BEFORE THE STATE OF NEW JERSEY

BOARD OF PUBLIC UTILITIES

I/M/O THE PROVISION OF BASIC GENERATION	**)**
SERVICE PURSUANT TO THE ELECTRIC	**) BPU DOCKET NO. EX01050303**
DISCOUNT AND ENERGY COMPETITION ACT	**)**

DIRECT TESTIMONY OF SCOTT HEMPLING
ON BEHALF OF
THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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Q. Please state your name and business address.

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Q. Please state your educational background and professional qualifications.

A. I received a B.A. cum laude in Economics and Political Science from Yale College. I received a J.D. magna cum laude from Georgetown University Law Center. I am a member of the Bars of the District of Columbia and Maryland.

I am the principal in a law practice which provides legal and policy advice related to regulated industries. I have advised the state commissions of Arkansas, Arizona, Connecticut, District of Columbia, Indiana, Kansas, Massachusetts, Michigan, Missouri, Nevada, New Hampshire, Oklahoma, Rhode Island and Virginia; the consumer counsels of Connecticut, Indiana, Nevada, New Jersey, Pennsylvania and Texas; the legislatures of South Carolina and Vermont; municipal systems in Connecticut and Iowa; associations of competitive generators, consumer representatives and public power entities; and public interest organizations. I have authored articles which have appeared in The Electricity Journal and Public Utilities Fortnightly.

I have testified before committees of the U.S. House of Representatives and the U.S. Senate on many occasions; before committees of the state legislatures of California, Maryland, Minnesota, Nevada, North Carolina, South Carolina and Vermont; and before the state commissions of Illinois, North Carolina, Texas, Vermont and Wisconsin. I am a frequent lecturer at professional conferences and training sessions, including sessions sponsored by the U.S. Department of Energy and the National Association of Regulatory Utility Commissioners.

More detail on my professional background appears in Schedule SH-1

Q. On whose behalf are you testifying?

A. The New Jersey Division of the Ratepayer Advocate.

Q. What is the purpose of your testimony?

A. I explain how, under Section 9(c) of the Electric Discount and Energy Competition Act (EDECA), the Board has the opportunity to establish a system of providing Basic Generation Service (BGS), consistent with the goals of retail competition, by allowing non-utilities[1] to compete to serve customers who have not chosen a competitive supplier or who are unable to get service from a competitive supplier.

My testimony therefore explains that the Board's method of providing BGS should adhere to the following principles and objectives:

1. BGS should be competitively procured under a Board-supervised bidding process.

2. The BGS provider must have nondiscriminatory access to the utility's transmission and distribution system and any other utility resources that (a) are essential for provision of the BGS package and (b) are not economically duplicable by the BGS provider.

3. The BGS supplier should have the flexibility to determine the scope of its commercial relationship with retail customers (and by implication the scope of the retail customer's relationship with the utility), including whether the customer receives one bill from the supplier for the total bundled package (including T&D services) or separate bills from the supplier and the utility.

4. Competitive BGS suppliers should produce, or procure on their own, the maximum array of services that are part of the total BGS package that the supplier can reliably and economically provide.

My testimony also describes various options that the Board will need to consider when deciding how to design a competitive BGS system for achieving the goals of

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[1] For purposes of this testimony, when I use the term "nonutility" I mean to include a utility affiliate operating at arm's length from the utility.

EDECA.

In choosing from among the many options for competitive BGS procurement, the Board should strive for a procurement method that is most consistent with the development of energy competition in New Jersey. The Board will have to determine, based on an investigation and analysis of the facts, which products and services the BGS provider should produce or procure and the scope of the BGS providers' commercial relationship with retail customers. Competitive BGS suppliers should produce, or procure on their own, the maximum array of services that are part of the total BGS package that the supplier can reliably and economically provide. Further, the BGS supplier should have the flexibility to determine the scope of its commercial relationship with retail customers.

My testimony describes these propositions for achieving the goals of EDECA in two main parts.

1. Allowing BGS Bidders to Bid to Supply Integrated Retail Service Will Stimulate Retail Competition, While Restricting the Bidders to Wholesale Generation Only Will Not.

2. To Achieve the Maximum Customer Satisfaction from BGS Bidding, the Board Will Need to Choose From Among Several Options for Shaping the Final Program.

