Federal Energy Regulatory Commission
Capacity Markets Technical Conference

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Comments presented by:

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Good afternoon. I want to thank the Commission for the opportunity to share our perspective of the emerging capacity markets.

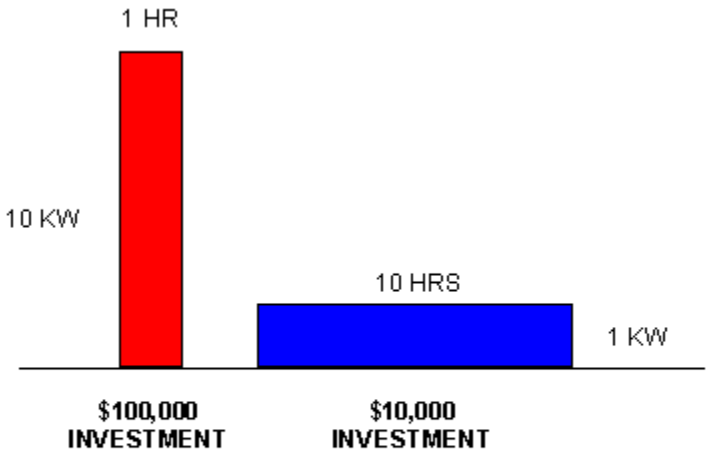
My name is Steve Elsea and I am the Director of Energy Services for Leggett & Platt Incorporated. Leggett & Platt is a diversified Fortune 500 manufacturer that conceives, designs and produces a broad variety of engineered components and products that can be found in virtually every home, office, retail store, and automobile. Leggett serves a broad suite of customers that comprises a "Who's Who" of U.S. manufacturers and retailers. We are celebrating our 125th anniversary this year. In that time, our company has grown into 22 business units in more than 250 facilities located in 20 countries operated by 24,000 employee-partners. About 75% of our facilities are located in the United States.

As you can imagine, our production facilities and their respective hours of operation are very diverse. We have small assembly plants that operate one or two shifts a day five days a week to large 24x7 integrated processing facilities where feed stock is turned into finished components. For example, Leggett operates one of the largest electric arc furnaces (EAF) in the world at Sterling Steel Company located behind PJM. Although Sterling's 15-megawatt rolling mill operates 24x7, the 85 mW EAF operates from Friday evening to Monday morning. More on this later.

As a large power user, our perspective of capacity markets may differ from some of our peers. The emergence of ISO/RTO capacity markets is a logical evolution. In the absence of a demand or capacity price signal, the cost-to-serve energy subsidizes the cost-to-serve capacity which inherently creates disincentives for supply-side investment and demand-response participation. Prior to wholesale & retail deregulation in the days of the regulatory compact between utility and consumer cross-subsidization between billing determinants and even between rate classes served multiple purposes.

Often, however, that cross-subsidization had unintended consequences. For example, demand costs that were much lower than the cost-to-serve that marginal capacity reduced investments in technologies that specifically mitigated peak demand. The unintended consequence was lower utility system load factors and higher capital costs to meet new peaks in the entire electric supply-chain infrastructure. In the best case, those costs became imbedded in those kilowatt-hours aggregated within the time-of-use rate blocks that were typically spread around an entire season. In the worst case, every kWh regardless of TOU or seasonality subsidized the marginal cost of every new kW added to the system peak.

In one of my first presentations on the subject 30 years ago, I used a very simple illustration (below).



Capacity & Energy:

Are all kwhs created equal?

