

# INVESTIGATION OF RESOURCE ADEQUACY ALTERNATIVES

## BPU DOCKET NO. EO20030203

### COMMENTS OF THE NEW JERSEY LARGE ENERGY USERS COALITION

The New Jersey Large Energy Users Coalition (“NJLEUC”) appreciates the opportunity to offer comments regarding the Board’s investigation of resource adequacy alternatives in response to the Minimum Offer Price Rule (“MOPR”) Order issued by the Federal Energy Regulatory Commission (“FERC”). We welcome the opportunity to participate in this proceeding, as its outcome could have a significant impact not only on how capacity will be procured and reliability of service maintained for ratepayers, but also on the continuing viability of the utility regulatory paradigm that has existed since the restructuring of the electric and gas industries two decades ago.

For the many reasons stated below, NJLEUC urges the Board not to pursue the Fixed Resource Requirement alternative, as this largely untested, uncertain and risky remedy would represent a clear case of the prescribed “cure” being far worse than the disease.

#### **I. Background**

On December 19, 2019, following a divided vote, FERC issued the MOPR Order, which directed PJM to make significant changes to the wholesale capacity market. FERC directed PJM to expand the application of the MOPR to all “state-subsidized” resources, a term that was broadly defined to include all new state-subsidized renewable energy projects that seek to participate in the PJM capacity market, the nuclear plants and the Basic Generation Service auction. Existing renewable resources were exempted from the Order.

Under the Order, all new solar and wind facilities that benefit from payments received for renewable energy certificates for the electricity they generate will be subject to the MOPR. Therefore, these facilities will be required to bid into the capacity market a minimum offer price

based upon the net cost of new entry in PJM. Because the minimum price established for these resources could exceed the base residual auction market clearing prices, there is a potential that these resources will not clear the auction and, therefore, will not be eligible to receive capacity payments from PJM. The concern is that FERC's Order will increase the cost of solar and wind energy and undermine achievement of the State's aggressive clean energy goals.

The Governor's Energy Master Plan ("EMP") noted that the FERC MOPR "could effectively bar clean energy resources receiving state financial support from providing reliability services" and vowed to challenge attempts by FERC or PJM to mandate that New Jersey customers purchase capacity from a generation resource mix that is "inconsistent with state policies". The EMP indicated that New Jersey would explore all possible options, including "leaving the PJM capacity market, to ensure that the State can realize a clean energy future at reasonable prices." The EMP therefore directed that this proceeding be convened to examine how New Jersey's resource adequacy needs can best be satisfied consistent with the State's clean energy goals.

## **II. The Tension Between State And Federal Energy Policies**

For years prior to the FERC MOPR, friction had been building between State and Federal energy policies, with Federal regulators perceived as largely indifferent, if not hostile to New Jersey energy policy goals. The tension goes as far back as the proposed PSEG/Exelon merger in 2005, in which the FERC refused to hold even a single day of hearings and quickly approved the merger, notwithstanding the considerable concerns expressed by the State and others regarding the extraordinary market power that the combined entity would wield and potentially leverage to increase customer rates.

When FERC subsequently approved the Reliability Pricing Model ("RPM"), its stated intent was to foster the development of much needed local generation facilities in states like New

Jersey. When it became apparent that RPM's three-year price signals would not provide the long-term revenue certainty required to construct intermediate and base load generation, New Jersey responded by adopting the Long-Term Capacity Agreement Pilot Program ("LCAPP"), N.J.S.A. 48:3-98.2 et seq., to provide the longer term price signals needed to foster reliable in-state generation. In response, FERC fought the LCAPP program all the way to the United States Supreme Court and modified the PJM MOPR to subject LCAPP subsidy awardees to price mitigation. Then, as now, FERC's actions had the effect of frustrating State policies aimed at ensuring the availability of reliable, in-state generation capacity that, in turn, would also promote competition and blunt the possible development of market power by any capacity market participant. Then as now, the State recognized that it could exit the PJM capacity market by availing itself of the FRR alternative in the PJM tariff. However, in the end, the Christie Administration concluded that FRR was not a reasonable or viable alternative and elected not to pursue it.

More recently, the continuing discord between the State, FERC and PJM has been evidenced in transmission-related policy and pricing issues, "seams" issues and "leakage" issues.