II. Allowing BGS Bidders to Bid to Supply Integrated Retail Service Will Stimulate Retail Competition, While Restricting the Bidders to Wholesale Generation Only Will Not

A. Introduction

Q. What is basic generation service?

As defined by Section 3 of EDECA, "basic generation service"

> "means electric generation service that is provided, pursuant to section 9 of this act, to any customer that has not chosen an alternative electric power supplier, whether or not the customer has received offers as to competitive supply options, including, but not limited to, any customer that cannot obtain such service from an electric power supplier for any reason, including non-payment for services. Basic generation service is not a competitive service and shall be fully regulated by the board;"

"Electric generation service" is defined in EDECA Section 3 as

> "the provision of retail electric energy and capacity which is generated off-site from the location at which the consumption of such electric energy and capacity is metered for retail billing purposes, including agreements and arrangements related thereto;"

I have been informed by counsel that, based on these definitions, Basic Generation Service (BGS) is the retail supply service which automatically becomes available to customers who fail to choose a competitive retail supplier or who cannot get service from such a supplier.

Q. What services does a BGS customer receive?

A. From the perspective of the retail customers, the BGS supplier would replace the utility as the retail provider of the traditional package of retail electric services. The basic retail products and services include electric capacity and energy, physical delivery of the energy, and customer account services such as billing, metering and customer relations.

While the BGS supplier would have the retail relationship with the customer, it would not necessarily manufacture or produce itself the services sold at retail. For example, the utility remains the owner of transmission and distribution facilities and thus the producer of transmission and distribution service (unless a regional transmission organization replaces the utility in the transmission role); thus the BGS provider could purchase these noncompetitive services from the utility, and pass their costs to the BGS customer.

Alternatively, if the Board views BGS as confined to the acquisition of generation services at wholesale, it still should consider adding a retail version of BGS so as to give nonshopping customers the benefits of competition.

Q. In New Jersey, who is the BGS provider?

A. I have been informed that the New Jersey restructuring law assigned the incumbent utility the task of serving as the BGS provider for three years. After three years, Section 9(c) of EDECA permits the Board to hold a bidding process to allow competitive suppliers to be BGS providers. I understand that the Board has made a determination to implement a competitive bidding process for procuring BGS supplies beginning in August 2002.

Q. What are the possible relationships of the competitive BGS provider and the utility with the retail customer?

A. Assuming that (a) the incumbent utility continues to have its traditional responsibility for providing the monopoly services of transmission and distribution and (b) the BGS supplier provides some or all of the remaining retail services traditionally provided by the utility, the question arises as to what relationship, if any, the incumbent utility and the BGS supplier should have with the retail customer. The options are:

1. The BGS supplier has the exclusive relationship with the retail customer. In

this scenario, the BGS supplier would acquire the necessary transmission and distribution service from the utility, and bundle those services with the retail services sold by the BGS supplier into a single product and a single bill.

2. The utility has the exclusive relationship with the retail customer. In this scenario, the utility would purchase the retail services, other than transmission and distribution service, from the BGS supplier, and bundle those services with its own transmission and distribution service into a single product and a single bill.

3. The BGS supplier and the utility each has an independent relationship with the retail customer for those services for which each is responsible. The possible permutations of this option are many, spanning all the possible combinations between exclusivity on the part of the BGS provider and exclusivity on the part of the utility.

The decision on which of these options -- including the range of possibilities within the third option -- will work best in New Jersey requires factual analysis, focusing on questions like the importance to the development of retail competition of having a direct relationship with the customer, the potential for customer confusion under the various options, and the costs associated with separate vs. bundled billing.

B. BGS Bidding Promotes Retail Competition

Q. Is bidding for BGS service consistent with the objectives of retail competition?

A. Yes. On the day competition begins, not all customers shop. New Jersey is an example. I have been informed by counsel that since New Jersey authorized retail competition, very few retail residential customers have chosen competitive suppliers.

To increase the level of entry into New Jersey, the Board can invite competitive suppliers to compete to supply the basic services presently provided by the utility. The

Board would host a competitive bidding process to select companies based on their price bid and/or other criteria. If carefully designed, the bidding process would bring to suppliers and customers some benefits of competition that are precluded when the provision of BGS is assigned automatically to the incumbent utility.

