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MARKET MONITOR FINDS

PJM WHOLESALE ELECTRICITY MARKETS REMAIN COMPETITIVE

2008 State of the Market Report Released

(Washington, D.C. – March 11, 2009) – PJM Interconnection’s wholesale electric energy markets produced competitive results last year, according to the 2008 State of the Market Report, released today by Monitoring Analytics, LLC, the Independent Market Monitor for PJM.

Market Monitor Joseph Bowring discussed findings of the report today during a briefing in Washington, D.C. The report is the Market Monitoring Unit’s annual assessment of the competitiveness of the wholesale electricity markets managed by PJM in 13 states and the District of Columbia. It analyzes market structure, participant behavior and market performance.

“Our analysis concludes that the results of the PJM markets in 2008 were competitive,” Bowring said. “At the same time, the report recommends rules and rule changes required for continued competitive results and for continued improvements in the functioning of the markets.”

Bowring stated, “There were several positive developments in 2008 that will help ensure that the markets continue to produce competitive results. The Federal Energy Regulatory Commission (FERC) ended exemptions from market power mitigation rules affecting the energy market. PJM and its members also filed and FERC accepted the application of the three pivotal supplier market power test to the regulation market. Finally, rules governing the payment of operating reserve credits to generation owners were modified to address market power issues and to improve the allocation of the associated charges to those causing the charges.”

Among the report’s recommendations are: enhancements to PJM’s scarcity pricing rules to create stages of scarcity and corresponding stages of locational scarcity pricing without lifting offer capping; improved pricing and management of power flows at the interfaces between PJM and its neighbors including measures to reduce gaming incentives; improvements in cost-based data submission by generation owners to permit better monitoring and better evaluation of the impacts of environmental costs on markets; and improved measurement and verification for PJM’s demand side programs.

The report finds competitive results for PJM’s Energy, Capacity, Synchronized Reserve and Day Ahead Scheduling Reserve Markets and the Financial Transmission Rights Auctions. In addition, the report says the Regulation Market results cannot be determined to have been competitive or noncompetitive. However, Bowring noted that “the application of the three pivotal supplier test for structural market power in the Regulation Market beginning on December 1, 2008 should resolve these issues in the regulation market.”

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The report also observes that:

- The overall results support the conclusion that prices in PJM are set, on average, by generating units operating at or close to their short run marginal costs. This outcome is strong evidence of competitive behavior.
- Overall, 2008 net revenues for generators were higher than in 2007, with the exception of coal units in some zones. The increased net revenues in 2008 were the result of higher locational energy prices and of higher locational capacity prices. Revenues from the sale of capacity resources increased significantly in 2008 as the result of the first full year of the new Reliability Pricing Model (RPM) Capacity Market. The locational pattern of net revenues reflected the underlying supply and demand conditions across the PJM footprint.
- The fixed costs of constructing a new combustion turbine or combined-cycle generation resource were fully covered in some, but not all, PJM control zones. The fixed costs of constructing a new coal-fired steam generation resource were not covered in any control zone. There was revenue adequacy in 2008 for the combined-cycle technology for more zones than for the combustion turbine technology. These mixed results were the outcome of increased fuel costs and sharply increased costs of constructing new capacity of all types.

The Market Monitoring Unit evaluates the operation of PJM's wholesale markets to identify ineffective market rules and tariff provisions, identifies potential anticompetitive behavior by market participants and provides the comprehensive market analysis critical for informed policy decision making. Bowring, the market monitor, ensures the independence and objectivity of the monitoring program. The Market Monitoring Unit submits the State of the Market Report to the PJM Board and to the Federal Energy Regulatory Commission.

For a copy of the State of the Market Report, visit www.monitoringanalytics.com > reports > PJM State of the Market >2008.

PJM Interconnection ensures the reliability of the high-voltage electric power system serving 51 million people in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia. PJM coordinates and directs the operation of the region's transmission grid, which includes 6,038 substations and 56,350 miles of transmission lines; administers a competitive wholesale electricity market; and plans regional transmission expansion improvements to maintain grid reliability and relieve congestion. Visit PJM at www.pjm.com.

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