After more than a decade of fraying relations and policy disagreements, it is little wonder why the Murphy Administration would revisit the possibility of exiting the PJM capacity market in favor of the FRR alternative. Now, as then, the State seeks greater control of its energy destiny, and added flexibility in achieving its energy goals, including adopting policies that are cost-effective to ratepayers. NJLEUC's members share this Administration's evident frustration with FERC's policy prescriptions and apparent indifference to market power issues. Increasingly, FERC has adopted policies that favor transmission owners to the detriment of the State and

ratepayers, while increasing transmission, capacity and other costs to ratepayers without delivering corresponding benefits.

In a word, we are in this together. Retail customers large and small have been adversely affected by these policies and we grow tired of them as well.

However, despite the significant Federal/State policy differences and occasional acrimony, we urge the State and our fellow stakeholders to proceed cautiously in considering where we go from here. Before the State gives serious consideration to adopting the FRR or other alternatives--alternatives that represent a dramatic and potentially risky departure from the status quo--we should all take a collective deep breath. Decisions made in haste or anger likely will not reflect the careful consideration that this moment requires. “Too good to be true” alternatives proposed by opportunistic stakeholders must receive the close scrutiny they deserve. We must seriously consider the many potential ramifications, both anticipated and unanticipated, of adopting alternatives like FRR that are largely untested, particularly in a deregulated state like ours, predicated on burdensome and complex rules that were designed to be unappealing and that carry huge potential financial, performance, administrative and other risks. Given the recent history of State/Federal policy disagreements, the fact that the FERC MOPR Order touts the FRR alternative and repeatedly invites us to adopt it should be reason enough to view the approach with great skepticism.

FRR would represent a tremendous leap of faith into the unknown, a leap that NJLEUC strongly urges the State not to take, particularly in a fit of pique. The State has considered and properly rejected the FRR alternative once before. If the only intervening change has been an increased level of frustration with FERC policies, then there exists no credible basis for adopting the FRR approach now. For all the negatives that are justifiably associated with PJM and FERC,

we must always keep in mind that the country's last major rolling blackout was stopped at the PJM border and that however flawed they may be, the PJM capacity auctions are actively competitive, closely monitored by the Independent Market Monitor, and are subject to multiple price-related protective devices that would be absent from an FRR regime.

### **III. FRR: The Promise and the Harsh Reality**

It is known that PSEG and certain of its supporters are actively lobbying the State to adopt the FRR alternative available under the PJM tariff. We recognize that some of the arguments advanced to support this seismic shift in energy policy may have certain facial appeal, so we explore these arguments below to cast them in a proper light.

As a threshold matter, as was the case with the aborted PSEG/Exelon merger, FRR is all about market power. The State should entertain no doubt that the adoption of FRR would enable PSEG, which continues to maintain enormous market power within its zones, to leverage this power to extract extraordinary windfall profits from ratepayers that would eclipse the market clearing prices established by the PJM capacity auctions as well as any capacity-related savings that proponents argue can be obtained through FRR.

The State should therefore be clear-eyed about the market power issue, and dismiss any thought that adoption of FRR would necessarily reduce costs to ratepayers and enable the State to more readily advance its clean energy goals. Rather, as discussed at length below, PSEG's extraordinary market power--combined with the fact that FRR entities will be compelled to acquire their capacity through bilateral contract negotiations devoid of PJM-style price mitigation rules and independent oversight--would afford PSEG an unfettered ability to significantly raise the prices that ratepayers will pay for capacity. *There is a reason why PSEG is advocating for the FRR alternative and this is it.*

In addition, the State should be aware of the many legal, policy, and Legislative hurdles, described below, that would have to be cleared, and the significant and ongoing administrative and oversight burdens that the State would have to assume to position itself to adopt the FRR alternative. In short, the State should similarly reject any notion that FRR would provide an easy to implement, cost-effective alternative that will enable the State to cast off the shackles of Federal regulation. Rather, the tremendous effort required to implement and oversee an FRR regime, coupled with the likely creation of market power and increased energy costs, should weigh decisively against pursuing FRR which, in truth, would be an unattractive, cumbersome and financially risky alternative to the PJM capacity market.

#### Arguments in Favor of FRR

The arguments in favor of the FRR alternative are by now well known. Because the MOPR would subject new renewable resources to high minimum floor prices, many of these resources would not be expected to clear the PJM capacity auction, rendering them ineligible to receive PJM capacity revenues and creating a bias in favor of fossil-based generation. The loss of capacity revenues for renewable resources would, in turn, would increase Renewable Energy Certificate (“REC”) values and drive up the cost of achieving the state’s clean energy goals. According to its proponents, FRR would afford the State energy autonomy while permitting it do direct additional revenues to the development of renewables, thereby allowing REC values, and potentially capacity values, to moderate.

