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July 12, 2011

**In the Matter of the
Board of Public Utilities'
Investigation of Capacity Procurement and
Transmission Planning
BPU Docket No. EO11050309**

VIA ELECTRONIC & REGULAR MAIL

Kristi Izzo, Secretary
Board of Public Utilities
44 S. Clinton Avenue
Trenton, New Jersey 08625

Dear Ms. Izzo:

Enclosed for filing please find an original and ten copies of Public Service Electric and Gas Company, Jersey Central Power & Light Company, Atlantic City Electric Company and Rockland Electric Company (the "EDCs") Redacted and Unredacted Reply Comments to the June 17, 2011 hearing in the above-referenced matter.

Should you have any questions, please contact the undersigned.

Very truly yours,

*Original Signed by
Tamara Linde, Esq.*

Attachments

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BPU DOCKET NO. EO11050309**

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**STATE OF NEW JERSEY
BEFORE THE
BOARD OF PUBLIC UTILITIES**

REDACTED VERSION

In the Matter of the Board’s Investigation of)
Capacity Procurement and Transmission) Docket. No. EO11050309
Planning)

**COMMENTS OF THE ELECTRIC DISTRIBUTION COMPANIES IN RESPONSE TO
THE JUNE 17, 2011 LEGISLATIVE HEARING**

In conformance with the directives of the New Jersey Board of Public Utilities (the “Board” or “BPU”) in its Order issued on May 27, 2011 in the above-captioned matter (“May 27 Order”)¹, Public Service Electric and Gas Company, Jersey Central Power & Light Company, Atlantic City Electric Company and Rockland Electric Company (the “EDCs”), hereby submit their comments in response to the Legislative Hearing held by the Board on June 17, 2011 (“June 17 Hearing”).

Executive Summary

The EDCs address five main issues in these responsive comments²:

- Competitive markets are the best long-term mechanism to provide New Jersey consumers with reliable electricity at the lowest cost;
- LCAPP-like governmental intervention in the competitive markets will ultimately lead to higher prices and greater risks for New Jersey consumers, in a manner similar to the above-market contracts entered into pursuant to the Public Utility Regulatory Policies Act of 1978 (“PURPA”);

¹ By email dated June 20, 2011 from Board Staff to the Service List for this proceeding, the BPU Staff advised that anyone interested in submitting reply comments in response to those that have been received and posted are welcome to do so and that further reply comments are due by the close of business July 12, 2011.

² The EDCs are also filing the supporting Comments of Frank Graves as an attachment to these comments (“Graves’ Comments”).

- The LCAPP Contracts are above-market as compared to current and historic capacity prices and potential benefits were overstated and the economic benefit analysis prepared to support LCAPP needs further public disclosure and review;
- There is no reliability crisis that the Board needs to respond to by contracting for out-of-market generation; and
- The Board should work to improve competitive markets rather than considering ways to interfere with them.

It is beyond dispute that the goal of providing electricity to customers at the lowest possible price is laudable and sound public policy. However, the EDCs urge the Board to consider carefully the facts, which overwhelmingly establish that State intrusion into the wholesale electricity markets is neither necessary nor beneficial to consumers.

A. Competitive Markets Are The Best Long-Term Mechanism To Provide New Jersey Consumers With Reliable Electricity At The Lowest Cost

A subject of the June 17 Hearing that various speakers addressed was whether PJM's Reliability Pricing Model ("RPM") is resulting in adequate, reasonably-priced generation for New Jersey's customers. The answer to this question, which is at the heart of this investigation, is quite simple. The facts demonstrate that RPM, while perhaps not perfect, has provided for adequate generation capacity and demand response resources to meet New Jersey's needs since its inception,³ and this capacity "was a lower cost alternative to building the same amount of new generation within the state."⁴

As explained by PJM, the RPM Capacity Market is an integral part of the wholesale competitive electricity market, and was designed to commit the least-cost set of capacity

³ The total installed capacity for PJM represents a 19.6 percent reserve margin for the region, well in excess of the roughly 15.3 percent reserve target. See written comments of EPSA <http://www.nj.gov/bpu/pdf/energy/epsa.pdf>, page 2.

⁴ See written comments of PJM <http://www.nj.gov/bpu/pdf/energy/pjm.pdf>, Page 2.

resources (existing generation, new generation, demand response and energy efficiency) so that adequate resources, plus a pre-determined reserve margin, is available on a three-year forward basis.⁵ RPM was not designed solely as a tool to encourage new generation. Rather, as PJM's Andy Ott explained during the June 17 Hearing, when PJM decided to file the RPM construct with the Federal Energy Regulatory Commission ("FERC") there were so many pending generation retirements that the region faced potential capacity shortages in the 2008-2009 time-frame. (Tr. 18:1-9). Mr. Ott further explained that when RPM was first implemented, many of those retirements were either cancelled or deferred. *Id.*

The fact that RPM compensates existing generators does not in any manner support the notion that RPM is a windfall for existing generators. Rather, it simply demonstrates that energy markets that have price caps (as PJM does) do not fully support the revenue requirements of generators.⁶ As explained in the attached comments of Frank Graves virtually all generation types could not fully recover all of their avoidable costs (i.e. fuel plus fixed O&M, ignoring returns on capital) from just the energy and ancillary services markets. Capacity payments fill the gap needed for the incumbent units to remain viable when they are the least cost option to meet resource needs. Graves' Comments at 8.

