7 they can ask for the moon, they'll take the moon. I
8 understand that. The question is how are you going to set
9 up a system of dynamic efficiency? How are you going to set
10 up a system where a load knows where to locate should he be
11 in this little load pocket or should he be three miles away?
12 How the heck can he ever know under those circumstances and,
13 if his costs actually reflect whatever the next best
14 alternative is in a dynamic sense, you'll get there. Of
15 course, that's what the auction ought to do.

16 And that's what I think is the difficult problem.
17 And I don't mean to say it's not a difficult problem of
18 trying to figure out how much rents need to go to these
19 specific units for their extra value, that's the bogey you
20 ought to have in mind and not his own costs. His own costs
21 just aren't particularly relevant for that.

22 MR. BOWRING: As you said at one point, the
23 auction is a mechanism for doing that. While it's -- you
24 could say what the goal is, it's difficult to develop a
25 mechanism when you don't really have a market in the area to

1 do that. That's the point of the auction, is to have a
2 market mechanism which reveals what the real economic cost
3 of meeting load is there. If it's higher, it's higher,
4 people ought to pay it, the load ought to see it and react
5 to it.

6 MR. KATHEN: Your auction you've been talking
7 about in your submission is planning, it's looking forward.
8 In some cases, there may be retirement and you've suggested
9 the auction may occur. Part of my question is, one, are you
10 saying that retirement would cause some potential
11 reliability problems and that therefore you need to keep
12 those on and so they are regarding some kind of reliability
13 service and someone needs to come in and build or buy that
14 unit.

15 MR. BOWRING: That's a multi-part question. But
16 if we have a load pocket that needs 500 megawatts of
17 generation in the load pocket and 400 of it retires, that
18 does create a problem. In the same sense, however, we need
19 a certain amount of generation on the eastern side of the
20 eastern interface. If we lose 1,000 megawatts to 2,000
21 megawatts on the eastern side of the eastern interface, then
22 we also have a reliability problem. There's nothing unique
23 in the fact that units provide reliability. Absolutely.
24 That's what they do. That's why there has to be market-
25 based compensation, to make sure all units receive

1 reasonable compensation.

2 MR. GRAMLICH: Joe, yesterday Bill Hogan said on
3 this question of what the appropriate role of ISOs and RTOs
4 are, he said well if you really do get to a market failure
5 where there's just no alternative, maybe it's okay for an
6 ISO or RTO to involve themselves in the long-term adequacy
7 question but only if it's a very well-defined and limited
8 role and I can see many scenarios where that would lead you
9 down a slippery slope. What you just described now is if
10 generation of a significant amount east of the eastern
11 interface wants to retire, then you'd be in that situation.
12 I'm wondering if the only source of this capacity value is
13 in this auction mechanism, aren't we leading into a
14 situation where we're going to keep running into that,
15 nobody is going to invest until we get to that scarcity
16 situation and all procurement is going to be through a PJM-
17 administered auction.

18 MR. BOWRING: I think that's at the bottom of the
19 slippery slope. We've attempted to define -- I think it's
20 defined narrowly such that it is only looking at narrow
21 instances of failure. Load pockets do represent a failure
22 of the market, it's not a competitive market there. But our
23 load pockets are small and very well defined. We're not
24 talking about implementing this kind of auction on a broader
25 scale. But there is a broader auction which is very

1 generally comparable to this and that's the ICAP auction.
2 The ICAP auction, at least under the proposal being
3 considered now, would be a central auction administered
4 again by the RTO but in a sense comparable giving everyone
5 the opportunity to bid and to offer into it.

6 MR. O'NEILL: If you notify the consumers in the
7 load pocket that there's a load pocket and somebody wants to
8 retire their resources and all that, why is it incumbent
9 upon them to deal with that problem? Why isn't it incumbent
10 upon PJM to deal with that problem? I mean, it seems to me
11 that in the first instance the local LSE should be paying
12 attention to that issue. You can notify them of that.
13 Steve Hurley can say, in my planning studies, you've got
14 problems. Why isn't it incumbent upon them to solve the
15 problem?

16 MR. BOWRING: I'd agree with you if you were
17 selling ice cream, but we're not, though. We're not selling
18 anything obviously.

19 MR. O'NEILL: John's willing to deal with the
20 LSEs. Do you sell ice cream to these guys?

21 (Laughter.)

22 MR. BOWRING: Seriously, if you're sitting in a
23 load pocket and you're an individual in a load pocket and
24 you receive a letter in the mail saying you're in a load
25 pocket, beware, what are you going to do about it? What

1 ability do you have to react to that? You don't have any
2 ability to react to that.

3 MR. O'NEILL: The entities are not small and
4 uninformed in most cases, they're parts of very large
5 organizations.

6 MR. BOWRING: That raises some of the
7 institutional incentive issues we talked about yesterday.
8 Let's take two possible scenarios: one is where you have an
9 LSE which has a one year contract to serve load in a load
10 pocket. It doesn't care, it's going to pass whatever the
11 price is through to the ultimate load. The ultimate load
12 cares about it and the issue is if you want it --

13 MR. O'NEILL: Doesn't the state care about that?
14 Doesn't the local distribution company?

15 MR. BOWRING: Hang on, that's the second
16 scenario.

17 The second scenario is where you have an
18 integrated company that has a power obligation that is going
19 to pay the higher prices. We've seen that behavior in PJM
20 where it's integrated. We've seen a transmission investment
21 and the response to it to try to avoid some of the
22 congestion and the higher costs. That's actually happened.

23 23

24 The difficulty is that when you're in that prior
25 situation and there really isn't one with an institutional

1 incentive. States can act, but states aren't market players
2 any more than PJM is a market player.

3 MS. FERNANDEZ: It actually looked like some of
4 the other panelists wanted to get in. Why don't we just go
5 down, and start with Gina, and just go down.

6 MS. CARRADO: I just wanted to add that the basic
7 principle that we're working from is that we have a load
8 pocket, we need a unit to control reliability problems yet
9 that unit may not be recovering its costs. I think there's
10 a principle or at least a minimum burden of proof to say
11 that PJM needs to identify that that particular unit is
12 needed for reliability. I don't think it's enough to say
13 that all units are needed for reliability.

14 On the other hand, I think there should be a
15 burden of proof on the generator owner to show that they're
16 not recovering its costs. I think you need to look at it
17 from both sides and it's a very granular approach. But I
18 don't see any other way out of the situation.

19 MR. WOLAK: I'd just like to follow-up on some
20 things that Joe said because I think they deserve
21 elaboration. The first I think is his point -- that didn't
22 get emphasized -- was that a lot of locations that are,
23 quote, load pockets really don't need new capacity. There's
24 plenty of capacity there. The difficulty is exactly what
25 Joe said, which is there's insufficient competition at that

1 location to supply electricity among the suppliers that
2 exist there. Then the other part is a sufficiently large
3 fraction of hours so that it is essentially costly in terms
4 of allowing market prices or market mechanisms to set the
5 prices that suppliers are paid at that location.

6 I think similarly, to follow on his point, if you
7 take a larger geographic area and said Okay, now let's give
8 the same fraction, if you like, of the generation capacity
9 in that larger geographic area to this one entity, you'd
10 have almost exactly a scale-up of the same problem you have
11 in the load pocket. But the good news is that that's not
12 the case: generation ownership over a larger geographic
13 area tends to be more dispersed. That's why you don't see
14 the problem -- the problem scale-up in that manner.
15 Although there are some markets where it does scale up to
16 that level in terms of the problem.

17 But fundamentally, I guess, what I'd say is it's
18 the issue of insufficient competition at the location, a
19 sufficiently large number of hours, and that really is the
20 heart of the problem. And, you know, in most instance it's
21 not because of the planning processes that take place at PJM
22 and other ISOs, it's not the case that there's insufficient
23 generation capacity, it's just really a case of insufficient
24 competition at isolated locations.

25 MR. MEYER: I was going to respond a little bit

1 to the question whose responsibility is it? I think it's
2 the load serving entities first. Next, I think it's usually
3 the transmission owner who has an obligation to serve. The
4 LSE may or may not have an obligation to serve depending on
5 how the state retail market gets structured. Somebody
6 probably does, though. As I think Joe pointed out, coal may
7 usually be in the picture which could be the incumbent or
8 not.

9 And lastly, the reason Joe was worried about it
10 is if none of those take the responsibility, the RTO has
11 been sanctioned as far as I know by FERC to have that
12 responsibility to maintain reliability. Maybe not. Maybe
13 I'm misinterpreting that, but that's the way I view it in
14 Texas, it's the way I view it in PJM and the way I view it
15 in California, the RTO will take the steps necessary to
16 preserve the reliability to its ability if no one else takes
17 that step.

18 MR. GRAMLICH: On a short-term basis or long-
19 term?

20 MR. MEYER: On a short-term basis. In some
21 states, in Texas actually I think it's long-term. We've
22 introduced a very strong transmission-planning requirement
23 from the ISO to solve long-term problems such as this.

24 MR. GRAMLICH: For transmission owners and
25 generation?

1 MR. MEYER: Right. The only problem I'm having,
2 when the RTO takes a bid and takes a long-term position,
3 he's not only taking a long-term fix on this, he's also
4 taking a position in the market usually. The more he does
5 that, the more we start destroying the market. This isn't
6 something we like to see everywhere where the ISO pays a
7 generator or really anybody to fix the problem necessarily.
8 I think that was brought out yesterday. There's some fine
9 line you've got to carefully walk down. You don't want them
10 to interfere with the market if you can help it. Sometimes
11 you have no other choice.

12 MR. FALK: The only thing I'd add to that is if
13 the customers are less concerned about protecting themselves
14 than the ISO is there's something profoundly wrong with the
15 market.

16 MR. O'NEILL: Let me just pose a potential
17 problem: suppose PJM goes out and conducts an auction,
18 signs a bunch of contracts, and afterwards the states come
19 in and say these were terribly imprudent and they botched
20 the process. It was hideously incorrect. Maybe the
21 Commission, after a hearing, finds out that PJM was
22 imprudent in acquiring the assets. Where do the imprudent
23 costs go?

24 MR. MEYER: I think in an RTO situation, they're
25 going to be shared by the RTO participants. If you disallow

1 that totally, basically you have to break the contract.

2 MR. O'NEILL: So PJM is now going to sign some of
3 the eastern costs of their auction to CommEd?

4 MR. BOWRING: Hang on.

5 (Laughter.)

6 MR. BOWRING: It's an interesting hypothetical,
7 but presumably the Commission would have not only approved
8 the process by which the contracts entered into -- with the
9 opportunity for the states to participate, but also the
10 particular contracts. Remember, PJM is not taking a
11 position in the market. PJM is not entering into contracts.
12 PJM is not a party to a contract. It is obligating load in
13 a load pocket to pay. It's required to have generation
14 there to serve it.

15 MR. O'NEILL: If the LSE doesn't like the results
16 of the auction, the entity to whom you assign the costs, do
17 they have a right to come to us and say You screwed up or do
18 we have to approve everything?

19 MR. BOWRING: You would be in a better position
20 to judge whether they have the right to come to you. I
21 don't know. But clearly the notion is that the process, the
22 procedure at PJM which develops the auction process and
23 addresses the contracts should be one in which everyone is
24 participating, including the states. And they would come to
25 the Commission for approval before it's implemented.

1 MR. O'NEILL: So you wouldn't conduct any of
2 these processes unless the states had signed on to this?

3 MR. BOWRING: No, unless they were part of the
4 process clearly.

5 MR. O'NEILL: Not part of the process, don't they
6 have to sign on? They don't? So they have a right to
7 complain at the end?

8 MR. BOWRING: I didn't say anything. I think
9 it's a very good question. The role of the states is
10 evolving and clearly they should be intensely involved. If
11 they really think this is a bad idea, then we have to think
12 about where there's a better one. But nonetheless it's
13 incumbent on us to come up with a market solution to
14 reliability and market power problems. If the states don't
15 like it, ultimately it's the Commission that decides whether
16 it goes forward with or without them.

17 MS. FERNANDEZ: Does anyone else want to comment?

18 MR. WOLAK: I just wanted to say that I think
19 Dick identified the really important issue, the willingness
20 of the RTOs to step in perhaps may cause the states not to
21 do what we think the states should do. I don't have a
22 solution. Just to say exercise caution in allowing RTOs to
23 rush in is, I guess, all I would say. But in that regard, I
24 think one of the things that would be very useful is the
25 identification of these things, the quantification of the

1 costs, the sorts of mechanisms that John discussed in Texas
2 I think is really a great idea in the sense of Look, this is
3 a level of congestion we're initiating a transmission
4 upgrade process for. Because this level of congestion has
5 been reached, alerting the relevant stakeholders so that at
6 least when the lights go out you can at least point to all
7 the evidence that you've given to the state process to tell
8 it that it needs to do what I think, at least I certainly
9 agree with John, is the first line of defense.

10 MR. O'NEILL: Think of what would happen if we
11 invoked that procedure in California, if we told the
12 California ISO to go out and procure some resources.

13 MR. WOLAK: That's why I'm saying don't do it.

14 (Laughter.)

15 MR. MEYER: I've got a question. When we talked
16 about the auctions as a good way to value the market value,
17 why don't you conduct an auction for every load pocket which
18 you identify? That's the right way to value the market
19 value of it. That's what we're really struggling at, isn't
20 it?

21 MS. FERNANDEZ: I thought Dick's point would be
22 that it would be one thing to conduct an auction but it's a
23 question of who should be conducting the auction, because
24 the obligation of the LSE and the transmission owner to do
25 it or, if PJM steps in, then the transmission owner isn't

1 going to do what's right.

2 MR. WOLAK: I think on the point of the value,
3 just one thing I think it's important to clarify on that is
4 the fact that we unfortunately don't know the value because
5 we can't get demand to bid in. And it's demand bidding in
6 that is going to tell us what the value is. As Dick always
7 likes to say, demand's bidding in like this which says the
8 value is infinite. That has severe problems when you say
9 let's price it at the value. So that is sort of, I think,
10 the reality that exists. And so it really is preventing us
11 from getting a very good idea of what the value of the
12 energy is in a load pocket.

13 MR. O'NEILL: Let me ask another question: if
14 you have a load pocket where there is genuine excess
15 capacity and we conduct an auction, who do you expect to see
16 showing up? If I'm a potential generator, I'm going to go
17 and read all the specs for the bid and all that kind of
18 stuff and spend a lot of money to put the bid together, try
19 to find a site -- and load pockets are notoriously site-
20 deficient.

21 21

22 22

23 23

24 24

25 25

1 This is all to basically lose the auction to one
2 of the existing units?

3 MR. FALK: I think the first answer to that is
4 that allowing the transmission system to bid in as well, it
5 seems to me, is the critical part of this.

6 MR. O'NEILL: Transmission doesn't supply energy
7 by itself. It needs a generator on the other end.

8 MR. FALK: It can combine with contracts.

9 MR. O'NEILL: Okay, so we're saying that
10 generators outside the load pocket can bid into that,
11 assuming that they can upgrade.

12 MR. FALK: Assuming they can upgrade the system,
13 otherwise --

14 MR. O'NEILL: How do you evaluate those bids?

15 MR. FALK: The PPL proposal essentially has
16 everyone offering what is in essence a capacity payment.

17 MR. O'NEILL: Again, if there's excess capacity
18 in that load pocket, who's going to spend the money to put
19 together a bid and get a site and do everything they need to
20 do to see themselves lose to one of the incumbent
21 generators?

22 MS. FERNANDEZ: I was going to say, why don't we
23 finish this round of question, then I really want to take a
24 break. We've been going for about an hour and a half and
25 try to get some of the other people involved?

1 It looks like Gina?

2 MS. CARRADO: I just wanted to say the auctions
3 that some of us are talking about are specifically when
4 there's no investment. Other folks are saying "run an
5 auction even if there is just market power," not just -- but
6 there's not scarcity. There is market power to get a
7 competitive price and I think we have to look at this, at
8 these two things very differently because in the latter you
9 have to look towards physical and economic withholding and
10 that they're just trying to drive up the price.

11 MR. FALK: I think the case of excess in the load
12 pocket is more difficult particularly where there's only one
13 owner. I think that does present a difficult case but,
14 where there are multiple owners within the load pocket, you
15 know, they can compete with each other.

16 MR. BOWRING: And you don't have a problem to
17 start with.

18 MR. FALK: That goes back to what I said -- I
19 don't think we had a problem to start with. That goes back
20 to the other point.

21 MS. FERNANDEZ: We've been going about an hour
22 and a half. I know I did promise to take breaks about every
23 hour and a half today. Why don't we take a break and start
24 promptly at 11:00 a.m? And I do mean promptly.

25 I'd also like -- a number of people had told us

1 that they wanted to make some comments. I'd like to start
2 working them in so if you see us during the time, let me
3 know if you want to make some comments. I think we'll try
4 to use some of the empty seats for that.

5 (A brief recess was taken.)

6 MS. FERNANDEZ: I think of the people who said
7 they wanted to speak we've got like three more seats.
8 Actually we've got another one over there, too.

9 Just a sort of word of warning. This is being
10 transcribed. If you're one of the people who have just
11 joined us at the table or who is going to when we get some
12 more seats, you need to state your name and your company for
13 the court reporter.

