



**NEW JERSEY BOARD OF PUBLIC UTILITIES
I/M/O THE BOARD'S INVESTIGATION OF CAPACITY PROCUREMENT AND
TRANSMISSION PLANNING – DOCKET NO. EO11050309**

**REPLY COMMENTS
OF HESS CORPORATION**

Hess Corporation (“Hess”) submits these Reply Comments in the above-referenced proceeding before the New Jersey Board of Public Utilities (“Board” or “NJBPU”). As with our initial Comments¹ in this matter, Hess submits these Reply Comments from the perspective of a market participant seeking to build merchant generation in the State of New Jersey, having the financial wherewithal to commit to invest in new generation in New Jersey, and facing problems and obstacles that the Board is seeking to uncover and remedy in this proceeding. Hess appreciates the opportunity to offer these reply comments in response to the initial comments and testimony provided by the other stakeholders in this proceeding.

At this point in this LCAPP investigation proceeding, two irrefutable facts are extremely clear – minimal new generation has been constructed in New Jersey in recent history and the State can and must act to remedy this problem. While several stakeholders debate whether the State can or should appropriately take action, Hess submits that the time for continued debate on this subject has long since passed and now is the time for the State to act on behalf of its citizens to correct this grave problem. Indeed, the State has reached a crossroads with respect to solving the very real problem of its long-term electricity needs and does have within its powers and jurisdiction the ability to take clear actions that will provide tangible benefits to New Jersey ratepayers.

¹ *I/M/O The Board's Investigation of Capacity Procurement and Transmission Planning*, Docket No. EO11050309, “Comments by John Schultz, Vice President On Behalf of Hess Corporation” (June 17, 2011) (“Comments”).

Over the short and long term these solutions take different forms, and carry varying degrees of difficulty. In the short term, the State has some tough decisions to make in order to realize the benefit of the three SOCA contract awards. Long term strategies require the State to assume a more active and decisive role on factors influencing the merchant generation markets. As set forth below, these Reply Comments address these short and long term problems, the solutions that are within the State's control and discretion as well as how the State can best develop action plans accordingly.

Benefit of the LCAPP Bargain

PJM and its Independent Market Monitor ("IMM") each testified that the Reliability Pricing Model ("RPM") and the Interconnection Process present significant hurdles for new generation. The recently released Draft Energy Master Plan of the State of New Jersey explains that the State has its own "environmental, economic, and reliability goals....[which] include job creation and employment." (EMP at 14). Because PJM's capacity market was not designed to address New Jersey specific environmental and economic goals, and there are acknowledged and uncorrected problems with the PJM markets, LCAPP was the best short term measure available to the State to accomplish its goals.

Completing the LCAPP process and bringing these plants on-line will fulfill most of the Energy Master Plan's and LCAPP's objectives of job creation, increased tax revenues, long term reliability in New Jersey from more efficient and environmentally friendly generation resources, and a reduction in energy prices. As set forth by Hess in its Comments, the new cleaner LCAPP generation units are not likely to clear the RPM auctions until the older, dirtier and less efficient units are scheduled for retirement and not bid into the RPM auctions. As directly stated by the PJM Independent Market Monitor (IMM), "[I]f New Jersey decides that they want certain older units to shut down for environmental reasons, New Jersey should take actions which will directly produce that result." (IMM at 6). New Jersey has initiated those actions, but now must follow through on them as follows.

NJ NO_x Regulations

In 2009, the New Jersey Department of Environmental Protection (NJDEP) adopted new rules and amendments for the Reasonably Available Control Technology (RACT) regulations for Nitrogen Oxides (NO_x) under N.J.A.C. 7:27-19 (“NO_x Regulations”) which were designed to reduce emissions of NO_x with a focus on tightening the emission standards for High Electric Demand Day (HEDD) units. These rules, to become fully effective by April 30, 2015, are some of the tools New Jersey must use to directly achieve their desired goals while still operating within the PJM RPM construct. These rules cannot directly force retirement, but if enforced may facilitate the cleaner more efficient LCAPP units getting built and clearing the PJM RPM auctions. Unfortunately owners of impacted HEDD units can get around these more stringent emissions requirements by asking the NJDEP for waivers or delayed implementation of the regulations. These requests will be based presumably upon purported reliability concerns, creating a convenient and interesting irony.

