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June 17, 2011

Via Hand Delivery and Electronic Mail

Secretary Kristi Izzo
Board of Public Utilities
Two Gateway Center
Newark, NJ 07101

Re: I/M/O the Board's Investigation of Capacity Procurement and
Transmission Planning
BPU Dkt. No. EO11050309

Dear Secretary Izzo:

Enclosed for filing please find an original and ten (10) copies of the Division of Rate Counsel's comments in the above referenced matter. These comments are being submitted pursuant to the Secretary's Notice dated May 27, 2011. An electronic copy of these comments will be sent to the parties on the BPU's e-mail service list in this docket.

We are enclosing one additional copy of the materials transmitted. Please stamp and date the copy as "filed" and return it to our courier. Thank you for your consideration and assistance.

Respectfully submitted,

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**In the Matter of the Board's Investigation of Capacity
Procurement and Transmission Planning
BPU Docket No. EO11050309**

**Comments of the New Jersey Division of Rate Counsel
June 17, 2011**

1. Introduction:

In these comments Rate Counsel will address our on-going concerns about the adequacy of electric supply in New Jersey, what Rate Counsel believes are the impediments to the construction of new generating capacity available to serve the New Jersey market, and possible actions the Board may take to address these issues.

Initially, it should be noted that PJM's Reliability Pricing Model ("RPM") was proposed back in 2005 primarily in response to concern about capacity inadequacy in New Jersey, where no new capacity had been built for several years. Now, several years later, it is still the case that new generation is needed in New Jersey but has not been built. The fundamental notion on which RPM is designed – that high RPM revenues will motivate the construction of new generation – is conceptually flawed and disproven by RPM results to date. RPM does not provide the type of long term revenue assurance needed to support the construction of new generation capacity. As a result, prices remain high with little or no new generation being built to serve the New Jersey market.

2. Capacity adequacy in New Jersey is and will continue to be a concern

The Board is properly focused on the looming and significant capacity adequacy issues facing the state. There are multiple bases for concern, including continued projections for load growth, albeit moderated; delays in the construction of new transmission facilities; ongoing energy exports into New York; and, known and expected

capacity retirements resulting from high operating costs and new environmental regulations. Taken together, these factors portend a need for additional capacity in New Jersey in the not-so-distant future. These factors compel a continued focus by the Board to foster the construction of new, clean, and efficient generation to support New Jersey's current and projected energy needs.

It has been suggested that because the observed RPM prices are less than PJM's administrative Net CONE figure, that additional capacity from a state program is not needed. Rate Counsel does not agree that RPM prices less than the administrative "Net CONE" indicate that additional capacity is not needed.¹ RPM is a one-year spot market extending out three years. We have no reliable information from RPM on capacity supply and demand conditions beyond the three year time horizon. However, the construction of any needed new capacity will require long lead times. Moreover, a planning reserve margin is considered to be a minimum requirement for reliability, and it is prudent to ensure reliability by at least slightly exceeding the minimum. Prudent planning for installed capacity should not be based on a minimalist, "just in time" approach.

a. Retirements in (and exports from) New Jersey and Eastern MAAC

Retirements due to pending EPA regulations and high operating costs add an additional level of uncertainty to New Jersey's energy future and call into question the prudence of relying heavily on transmission upgrades to meet reliability concerns. Key

¹ Also, the administrative Net CONE value is based on some very questionable assumptions, such as the historical average energy and ancillary services revenues.

drivers for retirement of inefficient and/or “dirtier” fossil generation include recently proposed federal EPA regulations, and existing state emission control requirements. All emission control requirements impose fixed and variable costs on applicable resources that may not be recoverable in the energy and capacity markets. Additionally, increasing RPS requirements will allow for greater levels of renewable energy to displace fossil-generated electricity, further lowering revenue streams for these units.

At the June 2010 BPU technical conference on capacity, the NJDEP presented information on the existence of 7,800 MW of “High Electric Demand Day” (“HEDD”) units in New Jersey. Those units consist of “low efficiency, high operation cost electric generating units used during periods of high electric demand.” A subset of these units are at risk of retirement due to emission regulations forthcoming over the next four to six years. All of these 7,800 MW are currently subject to phase I NO_x restrictions, and 4,630 of these megawatts will likewise be subject to phase II NO_x emission restrictions by 2015 or 2017. Compliance options for these 4,630 MW include retirement, emission control or placement on “emergency standby.”