14 MR. COLEMAN: Why don't we just start around and
15 do that to begin with so we all know who is at the table
16 now?

17 MS. FERNANDEZ: Why don't we start by giving some
18 new people a chance to make some comments. One thing I was
19 going to get the other panelists to do eventually -- but it
20 may be helpful to get you guys to start doing it is that, in
21 terms of the specific proposals as to what should be in
22 PJM's market mitigation measures, when you're sort of giving
23 your reactions to I think some of the things that have been
24 said, if you have specific views as to what should be
25 included in PJM's tariff specifically right now, there's a

1 cost capping for the pre-1996 units in PJM's proposal. It
2 would continue the cost capping for the pre-1996 units. It
3 would also apply the cost capping to the post-1996 units and
4 there would be an auction if there was a scarcity.

5 Those are basically the three elements of the
6 proposal. So that, in your comments, it would also be
7 helpful if you put in sort of your reaction to those
8 elements in terms of what the Commission should do, should
9 order in terms of changes.

10 Why don't we start here?

11 MR. LALOR: Pete Lalor with Commonwealth Shore
12 Power. I didn't quite have a chance to organize my thoughts
13 so I guess this will be briefer than it would otherwise.

14 First of all there was a lot of discussion
15 yesterday about getting prices right and how important it is
16 to get prices right. I think it should be emphasized as I
17 am a part owner of an existing generating unit in PJM as
18 opposed to '96 unit, I think it is a terrible idea to cost
19 cap a unit that came into a system that expected certain
20 market systems to be in place and then say that the market
21 system is not going to be there.

22 I think it raises what I call the "Republic of
23 Chad" problem. Somebody yesterday -- I think it was Mr.
24 Perlman here, said "What exactly do you mean by 'regulatory
25 uncertainty?'"

1 The answer is, when you have market rules and
2 have stable market rules and FERC permits them to be
3 unstable, that's what I think is "uncertainty" -- that
4 actually leads logically to the second issue, which is the
5 purpose of the auction.

6 .

7 We are developers and we have another project
8 that we're developing in an area that we think is about to
9 have a big reliability problem, a load pocket that hasn't
10 yet been identified, in effect, in PJM.

11 Because of the traditional uncertainty, getting
12 the prices right, which is definitely something FERC should
13 do with their market system, is a terrific idea but it's not
14 going to solve the problem of getting new generation in
15 because I believe capital markets will be closed for the
16 indefinite future.

17 The reason they'll be closed is because there's
18 been all this uncertainty in the past and they developed a
19 project that went in under a certain capacity market
20 expectation and it was a peaker in the capacity market
21 structure was completely changed between 1999 and 2000 when
22 we were raising our capital.

23 In 2001 - 2002, who's going to believe it next
24 time in order to get more capital in PJM even if you get the
25 prices right, which you should -- you're going to have to

1 give people long term commitments.

1 That is, I think, one of the most important
2 points about the proposed PJM auction that Joe and others
3 have been designing because it is going to give people the
4 kind of certainty they need to come in.

5 MS. FERNANDEZ: So your position is that PJM is
6 the entity who should be making the long term commitment?

7 MR. LALOR: I think the question has been asked
8 several times by Mr. O'Neill and the answer to that is, "yes
9 I do."

10 And I think that probably there are several good
11 reasons for it, many which have already been elaborated.

12 The first one is, assuming that you're successful
13 at having competition in the load pocket area and you have a
14 number of LSEs that are competing with one another, you're
15 not going to find anybody who is willing in many cases --
16 and in many cases anybody who is able to make long-term
17 commitments -- I also think yesterday there was a focus on
18 risk and that we want to make sure that, when there is real
19 risk out there, whoever should bear the risk bears the risk.

20 In this case, I'm not sure whether it's PJM-wide
21 or whether it's in the load pocket but there really is a lot
22 of risk. I think that the load is going to grow pretty
23 predictably and you might be off by half a percent this year
24 or a percent that year, but there is going to be a
25 predictable growth in load.

1 If you say "let's find somebody to take that
2 risk," the LSEs are clearly not going to take it and they'll
3 be happy to let the lights go out. New generators to the
4 extent that you need new generation investment are not going
5 to take it. Somebody has to take it and I think ultimately
6 it's up to the regulators, whether it's the state or whoever
7 is ultimately backstopping the obligation.

8 Somebody needs to say "there's got to be load
9 there." We don't know which LSEs are going to serve, if
10 they're going to compete. Hopefully they'll all cut each
11 other's throats and they'll keep the prices low but
12 ultimately the load's going to be there and there has to be
13 somebody at a higher level who's going to say "we've had to
14 make this commitment for reliability on a longer term basis
15 and so we're going to take those costs which we had
16 determined were the least costs by going through a proper
17 auction process and we're going to allocate them."

18 Can the state do it if you've got a load pocket
19 exclusively within one state's jurisdiction? You can under
20 certain circumstances -- you may have new investment for the
21 eastern side of the interconnection that may be properly
22 allocated in multiple jurisdictions, in which case I don't
23 think you can -- then you've got to have an RTO doing it and
24 doing the allocation.

25 Actually -- I had one minor point to add to that,

1 which is, yesterday people talked about how generators are
2 going to need to have ten year contracts in order to get
3 recovery. I think that's fine. Obviously the sooner you
4 could recover your capital the better generators,
5 perspective generators, will be happy -- but I also note
6 that there filing the transmission owners have proposed --
7 to have a 15 year recovery for their capital.

8 I think if there is to be an auction, everything
9 possible ought to be done to meet PJM's goals and Joe's
10 goals of finding the least cost solution. Doing that you
11 don't want to have various capital recovery standards.

12 It seems to me, if and when you say "schedule
13 12(a) for the transmission owners is the amount of proof,"
14 you give them 15 years, here is their capital recovery
15 schedule front loaded on a declining basis over 15 years --
16 then if you have an auction, everybody ought to be bidding
17 in effect against that schedule, as opposed to saying "well,
18 I'll levelize mine for 10 years because then the auctioneer
19 is going to have to make decisions about cost of capital and
20 this kind of thing" -- which will affect the results.

21 MR. O'NEILL: I don't quite understand what
22 you're proposing -- you're proposing a merchant generator
23 where we specify the depreciation rate for the asset?

24 MR. LALOR: I'm not proposing a merchant
25 generator at all. I'm suggesting that, given the

1 uncertainty that has been attendant to these markets, you
2 will not get any more merchant generators.

3 MR. O'NEILL: So you want a cost of service rate?

4 MR. LALOR: In effect, the section 6.5 auction as
5 proposed is filing the lowest cost subsidy in order to solve
6 the liability problems, yes.

7 MR. O'NEILL: So subsidy is a lump sum payment --
8 we're not going to regulate your depreciation rate?

9 MR. LALOR: That's correct. As I understand, the
10 section 6.5 auction, the goal will be to come up with the
11 lowest cost solution which would be the lowest cost subsidy.

12 In effect, the transmission lines would be
13 bidding what they're going to require and whatever they
14 would get from building a new facility, somewhere the
15 generators would be saying "I'm looking at the market. I
16 see what I can get for X-Y services, for the capacity market
17 and the energy market -- here's the supplement payment"

18 And I think the auctioneer would want to say "I
19 would like your schedule for the following period" and if
20 the period is other than 15 years it's going to be difficult
21 for the auctioneer to compare.

22 MR. O'NEILL: But it's a lump sum payment. I
23 don't know why we have to figure out what your depreciation
24 rate should be.

25 MR. LALOR: I agree. There's no way. I misspoke

1 if you understood that I thought you'd be calculating my
2 depreciation rate.

3 I had assumed that it was going to be a schedule
4 of payments and that schedule of payments without any, with
5 no further inspection other than the fact that it is the
6 market based solution, then that schedule of payments is
7 going to be cheaper than anybody else's schedule of
8 payments.

9 So in effect I would be proposing a schedule that
10 has the same shape as the curve under schedule 12(a) that is
11 lowered by 5 percent or 10 percent or 20 percent.

12 MS. FERNANDEZ: If you had a generator that bid
13 in the auction, would that generator get a series of
14 payments over 15 years? If that's what the schedule is for
15 transmission owners?

16 MR. LALOR: That's correct. You would structure
17 the auction in a way to have comparability so you'd be
18 saying to people, "how much can you beat our other
19 solutions?"

20 MR. O'NEILL: I thought we agreed just earlier
21 that competition should include distant generators plus
22 transmission not transmission versus generation.

23 MR. LALOR: As I understood the discussion
24 earlier, the sense was that there was going to be an open
25 solicitation. It could be generation. It could be

1 transmission. It could be regulated or merchant
2 transmission.

3 MR. O'NEILL: How do you compare a transmission
4 project to a generation project?

5 MR. LALOR: In effect, that's an interesting
6 question. That's the very question that Joe and his
7 consultants have been addressing -- how do you create a
8 system that allows all of these options to compete against
9 one another? I think that's actually what's in the tariff.

10 It says in the tariff under 6.5 "there will be an
11 auction to find the least cost solution to the reliability
12 problem."

13 I think there is an answer to your question but
14 (a) I don't have it and (b) if I had it I'm sure it would
15 take longer to explain than I have here.

16 MR. PERLMAN: Isn't the only point you're really
17 talking about when you do the evaluation to end up with the
18 lowest MPV cost for the solution chosen based upon some kind
19 of fair value criterion that didn't skew it one way or
20 another? That's all I hear you saying.

21 MR. LALOR: That is exactly correct. And my
22 concern is that, if you have a regulated transmission option
23 that has a certain recovery schedule you should provide the
24 same recovery schedule for other options.

25 MR. MEYER: I think the big problem here, and I

1 think what you're trying to say, we haven't quite figured
2 out how to value them exactly either because when you have
3 a regulated unit bidding, you can say "everybody has to
4 recover all their costs in five years, 10 years, 15 years"
5 whenever you want.

6 But the residual value on the regulated entity at
7 the end of that time means you can probably roll it over as
8 rate base, which means you would recover whatever you've got
9 left anyway.

10 And a non-merchant transmission would have to
11 recover at a residual value of zero -- the merchant
12 generator, the same thing. Whatever time he thinks he wants
13 to risk that amount of capital.

14 So, it's a real difficult problem of trying to
15 compare that unregulated transmission fix versus a merchant
16 fix. Somehow you have to do it. That's what I think we're
17 missing.

18 MR. LALOR: My point was exactly how Mr. Perlman
19 said "how do you come up with a mechanism that gives you a
20 fair assessment?"

21 I would suggest we need to look at the regulated
22 transmission solution and create a structure that is
23 cognizant of that as a competitor.

24 MS. OGENYI: This is Gloria Ogenyi with Conectiv
25 Energy. I'd like to start by saying that Conectiv is in a

1 very unique position in the PJM market. We do have a lot of
2 load in addition to generation. We're very concerned about
3 reliability issues for our customers, and we're very focused
4 on having a balanced market outcome that would work best for
5 customers and also would make sure that the results that are
6 needed for reliability remain in the market going forward,
7 and that's kind of provided from my comments today.

8 I wanted to kind of lay out a few kind of general
9 principles and then go into one of them being hot buttons
10 for me here which is the post '96 units.

11 Joe has said a lot on this issue and I am very
12 privileged to be here and to have the opportunity to talk
13 before the Commission on this, too. PJM must be required to
14 specifically identify the potential and incentive to
15 exercise market power.

16 I think the position we have, transmission
17 congestion -- granted, that's the language in the PJM
18 operating agreement, but I think that is not sufficient.

19 Transmission constraints should only be the
20 trigger. PJM should go beyond that and look if there is no
21 market power within the region. If there's no market power,
22 that unit has -- cost capping should not be imposed.

23 It shouldn't just be something that is said.
24 There should be a demonstration that a unit or the owner has
25 the ability and incentive to influence prices before cost

1 capping is imposed. I think PJM should be required to
2 establish a clear and objective standard on what constitutes
3 abuse of market power.

4 We heard a lot yesterday and hopefully we need
5 something that is clear-cut. We need Joe, PJM or all the
6 RTOs to set up, make us understand. I'm a generator. I'm
7 sitting here -- it shouldn't be a black box. It shouldn't
8 be like pornography: we know it when we see it. We should
9 have some objective standards that are applied.

10 I think that a determination of insufficient
11 competition at a specific location should be based on
12 objective, pre-published criteria and study procedures
13 should be known and the results should be published.

14 When PJM tells us there is insufficient
15 competition in a particular location I think the generators
16 would like to see what the criterion is that you used to
17 arrive at your decision.

18 How did you conduct the study? What parameters
19 did you use -- and that should be made public. I think it
20 should not be something that should be done privately or
21 just within the market monitoring unit.

22 I think the market needs to know -- that provides
23 one I think of the rules that the Commission has set out --
24 rules should be clear and provide a bright line where
25 possible.

1 This is one of those situations where it is
2 possible to know because Joe knows or the market monitoring
3 unit knows how it arrives at this decision. I think that
4 should be made public.

5 MR. O'NEILL: Excuse me, would you include in
6 "making public" information about your generators that you
7 would consider proprietary?

8 MS. OGENYI: No, I would not.

9 MR. O'NEILL: So you wouldn't make Joe's study
10 public?

11 MS. OGENYI: That would harm the market.

12 MR. O'NEILL: Then what would you make public?

13 MS. OGENYI: For instance, if Joe has a model
14 that he runs, that needs to be made public. If he's going
15 to say "this location has market power" and this is the
16 model that he runs to come to that determination, we need to
17 know the parameters and the assumptions that fit into that
18 model so that we can replicate that within our own company
19 and come up with our own solutions and compare that with his
20 outcomes that he proposes.

21 I think that the focus of market power mitigation
22 should not be just to restrain prices but to restrain the
23 abuse of market power, and I think it may be a distinction
24 that I think is critical -- the purpose of the RTO or any
25 market monitoring unit is not to keep prices at a

1 predetermined or set level but to make sure that no party
2 exercises market power -- if that is done then the parties
3 or the market will be allowed to function.

4 And that's what I heard yesterday and today.
5 Markets need to be allowed to function. If markets function
6 they will do what markets do, which is allocate risk and
7 reward. But if there's intervention the market, be it by
8 market mitigation, it could destroy the market and that's
9 the kind of thing that we're seeing here.

10 So inappropriate forecasts and low prices will
11 distort markets. I'm not saying that's what Joe is doing
12 but that's what's happening in the market.

13 Sometimes the market is high and sometimes the
14 market is low. I understand that. We have been in a down
15 cycle but we need to be sure that that is where the market
16 returning and that is not what is happening because of
17 individual intervention in the market by RTO or by market
18 participants.

19 The focus of this meeting so far has been market
20 participants.

21 I can tell you one of the major parties to affect
22 markets is the RTO in the way they administer the markets.
23 That is something that the Commission needs to focus on,
24 it's not just the market participants but those who
25 administer the market have a lot of influence on market

1 outcomes.

2 I think I will now go to my major point. I think
3 that encouraging new resources -- yesterday and today we
4 heard that encouraging new resources is in all market
5 participants' best interests and there's no better way to
6 mitigate market power. There's no better way to deal with
7 scarcity than to have new entry into the market.

8 I think that any policy that discourages new
9 entry concerns us. First '96 units in PJM were specifically
10 excluded from cost capping rules for that reason and they're
11 responding to market signals. They're here to respond and
12 to solve the constraints in the market to address where
13 there's been insufficient resources and they're coming to
14 provide those resources -- they should not be cost capped.

15 Before I began to work for Conectiv Energy I used
16 to work in another company that dealt internationally. I
17 tell you this was something that we were afraid of in the
18 international markets -- you go there, you respond to
19 investment based on some rules and then someone changes the
20 rules on you and takes away your ability to make your
21 expected recovery. That is something we should not allow
22 here.

23 That is something the Commission should stop --
24 cost capping of post '96 units impairs the value of the
25 units. We have units that are post '96 units and I tell you

1 that just the prospect of cost capping those units devalues
2 those units.

3 I'm not proposing that the units post '96 should
4 have the ability to exercise market power, that is not what
5 I'm saying. What I'm saying is, if PJM wants to cost cap
6 those units, they should show that those units, this
7 particular unit, has the ability and the incentive to
8 exercise market power. I don't believe the unit should be
9 cost capped. There should not be blanket imposition of cost
10 capping on all post-'96 units. I think we'd be sending the
11 wrong signal.

12 We heard yesterday from the investment community
13 they're not planning to build when you have this hanging
14 over your head. That is something the Commission needs to
15 pay attention to.

16 MR. O'NEILL: Just to clarify, when you say "cost
17 capping," you mean 'cost capping,' not 'bid capping?'

18 MS. OGENYI: Well, that's what PJM proposed --
19 that's what PJM does, to be fair to Joe, who's sitting right
20 here -- and I think if the Commission wants to support PJM
21 in cost capping post '96 units, the units that are existing
22 post '96 constructed under the new rules today should be
23 grandfathered and then the new regime can start with new
24 units and the Commission from now on going forward -- maybe
25 cost capping will determine that that is the right thing to

1 do.

2 The units that were constructed under those
3 rules, the Commission should not take that back in my mind.
4 That would be creeping expropriation if the Commission
5 allows that to happen.

