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DEPARTMENT OF THE PUBLIC ADVOCATE
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JON S. CORZINE
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August 24, 2007

KIMBERLY HOLMES
Acting Director

Via Hand Delivery and Electronic Mail

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

Re: I/M/O the Provision of Basic Generation Service for the Period
Beginning June 1, 2008
BPU Dkt. No. ER07060379

Dear Secretary Izzo:

Enclosed for filing please find an original and ten copies of the Department of the Public Advocate, Division of Rate Counsel's comments in the above matter. These comments will also be circulated electronically through the electric list server used by the Board of Public Utilities for these types of communications. **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,

RONALD K. CHEN
PUBLIC ADVOCATE OF NEW JERSEY

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**I/M/O the Provision of Basic Generation Service (“BGS”)
For the Period Beginning June 1, 2008
BPU Docket No. ER07060379
Comments of the Department of the Public Advocate
Division of Rate Counsel
August 24, 2007**

The Department of the Public Advocate, Division of Rate Counsel (“Rate Counsel”) respectfully submits these comments to the Board of Public Utilities (“Board” or “BPU”) in the above-captioned matter. In this proceeding, Rate Counsel has also filed written comments dated July 2, 2007. Four additional sets of comments dated March 30, 2007, April 13, 2007, May 9, 2007, and May 16, 2007 were attached to the July 2 submission. The issues addressed in these comments are the following:

- Pay As Bid and Tick Down on Ties,
- Pass through of changes in transmission charges,
- Information concerning BGS-FP supply sources, and
- The BGS Portfolio.

Rate Counsel has put all of these issues before the BPU on previous occasions. They are being put forward again because, up to this point, none of them have been dealt with in a satisfactory fashion. The first three issues deal with specific features of the BGS-FP auction. The last is broader. It deals with the framework within which the electricity supply for BGS-FP customers, and indeed all energy supply issues for the State of New Jersey, should be considered.

Pay As Bid and Tick Down on Ties

Rate Counsel recommends that the Board adopt a “Pay as Bid” procedure wherein winning bidders in the BGS-FP auction are paid the lowest price they freely agreed to accept, not the highest price accepted for the product on which they bid. The basis for this proposal is clear. In a comparable situation, such as a negotiated bilateral contract, the supplier would bargain for an acceptable price. If the purchaser agreed to the price offered by the supplier, the supplier would freely accept the result. The supplier would not then expect to be paid a higher price than some other supplier may have offered. Rate Counsel urges the Board to allow that same result to obtain in the BGS auction. Let the winning bidders be paid the price they have freely bid, not a higher price. That would be the most equitable result from the perspective of all participants, especially those participants who must ultimately pay the price the Board approves.

In the BGS-FP auction, prices “tick down,” starting high and being reduced gradually until the supply bid is just sufficient to meet the load to be procured. However, prices do not tick down when the number of tranches freely bid equals the number of tranches desired. (Such equality is the “tie” referred to in the section title.) It is Rate Counsel’s suggestion that the auction rules be modified so that, when there is a tie, the price for that product does “tick down.” The reason for proposing this change is quite simple: failure to Tick Down on Ties is unfair to the customers who will pay the prices produced by the auction. The auction process should attempt to determine if the supply needed can be procured at a price lower than the one at which there is a “tie.” In that way, the customers would receive their BGS supply at the lowest price acceptable to the bidders and the Board.

These two issues have been before the Board on a number of occasions. Here a brief review of the most recent developments may be useful. On April 6, 2006, Rate Counsel filed

comments responding to questions raised by the Board. Rate Counsel recommended that the Board reconsider its rejection of the Tick Down on Ties and Pay as Bid adjustments to the auction process recommended by Rate Counsel in previous years. Rate Counsel urged the Board to “make these changes unless [the Board] is presented with compelling evidence that these changes will have an effect which fully offsets the reductions in costs which, on their face, these changes could provide.”

In an Order dated December 22, 2006, the Board approved the auction rules as proposed by the Electric Distribution Companies (“EDCs”).¹ In that Order, the Board expressed its interest in gaining “additional knowledge” regarding the potential impact that the implementation of Tick Down on Ties and Pay as Bid could have on the BGS auction and requested that the “Auction Consultant, in its Final Report to the Board on the BGS Auction, provide an assessment of these proposals and their potential impact on the BGS Auction.”²

Item number 2A on the Board’s May 23, 2007 agenda was the adoption of the Boston Pacific Final Report on the 2007 BGS FP and CIEP Auctions (the “Report”). In support of its recommendation that the Board adopt the Report and approve final payment to Boston Pacific, Board Staff discussed the Board’s earlier mandate that the Report should provide an assessment of Rate Counsel’s Pay as Bid and Tick Down on Ties proposals. Board Staff informed the Board that Boston Pacific had found that the two adjustments to the BGS auction recommended by Rate Counsel:

...could negatively impact the competitiveness of the BGS auction, thus resulting in higher prices for ratepayers. They pretty much kind of were consistent with the same recommendations staff has made to you for the last four, five years on that issue.
Tr. P 311 1-2.

