

July 25, 2008

Sent via Email and First Class Mail

New Jersey Board of Public Utilities
Office of Policy and Planning
Attention: Draft EMP Comments
Two Gateway Center
Newark, New Jersey 07102

Attached please find the comments of the PJM Power Providers Group (P3) regarding the April 17, 2008 Draft New Jersey Energy Master Plan.

Respectfully submitted,

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Comments of the PJM Power Providers Group regarding the New Jersey Energy Master Plan

On behalf of the PJM Power Providers Group (“P3”), thank you for the opportunity to submit comments in response to the April 17, 2008 draft New Jersey Energy Master Plan (“NJ EMP”). P3 is a non-profit organization dedicated to advancing federal, state and regional policies that promote properly designed and well-functioning electricity markets in the PJM region.¹ Combined, P3 members own nearly 74,000 megawatts of power and over 51,000 miles of transmission lines in the PJM region, serve nearly 12.2 million customers and employ over 55,000 people in the 14-state PJM region. P3 members are active market participants in the New Jersey market and are well positioned to assist in the effort to bring reliable, competitively-priced power to the consumers of New Jersey.

Over the long term, P3 firmly believes that properly designed and well functioning wholesale markets will provide the most effective means of giving New Jersey consumers access to a reliable supply of power at the lowest available costs. Indeed, there may be bumps in the road, and it may take time for the market to mature, but consumers will be best served in the long run by a market that relies on competition, not regulation.

The Governor and the Board of Public Utilities (“BPU”) are appropriately concerned about ensuring an adequate supply of power for New Jersey’s consumers. Being a net importer of electricity, New Jersey will require new generation, new transmission and additional demand response if it is to meet the needs of its consumers. A competitive market, with accurate and transparent price signals, will allow these investments to occur in an economically efficient and rational manner that will serve New Jersey’s consumers’ long-term interests.

Price Increases Are Everywhere, Not Just in New Jersey

The draft EMP appropriately observes that electricity prices are rising with no apparent end in sight. Not surprisingly, prices are increasing throughout the country, not just in New Jersey. As reported by the Federal Energy Regulatory Commission (“FERC”), forward market prices for electric power are higher than last year. The two main factors for this are well known -- increased fuel costs and increased costs for new construction.²

¹ The views expressed in these comments are those of the PJM Power Providers Group and do not necessarily reflect the views on any individual P3 member on any individual issue. For more information on the P3 Group visit: www.p3powergroup.com.

² See: <http://www.ferc.gov/legal/staff-reports/06-19-08-cost-electric.pdf>

Further, as FERC reported on June 19, 2008, “higher fuel prices, increased capital costs and continued uncertainty about climate policy are helping fuel the rising costs of electricity faced by consumers across the country.”³ In virtually every region of the country forward market prices have increased. FERC reported substantial increases in Midwest ISO, Massachusetts Hub, New York City, PJM Western Hub, Henry Hub, Palo Verde, Southern California, and Northwest. FERC noted that current increases may be the beginning of significantly higher power prices that will last for years. While both natural gas and coal prices have increased rapidly, natural gas is increasingly important in every region of the country. FERC notes that even in regions where coal has historically dominated, natural gas usage has grown substantially since 2000.

Additionally, FERC notes that there are legitimate reasons to be unsure about exactly how much new generation the country will need in the coming years. Higher prices will discourage some power demand. However, a significant level of demand increase seems virtually inevitable, resulting in the need to build more capacity. FERC notes that the need for new generation is particularly important because new construction itself is becoming more expensive, aside from fuel price increases. New construction costs are increasing because of rising primary construction costs (e.g., iron, steel, and cement), secondary construction costs (e.g., copper, nickel, zinc, and aluminum) and increased labor costs.

Benefits of New Jersey as Part of a Regional Market

Fortunately, New Jersey is, as the NJ EMP correctly states, part of a regional market -- PJM Interconnection, LLC (“PJM”). The PJM market allows New Jersey to access resources in 13 other states to help meet the needs of New Jersey consumers. The PJM marketplace helps New Jersey meet its reliability needs by providing access to a pool of over 160,000 megawatts. A healthy installed reserve margin allows New Jersey to draw on out-of-state generation during times of high demand. Absent the regional reliability benefits, New Jersey, standing alone, would require a greater reserve margin to accommodate in-state generation or transmission contingencies which ultimately New Jersey ratepayers would need to pay for.