Using a competitive bidding model, RPM has secured needed capacity on a least-cost basis by retaining economic existing generation, encouraging new investment in uprates and new plants, and encouraging significant demand response and energy efficiency commitments to meet both the capacity needs and a pre-determined reserve margin. Focusing on incremental resources, PJM explained that 42,173 MW of incremental capacity was made available or

⁵ <http://www.nj.gov/bpu/pdf/energy/pjm.pdf>, Page 10.

⁶ As explained by Dr. Bowring at the June 17 Hearing, "...the energy market by itself does not provide adequate revenues to cover the fixed cost of new entry as well as the fixed cost of complying with environmental regulations." T166:18-21.

offered into the 2014/2015 Base Residual Auction across the PJM region, with 9,189.5 MW of that being made available in the Eastern Mid-Atlantic Area Council (“MAAC”) region (which includes New Jersey). (Tr. 8:15-20). This amount includes 5,564.9 MW of additional capacity made available in New Jersey.⁷ This incremental, new capacity made available through RPM includes new generation capacity resources, capacity upgrades to existing capacity resources, new demand response, upgrades to existing demand response resources, and new energy efficiency resources. As PJM explained at the June 17 Hearing, all of these incremental capacity resources were supplied at a lower cost to New Jersey consumers than building the equivalent amount of new generation in the State.⁸

Further, as Dr. Bowring noted, a “substantial amount” of even cheaper capacity is available from the western portion of PJM over the transmission system. (Tr. 165: 17-19). Similarly, Dr. Bowring noted that New Jersey residents “frequently” benefit from the ability to receive transmissions of lower cost energy from western PJM. (Tr. 164:25 - 165:2). As summarized by Mr. Glen Thomas, testifying on behalf of P3: “Ultimately, the benefits of being in a regional market outweigh substantially the benefits of trying to do all this stuff on your own.” (Tr. 141:17-19).

During the June 17 Hearing an issue arose as to whether New Jersey customers benefit from generation being built in parts of PJM outside New Jersey. (Tr. 15:5-24) PJM clarified that when generation is located in the MAAC region “it would tend to have a beneficial effect on both Eastern MAAC and New Jersey price.” (Tr. 15:17-24). In addition, depending on the constraints on the transmission system in a given year, generation built in the rest of PJM can also have direct benefits for New Jersey. (Tr. 15:25 – Tr. 16:1-19). This region-wide capacity

⁷ Tr. 8:20-23 and <http://www.nj.gov/bpu/pdf/energy/pjm.pdf>, page 12-14

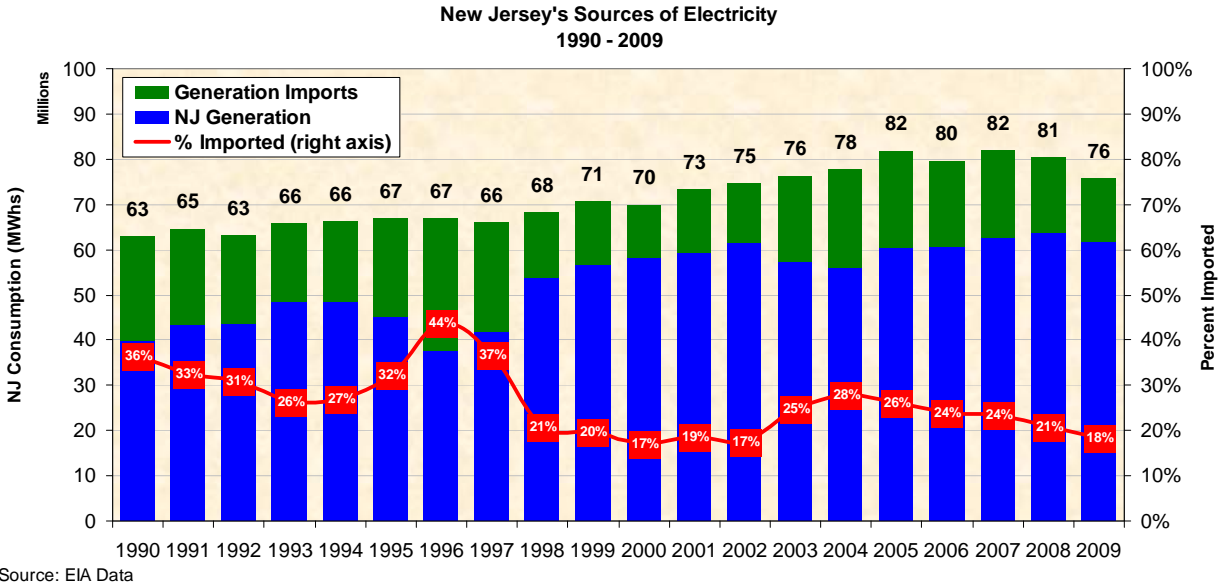
⁸ Id. at page 14.

market provides that the least cost capacity resource needed to maintain reliability is available for customers – benefitting New Jersey customers.

