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BY UPS OVERNIGHT

January 8, 2009

Mr. James J. McNulty
Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
2nd Floor, Room N-201
400 North Street
Harrisburg, PA 17120

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JAN 8 2009

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Re: Pennsylvania Public Utility Commission ("PUC") Docket No. M-2008-2066901
Reply Comment to December 18, 2008 Wholesale Electricity Markets En Banc Hearing

Dear Mr. McNulty:

On behalf of LS Power Associates, L.P. ("LS Power") and pursuant to the PUC secretarial letter dated December 22, 2008 in the matter referenced above, we submit the following comment in reply to the December 18, 2008 *en banc* hearing on current and future wholesale electricity markets. This letter follows a November 17, 2008 reply comment submitted on behalf of LS Power in this matter after the November 6, 2008 *en banc* hearing.

1. LS Power agrees that competitive wholesale energy markets offer the best way to address the need for new generation in Pennsylvania. LS Power supports the restructuring of the electric industry in Pennsylvania which began when the Electricity Generation Customer Choice and Competition Act¹ became effective on January 1, 1997.

2. Support for wholesale energy markets should not be equated with support for their current design as the only mechanism by which a utility meets its customer's needs. As the PUC noted on October 19, 2006 in commenting to the Federal Energy Regulatory Commission ("FERC") on a settlement involving the Reliability Pricing Mechanism ("RPM") proposed by PJM Interconnection, L.L.C. ("PJM"), "[a] fully competitive wholesale market design is yet to be developed."² The PUC has not seen RPM as the fulfillment of the competition promised by deregulation of electrical generation in Pennsylvania and has noted instead that "the proposed market structure for PJM's wholesale markets looks a lot like rate regulation when viewed

¹ 66 Pa. Con. Stat. Ann. § 2801 et seq.

² October 19, 2006 *Comments of the Pennsylvania Public Utility Commission, PJM Interconnection, L.L.C.*, FERC Dockets EL05-148-000, EL05-148-001, ER05-1410-000, and ER05-1410-001 (2006), at 5.

through the prism of the” RPM.³ The development of wholesale energy markets in Pennsylvania since 1997 has not always fostered both competition and the development of new generation.

3. No one testifying at the hearing on December 18, 2008 disagreed with the observation, made then by PUC Commissioner Christy, that long-term power purchase agreements encourage the development of new electrical generation by developers owning little if any generation in Pennsylvania. It is LS Power’s experience that such agreements provide developers entering Pennsylvania with a revenue stream that secures the financing to build new power plants. LS Power shares the concern, which Commissioner Christy voiced during the December 18, 2008 hearing, that relying solely on artificial pricing mechanisms in the RPM may impede the development of new generation by independent power producers.

4. The deregulation of generation brought about by the Electricity Generation Customer Choice and Competition Act does not mean that the PUC lacks the tools to encourage construction of new generation. By codifying earlier regulatory efforts of the PUC, enactment on October 15, 2008 of Act 129 of 2008 (“Act 129”)⁴ effectively expanded the power of the PUC to encourage such new generation.

5. Act 129 amended the Electricity Generation Customer Choice and Competition Act and expanded the PUC’s jurisdiction over electric distribution companies, which remained public utilities subject to the PUC when the Electricity Generation Customer Choice and Competition Act was originally enacted.

6. Act 129 requires certain electric distribution companies defined therein as default service providers to take certain steps when, after rate caps have expired, a customer either does not chose an alternative electric generation supplier or instead contracts for electric generation supply service but does not receive such service from the chosen electric generation supplier. In such instances, the default service provider must provide electric generation supply service to such retail customers “pursuant to a Commission-approved competitive procurement plan.”⁵

7. Electric power procured through such a competitive procurement process must “include a prudent mix” of spot market purchases, short-term contracts, and long-term purchase contracts.⁶ Such long-term contracts must be for “more than years” but “not more than 20 years” unless the

³ *Id.*

⁴ All citations to Act 129 in this comment are made to the pages and lines in the copy of House Bill No. 2200 posted on the PUC website at http://www.puc.state.pa.us/electric/Act_129_info.aspx

⁵ Act 129, § 3.1 [pg. 64, lines 5-6].

