

EXECUTIVE SUMMARY

I. SUMMARY

This chapter contains a summary of the audit process, an overall balanced assessment of the Company, and a detailed list of all recommendations.

I.A SUMMARY OF THE AUDIT PROCESS

In 1999, New Jersey passed the "Electric Discount and Energy Competition Act" (the Act), or New Jersey Statutes Annotated (NJSA) 48:3-49, *et seq.* The Act provided for customer choice in energy services. The Act also provided for the restructuring of New Jersey's seven utility companies such that the delivery of the energy service would remain regulated and a "protected monopoly." However, the actual provision of source energy and energy related services were to be available and subject to the competitive forces of the marketplace.

I.A(1) The Act

The Act provides for assurances that the regulated utility will not unfairly use its market power to undo the expected benefits of a competitive marketplace. At NJSA 48:3-55, 48:3-56 and 48:3-58, the Act empowers the New Jersey Board of Public Utilities (BPU or the Board) to secure services of independent consultants to conduct audits of the utilities and their related competitive business segments (RCBS) to determine whether they enjoy unfair competitive advantage.

I.A(2) Purpose Of The Audits

The purpose of the audits is to provide an assessment to the Board of the results of the introduction of the competitive arena. Specifically, the purpose is to evaluate and report to the Board whether a level playing field exists for all participants in a competitive service offering. Where unfair competitive

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advantages may exist, the consultant is expected to recommend corrective actions. These audits are to be conducted at least every two years.¹

I.A(3) Major Issues

For the Board, there are two major issues. The first issue is whether the standards developed by the Board to cover the utility, the RCBS and the public utility holding company (PUHC) are sufficient and working effectively. In essence, does this "Code of Conduct" provide for the level playing field with non-affiliated purveyors of competitive services having access to all the existing benefits the RCBSs have with the utility.

The second major issue is to provide, through the Board, to the energy customers of New Jersey, the assurances of fair and proper allocations of costs between the non-competitive (regulated) and competitive products or services. The Act and the Board specifically wish to prevent and avoid any cross-subsidization.

I.A(4) The Standards For The Code Of Conduct

The Board has published "Affiliate Relations, Fair Competition and Accounting Standards and Related Reporting Requirements." The Standards serve as the road map for the generic work plan. The major tasks of the work plan are defined as:

- ***Nondiscrimination***

The standards of conduct are designed to assure the absence of preferential treatment by the utility or any affiliate or RCBS. Consequently, eleven (11) standards covering the utility's specific processing of transactions have been

¹ Section 7 Regulatory Oversight §3c of the Standards

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constructed. These standards also prohibit the utility from partaking in any activity that would provide unfair advantage in business development and customer relations.

- ***Information Disclosure***

The Board recognizes that information is a valuable commodity and would be an unfair competitive business practice. The Board has defined that privileged access to such information sources as customer lists would be an unfair competitive business practice. The Board has defined seven (7) standards covering this issue. The standards cover conduct between the utility and RCBS plus the utility and the utility customer or potential customer.

- ***Separation***

The legal and structural separation of the utility, its PUHC, and RCBS are provided for by the Standards. The Board specifies certain physical separation requirements. Nine (9) general standards cover books and records, sharing of assets and services, relationship of the utility to the PUHC and RCBS, employees and transfers of services and assets.

- ***Competitive Products/Services Offered by a Utility or RCBS of a Utility***

The Board has designed seven (7) standards plus prescribed remedies for violations to these standards of conduct. All competitive services/products offered by the utility or an RCBS must be reviewed and have a Board-approved tariff. The Board holds itself the decision-maker as to what is an allowable competitive product/service.

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I.A(5) Scope

The Board wished to receive from the auditors an informed and supported opinion of each utility's compliance plan and historic actions since inception of competition and energy choice in New Jersey. Key to this opinion are the Board's standards. Further, based on technical accounting guidelines and process information flow auditing, we determined the degree of separation and allocation of each utility's revenues, costs, assets, risks, and functions between and among the utility and its RCBSs. To achieve this scope of effort, determination was made as to whether²:

- Cross subsidies exist between the utility and its non-utility segments within a PUHC;
- The separation of utility and non-utility organizations is reasonable based on the above noted standards;
- There is any impact on the use of utility assets in the provision of non-safety related competitive services;
- There is any impact or effect on the utility's employees with particular interest in professional assignments to RCBS;
- The utility is unfairly affecting competitive services; and
- The utilities can completely demonstrate compliance with the Act.

