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Comments of the American Public Power Association

In the Matter of the New Jersey Board of Public Utilities Review of the State's Electric Power and Capacity Needs -Docket No. EO09110920

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Introduction

APPA is the national service organization representing the interests of the approximately 2,000 not-for-profit, publicly-owned electric utilities throughout the United States that collectively serve more than 45 million consumers. Public power systems provide over 15 percent of all kilowatt-hour (kWh) sales to ultimate customers, and provide service in every state except Hawaii. APPA member utilities are owned by the communities they serve, operate on a not-for-profit basis, and have retained the legal obligation to provide retail electric service to their customers. Since they are owned by the customers they serve and have no outside shareholders, all costs are passed through directly to the customer. Public power systems own approximately 10 percent of the nation's electric generating capacity, but purchase nearly 70 percent of the power used to serve their ultimate consumers from the wholesale market. APPA's members therefore have an abiding interest in well-functioning wholesale power-supply markets and in an adequacy of supply to meet future load.

In response to growing concerns of APPA members in RTO regions with the fundamental changes that had been made to the wholesale electricity markets, in March 2006, APPA initiated the Electric Market Reform Initiative (EMRI). There are two central components of EMRI: 1) detailed investigative studies of the restructured wholesale electricity markets; and 2) the development of proposed reforms to those markets to remedy the problems identified by our members and in the investigative studies.

The EMRI studies and the real-world experience of consumers demonstrate that the deregulated wholesale markets have produced both higher prices and higher profits¹ than one would expect in a competitive market. These additional dollars, however, have not resulted in corresponding substantial new generation investments by those receiving these revenues. Because ensuring an

¹ For the most recent analysis of the profits of owners of unregulated generation in PJM, see *2009 Financial Performance of Owners of Unregulated Generation: High Profits Earned in Restructured Wholesale Electricity Markets During the Recession*, <http://www.appanet.org/files/PDFs/2009FinancialPerformanceMay2010.pdf>

adequate supply of resources within RTO regions has been a primary focus of EMRI, APPA is submitting comments in this docket on our recommendations for reforms to both the wholesale markets and to state procurement of power from these markets.

APPA's recommendations for market reforms were presented in its Competitive Market Plan (CMP or the Plan), released in February 2009.² The goal of these reforms was to achieve just and reasonable rates for consumers, reduce opportunities for the exercise of market power, and meet future load in a reliable manner. More specifically, the reforms proposed in the Plan are designed to:

“Increase the availability of long-term bilateral power supply contracts (e.g., a 10-year term) and opportunities for LSE [Load-Serving Entity]-owned generation, in turn enhancing the viability of financing new generation and renewable energy technologies.”

Plan at 6. Although APPA is indeed concerned with high prices and profits in the restructured markets, we are as interested in ensuring a stable diverse energy supply as about just and reasonable prices. Central to the CMP is the creation of a competitive and equitable marketplace that ensures both goals are achieved. A primary means of creating such a market is to implement market reforms that would create greater opportunities and incentives for long-term bilateral contracts and ownership of generation.

There are two broad categories of generation in the wholesale markets. First are the incumbent-owned previously regulated, largely depreciated generation units which are earning revenues in excess of their costs and are the greatest beneficiaries of centrally operated energy and capacity markets. The bulk of the payments made under PJM's Reliability Pricing Model (RPM) continue to be earned by existing resources. In the 2013/14 base residual auction, out of the 142,782 MW of unforced capacity that cleared the auction, 1,737.5 MW was either new generation or upgrades (1.2%), and when deactivations and retirements are taken into account; there was a net decrease in generation.³ Including demand resources and energy efficiency, the total new resources that cleared the auction is equal to 8,548 MW or 5.6 percent of the total.⁴ The implication is that over 94 percent of the cleared resources are existing units. It therefore is likely that many of the plants that received stranded cost payments as part of state retail access legislation are also receiving capacity market payments.

At the same time, there are new and more efficient generation resources, many of which are encountering difficulties securing financing. APPA's Plan seeks to avoid the payment of undue economic rents⁵ by consumers to this first category of units while providing development opportunities for the second category.

² APPA's Competitive Market Plan: A Roadmap for Reforming Wholesale Electricity Markets, <http://www.appanet.org/files/PDFs/EMRICompetitiveMarket.pdf>

³ 2013/2014 RPM Base Residual Auction Results, PJM, June 2010, http://www.pjm.com/markets-and-operations/rpm/~/_media/markets-ops/rpm/rpm-auction-info/2013-2014-base-residual-auction-report.ashx

⁴ 2013/2014 RPM Base Residual Auction Results.

⁵ Economic rent is the difference between what a factor of production is paid and how much it would need to be paid to remain in its current use. The existence of economic rent is an indicator of market power and the absence of true competition.