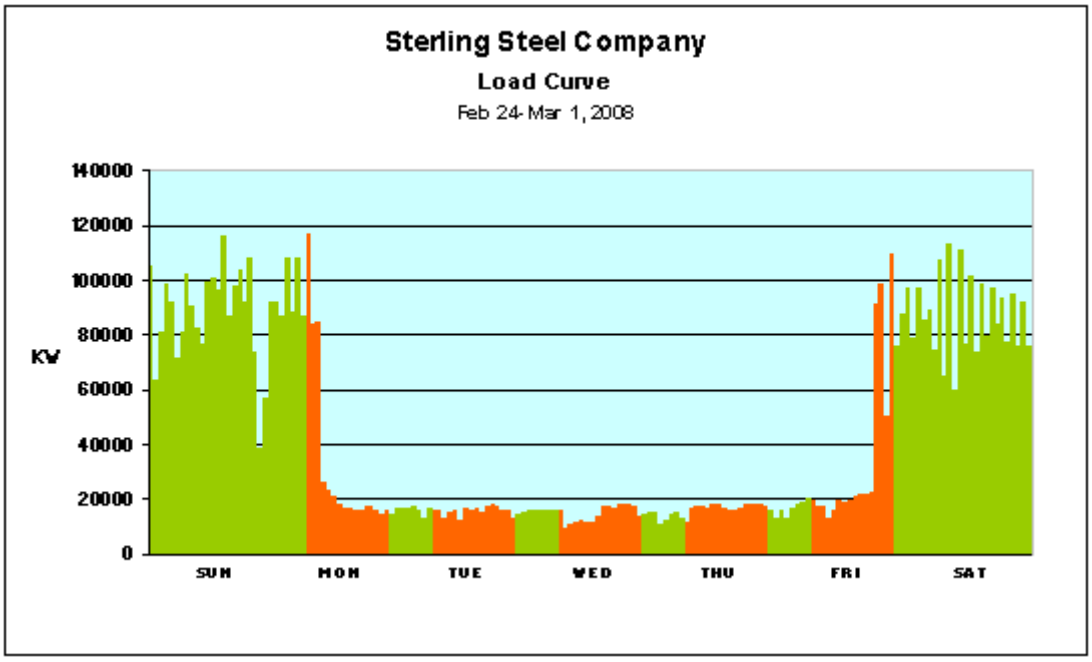
This was at a time after scale economies and thermal efficiencies of generation had peaked, after the 1973-74 Arab Oil Embargo and the subsequent run-up on fossil fuel prices and during a period of double-digit inflation. The industry had to

move beyond bundled rates to pricing structures that more accurately reflected the true cost-of-service.

Fast forward to present day. Improvements in technology and communications provide real-time access to behind-the-meter energy usage and the supply-side marketplace. Deregulation is producing transparency in the market where the argument can be made that the bundled energy and capacity pricing construct accurately reflects the cost-of-service on a real-time basis. We have all witnessed the volatility in the various markets as a result of the supply-demand dynamic.

Unfortunately, hourly price volatility provides too short a time horizon for capacity to be valued in such a way as to produce adequate incentives for supply-side investments and demand-side management.

I'll use Sterling Steel as a case-in-point. I had mentioned that Sterling operates a 24x7 15-MW rolling mill and an 85-mW electric arc furnace that operates primarily on weekends.



The EAF weekend operation takes advantage of the lower hourly prices behind PJM. The load curve illustrates a typical week where the EAF is brought on-line after 6:00 p.m. on Friday and is taken off-line on Monday morning. Recent business demand has necessitated that we extend the EAF operation until Tuesday morning. The difference in energy prices during the peak 5x16 hours on Monday is not great enough to justify maintaining the weekends-only operating schedule.

However, the RPM provides a sufficient price signal to plan around PJM peaks. If Sterling was located 75 miles to the south behind MISO, we'd absorb the differences in energy price and extend weekend operations without regard to system peaking conditions potentially contributing to new peaks and/or affecting the integrity of system reliability.

Additionally, the RPM has provided the necessary price incentive to review our 24x7 sourcing strategy for the rolling mill. For example, we are currently reviewing a renewable source that would supply 10 mW of base load. Of particular interest in this product is that it includes capacity as well as energy. Again, in a typically energy-only construct we would maintain our present strategy of sourcing base load energy-only hedges.

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

Just a few parting comments. In the absence of capacity markets, load serving entities (LSEs) have difficulty valuing capacity. Prior to the emergence of

capacity markets LSEs tended to under-value capacity thus restraining supply & demand-side investments. We commend the FERC for its role in shaping capacity markets and we encourage the Commission to promote more transparent long-term forward capacity markets that would increase supply and demand-side investments. Thank you, again, for the opportunity to share our perspective.