For example, the comments submitted by the PJM Power Providers Group (“P3”)² claim “[t]here is no generation shortfall problem in New Jersey” and “[t]he notion that the lights are going to go out in New Jersey in the near future due to a lack of adequate generation is simply false.”³ Yet, the very argument the NJDEP is likely to hear from members of P3 in favor of waivers or delay of the new NO_x Regulations for their impacted units is if the State chooses to stay its course in favor of cleaner in-state generation by enforcing the regulations already on the books too much generation will retire, creating reliability problems. Reliability appears to be the trump card played when convenient for the incumbent generators, and it is in the State’s own hands to put an end to it.

² *I/M/O The Board’s Investigation of Capacity Procurement and Transmission Planning*, Docket No. EO11050309, “Comments of Glen Thomas On Behalf of the PJM Power Providers Group” (June 17, 2011) (“P3 Comments”).

³ *Id.* at 2.

The contention that these retirements will result in reliability violations is not valid when new entry is poised to replace the retired generators. Reliability is often used to justify inaction on environmental initiatives mainly by parties whose interests are compromised by the proposed regulations.. The fact that the NJDEP is considering the possibility of delayed implementation of these regulations remains troubling from the perspective of those who wish to see new, cleaner and more efficient generation constructed in New Jersey. As discussed herein, there is simply no reason for the State to compromise the health and economic considerations of its ratepayers through a possible rulemaking delaying the implementation of these regulations. The State has already taken the steps necessary to identify and contract for the newer, cleaner, more efficient and more reliable generation that will fill the void and provide even greater reliability given the significantly improved efficiencies of the LCAPP units and should stand firmly against any possible delays under a false presumption that reliability will somehow be compromised if the NJDEP enforces regulations already on the books.

What New Jersey Ratepayer Dollars Buy

In the short term if the State's actions through the LCAPP program result in new generating units replacing old inefficient combustion turbines, New Jersey will receive significant benefits, even if capacity prices do not go down. Jobs will be created from the construction and operation of some of the most efficient and environmentally friendly natural gas generation in the country. These more efficient units will result in reduced energy prices for consumers as well as additional tax revenue to the State. These benefits alone make New Jersey ratepayer investment in this policy course justified and worthwhile. In addition to these benefits, however, there are even more benefits accrued to the New Jersey ratepayer.

Specifically, New Jersey's existing generation fleet is made up of a significant amount of dirty, inefficient resources built many decades ago. One generation owner holds thirty eight Pratt Whitney FT4 units built between 1965 and 1972, over 1900 MWs, which cleared in the PJM RPM auctions. Despite the inefficiencies of these units that

rarely run, and despite their environmentally unfriendly attributes, these units generate a significant amount of revenue in the form of capacity payments for their owner. Over the eight Planning Years in which PJM's RPM has been in existence (PY 07/08 – PY 14/15) these units have and will cost consumers almost \$850 million in capacity payments. These dollars could have gone toward cleaner more efficient generation in New Jersey, but as described in our Comments, existing RPM and Interconnection Process rules favor the preservation of incumbents over new entrants.

If these dollars go to the cleaner more efficient LCAPP units, New Jersey ratepayers will not only receive a better value for their capacity dollar, but they will in fact see both reduced energy prices and improved environmental conditions. These older inefficient units run only about 5% of the time, leading not only to very high LMPs at those times, but create ozone and health problems for New Jersey residents. The high efficiency of the LCAPP units allows them to run a significantly greater amount of time, as with a baseload unit, at lower energy costs to ratepayers, and without the environmental or health hazards created by the older units. The net benefit accrued to New Jersey ratepayers, both economically and otherwise, even if capacity prices are not lowered, is wholly in their favor. New Jersey no longer needs to subsidize these older, less efficient, environmentally unfriendly units.