Independent entities seeking to build new renewable and other forms of generation have noted the difficulties created in seeking financing for their units from a market with a short-term focus. At a January 2009 FERC technical conference on credit and capital issues, one IPP representative stated that “current terms available in organized markets, such as five-year PPAs, are simply inadequate to attract the substantial debt and equity necessary to put steel in the ground.”⁶ A developer of renewable energy projects, stressed the necessity of long-term (15-year) power purchase contracts to support the financing of renewable projects.⁷ A representative of Morgan-Stanley summed up the dilemma by saying: “I think the challenge that we have is that we’re trying to build long-term assets with short-term pricing, and that just doesn’t line up.”⁸

In July 2009, CPV Maryland filed a request with the Maryland Public Service Commission for a 20-year contract for the sale of power from a proposed natural gas plant at actual cost. CPV estimated that such a cost-based long-term contract would save ratepayers between \$150 and \$400 million in capacity costs.⁹ In comments before the state’s Public Service Commission in the resulting docket, Governor O’Malley noted that “long-term power purchase agreements or construction contracts for new, renewable generation would help reduce price volatility, expand generation capacity and accelerate the transition to a more diverse and sustainable energy future.”¹⁰

Even companies with assets located primarily in regulated states are avoiding building generation in the uncertain restructured markets. At a climate conference in December, Jim Rogers the president and CEO of Duke Energy, said the complexity of trying to meet climate change challenges in a deregulated environment has made him re-evaluate his position because a regulated industry allows for more comprehensive planning. He also stated that new generation generally is being built only in regulated states, where generators have assurances that they can recover their costs.¹¹

As illustrated by these examples, there is an absence of a stable market that provides a stream of revenue to new generation developers in an uncertain financial environment. The next two sections summarize several of the primary proposals contained in the CMP that seek to remedy these barriers to new resources, while continuing to ensure just and reasonable rates for consumers.

⁶ Testimony of Bruce L. Levy, President, International Power America, Technical Conference, In the Matter of Credit and Capital Issues Affecting the Electric Power Industry, Docket Number AD09-2-000, Jan. 13, 2009. Transcript, p 32. http://elibrary.ferc.gov/idmws/file_list.asp?accession_num=20090113-4007

⁷ Testimony of Michael Polsky, President & CEO, Invenergy LLC, FERC Technical Conference, Jan. 13, 2009, Transcript, p. 38.

⁸ Testimony of Anthony Ianno, Managing Director, Morgan Stanley, FERC Technical Conference, Jan. 13, 2009, p. 50.

⁹ CPV Maryland, LLC - Motion for an Order Requiring Investor-Owned Utilities to Enter into Long-Term Contracts for the Sale of Power and Request for Expedited Treatment. Case No. 9117, July 6, 2009, http://webapp.psc.state.md.us/Intranet/Casenum/NewIndex3_VOpenFile.cfm?ServerFilePath=C:\Casenum\9100-9199\9117\207.pdf

¹⁰ Comments of Governor O’Malley, Maryland PSC Cases 9117 and 9214, December 18, 2009, http://webapp.psc.state.md.us/Intranet/Casenum/submit_new.cfm?DirPath=C:\Casenum\9200-9299\9214\Item_022&CaseN=9214\Item_022

¹¹ *Duke chief: States may need to reregulate, replace RPS with ‘low-carbon’ standards* by Glen Boshart, SNL Energy Electric Utility Report, December 14, 2009. www.snl.com Subscription required.

Wholesale Market Reforms in the CMP

Phase out capacity markets. Under the CMP, existing RTO-administered locational capacity markets, such as PJM's RPM, would be phased out and capacity would be supplied through bilateral contracts.

Reduce opportunities for supra-competitive earnings in the short-term energy market through cost-based bidding. To address possible market disincentives for generators to enter into long-term stable priced contracts, APPA is proposing that the offers to sell power into the short-term "optimization" (spot) market be limited to short-run marginal costs (with the exception of demand response). A single clearing price mechanism would remain in use.

Must-offer requirement. Generators would be subject to a must-offer requirement into the optimization market for energy not already committed under bilateral contracts or owned generation arrangements (subject to forced outages, scheduled maintenance, and special rules for limited-run units and intermittent resources).

Long-term transmission rights. RTOs would also allocate long-term transmission rights (LTTRs) to LSEs to support bilateral contracts or owned resources, with a priority for power supply arrangements of 10 years or longer. These LTTRs would be paired with LSEs' power supply arrangements developed to comply with the RTO's resource adequacy requirements and applicable state resource procurement requirements, both of which are described below.