One of the plants likely to retire is PSEG’s Hudson Unit #1 (454 MW nameplate, 355 MW practical maximum summer rating) which has been operating since 2006 on a Reliability Must Run (“RMR”) agreement. Hudson 1 is a gas fired unit that was first activated in 1964 and is considered by PSEG as “inefficient by modern standards and currently operates at very low operating factor.”² On June 3, 2011, PSEG made an Informational Filing at FERC identifying “approximately \$59 million in needed upgrades which is considerably larger than (sic) level of reliability-must-run (“RMR”) upgrades

² PSEG ER&T, PSEG Fossil Information Filing, dated Oct. 1, 2010, Affidavit of Kenneth Daleda, p.3.

that have been historically needed.”³ PSEG claims that the upgrades are “a direct result” of PJM’s request to extend the Hudson 1 RMR arrangement beyond September 1, 2011.

The BL England Generating Station (“BLE”), a 450 MW facility located in southeast New Jersey, currently consists of three units, two coal fired and one oil fired. In a March 24, 2011 letter to the LCAPP agent, Rockland Capital notes that the BLE coal units are subject to an Administrative Consent Order and states that the owner is currently exploring a conversion of all three units to No. 2 oil, “rendering the entire site a peaking facility.”⁴ Rockland Capital further notes that the conversion of the BLE coal fired boilers, in combination with the announced 2019 shutdown of Oyster Creek nuclear generating facility, will by the end of this decade eliminate approximately 1000 MWs of baseload capacity from the southeast quadrant of the state.

Exelon Generation LLC has petitioned FERC seeking an RMR rate schedule for two of their generation units located in the PJM Eastern MAAC Locational Deliverability Area (LDA). Both of these units have been in operation for more than 50 years and are considered by Exelon as “uneconomic due to the combined effect of market conditions, relatively high capital and operating costs caused by their age, and environmental restrictions that would severely restrict operations or require significant capital investment.”⁵

b. Retirements in the rest of PJM region

Retirements outside EMACC could also have an impact on New Jersey’s energy sufficiency. According to the PJM Independent Market Monitor (“IMM”), “there are over

³ Letter dated June 3, 2011 to Kimberly D. Bose, Secretary, Federal Energy Regulatory Commission, from Vilna Waldron Gaston, Associate General Regulatory Counsel, PSEG Services Corp.

⁴ Letter Dated March 24, 2011 to Levitan & Associates, Inc from Jim Maiz, Rockland Capital, on behalf of RC Cape May Holdings, LLC.

⁵ *Exelon Generation, LLC*, Petition, ER10-1418-000, p.2.

11,000 megawatts . . . of coal-fired units at risk of retirement due to their inability to cover their avoided costs.” N.J.S.A. 48:3-98.2g For example, in a recent press release, American Electric Power (“AEP”) announced the planned retirement of 6,000 MW of coal capacity due to environmental regulations, most of which is in PJM. This equals about 25% of all of AEP’s coal-fired facilities. The Company claims that another 1,500 MW to 5,200 MW would be idled or curtailed for extended periods as pollution control equipment is installed. While AEP is largely a regulated or self supply utility, this announcement raises questions about whether AEP will be able to continue its past practice of exporting surplus energy to the rest of PJM.

That a substantial amount of coal-fired capacity in PJM will have to retire or undertake very large investments was reflected in the results of the recent RPM base residual auction, in which the clearing price for the Rest of RTO region rose from \$27.73/MW-day in last year’s auction to \$125.99/MW-day in this year’s auction. In an addendum to its report on the auction, PJM stated that nearly all of the price increase was due to decreased supply in the western part of the RTO and increased cost associated with anticipated investments in emission control technologies.⁶

c. Delays in Building New Transmission

To address identified reliability concerns, PJM ordered the construction of a backbone 500 kV transmission line from Pennsylvania into northern New Jersey called the Susquehanna-Roseland line. The total cost for the project is estimated at approximately \$1.2 billion, with New Jersey’s share of the overall construction cost totaling approximately \$750 million (for 45 miles). After receiving BPU approval,

⁶ PJM, 2014/2015 RPM Base Residual Auction Results (Addendum), p. 2-3.

