

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

PJM Interconnection, L.L.C.,

Docket No. EL05-148-000
Docket No. ER05-1410-000

PREPARED STATEMENT OF ANDREW TUBBS
ON BEHALF OF THE PENNSYLVANIA PUBLIC UTILITY COMMISSION
February 3, 2006

My name is Andrew S. Tubbs, Energy Counsel to Pennsylvania Public Utility Commissioner Kim Pizzingrilli. Today I have been asked to offer these remarks on behalf of the Pennsylvania Public Utility Commission. Initially, the Pennsylvania Commission would like to commend the FERC for holding today's conference as a part of its continuing efforts to facilitate a resolution on this complex and important topic.

The reason that Congress created a competitive wholesale energy market in the United States through the Energy Policy Act of 1992, and that the Pennsylvania Legislature created a retail energy market in the Commonwealth through the Electricity Generation Customer Choice and Competition Act in 1996, was to capture the benefits of competition and economic efficiency that had not been achieved through traditional regulation. The transition from the former regulatory paradigms to competitive wholesale and retail markets is undeniably a "work in progress" as we continue to discuss the appropriate wholesale market structure and many retail markets remain under transitional competitive models. As regulators, we must look at the big picture and ask ourselves how the Reliability Pricing Model fits into the goals established by Congress and the Pennsylvania legislature to create competitive wholesale and retail markets.

To achieve workable competitive markets – suppliers and consumers must have a means in which to reach each other via competitive market prices that represent the collective judgment of a marketplace free from abuse and provide the economic information necessary for suppliers and consumers to make future plans for new and existing capacity, transmission and energy efficiency investment. Regulators must ensure that the market structures are in place to allow suppliers and consumers to respond to each other while remaining vigilant to avoid market abuse and to ensure that the notion of just and reasonable rates is not lost in the transition.

The PJM "Reliability Pricing Model" proposal purports to resolve localized reliability concerns in regions of PJM. However, we remain concerned that the

administrative nature of RPM, its proposed centralized forward procurement capacity obligation and variable resource requirement, may become such an embedded feature of PJM's market design that it compromises the long-term goal of establishing reliable, efficient and competitive wholesale electricity markets.

RPM was initially proposed by PJM in a white paper presented to the PJM Market Implementation Committee on June 30, 2004 to address specific developing generation inadequacies in certain portions of New Jersey and the Delmarva Peninsula. Since then, the proposal has evolved as PJM has sought to address a number of stakeholder criticisms and incorporate additional features to address unresolved market design issues such as load response participation and market monitoring rules. There is a concern that this complex and costly centralized auction model with its heavy reliance on RTO cost supervision and price mitigation will turn into a permanent "interim" solution. However, RPM may not successfully create investment incentives for new generation, transmission and demand response initiatives where they are needed. Theory does not always completely predict actual behavior, as forecasted high LMP prices in New Jersey have yet to result in substantial new generation investment in that region. It remains unclear from PJM's filing how its RPM model will serve as an interim solution on the road to a competitive wholesale energy market, rather than a permanent one.

Capacity pricing mechanisms are not a fundamental element of wholesale market design – in PJM, they were initially designed to allocate generation investment responsibility among a handful of vertically integrated monopolies. Presenters at the June 16, 2005 Technical Conference¹ offered a variety of reasons why they supported or opposed RPM, but generally agreed that RPM is an artificial construct engendered by other inadequacies in the current PJM market design.

Proponents of RPM seem to state that the existing bid-capped energy market with inadequate demand response is a given that cannot or should not be changed, and that the primary problem to be solved is that some peaking generation resources have been losing revenue over the last several years. They suggest that some increased assurance of a stream of revenue over a future period is worth more than revenues from the current unforced capacity obligation and will result in increased investment, reduced generation retirements and some increased level of generation and system reliability. Proponents have repeatedly cited the need for increased certainty about what market rules will be in effect.