LCAPP, and the aforementioned NO_x Regulations, together have provided a means by which New Jersey can have a voice in the types of capacity resources to which they want their dollars going. PJM, by its own admission, is not in the business of picking winners and losers among new entrants, it simply administers RPM and the Interconnection Process. Through a competitively bid process, New Jersey has already undertaken the effort to pick some winners to provide New Jersey with the greatest benefit at the lowest cost. Parties such as the NJ EDCs argued against LCAPP, drawing parallels between LCAPP and the NUG contracts. However, they fail to acknowledge the NUG contracts did not result from a competitively bid process. The SOCA contracts resulting from the LCAPP process are set at the very definition of market prices because contracts were awarded at actual bid prices. The winning bidders are not receiving the

bid prices of other units, such as in RPM, nor are they predetermined to be a subsidy as repeatedly claimed in many of the comments submitted in this docket. As Hess previously stated, if our SOCA agreement had been in place over the past two years for the most recently cleared PJM Base Residual Auctions (BRAs), Hess would have made payments back to the State of New Jersey and its ratepayers in order to build its Newark Energy Center.

New Jersey has a clear path in front of it to realize the benefits of the deal it has made but this will require the State to remain steadfast in its stated policy goals and follow through on environmental regulations already on the books. In essence, the most important way to ensure the success of LCAPP and the State's goals does not require doing something special or new -- it just requires the State to enforce what is already law.

Long Term Solutions For New Generation

Beyond the short term need to ensure the already-awarded LCAPP units are built and cleared in PJM's RPM, there are market solutions New Jersey must focus on to facilitate the development of additional new generation over the long term. Market solutions will obviate, or limit the scope of, the need for any ongoing legislative fixes, yet still preserve the ability of the State to pursue its unique policy objectives on the types of generation it seeks within New Jersey. They will also allow, in fact foster, the coordination between the diverse, yet equally important objectives of states, the Federal government, the regional transmission operators and their stakeholders. PJM and the IMM already conceded that a state like New Jersey with broader objectives or preferences in its choice of supply is free to pursue them, through its own initiative. Indeed, with LCAPP the State began to assert such authority. In the long term however, the State should exert its authority in pursuing the following market solutions.

NEPA

A properly designed New Entrant Price Adjustment (“NEPA”) is one of the most effective solutions for incenting the development of new generation within the administrative construct of the RPM Market. PJM concedes that in RPM all generation MWs are awarded the same payment regardless of the type or quality of the source. Yet, while both new entrants and existing generation need RPM to cover costs, the drivers behind, and types of, costs each must recover vary greatly. New entrants face unique cost and financing challenges that simply cannot be met by the short and volatile price signals of RPM. As discussed at length in our Comments, the lack of a long term price signal and volatility of clearing prices year over year are a barrier to new entrants yet more than adequately allow incumbents to cover incremental costs. The NEPA mechanism in the RPM design represents an acknowledgement that the new generation entrant requires a promise of stable, long-term market returns to develop and finance a significant generation project.

The problem is that insofar as the original RPM model is a product of a regulatory settlement process between competing stakeholder interests, the number of years where NEPA is in effect (currently three) is a product of compromise. Several years ago PJM itself recognized the NEPA was ineffective in serving its purpose and pursued changes at FERC, most notably extending the term of its applicability. FERC rejected the extension, throwing up a hurdle of not wanting to create undue discrimination between new entrants and existing units. PJM has again acknowledged the need for a review of the NEPA and its effectiveness for its intended purpose, and under the recent FERC MOPR Order, PJM was directed to conduct a review of its NEPA with its stakeholders and report back in October of this year.

Just as RPM itself was predicated on providing incumbent generators the so-called, “missing money” they required to attain adequate recovery of their costs, so too NEPA is intended to provide the “missing money” that the new generation entrant requires to be economically and financially sustainable, so as to provide the market with

the new technology that it seeks. Both types of resources have the same need to cover the missing monies but due to the different costs that each must bear, it is appropriate to provide different mechanisms to achieve the same purpose. Hence a modified and properly functioning NEPA -- one that provides a longer term guarantee of revenues than currently exists AND is appropriately priced to compensate new generation -- is not discriminatory, it is necessary, and partially levels the playing field between the existing generator and the new entrant's expectation to recover its costs. On the contrary, absent redesign it is the current NEPA that discriminates against new entrants by expecting they meet their unique economic needs with the same tools afforded aged, depreciated incumbent generation.