6 Thank you.

7 MS. FERNANDEZ: Next?

8 MR. WEMPLE: Steve Wemple from Con Ed Energy.
9 Thanks for giving me the opportunity. Some of the things
10 that were outlined in the PJM proposal I think are very
11 productive and very good initiatives.

12 Con Ed Energy supports the concept of local
13 auctions to solve problems, to solve reliability needs that
14 aren't being taken care of through the normal market
15 mechanism.

16 We think that's an inappropriate way to meet
17 anticipated needs and from a planning perspective you're
18 taking care of your needs.

19 However, it's important to distinguish between
20 that and short term scarcity. There is still a need for
21 explicit pricing mechanisms to reflect short term scarcity
22 that may occur even if, from a planning perspective, you've
23 met your anticipated needs.

24 When PJM is experiencing shortages of a regional
25 or local reserves we need appropriate pricing signals to

1 reflect that to both get the correct dispatch from the
2 generating units that have some flexibility perhaps in the
3 upper range of their capabilities as well as from demand
4 response, so we're actually sending the signal to the
5 consumers in the various load pockets -- that we're short of
6 reserves -- or in the general region as a whole we're short
7 of reserves and we need a response in order to meet our
8 reliability criterion.

9 One of the issues of the auction proposal that's
10 not yet in any documents that have been filed with FERC that
11 has been discussed in the market, local market power working
12 groups and was touched on a little bit in Joe's comments --
13 is this FTR obligation that a winning bidder who gets a
14 contract in this load pocket and wins this subsidy payment
15 over some period of time and maybe it's lump sum paid, it
16 doesn't really matter as long as it's defined over in
17 consistent terms for all suppliers.

18 But to now suggest that the supplier has to
19 supply PJM with an FTR (if I understand Joe's comments),
20 what he is suggesting is an improvement over previous
21 proposals. The previous proposals required the supplier to
22 give an FTR from the load pocket price to an outside price
23 which would have created unhedgeable risk for a supplier and
24 would have basically excluded any rational bidder from
25 participating without putting in a huge premium which would

1 have been bad for consumers.

2 If I understand the suggestion now, which is to
3 have the FTR be from the marginal cost to the clearing
4 price, all that doesn't necessarily create unhegeable risk.

5 What that does mean is, the builder of that plant
6 would no longer have any inframarginal revenues. They
7 couldn't count that unit as a hedge towards their own
8 requirements or towards other requirements and wouldn't have
9 any optionality in that unit.

10 What effectively you would be doing is taking
11 that unit out of any ability to sell into the forward
12 market, which I think, from a policy perspective, is going
13 the wrong direction.

14 It's better to leave these units as capable of
15 participating in the market so we have the right tools to go
16 out there and sell forward and hedge post 1996 units.

17 As the owner of about 600 megawatts of them we
18 built them with the clear expectation that, while we
19 wouldn't be allowed to exert market power, the local market
20 mitigation rules would not automatically apply to us.

21 I think it would be both unfair for folks who
22 developed these units and set a bad precedent for any new
23 developer to start changing the rules retroactively on these
24 units -- this is especially critical because PJM is talking
25 about a "need" date in like the '07 or '08 time frame and

1 under the normal lead process you'd expect people to be
2 gearing up by the end of this year, if there's this
3 regulatory uncertainty let alone the financial uncertainty.

4 You're not going to get the kind of response in a
5 merchant response in a time frame that PJM as a global
6 system needs, let alone in these local areas.

7 Finally, the mitigation proposals applicable kind
8 of across the board, I think the proposed screen is too
9 inflexible to say that three suppliers collectively pivotal
10 but individually not -- if that's not sufficient to relax
11 things, I'm not sure what is.

12 Having to go to four entities in that scenario
13 before there's a relaxation of the mitigation is just too
14 high a standard that I don't think we'll ever meet even in
15 the Delmarva Peninsula, the larger load pockets, let alone
16 the smaller ones.

17 So we have to set an initial screen that's much
18 more rational and doesn't err on the side of mitigating on
19 the side of caution but really is trying to address
20 situations where market power is likely or actually is
21 occurring and only mitigate where necessary.

22 The other issue is mitigating to cost plus 10.

23 While some of the analysis that's been presented
24 suggests that average bidders across the PJM system have a
25 ten percent markup, I don't think it's fair to extrapolate

1 from that and say that that's the appropriate markup for all
2 units especially peaking units in load pockets because the
3 bulk of the PJM units that are probably included in that
4 average, probably a 10 percent markup, include coal units,
5 nuclear units, units who are de facto price takers and will
6 want to bid low and will always be in merit -- whereas, a
7 peaker that needs to recover some of its fixed costs from
8 the energy markets to mitigate them to cost plus 10 denies
9 them an opportunity when they're on the margin to collect
10 any fixed costs from the energy market.

11 MS. FERNANDEZ: Joe, I think said "no" on
12 something on the FTR obligation and I think I'd like to
13 clarify to see if his understanding of the FTR proposal is
14 correct.

15 MR. BOWRING: Steve is reacting to a prior
16 proposal which has been communicated. We've had some
17 discussions about it over the last three months or so, the
18 last couple of months. We heard the objections about the
19 risk and we reacted to that and modified the proposal.

20 People haven't seen the details, and that's
21 reasonable, but the detail is that there would not be an
22 unhedgeable or infinite risk associated with a peaker and
23 there would not be a risk between the price in the load
24 pocket and the marginal cost of the unit, for example, if
25 that price was less than the marginal cost of the unit.

1 So I think it is appropriate to address those
2 risk issues.

3 But nonetheless, the FTR properties of the sale,
4 I think, are critical to having ongoing incentives not to
5 exercise market power. That discussion is ongoing. Our
6 group will continue to have it. It's not been finalized by
7 any stretch but nonetheless that's the current status of it.

8 MR. CAMPBELL: My name is Bruce Campbell, the
9 Manager of Regulatory Affairs in the Mid-Atlantic Region for
10 the Mirant Company. We own 5,000 megawatts of independent
11 generation in the PJM region.

12 I have been an active participant in the
13 mitigation discussions that have been going on for some time
14 at PJM and I am quite familiar with the issues that are
15 here.

16 I'd like to elaborate and clarify on some of the
17 things that have been said today and hopefully provide some
18 clarification for FERC and FERC staff.

19 The first thing I want to remind everyone is that
20 PJM has in the LMP market with a locational marginal price
21 market design, the promise of the LMP market is that it
22 provides market signals for location of investment.

23 Very simple.

24 When we mitigate, mitigation at best -- and I
25 acknowledge that mitigation may be appropriate in some

1 situations, but mitigation at best should simulate a
2 competitive result.

3 I think everyone would agree with that. I'd also
4 add to that, we've kind of clarified that the facilities at
5 issue here are primarily peaking units. I would suggest
6 that peaking units in a competitive unit should be making
7 scarcity bids. They shouldn't be bidding at marginal price
8 in order to cover their investment costs and on their fixed
9 costs they should be making scarcity level bids regardless
10 of their location.

11 They may vary those according to market
12 conditions but those scarcity bids should be occurring
13 through the market monitor.

14 Joe Bowring comments about the cost plus 10
15 percent mitigation resulting in equivalent net revenues for
16 units that are mitigated and not mitigated and indicates
17 that that tells him that the mitigation is appropriate.

18 I would suggest a very different conclusion is
19 appropriate here.

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1 I would suggest that the fact that mitigating
2 units have roughly the same net revenues as unmitigating
3 units is a symptom of a problem. We have a situation where
4 there is the need for mitigation; we have constraints; we
5 need investment in certain regions, yet we mitigate prices
6 so folks don't get revenues.

7 We want to see those prices higher, because we
8 want to show the proper market signals to get the right
9 investment.

10 MR. O'NEILL: What about the load pockets where
11 there is enough generation?

12 MR. CAMPBELL: I think you need to make the
13 distinction between having enough for generation and having
14 enough economic generation. Currently --

15 MR. O'NEILL: How does that change things?

16 MR. CAMPBELL: Well, if you would have a higher
17 price, if higher prices were allowed at seam, there would be
18 more incentive for lower-priced generation to invest, build,
19 construct, and maybe existing generation would become more
20 efficient in operation.

21 MR. O'NEILL: Higher than what?

22 MR. CAMPBELL: I'm sorry?

23 MR. O'NEILL: Higher than what?

24 MR. CAMPBELL: Higher than cost plus ten percent.

25

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1 MR. O'NEILL: Higher than the marginal cost of
2 the last unit dispatched?

3 MR. CAMPBELL: Yes.

4 MR. O'NEILL: Why?

5 MR. CAMPBELL: Because you want to reduce the
6 congestion cost in the load pocket.

7 MR. O'NEILL: No, we want a competitive result,
8 like you're asking for.

9 MR. CAMPBELL: A competitive result, which may or
10 may not be. I would concede that it may or may not be new
11 investment, but you don't know.

12 With a cost-plus-ten-percent cap, you have no
13 idea; you just don't know; you've buried it somewhere. You
14 don't know what the economic solution is.

15 MR. MEAD: If you've got enough generation in the
16 load pocket, and a new entrant doesn't find it profitable to
17 enter when the price is equal to the incumbent generator's
18 110 percent of marginal cost, why would you want a new
19 entrant to come into the market?

20 MR. CAMPBELL: You may not. It's certainly true
21 that you have locational costs. On the other hand, you want
22 the existing generator to remain there. If you over-
23 mitigate, they're not going to be viable investments to
24 remain in place.

25 We have seen that. Reliant has testified to

1 that. We're on a load pocket mitigating costs plus ten
2 percent and that's simply not enough. The point is that in
3 some cases, certainly, the costs in load pockets are,
4 indeed, higher than other locations.

5 Look at the Delmarva Peninsula, for example,
6 where the costs of fuel would be higher. Investment costs
7 may be the same, but the cost of fuel is higher. And what
8 that means is that when facilities in the Peninsula run,
9 when they run, they're competing normally in the competitive
10 market, but to make up their investment, they would need to
11 see higher prices when they're running constrained.

12 MR. O'NEILL: Are you saying that the variable
13 costs Joe is calculating don't include the higher cost of
14 fuel?

15 MR. CAMPBELL: I don't know.

16 MR. MEYER: This question has come up a bunch of
17 times, why encourage that in a load pocket that already has
18 an excess?

19 The point is that it doesn't have an excess of
20 economics. I think Bruce hit it right on the head. It
21 doesn't hurt if the generator sees a higher price and a new
22 generator comes in and suddenly he's going to sell into the
23 market and suddenly the load pocket goes away if he's big
24 enough.

25 If not, he certainly creates more transmission

1 capability to import into that, so, either way, the consumer
2 wins in the long run, both in the load pocket and outside.
3 I'm trying to understand why you care.

4 MR. O'NEILL: We're not against investment in the
5 load pocket. We're trying to figure out what price that
6 investment should be compared against.

7 MR. MEYER: Replacement.

8 MR. MEAD: But if you have more than enough
9 physical capacity in a load pocket, and no new entrant would
10 want to enter, if the load pocket price is 110 percent of
11 the incumbent's marginal cost, why do you want to a new
12 entrant? Why does raising the price higher get you a better
13 result?

14 MR. MEYER: Because you've artificially limited
15 the price. You haven't included enough scarcity pricing.

16 MR. FALK: The way to think about it is, suppose
17 the guy bidding the highest price, the 110 percent guy,
18 still isn't earning enough money, right? It's certainly
19 true that he's there. He can provide resources, he's
20 contributing to the excessive generation, because he's
21 there.

22 But if he's not making any money at 110 percent,
23 it must mean that you need more.

24 MR. SHANKER: That's not right. This becomes the
25 issue of what's the dynamics of retirement. If we have

1 surplus in the pockets, I don't know if it's cost-plus-ten
2 or if it's the mitigation scheme in New York, we do want a
3 mitigation scheme where there's concentration of ownership,
4 whether there's four, six, or whatever it is, that threshold
5 to get out. Let's assume it's one, so we don't have an
6 argument.

7 The only issue that I can see that would come to
8 Bruce, which is one we talked about but never addressed, is
9 when there's a lumpiness, what Dick has called a lumpiness,
10 where there's a high spread in the distribution factors of
11 the units that can resolve the problem.

12 Then they're all not substitutable, and then we
13 talk about -- and this is something you've been concerned
14 about -- in the past, David, if it's a \$10 unit, a \$300
15 unit, an \$800 unit, what's the right price? The mitigation
16 is the issue of choosing among those prices, based on a
17 lumpiness in increment.

18 When there's a surplus generation, you cannot, I
19 think, other than selecting which of these prices is right,
20 you can't justify some sort of scarcity rents, because
21 there's no scarcity. The issue for the auction, the
22 predicate is, is there some scarcity? Then we want to see,
23 when there is scarcity -- I think I'd rather see it done a
24 different way.

25 But the predicate is the scarcity. It's not the

1 situation where there's the six generators and we only need
2 one.

3 MR. MEYER: You're saying you charge the right
4 price. If you had a \$100, a \$300, an \$800 unit, if you
5 never really needed the \$800 unit, you obviously wouldn't
6 set that as its price. You would use the \$300. And if you
7 used the \$300 unit, you'd probably attract new generation
8 into that area.

9 MR. SHANKER: If that was the right price and we
10 decide that the opportunity costs of the next unit is the
11 right one, that's something to fight about, and whether it's
12 cost plus ten or the opportunity on the next one, it depends
13 on the size of the unit.

14 There are lots of things going on to make that a
15 more complicated decision than cost plus ten, but it's not
16 that there's scarcity; the question is, what's the pricing
17 increment or the decrement? It's not that there's a
18 scarcity component there.

19 MR. MEYER: But it is the right pricing to
20 recover that unit's cost, if he's not recovering his costs.

21 MR. SHANKER: We want him to retire, John. In
22 that situation, we want him to retire. If there are six
23 units and we only need one, we want the five to retire. If
24 they can't carry it in the market, we want them to retire.

25 One of the alternatives: For an example, assume

1 there is no real estate value, which, I agree, complicates
2 this. Put all the five other units up for sale.

3 Let's say you have six. Let's say they all have
4 the same cost. Put the other five up for sale. If anybody
5 offers you anything positive, take it and those units will
6 not be subject to mitigation, okay? That's the kind of
7 solutions we could be looking at.

8 MR. MEYER: Let's back up. If I sold it to
9 someone else, it's not subject to mitigation.

10 MR. SHANKER: But he can set clearing price for
11 you.

12 (Laughter.)

13 MR. SHANKER: I said five, so I don't want to
14 have a fight with Joe.

15 MR. MEYER: Sold one fish in the unit here, to
16 five different people.

17 MR. SHANKER: The point is that we want you to
18 get rid of the unit in that situation. That's a good
19 result, but the real estate issue does complicate it. The
20 joint product makes it a little more complicated.

21 MR. BOWRING: The point you're making, Roy, about
22 -- take West Met Ed or other load pockets. If you don't
23 want to be in the business and you think too many units are
24 not getting compensated properly, put them on the market,
25 sell them to any positive value, and the problem goes away.

1 Then you won't be mitigated and neither will the
2 new entrants. That's a structural solution, and we've said
3 that repeatedly. That's exactly right.

4 MR. SHANKER: I agree with that. That's
5 different from the auction proposal.

6 MR. BOWRING: It's a lot nicer. I prefer it.

7 MR. SHANKER: The auction proposal predicates
8 scarcity.

9 MS. FERNANDEZ: Let's get back. Were you done?

10 MR. CAMPBELL: I was just going to say that I
11 heard Joe say that the new unit wouldn't be mitigated.

12 (Laughter.)

13 MR. CAMPBELL: I was nearly done.

14 (Laughter.)

15 MR. CAMPBELL: Moving on to a somewhat different
16 subject, I wanted to -- PJM has proposed the auction
17 concept. It's a good one.

18 I think I support other comments that were made,
19 that it ought to be more broadly applied than just when
20 reliability shows up to be a problem. That would be a
21 solution to get to finding what an appropriate cap or
22 appropriate way to provide adequate revenues is.

23 I think we ought to think and really consider
24 broadening that concept. The last thing is -- it's kind of
25 an underlying issue, but it's an important one to keep in

1 mind -- that is, we've had some discussions about ICAP and
2 its impact.

3 We should recognize that these units we're really
4 talking about here are peakers. Their fundamental revenue
5 stream is from the ICAP market, and from my view, it could
6 be 80 percent, as much as 80 percent of what their value is,
7 is ICAP.

8 We currently have, in my view, a broken ICAP
9 market in PJM, and I think that creates a fair degree of
10 stress and problem for those units that are cost-capped as
11 well in load pockets. If we had a more appropriate ICAP
12 market, this problem might not be as urgent as it is in some
13 cases right now.

14 I don't think the ICAP market is appropriate to
15 integrate in this particular docket and forum on mitigation,
16 but it is important to understand its relationship, as we
17 move forward on how we do mitigation in the future.

18 MR. MEAD: Are you talking about locational ICAP?
19 What would you improve?

20 MR. CAMPBELL: No, I'm not. I'm talking about in
21 general ICAP in terms of resource adequacy overall for PJM
22 and the deliverability construct. Certainly we talk about
23 auctions, and certainly auctions create a formal locational
24 ICAP. That's not what I'm talking about.