Opponents of RPM point out the costliness of RPM, the artificial nature of the RPM centralized market, the susceptibility of capacity markets to exercise of market power, the transfer of investment risk from generation owners to energy consumers and the difficulty that load will have in bidding into the RPM market on the same footing as generation.

It appears that both sides agree that capacity markets are, in essence, a substitute for a well designed wholesale generation market that operates the same way that all other

¹ *Capacity Markets in the PJM Region*; Docket No. PL05-7 (2005).

competitive markets do – through competitive supply and demand. As PJM Market Monitor Joseph Bowring testified on June 16th:

In an energy-only market, investment incentives derive from scarcity pricing, which occur, obviously, when the market is short. In a capacity market, those incentives, those same incentives, really, effectively the same dollars, are captured in capacity prices. They're really substitutes for one another, and the relationship between the two must be remembered.

(PL05-7, Hearing of June 16, 2005, Tr. 7)

The Pennsylvania Public Utility Commission has filed a protest in this proceeding, and has asked for hearings to fully examine the difficult issues that this filing presents. We have done so not because we are necessarily an opponent of a change to the existing capacity construct, but because of our serious concerns that implementation of RPM, as currently proposed may stall continued improvement of competitive wholesale markets, efficient transmission grids and robust demand response. While we must and do value system reliability very highly and have concerns about generation and transmission investment in particular geographic locations within the PJM footprint, it should be noted that PJM as a whole is relatively generation rich.

We also agree that the wholesale markets have, in the recent past, seen a high degree of “rules turbulence”, as the national debate on market development has continued. To the extent that RPM would provide some market rule stability, it would provide a benefit to generation investment, but that would be true of almost any proposal to modify the existing PJM capacity construct. Whatever wholesale market redesign results from this proceeding is likely to be in effect for a very long time.

If RPM is as seriously flawed as its detractors suggest, we will be living with those flaws for a decade or more.

Thus far, PJM has focused primarily on obtaining approval for this specific proposal under Section 205 and 206 of the Federal Power Act and has urged that your Commission approve the heart of the RPM design without hearing. PJM has not discussed or proposed any roadmap for where market design should go *after* RPM.

Avoiding the “day after” issues may be tactically prudent, but also may be a strategic error. It is worth noting that while New York has implemented a capacity market redesign, New York’s generation capacity inadequacies have not noticeably improved. The Neptune Project, a proposed 64 mile long undersea transmission line to bring power from New Jersey (which is itself running short of generation capacity) to generation-poor Long Island is evidence that whatever the merits of that capacity market, New York still has serious localized generation capacity and generation investment issues that are not being adequately addressed internally.

What should not be lost in this proceeding is an opportunity to seriously think about and plan for the wholesale energy markets of our future, when generation *and* transmission *and* demand response can participate freely and transparently in setting equilibrium prices and when technology to unlock new efficiencies in energy production and consumption emerges from the laboratory to everyday use. While PJM has made a tremendous effort to shepherd this proposal through the stakeholder process and seek consensus, it is apparent from the tenor of the comments supporting and opposing RPM that there is no consensus.

Unquestionably, PJM has served a vital role in the establishment of competitive wholesale and retail markets in our region. The Pennsylvania Commission values the working relationship it has with PJM and is confident that through our association with PJM and the efforts of other stakeholders our markets will move forward. Therefore, we commend them for moving the debate forward on the future capacity construct in PJM but an “exit ramp” for the future is needed and we emphasize that the capacity market/generation incentives issue is only one component of our markets. Concentrating on only the problems in the capacity market without addressing the other components of the market simultaneously seems inefficient and an ineffective means to address the future of wholesale energy markets.

If this proceeding is to set the pattern for wholesale market design in other parts of the United States, we should have some idea what comes afterwards. At a minimum, any modification to the existing capacity construct should include a clear roadmap and commitment to implement mature market design that fully delivers the economic efficiencies, market transparency, robustness and reliability that competitive wholesale markets have promised.