Another issue that the EDCs want to clarify is the misconception that RPM is not sending the right signals to build new generation in New Jersey (Tr.137:1-4), and that all new generation is being developed outside of New Jersey. (Tr. 73:7-9, 188:4-12) During the June 17 Hearing, the Board expressed concern that ratio of new generation being built in New Jersey was disproportionately low as compared to the rest of PJM. (Tr. 73:7-19, Tr 188:4-12). Yet, the facts do not bear this out. As discussed above, since its inception in 2007, RPM has made available 42,173 MW of incremental capacity to meet reliability obligations, including 9,189.5 MW in the Eastern MAAC region, and 5,564.9 MW of incremental resources in New Jersey. (Tr. 8:15-23). In examining this data, one must remember that New Jersey is only a small portion of PJM, equating to approximately 13% of the entire peak transmission load in the PJM region. When one looks at a rational comparison of the amount of incremental resources added, it has not been disproportionately low in New Jersey.⁹

Further, while New Jersey has historically relied on some level of imported electricity to meet its needs, the suggestion that New Jersey is relying more and more on imports to meet its electricity needs is simply not consistent with the facts. From an energy perspective, imports into New Jersey have actually been on the decline as a percentage of consumption in the State, as the chart below demonstrates.

⁹ Safeway's representative also provided an explanation that capacity prices are not the only driver to a generator choosing a site. He commented that the cost of siting and permitting may be an issue in New Jersey, cost of living, salaries and regulatory uncertainty were some of the other factors that he cited as that likely affected siting choices. Tr. 189:6-12.



B. LCAPP-Like Governmental Intervention Will Ultimately Lead To Higher Prices And Greater Risks For New Jersey Consumers, In A Manner Similar To The NUG Contracts

Government intervention to “improve” market outcomes that would otherwise be determined by competitive forces can be expected to have an impact that will be precisely opposite of what is intended. As shown by the comments of numerous witnesses at the hearing, on a long-term basis the LCAPP will actually increase costs and risks borne by consumers in New Jersey – ultimately undermining the State’s goal of fostering additional industrial development and job growth. Economic theory and history both show that consumer interests would be much better served by allowing the market to determine when new generating facilities are constructed, and by allocating the costs and risks of such construction on the owners of the assets.

As discussed above, the operation and scope of PJM’s capacity and energy markets have significantly benefitted New Jersey residents. Moreover, any benefits realized by consumers from adding subsidized generation projects into these markets would be short-lived at best, and

would ultimately be offset (and exceeded) by incremental long-term costs. As Frank Graves explained, the unintended consequence of such direct government intervention into markets is “an adverse feedback effect that will occur that is going to tend to make you not able to capture long-run benefits from off-market development strategies, even though they will have short-term benefits almost assuredly.” (Tr. 105:10-15). As Graves further explained, governmental intervention in markets in the manner of LCAPP-type arrangements:

would tend to discourage [market participants] parties from doing the things that they would otherwise do in the PJM, so they may perhaps participate less heavily in future RPM auctions, they will be receiving less of energy signals that capacity is valuable, they would likely reduce their participation, and you will see less demand-response, less life extension, less new plant development, which will cause energy prices and capacity prices to rebound back up.

(Tr. 79:16-24). Ultimately, the result could be a situation in which developers will “become unwilling to rely on exposure to the way . . . prices would move through the RPM process and they will start to wait for and insist on participation in a State sponsored program.” (Tr. 80:7-11).

Other witnesses at the June 17 Hearing concurred. Mr. Waidelich, appearing on behalf of Safeway, testified: “We believe wholeheartedly that in the long-term subsidized generation by New Jersey consumers will actually lead to higher electric rates, higher cost for goods and services and fewer jobs.” (Tr. 183:18-22). Additionally, as Graves noted, New Jersey will not even realize all the transitory benefits that might be created because “benefits will also be diluted by being shared across the boundaries of PJM.” (Tr. 79: 5-6).

Further, the adverse impacts on the marketplace of direct governmental intervention into generation investment decisions would be very difficult, if not impossible, to undo. Once the government starts down this path, there is no easy way back. As Graves explained, “you will be driving yourself into a situation in the extreme where you have to procure most or all of your

incremental capacity needs under full cost long-term payments because you have sort of driven out the natural market response that you otherwise would have had.” (Tr. 80:12-17). Mr. Thomas also made this point by posing the question whether the market serving New Jersey “is ... going to be a market where we are dependent on out-of-market contracts like LCAPP, or is it going to be a market where generation, transmission, energy efficiency, demand response and all these different capacity resources are competing against each other?” (Tr. 132:18-24). Dr. Bowring also observed that “[o]nce you move away from reliance on the market, it’s very difficult to go back to reliance on it.” (Tr. 168:17-19).

The risk of the governmental intervention not yielding the desired benefits, moreover, is borne directly by consumers. Under the market construct, the consequences of an ill-advised decision to construct a new generating plant fall on the developer. However, when consumers assume market risk by agreeing to fund new construction under a long term contract, they become responsible. As explained by Frank Graves, “[t]his process in effect would undo the goal of restructuring, which was to try to put the burden of resource development on investors and not on customers, and this would sort of flip that back and say that we are going back in effect to a regulated process[.]” He recommended that a better approach was to “keep the risk-bearing as much as you can on developers[.]” (Tr. 94:10-11).