25 I'm talking about the general resource adequacy

1 market to assure there's enough capacity in the PJM region.
2 You may or may not be aware that it's currently clearing on
3 a daily market in pennies per megawatt day and it's capped
4 at the nominal value of \$160 a megawatt day. It's basically
5 worthless today.

6 And, again, for peaking units, it is a
7 significant revenue stream or a significant valuation for
8 the asset. That poses a lot of stress when independent
9 owners look at these resources. We're looking at the
10 revenue streams in a valuation of what this stuff is worth.

11 If ICAP isn't worth much, it's certainly at cost
12 plus ten percent and the mitigation revenue isn't worth very
13 much, either. Often these peaking units, oil-fired,
14 combustion turbines, they're the marginal units on the
15 system. They're the units that ought to be retired.

16 And if we don't extract the value for them in
17 mitigation or when they are constrained where they have
18 value, then we have this continuing issue.

19 MS. PHILIPS: Margie Philips from PSEG Energy
20 Resources and Trade. Bruce's was a great setup, because I
21 disagree. I think you cannot possibly talk about mitigation
22 of the market unless you take a holistic viewpoint.

23 In fact, Joe's very solutions are mitigating
24 energy, so I'm going to have to have a location capacity
25 auction, so we can't possibly talk about this market unless

1 we get all the structures right.

2 I'd like to think that what we're proposing will
3 satisfy the lenders that we saw yesterday. We're very
4 supportive of our BGS auctions in New Jersey, so we think
5 this works well in a retail program.

6 So let me go at it: Our markets are not supposed
7 to guarantee recovery, and so I think that's part of the
8 concern we hear sometimes, is people are looking for a
9 guaranteed rate of recovery. That's not what markets should
10 provide; they should provide an opportunity to recover, and
11 they need to provide some price stability, so folks will
12 invest.

13 As you heard, right now markets aren't doing that
14 well. I'd like to lead off -- Bruce and I do agree that
15 ICAP is really what needs to be enhanced. We really don't
16 value reliability as well as we should. We have all sorts
17 of NERC rules that shield our consumers from what the real
18 price of having the steel in the ground is to deliver the
19 energy.

20 We all are very happy to pay for transmission on
21 a peak basis, knowing that we don't fill the wires every
22 single day. We should be happy to pay for the capacity in
23 the ground for the couple of times a year that it's going to
24 run to keep our systems running.

25 And, right now, we don't have a holistic market

1 that gives all the right signals. What we would like to do
2 or propose is taking Joe's auction, which is really trying
3 to buy insurance after the accident has happened, and put it
4 prospectively.

5 The concern is that if we get this right, and Joe
6 wants to mitigate, god bless him. Just let me get out of
7 the market, which I can't do right now. If you have the
8 right market structures, people are going to come in and
9 out, and that's what you want to see.

10 What we support -- and you may have heard that
11 this has been going on in the Northeast -- is a procurement
12 process. I'd like to talk about the process and then the
13 price, so we all focus on the process first.

14 The process is a procurement one, and it is the
15 ISO procuring it, but it is really nothing different than
16 what they do today in energy markets. They're going to
17 match bidders and sellers, and they are going to procure it
18 on a three -- actually five years is even better, because
19 that allows transmission to compete a little bit more
20 effectively with the five-year lead time.

21 But the three- to five-year procurement process,
22 what they would do is run an auction process, and you use
23 the current PJM methodology, if you will, for
24 deliverability.

25 What we would then say is, after you've run your

1 auction, you then use the CTO, CITELE analysis. You just tap
2 my knowledge on it to get more refinement and look to make
3 sure that everything you want in the overall auction, can,
4 in fact, be delivered to these load pockets.

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1 I think you'll find, as Joe has said, that there
2 are very few spots in the PJM market that, with a further
3 refinement, wouldn't meet the initial deliverability test,
4 but those that don't, you have a second auction and you
5 would then price that auction, which is exactly what Joe is
6 doing, only you're doing it prospectively, so you have your
7 second auction.

8 I think I've hit on the process.

9 MR. O'NEILL: You said something that maybe I
10 just didn't understand. You're going to have buyers and
11 sellers in this auction?

12 MS. PHILIPS: The load would bid.

13 MR. O'NEILL: The load bids.

14 MS. PHILIPS: Sure, or PJM would bid, based on
15 the load forecast.

16 MR. O'NEILL: Now you have PJM as the buyer.

17 MS. PHILIPS: No, they're forecasting, Dick.
18 They do that every day. They set the reserves, they
19 forecast what's going to be needed.

20 MR. O'NEILL: We're going to do this now for 20
21 years, right? This is a 20-year deal now, right?

22 MS. PHILIPS: You know what, if some day we have
23 this fantasy there won't be energy caps and then we can have
24 real markets reflected at LMP, but until we get there --

25 MR. O'NEILL: Let's just clarify that PJM is

1 inserting a bid on behalf of the bidders.

2 MS. CARRADO: I think what Margie is saying is
3 that PJM is determining how much load they're going to
4 require capacity for, but the price would clear.

5 MR. O'NEILL: Why don't we ask the entities how
6 much load they're going to have?

7 MS. PHILIPS: Because you can't. Like was
8 mentioned earlier, Dick, you've got LSEs, you've got EDCs.
9 It varies from state to state or utility to utility, who is
10 responsible.

11 MR. O'NEILL: You have a state involved; don't
12 you?

13 MS. PHILIPS: The state, I believe, coordinates
14 with PJM, but PJM sets our reserve.

15 MR. O'NEILL: If the state puts the number in and
16 approves the process, that's a different story.

17 MS. PHILIPS: I am not getting into the details,
18 but the point is that there is a forward-looking pricing, if
19 you will, that folks can look at, both for retirement and
20 new entry. It mitigates market power, because in three to
21 five years, you can have new entry.

22 MR. O'NEILL: To me, it's a significant
23 difference for PJM to be running an auction where people bid
24 into the auction, both to buy and sell, as opposed to PJM
25 being one side of the auction.

1 MS. PHILIPS: I don't believe it's an agent. It
2 really is not one side.

3 MR. O'NEILL: PJM is running the auction and not
4 bidding in or not inserting bids on behalf of somebody else
5 by doing forecasting. That's a different animal.

6 MS. PHILIPS: As I understand it, PJM receives
7 the forecast from the EDC. That's what it would actually be
8 representing when it put in the bid. It wouldn't be wild-
9 catting some invented number.

10 MR. BOWRING: Just for clarity, PJM is not
11 offering a price into the market. Where PJM does have a
12 role is as security coordinator for making load forecasts.
13 Historically, we've built them up from the load forecast in
14 individual load-serving entities.

15 They've all kind of degraded their capability of
16 doing that. The fact that PJM makes the forecasts and other
17 people agree with it, is how it works. There's a committee
18 and the states are involved, the LSEs are involved. It's
19 not us imposing it; it's trying to get to the best number.

20 But there is a quantity that's being determined.

21 21

22 MR. O'NEILL: But the key thing is that you
23 create a number and the entity that's going to have to pay
24 based on that number, agrees to it.

25 MS. PHILIPS: No, that's where you're wrong,

1 because what happens is, they bid in the number to represent
2 load. Load changes.

3 The ultimate customer is going to pay for it, but
4 their LSE may change, so the idea is, the obligation, just
5 like they bill out, PJM bills out a monthly charge for
6 transmission, they bill out a monthly charge for capacity.
7 It's almost like an ARR. It goes with the load, so that
8 you're not locked in.

9 And everybody knows what that price is going to
10 be, so you can hedge, and it's not unfairly burdening one
11 party or another.

12 Can I keep going just for a little bit? So then
13 we get to the issues that I know you care most about, and
14 that is pricing. We, frankly, have not had time in my
15 company to work all this out, but we've thrown a couple of
16 things around.

17 We've seen sort of two solutions. You have the
18 quote, market solution, where it's this auction where it's
19 bid-based. But even in the proposal that's out there, there
20 are some administrative safety caps, if you will, that would
21 be set if it was perceived to not have enough competition or
22 market power.

23 That's one way to have this auction. I don't
24 know if you're familiar with the NERA proposal, but there
25 are administratively-set safety caps. The other way to do

1 it is to overlay a demand curve, because that, too, is a
2 pricing mechanism, so, the process is the forward
3 procurement pricing. We think there are merits to both
4 pricing approaches, but the idea is, you avoid getting to
5 Joe's situation.

6 This is insurance. Nobody is guaranteed anything
7 but there's stability in the numbers.

8 The other thing is, there is going to be one
9 little problem with this proposal, and that is, we're
10 talking about a three- to five-year procurement period, and
11 right now in PJM, we have units that want to retire. So we
12 recognize that there is going to be a short period before we
13 get this process in place, which, frankly, would exist under
14 Joe's, too, where you're going to have to deal with the RMRs
15 in the short period.

16 We're saying, let's not just focus on the short-
17 term problem. Let's fix this with a long-term solution.
18 Then you've heard people far more educated than I am about
19 how you deal with the short-term RMRs. Our view is that if
20 a unit tells you that you want to retire and you don't want
21 it to retire, you pay their to-go costs, no questions asked,
22 because you've got a market that has put them in that
23 situation.

24 But the idea of this procurement process is, in
25 the future, anyone can exit and enter, and, shame on you if

1 you make a bad investment. Then get out.

2 But people are really investing in reliability.

3 MS. FERNANDEZ: Actually, can I ask for a
4 clarification? If a generator currently wants to retire,
5 what do they need to do within PJM?

6 MR. BOWRING: It's not exactly set in stone.
7 It's unfortunate.

8 (Laughter.)

9 MR. BOWRING: I've said this and I've pushed PJM,
10 and PJM is moving towards having a clearer process. Right
11 now it says in the most currently posted, without boring you
12 with all of the details, MAC criteria for the MAC part of
13 PJM, that you have to give some notice.

14 If someone tells us they don't want to retire,
15 even if PJM will do an analysis and we turn it around in 30
16 days, whether the units are needed for local reliability, if
17 it is needed, right now, we work with the owner to figure
18 out a way, and with the transmission owner to see what the
19 least-cost solution is.

20 What we're trying to do is segue that into a more
21 formal process with a longer notification period and a clear
22 set of rules about what happens. Right now, it's negotiated
23 as it goes along.

24 To answer your question, there is no clearly
25 defined set of rules. That's a problem.

1 MS. FERNANDEZ: Have you had retirements so far
2 that have raised reliability problems?

3 MR. BOWRING: Yes. And so far, one very recently
4 was resolved, actually, by -- it's a matter of public
5 record, I believe, that was resolved by the transmission
6 owner, basically agreeing to find, to come up with a the
7 right short-term transmission solution to make retirement
8 acceptable. It's not always going to be that easy.

9 MR. MERONEY: Is the process clear to the point
10 where if it doesn't raise a local reliability problem, then
11 it just goes forward?

12 MR. BOWRING: That's the current PJM approach to
13 it.

14 MR. MERONEY: And you've had retirements under
15 that?

16 MR. BOWRING: Yes.

17 MS. CARRADO: Nothing is in stone, but we've
18 heard comments to the contrary. Even if it's not a local
19 reliability problem, if it's a systemwide problem, a
20 shortage projected for capacity, then a retirement could be
21 stopped in that way.

22 This is a very critical problem. I agree with
23 Joe that we need clearer guidelines, and any guidance on
24 that would be greatly appreciated.

25 MR. O'NEILL: Suppose you have multiple unit in

1 the system and the system is starting to become short, and
2 you propose to retire. How does that differ from physical
3 withholding?

4 MS. CARRADO: I think it differs because you, as
5 an entity, may be long capacity, so, in my view, you have a
6 right to retire.

7 MR. O'NEILL: The system is short.

8 MS. CARRADO: If you've committed your capacity
9 to the system, then you do not have the right to retire that
10 unit. If you have not committed the capacity to that
11 system, then PJM does not have the right to hold onto that.

12 MR. O'NEILL: Would you put that capacity on the
13 market?

14 MS. CARRADO: You could.

15 MR. O'NEILL: That would clean up some of the
16 market power problems. In other words, if you said I want
17 to retire this unit, but I'm willing to offer it to the
18 market, and if the market would take it, then that would
19 probably give you -- you could step out your retired --

20 MS. CARRADO: I agree with you.

21 MR. MEYER: I was going to say that we've retired
22 several market units. Usually, though, we're not obligated
23 to. Usually the obligation is some sort of notice provision
24 of 60 or 90 days. It varies. But usually we've offered
25 either the capacity or the unit for sale and see if anybody

1 will pick it up.

2 MR. O'NEILL: That's all you need to do.

3 MR. MEYER: If that works, that's one clear way
4 to distinguish it, and if you put in some minimum bid that's
5 reflective of something at cost or slightly above, if you
6 could sell it for a much higher market value, you'd sell it,
7 I assume.

8 MR. CORNELI: If I could throw in a point, this
9 is Steve Corneli, NRG. If I could just throw in quick point
10 about the retirement, and maybe a couple of observations
11 about Margie's vision, you could think that maybe there are
12 two fundamentally different retirement drivers that I think
13 need different policy solutions.

14 One is where the market signals are, let's just
15 say, right. A unit is receiving prices that are lower than
16 the cost its owners feel they need to stay in the market.

17 And that's the signals the market should be
18 sending. Even though a unit is getting that signal, there
19 may be a temporal issue or perhaps a local thing related to
20 that unit's exciter coils or some other kind of little
21 service that is needed, and there needs to be a replacement
22 or an adjustment of the system over a period of time for
23 that.

24 In that situation, I think this is basically the
25 right approach, but there can be another situation, which we

1 talked about yesterday, where there's a fundamental market
2 flaw that makes a unit owner say, gee, I should be earning a
3 lot of money for this unit, but I'm not.

4 I'm earning so little that I want to retire, and
5 I think that raises a whole different set of issues that we
6 did discuss yesterday, but basically it's what would the
7 market clear at if it were well designed? It would clear at
8 or above the cost of new entry, and that's probably what the
9 unit in that situation would do.

10 To-go costs are going-forward costs. Everybody
11 can disguise that second market flaw situation from this
12 more simple one. You know, it takes awhile to fix things
13 up, so a unit can get out of the market when it's no longer
14 needed.

15 And on the market vision, I think there's one
16 area that I think could be simplified as kind of planting a
17 seed for Margie's vision to grow, and that really is -- I
18 think she said you could overlay the demand curve and
19 collapse back to the demand curve if this other procurement
20 process didn't work.

21 And that really is what NERA has described.

22 MS. PHILIPS: Can I suggest, say, we actually
23 didn't see it as being a separate process, as much as a
24 pricing mechanism.

25 MR. CORNELI: Well, so you could have it as a

1 pricing mechanism in this long-term thing. I think what
2 we've seen already -- and, again, a number of us talked
3 about this yesterday -- is that if you have -- probably the
4 most important thing is to get that first period price
5 right, the summer capability price or this winter capability
6 season price like in New York, and that the long-run price
7 signals will be carried forward by people capitalizing those
8 expectations into their contracts and positions, and a long-
9 term procurement period may be helpful, but I don't think
10 it's necessary.

11 And if it's complicated to get started, I don't
12 think we need to wait to buy the insurance. I think we can
13 pay for the insurance and get the insurance policy for
14 reliability out there right away with a demand-curve kind of
15 approach.

16 And if that doesn't seem to be getting the kind
17 of price signals for developers and buyers to really come up
18 with the instruments for investment, that could be adapted
19 with extending this period. I just hate to wait, you know,
20 when there's a clear need to get the insurance policy in
21 place right now.

22 One final point: In terms of the deliverability
23 component, or the test for where you might need this stuff
24 the most in PJM, I do know a little bit about the CITO and
25 CITEL tests and how they work and how they're done.

1 It's certainly our perspective and we've issued
2 some filings and sent testimony off to states, explaining
3 this in detail, that the CITO and CITEL deliverability tests
4 will not accurately identify where capacity is needed or
5 useful to resolve constraints, long-term constraints, and
6 prevent shortages.

7 You need a different test, related fundamentally
8 to interface capacity. That determines where the capacity
9 markets should be. Those are my comments.

10 MS. FERNANDEZ: Were you done?

11 MS. PHILIPS: Yes.

12 MS. FERNANDEZ: Mr. Mellody?

13 MR. MELLODY: My name is Jim Mellody, from First
14 Energy Solutions. I just wanted to mention that we are the
15 LSE for the West MetEd load pocket.

16 Just by way of introduction here --

17 MR. BOWRING: Glad to meet you.

18 (Laughter.)

19 MR. MELLODY: I wanted to let you know that we
20 were here. We do see that there are competing issues here.
21 There is a need for reasonable compensation for units that
22 are needed for reliability, but also need to protect
23 customers from unreasonable prices and from volatility.

24 First Energy supports PJM's method for bid-
25 capping RMR units to prevent the exercise of market power,

1 but also recognizes that there is a need in many cases for
2 additional compensation to cover the fixed costs of RMR
3 units needed for reliability. We think there are several
4 important points that need to be in a compensation plan.

