September 16, 2013

Mr. Howard Schneider  
Chair, PJM Board  
PJM Interconnection, LLC  
P.O. Box 1525  
Southeastern, PA 19399-1525

Dear Howard:

The purpose of this letter is to express concern with how PJM Interconnection, LLC (PJM) has handled FirstEnergy’s recent announcement that it will close two power plants in southwestern Pennsylvania.

The Pennsylvania Public Utility Commission (PA PUC) has no jurisdiction over these decisions. However, we have been extremely vocal in making sure the relevant parties consider all viable options to protect jobs and the long-term viability of the plants. I am very concerned about the tone taken by the company and its attacks on PJM’s capacity market construct. FirstEnergy has made repeated claims that PJM’s Base Residual Auction (BRA) is inherently flawed and fundamentally biased against their coal generation assets. Please refer to the attached articles to see examples of these claims.

Howard, enough is enough. Quite frankly, I feel strongly that PJM senior management must be willing to publicly reassure market participants, as well as state commissions, that the market construct is working and that reliability is intact. To date, management has decided to sit back and let a member company control the public discourse on this issue.

Considering PJM’s important role in the power market arena and its longstanding relationship with the PA PUC, I hope you and your fellow board members will give this request serious consideration. I look forward to hearing from you and working with you to establish a mutually acceptable outcome to this issue.

Sincerely,

[Signature]
Robert F. Powelson  
Chairman
Committee holds hearing on plant closings

BY BOB NIEBALA
STAFF WRITER
NIEBALA@OBSERVER-REPORTER.COM


WAYNESBURG – FirstEnergy plans to proceed with the deactivation of its Hatfield's Ferry and Mitchell power stations Oct. 9 as originally stated in the company's announcement of the closings in July.

FirstEnergy Generation President James Lash testified Friday before the state Senate Consumer Protection and Professional Licensure Committee that the company would hold to its plan to close the two coal-fired plants on that date, eliminating the jobs of 380 employees.

The company has said it will close Hatfield's Ferry, a 1,710-megawatt plant in Greene County, and Mitchell, a 370-megawatt plant in Washington County, because of weak demand, low electricity prices and the costs of bringing the plants into compliance with environmental regulations.

The committee hearing, organized by state Sen. Tim Solobay, D-Canonsburg, and held at Waynesburg University's Stover Center, focused on the loss of jobs but also the continued reliability of electrical services with the loss of the two plants, which represent 10 percent of FirstEnergy's total generating capacity.

Lash testified that for the last few years the company has faced a weak demand for power, as well as market prices at "historic lows," partly as a result of the abundance of natural gas.

It also faces the costs of bringing the plants into compliance with environmental regulations, including the Mercury and Air Toxic Standards that take effect in 2015.

The company would have to invest $270 million just to bring the two plants into compliance with MATS and more regulations on power plant emissions from the Environmental Protection Agency are on the horizon, Lash said.
Responding to a question from the panel about the impact of the environmental regulations on the company’s decision, Lash said the regulations are a factor long term, but even if the regulations were not part of the equation the plants now remain “uneconomical.”

Part of the problem is low prices in the PJM capacity auction, which was created to provide payments to utilities in exchange for making power capacity available, Lash said. Those payments help keep existing plants running and encourage development of new generation.

Capacity payments, however, have not been sufficient to offset low energy prices, he said. The effects of this market “dysfunction” are not limited to Hatfield’s Ferry and Mitchell, he said.

Asked about a plan the company proposed to investors in March to convert Hatfield’s Ferry to burn natural gas and coal, Lash said the company investigated it but found it did not make economic sense.

In response to a question about the company’s willingness to sell the plants, Lash said no one so far has expressed interest in buying them.

FirstEnergy hopes to find employment within the company for at least 25 percent of the employees who will lose their jobs, Lash said. Severance packages and assistance in finding new employment will be provided those who aren’t retained, he said.

The closing of the plants is currently being reviewed by PJM Interconnect, a not-for-profit corporation that ensured the reliability of the power grid in Pennsylvania and all or parts of 12 other states.