The risk, as explained by Mr. Ott, is that “the entity who is on the buy side of [a long term capacity contract] is the load who is guaranteeing to pay for that who may find that after the [term has] expired that they paid more than they would have paid had they just paid the RPM auction price.” (Tr. 27:11-15). Mr. Waidelich expressed similar concerns, stating that “[i]nvestors, not consumers, should continue to be at risk for new generation; this is one the main corner-stones of the competitive market. (Tr. 184:25 – 185:1).

C. The LCAPP Contracts Are Above-Market As Compared To Current And Historic Capacity Prices And Potential Benefits Were Overstated And The Economic Benefit Analysis Prepared To Support LCAPP Needs Further Public Disclosure And Review

The claims made by Mr. Schultz, the witness for Hess, overstate the limited benefits that consumers could expect to realize from LCAPP. Mr. Schultz stated:

In fact, the standard offer capacity agreement for the Newark Energy Center as part of the LCAPP sets a fixed capacity price that is lower than the clearing price in the past two Base Residual Auctions.

To be clear, if our SOCA agreement had been in place over the past two years, my company would have made payments to New Jersey ratepayers, not the other way around.

(Tr. 161:1-9). Mr. Schulz's statement, while literally true, does not convey the whole story and is misleading.

The capacity prices in the PSE&G North Local Delivery Area ("LDA") for the past two years were \$245/MW-day and \$225/MW-day respectively, for an average price of \$235/MW-day over the two-year period. The prices under the Hess Standard Offer Capacity Agreement ("SOCA") for the first two years are \$█/MW-day¹⁰. Mr. Schultz's statement thus is literally true that for the first two years of the Hess SOCA, the guaranteed price that ratepayers will provide to Hess was literally less than the past two year's clearing price for the PSE&G North LDA. However, what Mr. Schultz did not say is that the prices under the Hess SOCA increase up to a level as high as \$█/MW-day and average \$█/MW-day over the entire 15-year term. Accordingly, over the fifteen-year term, assuming an average RPM clearing price of \$235/MW-day (the average of the two years picked by Hess for comparison) and an average SOCA price of \$█/MW-day over the same two-year period, the 640 MW Hess plant would realize a total net payment due to Hess of about \$█ million – a payment *by* New Jersey ratepayers.

¹⁰ Actual SOCA price guarantees that consumers will bear have been redacted consistent with the Board's Order dated March 29, 2011.

The other SOCA contracts, moreover, would result in *very* substantial payments under this type of analysis. Clearing prices in the PSE&G Zone where those resources are located were \$245/MW-day for the 2012/2013 auction and \$136.50/MW-day for the 2013/2014 auction or an average of \$165.50/MW-day. In comparison, the average price under the CPV SOCA is \$■■■■/MW-day. Using the last two auctions as a benchmark as suggested by Hess, this would show a potential payment by New Jersey ratepayers to CPV under the contract of about \$■■■■ million over the fifteen-year term. Similarly, the average price under the New Jersey Power Development LLC SOCA, also a 700 MW installed capacity plant, is \$■■■■/MW-day. Again using the average of the last two auctions as a benchmark, a potential payment by New Jersey ratepayers of \$■■■■ million over the fifteen-year term would result. As illustrated by these calculations, the sums potentially at issue under the SOCAs are clearly material by any metric and should be part of any discussion surrounding a second round of regulatory intervention into the wholesale electricity markets – especially since one of the SOCA winners has now attempted to use the level of the current SOCA prices to argue for additional LCAPP-type procurements.

D. The Economic Benefit Analysis Prepared To Support LCAPP Needs Further Public Disclosure And Review By New Jersey Stakeholders

The economic benefit analysis supporting the Board’s initial LCAPP needs further review before the Board considers an expansion of it or a similar initiative.¹¹ The economic benefits claimed for the long-term and irreversible financial commitments for New Jersey electric customers under LCAPP are a key component in the development of sound public

¹¹ Further, the legal authorization for an additional LCAPP procurement does not exist. Rate Counsel contends that the Board does not need new legislative authorization to undertake additional LCAPP-type procurements for the purpose of incentivizing new generation development, citing to a provision in the Electric Discount and Energy Competition Act (“EDECA”) that refers to the ability of the Board to take steps intended “to restore a competitive marketplace” in the event it determines that market power is being exercised. (Tr. 228:18 – 229:5, citing to N.J.S.A. 48:3-50(c)(5)). However, the provision identified by Rate Counsel does not provide the grant of authority that the Board would require to undertake additional LCAPP-like procurements.

policy. Because of its importance and the significant commitments that these long-term contracts will place on New Jersey consumers, the development of the economic benefit analysis should be subject to a thorough and structurally transparent review process by all concerned stakeholders before it is used to support a second regulatory intervention into the market.