Given the already-initiated stakeholder process on NEPA, and the FERC filing deadline of October 2011, now is the time to develop a solution to the ineffective NEPA. New Jersey must play an active role in the development of that solution, and work directly with PJM to do so. A component of the needed changes is undoubtedly a longer term than three years. If NEPA had already been properly structured with an adequate term, LCAPP may not have been needed to provide long term revenue certainty. Due to New Jersey's recent activities under LCAPP, and its review of the appropriate duration of term for SOCA contracts, New Jersey is uniquely positioned to provide input and guidance on the appropriate duration of the NEPA. We encourage New Jersey to not only directly assert to PJM its preferences in the current review NEPA and ultimate FERC filing, but to also engage its brethren in OPSI to participate as well.

Absent the availability of long-term contracts in the marketplace, the institution of a properly designed NEPA is one of the best opportunities for the RPM markets to provide the needed new entry in New Jersey, and for ultimately obviating the need for future LCAPP actions. A solution to this problem of the ineffective NEPA is the first long term solution on which New Jersey should focus its efforts with PJM

Interconnection Process

Fixing the broken PJM interconnection process is the second big long term market solution to removing barriers to new generation entry because proper price signals will not help if new units can not get connected to the system in a timely or cost appropriate manner. PJM's straightforward recitation of the problems with the interconnection process in their initial comments,⁴ combined with Hess' provided first hand experiences, provide the NJBPU with a good road map of the fixes needed to correct the overwhelming 33,000 MWs withdrawn from the active queue process. As with NEPA, there is a currently engaged PJM Interconnection Process Senior Task Force ("IPSTF") that the Board must engage itself in for the purpose of advocating changes that will directly impact the unique problems faced by New Jersey.

Cost Allocation

While the IPSTF is taking on many procedural fixes to the Interconnection Process, there are significant policy concerns currently under consideration that have a direct and significant impact on the ability of new generation to get built in the highly congested and clustered areas of New Jersey. Most notably is the issue of system upgrade costs needed to accommodate new generation and the allocation of those costs, as set forth by Hess in its Comments. In most areas of PJM, the existing cost allocation rules yield reasonable results and do not pose a significant barrier to new entry. However in constrained areas such as New Jersey, new entry is deterred where it is needed most because of high infrastructure costs and the clustering of multiple new entrants in the queue, 90% of which will not ultimately be built. Hess itself has recently proposed solutions at the IPSTF on the issue of cost allocation, and stakeholders are considering a multitude of options. It is possible that some solutions dictate different treatment for cost allocation based upon the unique circumstances of the area, such as with New Jersey,

⁴ *I/M/O The Board's Investigation of Capacity Procurement and Transmission Planning*, Docket No. EO11050309, "Comments of PJM Interconnection, LLC." (June 17, 2011) at 25-27.

therefore it is critical for the Board to play an active role in determining the resolution of this issue in the IPSTF.

Capacity Injection Rights

An additional topic being considered at the IPSTF that combines policy and procedural changes, is Capacity Injection Rights (“CIRs”). Hess discussed this issue in its initial Comments, and in the IPSTF PJM has set forth a proposed change on the disposition of CIRs. In debate of this issue at the IPSTF, PJM acknowledged that in highly congested and clustered areas such as New Jersey, CIRs can play an influential role in hampering the interconnection process, and there are fixes, in line with that suggested by PJM, that would yield significant improvement to the process yet have minimal impact on the incumbents who hold them.

Additionally there are more innovative and extreme changes to the treatment and disposition of CIRs impacting new entrant’s access to the system that would better reflect the property rights in CIRs that were largely originally paid for by ratepayers. As mentioned in our initial Comments, CIRs carry significant value, which is assigned to the incumbent generators who hold them, not the ratepayers who originally paid for them, and which discriminates against new entrants who are denied the same free access to those rights. While the ability to challenge current policy on who has a right to the CIRs would need to occur at FERC and or the courts, an argument can be made that current policy represents a *taking* of the property rights properly held by ratepayers.

Whether the moderate, yet very important, changes already presented by PJM at the IPSTF, or the more significant changes that could be considered in other forums, it is important for the NJBPU to actively engage in discussion of the solutions. Notably, the Board should interact directly with PJM on the more immediate changes at hand, given the significant impact on the interconnection process that resolution of CIRs can have on new generation projects specifically in New Jersey.

