

Before the
COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Docket No. M-2008-2066901

En Banc Hearing on the Current and Future Wholesale Electricity Markets

December 18, 2008

Comments by
Rajnish Barua, Ph.D.
Executive Director
Organization of PJM States, Inc.
62 N. Chapel Street, Suite 203
Newark, DE 19711

Good afternoon, Chairman Cawley, Vice Chairman Christy, Commissioner Pizzingrilli, Commissioner Gardner, and Commissioner Powelson. It is an honor and a pleasure to appear before you today. I have good memories and experiences of spending over two years in your Commission.

On behalf of the Organization of PJM States, Inc. (OPSI), I thank you for this opportunity and I hope I will be able to answer most of your questions. As an employee of an organization that serves you as members, I have discussions with some of you on an ongoing basis. I would like to thank Commissioner Gardner for inviting me to this forum and Vice Chairman Christy for seeking approval for my appearance from the OPSI Board. I want to disclose that these comments have been reviewed by the OPSI Board to ensure that none of the 14 Board members have any concerns with my presentation. Based on recent discussions I had with some of you, I have divided my comments into two parts: Sections 1-3 will be strictly on behalf of OPSI and its official positions; Section 4 contains my personal comments based on my experience as an energy policy

analyst working in this field for the last 20 years. I have attached a brief bio at the end of these comments for information purposes (Attachment 1).

Given the short time set aside for my testimony, I am going to only touch on a few issues about OPSI and its operations to date.

1. THE NEED FOR OPSI

Let me begin by stating the obvious: your Commission, along with the utility regulatory agencies from 12 other states and the District of Columbia are all members of OPSI. What binds the 14 Member Regulatory Agencies of OPSI is the PJM transmission grid. While you are aware of this, I want it to be understood that OPSI is not funded by PJM and I am not an employee of PJM. To be precise, OPSI is funded through a tariff approved by the Federal Energy Regulatory Commission (FERC) and administered by PJM. OPSI's funds are based on the monthly electricity sales within PJM, and this amounts to less than one cent annually from each customer in the PJM service territory. So I would venture to say that OPSI is a streamlined organization, in which each jurisdiction has one representative on its Board of Directors, and Vice Chairman Christy is your representative on the OPSI Board.

Earlier in this decade, the FERC had seen the need for and encouraged creation of regional state committees (RSCs) for better cooperation among federal and state regulators in dealing with regional electricity issues. Initially, when PJM transformed from a power pool to an independent system operator (ISO) and later to a regional transmission organization (RTO), its service territory was limited to its original area within the Mid-Atlantic region and PJM interacted with the states through an existing

organization: the Mid-Atlantic Conference of Regulatory Utility Commissioners (MACRUC), of which this Commission is a member. Later when PJM expanded west and south, states who were not members of MACRUC needed to participate in discussions. At the request of those states, former commissioner Gail McDonald of the Maryland PSC, who was the MACRUC president at that time, assigned this Commission's former chairman, Glen Thomas, to lead the discussions with PJM and its stakeholders in forming a new entity that would allow better representative interaction; as a result, OPSI was created as a non-profit LLC in May 2005. OPSI did not have its own staff until mid-2006, and during this time, staff of various member commissions – including yours truly – “volunteered” time and effort on technical and administrative matters of OPSI. OPSI's strength lies in the participation of the commissioners and staff of each of its 14 member agencies.