In addition, the MOPR-induced inability to count capacity associated with new renewable sources in the PJM auction would mean that ratepayers could potentially be required to pay twice for capacity—first through the PJM auction for fossil and other resources, and next through increased REC costs needed to achieve the State’s clean energy goals. Proponents also argue that

FRR would require less capacity for the reliability reserve margin than under current PJM requirements, which would mitigate the double payment problem and result in additional savings.

Finally, FRR supporters may suggest that delegating significant capacity procurement responsibilities to utilities acting as FRR entities in their respective service territories could reduce the Board's administrative burdens and oversight responsibilities.

#### What Are The Requirements And Guidelines For The FRR Alternative?

Pursuant to the PJM Tariff and Schedule 8.1 of the PJM Reliability Assurance Agreement, certain entities that serve load in PJM are afforded the option to opt out of the PJM capacity market by selecting the FRR alternative. The FRR alternative differs from RPM in that FRR entities do not pay RPM locational reliability charges, the capacity resources requirement is fixed rather than variable, and the FRR plan to satisfy the FRR obligation is comprised of capacity resources that do not receive RPM auction payments. The FRR alternative only encompasses the RPM auction, FRR entities remain PJM members.

The entities eligible to elect FRR are investor-owned utilities, electric cooperatives or public power entities who demonstrate the capability to satisfy the unforced capacity obligation for all load, including expected load growth, within the FRR delivery area, throughout the term of the entity's participation in the FRR alternative. In retail choice states like New Jersey, the FRR entity would be required to include all projected load, including the load associated with customers who switch to competitive suppliers.

The FRR service territory is defined as either (i) the service territory of the investor-owned utility, (ii) the service area of a public power entity or electric cooperative, or (iii) a separately identifiable geographic area that is (a) bounded by wholesale metering or similar appropriate multi-site aggregate metering that is visible to, and regularly reported to, PJM or to an electric distributor, and such electric distributor agrees to aggregate the load data for the FRR service area and

regularly reports the aggregated information, by service territory, to PJM, and (b) for which the FRR entity has or assumes the obligation to provide capacity for all load, including load growth, within the service area.

Under the FRR option in its current form, an eligible entity must elect the FRR option and so notify PJM no later than four months prior to the PJM base residual auction for the first delivery year for which the FRR election is to be effective. The entity must submit its initial FRR capacity plan not later than one month prior to the base residual auction, and is required to annually extend and update the plan not later than one month prior to the auction for each succeeding delivery year. The minimum term for election of the FRR option is five consecutive delivery years.

The entity can terminate its election following the five year term by providing notice to PJM no later than two months prior to the base residual auction for the delivery year. An entity may also terminate its election in the event of a “State Regulatory Structural Change” by providing notice to PJM two months prior to the base residual auction for the effective delivery year. A State Regulatory Structural Change is defined in Article 1 of the Reliability Assurance Agreement to include, among other things, state actions that terminate or expand retail choice programs or that modify retail electric market structure or market design rules, including mandatory divestiture of utility-owned generation or changes to default service rules “that materially affect whether retail choice is economically viable.” An FRR entity that terminates its FRR election is not eligible to renew its FRR election for five years.

The FRR capacity plan of each FRR entity must commit capacity resources in a megawatt quantity no less than the FRR entity’s unforced capacity obligation, equivalent to the forecast pool requirement (including all existing load, including customers electing competitive supply, and forecast load growth) multiplied by the FRR entity’s allocated share of the zonal peak load forecast



for the delivery year. For FRR load located in an LDA for which a separate VRR curve is required, the entity must commit capacity resources located inside the LDA in a megawatt quantity no less than that calculated as the percentage internal resources required multiplied by the entity's unforced capacity obligation. The FRR capacity plan may only include capacity performance resources and may not include any capacity resource that has cleared in an RPM auction for the relevant delivery year.

If insufficient capacity is committed for a delivery year, the FRR entity would be assessed an FRR "Commitment Insufficiency Charge" for the shortfall occurring during the remainder of the minimum term of the FRR plan. The Commitment Insufficiency Charge is considerable and is calculated by multiplying two times the cost of new entry (in \$/MW-year) by the shortage of unforced capacity resources. Similarly, an FRR entity is required to pay a "Capacity Resource Deficiency Charge" for any shortage of resources to meet the amount of internal resources required in an LDA and the final daily unforced capacity obligation. Any shortage would be assessed the FRR Capacity Resource Deficiency Charge, which is derived by multiplying the weighted average resource clearing prices from all RPM auctions for the LDA encompassing the FRR service territory times the shortfall amount. In all instances, the FRR entity is responsible to PJM for curing any penalty for failure to perform, insufficiency of performance or daily shortages as required under its FRR plan. Each penalty is quite significant.

