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STATEMENT OF JOHN SCHULTZ, VICE PRESIDENT OF ENERGY OPERATIONS ON BEHALF OF HESS CORPORATION

Good morning. My name is John Schultz and I am the Vice President of Energy Operations for Hess Corporation. I appreciate the opportunity to continue the dialogue that you started in your last legislative style hearing on June 17, 2011. I do not want to repeat too much of what I said, but I think it will give my remarks today some context if I reiterate the unique perspective Hess brings to this process and some of the points we have made. Hess has been trying to develop its 635 megawatt ("MW") combined cycle plant in Northern New Jersey for a number of years now. But as I noted previously, there are some barriers to new entry that need to be addressed if Hess, or indeed any other third party, is to build new generation in this area.

I last testified about the numerous challenges Hess faces, primarily with PJM's Reliability Pricing Model, including concerns about the Minimum Offer Pricing Rule or MOPR, lack of a long term price signal and the fact that RPM does not price distinguish between older, less efficient units and newer, more efficient and environmentally benign units. I also testified that we believe it is imperative that the State of New Jersey continue to strictly enforce its existing environmental regulations for older units. Finally, I spoke about the PJM interconnection process; and it is this last topic that I would like to address in my formal comments today as it appears to us to continue to be a major barrier to the advancement of our project.

Let me start by thanking PJM for recognizing that the interconnection process is in need of some major modifications. PJM has led a very focused effort to reform some of the legacy interconnection rules that simply do not work in today's market. We are excited that the evolving package of changes being proposed in PJM will improve the situation. That said, we remain both frustrated and concerned that we may be using band aids when more comprehensive and effective fixes are necessary and available to reduce or eliminate interconnection queue problems in congested areas, such as NJ.

Project Clustering

The areas in greatest need of new generation tend to have the highest cost of interconnection. Why is this? High priced capacity zones, like New Jersey, do attract significant *prospective* generation projects. In response to high prices, developers file transmission interconnection requests in increasing numbers and this leads to a cluster of projects in a relatively small area of the transmission system. This cluster in turn compounds the estimated number and cost of transmission upgrades needed, as it appears more MWs will be injected into the system than will ever actually be built. Projects later in queue cluster receive even more inflated cost estimates based on the assumption that all the previous projects are going forward regardless of actual developments. The cluster also has the effect of driving up the analytical workload for those studying the impact of those projects and increases the complexity and interdependencies of those evaluations.

Today, we do not have the right rules to identify when a project is truly moving forward in its development cycle and there is little disincentive for a developer who has an existing queue position to withdraw it. The cost for a developer to maintain a queue position for many years may be in the tens of thousands of dollars, not an insignificant sum, but not material in the scope of overall development costs. Consequently, developers today treat PJM's queue like a cheap option, causing paralysis in areas of the system in the greatest need to future development.

A lot of these problems would likely go away if we had interconnection traffic police that were armed with objective standards. This would allow projects that are capable of moving forward to do so and projects that are not advancing would either be forced to go around and start over or could be bypassed by the more meaningful projects. We don't envy PJM's task of having to determine which developers are diligently advancing their projects. However without such policing, we are left to rely on the existing interconnection rules that are in many ways subjective and discriminatory.

But-For Test

Interconnection costs in congested areas are unnecessarily inflated, and a large part of the problem lies in the cost allocation methodology. PJM uses the "But-For" test for determining new generation upgrade responsibility, which on the surface means that the interconnecting generator pays for its impact on the system. It sounds fair; but not only is it unfair, it also is illogical in its implementation. The "But For" test assumes that every MW in the queue will get built. This is a ludicrous assumption when history has borne out that less than 10% of the MWs in the queue are built. The aggregate impact of building all the queue projects is a profound impact on the grid (overloads) with costly and far-reaching upgrade requirements.