I.A(6) The Need For A Compressed Time Schedule

The Act requires the Board to render a decision, after notice and hearing, on any further restrictions required for any or all non-safety

² NJSA 48:3-55, 7K(1)

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related competitive services offered by an electric utility (see 48:3-55, 7K) by December 31, 2000. This is a critical end date. One must consider the process for review by the Staff and by the Commissioners. Due process was calculated by Staff to take two and one-half months.

The Board made its selection on July 6, 2000. Winning consulting teams were invited to Newark for an administrative kick off meeting on July 12, 2000. The primary timing need was for Final Reports on October 15, 2000. A three (3) month time frame for field work and final report is the only option open to Staff.

I.A(7) The Matrix Management Approach

PMC-WGA was charged with this audit and those of two other electric utilities. Consequently, consideration to scheduling and the short time frame had to be in the context of all three assignments and the Board's desire to have staff attend the maximum number of interviews. A matrix management was proposed as the best way to meet the quality and time of performance issues.

A matrix approach considers both the operational and the functional requirements of a consulting assignment. From the operational aspect, a short duration assignment with intense scope requires constant and immediate attention to identifying data needs and facilitating the response times with the utility. The multiple utilities in the present situation dictate that the responsibility rest with a single individual for the quality and completion of the functional tasks. Further, the report writing function must be laid upon the key operational consultant. For these reasons, a utility lead was selected for each utility and was charged with keeping a contemporaneous management of the assignment.

The functional aspects of the assignment were divided into four specific task areas that specifically complied with the Standards. These are described above in §I.A(4). The functional

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lead consultants were scheduled to visit all three electric utilities. Specific requests for data were made. These data requests reflected an expansion of the proposal's generic data requests. The consultants reviewed the responses to assess whether non-compliance was clear. Failure to detect non-compliance resulted in the attempt to verify compliance or non-applicability.

To maximize the knowledge gained by all consultants involved, group meetings were held each Thursday evening. Lessons learned were shared on a group basis with comparative analyses being tested directly by other skilled consultants. The utility lead used this and the following workday to jointly prepare, with the functional lead, the pre-established checklist of compliance standards. These checklists formed the prime basis of the task reports and finally the Final Report.

I.A(8) Generally Accepted Government Auditing Standards

PMC-WGA followed Generally Accepted Government Auditing Standards (GAGAS), also referred to as the "Yellow Book". The germane chapters of the "Yellow Book" are Chapter 6: Field Work Standards for Performance Audits and Chapter 7: Reporting Standards for Performance Audits. This continues **PMC's** history as the first consulting firm to use GAGAS during a utility performance audit.

PMC-WGA complied with applicable elements of GAGAS by the following:

- **Adequate Planning** demonstrated by the proposal and the required detailed work plan;
- **User Needs** were considered by our analysis of the BPU's standards and the Act;

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- **Understanding** was shown in our description of the assignment in the proposal;
- **Criteria** covering our evaluation were based on the BPU standards;
- **Management Controls** were maintained through the use of **PMC-WGA's** AMS;
- **Supervision** was adequately maintained through the use of the utility lead consultant and prescribed performance check lists;
- **Compliance** with GAGAS was maintained by the utility lead consultant;
- **Evidence** was enhanced in quality by the cooperative approach used by **PMC-WGA**;
- **Working Papers** were provided for by the Administrative Management System's records and by filings that are kept at the utility for BPU use.
- **Reports** are in accordance with BPU requirements;
- **Timeliness** was held by tracking to the BPU pre-set schedule for completion; and
- **Views** of utility officials concerning accuracy were sought through the cooperative approach and reading of draft reports.

I.B SUMMARY OF AUDIT

In this section, we provide the listing of consultants who were the project leads, the statistical volume of activity, and the list of recommendations.

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I.B(1) Lead Personnel

As noted at I.A(7) of this chapter, the matrix management approach to project control was employed. A utility lead was assigned full time to assure technical and administrative consistency. The utility lead has responsibility for work papers, review of checklists from each functional lead, quality control

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check of footnotes to work papers, and authorship of the Final Report. The responsible consultants are:

Stephen Duffy RECO Lead Consultant
William Warinner Non-Discrimination
Victor Hurlbert Separation
Michael Patterson Information Disclosure
Kurt Harms Competitive Products/Service Offerings
William Roberts Human Resources

I.B(2) Statistical Summary

The utility was presented with 159 data requests, all of which were responded to and secured in the work paper file. A list of the data requests is an appendix to the technical report. Additionally, thirteen interview requests were issued and interviews conducted with personnel from RECO, ORU, and CECONY .

I.B(3) Summary of Recommendations

The audit produced one (1) recommendation. This change is associated with technical compliance with the Standards. At the end of the recommendation, we provide the chapter reference.

- 1. Formalize and test employee understanding of the information disclosure rules. [Chapter IV.B(1)]***