PSE&G notified PJM that, due to on-going environmental permit reviews, the in-service date for the eastern portion of the project has been delayed by 2 years to 2014 with the overall in-service date for the project delayed until 2015. PJM released its annual project assessment on March 14, 2011 as part of the 2010 Regional Transmission Expansion Planning Report. PJM's most recent analysis confirms that the line is needed by 2012 to prevent overloads on other power lines in the region. According to the report, PJM has developed a strategy to deal with potential reliability problems on an interim basis until the line is completed.

Increases in transmission export capability to New York put additional pressure on the availability of resources to meet New Jersey's needs. Recently completed merchant transmission lines with a firm transfer capacity of almost 1,000 MW significantly increase the potential export of power from New Jersey to New York.⁷ Another New York merchant transmission project (660 MW) is planned to be in-service in 2013.⁸ Additional merchant projects for further export from New Jersey to New York are discussed in the PJM RTEP report.⁹ All such exports heighten the challenges facing the state in its quest to ensure reliability in New Jersey (and eastern PJM), and further support the construction of additional capacity resources in the region.

d. Conclusion

These facts support an important conclusion: New Jersey's concerns about capacity inadequacy are real and imminent. Absent corrective actions, the combination

⁷ The Neptune line, completed in 2007, supports the transfer of 670 MW of power to Long Island, the Linden VFT project, completed in 2010, supports the transfer of 300 MW of power to New York City.

⁸ The Hudson Transmission Partners project will support transfer of an additional 660 MW of power from New Jersey to New York.

⁹ PJM RTEP 2009, p.272.

of delays in the completion of needed transmission facilities, and significant anticipated generation retirements will ensure that these concerns will continue for the foreseeable future. Unless the barriers to entry for new generation are lowered, New Jersey may face shortages and/or escalating power prices that could be devastating to its economy and its citizens.

3. *Why the existing institutional arrangements do not ensure adequate capacity in New Jersey.*

- a. *The unavailability of long term assured sources of revenue has resulted in the failure of the market to promote the construction of the resources needed to meet New Jersey's reliability needs.***

As noted by more than one commenter in the Board's recent LCAPP proceeding, the development of new generation capacity is fundamentally different both in terms of financing and in terms of risk, when compared to other shorter-term financing needs such as those associated with wholesale power purchases.¹⁰ The record in that proceeding made plain that the investment community will remain unwilling to invest large sums in the development of new generation absent some level of assurance that the project will receive needed and stable revenue streams over the term of the financing.

The existing market arrangements which feature the capacity spot market construct known as RPM, do not provide the requisite assurance. RPM's failure to support the construction of new generation serving New Jersey loads stems primarily from the lack of long term revenue certainty. Specifically, the current RPM auction structure, in which prices are set for one year three years in advance, does not provide the

¹⁰ See, e.g., letter dated February 25, 2011, to Ms. Kristi Izzo, Board Secretary from LS Power Group, LLC.

level of revenue certainty necessary for the developer of generation to secure long-term financing or to commit the significant resources needed to build a multi-million dollar construction project. New Jersey's Basic Generation Service ("BGS") supply contracts, with its associated three-year commitments, also can not provide long-term revenue assurance.

Adding to the uncertainty engendered by RPM's one year price setting auction is the volatility of the prices that come out of the auction each year. After eight base residual auctions, no clearing price for the RTO or for any LDA has changed in the same direction (up or down) three years in a row. In every location in the PJM RTO, RPM prices have changed direction three or four times. Moreover, these price fluctuations can be significant. For example, this year's base residual auction saw a substantial increase in the [Rest of] RTO region (outside of MAAC) from \$27.73/MW-day in the prior auction to \$125.99 /MW-day in this year's auction for Annual and Extended Summer resources. This price volatility is reflective of the RPM's role as a residual capacity spot market and primarily results from changing estimates of future peak load and future transmission availability to various zones, as well as changes in the quantity and prices of offered supply.

