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PSEG
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October 31, 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 the Reply Comments of the PSEG Companies in response to the October 14, 2011 Legislative-Type Hearing.

Should you have any questions, please contact the undersigned.

Very truly yours,

Original Signed by
Tamara Linde, Esq.

Attachments

C Attached Service List

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BPU DOCKET NO. EO11050309

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STATE OF NEW JERSEY
BEFORE THE
BOARD OF PUBLIC UTILITIES

IN THE MATTER OF THE BOARD'S INVESTIGATION OF CAPACITY PROCUREMENT AND TRANSMISSION PLANNING	))))	Docket No. EO11050309

REPLY COMMENTS OF THE PSEG COMPANIES IN RESPONSE TO THE OCTOBER 14, 2011 LEGISLATIVE TYPE HEARING

The PSEG Companies appreciate the opportunity to submit these limited reply comments in response to the New Jersey Board of Public Utilities ("Board," "BPU") October 14, 2011 Legislative-type hearing ("October Hearing") in the above-referenced matter. This responsive filing is limited to certain new issues raised during the October Hearing.[1]

Several questions were posed at the October Hearing with respect to market power including whether having generators with high market concentration or affiliate relationships with transmission companies necessarily cause the market to be uncompetitive or discriminatory.[2] The answer is no.

In electricity markets, this question has been addressed on numerous occasions and in many regions in the country. For example, the Federal Energy Regulatory Commission ("FERC") performs periodic evaluations of companies that participate in the wholesale

[1] While not addressed in detail in these limited reply comments the PSEG Companies continue to oppose LCAPP type programs that provide targeted subsidies to new natural gas fired generators. We continue to believe that such targeted subsides are not necessary, that they are inconsistent with competitive markets and that they will be harmful to our companies, our customers and the competitive market place. We have limited our reply comments to new issues raised during the October Hearing.

[2] President Solomon, Tr.64:20-25, 65:1-7.

electricity markets to examine whether sellers have horizontal or vertical market power.[3] These reviews, as well as the more frequent and ongoing examinations by the PJM Independent Market Monitor of individual bids and day-to-day behavior of sellers, have consistently found that any market power in the PJM energy and capacity markets including in any constrained sub regions, is adequately mitigated.

In the case of energy markets, the PJM Independent Market Monitor uses the "three pivotal suppler" test to determine – as frequently as every five minutes when system conditions warrant -- whether suppliers are in an position to exercise market power. This test looks not only at whether a particular supplier may be able to exercise market power on its own but whether the supplier being examined *along with the two other largest suppliers* are jointly pivotal. When these conditions are present, the supplier's bids are mitigated to a cost-based level if they were bid in excess of this level. This test enforces a very stringent measurement of potential market power because it analyses the market share of three unrelated suppliers as if they were acting in concert. As stated in the 2011 Quarterly State of the Market Report: "While transmission constraints create the potential for local market power, PJM's application of the three pivotal supplier test mitigated local market power and forced competitive offers, correcting for structural issues created by local transmission constraints."[4] Similarly, the PJM Independent Market Monitor also uses a three pivotal supplier test to determine when to mitigate capacity markets and to impose "going forward" cost bids on existing resources.[5]

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3 FERC Order No. 697, FERC Stats. & Regs. ¶ 31,252 at P 62, 399, 408, 440.

4 2011 Quarterly State of the Market Report, Section 2, Energy Market, Part 1 p. 2 (available at http://www.monitoringanalytics.com/reports/PJM_State_of_the_Market/2011/2011q2-som-pjm-sec2.pdf)

5 See 2011 Quarterly State of the Market Report, Section 5, Capacity Market, p. 5 (Noting that "Participant behavior was evaluated as competitive. Market power mitigation measures were applied when the capacity

To the extent that the PJM Independent Market Monitor believes that market power abuse is potentially being exercised, notwithstanding the ongoing mitigation process described above, it has extensive authority to investigate that activity individually, and in coordination with FERC. FERC has found that the PJM market monitoring and mitigation rules are sufficient to address the potential exercise of market power included in the PJM-East submarket.[6]

Reacting to the LCAPP Program as a tool for addressing perceived concerns over market power, Professor Willig, an expert in economics and antitrust,[7] explained that "[c]oncerns about structural market power are not necessarily well-founded in New Jersey." (Tr.309:6-7.) He gave two reasons for this conclusion. First, Professor Willig explained that "…if mitigation is strong and persuasive and actively applied, as I believe it is here, there's no ability to raise price uncompetitively. So the very definition of market power is at odds with the regulatory market which seems to function relative (sic) well here." (Tr.309:20-25.) Second, "[i]n economics it's not even valid to think about concentration until you define, quote, the relevant market…" (Tr.310:9-11). New Jersey, for example, is not a market, but rather New Jersey is part of a broader regional electricity market. (Tr.66:2-3.)

