COMMENTS OF PJM INDUSTRIAL CUSTOMER COALITION, ILLINOIS INDUSTRIAL ENERGY CONSUMERS, INDUSTRIAL ENERGY CONSUMERS OF PENNSYLVANIA, INDUSTRIAL ENERGY USERS-OHIO, AND WEST VIRGINIA ENERGY USERS GROUP

RELIABILITY PRICING MODEL – DOCKET NOS. ER05-1410-000 AND EL05-148-000
FEBRUARY 3, 2006 TECHNICAL CONFERENCE

Good afternoon. My name is Bob Weishaar. My colleagues at McNees Wallace & Nurick and I have the privilege of serving as counsel to the PJM Industrial Customer Coalition. The comments I offer today are on their behalf and on behalf of other industrial groups that joined in PJMICC's initial protest in these dockets. Thank you for the opportunity to share our views.

As stated in our protest, industrial and large commercial customers are gravely concerned that the RPM proposal will result in significant wealth transfers from customers and their shareholders to power suppliers and their shareholders, with little or no assurance that another layer of administratively determined revenue will produce an economically and operationally optimal mix of system resources. Large customers' perspective is that investing in RPM is throwing good money after bad.

This panel, of course, has been focused on determining whether PJM's proposal would provide for just and reasonable wholesale power prices at levels that provide for adequate reliability or, alternatively, whether changes must be made to the proposal. Our short answer is that the RPM proposal is so conceptually flawed that, even with modest modifications, it will not produce just and reasonable wholesale power prices or provide reasonable assurances of resource adequacy.

Industrial customers and other industry segments have been grappling at least since 1996 with development of a true market-based approach, or at least a nominal market-based approach, to resource adequacy. And, to date, no alternatives have been able to strike the careful balance between providing sufficient revenue to maintain the economic viability of needed generation and preventing undue enrichment – via large amounts of inframarginal revenue - to certain types of generators. Under the current structure, for example, utility-affiliated generation owners have generally been very profitable because ratepayers are paying inframarginal revenue to those units, after having already paid billions of dollars for the capital costs of those units via depreciation and stranded cost payments. Overlaying untested wholesale market designs that do not take into account this situation necessarily leads to unjust and unreasonable outcomes.

The RPM proposal is yet another revenue overlay on a structure that is not providing customers the optimal return on their monthly bill investments. The suggested market-based solutions are plentiful and large customers have seen them all, each supported by a different school of economics. The theorists are not on the same page as to a reasonable market-based approach to resource adequacy. And, after 10 years of in-the-trenches grappling with these issues, one is left to wonder whether a centralized market approach to generation resource adequacy is even possible in an industry that is both capital-intensive and politically sensitive. One is left to wonder also whether the extraordinary expenditure of customer and supplier resources toward developing a central market approach to generation resource adequacy should be treated as an accounting write-off, while the industry redoubles its efforts toward more pragmatic alternatives. Large customers suggest this may be the next prudent step.

Although large customers have submitted PhD-backed affidavits, the comments here today operate from a more practical perspective. Large customers need to budget electricity expenditures year-to-year. They need to ensure that their capital investment is not undermined by unpredictable electricity prices or, worse, the unavailability of energy. For this reason, some manufacturers have begun to flee RTO-market regions in favor of regions where electricity supply is stable, capital investment in generation occurs systematically, generation and transmission are planned together, and ratepayers pay the actual cost of each of these components. These are present-day realities. Some may claim that this ultimate form of demand response is economically rational; large customers view it as an overwhelming signal that the current approach to pricing electricity is broken.

Industrial Customers' primary concerns with RPM, as it has been proposed and as identified in Industrial Customers' pleadings, are the following:

1. RPM aggravates the existing problem of severely overcompensating many existing generation resources without any return or benefit to consumers for that overcompensation.

2. RPM relies only on guaranteed payments to generators to ensure resource adequacy. RPM operates on the same concepts – locational payments and marginal clearing prices – with no assurances that this additional layer of revenue will cure problems that LMP was unable to cure. System operators are left stabbing in the dark with wads of customer money.

3. RPM's proposed planning horizons will preclude meaningful demand resource participation.

4. RPM's centralized approach to resource adequacy will hamper bilateral contracting, much like LMP has hampered long-term bilateral contracting in the energy market.

5. A demand curve is an administrative approach to resource adequacy price formation that has been proven to be capable of forming prices, but has not been proven to be capable of achieving resource adequacy objectives. If the only answer to resource adequacy is to vest such administrative discretion in a central coordinator, then the central coordinator should be given authority to ensure that resource adequacy objectives actually materialize.

6. If it is determined that the existing LMP energy payments are inadequate incentive to make long-term investments, any alternative approach that provides guaranteed payments to mitigate perceived risk of capacity recovery should be linked with an obligation to supply energy from units receiving such payments at actual marginal cost, to prevent excessive returns for units receiving these payments.

In short, the RPM proposal is, itself, an admission that what we have conveniently come to call "markets" or "competition" is wildly missing the target that we associate with efficient markets and the dynamic forces of competition – that is, lower prices, innovation, and better service. Instead of a structure and system that provide a foundation for private capital to come forward, take risks, and offer positive solutions to problems, we have compensation systems and cultures that produce bounties for supply-side scarcity and price volatility, and negative intervention in the form of curtailment. The value that customers were told to expect from competition has been stranded, after customers themselves paid billions for "stranded costs" demanded as the price of gaining access to the benefits of competition. If we have learned anything since FERC found 10 years ago that the structure of the electric industry is inherently anticompetitive, it is that the dynamic forces of competition do not rise to serve the public interest simply when competition is presumed to exist or administratively determined wealth transfers (in the form of RPM or otherwise) are centrally directed.

RPM is not a proposal derived from a root cause analysis of fundamental problems, some of which can be connected to our Nation's inability to address the imbalance between supply and demand for natural gas. Only by coincidence will RPM do anything more than raise administratively determined rates significantly and provide more reason for the public to increase its well-justified doubt about the ability of electricity "markets" to promote and serve the public interest. The debate here today may be focused on a proposal known as RPM, but the discussion really begs the larger question. We – speaking on behalf of the folks who pay the bills and provide jobs – urge the Commission to recognize that there are much larger issues than the relative health of the ICAP piece of the equation and turn all attention to those larger issues. In the meantime, and as a concession to reality, RPM ought to be put back on the shelf.

Thank you again for the opportunity to share with you the perspectives of PJM's largest customers.