State & PJM Coordination

As stated above, PJM has clearly and appropriately indicated they are not in the position of determining or judging “winners and losers” in the interconnection process. Yet, as discussed in their initial Comments and at the IPSTF, earlier identification of the 90% of projects that will never get built is critical to speeding up the queue process and producing more timely, reliable and reasonable estimates of cost upgrades for the 10% who will move forward. It is New Jersey’s obligation to step up to the role of providing direction on the feasibility of projects. To that end, a New Jersey resource planning task force should be immediately implemented whereby the State, and its relevant permitting agencies, can work and coordinate with PJM on identifying the status of projects in queue as well as the status of current units that are not meeting environmental requirements. At this point PJM is dependent on the developers themselves to provide this information, and understandably all developers consider their projects as feasible. Objective input, based upon the status of permitting, is necessary to inform this process. Hess has proposed this solution at the IPSTF, and active engagement by the NJBPU in support would facilitate its implementation.

Transmission over Generation

With new generation entries being stymied in New Jersey due to the above shortcomings in wholesale markets and planning methods, major transmission options naturally are favored in the planning process (RTEP) to secure reliability. This is neither a preferred nor least cost market selection process where transmission competes against generation options, but a result by default. Unlike the new generation, the transmission options are guaranteed stable and adequate returns on investment through rate based, rate treatment, plus incentives from the FERC. Thus, transmission investment, economically and financially, has an unintended competitive advantage to generation investment options even though it may not always be the optimal solution to a reliability problem.

As such, and in the void of any State initiatives to correct this bias, the shortcomings in the PJM planning process are determining New Jersey's electric supply infrastructure without a thorough economic optimization or strategic direction. Given the total social cost of transmission development, including land use considerations, generation might often be the economically favorable option. Absent State intervention, strategic decisions on importing power, fuel supply, air quality and the environment, the State's power industry in general (jobs, tax base, dependence on other states) are largely pre-determined for New Jersey by the PJM planning process.

LCAPP is the State's initial attempt to correct this bias and to assert a strategic preference in NJ's electric energy supply, and must be encouraged. Long term solutions to the advantage of transmission over generation are difficult, but necessitate the coordination between state entities such as the NJBPU, on the one hand, and FERC.

RMR Contracts

When FERC first agreed to grant Reliability Must Run ("RMR") payments to would-be retiring units, it acknowledged that such a mechanism was symptomatic of a dysfunctional market. If RPM were properly attracting new entry in regions of need like New Jersey, then RMR would not exist. RMR payments are monies that should rightfully be directed toward new generation in a functioning market. The changes and enforcement options we have identified will, correct the dysfunction (disincentives for new builds), and RMRs will go away automatically. From our perspective, efforts of the State, PJM and its stakeholders are more valuably spent on correcting the dysfunction, than devising changes to RMRs. The reality that the existence of an RMR payment means that ratepayers are literally paying for PJM, on behalf of Load, to over-procure capacity, further subsidizing the older inefficient units, underscores the need to take action on the solutions identified herein. As a blemish on its market design, PJM, too, should be excited by the prospect of their elimination.

Conclusion

The State of New Jersey's primary focus should be on realization of the benefits of LCAPP by taking the actions outlined herein. While, New Jersey is at a cross-road with enforcing critical environmental regulations in order to make way for the new cleaner and more efficient units, the net benefit realized by New Jersey ratepayers is undisputed. Proper action by the State now – i.e. timely enforcement of regulations already on the books – will clear the path for New Jersey to gain the immediate benefits outlined here as well as the longer term benefits of one of the most modern and efficient generating fleets available. Additionally, the State needs to directly engage with PJM to play an active role in formulating the market solutions discussed herein. Finally, the State should consider more drastic changes if, and only if, the adequate changes on the issues identified herein fail to be adopted and implemented. Absent acceptable progress in correcting the current situation with PJM and FERC, New Jersey should consider other more significant actions that are within its control. A perpetuation of the status quo is not in the best interests of New Jersey, its citizens or the environment.