¹ *I/M/O the Provision of Basic Generation Service for the Period Beginning June 1, 2007*, BPU Docket No. EO06020119, Decision and Order, December 22, 2006.

² *Id.* p.8.

The Board adopted the Report based on Staff's recommendation.

Subsequently, a redacted version of the Report was posted on the Board's web site. After a review of the redacted version of the Report, Rate Counsel was unable to find any factual basis for the assertion that Rate Counsel's recommendation could result in higher prices for ratepayers. Rather, the rejection of Rate Counsel's recommendation was based on Boston Pacific's unsupported speculation that paying bidders what they offer would cause bidders to change their behavior. According to the report:

. . . our concern is that the proposed change encourages earlier or more substantial withdrawals in future auctions. The motive would be to restore the lost revenue from the rule change so that bidders may withdraw more substantially in earlier rounds.³

In response, Rate Counsel submits that, in a competitive market, bidders make offers based on individual determinations of how much load they can profitably serve at a given price. Without evidence to support the position of Boston Pacific, Rate Counsel remains skeptical of Boston Pacific's conclusion that Tick Down on Ties and Pay as Bid will "earlier or more substantial withdrawals in future auctions."

Accordingly, Rate Counsel respectfully requests that the Board reconsider its decision to reject Pay as Bid and Tick Down on Ties. These are simple, modest changes to the BGS-FP auction which, on their face, would reduce rather than increase costs to ratepayers. Without evidence to back up the concern that these changes will trigger bid increases sufficient to offset such savings, the two changes proposed by Rate Counsel should be adopted.

³ Report, page 10.

Pass Through of Changes in Transmission Charges

On July 2, 2007 the EDCs filed their joint *Proposal for BGS Requirements to be Effective June 1, 2008*. Section III.A of that document describes the BGS-FP supply proposed for procurement as a “full requirements product” which the EDCs go on to state “...places the portfolio acquisition and price-risk management function in the hands of the competitive entities that can most efficiently carry out these tasks.”⁴ However, as in the past, the EDCs’ proposal provides an important exception to the preceding statements. That is the provision for the transfer of the risk associated with changes in transmission rates from suppliers to BGS-FP customers. Rather than continuing current practice of passing through changes in transmission rates to BGS-FP customers, Rate Counsel proposes that BGS-FP suppliers should include an estimate of the costs associated with electric transmission in their offer to provide BGS-FP service.⁵ Rate Counsel believes that this treatment of transmission costs best serves the interest of New Jersey ratepayers.

The BGS-FP auction should procure a **true full requirements product**. Bidders should offer to provide a product that includes all the components necessary to provide BGS-FP service. An auction designed in this way would reflect the EDCs’ professed belief that a full requirements product was the best way to foster a competitive market, while at the same time providing low-cost, fixed-price energy for those ratepayers who do not or can not switch to a competitive supplier.⁶

If the Board continues to allow the suppliers to pass transmission rate increases on to ratepayers, there will continue to be little incentive for the suppliers to help control these costs. On the other hand, if the Board eliminates the pass through of transmission rate increases to

⁴ *Proposal for BGS Requirements to be Effective June 1, 2008 (“Joint Proposal”)* Section III.A.

⁵ *Joint Proposal, BGS Supplier Master Agreement*. Section 15.9.

⁶ See, *Joint Proposal*, Section III A.

BGS-FP customers, this would encourage BGS suppliers to actively participate in proceedings at FERC when transmission rates are reviewed. As the payers of such rates, and as the entities with day-to-day knowledge of transmission operations, suppliers are in a good position to obtain the necessary information to refute requests for an increase in rates by transmission owners.

In conclusion, it is Rate Counsel's position that low cost and price stability are best achieved through the elimination of the pass through of transmission rate increases. This change would foster careful scrutiny of requests for transmission rate increases at FERC.

Information Concerning BGS-FP Supply Sources

Rate Counsel requests that the Board direct BGS-FP suppliers to provide, on an after-the-fact basis, information on their underlying supply sources. The information would be provided to the BPU and to those who are privy to detailed auction information. Rate Counsel's interest in this information is based on concerns regarding the safety and reliability of the electric supply procured through the BGS-FP auction. Without information regarding the source of New Jersey's electric supply, the Board is unreasonably hindered in meeting its obligation to protect the State's ratepayers from the increasing risks associated with the restructured generation market.