Through this process, new suppliers could win, on the merits, large numbers of customers while incurring relatively low transaction costs. Markets for utility services formerly provided by a regulated monopoly (such as gas, electric and telecommunications services) are likely to have high entry barriers for new sellers, who must incur substantial costs to lure a customer away from the incumbent. By entering a competition to provide basic service, one or more suppliers may win large numbers of customers at a much lower total cost per supplier. In this manner, competitive outcomes are determined more by the merits and less by incumbency.

The competitive process also may promote new efficiencies and innovations. For close to a century, the existing utility has enjoyed the exclusive right to serve a large customer base, under circumstances which allowed relatively certain recovery of and return on rate base, and of operating expenses. Depending on the structure of the competition, bidding suppliers may package different and competing services from which the Board may choose.

Q. Doesn't the statute say that BGS is a "noncompetitive service"?

A. Yes, but this status means only that the customer is not procuring the service competitively in retail markets; it does not mean that the decision as to who provides the noncompetitive service cannot be made through competition. Section 9(c) makes clear that the Board can use competition to select the provider of this noncompetitive service.

C. BGS Bidding Would Not Affect Reliability

Q. Would reliability necessarily be affected by a competitively bid BGS?

A. There is no inherent reason why a nonutility BGS supplier will be less reliable than the utility. First, the Board should have the same regulatory authority over the nonutility BGS supplier as it does over the utility. I have been informed by counsel that nothing in the statute precludes such a result. Arguments that nonutility BGS suppliers are less reliable because the Board lacks authority over them are therefore circular. The nonutility BGS supplier should be subject to quality of service regulation in the same manner as has been the utility. The Board must impose the same standards on the BGS provider as it imposes on the utility, and the same penalties.

Second, the Board can establish minimum terms and conditions and select qualified providers capable of satisfying those minimum terms and conditions. Examples of minimum terms and conditions that the Board may consider adopting include:

- Subjecting BGS providers to the pre-qualification licensing requirements of an electric power supplier;

- Requiring those competing to provide BGS service to file with the Board a proof of bond or a letter of credit, or a corporate guarantee, that will provide funding for replacement BGS service in the event that the provider fails to provide uninterrupted service to its customers;

- Subjecting an affiliate of the electric utility providing service, if permitted to provide BGS service in the same service area, to comprehensive affiliate relations standards that require an arm's length relationship between the affiliate and utility; and

- Requiring membership in a Regional Transmission Organization (RTO) approved by the Federal Energy Regulatory Commission, to the extent the RTO requires membership to obtain transmission or other reliability-related services.

Third, the nongeneration portion of BGS, such as physical delivery, i.e., transmission and distribution services, should not be affected by competitive procurement of the BGS services because physical delivery services will continue to be provided by the incumbent utility. The incumbent utility will remain responsible for reliable physical delivery subject to Board regulation and under contract with the BGS provider.

D. The Board Can Assign Customers to BGS Providers Consistent with Switching Rules

Q. Should the Board be able assign customers to a BGS provider?

A. Yes.

Q. If the Board would adopt rules that assign a nonchoosing retail customer to a nonutility BGS provider, would that be "slamming"?

A. The substitution of a legally authorized provider of service, subject to Board regulation, in place of the utility, is not slamming. Slamming is the unlawful transfer of a customer from one supplier to another. Where the BGS provider is selected through a Board-conducted or Board-supervised bidding process, customers transferred to the winning bidder are assigned lawfully.[2]

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[2] See, e.g., PECO Energy Company Competitive Default Service Program Bidding: Joint Petition For Approval Of Competitive Default Service Coordination Agreement, Docket No. A-110550 F0147 (Nov. 29, 2000)(approving basic service plan under which twenty percent of all PECO's residential customers, determined by random selection, were assigned to a non utility provider).

The Board should, of course, inform customers that their failure to select affirmatively a competitive supplier will result in their being assigned to receive service from a qualified BGS supplier, which will be determined through a competitive selection. Thus, unlike a typical slamming situation, customers will know exactly what will happen, and when, as a consequence of their inaction. They may even be given the opportunity to switch to a competitive supplier before they are assigned to a BGS service provider. Further, after a minimum period, or upon payment of an early withdrawal penalty, BGS customers may switch to a competitive supplier of their choice. To label this situation "slamming" is inaccurate.