In sum, in the absence of long-term fixed price contracts, which markets do not now provide, price volatility and the short term nature of RPM contribute to an inability to obtain financing that has become an almost insurmountable obstacle to the construction of new generation serving New Jersey. In addition, in the highly congested state of New Jersey with strict environmental regulations, siting a new power plant can be

a difficult process. Thus, before a new entrant can participate in the market, significant barriers to entry must be overcome.

- b. *The revised MOPR creates additional barriers to entry and almost guarantees no new generation will be built in New Jersey in the foreseeable future.***

As originally conceived, the MOPR was a narrowly-tailored rule designed to prevent purposeful, anti-competitive price suppression by buyer-side market participants. The recent FERC MOPR Order¹¹ has transformed the MOPR into a wide-ranging, administrative price support mechanism designed to insulate RPM's residual capacity auction from the incidental price impacts of legitimate market-participant and state regulatory (or legislative) efforts to bring forth new capacity. The recent changes to the MOPR revamp the mitigation rules in a way that effectively precludes much non-RPM procurement and transforms PJM's residual capacity market into an all-or-nothing proposition (except for entry by favored resource types that are exempted from the MOPR). Absent opting out entirely, the only way a state or LSE can procure a resource that RPM would deem as not economic - based on PJM's flawed definition of what is economic¹² - is to pay for duplicative capacity. In that instance, the state or LSE would pay for the new and needed resource, but would receive no RPM credit for it, and would therefore be required to buy its full complement of RPM capacity (as if the new resource did not exist). That outcome is both inefficient and punitive.

¹¹ PJM Interconnection, L.L.C., FERC Dkt No. ER11-2875-001 and PJM Power Providers Group, FERC Dkt No. EL11-20-001 (not consolidated), Order dated April 12, 2011 ("FERC MOPR Order").

¹² Rate Counsel does not agree that whether a power plant is "economic" or "uneconomic" can be determined by comparing its levelized net cost (its Net CONE) to one RPM clearing price. Whether or not a new power plant is economic can only be judged with a multi-year (or life-cycle) assessment of costs and revenues, and taking into consideration all attributes of the plant, not a simple comparison of cost to one year's (highly unpredictable and volatile) RPM price result.

The changes wrought by the recent FERC MOPR Order increase barriers to entry. The MOPR now has a new function, as the use of mitigation no longer depends upon a demonstration of some incentive to exercise market power, or its actual exercise with a resulting impact on the market price. Instead, the purpose of the MOPR has shifted to the deterrence of what FERC regards as “uneconomic entry” – but only from certain types of generating resources. Thus, the removal of the previously-in-place net buyer requirement and related impact test raise the specter of over-mitigation – administrative interference with offers that actually are consistent with rational economic behavior and properly functioning markets, causing new resources that would have little or no impact on clearing prices not to clear. This result is unfair and inefficient.

- c. ***While large incumbent generators may have the financial wherewithal and available sites to build additional generation, they may have a strong disincentive to do so.***

As discussed above, the PJM markets as currently designed do not provide the stable revenue streams required by those who would finance the entry of major new capacity projects. Also as discussed above, in the highly congested state of New Jersey with strict environmental regulations, siting a new power plant can be a difficult process. Thus, before a new entrant can participate in the market, significant barriers to entry must be overcome.

The large incumbent generation companies in PJM have the balance sheet strength and capital access to undertake major power plant projects. Unlike the new entrants they are not impeded by capital barriers to entry. Moreover, these large incumbent generation companies have control over the existing generation sites which may be the best sites for expanding capacity and are not available to competitors.

Ironically, those with the abundant cash flow, strong corporate balance sheets, access to economical capital and control over the best sites may have a strong disincentive to add capacity to the market (particularly baseload-type capacity) because doing so would have the effect of moderating supply prices and therefore revenue streams for their existing generation portfolio in the region. Therefore, their profit maximizing strategy is not to build, and even to retire existing capacity that is marginal.