Beyond the reliability benefits, regional markets promote the development of renewable resources in New Jersey, the rest of the PJM region and throughout the country. Indeed, the Board of Directors of the American Wind Energy Association issued a resolution in January of 2008 strongly supporting “the preservation and expansion of competitive regional wholesale electricity markets.”⁴

New Jersey commendably has already enacted very aggressive renewable goals within its Renewable Portfolio Standard (“RPS”) and the draft EMP suggests moving even beyond the current lofty goals. P3 encourages New Jersey to continue to pursue a diversified portfolio of

³ See: <http://www.ferc.gov/news/news-releases/2008/2008-2/06-19-08-A-3.asp>

⁴ See: http://www.awea.org/newsroom/pdf/AWEA_Board_Resolution_on_Wholesale_Electricity_Markets.pdf

energy sources that includes a reasonably attainable and cost-effective RPS, as well as the necessary traditional energy sources.

The ability to meet these aggressive renewable energy goals is enhanced by being part of a broader regional marketplace like PJM. Organized, wholesale electricity markets provide ready access for generation developers, and also provide for beneficial competitive market conditions and economies of scale for consumers. All these activities exist in an open market and in the context of an open governance system, one which provides a responsive process to improve market design and accommodate new technologies.⁵

The result of a well designed market and well designed energy policy is the willingness of capital markets to invest in New Jersey and neighboring states, thus providing the consumer the benefit of a competitive market while mitigating the consumer's risk in these markets. Put simply, developers assume the risk, not consumers.

PJM's Reliability Pricing Model Provides A Market-Based Approach to Promote Adequate Power Supply

The PJM market has a built-in mechanism to insure that an adequate supply of power is available to meet the needs of New Jersey consumers. The Reliability Pricing Model ("RPM") is PJM's newly-instituted capacity market construct, which is specifically designed to encourage generation, transmission and demand response in the locations where it is needed most. Although RPM has been in effect for slightly over one year, there is every reason to believe that it will lead to the necessary investments in new resources.

Indeed, it is not a question of waiting for the market to work – it already is. A recent independent study by the Brattle Group found strong evidence to support this conclusion. The report specifically noted that the five base capacity auctions to date in PJM "have been successful in achieving the stated reliability and economic objectives of RPM."⁶ Among the Brattle Group's findings were:

- To date, under RPM, over 14,500 megawatts (MW) of resources that likely would not have been available in the absence of RPM have been created. Of this, at least 4,600 MW is capacity that has been retained that otherwise would have been retired; and
- RPM has helped to retain over 20,000 of other existing resources that likely would not be financially viable in the absence of capacity payments.

While P3 submits that it is too early to declare RPM an unqualified success, calls to end RPM are certainly premature and not a productive signal to those looking to invest in New Jersey and the PJM region – especially considering the positive response to RPM to date. Legal

⁵ See: http://www.isorto.org/atf/cf/%7B5B4E85C6-7EAC-40A0-8DC3-003829518EBD%7D/IRC_Renewables_Report_101607_final.pdf

⁶ <http://www.brattlegroup.com/documents/UploadLibrary/Upload696.pdf> at 2

challenges to RPM, particularly at this early stage, thwart the regulatory certainty that investors demand. Instead, New Jersey should focus its resources on the surgical changes that PJM can deploy to further improve RPM.

Capacity markets are a critical element of a well designed wholesale market and, as FERC Chairman Joseph Kelliher has stated, the early results of RPM are “encouraging.” While solutions to the capacity challenge are not easy, RPM appears to be functioning in a manner that meets the goal of any capacity market – providing adequate support for infrastructure investments to insure a reliable grid. Now is not the time to retreat from this critical mission.

Response to Action Items

P3 supports the action items as stated in the NJ EMP that reduce demand and improve efficiency. New Jersey consumers as well as the nation benefit from common sense conservation.

However, P3 does not believe the most effective or efficient way to meet the worthy goals as put forth by the NJ EMP would be to develop a New Jersey public power authority to influence the development of the infrastructure. The current market has shown that inroads have been made when allowing market forces to create incentives for energy providers. The market forces have in fact yielded results. Although this has taken and will take more time, examples such as the ones noted above reveal that such market forces are in fact working.

Risks Associated With A New State Regulatory Authority

While P3 applauds the State of New Jersey for its well intentioned interests, the involvement of state government as a dominant participant in the marketplace will only heighten regulatory uncertainty, chill private sector investment, and cast doubt on the viability of competitive markets. Involving state government via a public power authority is a high-stakes policy gamble – one experienced by other states -- which the New Jersey policymakers would be wise to avoid. State regulatory authorities have the potential to increase the price of energy, stifle investment, and compromise system reliability – the very items which the state of New Jersey is in fact trying to promote. Additionally, the financial burden New Jersey energy customers face today could be dwarfed by the commitments associated with a state government agency overseeing certain aspects of power generation, construction, operations and transmission.