5 It must provide sufficient fixed and variable
6 cost compensation to permit RMR units to remain in
7 operation. I know this may be shocking to hear from an LSE,
8 but we don't dispute that.

9 We also believe it must be based on actual costs
10 and not proxy costs. It must provide for adjustment for
11 other revenues received by the units through the market
12 tools such as ICAP.

13 What we are proposing, which is really the
14 difference here, is that in the short run, that these
15 requirements, these additional revenue requirements should
16 be paid in the form of a capacity payment, but that these
17 requirements should be filed with FERC by the unit as a
18 revenue requirement payment to be support those units'
19 existence.

20 We believe that the Commission is best suited to
21 set the appropriate compensation level. Some of our
22 thinking on that is that we see that reliability support in
23 a load pocket is a non-competitive service that a generation
24 source is providing, not unlike other non-competitive
25 services that generation sources provide such as reactor

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1 These are transmission services that they are
2 providing and we believe the Commission is the appropriate
3 authority to review and approve reasonable compensation for
4 these services.

5 Now this is our short term solution. I'll get
6 into our thoughts on long-term as well. We believe that
7 wholesale customers, LSEs, RTOs, owners of these units and
8 state regulators, have legitimate interest in the process of
9 setting the compensation levels for these services and
10 should have rights with respect to this compensation
11 process.

12 That is one concern we talk about to go costs and
13 RTOs, setting those -- there is a concern that the LSEs will
14 not be appropriately represented in those discussions to
15 present their point of view and that needs to be protected.

16 We believe yesterday's discussions showed that
17 just raising price to very high levels will not necessarily
18 solve the load pocket problems because high volatile price -
19 - what I heard from the investment community -- is not
20 enough to justify new investment.

21 In terms of long-term, we must look for new ways
22 to continue to create incentives for transmission owners to
23 eliminate the load pockets or to at least reduce them where
24 it's economically feasible.

25 We should consider all alternatives including

1 transmission generation and demand side management. The PJM
2 auction process is a method of addressing the need to
3 address these load pockets and First Energy is supportive of
4 the PJM auction proposal, but recognizes the need for a lot
5 more details on how bids are evaluated.

6 First Energy also believes the transmission
7 reliability planning groups and RTOs such as the RTEP Group
8 in PJM, must be charged with working to reduce load pockets.

9 That summarizes my comments.

10 MS. FERNANDEZ: I was going to say, "do you have
11 any comment on the mitigation of the post '96 units?"

12 MR. MELLODY: I don't have a specific opinion on
13 that issue one way or the other. I think in general -- it
14 would be inappropriate to allow them to exercise market
15 power in terms of the specific proposal of PJM to include
16 them in the cost plus 10 -- I don't have an opinion one way
17 or another on that at this time.

18 MR. O'NEILL: Let me ask a question -- suppose
19 you were an LSE who is long in that load pocket and there
20 was another LSE that was short. Would only the other LSE
21 get assigned the cost of the auction?

22 MR. MELLODY: I would say, if the load is in the
23 load pocket, the cost has to be shared by all.

24 MR. O'NEILL: There's one LSE that's long on the
25 market, long hardware. It doesn't need anything. It's been

1 very prudent and it's contracted long and it's sitting there
2 with all the resources that it needs, so they don't have to
3 take part in this auction. They get none of the costs.

4 MS. CORRADO: I think the problem is that you
5 can't just interrupt the short LSE's customers. The
6 investment is needed because there's not enough to serve the
7 load.

8 MR. O'NEILL: No, I went out and contracted long.
9 I'm long on hardware. I paid dearly for it -- now I'm going
10 to get a second allocation of costs from somebody else.

11 MS. CORRADO: If there's an interruption of load
12 that's needed in that load pocket, your customers are also
13 at risk.

14 MR. O'NEILL: So I should never be long in the
15 market?

16 MS. CORRADO: No. That depends on how high spot
17 prices are.

18 MR. WEMPLE: Dick, if I understand the auction
19 proposal, it's a clearing price for all resources that can
20 meet the requirements and are needed to meet the
21 requirements so the long LSE, if you allocate the cost to
22 all LSEs immediately that sounds unfair. But the long LSE
23 is effectively selling into and getting the revenue back
24 from that long position.

25 So I think it works out and becomes fair to both

1 LSEs -- the one that overshot gets a little extra revenue
2 for it, the one that undershot pays up to the right level.

3 MR. O'NEILL: So that other LSE who basically
4 doesn't buy all the defect calculations and things like that
5 who says "I just don't want to be in this market, I'm fine?
6 I'm long" -- doesn't have a choice?

7 MR. CAMPBELL: This is Bruce Campbell. This
8 discussion has come up in the context of the economic
9 expansion at PJM as well with a similar issue. I think
10 you've got an excellent concern and I would suggest that
11 part of the answer is that, if you are long, that PJM or the
12 ISO needs to recognize in some way that, whatever facility
13 you bring to the marketplace long -- they need to be able to
14 see that, incorporate it and include it -- say "okay, he's
15 long, he's not."

16 Now we add them all together to get the total
17 picture. Then I think you can do it equitably, if you can
18 do that. The trick is to recognize your bilateral
19 arrangements as somehow providing an overall capability to
20 the system. That's incumbent on PJM to do that, to come up
21 with the mechanism to have that recognitionl.

22 MR. LALOR: I'd like to add one thing to what
23 Bruce said. You also have to look at what's the default
24 here, if there's a reliability problem. And that's what's
25 triggering these auctions. Something's going to be done if

1 you don't have this auction and have a new generator win it,
2 assuming a new generator wins -- and then it goes in and has
3 his costs allocated to everybody -- then you're going to put
4 in a transmission line, who are you going to charge that to?

5 I think the answer is you're going to charge it
6 to everybody in the load pocket.

7 So it's a difficult issue but it should not be
8 'should you have an auction or shouldn't you?' Without an
9 auction you're just going to put in a transmission line to
10 resolve it or you're going to have reliability problems.

11 MR. SHANKER: The Commission's guidance here in
12 the economic transmission case was not to allocate costs at
13 an aggregate level if possible and to track it and there's
14 no reason why you could not identify who isn't hedged to
15 track that party and charge them.

16 And the same would happen for transmission.
17 Peter?

18 MR. LALOR: I think the distinction is that
19 you're thinking about economic transmission solutions. I'm
20 saying that 6.5 in a different context, although I thought
21 it was in the context for 6.5, which is PJM and/or state
22 whatever identifies a reliability problem.

23 Let's assume most people who are focused on
24 retirement including the reliability problem, let's assume
25 that you've got a load pocket or you've got a load pocket

1 created by load growth -- if somebody's retiring you just
2 need to get a new generator in that.

3 Under those circumstances, you either will have
4 to put in under the RTEP process a new transmission line to
5 resolve it or you'll have to create a system that finds the
6 least cost solution which might be transmission generation
7 on load management or some combination of those three.

8 MR. SHANKER: One of the problems with
9 interfering with the pricing, because it leads to that
10 allocative distortion, if we'd had all the pricing right, we
11 wouldn't have to have the intervention of the reliability
12 investment that gets spread to everybody.

13 MR. LALOR: I don't want to be considered on the
14 record as objecting to getting the pricing right. I agree
15 we shouldn't have messed it up in the first place but now we
16 have a situation -- it goes back to the points that were
17 made yesterday by the money men -- we have a situation where
18 we created great uncertainty in the market and even if you'd
19 got the rules exactly right today nobody's going to believe
20 you that you're not going to change them in two or three
21 years when you get political pressure again.

22 MR. BOWRING: If the prices were higher all of
23 the load is going to be paying the price. If you're hedged,
24 you're hedged financially.

25 But nonetheless the LMP would reflect the

1 marginal unit and would be more expensive. It's not really
2 all that different.

3 MR. MEYER: I've got a question. The last
4 solution is what I heard suggested that we set more or less
5 a regulated type rate for that entity or it could be a lump
6 sum, but you come up with all the costs and you go through
7 state commissions.

8 Basically what you're doing is going through a
9 rate case on every unit that's RMR potential, right? Or has
10 local market power -- does the Commission really want to do
11 that?

12 First of all, the state commission, if they're
13 involved, they probably have a docket in the rate case and,
14 since it's a FERC tariff, you'd have to have a docket in the
15 rate case eventually for that unit to recover its costs.

16 It seems like an awfully burdensome way to do it.
17 In fact, we've tried to avoid those things but we also
18 assume from what we're talking about, is each unit standing
19 on its own.

20 As you know, in the old utility world rate cases
21 it was all the units put together and I don't know how you
22 mix market units and these regulated units.

23 MS. FERNANDEZ: There could be some issues with
24 that.

25 (Laughter.)

1 MS. FERNANDEZ: And I'm actually looking at Steve
2 without discussing the specific cases he probably has some
3 experience with that.

4 MR. MEYER: One other comment I'd like to make
5 back on the sale. We kept dealing with the sale and I
6 understand the point but it's not always easy to sell an old
7 unit and I am pointing to a case where the land had a lot of
8 value and it was a pretty clean one where you could take the
9 unit away and clean the site and sell it for condos or
10 something -- but there's many other cases -- that old unit
11 had a 100 year history of power plants being there.

12 We assumed all the liability from the seller
13 because the state commissions wouldn't let the seller take
14 that obligation on and we sell it? We're going to want the
15 new part to take on that obligation for environmental risk.
16 That probably gives it a big negative value.

17 MR. O'NEILL: Then you won't get any bidders I
18 assume and it will be something to retire on?

19 MR. MEYER: It's not real easy but I'm saying
20 that risk is not easy to price either.

21 MR. BOWRING: Let's just say that's a more
22 complicated discussion than it sounds and, since you have
23 liability regardless of when it's retired, it's not obvious
24 what the right offer price is.

25 But in any event --

1 MR. O'NEILL: This is the same problem the nukes
2 face.

3 MS. FERNANDEZ: Why don't we move on?

4 MR. FIELDS: Thank you. I'm Bill Fields with the
5 Maryland Office of People's Counsel.

6 My office, as well as the Pennsylvania Office of
7 Consumer Advocate have participated extensively in the PJM
8 stakeholder process on this issue and have filed comments
9 here.

10 We put together a single sheet summary of our
11 position although it does go on the back a little bit.

12 (Laughter.)

13 MR. FIELDS: We did the best we could. I'll just
14 summarize the summary and then respond to a few points that
15 I've heard the last couple of days.

16 The first principle -- we tried to lay out five
17 principles -- that we think are important in these issues,
18 the first being that the only way to get true scarcity
19 pricing is to have a competitive market in these load
20 pockets.

21 If you don't have a competitive market you're ont
22 going to be able to get true scarcity pricing and that puts
23 you in the position of trying to figure out what it's going
24 to be if you're going to go that way. That gives us great
25 concerns about coming up with a "just and reasonable" price

1 and we think that an administrative approach is the better
2 way to go.

3 The second point, we certainly don't think you
4 ought to look at any kind of scarcity pricing if there's no
5 scarcity. There's just no economic justification for prices
6 to rise to the level of a new entry when you don't need new
7 entries.

8 The third one is, even if you have true scarcity,
9 trying to address it through short term energy prices brings
10 in volatility which can harm consumers and also create
11 insurmountable barrier to entry and I think that concern
12 that we had from what I heard from the Wall Street people,
13 though they sometimes talk pretty fast and it's a little
14 hard to follow them, I thought reinforced that concern that
15 those kind of volatile short term prices is not what they're
16 really looking for to make an investment.

17 The fourth point is that, if you have a monopoly
18 incumbent supplier that the compensation for that service
19 should be based on reasonable cost to provide that service
20 and that it is not reasonable under any circumstances to pay
21 that kind of incumbent in excess of the full cost of service
22 for providing reliability service on a monopoly basis.

23 We support the PJM auction proposal. We support
24 that framework. We think you need to continue the price
25 capping rules the way they are. That keeps the market

1 prices at a competitive level, which keeps you at efficient
2 dispatch. We think those price capping rules should be
3 applied to post 1996 units.

4 We have a problem with prices resulting from
5 market power from whatever unit they come from.

6 We think the auction needs to be performed by a
7 neutral party that has the information necessary to do it
8 and PJM is really the only option for a party to do that.

9 That's our basic position on the issues.

10 There was some discussion about evidence on local
11 market power and we need to see evidence of it before we do
12 anything.

13 I think that gives us great concern, the evidence
14 of market power would be high prices and potential wealth
15 transfer from load to generation. Chances are there's not
16 going to be anything to be done about it once it's happened
17 unless you start talking about some kind of a refund which I
18 think gets you into all kinds of uncertainty problems.

19 We certainly don't want to leave it up to waiting
20 for evidence of market power when you have a local load
21 pockets with just a few suppliers. I don't think we need
22 for evidence to do something about that.

23 I want to urge the Commission, there was a lot of
24 discussion about "well, we need to get the prices right. We
25 need to get the prices right and the implication is that

1 somehow the PJM market design is wrong in talking about
2 operating reserve payments capacity and some other things.

3 I would urge the Commission not to jump to any
4 conclusion on that and to let the PJM stakeholder process
5 have a shot at that.

6 We haven't discussed in that process much about
7 operating reserve demand curves. We've talked a little bit
8 about capacity demand curves. I think those are very
9 intricate issues. They are market specific. They get into
10 looking at how the system is operated under certain
11 conditions. It gets you into a very difficult subject and I
12 think you heard from one group that was telling you, "you
13 know, we think the prices aren't right for some reason."

14 I think you should wait to let the stakeholder
15 process go forward and hear what the rest of the folks have
16 to say about that and come to you with about whether or not
17 the prices are "right" right now.

18 And I don't think -- a corollary to that is -- I
19 don't think you can design away market power problems.
20 You're going to have market power problems and load pockets.
21 That's just a physical reality and it's going to have to be
22 dealt with no matter what your market design is.

23 Some of the discussion about operating reserve
24 levels and scarcity and some other things -- I think it
25 raises a concern for me that the system has been operated in

1 a certain way for many years and it's been considered
2 reliable operations.

3 When you get into attempting to draw lines and
4 say, "Well, you're going to say you need a certain level of
5 operating reserves and if you go below that, you're into
6 scarcity."

7 I think you need to be very careful that you are
8 not ending up with a situation or what we thought was
9 reliable operations today is now in the future called
10 "scarcity" and that triggers some kind of pricing mechanism
11 which may be signalling that we don't have enough resources
12 or that we're basically in the same situation that we
13 thought it was for reliable operations in the past.

14 Those are very difficult lines to draw and it's
15 really one of our real problems with the scarcity pricing
16 approach which is why we favor the auction approach.

17 One, you have to figure out how to draw that
18 line, which is extremely difficult.

19 Second, once you draw the line you have to figure
20 out what the scarcity price is going to be because you can't
21 get it from a competitive market. It seems to us you either
22 are going to end up with a price that's too high or too low.

23 We don't think, if the price is too high -- we
24 think that's unjust and unreasonable. Customers cannot
25 respond to that in any timely fashion, if at all, and the

1 economic harm will be done.

2 The customers I represent are going to be 90 - 95
3 percent of them will be served through standard offer of
4 service obligations just the same as sa polar or PGS
5 obligation. One or two or maybe three year supply contract
6 at the most.

7 The LSEs -- I shouldn't say "LSEs" -- the
8 wholesale suppliers that bid on those contracts to supply
9 that load are not going to be in a position where they can
10 make a long-term investment in order to supply that one or
11 two or even three year contract.

12 On the other side, if the prices that you come up
13 with, your scarcity price is capped too low, then you
14 haven't necessarily resolved the reliability problem. That
15 of course is a big concern to us as well. You may have to
16 have another backstop behind that, in which case we're sort
17 of paying over and over again for the same problem.

18 One last point. I think, from our perspective as
19 representing consumers, we feel comfortable going to our
20 clients and saying and saying "you live in a certain area
21 and you have high prices there. The price of power is high
22 there."

23 We feel comfortable saying that when the prices
24 are the result of a competitive market situation.

25 You say "the costs are high" and while stepping

1 back, if it's a situation where it is a high cost area and
2 the prices are high, I feel comfortable saying to my clients
3 that "the prices are high then. That reflects the cost to
4 provide you, which is high -- and I can tell you with some
5 confidence that it reflects a reasonable level of the cost
6 to provide you service because those prices came from a
7 competitive market."

8 Entities in that market are taking risk and all
9 the rest of it to come up with that competitive price.

10 I also feel confident telling that "yes, your
11 prices are high" and those prices result from some neutral
12 determination of what the actual cost is. That is another
13 way that it can be done and I can tell them "that's a
14 reasonable price. You need to pay that."

15 If we get into some other area where it's some
16 hypothetical proxy price or some other thing, I don't feel
17 comfortable giving that response to my clients and I don't
18 think that they will be very well satisfied with it, that
19 it's a high price, that somehow in the future is going to
20 benefit them.

21 I don't think they'll take that as a very good
22 answer and I'd rather not have to give it to them.

23 I'd rather we take the auction approach and I can
24 tell them that this is a cost that you have to pay to get
25 reliability and it's a competitive market price.