The EDCs have several concerns with the economic benefit analysis underlying LCAPP. For example, the economic benefit assumes that the SOCA contract recipients are willing to accept a below-market payment for capacity (i.e., the SOCA price is less than the expected RPM). While this is and of itself is unusual, it might be explained by the desire of the developers to mitigate the risk a variable but higher market payment for a fixed but lower than market contract payment. However, as Mr. Graves points out:

If the bidders had just told you that they, for instance, would not be willing to develop for an expected RCP price of three hundred dollars per megawatt day, that's about in the range of the forecast evaluation, but they would be willing to do it for two hundred and fifty dollars per day for certain over fifteen years, in effect what they are saying is they don't want fifty dollars worth of the problem and they want the ratepayers to have fifty dollars worth of the problem.

If you then calculate the savings as though you just saved people fifty dollars when what you have really done is transferred fifty dollars of the risk to the customer, it is not the right evaluation. (Tr. 90:15 – 91:4).

The EDCs respectfully suggest that the economic benefits analysis be subject to more rigorous review, participation and constructive vetting by the stakeholders prior to its results being used to justify further expansion of LCAPP-like initiatives.

Moreover, the Board has never provided a valid justification for not releasing the SOCA contract prices to date. The BPU's March 29, 2011 order states that that providing these prices may "provide an undue competitive advantage to other generators" and that it may "impact bidding behavior" in RPM auctions.¹² Yet, neither rationale withstands scrutiny. The Board has

¹² March 29, 2011 Order, p. 18.

never explained how the disclosure of SOCPs would provide an “undue competitive advantage.” The SOCPs for a 15-year contract provide no discernable information as to a bidder’s cost structure or its view of the market. Further, the SOCP has nothing to do with how a developer will actually bid its unit into RPM markets. Rather, SOCA contract holders will bid their units to clear in RPM without regard to the SOCP level or will bid the units as low as possible under the parameters of the “minimum offer price rule.”

Indeed, public access to the SOCPs is vital in order to adequately evaluate LCAPP-type procurements from a cost-benefit standpoint. As stated by Graves:

In my experience it is very unusual for the utility industry to make very large resource decisions of this scale and very long-term regulatory commitments and obligations on ratepayers without more of a give and take scrutiny and exploration of whether the results have a shared view.

(Tr. 92:14-20). There is simply no valid justification for failing to disclose the SOCPs. The Board should make the debate about the need for additional capacity procurement more transparent and fair – consistent with the process used in other jurisdictions – and release the price information under the SOCPs.

Perceived environmental benefits were apparently also among the justifications underlying the initial LCAPP program. However, for several reasons, these perceived benefits may well be overstated or even non-existent. First, as more stringent environmental restrictions come into effect, many coal plants will be forced to retire because they cannot economically install the requisite environmental controls, while those that do install the necessary controls to remain in operation will, of necessity, be cleaner than the prior vintage of coal-fired power. In essence, the coal power that will remain to be imported in the future is probably going to be cleaner than in the past. (Tr. 85:22 to 86:8); initial written Comments of Frank Graves at 14. Second, as a consequence of these considerations, many new gas-fired generation facilities are

likely to be developed to replace retired coal-fired facilities even without LCAPP-type interventions, but this possibility may not have been fully taken into account in the Board's LCAPP analysis. *Id.*; (Tr. 91:10-23).

F. There Is No Reliability Crisis That The Board Needs To Respond To By Requiring Contracts With Out-Of-Market Generation

One theme that continues to be raised in this proceeding is whether LCAPP or LCAPP-like procurement is needed to maintain reliability. While maintaining reliability and ensuring that the system is planned for reliable future needs is critical, the facts demonstrate that there is no reliability need that is driving LCAPP-like procurement.

During the June 17 Hearing, Michael Kormos, PJM's Senior Vice President of Operations, discussed PJM's perspective on expected reliability in New Jersey and responded to a number of questions on this important topic. Mr. Kormos discussed the delays in the Susquehanna Roseland transmission project and explained that while the transmission project is still needed, with some of the changes in load forecasts and with increased demand response, special operating procedures and the short term extension of a reliability-must-run generator, the temporary delays in its construction is controllable. (Tr. 33:1-14, 36:6-23). Mr. Kormos explained, "I don't believe it is a crisis at this point. If there was a crisis at this point you would have heard from us before now." (Tr. 54:1). And, as explained by Frank Graves of Brattle, even if concerns remain, they cannot be addressed with LCAPP or another similar solicitation.¹³

Further, there is no reason to believe that PJM markets will not respond to future changes in supply and demand dynamics. Existing PJM markets have responded well to shortages, retirements and load growth going-forward. As Dr. Joseph Bowring, the PJM Independent

¹³ See initial written comments of Frank Graves on behalf of EDCs, <http://www.nj.gov/bpu/pdf/energy/edcs.pdf>, page 6.

Market Manager, stated in his oral testimony: “PJM market outcomes are competitive overall and they are competitive in New Jersey.” (Tr. 164:20-23). “By definition a competitive outcome is the lowest possible price consistent with the cost of providing the service; that’s the definition of a competitive outcome.” (Tr. 173:14-16.). Dr. Bowring also testified that the results of the PJM RPM auctions were competitive in New Jersey. (Tr. 173:24 – 174:6). Provided that the market is designed properly and there are no impediments to entry, as generation retires and new resources enter, there is no reason to believe that the market will not respond with the lowest cost solution.