4. Possible solutions

a. The Board should continue to work towards a successful implementation of the LCAPP program

The Board has taken a major step forward with the LCAPP, and the Board should focus on moving that process forward. At this point, the future of the program may depend on the outcome of litigation currently pending before the FERC and from court legal challenges. The FERC MOPR Order is an impediment to efficient new generation generally and could impair the effectiveness of LCAPP. The Board should continue to pursue its rights before the FERC, including participating fully in the technical conference ordered by FERC, and any further proceedings that result from the rehearing decision.¹³ In addition, FERC's Order can be properly characterized as thwarting state efforts to ensure reliable electric service, to promote economic development, to create jobs, to moderate costs from transmission congestion and to replace older and less environmentally friendly resources with new and more efficient replacements. In effect, the FERC MOPR Order offers New Jersey and other states an unreasonable choice: pay a

¹³ On June 13, 2011, FERC issued an Order Granting Rehearing for Further Consideration and Establishing a Technical Conference of its April 12, 2011 Order.

severe and unwarranted economic penalty or give up the ability to take actions aimed at safeguarding electric reliability, promoting economic development, and reducing its dependence on environmentally harmful coal resources.

FERC's interference with the states' ability to protect their citizens is not consistent with state sovereignty protected by the Constitution, or, we believe, the intent of the Federal Power Act. The State should pursue any other avenues available, either at FERC or in Congress, to restore the State's ability to protect the fundamental needs of its citizens.

In addition, New Jersey should file a Section 206 complaint as invited by FERC. Filing a Section 206 complaint is the means by which entities petition the Commission to find that an existing rate is unjust and unreasonable and must be changed. In eliminating the state exemption from the MOPR, FERC held open the possibility of approving, on a case-specific basis, exemptions for individual state programs aimed at ensuring reliability and/or advancing important public policy objectives. The Commission stated that "any state is free to seek an exemption from the MOPR under Section 206,"¹⁴ and that removing the exemption "in no way impairs the ability of a state to request an exemption for reliability reasons under section 206."¹⁵

FERC did not elaborate further on the circumstances that would cause it to grant an exemption in response to a Section 206 complaint. In general, in order to succeed in a Section 206 filing, a complainant has to show that the revised RPM design, from which the state seeks an exemption, is unjust and unreasonable. The basis for this assertion in this case could be that the FERC MOPR Order effectively precludes New Jersey from

¹⁴ FERC MOPR Order, p.143.

¹⁵ Id. at 139 and n.75

addressing reliability and resource mix issues that RPM has failed to rectify. We believe that New Jersey can make a very persuasive case to FERC that a MOPR exemption for LCAPP is warranted and in the public interest.

Finally, it should also be noted that in the MOPR proceeding, PJM committed to working with stakeholders to develop changes to the RPM rules (in particular, the New Entry Price Adjustment, or “NEPA”) that it believes could provide additional revenue assurance needed to support construction of new power plants. However, we doubt that RPM can be modified to do this effectively. RPM is a capacity spot market, balancing one year of supply and demand and awarding one-year commitments. It is unlikely that stakeholders will find a way to stretch RPM to provide multi-year price assurance to new resources in a manner that will be both effective in attracting new resources and reasonably economically efficient. Nevertheless, the Board should actively participate in PJM’s stakeholder processes to consider possible modifications to RPM. While these efforts may be unlikely to appreciably improve the current situation, they also hold the potential to make the operation of RPM worse for customers, and the Board should be involved to help protect New Jersey’s interests.

b. The Board should investigate alternative ways of providing financial support to generators willing to build new power plants in New Jersey.

PJM argued before FERC that resources can “attempt to prove that their actual unit specific costs are lower than the applicable benchmark, thus gaining the ability to offer on terms consistent with these costs.”¹⁶ In the FERC proceeding, the IMM stated

¹⁶ PJM Answer at 11; Motion for Leave to Answer and Answer of the Independent Market Monitor for PJM at 4-5 (March 21, 2011), eLibrary No. 20110321-5189 (IMM Answer).

that some “subsidies,” like tax exempt status and laws affecting the cost of financing, are “legitimate as a matter of long standing public policy and would be considered actual costs under the exemption process.”¹⁷ On the face of it, this statement would seem to indicate that some subsidies are viewed as acceptable, while others (plainly) are not.