Since its creation, OPSI has interacted on a regular basis with PJM, its stakeholders, the FERC and its staff, and other interested entities. OPSI signed a Memorandum of Understanding with the PJM Board of Managers, which I have provided as Attachment 2. To date, OPSI has held four annual meetings where all the entities I just mentioned have participated, and we do interact with the same at other times via teleconferences. Stakeholders have looked to OPSI for its views on various issues and OPSI has provided official positions on some of these issues in the form of filings before the FERC and/or in communications to the PJM Board of Managers. I believe OPSI's fundamental function is well defined in a 2005 filing before the FERC, in which OPSI states that:

[O]ur federal system has split jurisdiction over the nation's power system between [the FERC] and the States in a way that demands better regional

and federal/state coordination. Better cooperation between the states in regional markets would improve federal/state exercise of complementary jurisdiction, would directly benefit wholesale markets, and would reduce the chances of jurisdictional stalemate or conflict. In addition, by streamlining PJM / State relations, PJM asserts . . . that PJM would experience cost reductions over the present approach of maintaining separate relations with each state in its region.¹

Subsequently in that proceeding, the FERC approved OPSI's funding mechanism and the funds have been primarily used to allow OPSI members to participate in meetings and interact with the FERC, PJM, and its stakeholders on regional electricity matters.

2. MARKET MONITORING

Since its creation, OPSI has been involved in several issues; I would like to focus on one at this hearing. In February 2007, the OPSI Board met with the PJM Board in Washington, D.C. During that meeting, one of the issues discussed was PJM's market monitoring unit (MMU). Specifically, there were concerns among OPSI members that the MMU, which was internal to PJM at that time, may not have been able to perform its functions with complete independence. Following that meeting, there were several written interactions between the two Boards, but without any satisfactory resolution to the issue.

In April 2007, the FERC held a technical conference to review market monitoring policies in RTOs around the nation. There, Commissioner Mark Christie of the Virginia State Corporation Commission, who was the president of OPSI, made comments that stated OPSI's belief that:

[I]ndependent market monitoring of the PJM wholesale markets is absolutely crucial to ensure that [the PJM] markets operate efficiently,

¹ FERC Docket No. ER06-78-000, *Comments of the Organization of PJM States, Inc.* (December 5, 2005); p.4.

competitively and without exercises of market power or market manipulation. . . . FERC should understand that if wholesale markets are going to survive, they must have the trust and confidence of the public and policymakers at both the federal and state levels of government. . . . [OPSI does not] believe that the PJM MMU is independent in the current PJM structure, despite the claims of PJM management. The lack of market monitoring independence could damage confidence in the PJM markets. . . . [T]his is no reflection on Dr. Bowring or his staff; this is a structural issue. . . . [OPSI believes] that the PJM market monitoring function must be restructured to ensure independence. At an absolute minimum, the PJM MMU must be removed from the control and influence of PJM management in its daily operations so it can conduct its operations in the public interest and help produce the just and reasonable market outcomes required by federal law.

Subsequent to that technical conference, FERC instituted settlement proceedings through the rest of 2007 and ultimately issued an order in March of this year which resulted in the separation of the MMU into a separate entity. I believe you have already heard from Dr. Bowring in this matter earlier during this proceeding.

3. PARTICIPATION IN OTHER ISSUES

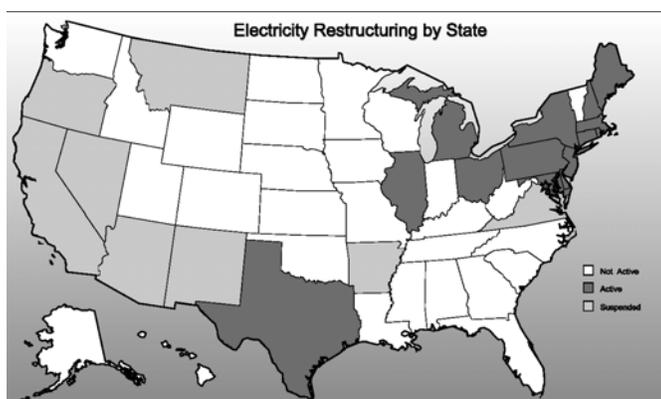
At this time, OPSI and its members are involved – as an entity as well as individual regulatory agencies – in various issues in PJM such as its governance and sector voting structure, reliability pricing model (RPM), and installed reserve margin (IRM), to name a few. OPSI interacts at several levels: at a minimum, staff from various member agencies and I attend regular PJM committee meetings while the OPSI Board and other interested commissioners interact with the PJM Board of Managers at least 3-4 times a year. As evident from my comments earlier, OPSI is also active at the FERC, as panelists in FERC technical conferences and as a party in various proceedings. I believe the commissioners and staff of the FERC seek input from OPSI and its member commissions on a regular basis and find the need for state input important to the success

of the wholesale electricity market. After all, electricity is primarily served to the end-use customers through the distribution sector, which is under the jurisdiction of the state commissions.