G. To The Extent That The Board Proceeds With Another Procurement Process It Will Likely Have Unintended Consequences That Are More Harmful Than The Problem he Board Is Attempting To Resolve

There seems to be an unstated, but prevailing, assumption that the development of new baseload generation facilities in New Jersey will inexorably lead to lower overall electricity prices in New Jersey, both in the short term and over a longer horizon. However, there is no basis for this assumption. Indeed, while a superficial analysis might support such an expectation, all other things being equal, in otherwise competitive markets all other things never remain equal. (Tr. 103:16-23). As Mr. Graves explained at the June 17 Hearing, and as further expanded upon in his comments attached,¹⁴ it is much more likely that attempts to foster the development of New Jersey-based generation through government mandates or subsidies, no matter how well-intentioned, will have just the opposite effect, resulting in higher prices over the longer term.

¹⁴ At the Hearing, Commissioner Fox had requested examples of what Mr. Graves referred to as “feedback” effects that could lead to such unintended consequences as are discussed here. (Tr. 110:21-22).

Rather than constituting a separate market for electricity (capacity or energy), New Jersey is, instead, part of the broader PJM market, from which it derives many benefits, including access to lower cost electricity from elsewhere in PJM, as discussed elsewhere in these comments. Thus, attempts to address a perceived shortfall in in-state generation through government mandates or subsidies will have disruptive effects on the broader PJM market, which will ultimately have detrimental impacts on New Jersey customers. Even if one of the principal desired impacts of this approach -- lower RPM capacity prices -- is temporarily realized in the near term, the result will likely be more plant retirements, reduced willingness from developers to risk private capital in investments in new generation, and less demand response, which will likely cause prices to “rebound back up.” (Tr. 79:8-24); Initial written comments of Frank Graves at 4-5; Graves’ Comments at 5-6. Achievement of another of the apparent goals of this exercise -- reduced energy prices -- will also ultimately be reflected in higher net cost of new entry, because more of the cost of new generation will have to be recovered through capacity revenues. Graves’ Comments at 8.

All of these adverse longer-term consequences will only be exacerbated if other PJM states respond to political pressure to take similar actions to realize the perceived “benefits” of immediate price reductions. Such actions would be particularly troublesome because these perceived price reduction “benefits” are likely to be ephemeral and achieved at the expense of undercutting the longer-term effectiveness of the competitive generation markets that have been the goal of both federal and state policies for many years. While long-term contracts such as the SOCAs may perhaps have the appearance of a hedge, their cost may well exceed what would have been paid through the unfettered RPM process, so that there is a real risk that customers end up simply “paying too much.” (Tr. 27:8-23).

Perhaps the consequence most to be feared is the prospect that private developers will no longer be willing to risk their own capital and will, instead, simply wait for further state programs to support new generation investment, programs that shift the risk of new development from developers back to customers, a result that undermines the entire thrust of industry restructuring. (Tr. 80:4-23; 139:6-13; 168:15-19). In fact, any new generation may henceforth require subsidies to locate in New Jersey -- just to be on a level playing field with the already subsidized generators. This could lead to fewer capacity additions, smaller reserve margins from uncleared capacity and demand response programs, and higher prices due to a new higher equilibrium point on the supply/demand curve. Further, as Mr. Graves explained, local decisions and policies to force additional capacity into the state “will inevitably be diluted in impact due to geographic spillovers and adjustments over time elsewhere.”¹⁵

In addition to the above-described risk, the perverse result of higher electricity prices, rather than the desired lower prices that presumably underlie this investigation, requiring the EDCs to enter into additional long-term agreements designed to fix the price of capacity creates its own substantial risk of saddling customers with additional above-market costs. The starkest example of this risk can be found in the many long-term power purchase agreements that the EDCs were required to enter into with non-utility generators NUGs under the PURPA. As the EDCs have previously noted, JCP&L’s customers have absorbed \$1.5 billion in above-market NUG costs since 2003, even after taking into account contract restructurings that substantially mitigated the costs, while PSE&G’s customers would have paid as much as \$2 billion of such above-market NUG costs in the absence of its own contract restructurings. ACE’s customers have also borne substantial above-market NUG costs. Even today, monthly New Jersey EDC utility bills for a typical 1000 kWh customer include NUG costs ranging from nearly \$6.00 to

¹⁵ Initial written comments of Frank Graves, <http://www.nj.gov/bpu/pdf/energy/edcs.pdf> at page 4.

over \$9.00, depending on the EDC. Written Comments of Frank Graves at 4; (Tr. 77:11 -- 78:13).

It is certainly true that energy market conditions today differ from those that prevailed when many of these NUG contracts were signed in the 1980s and 1990s. Indeed, market conditions are always changing, which is the nature of competitive markets. It is that very fact that militates against attempts to override the market by locking in any particular set of costs with no ability to adjust them over time to reflect changing market conditions. The one certainty is that no one can accurately project commodity market prices, and any attempt to do so will, essentially by definition, turn out to be wrong. (Tr. 78:14-22).