The "slamming" charge is particularly inappropriate when made by utilities, since the typical utility customer never had a choice to be served by his utility but rather was assigned many years ago to that utility without consultation.

E. Threshold Decisions Will Affect the Competitive Benefits of BGS

Q. What decisions of the Board will determine whether competitive procurement of BGS is consistent with the goals of retail competition?

A. Two key determinations will affect whether BGS is provided in a manner consistent or inconsistent with the objectives of retail competition. The first decision involves identifying the producer -- as between the utility and the nonutilty BGS provider -- of each element of the basic service package. The second decision involves determining the extent to which each entity -- the utility or the nonutilty BGS provider -- has a commercial relationship with the retail customer.

To resolve each issue in the manner most conducive to retail competition will require the Board to analyze the facts.

Q. Please explain the first decision, i.e., identifying the producers of each element of the basic service package.

A. The first decision involves determining which elements of the basic service package can be, and should be, produced or procured by the BGS provider and which should be produced or procured by the utility. These elements of the basic service package, as I noted above, include production and/or procurement of electric capacity and energy, delivery of energy, including transmission and distribution, billing; metering; and other customer services.

When I use the phrase "produced or procured," I refer to the fact that an element of BGS might originate with an entity other than the entity that sells the final package to the retail customer. My assumption is that with competitively provided BGS, the BGS provider will have the exclusive commercial relationship with the retail customer, at least with respect to some portion of the retail services, and will officially sell the final BGS package to that customer. That status does not mean that the BGS seller is itself originating, or producing, each element in the package. Like any retail seller of a bundled product, it may outsource some of the inputs.

The analysis of which services should be produced or procured by the BGS provider should depend on the facts: if there are significant economies of scale (i.e., characteristics of a natural monopoly, as in distribution or transmission), then the service should be produced by the incumbent utility at regulated rates. If one assumes that the only part of the retail service package for which significant economies of scale exist is physical delivery of energy, then it would be most consistent with the objectives of retail competition to have the BGS provider be responsible for producing all parts of the basic package except delivery.

An issue related to which services are produced by the competitive BGS provider and which are produced by the incumbent utility is the issue of who decides. Possible decisionmakers include the Board or the nonutility BGS provider. The Board could allow competitors seeking to provide BGS to pick and choose which parts of the package they will provide. Allowing the nonutility BGS bidder to choose would make participation in the competitive process most attractive to new potential bidders because they would have to produce or procure only those elements of the BGS package they believe are most likely to generate profits. However, leaving the decision to the nonutility means that the incumbent utility must play a backup role -- that is, the utility must be prepared to produce all services. The utility will be in the position of having to be ready (and incurring costs to be ready) to produce parts of the basic service package.

Another approach is for the Board to give discretion to nonutility BGS providers to produce or procure certain services while requiring that they produce or procure certain other services. For example, the Board could determine that it might be too costly at this time for potential BGS bidders to do their own metering services but that bidders should be responsible for billing. The Board might then require, at least for a transition period, that the utility perform metering services for BGS providers desiring it to do so, while requiring that all bidders produce or procure their own billing services.[3]

In the end, the issue of which entity, as between the utility and the nonutility BGS provider, produces the various elements of the basic service package should depend on a factual determination of what services can economically be provided by the nonutility provider.

Q. Please explain the second decision, i.e., determining the scope of the utility and nonutility's commercial relationship with the retail customer.

A. The second decision, independent of the first decision, is the determination of the utility's and nonutility's commercial relationship with the retail customer. The incumbent utility's longstanding relationship with its retail customer, a relationship compelled by the historic prohibition on retail competition, has competitive value to the incumbent. Utility affiliates competing in retail markets may reap significant, though unearned, benefits by virtue of their affiliation with the utility, with whom customers have had a compulsory, state-endorsed relationship. These benefits act as a barrier to new entrants.

With respect to BGS service, the Board has an opportunity to address this entry barrier, by creating opportunities for competitive BGS providers to establish their own commercial relationships with retail customers. Thus the BGS option least consistent with retail competition would be to deny the nonutility BGS supplier of any relationship with the retail customer, leaving in place the status quo where the utility controls all such retail relationships.

