



November 14, 2008

Mr. James J. McNulty, Secretary
Pennsylvania Public Utility Comm.
400 North Street
2nd Floor, Room N201
Commonwealsh Keystone Building
Harrisburg, PA 17120-0200

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Re: Public Hearing on the Current and Future Wholesale Electricity Markets
M-2008-2066901

Dear Secretary McNulty:

Enclosed find an original and ten (10) copies of the Reply Comments of Shell Energy North America (US), L.P. in the Public Hearing on the Current and Future Wholesale Electricity Markets that was conducted by the Pennsylvania Public Utility Commission. These Reply Comments are being submitted in response to your notice dated October 27, 2008.

If you have any questions regarding this filing, please call me at 267-568-2814.

Sincerely,

John F. Brodbeck
Directory
Regulatory Affairs

Cc: Chairman James H. Cawley
Vice-Chairman Tyrone J. Christy
Commissioner Wayne Gardner
Commissioner Kim Pizzingrilli
Commissioner Robert F. Powelson

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION
DOCKET NO. M-2008-2066901
PUBLIC HEARING ON THE CURRENT AND FUTURE WHOLESALE
ELECTRICITY MARKETS

REPLY COMMENTS
OF
SHELL ENERGY NORTH AMERICA (US), L.P.

These comments are submitted by Shell Energy North America (US) L.P. ("Shell Energy") in the Public Hearing on the Current and Future Wholesale Electricity Markets held by the Pennsylvania Public Utility Commission in Harrisburg, Pennsylvania on October 23, 2008 and November 6, 2008.

INTRODUCTION

On October 23, 2008 and November 6, 2008, the Pennsylvania Public Utility Commission ("Commission") held en banc Public Hearings on the Current and Future Wholesale Electricity Markets ("Wholesale Hearings"). At these Wholesale Hearings the Commission took testimony and asked questions of a variety of individuals and organizations with interests in the wholesale electricity markets existing in Pennsylvania.

Shell Energy commends the Commission on its interest in the wholesale electricity markets operating in Pennsylvania and believes such interest should provide the Commission confidence that the wholesale markets are providing economic, reliable power to the citizens and consumers of the Commonwealth. Wholesale markets in Pennsylvania provide power at the lowest cost consistent with reliability. The generation resources in Pennsylvania are a Keystone to regional reliability and economy.

Shell Energy hereby submits these reply comments to the Wholesale Hearings.

DESCRIPTION OF SHELL ENERGY

Shell Energy is an indirect subsidiary of Shell Oil Company, which itself is an indirect subsidiary of Royal Dutch Shell plc. Shell Energy conducts business in the electric and natural gas markets throughout North America, including in the PJM Interconnection, L.L.C. ("PJM") and Midwest Independent Transmission System Operator, Inc. ("MISO"). Shell Energy's subsidiaries Coral Energy Resources and Coral Power were licensed suppliers of retail natural gas and electricity in Pennsylvania until they were merged into Shell Energy. Shell Energy will soon be applying for retail supplier licenses.

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REPLY COMMENTS

Retail Markets

Mr. Mann of Donsco, Inc., testified at the October 23 hearing that he was having a difficult time finding alternative suppliers or quotes for the Donsco, Inc. facilities in Pennsylvania. The most important impact the Commission can have on the wholesale markets is by striving to improve the Pennsylvania retail markets, as the state comes fully off of rate caps. The Commission has a chance truly to reflect wholesale costs in retail rates in Pennsylvania and produce a vibrant market. Shell Energy believes this is best encouraged by rational bidding programs run by the utilities that will reflect wholesale costs. In that regard, we believe the bidding program recently proposed by PECO Energy Company to procure generation for its customers appears to be a reasonable, appropriate methodology. Shell Energy would recommend that the Commission extend similar programs to its other jurisdictional utilities. Commission oversight of this element will make an enormous difference in the wholesale markets.

Regional Markets

Mr. Ott and Mr. Edwards during the October 23 hearings described the operations and capabilities of the PJM and MISO systems, respectively. As these gentlemen described, Pennsylvania is blessed to sit between two cooperating markets that extend from the Atlantic Ocean deeply into the Great Plains of North America. Over that footprint, there is a wide range of weather, fuel availability, load characteristics and generating equipment – all of which enhances the reliability and economics of the power supplied to Pennsylvania consumers. These regional markets are enormous and provide a real competitive environment for suppliers and consumers of electricity.

The Commission should act to enhance the ability of Pennsylvania's generators to compete in that market and to assure that there is continued erosion of the barriers to out-of-state generation competing inside Pennsylvania. Shell Energy believes these actions would include (1) continued attention to standardizing MISO and PJM market structures, (2) assistance in siting transmission projects that enhance the ability to move power within the region, and (3) encouraging other jurisdictions to make better use of the resources available in the competitive market (such as energy products available on the wholesale market or bidding new resources).

