

Remarks by Terry Boston, President and CEO, on the State of PJM

Members Committee Meeting

May 19, 2011

Introduction

I'm happy to see the strong attendance again this year for the Annual Meeting as we return to Maryland and the Chesapeake Bay. Next year we move to the Midwest for our meeting to FirstEnergy's home turf in Ohio to mark the integration of ATSI.

We now have 716 members — up from 523 just three years ago. That's a 37% increase in membership!

Last year all of the PJM markets cleared a record of \$34.8 billion — up from \$26.7 billion in 2009, a 22 percent increase. Total transmission throughput was 745 million MWh, up 9 percent year over year.

This kind of growth is driven by hot weather — and excellence in reliability and innovation in our markets. I like the sound of those two words. I like *excellence* and *innovation*. They are easy to say but hard to achieve.

PJM has experience in excellence. We were founded in 1927 by three members with a simple goal to produce more value from the same resources. Now PJM stands as the nation's longest running power pool. Think about that: creating value for 84 years is a mark of excellence.

Excellence is still our watchword, and we saw it last year during a bitter cold winter and the hottest summer on record. The PJM system experienced more than 70 days when demand exceeded 100,000 MW.

On July 7, we hit 104 degrees in Richmond and Washington, and 103 degrees in Philly. We called on 2,700 MW of demand-side resources around the greater Washington, D.C. area.

Sharing reserves over a large area was not just a good idea back in 1927; it's a good idea today. We now know forming a power pool was a mark of innovation. Long before RTOs could have been imagined, these three companies figured out that, if they pooled their resources to optimize the whole, rather than the sum of their parts, it would increase value for both customers and stockholders. This is just as true today.

Innovation and excellence continued to find their marks as PJM grew and progressed to meet the needs of the times.

Innovation

Innovation — like installing our first online computer to control generation in 1962, or completing our first SCADA and Energy Management System for real-time monitoring of 250 transmission lines in 1968. Today we bring in data from 98,750 control points (RTUs). We launched our first website with real-time system information for members back in the early days of the World Wide Web in 1996.

Innovation — like the first LMP market, the first day-ahead market and the first capacity market. And in 2005, PJM implemented the first online, near real-time voltage stability analysis.

We've put into daily practice the "Perfect Dispatch" metric that the FERC recently cited as a "best practice" among RTOs because it has demonstrated system-wide savings of more than one-quarter billion dollars since April 2008.

Sometimes in the pursuit of excellence, we have a tendency to focus on operational capabilities, but it comes in many other forms as well — like our successful efforts to preserve the integrity of our markets last year that resulted in winning the "Platts Global Energy Leadership Award" thanks to our Legal and Finance Departments led by Vince and Suzanne.

Innovation is such a part of our PJM culture that we held an Innovation Forum at PJM two weeks ago, bringing employees together with innovative experts from a variety of companies and fields. The next day employees had the chance to brainstorm ideas to help PJM not only do new things, but do things better and improve processes.

Innovation can give us the answers when you, our members, ask the tough question, "What have you done for us lately?"

Challenges

And, innovation can help us deal with the challenges we face.

The first challenge is to rethink and reinvigorate PJM's transmission planning process. A new planning process must enable us to deal more effectively with the many economic, environmental and policy uncertainties.

As I wrote in a February letter to our membership:

"This region's electricity system faces more challenges in the next 10 years than any other period over the last 100 years.

"Transmission planners are on the leading edge, identifying future needs amidst growing uncertainties such as a changing fuel mix, increased storage possibilities, greater demand participation, as well as fluctuating forecasts for economic recovery.

“We urge stakeholders to find innovative ways to manage these complexities well... so that this region keeps — for the long-term future — the reliable electric service that drives our economy.”

And today I would add the need to serve our digital economy, having just learned the Internet consumes more electricity than automobile manufacturing.

It's not likely that the complexities and uncertainties facing transmission planning today are going to be easier in the future. One can hardly predict the impact of recent EPA rulings or the Japanese nuclear crisis following the earthquake and Tsunami.

The RTEP process took shape more than a decade ago, when the economy was growing and electricity demand was growing along with it. Generator retirements then were an economic decision such as shutting down old oil-fired plants.

Uncertainty has called into question the validity of the reliability “bright line” test that's an integral part of the current planning process. A bright line is simply not possible in the economic, environmental and policy world we now operate in now.