⁶ Act 129, § 3.2 [pg. 64, line 28 to pg. 65, line 2].

PUC determines “that a contract is required to be extended for a longer term of up to 20 years....”⁷

8. Before Act 129, retail customers who either contracted for electrical energy which was not delivered or who did not choose an alternative generation supplier were required by the Electricity Generation Customer Choice and Competition Act to be supplied with electricity by the electric distribution company or PUC-approved alternative supplier “at prevailing market rates.”⁸ Act 129 requires that the “prudent mix of contracts” entered into to procure electricity in such circumstances be, among other things, “designed to ensure ... the least cost to customers over time.”⁹

9. By repealing the requirement that electricity be sold at “prevailing market rates” and enacting in Act 129 a requirement that electricity be procured at “the least cost to customers over time,” the Pennsylvania legislature has acknowledged the potential for a conflict between “prevailing market rates” and “the least cost to customers over time” and sought to assure that, if a conflict does exist, the “least cost to customers over time” would determine the “prudent mix of contracts” needed to foster competition.

10. Competitive procurement processes under Act 129 can be used by the PUC to require long-term power purchase contracts that would give developers entering or expanding in the Pennsylvania marketplace the incentive to build new generation.

11. Such incentives may exist outside of, and supplement, incentives already created by PJM in the RPM. The PUC need not rely only on the incentives available within RPM to encourage construction of new generation and can use Act 129 to determine how the public interest may be served by long-term power purchase agreements.

12. As the PUC continues the process to determine how the long-term power purchase agreements (“PPAs”) deemed by Act 129 to be part of the “prudent mix” of contracts may best be entered into, LS Power would welcome the opportunity to discuss with the PUC how requests for proposal (“RFPs”) may be handled and bilateral contracts prepared to facilitate entry into such PPAs. We believe the outcome of such discussions (about employing transparent, fair RFP processes and implementing long term, bilateral PPAs to supplement PJM’s capacity market) will produce the best outcome for retail customers buying electricity in Pennsylvania.

⁷ Act 129, §§ 3.2, 3.3 [pg. 65, lines 5, 16]

⁸ 66 Pa. Con. Stat. Ann. § 2807(e)(3), *repealed by* Act 129, § 3.1 [pg. 64, lines 20-26].

⁹ Act 129, § 3.4 [pg. 65, line 22].

Mr. James J. McNulty
January 8, 2009
Page 4

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LS Power thanks the PUC for holding hearings on current and future wholesale electricity markets and appreciates the opportunity to comment on this topic.

Sincerely,



Robert P. Frank


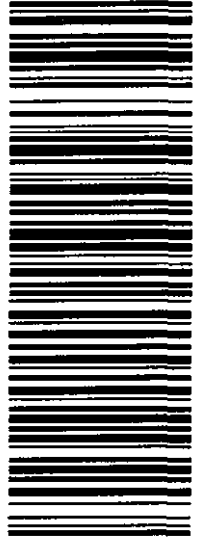

RPF

cc: Robert F. Young, Deputy Chief Counsel, PUC
Lynne Mackey, VP Legislative and Regulatory Policy, LS Power

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<p style="text-align: right;">LTR 1 OF 1</p> <p>MARGARET WELSH 215-851-8131 REED SMITH LLP - PHILADELPHIA 1650 MARKET ST PHILADELPHIA PA 19103</p> <p>SHIP TO: MR. JAMES J. MCNULTY, SECRETARY PENNSYLVANIA PUBLIC UTILITY COMMISS 400 NORTH STREET 2ND FLOOR, ROOM N-201 COMMONWEALTH KEYSTONE BUILDING HARRISBURG PA 17120-0200</p>	<p style="font-size: 2em; font-weight: bold;">PA 171 9-20</p> 	<p style="font-size: 2em; font-weight: bold;">UPS NEXT DAY AIR 1</p> <p>TRACKING #: 1Z 733 2X6 01 9790 3373</p>	
<p>BILLING: P/P</p>		<p>Client / Matter / Attorney Number: 884937/11001/1371</p> <p style="font-size: 0.8em;">CS 11.0.17. WHITE'S 84 OA 10/2008  TM</p>	