These markets have not reached their final state. As Mr. Ott and Mr. Edwards described, there is important work yet to do in all the organized markets in the United States of America and Canada, including PJM and MISO. These Wholesale Hearings provide the Commission with information needed to be a better partner in the continued evolution of these markets.

Energy Market Components

As Mr. Ott testified, among the most important markets that PJM sponsors are the locational marginal price (LMP) energy market and the Reliability Pricing Model capacity market (RPM). Thus, in PJM, the cost of energy is composed of two important elements – energy and capacity. As Mr. Edwards testified, while MISO uses LMP it does not have today a capacity market, although it is developing one. In addition, Mr. Ott and Mr. Edwards testified there are a variety of ancillary services needed to operate the transmission system that are sold by PJM or will be sold by MISO. Finally, certain costs defy categorization and are recovered through uplift charges (for example, the cost to start a generator believed needed for reliable operation but which is eventually not needed). Dr. Bowring testified that the two markets together provide the revenues required by generators to supply power to customers.

Energy Market Enhancement

Shell Energy believes an important part of the evolution of competitive electric markets in PJM and MISO is increasing the amount of revenues derived from the energy markets. Improvements to the energy markets – enhanced scarcity pricing, more useful and flexible mitigation schemes, reduced uplift, and improvements to reflecting units not currently setting locational marginal prices – will make the choices of consumers simpler and more flexible. Only by increasing the proportion of total costs in the energy market revenue stream will both suppliers and consumers have the ability to properly hedge their positions and make reasonable decisions about the future.

Capacity Markets

As the Commission heard from various witnesses, but especially Dr. Bowring and Mr. Thomas, the PJM and MISO markets do not currently yield sufficient revenues to support new supply – be that supply from the generation side or the demand side. For nearly 10 years, PJM markets have not returned revenues sufficient to support new generation. If an analogous situation existed in the reliability sphere – 10 years of operations below the NERC standards – all stakeholders would rightfully be in an uproar. The day of that reliability crisis is not far in the future if the market does not provide the revenues needed by existing and new generation. RPM helps to correct that situation and may provide real benefits in the future. Despite its belief that energy markets should be the primary electric market, Shell Energy strongly supports the RPM model for PJM and believes the Commission should as well. The alternative today is disinvestment in generation to the detriment of consumer reliability and cost in Pennsylvania.

Without RPM, generators could not today continue to serve consumers nor would new generation have any economic incentive to build in Pennsylvania or elsewhere in PJM. Even generation today located in Pennsylvania will seek ways

to deliver its capacity outside of the Commonwealth and PJM, to capacity markets in New York, for example. Currently, RPM is a much needed administrative market. Increasing the value in the energy markets would assist consumers in Pennsylvania. Moving more of the cost of generation into the energy price would also help reduce the heavy reliance that the PJM market has on RPM revenues.

Vintaging of Generation

Mr. Mann, Ms. Kelly and Mr. Ciarlone all stated or implied that existing, older plants in Pennsylvania (and presumably elsewhere in PJM) should not be compensated at the same level as new generation. People would recoil if Pennsylvania farmers were paid less for their corn than farmers in Kansas, simply on the basis that Pennsylvanian fields had been tilled for more years. Or if Pennsylvania aluminum or steel foundries were paid less for their product than other suppliers, simply because those plants might be older than plants in West Virginia or Arizona. Likewise, the Commission should support the RPM price being available to all resources in PJM – regardless of their vintage or other attribute.

It is unreasonable to construct a system whereby only new resources are permitted to recover their costs – and they for only a short period of time. The Commission should not seek to create a system of capacity payments that unfairly discriminates among generators, all of whom contribute to reliable operation and energy-for-load. Consumers have the opportunity to enter into contracts with generation that can lock-in prices for extended periods of time and it would be reasonable for the Commission to encourage such actions by consumers.

While we would support such actions by consumers, Shell Energy believes that the Commission should not encourage or require its jurisdictional electric utilities to build, own, or contract for generation. These are market activities that simply impose additional costs and risks on ratepayers. The only “benefit” customers will receive is an increased risk that the markets will not provide enough supply. This Commission should protect the Commonwealth from another round of stranded costs.

Demand Side and Alternative-Fueled Generation

In response to questions from the Commissioners, several speakers noted the value of adding alternative resources to the generation mix in PJM. The Commission can encourage the development of Demand Side Response and Alternative Generation. Development of demand response can best be done by encouraging retail access. In those contractual relationships with a licensed supplier, consumers can in their usage patterns. In addition, removing whatever barriers may exist in the wholesale and retail markets should be pursued, although Shell Energy believes these are few in the PJM market. Finally, Shell Energy supports this Commission taking reasonable actions to encourage demand-side resources and alternative-fueled generation. However, we would discourage the Commission from attempting to alter wholesale markets to accommodate these resources – they should be able to participate within the existing framework.

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