For example, there may be 5 projects in the queue class before the Hess project, none of which are guaranteed to be built. These projects use 99.5% of a line's rated capacity. The Hess project, in the next queue, has only a .6% impact on the line. But it is the Hess project that must pay for the ENTIRE upgrade, since it is the project that, if you will, "tilted" the line's capacity beyond 100%. Upgrades, of course, can be lumpy, and costly. What this has meant for the Hess project is that we have been tagged with hundreds of

millions of dollars in upgrade costs in systems as far away as Baltimore and central Pennsylvania. PJM is currently in the process of re-evaluating our interconnection study results and we are optimistic that that such a burdensome inequity of remote upgrades does not fall on one project, but those results are still pending. Without such a retooling, it is simply undeniable that when applied to a cluster of projects, the "But-For" test places an almost insurmountable financial burden on new entry to support grid expansion.

Recognizing that cost allocation rules are controversial and difficult to modify through consensus, Hess sought another way to address the inequities created by the "but for" test. In the PJM interconnection task force, Hess introduced a "Break Away" proposal. The Break Away provides precisely the incentives needed to jump start new generation investment by allowing a project to "break away" from its class year cluster at its individual (non-compounded) interconnection costs, while allowing a reasonable amount of time for other serious clustered projects to join it. In other words, instead of assuming that every MW is going to get built, the break away proposal enables PJM to assume that no project but the break away project or projects will get built, until informed otherwise. If in fact another project also chooses to break away, then the compounding of costs would start. This approach would reward precisely the behavior needed: a commitment to moving forward that would be secured by collateral and acceptance of consequences for failure to move forward.

The current proposed PJM stakeholder package includes the exact converse of the "Break Away" proposal – if a project owner is not sure it is going to proceed, it can elect to be put back a year in its studies – a break away backward, if you will, not forward. While the break away back is a move in the right direction, it still does not fix the underlying problem, which is that costs will continue to be modeled on the assumption that all remaining projects will move forward. The Hess "Break Away" proposal is an elegant solution that is more consistent with PJM's historical queue experience and is more than a mere band aid fix. PJM itself has stated repeatedly that the proposal has a conceptual appeal and is consistent with the stakeholder package being developed. While the TOs in the task force cite increased study requirements as a reason to not support the proposal, Hess would argue that is an insufficient reason to reject what could be one of the few equitable ways to advance meaningful generation projects.

The Least-Cost Solution

It is Hess' experience that in spite of well meaning efforts to comply with PJM's tariff and manuals, PJM (and the transmission owners evaluating interconnection projects) does not always suggest the least cost solution for transmission upgrades needed to accommodate new generation. First, the mere size of the queue presents PJM with a daunting task to process hundreds of projects in a given class year. The enormity of this task alone prevents PJM staff from performing the detail of an analysis that truly seeks to explore least-cost solutions for each generator, particularly in a cluster where there is project interaction and in fact much of the analysis is done by the transmission owners themselves.

Hess has found it effective to employ third party assistance in reviewing interconnection studies, and has worked collaboratively with PJM to reduce costs associated with its NEC project. That said, we still have concerns about the structure of the analytical approach to determining least cost solutions. Most troubling, Hess has become aware that it could reduce its costs by $55 million by slightly adjusting existing phase angle regulators or PARs that are placed in northern NJ to increase the loadability of the grid and as a transmission facility are subject to open access. Such adjustment mimics the movement of the PARs that are applied daily for existing generation.

We have approached PJM on this issue, and PJM concedes that the slight adjustment of the PARs for our project would not jeopardize reliability. But unfortunately, while PAR adjustments are routinely employed to manage grid congestion for existing generation, PJM states it does not have the tariff authority to adjust PARS to manage even slight grid congestion to accommodate the flow of energy from new entrants. We believe that consistent with Order 888 and open access, PJM should be operating the PARs to facilitate both new and existing generation. Unless PJM can consider and operate the PARs to facilitate least cost operation of the grid, there simply is no assurance that new entrants have non-discriminatory access to the grid.

Capacity Injection Rights

Yet another inequitable feature of the current interconnection process is the treatment of Capacity Interconnection Rights, or CIRs. CIRs are awarded on a MW basis to generators that wish to participate in the capacity market and be deliverable throughout PJM. Again, in theory CIRs sound fair and they serve a purpose in ensuring generation developers who paid for interconnection costs retain their deliverability rights throughout the life of the generating facility. In practice however, CIRs give existing generation owners those deliverability rights even beyond the useful life of the generation facility itself. Because CIRs are transferable and reusable by incumbents building new generation, they become a right in perpetuity, making the portion of the grid capacity where they have been allocated at best, very expensive to access, and in the worst case, essentially unavailable for open access.