1 Thank you.

2 MS. PHILLIPS: Alice? It's Margie Phillips. I
3 kind of have to respond because I think Bill threw in
4 something that is sort of a justification of why you need an
5 up front auction. The LSEs don't want to pay. We all have
6 to pay for reliability. We all have to pay for these
7 generators. The fact that you're an LSE just says maybe
8 this isn't the right way to assign it. That's why the up
9 front auction or the obligation follows the customer
10 regardless of who is the LSE.

11 We all pay for it and we're all assured it's
12 there. It also has the benefit, I think, in Joe's auction
13 there are going to be some issues where he has to make the
14 decision about the resource and the nature of it and what's
15 actually being bid, whereas in the up front auction, PJM is
16 adding no values. It's a straight bid on capacity. You
17 don't have to look at what the unit is or whatever.

18 And I think it takes a little bit of the judgment
19 out of the process by having it up forward. It's more of an
20 apples to apples kind of bidding.

21 MR. O'NEILL: Why can't we get the polar to take
22 on the reliability responsibilities?

23 MS. PHILLIPS: Essentially you will. Essentially
24 the charge probably should be charged like the transmission
25 charge, which is EDC but, when you talk about "polar" like

1 in BGS, there is no polar. It's bid out and the EDC is
2 responsible for serving but they're not the supplier.

3 MR. O'NEILL: I'm talking about a reliability
4 polar.

5 MR. BOWRING: There aren't going to be polars.
6 That's the problem.

7 MS. PHILLIPS: That's why you treat it like a
8 transmission charge. It just goes with the customer. They
9 pay their monthly bill for transmission. They pay their
10 monthly bill for capacity.

11 MR. SHANKER: Margie's proposal is essentially
12 the RAND proposal with the locational ICAP. I put it
13 forward. It was designed explicitly to solve this problem,
14 which is that it's a non-bypassable charge for reliability
15 that goes with the load. That element persists past this.
16 If you want the right price signal for some of this and you
17 have a locational ICAP charge it doesn't keep anybody from
18 hedging, it doesn't keep anybody from building those
19 resources longer term because the auction process in the
20 RAND process is going to buy it forward on behalf of load
21 and it's not bypassable so it doesn't matter who you move
22 to. That was the whole intent simply because we heard
23 perpetually that the LSEs were not willing to invest in that
24 and we were getting driven by bad retail design.

25 MS. CARRADO: We actually support Margie's

1 proposal on the forward capacity auction. We're not sure
2 where we sit on the demand curve but we're re-evaluating
3 that.

4 The comment I wanted to make was that that's a
5 resource adequacy solution and the conference today is about
6 reliability "must run" generation for transmission problems.
7 So although I think we need to pursue that and that's a good
8 structure, I'm not sure it's going to solve all the local
9 "must run" reliability problems because those areas are much
10 smaller and they vary depending on the operations of the
11 system.

12 MR. ROSSIGNOLI: My name is Joe Rossignoli from
13 National Grid. I guess I have a bit of a different take on
14 this. It may not be surprising.

15 (Laughter.)

16 MR. ROSSIGNOLI: I'd like to start by
17 acknowledging that our contracts are emblematic of market
18 failure. The reason we have market failure is because we
19 have a transmission platform that is inadequate to support
20 competition efficient markets in order to diminish the need
21 for RMR contracts.

22 We're going to have to begin moving towards
23 transmission adequacy.

24 One significant step towards doing that would be
25 the adoption of regional capacity markets with the

1 deliverability requirement much like PJM has done.

2 And we feel PJM has demonstrated tremendous
3 leadership in adopting that market design.

4 We also feel the Commission got it right in Order
5 2003 by setting forth the deliverability requirements in the
6 pro forma procedures and agreements.

7 Deliverability abroad in markets will restore
8 competition. It will give customers inside load pockets
9 access to remote suppliers, remote resources and it will
10 also stabilize pricing, which will ease the need for price
11 caps and begin to clean up the market signal that everyone
12 is so concerned about here today.

13 Deliverability is a key ingredient but it's not
14 the sole ingredient. You also need a regional planning
15 process that provides meaningful opportunity for regulated
16 economic upgrades or transmission.

17 Once you have those two key ingredients,
18 deliverability and regional planning for economic upgrades,
19 that's robust and isn't a series of obstacles to regulated
20 economic upgrades, but truly gives an opportunity to move
21 forward with the market to respond to have the kind of
22 transmission adequacy that's needed to, again, restore
23 competition and diminish the need for RMR contracts.

24 You've heard a little bit about locational ICAP
25 today. We don't feel that's the way to go.

1 We feel that organizes markets. It recognizes
2 that there are barriers between markets but puts a band-aid
3 on the barrier rather than incentivising market conduct.

4 To eliminate those barriers I'd finally like to
5 just comment a little bit on the local market auctions which
6 I think was much discussed today.

7 We feel that's a return to the regulation of the
8 1970s with the RTO filling the role that was formerly filled
9 by vertically integrated utilities. That's not very
10 helpful. That's not why we went through restructuring and
11 stranded costs and everything else.

12 It's just circling back and really what LMA, the
13 local market auction, does is it creates its own need
14 because you're going to have market participants that aren't
15 participating in the market which in turn creates a need for
16 LMAs so they can get the regulated subsidies that the LMAs
17 provide.

18 We'd be opposed to that as well.

19 I will respond to any questions that anyone might
20 have.

21 MR. MEAD: Regarding the deliverability
22 requirement. As I understand it, with the deliverability
23 requirement, if you've got a new entrant generator who wants
24 to locate in a generation rich area for which there's not
25 enough transmission to get to a load rich area, you're going

1 to make that generator bill transmission in order to enter
2 and some generators might decide "you know, it's not worth
3 it."

4 Why is it a good idea to impose that transmission
5 upgrade requirement in order to allow that generator to
6 enter the market?

7 MR. ROSSIGNOLI: The reason why a new generator
8 is getting the capacity credit is because they're supposedly
9 bringing some incremental reliability to the system, to the
10 extent that that generator cannot be used by the regional
11 system operator in a way that gets that output to anywhere
12 else in the region.

13 That incremental reliability benefit is an
14 illusion so if a new resource wishes or chooses to be a
15 network resource they must be and receive a capacity credit
16 in exchange for it they must be deliverable anywhere within
17 the region as set forth in the PJM.

18 MR. O'NEILL: Supposing you were to displace an
19 inefficient generator in that load area or that production
20 area?

21 MR. ROSSIGNOLI: I think Order 2003 provides for
22 an energy resource rather than a network resource and they
23 would be able to do that and not have to build to meet the
24 deliverability requirements.

25 MR. O'NEILL: Suppose they just signed a contract

1 with somebody next door and they're going to be a network
2 resource for that customer?

3 MR. ROSSIGNOLI: They wouldn't be a network
4 resource if they're not deliverable nor should they be
5 because --

6 MR. O'NEILL: But they're deliverable to the
7 customer that they signed a contract with.

8 MR. ROSSIGNOLI: But how does that help the
9 regional system operator who needs to dispatch that unit in
10 order to maintain regional reliability?

11 MR. O'NEILL: It's certainly another need.

12 MR. ROSSIGNOLI: But it's not serving the need
13 which the reliability -- the product that the individual
14 generator is getting in exchange for the deliverability.

15 MR. O'NEILL: Every generator has to be
16 deliverable anywhere?

17 MR. ROSSIGNOLI: If they want to be a network
18 resource they don't need to be in Order 2003 and we support
19 a dual interconnection product.

20 MR. MEAD: That would seem to raise the cost of
21 meeting reliability to loads near the generator and reduce
22 the cost of meeting reliability to loads farther away. Why
23 is that a good idea?

24 MR. ROSSIGNOLI: It would reduce the need.

25 MR. SHANKER: That's a new record. I agree with

1 50 percent with something National Grid said.

2 The answer, David, is that they won't build it.
3 That's why it won't happen.

4 MR. O'NEILL: If it's a more efficient generator
5 displaces an inefficient generator?

6 MR. SHANKER: That's why you have to go with a
7 package. That's why I said "half."

8 MR. O'NEILL: We don't have to go with a package.

9 MR. SHANKER: But it does to understand how you
10 got here. Nobody started from a dead heat in PJM with this.
11 The deliverability standard was built into the network as
12 it came up. In fact we had access to deliverability in
13 exchange.

14 MR. O'NEILL: His proposal is not a PJM proposal.

15 MR. SHANKER: I'm saying he's saying "to continue
16 with that we'd like to see it broader." The notion of how
17 the deliverability worked was basically if the system was
18 deliverable incrementally you'd get the expansion
19 transmission rights. You'd get the FTR. You'd get the
20 recognition to sell a fungible capacity product across the
21 entire network.

22 If you think about it it's still coupled with
23 LMP. It gave you the right signals to locate in the right
24 place because it would be consistent with the lowest network
25 upgrade costs in order to do that for deliverability.

1 And that would be the mechanism that would drive
2 overall transfer capability in the system and transmission
3 expansion and it would compliment the overall pricing.
4 That's exactly why you don't want to do the second half of
5 what he's proposing which unfortunately FERC has already
6 ordered to do, which is to have the economic transmission
7 expansion.

8 The baseline system that we had was sufficient.
9 It was driven by the deliverability standard and the choice
10 of energy or network and we had adequate drivers.

11 Coupled with the way the rest of the system was,
12 it does make sense, it doesn't encourage you to double pay.
13 It still encourages you to put the generation in the right
14 location.

15 But you've got to make sure the generator gets
16 what he pays for, which is the ICAP right and also the
17 incremental FTRs because he is expanding his deliverability
18 of the system.

19 MR. ROSSIGNOLI: Let me just respond. We support
20 them getting -- you're saying what we don't support is
21 incremental FTRs and the capacity rights. We do support
22 that.

23 MR. SHANKER: I was only saying I objected to the
24 second half, economic expansion, the full deliverability.
25 I'm assuming that's what you're asking for?

1 MR. ROSSIGNOLI: Right. Without it you're going
2 to have a lot more meetings like that, which is "the market
3 isn't working."

4 We're talking about preserving price signals,
5 Does that mean we're going to be preserving the same price
6 signals that produced the need for the RMR in the first
7 place?

8 MR. SHANKER: If the solution is you're going to
9 tax everybody across the board for a quote "economic
10 transmission expansion" then we're not going to be meeting
11 about RMR units, we're going to be meeting about who's going
12 to direct the construction of new capacity because there is
13 no incentive to build.

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1 We're going to switch topics. That's all that's
2 going to happen.

3 MR. SHANKER: Even though we're slightly out of
4 order I think it's worth starting with the issue of the
5 post-1996 units.

6 This is a disclaimer. I did submit testimony in
7 this proceeding on behalf of Edison Mission Companies.
8 These comments are my own.

9 People are talking by each other with respect to
10 the post 1996 units. We certainly don't want to give
11 anybody the right to exercise market power whether it's a
12 new entrant or not, but the standard for which the existence
13 of market power for the post 1996 unit was different.

14 Joe and I argued about the notion of what's
15 persistent and I'd argue that this is a good situation in
16 which "persistent" is different for pre '96 than post '96
17 units. You have eight years for which new entrants could
18 come into the market evidenced by the fact that they have
19 come into the market.

20 It's not clear that in any of these situations we
21 see other barriers to entry or market barriers. If we did I
22 think that would be a legitimate exception. We have had the
23 opportunity obviously up through this point to have adequate
24 supplies because absent that there would have been load
25 shedding in these situations.

1 So people could have hedged.

2 Those same parties have the ability hedge in and
3 of themselves by building, as evidenced by the new entry and
4 so then we'd have to ask yourselves why is it that we're
5 objecting to a situation that, absent the new entrant, we
6 would have had load drop.

7 Why isn't pricing it at the scarcity price -- in
8 this case, the \$1,000, the correct signal? People had an
9 opportunity to entry the market. People had an opportunity
10 to hedge. There is no barrier to entry and, of course, if
11 you can show a barrier then I will change my conclusion.

12 There's no market power and, again, unless you
13 can show no market failure -- again, unless you can show the
14 market failure, I'm not sure why we want to mitigate these
15 units? All it does is endorse the notion that somebody can
16 sit back and, in this case, take away a property right from
17 someone who developed in anticipation of a competitive entry
18 in a competitive market and, before you show it's not
19 competitive, I think the burden is to show why it is not
20 competitive, not by the instant solution whether or not that
21 person, how they can price right now, because if they're
22 scarce in that situation, they'll drive the price to \$1,000.

23 But by the reality of whether or not over an
24 eight year period anybody else has acted responsibly or
25 irresponsibly to create barriers to entry into the market,

1 that's the difference that's here. We've got an eight year
2 window where everybody had notice to adapt.

3 It's not like the generator just popped up. When
4 we changed the rules for whatever, '96 to '97, there was a
5 legitimate concern that the existing configuration of the
6 system can date market power and, in fact, that's exactly
7 where the rule came from.

8 This is a different circumstance. The standard
9 has to be different. I'm not proposing a specific standard
10 but certainly the presence or absence of barriers to entry
11 or specific market failures is a starting point.

12 With respect to the specific auction proposal, I
13 still -- and it's a basic philosophical difference -- I see
14 physical scarcity, if that is the problem, and I agree with
15 Bill, you don't pay people if there is no physical scarcity
16 but, if there is, I think we price it.

17 We have the \$1,000 as a proxy for scarcity in
18 that market. It drives all our other behaviors. We can
19 look at opportunity costs. We can look at the consumption
20 of reserves in reducing spin in the situation, reducing
21 operating reserves in localities, even nodally if we want to
22 look at it that way -- and we can set a price on it versus
23 the scarcity standard for the market as a whole.

24 I hear the statement about the bankers wanting
25 something and they want reliability or the expectation of

1 the firm revenues.

2 But if we go by the bankers' presentation,
3 remember on that chart, that was the first one at the far
4 left, the first one was the least risky environment was the
5 old regulated environment.

6 So you guys have to decide, are we going to have
7 a market or not? If we're going to have a market, some of
8 the price volatility that goes with this is inherent in what
9 you're doing. It happens in every other major commodity in
10 the world. People build new factories. They build new ore
11 smelters, they build aluminum smelters -- high volatile/high
12 capital - intensive and people live with it without
13 necessarily having 100 percent.

14 MR. O'NEILL: I think you're pointing at the
15 wrong "you guys."

16 MR. SHANKER: "You guys?" 'You guys' are the
17 state commissions here.

18 MR. O'NEILL: If you want to define "long term
19 contracts" at cost of service rates, that's perfectly okay.

20 MR. SHANKER: That's fine as long as we don't
21 design a mitigation scheme around creating financial
22 certainty for new entry to diffuse price signals so that it
23 underprices the value of the energy being produced by the
24 incumbents in the wholesale market.

25 If retail people want to mess it around, that's

1 fine. But we should not, as a wholesale design matter, be
2 setting the price signals to suppress the spot market prices
3 because somebody says "that won't make the bankers happy."

4 That's really got to be the wrong way for us to
5 do that.

6 Or alternatively you want to make everybody happy
7 from a banking and financial perspective. Go back to a
8 regulated environment. Applying that design criterion,
9 that's the ultimate conclusion.

10 The next consequence obviously is that, if you do
11 that, if you let the long term financial consideration set
12 the precedent, I think we're going to wind up essentially by
13 default in a world where nobody's going to build under these
14 criteria.

15 I was troubled earlier when someone said "oh,
16 it's only a few locations, don't worry about it, it's not
17 going to be a big issue."

18 The best locations to build: ultimately when
19 people don't build, when they have the highest LMP, will
20 default into these reliability issues.

21 If I'm advising anybody I'm not going to tell
22 them to invest a nickel until you trigger the auction
23 because that person who wins the auction is going to compete
24 with the capital structure that is much more efficient and
25 cheaper versus the merchant who came in three years'

1 earlier, didn't solve the reliability problem and then got
2 his legs cut out under him by the guy who came in with a
3 cheaper capital structure and the same operating costs.

4 So don't deceive yourselves. If we do this we
5 are going down the slippery slope. We are suppressing the
6 energy price because it's going to be a big hunk of this
7 coming in lump sums. It is not going to be in energy and
8 we're going to discourage any new entrant -- as far as I'm
9 concerned at least, the advice I would give -- from ever
10 building anything close to any of these locations absent
11 getting one of these contracts.

12 A couple of quick things on the auction details.
13 I think Joe's FTR, assuming we have to deal with this which
14 I really don't want to get to, it seems like we're there.
15 The FTR improvement that Joe came up with has both the
16 property that Steve was concerned about that it does take
17 away the up side but it's no different than a firm LD.

18 It's the equivalent to somebody selling a firm LD
19 so it is an improvement over what was there before. If
20 we're going to do that that's the right way to do it. I
21 think we have agreed on a clearing price but I don't know
22 what a "clearing price" means for some of the transmission
23 and generation related combinations.

24 The comparability of transmission and generation
25 offers -- I think Dick made a great point which I have

1 argued about, that you can't compare something that adds
2 adequacy in a load pocket so something that only adds
3 transmission to the load pocket.

4 It must be combined with the adequacy product.
5 It has to be tied to ICAP on the outside.

6 Again, there's a comparability issue with all of
7 this and the interaction with less than the planning process
8 -- again, we're going down a bad, slippery slope. We've
9 been mandated to have economic expansion which we shouldn't
10 be -- and actually PJM to their merit resisted strongly -- I
11 think you had to tell them three times to do it --

12 (Laughter.)