Andrew Ott, PJM executive vice president, said his corporation is now completing its review of how the closing will affect the reliability of the grid, but it appears the need to ask FirstEnergy to continue operating the plants beyond Oct. 9 would be “very limited” and would only need to address potential problems on the hottest days of the year when electric use is at its peak.

Ott spoke of the dramatic shift in power generation from coal to natural gas, noting natural gas now represented about 19 percent of generation in PJM’s area. By 2018, natural gas could represent 40 percent of the generation, he said.

Asked about the recent increase in importing power into the PJM area from power plants in other state, Ott said PJM is required to open its markets by interstate commerce laws but the amount of power Pennsylvania now imports is very small. Pennsylvania remains an exporter of power, he said.
Members of the panel expressed concern about what the closings of the plants might mean in terms of the costs of electricity to local homeowners as well as the removal of coal from the nation's energy mix as the nation seeks energy independence.

Robert Powelson, chairman of the Public Utility Commission, also spoke and expressed concerns not only about the loss of jobs but also the impact the plant closings would have on the reliability of the electrical grid.

Powelson said he had requested a meeting with Gina McCarthy, EPA administrator, to discuss options regarding compliance with environmental standards that could keep the plants operating longer.

He also noted the $650 million FirstEnergy's predecessor, Allegheny Energy, had spent to install scrubbers on Hatfield's Ferry in 2009 would not be paid by FirstEnergy customers but by the company's shareholders.

Robert T. Whalen, president of the Utility Workers Union of America, Local 102, said for years Hatfield's Ferry has been a "cornerstone" of the grid and the company should consider selling the two plants if it no longer wants to operate them.

Whalen said independent investor groups have been purchasing coal-fired plants and he knew of one group that might be interested in Hatfield's Ferry.

Whalen also said that for years the company has done little to ensure reliability on the distribution side of the business and some of the workers losing their jobs at the plant could be employed on the distribution side as linemen and substation operators.

He also suggested the state take a hard look at whether the deregulated utility industry best serves the public interest. It may be that ensuring reliable and cost-effective power may require returning generation to a regulated entity under control of the PUC, he said.
FirstEnergy exec says PJM market flaws led to decision to retire coal plants

By Matthew Bandyk

FirstEnergy Corp.’s decision to retire the 1,700-MW Hatfield’s Ferry and 370-MW Mitchell coal-fired plants in Pennsylvania is the result of a basic “market dysfunction,” a company executive said Sept. 13 in response to skepticism of the decision at a Pennsylvania Senate hearing on that day.

The chairman of the Pennsylvania Public Utility Commission and several politicians questioned why FirstEnergy is not selling the plants or repowering them with natural gas, rather than allowing them to close.

It comes down to a simple math that power prices are too weak for the plants to make money and capacity payments from PJM Interconnection LLC are not enough to provide relief, FirstEnergy Generation Corp. President James Lash said at the hearing before the Senate Consumer Protection and Professional Licensure Committee.

The audience at the hearing was crowded with people protesting the plants' retirement, with the slogan “FirstEnergy Unfair” emblazoned on the backs of their t-shirts.

But Lash’s response seemed to be that if one is looking for someone to blame, look to grid operator PJM.

Hatfield’s Ferry and Mitchell are dependent on the revenue they can make by selling their power in the wholesale markets, and in the past few years those revenues have taken a beating. Pennsylvania utilities are serving fewer customers today than they did in 2007, and wholesale electric prices are about half of what they were in 2008, Lash said in his testimony at the hearing. “What you would typically expect to see is that when power prices are low, capacity payments should be high,” he said.

But PJM has not stepped in to change the way it pays for plants to provide capacity for the grid, Lash argued. “Capacity auction prices have not been sufficient to offset those losses. The market is not achieving the purpose of retaining generation and causing new generation to be built,” he said.

“This market is a flawed competitive market.”

Hatfield’s Ferry and Mitchell failed to clear the most recent PJM base residual auction, meaning they will not receive payments for their capacity to be available in 2016 and 2017.

The two plants are losing money and only running to cover the costs of their fuel, with their capacity factors falling from about 75% at Hatfield’s Ferry and 60% at Mitchell in prior years to 67% and 47% in 2012, according to Lash. FirstEnergy is keeping confidential the actual costs of their production.

