



FPL Energy

November 15, 2006

Phillip G. Harris
President and CEO
PJM Interconnection
955 Jefferson Avenue
Valley Forge Corporate Center
Norristown, PA 19403-2497

Dear Mr. Harris and Members of the PJM Board of Managers:

FPL Energy, LLC is pleased to respond to the October 6, 2006 request by the PJM Board of Managers for input into the strategic direction of PJM over the next five to ten years. We always appreciate the opportunity to communicate with PJM, whether through the stakeholder committee process or in more general sessions with PJM senior management and the Board of Managers.

The role of long-range strategic planning is critically important in any organization, particularly when the reliability and future growth of something as vital as the electricity grid is at stake. While many rhetorically embrace strategic planning, few actually practice it to the level required to adequately adapt to the future needs of their customers and the organization itself. The PJM Board of Managers clearly recognizes these needs and is responding to them, and while that effort is admirable, we have concerns that it may be missing the mark.

As the Board noted in its September 15, 2006 letter to the PJM membership, there is clearly a desire on the part of members to have PJM retain its "core missions of reliable operations and efficient electricity markets and to adhere to the principle that the Board acts independently and without undue influence by any Member or group of Members." The Board further noted the consistency of concern by Members regarding the lack of direct communication, and frequency of that communication, on critical issues with the Board of Managers. On this latter point, the membership has been clear over the last several years in indicating to the Board that this is a key area of deficiency that needs to be improved. We consider it an aspect of the governance structure of PJM, and so we shall address it more directly in our response to that section of the Board's inquiry.

That having been said, the Board's issuance of a detailed series of questions on multiple issues to member senior management is somewhat perplexing. Should the Board truly be interested in gaining the input of member senior management -- and we believe it is --

perhaps worthy of consideration is greater direct interaction between member senior executives and the Board of Managers. We are not recommending “general sessions” in which broad principles are exchanged, nor are we suggesting the kind of detailed survey such as that issued to senior executives on October 6. Rather, in smaller group settings, member senior executives and Board members can and should work together to better understand the needs of PJM and the member organizations and entities and plot a course toward meeting them. As an example, the fine details associated with the design of offer caps mean less to senior executives than whether mitigation, as with other market rules, is transparent and appropriately applied. While there is benefit in discussing the detailed aspects of market structures and implementation, these should occur at the stakeholder committee level following the broader, more senior level discussions noted above.

We would further note that the Board, in its September 15, 2006 letter, suggested that the issues of strategic planning and improving Member/Board communication “actually come together in a way in which Members can provide helpful and meaningful input to us.” It’s true that a nexus exists, but only in part. Developing an effective means of communication between PJM members and the Board on a Strategic Plan is but one aspect of communication enhancement, but the broader issue of more direct and frequent Board/Member communication should not be lost. We are somewhat concerned, given the letters of September 15 and October 6, that perhaps the Board has underestimated the genuine desire and singularity of focus that members have in improving Board/Member communication. We recognize and appreciate the fact that input into a strategic planning process represents an important area of member communication with the Board of Managers and PJM senior management, but it should not be confused with a much broader interest of members, in the Board’s own words, “to communicate in an unfiltered way and with adequate frequency with the Board on matters of importance to the membership.” Again, this issue will be discussed in greater detail in our responses to the Governance section.

In addressing the array of specific questions asked by the Board, FPL Energy will do so through general responses by category:

1. **Network Services** – Generally, as the Board suggests in its correspondence, the advent of ISOs and RTOs and the integration of competitive forces is a relatively new phenomenon in the electricity industry. It is a significant paradigm shift from the decades-old way that electricity had been generated and delivered. Therefore, to reach definitive conclusions as to whether one model or another, or one control area operator or another, is better than others is at best premature.

FPL Energy believes in the benefits of competition. As a company, we actively seek out opportunities to participate in the developing competitive markets throughout the U.S. Our continued participation in PJM, and our desire to grow in this region, is based on what we see every day – the continued effort by PJM to fairly, neutrally and independently provide reliable electric service to consumers. If anything, this is what companies like FPL Energy expect, and what we want to see more of.

While FPL Energy recognizes that several industry groups have suggested that regional operators should refocus their efforts on network operations and planning, and phase out market administration, at this point FPL Energy would take exception to that approach. While, perhaps somewhere in the future, we can reach a stage where regional operators are no longer needed to administer markets, we do not believe that we'll see that day within the next 5-10 years. When dealing with a commodity as important to consumers as electricity, it's critically important for all market participants – particularly for consumers – to have confidence in the independence and impartiality of the entity administering the various markets. Managing reliable service provision over such a broad footprint and with such a wide array of services takes a unique, complex organization that only an entity like PJM is designed to handle, at least for the immediate future.