4. ELECTRICITY RESTRUCTURING AND RECENT TRENDS

The comments in this section are mine and do not represent any views of OPSI or its member agencies. I am sure you as well as others have been intrigued by what has happened to electricity prices around the nation and as well as in your state since the electricity industry has been restructured. I will not go into the theoretical underpinnings of this phenomenon; rather I will use a simple example and provide you trends to give you some understanding. I do not claim what I am about to present as an exhaustive study of this issue and I am sure academia and industry will have a field day in poking holes at my comments.

We all know the electric industry structure began sometime after the Energy Policy Act of 1992 and are well aware of the rapid restructuring of the industry on a state-by-state basis. But with the notoriety the “movement” received, many states never restructured and

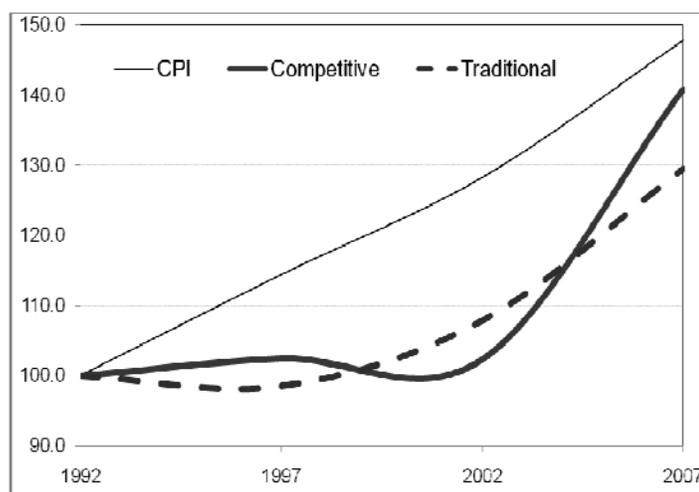


some suspended such a move. The map of the U.S. above shows the current status of electricity restructuring by state. I point out that only 17 states (with the very dark shade) are currently restructured and have retail choice programs while the rest have traditional

rate regulation. Given that, I examined the status among OPSI's members and found that seven are still vertically integrated with traditional rate regulation (Indiana, Kentucky, North Carolina, Tennessee, Virginia, West Virginia, and Michigan at 90%), and the other seven (District of Columbia, Delaware, Illinois, Maryland, New Jersey, Ohio, and Pennsylvania) have retail choice programs.

I then decided to examine if there were any differences in prices over the years between the traditionally regulated states and the retail choice states. To alleviate any

concerns of effects of different variables, I performed a simple analysis by comparing the indexed values of average electricity prices for the two groups of states compared to the Consumer Price Index (CPI).



The graph above shows the trends where I believe average electricity prices were flat in the retail choice (competitive) states due to rate caps but have lately increased due to the end of the rate caps and increases in fuel prices. Please keep in mind that these are prices to the end-use customers or ratepayers and not the wholesale electricity prices. The trends for individual sectors – industrial, commercial, and residential – also show similar trends since 1992. I would not venture to use this simple examination of trends to comment on the success or failure of electricity restructuring. Rather, I see these trends – and I am sure the experts in this field know – that ratepayers are now faced with

increased electricity costs. You, as the state regulators, are faced with dealing with the end result of increased electricity prices on factors that may be beyond your jurisdiction.