Most states have found that power authorities have been costly experiments without a corresponding yield in consumer benefit. For example, the Tennessee Valley Authority, Bonneville Power Authority, New York Power Authority, Long Island Power Authority, and the Vermont Public Power Supply Authority have all changed over the years from their stated

purposes, now require significant oversight, and have proved costly to taxpayers.⁷ While some state power authorities do have the benefit of having access to low-cost financing and bonds through guaranteed taxpayer backing, in all other respects they face the same challenges as private entities investing in the energy industry. It is questionable whether government can improve upon the private sector approach and it unquestionably saddles ratepayers with significant price risk.

As New Jersey looks ahead to its energy challenges, a variety of policy tools should be examined. In this examination, it is important to keep in mind that there is no silver bullet that will easily and painlessly solve all the challenges of infrastructure needs, growing demand and costs, environmental considerations and all the related energy policy issues. New Jersey should avoid creating a power authority that constructs, owns or operates generation resources, as this is fraught with risk and should not be considered an answer to the significant energy policy challenges ahead for New Jersey.

BGS Process

As P3 noted in its July 2, 2007 letter to the BPU, P3 urges the BPU to continue using the existing Basic Generation Service (“BGS”) process and procedures, as the results have consistently provided New Jersey consumers with competitively priced wholesale full requirements services since the auction’s inception in 2002.⁸ The BGS procurement has been efficient, market responsive and non-discriminatory. Both the Board and the State should be proud of the national model that it has become.

The BPU’s independent advisory overseer on the auction process, Boston Pacific, concluded that: “(a) the Auctions were fair and transparent; (b) the Auctions were robustly competitive; and (c) the winning prices were consistent with market conditions.”⁹ Furthermore, FERC has found the BGS descending clock auction meets the *EDGAR* standards, allowing affiliates of New Jersey electric distribution companies to participate in the auction as well, insuring a large number of participants to guarantee competitive results.¹⁰ Therefore, FERC has concluded that the BGS Auction satisfies the following criteria:

- a. Transparency: The competitive solicitation process should be open and fair.
- b. Definition: The product or products sought through the competitive solicitation should be precisely defined.

⁷ See: <http://www.p3powergroup.com/sitecontent.cfm?page=pressdetail&id=337>

⁸ See: <http://www.p3powergroup.com/sitecontent.cfm?page=pressdetail&id=323>

⁹ Final Report on the 2007 BGS FP and CIEP Auctions and the RECO Swap RFP under NJ BPU Docket No. EO06020119, prepared by Boston Pacific Company, Inc.

¹⁰ In *Allegheny Energy’s Supply Company*, 108 FERC ¶61,082 (2004), *inter alia*, the Commission provided guidance as to the standards it will employ to review market-based rate sales to affiliates resulting from a “Request For Proposals” acquisition process. The standards enunciated in *Allegheny Energy* are based on the principles announced earlier in *Boston Edison Co., Re: Edgar Electric Energy Co.*, 55 FERC ¶61,382 (1999) (“*Edgar*”).

- c. Evaluation: Evaluation criteria should be standardized and applied equally to all bids and bidders.
- d. Oversight: An independent third-party should design the solicitation, administer bidding and evaluate bids prior to the Company's selection.

The annual review and discussion on the BGS auction with the intention of continuous improvement is a model that must continue and further demonstrates New Jersey's commitment to a competitive procurement process that successfully creates a competitive result and benefits the consumer.

The BPU's commitment to ensuring the efficient market responsive and nondiscriminatory nature of the auction has given suppliers great confidence in the auction process. This confidence has reduced concerns associated with the risk of participating in the BGS process. This reduction in perceived risk is inherently reflected in supplier offers as consumers reap the benefits of competitive prices. The BPU should be commended for its oversight, and because the auction process has been so consistently successful, the BGS process should be continued in 2009 and beyond.

Conclusion

P3 appreciates this opportunity to comment on the draft Energy Master Plan and again commends New Jersey for this comprehensive effort. P3 supports the vision of the EMP of providing a reliable supply of energy in New Jersey's homes and businesses at competitive prices and in an environmentally responsible manner. P3 looks forward to working with New Jersey as it implements the recommendations of the Plan.