Network operations and planning functions will also continue to be critical responsibilities for ISOs and RTOs into the future, and so the suggestion that somehow PJM can exit one aspect of its current portfolio of services to focus on others is questionable.

We acknowledge that investment in both generation and transmission assets has lagged behind some industry participants' hopes and expectations. We do believe that PJM, with its network system operations function, is making an admirable effort to encourage investment in the PJM region. Investment in major generation and transmission assets takes a considerable amount of development time and resources; additionally, the electricity industry has been understandably deliberate in recovering from one of its most challenging periods. Understanding this, and the fact that the lag between the increasing demand for electricity and the development of new infrastructure has resulted in reliability challenges, particularly in certain region, PJM has worked with market participants to counter that trend. The Reliability Pricing Model, the Regional Transmission Expansion Planning Process, and the coordination between the two, represents an evolutionary step in prudent infrastructure development. Once both are fully implemented and their operation is proved, they should represent a significant incentive for infrastructure development where it is needed most.

Finally, the new analytical tools that are being rapidly developed and deployed to improve system operations security and reliability are both exciting and important to the future of competitive electricity markets. PJM has generally been a leader in deploying these technologies for the betterment of its members and, ultimately, consumers, and we appreciate that leadership. That having been said, we strongly encourage the PJM Board to ensure that the organization continues to focus on performing its core functions well, rather than diverting resources away from that mission toward for-profit market services and technology ventures. PJM has just gone through a period of significant expansion in terms of market structure evolution and geography. While such ventures may seem both promising and exciting, member confidence in PJM requires that the basics be performed right. We would hope that if

PJM is seriously considering forays into for-profit ventures, that it closely consult with its membership through the established stakeholder process.

2. **Regional System Planning** – FPL Energy appreciates the effort of PJM to expand the Regional Transmission Expansion Planning Process to incorporate a longer-term planning horizon. Generally, moving from a five- to fifteen-year timeframe offers an opportunity for PJM and market participants to better prepare for the reliability needs of the region. The RTEPP “expansion” represented both intelligent planning on the part of PJM, as well as responsiveness to stakeholders, including public entities at the state level.

Conversely, FPL Energy is less enthused about PJM’s Economic Planning proposal to, as the Board states, “enhance economic planning and more closely integrate the planning of transmission for market efficiency with its transmission planning for system reliability. As noted earlier, we acknowledge the critical importance of system reliability and, for that reason, agreed with most stakeholders that extending the RTEPP outlook timeframe to fifteen years was advisable. However, PJM’s desired extension of the planning process beyond its core mission -- reliability -- and into the economic realm is troublesome, and can quite possibly interfere in the market process. As other market participants have noted in expressing their concerns, the PJM’s economic planning proposal relies on long-term forecasts for electricity prices, fuel costs, load growth projections and other variable market conditions to justify regulated transmission projects, projections as far as 30 years into the future. The estimated savings in power purchases is compared with the estimated costs of the transmission project. If the benefits outweigh the costs, PJM staff can propose a project which is submitted to TEAC. If approved by TEAC, the project would be automatically authorized by the Board of Managers, whether or not there was a transmission owner identified to build the project. Due to the uncertainty of the long-term assumptions on which these forecasts and analyses hinge, projects may be built which are not the most cost-effective means of reducing congestion. For consumers, the result may be the wrong project in the wrong place and significantly higher costs than if investors had been allowed to compete and react to market signals.

A better option, FPL Energy believes, would be for PJM to provide information to the market to encourage market-based investment where it is truly needed, rather than dictating economic solutions. Other markets have considered and dismissed similar economic planning processes, concluding correctly that unless a system condition exists with reliability ramifications, it should be appropriately left to the market to determine the solution. Whenever possible, the markets should be allowed to work.