13 MR. SHANKER: -- the need to integrate that and
14 Joe has mentioned it, Steve Hurley has mentioned it. I
15 understand the intent of what he's trying to do. I am not
16 comfortable that we know how to do this.

17 I look at the interaction between the two
18 processes and I'm worried that they'll never mesh properly.
19 It's appropriate for us to be concerned but I think the
20 stakeholder process, whatever the final presentation, has to
21 really demonstrate that they work together.

22 There is one other notion that's come up here,
23 which is, I think it was from Bill Fields' comments, "don't
24 start paying for something that's reliable now."

25 I think there's a lack of understanding of what

1 the scarcity pricing, if properly implemented, is. If
2 somebody gave a summary -- I think David Patton mentioned it
3 yesterday, people still aren't getting it. We can and it's
4 not a subjective process.

5 If you go into the control room today, they can
6 tell you that, effectively, we have "spin by location."
7 There is a reserve requirement. The fact that, in the
8 operation of the system, and those guys have it. They're
9 doing it every day and we can take a look and that number is
10 there.

11 When they degrade that spin for energy because
12 they say "I want X and I have to get a little less than X,"
13 they're making a choice between dropping load and obtaining
14 spin which would drive us to the \$1,000 mark or degrading
15 the reliability of the system by reducing it from their
16 target spin amounts and converting that spin into energy.

17 Once we set the \$1,000 we'll know how to derive
18 values for scarcity very well. It's not that difficult and
19 it's something that can be implemented. New York has done
20 it.

21 It is "subjective," as Joe has said, but the
22 subjective step was the first step that said "It's a
23 \$1,000."

24 We have the mechanisms to do that and, right now,
25 we're consuming those services without paying for them every

1 time we hit those limits. The good example is the post-
2 contingency/pre-contingency switch in operations in PJM. In
3 certain situations PJM has gone to a post- contingency
4 dispatch regime. It has the property then of not committing
5 peakers in certain locations that used to previously be
6 committed because of pre-contingency standards. In doing
7 that it reduces the price, it drops the LMP.

8 De facto, the ability to that is that we now have
9 a non-synchronous call on that same peaker so we're relying
10 on him for non-synchronous reserve because we couldn't have
11 allowed ourselves to go to the post- contingency operation
12 without the peaker being there. It's the same guy that used
13 to be turned on before and part of the decision to do this
14 was 'how fast can he turn off?'

15 We've all seen in the stakeholder process that
16 the reliability of starts -- you know, 'he starts X percent
17 of the time and less than 15 or 20 minutes.'

18 That was part of the decision process to go post
19 contingency so we're relying on that to create a lower LMP
20 in a post contingency world without paying the guy for the
21 non synchronous reserves.

22 The same thing will happen in the circumstances
23 when Joe wants to trigger the auction. As we price right
24 now we're going to be consuming spin in the system without
25 paying peak and paying people and the first step ought to be

1 to pay people for that.

2 MR. LALOR: Could I ask Roy one question before
3 he passes the microphone? I'd like to go back to the
4 "slippery slope," Roy, that you're talking about -- and this
5 is in the context of the auction -- and ask you you to
6 change your hat from a theoretical economist to a practical
7 advisor of generation clients.

8 Let's posit the situation where there is going to
9 be a reliability problem that needs to be resolved either
10 through transmission or through some least cost solution
11 derived by an auction. Would you say to your guy "Listen,
12 getting the prices right, they're working on the RAM,
13 they're going to go back and not price cap units. They're
14 going to put in the \$1,000 cap and people are going to be
15 able to bid that."

16 Would you tell your guy, "Listen, you want to
17 invest in some generation based on these new rules that are
18 aborning, are going to be in soon or, even if they're in" --
19 or would you say, "You'd be out of your mind putting your
20 capital there without a long term contract because you know
21 what, they change the stuff before they can change it
22 again?"

23 MR. SHANKER: That's part of the problem and it's
24 a dilemma. I would rather see some certainty in the
25 decision. If the answer to your question is that 'I could

1 only make the judgment on the long term contract,' then I'd
2 argue that we need to change the overall market design.

3 People have invested up to now somebody said -- I
4 got a comment yesterday -- "Bad decisions here make 'stupid'
5 seem like, you know, 'a bad qualifier.'"

6 If we reach a point where no one can build
7 without the contracts, without long term contracts that are
8 sustained either collectively or have a load in aggregate or
9 somehow through an ISO mechanism, an ISO contract, then we
10 probably should be going back in another direction.

11 MR. ROSSIGNOLI: I guess I'm astonished by the
12 proposition that RMR contracts are not emblematic of market
13 failure. Let me just give you examples a little closer to
14 home in New England with Connecticut and Boston.

15 ISO New England, absent these contracts, fears
16 that the lights will go out inside these load pockets. That
17 means the market did not respond. It was given years to
18 respond. It did not.

19 Therefore, market intervention by a central
20 authority was deemed necessary.

21 I don't know how you separate the two. It would
22 be difficult for me to do it.

23 In terms of the economic plan, too, which I think
24 I have to respond to in the case of PJM, the market's been
25 in place since 1997. The market has had time to respond.

1 It has time to respond during the planning process as well
2 and even as yet another year of what I call a "third byte"
3 at the Apple to respond during the market that PJM is
4 providing after the study process finishes.

5 So there's plenty of time for the market to
6 respond. I guess you're left with a choice. You could
7 allow generators to collect monopoly rents forever along
8 with these RMR contracts or you can take needs that have
9 been identified through a rigorous regional planning process
10 -- economic needs -- and extract that value.

11 Markets don't exist for their own sake. They
12 exist in order to efficiently allocate resources.

13 If they're not doing that, then deregulation and
14 restructuring will not survive.

15 MS. FERNANDEZ: I was trying to end by about
16 1:00. Looks like we'll go a little bit longer.

17 MR. POWER: Joe Power with Reliant. Most of what
18 I wanted to say has already been covered. I will just jump
19 right to it.

20 The discussion focus today is on getting the
21 pricing right. There's a lot of different proposals out
22 there. You folks have the difficult job of figuring out
23 what that is.

24 I would submit there is record evidence to
25 demonstrate that this cost plus 10 is not appropriate for

1 units like Reliant's that run very few hours.

2 That evidence is in the form of the interim
3 solution that was offered by PJM. To the extent you're
4 offering interim solutions, you are de facto stating that
5 what you have is broken.

6 They recognize that units like ours which run
7 very infrequently cannot recover their to-go costs in the
8 market and they have proposed this -- when you're looking at
9 picking your choice of what price is right, I think clearly
10 there is evidence that that is not right for those units and
11 the interim solution is the evidence on that.

12 MS. FERNANDEZ: Actually I think there may be a
13 couple of other areas. One area I'd like Joe to respond to
14 is on the post '96 units as to why it would be appropriate
15 to apply the cost cap into those units?

16 MR. BOWRING: I obviously disagree with what Joe
17 said but the fact that we have provided interim solutions
18 does not demonstrate anything of the kind. I'll leave it at
19 that.

20 The post '96 units issue has come up from a
21 number of people from Peter yelling at me that I'm about to
22 screw his unit to everyone else suggesting it's a bad
23 signal, a bad market design.

24 First of all, Peter, you forgot exactly what I
25 wrote and you've forgotten our discussions about what's been

1 proposed for post '96. There are two issues. One is does
2 it make sense to have new units to be subject to a different
3 set of market rules and that was really what I was
4 addressing.

5 The second is, does it make sense to take a unit
6 which was built under a particular expectation and change
7 the rule in a negative way? That's a separate question and
8 one that I recognize and I have addressed in the filing.

9 I believe this is the September 30th filing in
10 which I recognized explicitly we need to do that.

11 But we don't want to do that. We can't simply
12 say, "You built expecting no offer capping. We're now going
13 to make you a cost plus 10 percent."

14 At the same time nobody had any reason to believe
15 that they were in a position to buy the ability to exercise
16 market power. I don't think you would argue that either.

17 So what we suggested is that because those units
18 built in the interim in the transition had a different set
19 of expectations that what we'll do is engage in bilateral
20 discussions to work out something that's reasonable so there
21 was not an unlimited ability to exercise market power at the
22 same time that they're not having their expectations
23 unreasonably affected.

24 I think that's a very fair issue and it's one
25 which is going to have to be worked out pretty much case by

1 case.

2 As far as new units going forward from the day we
3 first basically said that the rules have changed, it's a
4 different matter. I know where the units are and, as a
5 general matter, I agree. We don't need to cost cap them
6 all. Offer cap them unless they have market power but there
7 are some of these units that do and some of these units that
8 regularly exercise it.

9 Luckily so far it's been fairly insignificant in
10 terms of impact on the market but it's a real issue and
11 we'll get more real.

12 MR. O'NEILL: How did they get market power?
13 Load growth?

14 MR. BOWRING: It's a fair question. It can be
15 any one of a number of things. One is they could have
16 chosen to locate in an area where they believed they would
17 have market power.

18 The second is there could be transient changes in
19 the transmission system that would give them local market
20 power from time to time and the third possibility is load
21 growth.

22 I would say primarily it's the former two for the
23 bulk.

24 MR. O'NEILL: Are any of these entities just
25 simply highly concentrated units or that were built after

1 '96?

2 MR. BOWRING: I don't know what you mean?

3 MR. O'NEILL: In other words, if you already had
4 a fairly high concentration in the area and built a
5 generator --

6 MR. BOWRING: Some look like that.

7 But another key point that Roy made that's worthy
8 of response is that he indicated that \$1,000 would be the
9 right cap for them, or if the alternative was blacking out
10 an area, \$1,000 would be the right price. There aren't any
11 situations where but-for the output of a particular
12 generator -- post '96 generator -- in a constrained area
13 where that would be the case, it's not the case that the
14 alternative is blacking them out.

15 It is the case that they could affect price for
16 some amount of load whether small or large and they have the
17 ability to do that without any limits. If we get to the
18 point where we think the right response is to let people
19 price scarcity at \$1,000 they should be able to price
20 scarcity at \$1,000 like anyone else.

21 But as long as we're under a different regime
22 they should not be treated any differently. The accident of
23 when they were built should have nothing to do with their
24 ability to exercise market power.

25 MR. SHANKER: Any of those situations where

1 people -- the new entrant -- has the ability to keep anybody
2 else out of the market has erected barriers to entry over
3 their barriers to entry inherent in the locations you're
4 talking about.

5 MR. BOWRING: You know as well as I do just given
6 the physical features of the transmission system and the
7 geography generally that, by and large, there are some of
8 the most egregious situations -- there very clearly are
9 barriers to further entry.

10 MR. SHANKER: The example of the Peninsula is
11 probably the best one. ODEC built a 500 megawatt plant and
12 it consciously --

13 MR. BOWRING: I know you said that yesterday. I
14 understand.

15 MR. SHANKER: Why then does the guy who did then
16 locate there -- why is he exercising market power?

17 MR. BOWRING: Who is the guy who did locate
18 there?

19 MR. SHANKER: Me, tomorrow, when I build the
20 plant there.

21 (Laughter.)

22 MR. BOWRING: Let's be careful here.

23 MR. SHANKER: Two people could build and in fact
24 the person who is impacted chooses not to hedge and he has
25 eight years to figure it out and he builds in one location

1 and doesn't hedge and somebody else builds in his location
2 and says "Aha! You need me. I guess you're going to have
3 to pay."

4 I understand that, at some stage, we have an
5 issue associated with market power and whatever that
6 threshold is, I will agree we ought to mitigate. I'm just
7 not sure how that example reaches the threshold of where it
8 is appropriate to mitigate.

9 MR. FALK: If I could just add one thing. It
10 seems to me that's very close to the slippery slope of
11 saying that "what generators can't do is chase rents
12 anywhere." That is, we'll have a problem if somewhere
13 somebody in the system is making a buck.

14 The whole notion here is we want to allow people
15 to chase rents. We don't want to allow them to willy-nilly
16 exert market power. We can talk about what we mean by that.
17 But they d need to be able to chase rents. If this is a
18 rent chasing behavior it is to be commended and not
19 condemned.

20 If it ends up that they end up charging something
21 well in excess of their marginal costs for having done so --
22 by the way we didn't say anything about what their capital
23 cost was to actually get there.

24 MR. O'NEILL: Roy basically pointed that out that
25 it was more expensive to locate in the right area than the

1 wrong area.

2 MR. BOWRING: I mean, again, that's a generality
3 that may or may not be true. It's certainly not true by
4 assumption.

5 MR. SHANKER: Even if it's not true, even more
6 reasonable. Why doesn't a person build it in the right
7 location?

8 MR. BOWRING: Let's say you get lucky and make a
9 decision and locate on a node where, because of a change in
10 transmission system, you have local market power -- that
11 doesn't mean you have the right to exercise it, I don't care
12 how long anyone else has had to think about it.

13 MR. SHANKER: By definition, if you say "it's
14 market power, you win" -- the guy that was smart enough to
15 put the hot dog stand outside the Super Bowl is exerting
16 market power by charging more there.

17 Where is the barrier to entry? Where is the
18 exclusional behavior? Where is the prohibition against that
19 person hedging?

20 MR. MEAD: Roy, are you saying that the new
21 entrant would be unable to affect the market price?

22 MR. SHANKER: No. I'm saying that the new
23 entrant is able to impact the market price.

24 MR. MEAD: Isn't that market power?

25 MR. SHANKER: In the original Justice Department

1 perspective we're talking about the term, 'persistent.' I
2 have always, after many arguments, deferred to Joe on this
3 and I think when you inherit a situation, 'persistent' can
4 be like this -- "you can't persist, there is no reasonable
5 persistence" -- the fact that I can just be in a load pocket
6 and charge whatever I want because I'm the only owner is not
7 a reasonable behavior.

8 And some state the notion of persistence in an
9 environment where there is open opportunity to build no
10 barriers to entry, an eight year environment of people
11 capable of hedging themselves, there's got to be something
12 that's different from cost plus 10 there.

13 If you want to say "I say a thousand" -- if you
14 want to say 900 or 700 -- if you want to say I can only do
15 it 10 hours instead of 40 hours, we can argue about that.

16 But the notion that the blanket exercise in that
17 environment of the first time that I am needed, and that all
18 I could price at as a new entrant is cost plus 10 just can't
19 be right.

20 MR. O'NEILL: Are we arguing the issue of whether
21 or not the appropriate mitigation is cost plus 10 or what we
22 were discussing yesterday as appropriate scarcity pricing?

23 MR. BOWRING: Exactly. You're ont arguing about
24 post '96 units, you're talking about the broader question
25 because your logic proves too much for the post '96 case.

1 What you're arguing -- your argument applies equally well to
2 existing load pockets. And that's fine. It's an argument
3 that is different.

4 MR. CORNELI: We own old and post '96 units and
5 in PJM load pockets, one of the things people have to
6 remember here is market power is a policy issue because it
7 affects bigger policy issues, things Bill was talking about
8 and things we were talking about yesterday, "are rates
9 competitive in a market?"

10 And one of the things competitive rates should do
11 is they should attract needed investment. There has been
12 one assumption today that I don't think has really been
13 thought about carefully and that's that either you have
14 scarcity or you don't.

15 And actually, if you think about it, what you
16 want in an electricity market is you don't want too few
17 resources or you have loss of load expectations showing up
18 and other kinds of problems and if you have too many
19 resources you have prices suppressed and that's not really a
20 desirable thing in the long run.

21 What we really want in the electricity market is
22 just the right amount of resources or a fairly narrow band
23 around them. In that situation I don't think that economics
24 or policy tells us that we want people to only recover their
25 short run marginal costs if they're needed for reliability.

1 MR. O'NEILL: We do not want that.

2 MR. CORNELI: But I don't think the argument --

3 MR. BOWRING: Nobody said that either.

4 MR. CORNELI: The only reason we're arguing about
5 mitigation is because mitigation, if it's excessively
6 applied and prevents scarcity pricing when scarcity pricing
7 is needed, and when scarcity pricing is wanted -- going back
8 to Bill's point -- and when it's useful to recover the fixed
9 costs of that last marginal unit that you want to keep
10 attracting, to be there and to come in.

11 And when load grows again by an increment then
12 you don't want total revenues to be stuck at that poor guy's
13 short run marginal fuel cost. They're variable and I think
14 we all agreed on that.

15 MR. O'NEILL: I think the argument is that, given
16 the opportunity to enter the market, there should have been
17 people on the other side of long-term contracts that should
18 have signed contracts with these new entrants.

19 Marjorie keeps yelling at me that nobody's going
20 to do that and so we have a bad market design here. If we
21 could get the polar to step up and sign these long term
22 contracts, which reduce the cost to the end use consumer,
23 why don't we do it that way?

24 Why do we have to have PJM stepping in? What
25 you're doing is, you're going to put PJM into this process

1 and PJM is going to conduct all new future auctions to
2 decide where people locate, how they locate, what they get
3 paid and everything else.

4 MR. BOWRING: Let's not go down the slippery
5 slope too fast. Let's not get ahead of ourselves.

6 But at the same time there is an issue identified
7 yesterday and repeated today -- there's sort of a structural
8 incentive issue, an institutional incentive issue, and I
9 think everyone needs to think about it very seriously. It
10 comes up in the DSM area, it comes up in this area -- who is
11 it who has an interest in hedging loads exposure?