Another recent example of the potentially significant adverse customer implications of reliance on inherently uncertain projections, albeit in a situation where those adverse consequences were avoided because the policy under consideration was not pursued, can be found in Maryland's 2007-2008 assessment of the advisability of committing ratepayers to long-term purchase and/or investment commitments to foster the development of new generation resources. Analyses at the time, including some by Levitan & Associates, Inc., in retrospect appear to have grossly over-estimated the benefits of such a policy by, among other things, over-estimating the future price of natural gas, over-estimating the future price of capacity, assuming the near-term enactment of a federal program to control greenhouse gases, ultimate enactment of which remains far from certain, and making other unsupported assumptions about the technology and market evolution. Moreover, the analyses assumed that the regulatory intervention under consideration would be an independent event and that the marketplace would otherwise act as if no such intervention had occurred, thereby ignoring the inevitable unintended consequences of such regulator intervention. Had such a policy been adopted, customers would have been

committed to paying a level of costs for 20 years that today appear to be much higher than market costs. The point is not to criticize the work of any firm or the results of any particular set of analyses, but rather to demonstrate that such analyses, and the projections on which they are based, are inherently uncertain and speculative and form a poor basis on which to make a policy decision to move away from market-based solutions and shift risk from investors to customers.

With respect to long-term capacity agreements, in particular, as discussed elsewhere in these comments, it appears that strikingly high capacity prices, at least as compared to recent experience, have been locked in under the initial LCAPP SOCAs, prices based on projections that suppliers seem unwilling to rely on absent the subsidies inherent in the SOCAs. Conversely, if the capacity price projections underlying the LCAPP SOCA analysis are reliable enough to support a very expensive “bet” with ratepayer funds, one must question why suppliers would be willing to accept the lower prices reflected in the SOCAs’ Standard Offer Capacity Prices (“SOCPs”). Assuming that developers are willing to accept those lower prices in exchange for reduced risk, the value of shifting that risk to customers must be factored into the analysis of the perceived benefits of LCAPP, e.g., through an appropriate adjustment of discount rates. See Initial Written Comments of Frank Graves at 12-14¹⁶, which also discuss the many other unavoidable uncertainties inherent in the analyses supporting the award of the LCAPP SOCAs. Further reliance on these uncertain analyses for a second round of out-of-market capacity procurement would only add to customer risk (see also Tr. 87:20 -- 91:9).

There should be no expectation that these contracts will provide a hedge against rising energy prices. The simple fact is that nothing in the SOCAs serves to “lock in” any of the drivers of energy prices, including natural gas prices. As explained by Mr. Graves, this is not a situation where the Board is locking in low natural gas prices. Graves’ Comments at 3.

¹⁶ <http://www.nj.gov/bpu/pdf/energy/edcs.pdf>.

H. What Actions Should The Board Take?

There are a host of initiatives that the Board and the State of New Jersey can take to support new generation being constructed in New Jersey when it is needed. For example, NJ could examine the obstacles to the siting of new generation in New Jersey without producing the adverse impacts of direct intervention in the energy and capacity markets. Witnesses at the June 17 Hearing noted that overlapping jurisdictions and the absence of one-stop shopping for siting authority in New Jersey make it difficult and more costly for developers to obtain the requisite approvals for new generation units.

Recent New York legislation provides New Jersey with an example of a workable template for streamlining the siting process. On June 23, 2011, the New York legislature approved a bill (i.e., “Power New York Act of 2011”)¹⁷ reinstating Article X of the Public Service Law for the review and approval of new electric generation siting in New York State. The previous version of Article X expired in January 2003. The bill reestablishes a New York State Board for Electric Generation Siting and the Environment (“Siting Board”) to certify the construction and operation of all proposed new electric generation in New York State of 25 MW or more. The legislation provides for a two-phase process, requiring a pre-application scoping statement, subject to negotiation on the appropriate studies required for the application, and the subsequent submittal of a formal application, subject to public statement and evidentiary hearings. Once an application is deemed complete, the Siting Board would generally have 12 months to render a decision. Applicants would be required to submit an evaluation of the project’s expected environmental and health impacts and an assessment of its impact on the state’s electric system. Perhaps most importantly, the Siting Board would have the authority to override local laws and regulations that are deemed “unreasonably burdensome” and no other

¹⁷ Bill No. A8510/S5844. Governor Cuomo has not yet signed the legislation.

state or local permitting (other than required state environmental air, water, and hazardous waste permits) would be required. Siting Board determinations would be subject to petitions for rehearing and judicial review. New Jersey could give consideration to adopting similar mechanisms.

With regard to programs in New York that address generation siting, in its June 17 written comments, the Division of Rate Counsel suggested that the FERC recently approved a program similar to LCAPP in New York. Rate Counsel stated:

...On the face of it, this statement would seem to indicate that some subsidies are viewed as acceptable, while others (plainly) are not.

For example, FERC recently upheld a tax-exemption program in New York that was also aimed at encouraging new generation. The issue in that case was whether a tax abatement program enacted to induce the construction of peaking units in New York City should be included in the calculation of the Net CONE parameter for the demand curve used to set capacity prices in New York City. The Commission originally rejected the proposal to use the full abatement assumption in the determination of Net CONE because the tax abatement was discretionary and not a matter of right under the law. After political pressure and a change in the law to make the program an “as-of-right” program, the Commission decided that the tax abatement could be included in the calculation of Net CONE. While recognizing that the tax abatement was a state sponsored subsidy to provide an incentive for new generation, the Commission did not find that facilities that availed themselves of the abatement were submitting “uneconomic” bids or that their bids should somehow be “mitigated.”