Current PJM rules give existing generation owners a year beyond the retirement of their units to reuse those capacity injection rights. However in practice, that time period can be significantly extended, if an active queue position is maintained using those rights. This situation is discriminatory toward new generation developers as PJM is then required to model the transmission system as though these already retired (phantom) MWs still exist in their interconnection studies.

The result is that if an incumbent wants to retire a unit and construct a new unit up to the same size at a similar site, its costs to access the existing transmission system for their new unit are essentially zero. When a new entrant seeking to build in the same area and access that same grid, are subject to the “But For” test and could be facing hundreds of millions of dollars in interconnection costs.

Again, we commend PJM for recognizing at a minimum, that it is inappropriate for CIRs to live in perpetuity. A good start has been made to reign in CIRs, as the recent PJM proposal recommends that those rights should not be transferable to other points of interconnection on the grid and that existing CIRs holders must declare their intent to retain and use the CIRs within a year of a facility's retirement. Nonetheless, in our opinion this solution falls far short of fixing the ultimate problem, which is there still exists discriminatory grid access between incumbent and new generation developers.

Probably the most effective way to eliminate the discrimination would be to make CIRs expire when the unit with which they were awarded is mothballed or retired. In this way, no cost advantages will accrue to incumbents, as it does today. This is in fact consistent with what PJM already does for existing units – if their output over a measured period of time is less than their interconnection agreement designated output, the units lose their CIRs in an amount equal to the lost MWs.

The bottom line is for true competition to emerge, new generation must be treated the same, regardless of whether it is being proposed by an incumbent generation owner or a new entrant.

What the State of New Jersey and the BPU Can Do

I would like to summarize what I think the Board can do to help grant equal access to the grid, thus facilitating true competition that will in fact deliver to New Jersey consumers the benefits of cleaner, more efficient and environmentally friendly generation.

First, we would encourage the BPU to stay the course, and view LCAPP as a supplement to, and not replacement for, the PJM capacity market. Second, and equally important, the BPU can work with environmental regulators to ensure that New Jersey stays the course in its commitment to a cleaner environment as memorialized in existing legislation. Third, the BPU can continue to remain engaged in the stakeholder process in PJM addressing ways to enhance the interconnection process. Hess appreciates your having reached out to the PJM staff and supporting a number of concerns we have raised here: (i) the implementation of a "break away" proposal that would circumvent the barriers created by the "but for" test," (ii) reducing the declaration to reuse CIRs from a three year to a one year period; (iii) and the use of third party consultants at developers' expense to both speed up and make more accurate the process of determining what upgrades are needed to interconnect a new generator.

Nonetheless, as I have outlined here, we still need more radical fixes to this process. I would urge you to work with Hess, PJM and the stakeholders to see them implemented. Additionally, as PJM moves forward to comply with FERC Order 1000, which requires consideration of public policy in transmission planning, the BPU, along with other state commissions, could work with PJM and the stakeholders to develop a set of rules, or milestones by which PJM could appropriately model generation retirements in the Regional Transmission Expansion Planning process. This would allow common sense

planning for expected changes in the PJM topology, such as retirement of units that will be unable to comply with state and federal environmental laws.
We believe that Hess, the BPU, PJM and other stakeholders all share the same vision of non-discriminatory access to the transmission grid. We all acknowledge that we are not there yet, and may have disagreements about how and how fast we get there. We believe the changes we have outlined here will move us closer to achieving non-discriminatory access and lay the foundation for not only the Hess plant to be brought into fruition, but for successor new entrants to continue to deliver to New Jersey consumers the benefits promised by wholesale market competition.

Thank you again for providing me the opportunity to continue to dialogue with you about the challenges we face in getting new generation built in Northern New Jersey. I would be happy to respond to any questions you may have.