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[3] I understand that the utilities and other parties are in the process of developing business rules and information exchange protocols to allow nonutilities to provide billing services, and will follow with consideration of metering services.

The Board's decision regarding the commercial relationship with the retail customer is independent of its first decision regarding who produces which elements of the basic service package. That is, the commercial relationship with the retail customer, with respect to any element of the BGS package, could be assigned to an entity other than the entity responsible for producing that element. The nonutility provider of BGS to the retail customer could procure transmission, distribution and other services from the utility and package them for sale to the retail customer.

If the Board opted for the commercial relationship most consistent with retail competition, the nonutility BGS supplier would interact, exclusively, with retail customers for the elements of the basic service package, including elements that it produces <u>and</u> those that the utility produces. The nonutility would bill and collect from retail customers the utility's costs of producing the elements for which it is responsible (<u>e.g.</u>, for at least kilowatt delivery) and pass the payments on to the utility under rules established by the Board.

The Board by rule may determine the scope of the utility's and the nonutility's commercial relationship with retail customers, or it could permit the nonutility BGS provider to decide the scope of its relationship with retail customers. If the BGS provider is given a choice, it could decide to interact with retail customers exclusively, or it could decide that it wants the utility to have its own commercial relationship with retail customers for some elements of the BGS package (<u>e.g.</u>, for physical delivery services).

Q. Please summarize the policy choices available to the Board in making the provision BGS competitive.

A. The decision least consistent with the objectives of retail competition would be to restrict the elements of the BGS package produced by the nonutility (e.g., to capacity and energy only) and to deny the nonutility any commercial relationship with the retail customer. The decision most consistent with the objective of facilitating new entrants into New Jersey's retail market would be to invite nonutility BGS providers to produce as many of the elements of the BGS package as they desire, consistent with economic efficiency, reliability and customer convenience, and to give them the option of having the exclusive relationship with the retail customer.

Q. How does the utility proposal in this case fare under the criteria you have set out?

A. The utility proposal would restrict nonutilities to producing only one of the many elements of the basic package and deny nonutilities the benefits of having a commercial relationship with the retail customer (indeed, the identity of the nonutility may never even be known to the retail customer).

Thus, along the continuum of possible elements of the BGS package produced by the nonutility and possible commercial relationships between the nonutility and retail customer, the utility proposal takes the position least consistent with retail competition.

III. To Achieve the Maximum Customer Satisfaction from BGS Bidding, the Board Will Need to Choose From Among Several Options for Shaping the Final Program

Q. What is the purpose of this section of your testimony?

A. Assuming the Board supports the use of competition to supply BGS, it will have a variety of choices to make on how to shape the program. This section of the testimony describes some of these choices. It is not my intent to recommend specific outcomes because those outcomes depend on specific New Jersey facts. My purpose is to describe some of the options available to the Board so that it can gather the facts necessary to choose among them.

In this section, I will address nine questions:

1. Who should be eligible to bid to provide BGS service?
2. For what increments of load could competitive bidders bid?
3. Can competitive bidding facilitate market entry of more than one supplier?
4. What are the options if the load which the bidders offer to serve is less than the actual load?
5. What should be the relationship among (a) the consumer, (b) the BGS supplier and (c) the utility provider of transmission and distribution services and competitive bidding?
6. Should the competition be based on price or other factors?
7. Can the Board establish a price cap on the bidders, in advance of the bid?
8. Can there be one BGS rate (and cap), or separate rates (and caps) corresponding to each current rate class?
9. What should be the obligation of the utility under a BGS competitive procurement program?

Q. Who should be eligible to bid to provide BGS service?

A. Nonutilities. The program for competitive procurement of BGS should be designed to encourage the participation of as many viable, efficient nonutilities as possible.

Utilities. Utilities themselves should not be permitted to participate in the bidding or provision of BGS. Utility provision of BGS would result in electric service being provided no differently now than before competition, particularly since large numbers of customers fail to select competitive suppliers. Such a result would be inconsistent with the objectives of effective retail competition.

Utility affiliates. The most effective means of maintaining a level playing field in the competitive bidding is to preclude utility affiliates from participating altogether (or at least from bidding to provide BGS in their own service territories). Otherwise, the utility may find ways of using its status as the current and historical provider of monopoly services to gain for its affiliate an advantage in the bidding and to retain competitive advantages in the markets for retail services.