Resource adequacy standards. Overall RTO-established resource adequacy standards applicable to all LSEs are a vitally important feature of the APPA proposal. APPA's proposal would establish a multi-state regional process to develop needed RTO-wide resource adequacy requirements under agreed-upon policy goals.¹² States would then implement procurement processes to ensure that state-regulated investor-owned utility (IOU) LSEs obtain a diversified portfolio of power supply and demand-side resources of varying lengths and terms that will assist in meeting the RTO-wide resource adequacy requirements.¹³ This recommended state procurement process is an important part of the CMP and is described in greater in the next section of these comments.

Recommendations for States

These needed reforms to the wholesale markets under federal jurisdiction cannot be accomplished without parallel changes to state policies. The CMP therefore recommends that states implement procurement processes for standard offer service load in which the investor-owned utilities would obtain a diversified portfolio of power supply and demand-side resources

¹² Generation adequacy requirements traditionally have been the purview of state utility regulators and Regional Reliability Councils. An increased RTO/federal role would require coordination and cooperation among state regulators, RTOs, and FERC in establishing and approving regional resource adequacy plans.

¹³ Public power utilities in RTO regions, because they have retained their obligation to serve retail customers, already develop and implement such resource adequacy plans, under the supervision of their local governing bodies. APPA's plan would continuation of public power resource procurement under their own plans, unless they choose to opt into a larger state procurement process.

of varying lengths and terms, including long-term contracts of 10-15 years. (This recommendation is similar to LS Power's proposal for a third BGS for the procurement of longer term contracts of 15 years for new, efficient, in-state generation of 100 MW or larger.)

RTO-run centralized wholesale markets support the power purchases that incumbent IOU LSEs in retail access states make to support standard offer service (SOS). SOS is typically purchased through state-run auctions for relatively short-term contracts (such as the three-year contract length for residential and small business customers in New Jersey). The prices in these contracts generally incorporate generation prices based on the spot prices set in RTO markets with the addition of ancillary, capacity, and transmission costs, plus multiple risk premiums.¹⁴

APPA's Plan strongly recommends that state commissions establish competitive power supply procurement processes to develop diversified resource portfolios for incumbent IOU LSEs, with a significant portion of their power supplies being obtained under longer-term contracts or owned-generation arrangements. This recommendation is critical because such changes could provide much needed price discipline in RTO-run centralized markets, as well as a steady revenue stream to support construction of new generation resources and investment in demand response resources.

As part of such an improved SOS power supply procurement process, retail access states should allow their incumbent IOU LSEs to consider "self-builds" as generation resource options. In many retail choice states, incumbent LSEs are currently prohibited from building new generation (except through an unregulated affiliate), even though they still bear responsibility for providing SOS service. The availability of self-build options brings additional competitive discipline to bear on third-party suppliers submitting generation supply offers in power supply procurements. Of course, sufficient safeguards would need to be included in the resource selection process to ensure that third-party suppliers get fair and equitable consideration of their offers and proposed projects. Such state-implemented measures to provide additional sources of supply could reduce the impact of tight supply conditions that can drive up prices. Finally, states and LSEs could agree to pool their LSEs' respective resource needs for procurement purposes, rather than having each individual state or LSE act on its own, to increase the size of the procurement and hence call forth more competitive responses.

The use of demand response resources and energy efficiency investments as potentially lower-cost alternatives to generation resource obligations must also be fully considered in these portfolios. Such services could be provided by utility LSEs or third-party providers, depending on the policy of the relevant retail electric regulatory authority.

State requirements and policy preferences for fuel diversity (such as state renewable portfolio standard (RPS) and energy efficiency goals, and state/regional carbon mitigation regimes) should be honored in developing LSE resource portfolios. The RTO would have to ensure, however, that the LSE resource portfolios developed are, taken as a whole, both technically feasible and operationally reliable.

¹⁴ Testimony of Kenneth Rose, Ph.D., Independent Consultant, before the Pennsylvania Public Utility Commission, Nov. 6, 2008, http://www.puc.state.pa.us/electric/pdf/EnBanc-WEM/Ttmy-Kenneth_Rose110608.pdf, p. 8 – 11.

Once the selection of the resources is determined, contractual arrangements with the suppliers or providers of the resources (including arrangements for selected self-build options) would be made. The objective would be for LSEs to have a diversified portfolio of resources, including long-term supply commitments that provide customers electricity at a relatively stable and reasonable price, while assuring suppliers a steady revenue stream that can support financing of new resources.

Conclusion

We commend New Jersey for opening this docket for public comment, and urge the NJ BPU to recognize the importance of not only changes to state policies, but the need for reforms to RTO-operated wholesale electricity markets. APPA also strongly encourages the NJ BPU to take a more active role in communicating directly to FERC and to the state's Congressional delegation the importance of reforming RTO-run centralized wholesale markets to ensure both resource adequacy and protection of consumers from unjust and unreasonable rates.

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