The company announced in July that it would retire the plants by Oct. 9, citing low power prices and the expense of installing new pollution controls required for the plants to comply with the U.S. EPA’s Mercury and Air Toxics Standards.

FirstEnergy has estimated that the total cost of installing these controls at Hatfield’s Ferry and Mitchell would be $270 million, while the company is spending about $650 million on its remaining coal plants, FirstEnergy spokeswoman Stephanie Thornton said in an email.

But these costs are not the main reason FirstEnergy is retiring Hatfield’s Ferry and Mitchell. Under questioning from senators at the hearing, Lash said that “even without the EPA,” the plants would still be losing money.

The fact that market fundamentals seem to eclipse environmental regulations for FirstEnergy may make things difficult for the parties working to keep the plants running. In his testimony at the hearing, Pennsylvania PUC Chairman Robert Powelson said the PUC “is deeply concerned about the impact of these plant retirements on Pennsylvania and their potential affect on the overall reliability of the electric grid” and that the regulators want to prevent “an unreasonable increase in electricity prices or a situation where there is inadequate generation to respond to the electricity needs of the region.”

To that effect, the PUC has requested a meeting with EPA Administrator Gina McCarthy in order to discuss “environmental compliance options that could keep the plants operating longer,” Powelson said.

But alternatives that get around the EPA regulations may not be enough to save the plants. For example, Powelson mentioned that FirstEnergy said in a presentation at the Morgan Stanley Utilities Conference in March that it was looking at the possibility of converting Hatfield’s Ferry and Mitchell to natural gas-fired units.

“Given that those power plants are located in southwestern Pennsylvania and are sitting on top of one of the largest shale gas deposits in the world, it makes sense that FirstEnergy would want to take advantage of this low-cost resource and convert to natural gas co-firing units,” Powelson said. “The question is, what has changed in four months?”

The answer, according to Lash, is gas prices. Switching from coal to gas seemed possible when gas prices had fallen to about $2.40 per MMBtu, but FirstEnergy no longer believes the conversions make sense now that gas prices have risen from their lows in 2012. “At the end of the day, it was not economically viable,” Lash said of the planned conversions.
Mr. Terry Boston  
President and CEO  
PJM Interconnection, LLC  
955 Jefferson Avenue  
Norristown, PA 19403  

Dear Terry:

Thank you for meeting with the FirstEnergy team recently to discuss our concerns and thoughts with PJM's current capacity auction guidelines. I understand it was a productive session and I hope was a good first step to working with you and other PJM members to quickly address these issues.

As you know, we remain very concerned that the current rules may not provide the long-term signals or financial incentives needed to justify investments in generation—or in some cases, to ensure that adequate generation will be available. FirstEnergy also believes that the rules must also foster a level playing field among market participants, particularly generators that rely solely on the competitive market to recover costs.

Below is a recap of key issues we believe require market reform:

**Imported Generation**—A record amount of imported generation from MISO cleared the most recent auction—incredibly, some without firm transmission. Outside generation offers must be tied to real generating assets, not simply requests for firm transmission service tied up in another region's queue process.

**Financial Arbitrage**—We're seeing an unprecedented number of buyouts of capacity auction positions through incremental auctions and other replacement mechanisms. While this tactic creates an opportunity to arbitrage and make money by promising nothing, it is suppressing prices for real generating assets within PJM and will undermine system reliability.

**Demand Response**—Though treated like hard asset generation, demand response does not have to meet the same rules, is not subject to minimum bids and doesn't produce the same value from a reliability perspective.

**Market Distortions**—Regulated generation that receives full cost recovery, along with subsidized generation, competes with generators that rely solely on the market for revenue. Regulated generation is indifferent to price, so they can bid zero but get the market price.

FirstEnergy is committed to working with PJM and others to resolve these challenging issues in the months ahead. Again, thanks for taking the time to hear our concerns. Please contact me personally if you'd like to discuss any of these items.

Sincerely,

[Signature]

Cc: Andrew L. Ott  
SVP, Market Services - PJM