If an FRR entity intends to sell surplus capacity resources in an RPM auction, or to any purchaser that uses the capacity as the basis of a sell offer into an RPM auction or as replacement for an RPM commitment, the FRR entity must commit an additional megawatt quantity of capacity resources in addition to the quantity committed to satisfy the entity's unforced capacity obligation.

The additional quantity required is calculated as the lesser of the FRR entity's unforced capacity obligation or 450 megawatts.

#### A Leap Into The Unknown

Adoption of the seldom-used FRR alternative would cause a seismic shift in longstanding New Jersey energy policy. As discussed below, adopting the FRR alternative could dramatically increase energy costs to ratepayers, require extraordinary, complicated and time-consuming regulatory and legislative actions, including the partial re-regulation of the electric industry, requiring the Board to again assume significant resource planning and oversight responsibilities with regard to the State's generation facilities.

Despite any arguments to the contrary, FRR would not provide an easy fix to longstanding issues, but would instead impose a heavy lift for the state and its ratepayers, requiring many changes to current energy policies while creating the risk that extraordinary financial burdens and penalties could be imposed if FRR implementation is not be handled or planned properly. While the ability to assume greater control over the State's energy policies without Federal interference is an attractive goal, whether the benefits gained from exiting the PJM capacity market through FRR outweigh the costs that could be incurred remains far from clear. The extent of the regulatory and legislative actions that would ultimately be required for New Jersey to adopt and implement a viable FRR program are equally uncertain.

#### **IV. Market Power Issues**

A primary argument advanced in favor of FRR is its potential to reduce costs by eliminating double payments for capacity associated with new renewable resources that receive State subsidies but do not clear the PJM auction or satisfy PJM's capacity requirements. The loss of PJM capacity revenues would increase the costs associated with new renewable resources and, therefore, hinder attainment of the State's clean energy goals, which contemplate the rapid expansion of renewable

resources. It is argued that by avoiding the PJM capacity obligation through the FRR alternative the State would be better positioned to promote renewables and reduce costs to ratepayers through lower REC prices. It is also argued that FRR would provide additional savings by avoiding purchases of excess capacity associated with PJM-mandated reserve margins.

Despite its flaws, however, the PJM capacity market provides important competitive and administrative safeguards that would be absent under the FRR alternative. The PJM capacity markets and ratepayers benefit from the active participation of a multiplicity of geographically diverse generators that offer competitive, regulated bids into the RPM auctions, which are subject to price mitigation and oversight by the PJM Independent Market Monitor. Under the FRR alternative, FRR entities, including utilities that long ago divested their generation, would be compelled to procure the capacity needed to fulfill long-range capacity plans through bilateral contract negotiations with a limited number of generators that may be able to exercise significant market power within their narrowly defined LDAs. Under the FRR rules, the negotiating positions of the generators would be further enhanced by the likelihood that a significant percentage of the required capacity would be located within the generators' LDAs.

Further complicating the situation, certain LDAs in New Jersey that are subject to transmission constraints could be subject to Minimum Internal Resource Requirements ("MIRRs"), which require that at least a portion of procured capacity come from within the LDA. If applicable, MIRR requirements would further reduce the number of generators from whom FRR entities could procure capacity, dramatically increasing the potential for an exercise of market power by generators having concentrated ownership of generation facilities within the LDA. In some instances, all available capacity in an LDA might have to be procured to satisfy the FRR guidelines, further enhancing the supplier's negotiating leverage.

In these circumstances, FRR entities would have no alternative but to negotiate bilateral power agreements with suppliers having substantial, unmitigated market power. Such unconstrained market power would create the clear potential for increased capacity costs that could more than offset any purported financial benefits achievable through the FRR alternative.

The existence of market power wielded by certain generators like PSEG and the likelihood that the market power would be leveraged to substantially increase capacity costs in New Jersey are addressed at length in the May 13, 2020 Report by the PJM Independent Market Monitor entitled “Potential Impacts of the Creation of New Jersey FRRs” (“IMM Report”). The IMM Report describes the two leading “screens” by which market concentration is measured—the same indicators used by the IMM and State in the PSEG/Exelon merger proceeding to quantify the combined companies’ potential market power and, ultimately, to justify rejection of the merger.