Short of precluding utility affiliates from participating, the Board must adopt rules that preclude utility affiliates from gaining an unearned advantage in the bidding process or, if the affiliate's bids are successful, in retail markets subsequently. The requirement of operating the BGS program through a separate affiliate does not necessitate complete duplication of physical plant and employees. The Board could monitor and enforce affiliate rules for BGS service that require arms-length pricing, but not total separateness of employees, location or facilities.[4]

[4] By unearned advantage, I do not mean that the utility has made no effort to create the resources that give it an advantage. What the utility has earned through its efforts is a reasonable opportunity to recover its costs and receive a fair return. What it has not necessarily earned is a

Q. For what increments of load could competitive bidders bid?

A. Bidders could bid for: (a) a fixed number of customers, (b) a fixed percentage of BGS load, or (c) any increment of their choosing (but all be required to bid either a number of customers or an amount of load). In any case, bidders could bid on any number of increments and may offer the same or different prices or terms for each increment. This approach allows bidders to bid as their resources allow and to take advantage of any economies of scale created by winning a larger number of increments (this will be more true if the bid is conducted in small increments). The following is a description of the different options for bidding increments and a discussion of each.

1. Option (a): Bidding for a fixed number of customers

Description: Bidders bid in increments, such as increments of 10,000 customers. The Board would establish each block of 10,000 customers so that it has a similar load profile and includes customers from all customer classes. Alternatively, the Board could create different types of blocks, each of equal demand, and allow bidders to choose to bid on one or more types of blocks. The Board takes the lowest to the highest bidders until 100% of BGS service is covered, and offers the marginal bidder the option of serving the fraction of its bid that brings the total to 100%. If the bidder declines, the Board could offer (or require) other winners a pro rata share. A variation of this option would be to have the blocks represent individual rate classes.

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competitive advantage, because it has not achieved its advantages through competition. The utility has been the beneficiary of an historic government decision which excluded competitors and which mandated that customers cover the utility's costs. In that environment, customers had no choice but to pay for the very resources which would give a utility a competitive advantage over newcomers. Because these advantages were not earned by the utility through competition, they should not be available exclusively for the utility in competition.

Discussion: Under this option, bidders that do not score the best (e.g., 1st, 2nd, or 3rd) may still be winning bidders if the total number of BGS customers is large enough to require their services. These "nth bidders" will not know if they are actually going to serve BGS load until the size of the BGS load is established (i.e., if it turns out that there are 100,000 BGS customers but BGS providers were selected to accommodate 150,000 BGS customers, then some winners will have no load to serve). Thus, a potential winner might not know for a period of time whether it has any load and would be unable to firm up any contracts until shortly before service must be provided.

2. Option (b): Bidding for a fixed percentage of BGS load

Description: Bidders bid to serve customers in increments of some percentage of total BGS load. Maine used 20%. Using a lower percentage, such as 10%, could result in a larger number of new sellers. A lower percentage will allow bidders to tailor the number of increments they bid for to their own economies of scale and resources.

Discussion: Under this option, the winners would be certain of carrying a defined percentage of the total BGS load, but would not know what the actual load is until the total load is established. Unlike option (a), all bidders know that they have some load, but they will not know how large it is until the total BGS load is established.

Example: The Maine regulation establishing the bidding increments provides as follows:

> "Standard offer bids may be for a portion of the requirements of a standard offer class, but must be in multiples of 20% of the total standard offer class requirements. Standard offer bids may be to provide 20%, 40%, 60%, 80%, or 100% of a standard offer class's requirements. Any bid for a percentage of the standard offer requirement of a standard offer class that is greater than 20% shall also include a bid for each 20% multiple of the class's standard offer requirement up to the highest bid percentage. The bid prices may be different for each percentage of the standard offer class requirements."

Maine Regulation 65-407-301 §7.B.3.

3. <u>Option (c): Bidding on increments of any size</u>

Description: Bidders bid to serve customers in any increment of their choosing (perhaps subject to a minimum and maximum), but all bids must be for either some number of customers or a load of a particular size. Like option (a), the Board takes the lowest to the highest bidders until 100% of BGS service is covered, and offers the marginal bidder the option of serving the fraction of its bid that brings the total to 100%. If the marginal bidder declines, the Board could offer other winners (or require them to take) a pro rata share.