For example, FERC recently upheld a tax-exemption program in New York that was also aimed at encouraging new generation. The issue in that case was whether a tax abatement program enacted to induce the construction of peaking units in New York City should be included in the calculation of the Net CONE parameter for the demand curve used to set capacity prices in New York City. The Commission originally rejected the proposal to use the full abatement assumption in the determination of Net CONE because the tax abatement was discretionary and not a matter of right under the law. After political pressure and a change in the law to make the program an “as-of-right” program, the Commission decided that the tax abatement could be included in the calculation of Net CONE. While recognizing that the tax abatement was a state sponsored subsidy to provide an incentive for new generation, the Commission did not find that facilities that availed themselves of the abatement were submitting “uneconomic” bids or that their bids should somehow be “mitigated.”

Admittedly, we do not know at this juncture what subsidies FERC would find acceptable and what it will not find acceptable. There is virtually no generation in this state that has been built without some form of subsidy. The incumbent generators, for the most part, built their facilities when they were vertically integrated and thus relied on ratepayer funds to financially support their projects. They continue to do so for renewable energy projects. Federal and state tax incentives, in addition to ratemaking

¹⁷ IMM Answer at 7.

tools such as Construction Work in Progress (CWIP) and Allowance for Funds used during Construction (AFUDC), have all been used in connection with the state's existing generation resources. The Board should explore whether utilizing state and local tax incentives may provide the revenue certainty needed for non-rate-regulated entities to build.

The Board may also want to look into utilizing the Economic Development Authority (EDA) to aid in financing the construction of new generation. EDA has broad statutory power to assist in the financing of economic development projects. N.J.S.A. 34:1B-5 et. seq. Depending on how EDA's involvement is defined, its statutory powers may be sufficient or may require supplementation.

The program could be set up similar to the state's existing Environmental Infrastructure Financing Program ("EIFP"). Through the EIFP, borrowers can receive low cost financing for projects that protect water quality and improve drinking water facilities. Borrowers receive half of the loan amount at zero interest from clean water drinking funds maintained by the Department of Environmental Protection. The other half comes from the proceeds of highly rated tax-exempt revenue bonds sold by the trust. The result to the borrower is a loan with half the interest rate of traditional financing. The funds are released on a cost incurred basis with terms up to 20 years. The program is available to government entities and to private water purveyors.

In sum, the language of the FERC MOPR Order notwithstanding, FERC has shown some flexibility in this regard, and there may well be some government incentives that are acceptable and they should be explored by the Board.

c. The Board should investigate the feasibility of the creation of a state power authority.

Another option that should be further investigated by the Board is the creation of a state power authority to build new generation. A state power authority could be a state-owned and operated organization with the authority to own and/or lease power generation and transmission facilities, sell power at wholesale and/or retail for certain types of customers, and enter into long-term contracts for the purchase of power and transmission capacity.

Currently, state-owned power authorities exist in New York (NYPA) and California¹⁸. In addition, the State of Connecticut is actively considering forming a power authority in response to recent increases in electricity prices experienced in New England. Power marketing agencies operated by the federal government are the Bonneville Power Administration (BPA), the Western Area Power Administration (WAPA), the Southwest Power Administration (SWAPA) and the Southeast Power Administration (SEPA).

In investigating whether the State could form a State-owned and operated power authority, a good place to start would be to the east. The NYPA was organized in 1931 and owns operates 18 power generation facilities (hydro and fossil fuel) and approximately 1,400 circuit miles of high-voltage transmission lines. NYPA sells power at retail and wholesale (at rates below market) to various entities including government agencies, municipal utilities, electric cooperatives, and private companies (as a method of promoting job creation). All project construction is financed through revenue bonds sold

¹⁸ The California Power Authority was “de-funded” in 2004 and while still in existence does not function.

to private investors. NYPA does not use state tax revenues or state credit in its operation and, as such, is fully self-financing.

In New Jersey, the Electric Discount and Energy Competition Act of 1999 (“EDECA”) places ultimate responsibility for procurement on the EDCs, and thus legislation would be required if the BPU wishes to pursue this approach. In addition, unlike the NYPA, New Jersey would need to either construct new generation resources or purchase existing generation resources at market value. NYPA generates power from older plants (typically hydropower projects) from which power can be generated at costs well below market prices. Consequently, virtually all of the advantages associated with the NYPA would not be available to a newly created power authority.