I close by stating that you face challenging times; it is difficult to explain the complexities of a wholesale electricity market to ratepayers whose interaction with their electric distribution companies (EDCs) is usually limited to paying their bills monthly, or calling their EDCs when there is an outage, or criticizing the state regulatory commission when electricity bills rise significantly. As I mentioned, these are my personal views and I am sure there are rational explanations on how to resolve such issues.

Thank you, Chairman and Commissioners, for inviting me to this hearing. I welcome any questions and comments you may have at this time on anything I have presented or any related matters.

ATTACHMENT 1

Bio-data of Rajnish Barua, Ph.D.

Rajnish Barua joined the Organization of PJM States, Inc. (OPSI) as its executive director in February 2007. Dr. Barua has over twenty years of experience in the energy field and previously worked as an energy advisor to the chairman of the Pennsylvania Public Utility Commission. Prior to that, he worked in two other state regulatory agencies: as the director of the Integrated Resource Planning Division at the Maryland Public Service Commission and as a regulatory policy administrator at the Delaware Public Service Commission.

Dr. Barua has written testimony, briefs, papers, presentations, and appeared as a witness before several regulatory commissions. He was involved in the restructuring of the electric industry including being a member of the governor of Delaware's negotiating team and has considerable experience in regional electricity markets and utility regulation. He is active in international training and technical assistance programs with energy officials from other countries and has published and presented extensively in regional, national, and international conferences.

Dr. Barua taught as an adjunct faculty for a few semesters in the University of Delaware's School of Urban Affairs and Public Policy and has also served as a member of a master's analytical paper committee and doctoral dissertation committee. He earned a doctorate from the University of Delaware (specializing in energy policy).

ATTACHMENT 2

Memorandum of Understanding between OPSI and PJM

**MEMORANDUM OF UNDERSTANDING
BETWEEN PJM INTERCONNECTION, L.L.C.
AND THE ORGANIZATION OF PJM STATES, INC.**

This MEMORANDUM OF UNDERSTANDING (“MOU”), dated as of June 1, 2005, between PJM INTERCONNECTION, L.L.C. (“PJM”), which operates in accordance with requirements of the Federal Energy Regulatory Commission (“FERC”) as the Regional Transmission Organization for the PJM Control Area, and the ORGANIZATION OF PJM STATES, INC. (“OPSI”), the multi-regional organization of state utility commissions located in the PJM Control Area, defines an organizational structure to facilitate communication and, when appropriate, cooperative action among the undersigned parties on matters as to which each has substantial responsibilities so as to promote and protect the public interest in the provision of reliable and reasonably priced electric service within the PJM Control Area. To achieve this objective, the undersigned parties state and agree as follows:

WHEREAS, the Board of Managers of PJM is responsible under Section 7.7 (i) of the Amended and Restated Operating Agreement of PJM Interconnection, L.L.C., dated June 2, 1997, as amended (“PJM Operating Agreement”), to supervise and oversee all matters pertaining to PJM, including ensuring that PJM performs its duties and responsibilities in a manner consistent with (1) safe and reliable operations, (2) the creation and operation of a robust, competitive, and non-discriminatory electric power market in the PJM Control

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Area, and (3) so that no PJM Member or group of Members has undue influence over the operation of the PJM Interconnection; and,

WHEREAS, the current and future member Commissions of OPSI are responsible under their respective state laws to ensure that residents and businesses located in their states have access to safe, adequate, reliable and reasonably priced electric service; and,

WHEREAS, OPSI, as a collective organization of state commissions within the control area of PJM, and PJM, as Regional Transmission Operator share a mutual interest in the successful development, operation and monitoring of the wholesale electricity market which directly affects each state's retail end-users; and,

WHEREAS, PJM and OPSI agree that, to discharge their respective responsibilities efficiently and properly, it is important that they establish a mutually agreed upon protocol and organizational structure for communications and cooperation; and,

WHEREAS, PJM and OPSI have executed this MOU setting forth their current intent and understanding,