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market seller failed the market power test for the auction and the submitted sell offer exceeded the defined offer cap.") (available at http://www.monitoringanalytics.com/reports/PJM_State_of_the_Market/2011/2011q1-som-pjm-sec5.pdf).

6 PSEG Energy Resources & Trade, LLC 125 FERC ¶ 61,073 (2008).

7 Robert D. Willig holds the position of Professor of Economics and Public Affairs at Princeton University, where he teaches in the Economics Department and in the Woodrow Wilson School of Public and International Affairs, and served as the faculty chair of the Masters of Public Affairs program. He served as Chief Economist and Deputy Assistant Attorney General in the U.S. Department of Justice, Antitrust Division. Before joining the Princeton faculty in 1978, he was Supervisor in the Economics Research Department of Bell Laboratories. He received his Ph.D. in Economics from Stanford University in 1973, an M.S. in Operations Research from Stanford in 1968, and an A.B. from Harvard in 1967. For further background on Professor Willig, http://wws.princeton.edu/people/display_person.xml?netid=willig&display=Professors

Professor Willig also rejected the notion that New Jersey's electric restructuring, that occurred more than a decade ago, somehow provides the owners of that restructured generation an undue competitive advantage or creates an unlevel playing field. (Tr.334:10-21; Tr.337:23-25, Tr.338:1-9.) Rather, as Professor Willig explained, having this generation that was formerly in rate base compete and win where their going forward costs are lower than building new is the efficient outcome and is the proper result of competition. (Tr.337:23-25, Tr.338:1-18.) The history of the stranded cost proceedings is "…irrelevant for whether we want that unit to be able to bid irrespective of that history. And, we do want it to bid because costs are gone. And so we want it to bid and win based only on its current and forward-going cost, not based on that history." (Tr.340:24-25, Tr.341:1-3.) On the other hand, Professor Willig explained that "…if you have a subsidized auction, like I've characterized LCAPP, …somebody gets the boost and other people don't for whatever reason, the best player may not win in that auction, and then society is the loser and that's a subversion of competition that I keep talking about." (Tr.337:16-22.)

The question was raised at the October Hearing as to whether an auction that excludes some or even one competitor for the purpose of reducing market concentration would be a better approach than LCAPP. (Tr.55:4-5.) Such an auction, however, would likewise discriminate against competitors and would not serve the public interest. Joe Bowring explained that a result of such a program "…could be to exclude competitors and to increase the price paid by New Jersey customers." (Tr.56:11-12.) As Mr. Bowring explained "…you actually don't want to exclude any participant because excluding even one participant is reducing competitive pressures." (Tr.60:14-16.) Creating a regulatory barrier to entry is plainly not the right way to improve entry conditions in the capacity market.

Both prevailing law and economic theory indicate that the proper focus here should be to improve competition, rather than to thwart it through LCAPP-like programs or efforts to exclude competitors. Efforts to improve the wholesale electricity markets and make the market more efficient to enable new entry when and where it is needed was a theme throughout the October Hearing. Proposals to improve the speed at which generators can advance through the interconnection process, as well proposals to improve market signals, were suggested by several speakers. And, we also heard from PJM that many of these proposals are currently being considered in PJM stakeholder processes.[8] Well designed competitive markets in which non-subsidized developers can respond to price signals is overarching goal that the PSEG Companies support and we are actively participating in these stakeholder processes and encourage New Jersey to do so also.

CONCLUSION

The PSEG Companies appreciate this opportunity to submit these limited reply comments and request that the Board consider these comments in its deliberations.

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[8] See for example, Tr.13:6-8, Tr.35:20-23, Tr.37:12-17.