The Board should have information regarding the source of electricity obtained through the BGS auctions and the diversity of those sources, to allow it to identify and address risks associated with those sources. Suppliers have noted that information regarding source of supply is not known at the time of bidding. Rate Counsel therefore proposes that the Board require that information regarding sources of supply be provided on an after-the-fact basis. In particular, the Board should direct winning BGS-FP bidders to provide supply information for the first 6 months of their contracts and for each 6-month period thereafter, until the termination of their

contracts. This information should be provided no later than 3 months after the end of the 6-month period in question. These after-the-fact reporting requirements address suppliers' express concerns about confidentiality and timing of information availability while, at the same time, protecting ratepayers by opening the process to additional scrutiny. Rate Counsel is seeking production of contractual and other information which suppliers rely upon to show that their obligations have been met. The Board should have at its disposal at least this level of information regarding the source of supply that affects the reliability, safety and eventual cost of our electricity.

The BGS Portfolio

Rate Counsel recommends development of a BGS Portfolio that would permit BGS-FP load to be served from a variety of resources, including the BGS-FP auction. This recommendation is motivated by a concern about the stability of BGS-FP prices. To provide greater price stability for BGS-FP customers, the BGS Portfolio should include resources such as Demand Response and Long-Term Contracts (i.e., 10 to 25 years, or even "Life of Plant" contracts, etc.), in addition to 3-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, for example, if the EDCs procured 10 percent of the BGS-FP supply through longer-term resources, the BGS-FP auction would apply to the remaining 90 percent of the load, procuring it in 3-year contracts from the auction.

To put a BGS Portfolio into operation, Rate Counsel recommends that the BPU obtain the services of a professional Electricity Portfolio Management Group with expertise in Mid-Atlantic electric markets. The Portfolio Management Group could be provided by an outside consulting firm; could be assembled in-house under the auspices of the BPU, utilizing BPU or

other New Jersey government employees; or could be developed as a separate government entity. The charge of the Portfolio Management Group would be to 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 Management Group would recommend to the BPU an optimal mix of supply and/or demand side resources. The Portfolio Management Group would seek to continually and actively minimize and stabilize customer costs (“manage the portfolio” by working the market) by issuing solicitations for needed resources, in appropriate amounts and appropriate formats, at appropriate times, as approved by the BPU. Such solicitations could include RFPs and negotiated bilateral procurements, and would include ongoing supply via the existing BGS-FP auction. In its actions the Portfolio Management Group would be guided by a clear set of appropriate risk mitigation goals, which would be approved by the BPU.

Acting on the Rate Counsel’s proposals, to set up a BGS Portfolio and obtain the services of a Portfolio Management Group, is essential given that there is already an effort underway to procure one of the resources that could be included in a BGS Portfolio. At its Public Agenda meeting held on June 14, 2007, the BPU directed EDCs, Demand Response Providers, and any other interested parties to form a Demand Response working group, to be convened immediately and to be overseen by Board Staff, with the goal of designing a Pilot Demand Response procurement program as soon as possible, for review by the Board no later than October 1, 2007. To provide the appropriate framework to evaluate the results of this effort, and to situate any resources procured, immediate action on the Rate Counsel’s proposals is essential.

As a final note, Rate Counsel reminds the Board that consideration of the BGS Portfolio and the associated Portfolio Management Group is part of a larger and more comprehensive issue regarding the future of energy policy in New Jersey. Currently on-going in New Jersey is the creation of an Energy Master Plan, a long term vision for the state's energy needs through 2020. The goals of the Energy Master Plan are to secure safe, reliable and reasonably priced energy for New Jersey ratepayers while promoting economic growth and development within the state and protecting the environment. Also on-going at the Board are various Clean Energy initiatives, including the rebate and Solar Renewable Energy Credit programs. In addition, PSE&G has recently filed with the Board a proposal for a supplementary Solar Energy Program to be managed by the utility, not within the Board's Clean Energy division. Furthermore, in addition to Energy Efficiency programs set within the Clean Energy division, the Board has established a Demand Response Working Group to design a demand reduction program for New Jersey. At the same time, the Board is over-seeing on-going appliance cycling programs run by the State's electric utilities. Each of these programs has an impact on future procurement of BGS for New Jersey ratepayers. It is Rate Counsel's position that the coordination of these various programs and initiatives could be included as part of the BGS Portfolio Management Group's function. Without effective coordination of both the demand and supply sides of the energy equation, the State's energy future runs the risk becoming a hodgepodge of separate programs with no chance of meeting the aggressive goals of the Energy Master Plan.