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I/M/O the Provision of Basic Generation Service ("BGS") for the Period Beginning June 1, 2008
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Comments of Public Advocate Ronald K. Chen
Presented at a Legislative Hearing
Before the Board of Public Utilities
September 20, 2007

Good morning, President Fox. I'm Ronald Chen, the Public Advocate, and our consultant, Dr. John Stutz of the Tellus Institute, is here with me. I want to thank you for the opportunity to appear before you today on behalf of the state's ratepayers. I am here to express my concern -- one which I am sure all of us share -- that residential electricity customers throughout New Jersey have been hit hard with significant price increases.

Over the past five years, winning bid prices for generation have risen 97 percent overall, from over 5 cents to just under 10 cents per kilowatt, on average 15 percent per year every year, under the current pricing and procurement arrangement in the Basic Generation Service Fixed Price auction model. Customers will pay substantially more than they paid in 2002 because of this increase. Further, the volatile nature of the BGS-FP prices is clearly evidenced by the 55 percent hike in auction prices between 2005 and 2006. The price increases are not easily nor fully explained—although I understand a portion is due to known or projected fuel and capacity price increases.

While it is difficult to estimate the likely results of the next round of auctions to take place in February 2008, it stands to reason that prices are likely to follow the trends evidenced in the last few years: when forward prices for PJM power increase, and natural gas future prices increase, BGS prices can be expected to increase. It is critical that we take steps now to fine tune the auction process to ensure that New Jersey ratepayers are paying the lowest amount possible for their energy needs. Especially given the state's objective of revising its energy policy through the Energy Master Plan and its commitment to dramatically reduce greenhouse emissions, now is the ideal time to revisit the overall structure of electricity procurement under BGS.

A key recommendation I would like to highlight today is the portfolio management approach, which can offer a response to volatile and unreasonably high prices. The portfolio management program engages an agent on behalf of consumers to act as a smart shopper for electricity. Rather than rely on a single, relatively rigid procurement mechanism whereby prices rely on a static demand and the whims of potential suppliers, a portfolio approach introduces greater purchasing flexibility—both on the timing of purchases and on the contract term length—and increased competitive pressure on prices likely to result from the BGS-FP auction.

To provide better stability for customers, the BGS Portfolio would include resources, such as demand response and long-term contracts—ten to twenty-five years, or even "Life of Plant" contracts—in addition to three-year contracts procured through the auction. The size and/or number of tranches sold at auction would be based on load net of the contribution from the other resources in the Portfolio. Thus, if the electric distribution companies procured 10 percent of the BGS-FP supply through longer-term resources, the auction would apply to the remaining 90 percent of the load, procuring it in three-year contracts from the auction.

In putting a BGS Portfolio into operation, we recommend that the BPU obtain the services of a professional Electricity Portfolio Manager with expertise in mid-Atlantic electric markets. The Portfolio Manager would analyze the market alternatives available to meet BGS-FP load and then, after approval from the BPU, structure supply and/or demand response solicitations to competitively obtain resources to meet BGS-FP requirements.

Based on the results of such solicitations, the Portfolio Manager would recommend an optimal mix of supply and/or demand-side resources and would seek to continually minimize and stabilize customer costs by issuing solicitations for needed resources, in appropriate amounts and appropriate formats, as approved by the BPU. The solicitations could include RFPs and negotiated bilateral procurements, and would include ongoing supply via the existing BGS-FP auction. The Portfolio Manager would be guided by a clear set of appropriate risk mitigation goals, approved by the BPU.

It is important to note that consideration of the BGS Portfolio and the associated Portfolio Manager is part of a larger and more comprehensive issue regarding the future of energy policy in New Jersey. The state's current interrelated energy initiatives—namely the Energy Master Plan, the demand response working group, clean energy initiatives, the solar rebate and renewable energy credit programs, PSE&G's proposed solar plan, and energy efficiency programs—are programs that will have an impact on the future procurement of BGS for New Jersey ratepayers. Coordination of these various programs and initiatives could be included as part of the BGS Portfolio Manager's function.

Without effective coordination of both the demand and supply sides of the energy equation, the state's energy future runs the risk of becoming a clutter of separate programs with no chance of meeting the aggressive goals of the Energy Master Plan.

Working within the confines of the current auction model, the Division of Rate Counsel continues to press for changes, specifically on the issues of pay as bid and tick down on ties; pass through of changes in transmission charges; and information concerning BGS-FP supply sources. Details of these recommendations were filed in written comments on August 24, 2007.

I thank you for allowing me to present this testimony and in the interest of New Jersey's ratepayers, I strongly urge the BPU to seriously consider our recommendations. The BGS procurement process is an evolving one and implementing incremental modifications for improvements will go a long way toward ensuring reasonable and stable energy prices for New Jersey's ratepayers.

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