The first screen, the Herfindahl-Hirschman Index (“HHI”), determines a supplier’s market share by comparing the supplier’s output with the total supply available from all suppliers within a given market. The HHI assigns values in a numerical range that categorizes markets as “unconcentrated” if the value is below 1000, “moderately concentrated” if the value is between 1000 and 1800, and “highly concentrated” if the value is greater than 1800. Table 4 of the IMM Report reveals that the PSEG FRR (HHI of 5562) and NJ FRR (HHI of 2445) are highly concentrated and that the JCPL FRR (1572) is moderately concentrated, ostensibly because, unlike PSEG, JCPL divested its generation fleet as part of industry restructuring. These results are consistent with the IMM’s consistent finding in a long line of annual “State of the Market Reports” that market power is “endemic” in the PJM capacity market and that the potential for the exercise of market power is high.

The second market power screen, the “three pivotal supplier test” is considered the more precise measure of structural market power because pivotal suppliers having the ability to exert market power may exist even in markets determined by the HHI to be unconcentrated. The pivotal supplier test focuses on the relationship between demand and the ownership structure of supply available to meet the demand. A supplier is deemed “pivotal” if the capacity of the supplier’s generation facility is needed to meet the demand for capacity. Table 5 of the IMM Report shows that all suppliers in the New Jersey, PSEG and JCPL FRR zones fail the pivotal supplier test. This is problematic given the IMM’s further finding that the total capacity in New Jersey is not sufficient to meet the FRR obligations in each zone, meaning that the State would be compelled to procure capacity from resources both within and outside New Jersey. Within New Jersey, PSEG clearly holds the largest portfolio of generation assets, all of which would likely have to be tapped to satisfy the FRR load requirements.

In these circumstances, PSEG would be deemed pivotal because the State and FRR entities would have no alternative other than to negotiate a capacity supply arrangement with an empowered PSEG, without any of the competitive and bid constraints, independent oversight or ratepayer protection rules that are part of the RPM auction. The PSEG and PS North LDAs have historically exhibited particularly concentrated ownership of generation, with PSEG at times controlling up to 90% of the generation within the LDAs, generation that would have to be tapped to satisfy any FRR capacity plan for these LDAs. Is it any wonder that PSEG is actively advocating adoption of the FRR alternative?

The IMM Report modeled these and other factors to develop six separate potential New Jersey-specific FRR implementation scenarios and concluded:

Based on the analysis, the creation of a New Jersey FRR, a PSEG FRR or a JCPL FRR is likely to increase payments for capacity by

customers in New Jersey. It is expected that the actual price for capacity in New Jersey would be the result of a negotiation between the owners of the required capacity and the State of New Jersey. *The price for capacity resources could substantially exceed the capacity market clearing price and the capacity market offer cap.*

Creation of an FRR creates market power for the small number of local generation owners from whom generation must be purchased in order to meet the reliability requirements of the FRR entities. All participants in the New Jersey, JCPL and PSEG FRRs fail the one and three pivotal supplier test which reinforces the conclusion that there is structural market power in each case. A fundamental point about the FRR approach is that the FRR approach is a nonmarket approach. In the FRR approach, there are no market rules governing offers, and there are no market rules requiring competitive behavior. In the absence of a competitive market that includes the FRR area(s), there is no competitive market reference point to define what a competitive offer would be from the FRR generation owners in a bilateral negotiation or what the competitive market price would be. Prior market results do not define a competitive outcome in subsequent periods because market dynamics and market outcomes may change significantly. *As a result, even the higher estimates of the cost impact to the customers of New Jersey from the creation of an FRR are likely to be conservatively low.* If New Jersey were to subsidize any generating units, the subsidy costs would be in addition to the direct FRR costs.

IMM Report, at page 4 (emphasis supplied).

The IMM Report determined that if an FRR area encompassing the entire state were to procure its entire capacity obligation at a rate equal to the weighted average net Cost of New Entry times B offer caps applicable to the LDAs in New Jersey (\$235.42 per MW-day), the net load charges under FRR would increase by \$386.4 million, or 29.6 percent, compared to the results of the last RPM auction. Another scenario developed for an FRR established for the PSEG LDA using the same calculation resulted in a \$199 million, or 27.2 percent, cost increase compared to the RPM auction result. *Thus, even under current rates the FRR alternative is projected to increase capacity costs by almost 30% in these scenarios.* Similar increased cost outcomes obtained in five of the six scenarios studied, which projected capacity costs to increase by up to 28%. In the last

scenario, modeled for the JCPL LDA having the lowest level of market power concentration, capacity costs were projected to decrease by about 2%.