12 And right now it's not clear. As polar
13 obligations go away, which they will, there's not going to
14 be anyone in that position and that's very significant.

15 MR. O'NEILL: They do not have to go away. This
16 issue is an issue that the states can turn around on a dime.

17 MR. BOWRING: That's right.

18 MR. O'NEILL: If it's in the interest of the
19 local citizens of the state for someone to need to buy long
20 term contracts on their behalf to keep the prices lower than
21 they otherwise would have been if they'd bought in the spot
22 market.

23 Why aren't the states doing it?

24 MS. PHILLIPS: Dick, the problem is, the price
25 signal hasn't been set. The folks that don't want to spend

1 the money, they come to you guys for regulatory relief but
2 they haven't been successful lately so why should they
3 invest?

4 The point is, if you get a forward looking curve,
5 that says "this is what you're going to be paying in three
6 to five years, you may not get a ten year contract but an
7 LSE may sign a two year contract," which is even longer.

8 MR. O'NEILL: We have been approving scarcity
9 pricing regimes as fast as they're filed here, haven't we?
10 Give me an example of the scarcity pricing regime that was
11 filed here that we didn't approve.

12 MS. PHILLIPS: You may approve it but it's the
13 implementation --

14 MR. CORNELI: We can talk about the one that
15 needed to be two hours. It needed to be 20 hours.

16 MR. O'NEILL: I meant the fact that, if there's a
17 shortage in New England, the price goes to the cap.

18 If there's a shortage in New York, the new real
19 time rate design, if there's a shortage the price can go to
20 \$1,800. We had been very favorable to those types of
21 filings and the PJM stakeholders could get together and make
22 a filing like that and we'd be very happy to look at it.

23 MR. WEMPLE: We're trying to work with the
24 stakeholders to come up with that kind of filing.

25 MS. OGENYI: I wanted to make some comments

1 responding to you, Joe. All those units should be an
2 exception. I agree with what Roy had put forward and at
3 least the criteria I had talked about, "exceptional" not
4 "generic" rule, that's something that you probably need to
5 talk and work through.

6 You mentioned talking to them one on one.
7 Really, we don't want to get into black box situations. It
8 would be nice, if you're going to do that, you're going to
9 have to -- you've got to have a methodology that we all know
10 how this is going to work and I wanted to get to the issue
11 that had come up several times coming from opposition --
12 which I had pointed out earlier.

13 We have load and we do have generation.

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1 The Commission should focus on cost causation to
2 be sure that customers should be benefitting from whatever
3 methods are put in place. If you have RMR contracts, the
4 beneficiaries of those contracts should not have the option
5 of having the security of having those contracts and also
6 having the opportunity to participate in the market when the
7 market is up.

8 I think the choice they make over a period of
9 time, and they stay in, they do not come in and out,
10 depending on how the market floats. We all have suffered
11 from the low market, and they shouldn't have a competitive
12 advantage over other market participants. Thank you.

13 MS. FERNANDEZ: I really am trying to wrap this
14 up.

15 MR. WOLAK: If you want, I'll stop.

16 MS. FERNANDEZ: Did you have some comments?

17 MR. WOLAK: I just wanted to respond to some of
18 the things that have been said and to support Joe again. I
19 look at the point and say eight years, it hasn't come. That
20 means it's not going to come.

21 In fact, now it hasn't come. You then charge
22 high prices, and all that gets is a lot of politicians to
23 come and complain. It doesn't solve the problem, so I think
24 it's got be -- you've got to be realistic in terms of
25 getting the states involved in exactly the issues Dick is

1 talking about, and somehow get them to recognize that they
2 need to step up and make these purchases.

3 And on the issue of the cost-capping of the post-
4 1996 units, I think Joe raises the issue of the just and
5 reasonable rate standard, but I also think there is an
6 important issue that relates to some of the comments that I
7 said, that really has some complex problems, and that's
8 really the leveraging problem.

9 If there are units in your portfolio that you
10 have, that are pre-'96 units and cost-capped units in your
11 portfolio that are post-'96 and not cost-capped, there is
12 some serious opportunities to essentially take advantage of
13 that fact for the benefits of your pre-'96 units.

14 I think there's a lot there that certainly argues
15 against this differential treatment, although once again, I
16 fully recognize that generators should be able to pay for
17 their units.

18 The other issue that I really wanted to hit on
19 is the issue of scarcity bids. I think the one thing that's
20 important there is just the point, again, that scarcity
21 depends upon the number of suppliers in the region. In
22 particular, I would argue that one of the reasons that
23 suppliers don't divest the units in the regions is because
24 it is profitable not to divest the units in the region, so
25 that you could have effective competition in a local region

1 by the fact that the units get sold off to a sufficient
2 number of suppliers, so that Joe's tests don't get hit and
3 you don't have the subject the units to mitigation.

4 In that sense, I think that there is an argument
5 that says that the rewards for being a cost-capped unit in
6 one of these locations may be too great.

7 The other issue that I just wanted to emphasize
8 is the fact that it seems that in some sense, the market in
9 PJM is a victim of its own success, in the sense that new
10 entry has occurred.

11 One of the unfortunate implications of new entry
12 is that prices fall, and, moreover, it doesn't look like
13 this new entry has come at the wrong locations. True, it
14 hasn't come at the perfect locations, but there's no entry
15 that's just been dramatically at wrong locations.

16 There examples where you can say, yes, ex post,
17 that was probably not the best place to put it. The obvious
18 implication when that happens is that prices will fall, and
19 so I think it's very important to make the distinction
20 between the reasons, because a local market power mitigation
21 mechanism or the reason is just that there is simply too
22 much generation in the system.

23 And feeding back to the second point that I was
24 talking about, is that you could think of this in terms of
25 the divestiture of units. It really is the location of the

1 units and the owners of those units, probably not as much as
2 the systemwide concentration, so you think of the systemwide
3 concentration of units in terms of market power problems in
4 PJM, are probably not there.

5 But what the issue really is, is who owns what
6 and where they own it, in other words, the geographic
7 concentration of ownership is really the problem. So, in
8 some sense, this could be a problem that could solve itself
9 through the reshuffling of ownership in the specific
10 locations, to eliminate many of the local market power
11 problems that might exist.

12 MR. SHANKER: One more thing. I'm sorry. It's
13 certainly a good example of where mitigation should take
14 place. Certainly I didn't mean to imply anything other than
15 that.

16 In fact, that's what I'm suggesting, that it
17 needs to be a more explicit standard than just whether a
18 unit is constrained on, but the last half of what you said
19 is the predicate. There has been a lot of new entry, so it
20 has come over the eight years.

21 It's not the aggregate of what has come; it's the
22 parties who have hedged or not hedged themselves against the
23 new entry. There are the ones that are concerned about the
24 high prices.

25 If the party was hedged against these new

1 entrants, there would be no issue here. It's the issue that
2 new entry was possible, as you admitted, sufficient, and
3 parties have chosen not to hedge themselves against it,
4 therefore, that's what the situation comes up with.

5 MR. WOLAK: I don't disagree with the point.
6 The argument you make, I think, is quite elegant in the
7 sense that you've had eight years to fix the problem and you
8 haven't.

9 But I also think that it seems that we have to
10 live in the political world that we live in. If it's not
11 coming in eight years, despite all of the warnings and the
12 like, it's not a market failure problem; it's the fact that
13 I think that there is someone who is not getting the
14 message, that needs to get the message.

15 And to just simply punish someone for the fact
16 that it didn't happen, it doesn't seem that that really
17 serves your final endpoint.

18 MR. SHANKER: I'd like to introduce you to my
19 stock broker. People make mistakes. The issue here is the
20 concern --

21 MR. WOLAK: I don't think there's a reasonable
22 rate standard on the stock broker.

23 MR. MEAD: If I'm understanding you correctly, it
24 seems to me that some of these new entrants may have market
25 power. The load there could have protected itself against

1 that market power by hedging themselves at the time the
2 construction decision was made.

3 But the elected not to, and, therefore, we should
4 allow this new entrant to exercise market power.

5 MR. SHANKER: No. What I'm saying is that the
6 standard of what constitutes market power may be different
7 in that situation. I'm not arguing with leveraging. I
8 think leveraging is another form of withholding or playing
9 off the other units.

10 It's a perfect example of when we do want to
11 mitigate that the point becomes -- and Joe, I think,
12 clarified it, even for myself on how to express it -- if
13 there is scarcity that, but for the mitigation under our
14 market rules would go to the cap, and in the presence of
15 that, parties haven't hedged and there has been new entry,
16 why are we concerned about cost-plus-ten?

17 That's not the exercise of market power in the
18 sense that we're talking about. Why is that unit running,
19 David? It's running because it is needed in that situation.

20 If you didn't know what the price was, and we
21 just said without him being there, I need him, okay, this is
22 not a short-term reliability RMR issue; this is a scarcity
23 in the load pocket over time where new entry has been
24 possible. But for him being there, there would be a load
25 drop or you'd have to take him, and so what's the

1 difference?

2 MR. MEAD: I understand the argument that some
3 entrants may need to exercise market power in order to cover
4 their costs. There's enough of a lumpiness issue and the
5 load pocket is small enough that prices aren't going to get
6 high enough to recover this entrant's costs, unless it
7 exercises some market power.

8 That's an argument I would consider. It's a
9 different argument, though, to say that the new entrant
10 lacks market power and therefore we shouldn't mitigate him.
11 I'm not sure which argument prevails.

12 I agree that when there is scarcity, we ought to
13 have high prices. It's another issue about whether we have
14 high prices because of the contrived scarcity of exercising
15 market power.

16 MR. SHANKER: The sort of tautological -- the way
17 we have the market designed, when there's physical scarcity
18 anywhere, there's market power. I can bid ahead in the day-
19 ahead market. You're allowing me to bid a thousand dollars,
20 and I can impact prices, if I'm the marginal unit.

21 I'm not cost-based. In Mirant, there are no --
22 under our rules in Mirant, the aggregate load would be such
23 that the physical commitment of units would not result in
24 any internal transmission constraints. I can bid whatever I
25 want.

1 Is that market power or not?

2 MR. WOLAK: The decision was made on the amount
3 of market power that's tolerable.

4 MR. SHANKER: Exactly. Now, we're revisiting a
5 decision that was also made, not to price-cap those units
6 post-'96, because of the belief that there was the ability
7 for new entry.

8 It's the exact --

9 MR. WOLAK: It's very different. One is a right
10 then and now; the other is a dynamic process. Right then
11 and now, you're saying that we think the PJM market,
12 systemwide, when it clears systemwide with no constraints,
13 is a workably competitive market, so we don't have to worry
14 about guys exercising market power because they can't,
15 because there is enough competition.

16 But if they are lucky enough, when that happens,
17 the lights that somebody's unit falls off and their bid gets
18 accepted, then that's something that we're willing to
19 tolerate. That's why it's the point that we talked about
20 earlier, of the duration. There's a magnitude issue here,
21 but in the case of the locality, the difficulty is that
22 those conditions arise of sufficient duration, as Joe talked
23 about, that they can't do some significant damage. That
24 strikes me as quite different.

25 MR. FALK: The alternative is that you don't have

1 them at all. They're there now.

2 MR. SHANKER: If you can seize them now --

3 MR. WOLAK: You're don't have to seize then;
4 you're not seizing them.

5 MR. SHANKER: Sure you are; you're changing the
6 rules under which they were built.

7 MR. WOLAK: No, no. When they built the units,
8 they knew there was the Federal Power Act.

9 MR. SHANKER: Absolutely.

10 MR. FIELDS: This has given Staff a good
11 indication of how our working group sessions on this issue
12 have gone.

13 (Laughter.)

14 MR. FIELDS: But I do want to make a couple of
15 points: Over the last eight years, the utilities were the
16 load servers, back eight years ago. They knew restructuring
17 was on the way, and they didn't have -- they correctly
18 assumed that they weren't going to have a 20-year or a 30-
19 year relationship with their customers anymore.

20 To say that load hasn't has it over the last
21 eight years, restructuring prevented that at the state
22 level, and now they're saying that, at the wholesale level,
23 we're going to sort of assume that it could have happened.
24 We're kind of getting whipsawed by restructuring, on the one
25 hand, and on the other side from the wholesale level.

1 Similarly, someone asked, why aren't states going
2 for longer-term contracts? Suppliers come in and say they
3 will be real expensive.

4 MR. O'NEILL: We were told yesterday that they
5 were real cheap.

6 (Laughter.)

7 MR. FIELDS: Sometimes it's the same company.

8 (Laughter.)

9 MR. FIELDS: Sometimes it's the same company
10 saying different things, so that's the basic problem. It's
11 just not going to happen that way.

12 I did want to make a point. Someone talked about
13 limiting units to recovery of short-term marginal costs.
14 That's not what happens; that's the proposal.

15 They get other revenues. They're allowed to get
16 inframarginal revenues. I think that's just incorrect.

17 With those couple of points, I'll stop and let
18 you jump in quickly to try to end this.

19 MS. FERNANDEZ: Yes, this has been helpful, but
20 it's also rather obvious that we have no consensus, which I
21 guess is also an example of market power working group
22 meetings. In order to assist the Commission building a
23 record and making a decision, we wanted to give an
24 opportunity for additional comments.

25 I think the comments really need to focus on

1 basically in the various areas, I think, using PJM's
2 proposal in terms of what type of mitigation measures or
3 cost-capping should apply to existing units; what type of
4 measures should apply to the post-'96 units, if there should
5 be differences among which units should be subject to some
6 test as to whether or not you'd be subject to all of them or
7 none them, and also in terms of an auction, as to both when
8 one should be held, how it should be structured.

9 I think this is also an area where it sounds like
10 there's still an awful lot of things to be worked out as to
11 sort of how the Commission, if the Commission decides it
12 likes an auction, is there something that needs to be sent
13 back for further discussion in terms of stakeholder
14 discussions.

15 Is it a proposal that the Commission could
16 accept, or is it something that the Commission could only
17 accept, say, a general concept of, and is there something
18 that could be done before it could be implemented?

19 One other thing that would be helpful in the
20 comments -- and I think we had the discussion sort of at the
21 beginning in terms of some of the specifics, as to how the
22 issue relates to PJM in terms of how units are cost-capped.

23 23

24 If this is primarily an issue with peaking units,
25 if it also primarily affects certain load pockets, I think

1 it also would be helpful for the post-'96 units to get an
2 idea if that's something where it's only affecting certain
3 areas, or if it's across the board.

4 MR. KATHAN: I'd like to add -- let me do an
5 iteration of the economic expansion process and the proposed
6 auctions, how we'd work together, and what is the process.

7 MS. PHILIPS: Alice, do you have a sense of how
8 many days?

9 MS. FERNANDEZ: I'm going to give you the dates
10 now. You'll notice, if you were here yesterday, that these
11 dates are different from the dates for the PL. This is a
12 specific case where we have parties who filed to intervene.

13 If you didn't file to intervene and you want to
14 file comments, you really do need to file a Motion for Late
15 Intervention, but we'd like these comments filed in the
16 EL03-236 Docket. That would be comments on 2/20 and reply
17 comments on March 1st.

18 The anticipation we have is that this process was
19 originally set up so that the Commission could issue
20 something to basically say what changes should be made, and,
21 in effect, this summer, in terms of picking these dates,
22 we're trying to come up with dates for comments that the
23 Commission could issue an Order sometime in the Spring, so
24 that there would be time to implement something, if that's
25 what the Commission chooses.

1 Anything else?

2 MS. PHILIPS: When you post the notice, Alice,
3 are you going to put these questions in them, or are you
4 just going to -- is it going to be more generic?

5 MS. FERNANDEZ: I suppose -- unfortunately, all
6 of our attorneys have left. But, I mean, we probably could
7 put in like a supplemental notice or something.

8 MR. CORNELI: That would be handy, in case you
9 didn't write everything down we wanted.

10 MR. WEMPLE: There are two separate dockets for
11 the generic versus PJM-specific, you're saying?

12 MS. FERNANDEZ: Yes.

13 MR. WEMPLE: WE need to intervene then in the
14 PL04 or is everybody on the EL list automatically on the PL
15 list?

16 MS. FERNANDEZ: You don't need to intervene in a
17 PL docket.

18 MR. WEMPLE: I'm just a silly business person.

19 MS. FERNANDEZ: It's just that this is one where
20 when you have an EL or an ER-docket, in those, you have to
21 be a party.

22 MR. FIELDS: When is the transcript going to be
23 ready?

24 MS. FERNANDEZ: I think you need to talk with the
25 Court Reporter, because there's a potential for having it

1 this -- it's because it's a transcript in two weeks that it
2 would get posted on our e-library in this docket.

3 Any other questions?

4 (No response.)

5 MR. BOWRING: We want to thank you for doing
6 this. I know it wasn't necessarily painless for your, but,
7 nonetheless, we appreciate it.

8 MS. PHILIPS: For what's it's worth, this forum
9 was so interesting that even as an observer, it really is a
10 good format.

11 (Whereupon, at 1:35 p.m., the technical
12 conference was concluded.)

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