Discussion: This option has the advantage of allowing bidders to bid more precisely according to their own economies of scale and resources (but still has option (a)'s "nth bidder" problem). If bidders choose to bid in large increments, this option would limit the number of potential BGS providers.

Q. Can competitive bidding facilitate market entry of more than one supplier?

A. Yes. Consistent with the procompetitive potential of BGS bidding, the Board can make an affirmative decision to select multiple winners rather than a single winner. Such a decision to increase the number of entrants into the New Jersey retail market would increase the number of suppliers serving in New Jersey.

The Board could design the bidding process so as to have a preference for multiple providers of BGS service. For example, if the Board had a choice of picking three suppliers or one supplier to serve all BGS customers for the same price, the policy could require selection of the three suppliers.

It is very possible, however, that selecting more than one supplier may mean increases in cost; in other words there may be a tradeoff between increasing the number of BGS suppliers and limiting the price. This tradeoff is illustrated in the following example:

1. The total need for BGS service equals 30,000 MW.
2. Supplier A bids to provide 30,000 MW at 3.20 cents/kwh, but is unwilling to provide any lesser increment at the same price.
3. Supplier B bids to provide 15,000 MW at 3.00 cents/kwh.
4. Supplier C bids to provide 15,000 MW at 3.50 cents/kwh.

If price were the only consideration, the Board would select Supplier A because that supplier would serve the entire need for BGS service for the price of 3.20 cents/kwh. But if increasing the number of suppliers were a consideration, the Board could select Suppliers B and C for total average price of 3.25 cents/kwh. The tradeoff is the .05 cents/kwh price for two entrants (Suppliers B and C) instead of one (Supplier A).

Thus, a bidding process designed to increase the number of market entrants in

New Jersey could recognize the tradeoff. The policy also could limit the cost of the tradeoff by imposing a constraint that recognizes and limits its potential cost-increasing effects. For example, in selecting winning bidders, the Board could select at least five different providers unless selecting five providers would increase total BGS rates by X% relative to the selection of fewer than five providers.[5] If selecting five providers would exceed the allowable cost increase, then the Board could choose four providers, unless selecting four providers increases total BGS rates by Y%. And so forth down to two, with the percentage increasing as the number of providers decreases. (The Maine Commission requires that three providers be selected unless it increases BGS rates by more than 1.5%.) (Maine Administrative Code 65-407-301 sec. 8.C.4). In this manner, the regulator's use of bidding would promote more entrants into the state without compromising excessively or unknowingly the price of BGS service.

Q. What are the options if the load which the bidders offer to serve is less than the actual load?

A. There are at least three options for dealing with this situation:

Option (a): Require each winning bidder to take on a pro rata percentage of the load not covered by the bids. Drawback: This approach causes bidders uncertainty as to the amount of load they will have to serve. That uncertainty may discourage bidders.

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[5] The average BGS rate would be the average of the winning bid prices.

Option (b): Conduct a new bid, and succeeding bids, until all actual load is covered. <u>Drawback</u>: Unless the Board alters the terms and conditions or corrects market defects that limit the number of bidders, potential BGS providers may have no more interest the second time around.

Option (c): Order the utilities to provide BGS service through affiliates. Re-bid BGS service at end of the next BGS term when new circumstances may attract bidders.

Q. What should be the relationship among (a) the consumer, (b) the BGS supplier and (c) the utility provider of transmission and distribution services and competitive bidding?

A. Assuming that transmission and distribution services will continue to be monopoly services that will continue to be the responsibility of the incumbent distribution utility, regardless of the identity of the BGS provider, a distinct question arises: What should be the commercial relationship should be among three entities: the consumer, the BGS supplier, and the utility provider of transmission and distribution services?

The BGS supplier, like any retail seller, can obtain access to transmission and distribution service from the utility under uniform tariffs or standard contracts comparable to those available to competitive sellers. (For transmission, these tariffs or contracts would be established by the Federal Energy Regulatory Commission (FERC); for distribution, they would be established by the Board.) The retail seller may collect transmission and distribution costs from the retail customer, and turn those payments over to the utility pursuant to the tariff or contract.