Admittedly, we do not know at this juncture what subsidies FERC would find acceptable and what it will not find acceptable. (June 17, 2011 Written Comments, Division of Rate Counsel at p. 17)

Rate Counsel is in error in stating that FERC “recently upheld a tax-exemption program in New York” or that FERC approved the program “recognizing that the tax abatement was a state sponsored subsidy.” Neither question was before FERC in the decision cited by Rate Counsel. The issue before FERC was whether the award of a tax abatement under the New York program was sufficiently certain to include the abatement in the calculation of the Cost of New

Entry (“CONE”) for the NY-ISO’s Installed Capacity market (“ICAP”). The FERC decision cited by Rate Counsel was an Order on Rehearing in *New York Independent System Operation, Inc.* 135 FERC ¶ 61,170 (“Rehearing Order”). In the Rehearing Order, FERC approved the NY-ISO’s proposal to include the property tax abatements in the calculation of CONE. Both the NY-ISO and PJM capacity market demand curves use a CONE calculation to represent the cost of constructing a new generation resource, and both CONE calculations incorporate the estimated property taxes that new entry is likely to pay, which includes adjustments for property tax abatements.¹⁸ The Rehearing Order arose from the NY-ISO’s triennial review of its calculation of CONE. At the time of the last demand curve proceeding, the New York City Industrial and Commercial Incentive Program granted, as a right, reductions in real property taxes to new industrial and commercial projects, including power plants. FERC took that reduction into consideration and it was incorporated in the calculation of the NYC CONE. Subsequently, a revised program was established that eliminated the abatements as-of-right. FERC determined in its Initial Decision that the abatements should no longer be included in the calculation of CONE because they were discretionary.¹⁹ After the Initial Decision, New York State enacted legislation²⁰ that eliminated the discretionary nature of the tax abatement and returned it to an as-of-right program. In its Rehearing Order, FERC noted that the new legislation defined eligible peaking units in such a way as to mandate the assumption that tax abatement will apply to any new peaking unit in NYC, and concluded that it was appropriate to include the tax abatement in

¹⁸ See, e.g. PJM Filing of January 31, 2008 in ER08-516, Attachment C: Affidavit of Raymond M. Pasteris and 2008 Update of Cost of New Entry Combustion Turbine Power Plant Revenue Requirements for PJM Interconnection, LLC at p. 16 (In CONE study developing the cost of new combined turbine plant, actual tax rates are used rather than statutory rates because development/enterprise zone tax relief and negotiated payments result in actual rates that are lower than statutory rates.)

¹⁹ *New York Independent System Operator, Inc.*, 134 FERC ¶ 61,058 (2011) (“Initial Decision”).

²⁰ 2011 N.Y. Laws Chapter 28, (May 18, 2011).

the calculation of CONE.²¹ Therefore, the FERC decision did not address the legality of the state program or whether it was a subsidy; FERC approved, as it does for both the RPM and ICAP, a proposed method of calculating the cost of new entry.

As witnesses noted at the June 17 Hearing, construction costs in New Jersey are a factor in the decision to site new generation. A property tax abatement program similar to the New York program outlined above, and tax credits are additional tools that New Jersey has as a resource to reduce the cost of construction, and encourage new generation. Again, these tools avoid the adverse consequences that result from intervention in the energy and capacity markets.

Other witnesses at the June 17 Hearing encouraged the Board to continue to support Smart Grid initiatives. The term “Smart Grid” is an aggregate term for a set of related technologies designed to increase the efficiency and reliability of the electric grid. Among other benefits, Smart Grid investments can reduce operating costs through automation, improved asset utilization, and the reduction of system losses through voltage and reactive power optimization.

New Jersey can also work within the PJM stakeholder processes to make improvements to the energy and capacity markets. While the facts demonstrate that New Jersey customers benefit from PJM’s competitive markets and, through those competitive markets, receive reliable electric supply at the lowest cost, the Board’s investigation has highlighted some aspects of the PJM markets that can be improved so that customers continue to receive the supply needed at the lowest cost. As PJM explained during the June 17 Hearing, it has initiated two separate stakeholder processes focused on those improvements. First, PJM has undertaken to examine its RPM market design to consider improvements, including changes to new entry price rules and the relationship between RPM and the Regional Transmission Expansion Plan (“RTEP”). Second, PJM has a separate stakeholder process underway examining improvements to the PJM

²¹ Rehearing Order at ¶¶42-43.

generator interconnection process so that the process is efficient in enabling new generation to interconnect to the grid. These stakeholder processes are anticipated to result in filings at the FERC by the end of the year. The Board has the ability to participate in these stakeholder processes and ensuing FERC proceedings to shape these important elements of the competitive market.

Conclusion

The EDCs appreciate the opportunity to provide these post-hearing comments and urge the Board to take actions that would improve the competitive electric markets, rather than providing subsidies to select market participants, shifting risks to consumers, and undermining long-term competition.

Respectfully submitted,

*Original Signed by
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