3. **Market Administration** – FPL Energy appreciates the critical market administration functions provided by PJM. This is a core responsibility of PJM’s, and the products and services offered and administered have helped to establish PJM as a premier Regional Transmission Organization in North America. It should be noted, however, that PJM, as expert as it is in designing and implementing its various markets and

services, continues to learn and, with the support and input of market participants, improve market structures to make them more accessible, user-friendly and efficient. This is not intended as criticism. The competitive paradigm, barely a decade old, is relatively new. As PJM and its stakeholders learn more about improving existing products and implementing new ones, the investment of time and effort is generally made to do so. FPL Energy continues to support that effort. As noted earlier, however, we are wary of efforts to expend resources to move beyond the core functions and responsibilities of PJM until those functions are improved upon. Critical areas, such as the new settlement system, the Reliability Pricing Model (RPM), marginal losses and long-term transmission rights represent important reforms, but they have not yet been implemented. Once that occurs, they will undoubtedly require a level of continued monitoring and adjustment that may take months, if not years. Each of these programs represents a response to the need for accurate and longer-term price signals and new infrastructure investment, so “getting it right” is crucial. Market participants will always be willing to work collaboratively with PJM to develop new products and improve existing programs for the betterment of consumers and stakeholders, but expansion into additional for-profit commercial market ventures seems inappropriate at this time.

Additionally, FERC has recently identified an interest in assessing the role of market mitigation in the various markets, with a specific concern being that overly-aggressive mitigation may be interfering with the development and liquidity of the various markets in competitive RTOs and ISOs, as well as sending negative price signals for new investment. We strongly believe that the market monitor in each of the respective markets in which FPL Energy does business fulfills an important role. However, in light of the valid issues raised by the Commission, we would encourage the Board of Managers to consider acquiring the services of an objective, independent entity to review the existing PJM market monitoring plan and its impact on PJM’s markets. Such a review can only serve to better inform the Board, PJM senior management, and market participants.

Finally, the Board’s letter accurately points out that PJM and the other existing ISOs/RTOs do not share common market designs and rules, and there are large areas of the country that do not participate in organized markets. FPL Energy, like other market participants, does participate in multiple ISO/RTO markets. While standardizing market design might have been an admirable goal at one time, it is clear that what might have seemed optimal from a market structure and implementation perspective is no longer practical or political feasible. The goal, then, should be to eliminate seams and create comparable products wherever possible, and ensure that existing programs in each ISO/RTO function efficiently and provide for system reliability.

4. **Demand Response and Access to Markets** – Demand Response is not among FPL Energy’s core businesses or functions, but we certainly appreciate the critical and increasingly important role that demand response plays in PJM’s markets and in

support of overall system reliability. We encourage its expanded participation whenever feasible. At this point, we will defer to those entities more directly involved in providing demand response services within PJM.

- 5. Governance** – As the Board has appropriately identified in its note, governance is perhaps the most vexing issue confronting PJM and its stakeholders today. Clearly, there are market structure and administrative issues as well, but stakeholders have long expressed to the Board and PJM Senior Management the desire to have direct, unfiltered access to the Board of Managers. Why? Quite simply, the Board of Managers is a grouping of remarkable individuals, each of whom brings to the table a unique combination of expertise, experience and sensibility. Collectively and individually, they have a different perspective on PJM’s functions than, perhaps, PJM senior management and stakeholders might have, given the fact that the latter live and work with these issues every day. While we may get caught in the weeds, the Board can shed a broader, higher level perspective on key issues. Stakeholders, in particular, could benefit from the Board’s unique attributes and FPL Energy believes that the Board, too, could benefit from direct stakeholder interaction. In those limited opportunities during the course of the year when that direct interaction is afforded to stakeholders, including the PJM Finance Committee, it’s time very well spent. While we appreciate and understand the benefits associated with having PJM’s senior management distill stakeholder sentiment for the Board, and vice versa, it can never serve as a substitute for direct interaction. Stakeholders have highlighted institutionalized processes in other markets for direct Board interaction. The New York Independent System Operator, as a notable example, has a Liaison Committee in which stakeholders meet directly with Board members each month. In no way does the Liaison Committee interaction compromise the independence of the NYISO Board, nor is it intended to. FPL Energy and other stakeholders continue to recommend a process similar to this for PJM, and we urge the Board to consider a similar format. While we can only represent the views of FPL Energy, we feel fairly confident that those other PJM members who participate in the NYISO governance structure would be willing to attest to the benefits of the Liaison Committee as well.

In terms of the PJM governance structure itself, FPL Energy devotes considerable resources to participation in the PJM stakeholder process, including direct representation on the many committees and working groups devoted to PJM market structures, administration and other issues. As it relates to governance reform, the Governance Committee features a constructive and thoughtful effort by stakeholders and PJM to work together, and some progress is being made. That process, rather than detailed surveys, is probably a more useful method of working through the various governance issues that confront PJM and its stakeholders.

Once again, FPL Energy appreciates this opportunity to provide input into PJM’s strategic direction. We look forward to continuing to work closely with the PJM Board of Managers, its senior management, and all stakeholders to ensure that the goals of reliability of electricity provision and excellence in execution remain paramount.

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Sincerely,

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