NOW THEREFORE, PJM and OPSI mutually agree and commit to the following:

1. OPSI has been established by the state public utility commissions of the states of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia, and the

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District of Columbia for the purpose of functioning as a liaison group to PJM, the PJM Board of Managers, and the PJM Market Monitor. OPSI intends, as an organization, and through the staffs of the member Commissions, to collect information, monitor markets and events, and to consider proposals related to the operations and functions of PJM which affect those member Commissions' responsibilities for reliability, safety, facility siting and reasonably priced electric service imposed by law upon member Commissions of OPSI.

2. The PJM Board of Managers will meet at least annually with OPSI to discuss matters of mutual interest and at such other times as may be mutually agreed upon. PJM will participate in periodic or *ad-hoc* meetings or conference calls with OPSI on a mutually agreed upon basis as may be requested by either OPSI or PJM. OPSI representatives will meet with PJM staff to discuss issues of mutual interest and to plan agendas for the joint meetings between OPSI and the PJM Board. The goal of such meetings and conference calls will be to increase communication on relevant topics of interest and to facilitate working relationships among the parties.

3. PJM shall promptly provide such information as requested by OPSI, or shall state in writing its basis for withholding such information.

4. OPSI and/or one or more of its Regional Interest Committees for the Mid-Atlantic, Western and/or Southern regions (as defined in its bylaws) may adopt, from time to time, proposals for consideration by PJM. PJM will consider such proposals, consistent with the provisions of the PJM Operating Agreement, the

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PJM Open Access Transmission Tariff (“PJM Tariff”) and the requirements of the Federal Energy Regulatory Commission.

5. Participation in OPSI by Member Commissions shall not preclude such Commissions from acting independently to take such action respecting matters covered by this MOU or otherwise, as may be permitted by each Commission’s responsibilities under its applicable state laws.

6. This MOU shall not preclude Member Commissions, or PJM, the PJM Board of Managers, or the PJM Market Monitor from acting independently to communicate, make proposals, or take other action respecting any matter covered by this MOU as may be permitted by applicable law or, regulation or by provision of the PJM Operating Agreement or the PJM Tariff.

7. PJM will provide funding to OPSI by and through a new FERC-approved schedule to the PJM Tariff pursuant to which OPSI shall submit an annual budget for each calendar year to PJM by no later than September 30th of the preceding year, and PJM, on a monthly basis, shall charge each customer using Point-to-Point and/or Network Integration Transmission Service of PJM an amount equal to the OPSI funding rate set forth in the FERC-approved schedule which charge shall be based on the total quantity of megawatt-hours of transmission delivered during said month by customers using Point-to-Point and/or Network Integration Transmission Service, as said terms are defined in the PJM Tariff.

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8. PJM will remit payments of funds received from each customer using Point-to-Point and/or Network Integration Transmission Service of PJM to OPSI on a monthly basis.

9. PJM understands that it does not have the right to direct the affairs of OPSI due to the mere fact that OPSI is receiving funding from PJM through a FERC-approved tariff.

10. Any disputes that arise between PJM and OPSI regarding this MOU, OPSI's budget or the applicable FERC-approved schedule to the PJM Tariff will be submitted to the FERC for resolution. The rights and obligations of the parties hereto will be governed by Delaware law without regard to its rules regarding conflicts of laws.

11. This MOU may be executed in any number of counterparts, each of which shall be an original but all of which together will constitute one instrument. The MOU shall be effective as to the parties that execute it upon the date of their signatures.

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IN WITNESS WHEREOF, the Parties have caused this MOU to be executed by their duly authorized representatives on the dates shown below:

PJM INTERCONNECTION, L.L.C.

By: Phillip G. Harris
Phillip G. Harris, President and CEO

June 8, 2005
Date

ORGANIZATION OF PJM STATES, INC.

By: Wendell F. Holland
Wendell F. Holland, President

June 1, 2005
Date