On the other hand, the creation of a state power authority would give the state the ability to construct generation on a schedule to match consumer demands for electric energy; prices charged would reflect the costs to generate the power rather than market conditions; and the cost to finance construction of the generating facilities would be lower than private sector costs.

- d. The Board should also investigate the feasibility of the implementation of a long term power purchase agreement through either a self-supply arrangement or modification of the BGS auction.***

Another means to consider would be returning at least a portion of the capacity obligation to the EDCs, from the BGS suppliers. Currently, no one in New Jersey – not the BGS suppliers, who are short-term Load-Serving Entities - nor the EDCs have the obligation to provide capacity to customers beyond the 3-year window of the BGS supply

contract. This is the case even though power plants can last for 20-30 years or longer and even though RPM requirements themselves don't begin for 3 years after the auction.

"Self-supply" is a technical term used by PJM to describe how a Load-Serving Entity provides for its own capacity needs without directly buying RPM capacity. If self-supply becomes the only vehicle under which New Jersey could decide its own course of action, then we should be prepared. We should have our BGS procurement institution ready to adapt so that New Jersey could self-supply its capacity obligation using longer-term contracted resources such as the LCAPP units. Current LCAPP contracts are not "self-supply" style arrangements. Shifting such an obligation back to EDCs does not need to undermine competitive procurement of energy supplies using a BGS-like auction approach, and it also can work well with competitive procurements such as the one used to determine the LCAPP winners in the first place.

Finally, the Board should also review the impact of energy efficiency and demand response programs on peak load. It is important that these programs are appropriately accounted for in the PJM planning processes.

In sum, there are options available to the Board to address the state's concerns about electric system reliability and high market prices. These various options should all be open for further discussion among all the interested parties to this proceeding.

- e. The Board should exercise its authority under EDECA to examine the competitiveness of the New Jersey Electric Generation Market.*

Rate Counsel believes that the Board should use its statutory authority to review the competitiveness of the electric generation markets in New Jersey. With the passage of EDECA the legislature found that it was the policy of this state to "lower the current

high cost of energy” and to “place greater reliance on competitive markets.” N.J.S.A. 48:3-50a. Accordingly, the Board was authorized to allow competition in the electric generation marketplace and thereby reduce energy rates for all New Jersey consumers. N.J.S.A. 48:3-50c. With the authorization of competition, the legislature found it was in the public interest to:

Provide the Board of Public Utilities with ongoing oversight and regulatory authority to monitor and review composition of electric generation and retail power supply market place in New Jersey, and to take such actions as it deems necessary and appropriate to restore a competitive marketplace in the event it determines that one or more suppliers are in a position to dominate the marketplace and charge anti-competitive or above-market prices.

Id. The statute further provides that, based on factors such as ease of market entry and presence of other competitors, the Board can decide to:

. . . . reclassify as regulated any electric service or segment thereof that it has previously found to be competitive, including electric generation service, if it determines that sufficient competition is no longer present, . . .

N.J.S.A. 48:3-56

The additional information provided to the Board during this review may help the Board find new solutions to overcome existing barriers to entry and to ensure that the state’s ratepayers are receiving reliable electric service at reasonable rates.

As discussed above, Rate Counsel is concerned that the energy markets that have developed in New Jersey since EDECA are highly concentrated, leading to fears that the incumbent generators have the ability to exercise anti-competitive behavior in these markets. Incumbent generators have a strong disincentive to add capacity to the market because doing so would have the effect of moderating prices. Therefore, the profit maximizing strategy would be not to build, and even to retire existing capacity that is

marginal. Indeed, it is conceivable that these companies will attempt to discourage competition and erect barriers to entry to competitors. For example, they may propose new generation and transmission projects to discourage new entrants and then delay or cancel these projects or export the capacity.

In sum, while much of the focus in the LCAPP debate has been on allegations that buyers or states could manipulate the marketplace to achieve below-market prices, the fact is that the supply-side of the New Jersey market may not be as competitive as hoped by the Legislature. As a result, there may be a need for the Board to invoke its statutory authority and investigate (a) the competitiveness of New Jersey's supply (b) the barriers to entry that inhibit the addition of new supply, and (c) the steps that the Board can take to reduce those barriers. This may provide further information that will assist the Board in finding solutions and ways to overcome New Jersey's electric capacity challenges.