PJM is blessed to have many bright people, but in this economic recovery — with on-again, off-again growth forecasts — we cannot pinpoint the exact day in the future when a reliability violation will occur that requires new transmission. We must plan transmission needs in a way that is more flexible and accounts for multiplying uncertainties associated with new environmental regulations, the growth of renewable resources and the rapidly expanding role of demand response.

Even as we're talking about reinventing the process, Mike Kormos and I will sleep better this summer as the first backbone 500-kV lines authorized by the Board through the RTEP process will be fully in service today. Allegheny Power, now FirstEnergy, and Dominion deserve congratulations for their success in permitting and building the 502-Junction-to-Loudon line — better known as the “TrAIL” Line — as well as Dominion's Carson-Suffolk line.

These lines will make a significant contribution to the reliability of the system. And with respect to the planning process, it just shows you how much has changed in the five years since the TrAIL project was authorized by the Board in 2006.

The second challenge for PJM is to manage the rapid growth of demand response in PJM's markets. Last week we cleared 14,118 MW of DR in the capacity market — so much that we reached the saturation point for the limited “6-by-10” product. I am really glad we had already planned for that possibility, and had other DR options so that system reliability is not threatened.

Looking ahead, we are working with members to develop the rules for Price Responsive Demand so that PJM will have more dispatchable resources, and our members will have even more options to serve customers.

The third challenge is what Sony's CEO called yesterday in *The Wall Street Journal* — A Bad New World. The challenge of cyber and physical security. We know the threat is real, and I can assure you that PJM is quite focused and working closely with governmental authorities and the industry experts to protect the system.

The fourth challenge is how well we all work together. We need a stakeholder process that is more efficient, effective and nimble. We need to be prepared to make meaningful enhancements to both market and reliability rules. The Governance Assessment Special Team — led by John Horstmann, Diane Huis and Ed Tatum — developed solid improvements to the stakeholder process, which are being implemented. But, there is more work to be done. The PJM staff and the Board stand ready to help in any possible way.

This Year

We need to communicate, collaborate and coordinate to meet these challenges.

In less than two weeks, FirstEnergy Corp.'s American Transmission Systems subsidiary will integrate into PJM. This integration will increase the generating capacity in PJM to 176,000 MW and bring the miles of transmission to more than 61,000.

The integration includes the City of Cleveland's Department of Public Utilities, and I'm pleased how — under Frank Koza's project management — this project is under budget and right on schedule.

Achievements

Now let me now return to your question, which I posed earlier: "PJM, What have you done for us lately?" and quickly touch upon some of the past year's highlights that benefit you:

- On Monday of this week, we went into parallel operations 7x24 on 34 of 36 Advanced Control Center systems. With pride, I can say it is the most advanced in the world.
- We reached a comprehensive, zero-dollar settlement for the market-to-market transaction issues with the Midwest ISO under the Joint Operating Agreement.
- We connected 1,507 megawatts of new generation to the system, including 1,032 MW of wind energy.
- We sharply reduced the backlog of planning studies for generation and merchant transmission projects; 637 interconnection studies were completed. That's equal to half the number of generators already connected to the system.
- We reached a favorable settlement of the Tower Research litigation stemming from the 2007 Power Edge default.

- We formed PJM Settlement, Inc. to act as a single counterparty in pool transactions, and we took 20 other measures to reduce your credit-risk exposure.
- We are by far the lowest cost RTO that offers the full spectrum of market services — we benchmark best in class worldwide, and Suzanne will talk soon about a reduction in PJM's Stated Rate.
- In 2010, we had a 21 percent increase in membership.

I would suggest that our growing membership reflects not only the business opportunities in PJM's markets but also our efforts to be responsive to you, our members. Under Sean McNamara's leadership, we are working hard to continue improving and enhancing our customer service.

Closing Comments

As I close, I'd like to offer my thanks to John Coughlin for his 14 years of service to PJM as a member of the Board. His experience and knowledge has been a true asset. More personally, I thank John for his role on the CEO selection committee in giving me the opportunity to serve PJM's members.

Let me emphasize once again PJM's unwavering commitment to excellence in carrying out our three mission-critical priorities:

#1 Reliability,

#2 Fair and efficient markets, and

#3 Sound infrastructure planning.

We must perform our best every minute of every day to keep the lights on — if we don't, nothing else matters.

We must to operate fair and efficient markets that produce competitive results and plan effectively to meet the infrastructure needs of the region and the 58 million people we, collectively, serve.

We know that you, our members, expect and deserve the continued excellence and innovation that is the legacy of PJM.

I thank each of you for doing business with PJM.

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