The Board will need to create standard contracts to avoid time-consuming, utility-by-utility controversies between the utility and the new BGS providers.

Q. Should the competition be based on price or other factors?

A. There are least three possible options for determining the winning bidders: (a) the price bid for providing BGS service; (b) the various services or other benefits offered in connection with BGS service; or (c) some combination of the foregoing (a) and (b). A description and discussion of each of the two main options follows.

1. <u>Option (a): Competition based on the price a supplier is willing to charge for BGS service</u>

Description: Competition is based on the price proposed by the bidder to provide BGS service (not including the cost of any services to be provided by the utility). The Board determines all non-price terms and conditions of service. The Board could establish a price cap under which the competition could take place.

Discussion: This option of selecting the bidder offering to provide BGS at the lowest price for retail consumers is the most logical and least cumbersome means of BGS competition. It is most logical because the price bid would be the price the supplier proposes to charge retail consumers. It is the least complicated because the Board would establish all the non-price terms, and the selection of providers would be based on the purely objective criterion of price.

2. <u>Option (b): Competition based on terms and conditions offered by the winning bidder</u>

Description: Competition is based on terms and conditions proposed by the winning bidder, <u>e.g.</u>, service quality, rate structure, proposed customer education campaigns, proposed movement of customers off of BGS service, how many meter readings would be estimated, and any expanded services bidders are willing to provide customers. For any of these terms and conditions, the Board could establish minimum standards in advance of the bid.

Discussion: A potential problem with this approach is that the services bid could be difficult to compare in a transparent, quantitative fashion. Compliance with nonquantifiable commitments may be difficult to enforce, and might require a set of milestones and penalties. On the other hand, allowing bidders to differentiate themselves through different offerings is the essence of competition and can spur efficiency and innovation.

Q. Can the Board establish a price cap on the bidders, in advance of the bid?

A. Yes. If the competition is based on the price of BGS service, it could take place under a price cap established by the Board. The Board could separately impose a rate cap on any services provided to BGS suppliers by the utility.

Q. Can there be one BGS rate (and cap), or separate rates (and caps) corresponding to each current rate class?

A. There are several items. First, the Board could establish a single category of BGS service**,** with one rate for all customers, assuming that one rate is consistent with applicable New Jersey law. Alternatively, the Board could establish different BGS rates according to each current rate class. In this multiple rate scenario, each bidding increment could include customers from all categories, or bidders could bid on increments that include customers only from one category or another. If different rates for different rate classes are utilized, terms and conditions for serving the customer groups could vary.

Q. What should be the obligation of the utility under a BGS competitive procurement program?

A. The utility should provide the elements of the BGS package that the Board has determined are not subject to competitive procurement. If the Board provides nonutilities with a choice of bidding on other elements, the utility may have to provide other elements of the package which winning bidders opt not to provide.

The Board also should require the utilities to create a statistically representative load profile for the bidding increment (i.e., if bids must be submitted in increments of 10,000, the load profile should reflect the 10,000 increment). The load profile should include monthly energy consumption data and monthly demand data on a coincident and non-coincident peak basis. The utilities should provide the information to all bidders. (The Board should require refined load profiles after identifying the actual BGS customers.)

The Board may need to require the utility to provide other information necessary for the preparation of bid documents or require the utility to prepare such documents.

CONCLUSION

Q. Please summarize your testimony.

A. The Board has the opportunity to establish a system of providing BGS consistent with the goals of energy competition, by allowing non-utilities to compete to serve BGS customers through a competitive bidding process. The Board may choose among many options for procuring BGS competitively, but it should strive for a procurement method that is most consistent with the development of a competitive marketplace in New Jersey. To maximize the consistency of BGS with EDECA's mandate for competition, the Board must determine, based on an analysis of the facts, which products and services the BGS provider should produce or procure and the scope of the BGS providers' commercial relationship with retail customers. Competitive BGS suppliers should produce, or procure on their own, the maximum array of services that are part of the total BGS package that the supplier can reliably and economically provide. Further, the BGS supplier should have the flexibility to determine the scope of its commercial relationship with retail customers, such as whether the customer receives one bill for the total bundled package (including T&D services) or separate bills from the supplier and the utility.

Q. Does this conclude your testimony?

A. Yes.