It is important to reiterate that the IMM projections of up to 30% capacity cost increases are based upon current PJM clearing prices as the benchmark. One can only imagine the increases that could result if prices were established based upon bilateral negotiations between an FRR entity and a generator having significant market power and emboldened by the knowledge that its capacity must be secured to satisfy the FRR entity's load responsibilities. There should be little question that this would be the case in New Jersey where PSEG has for many years enjoyed substantial market power, particularly within the PSEG LDAs. As the IMM notes, the "nonmarket" negotiations that would occur with PSEG would not be constrained by any rules governing offers, price mitigation or competitive behavior and or be subject to IMM-type oversight.

As the Board well knows, at various times PSEG has owned up to 90% of the generation within its LDA and has in the past resisted efforts by the State to mitigate its market power. Is it possible that PSEG would ignore the considerable leverage it would possess to significantly increase its capacity costs and instead generously offer capacity prices consistent with the RPM base residual auction? We think not. The IMM Report makes clear that PSEG has considerable market power in its LDAs and in New Jersey generally and is a pivotal supplier in a market that would have insufficient capacity to satisfy the State's FRR capacity requirements. It should come as no surprise then that PSEG strongly urges adoption of the FRR alternative—they've done the calculations and they clearly like what they see.

#### **V. Other Risks And Legal Issues Posed By The FRR Alternative**

It is no secret that the FRR alternative was not designed to be an attractive one, particularly for states like New Jersey that deregulated their electric industries. As noted in the IMM Report, the FRR alternative was developed as an accommodation to the American Electric Power

Company (“AEP”), a vertically integrated electric utility that participated in all of PJM’s non-capacity markets but benefited from capacity payments based on a cost of service model developed with the regulated states that comprise the company’s service territory. The capacity costs payable to AEP under the state model exceeded what the utility could receive from the PJM capacity market. As a vertically integrated monopoly, AEP easily transitioned to the FRR structure. The utility owned its generation and was authorized to engage in integrated resource planning to develop the supply mix of resources needed to serve its customers and future load growth. It was left to the affected states (Virginia, Michigan, West Virginia and Indiana, all of which are largely regulated) to determine whether the resulting rates AEP charged to customers were just and reasonable. On information and belief, the only other utility to exercise the FRR alternative has been Duke Energy, which operates in Kentucky, another regulated state. On information and belief, the FRR alternative has not been successfully implemented in a deregulated state.

In a deregulated state like New Jersey, any thought that adoption of FRR would be easy, or that it would lighten the State’s regulatory burden by transferring certain responsibilities to the utilities as FRR entities, is misplaced. As a threshold issue, the preceding section makes clear that expansive market power mitigation and oversight mechanisms would have to be enacted to restrict potential unchecked exercises of market power. Whether New Jersey currently has the statutory authority or necessary resources to establish these mechanisms, or implement the State equivalent of the PJM Independent Market Monitor is at best an open question.

In fact, the “freedom” that would come from escaping federal regulation would create a regulatory void that the Board or other state entity would have to fill. At minimum, the State would first need to replicate various functions currently performed by PJM, including establishing bidder qualification and capacity procurement guidelines and capacity pricing restrictions. The Board



would also have to engage in resource planning and capacity market oversight responsibilities that are not currently within the Board's regulatory purview, have not been exercised in over two decades, and likely exceed its current legislative authority. The State should therefore pause to consider whether currently available resources would allow it to perform these significant tasks and at what cost. A serious question would also exist whether the State currently has the authority to direct unwilling utilities to become FRR entities, or for the State to assume those duties itself, potentially by the creation of a state power authority. All told, these changes to the regulatory paradigm could ultimately require the partial re-regulation of the State's electric industry

Further, the capacity procurement-related obligations assumed by FRR entities or the State would be considerable and attended by significant financial and operational risks. In New Jersey, with the exception of PSEG, most utility-owned generation was divested as part of the restructuring of the electric industry. Therefore, if the utilities become the FRR entities, they would be obligated to promulgate long-range capacity plans involving bilateral capacity agreements with generation owners who could wield considerable market power and demand monopoly prices.

Equally concerning, however, is PJM's minimum five-year FRR requirement, which also requires each FRR entity's capacity plan to identify in advance existing and projected capacity resources to be called upon during the entire five-year FRR period. As is the case with the RPM base residual auction, the capacity must be identified three years before the delivery year in which the capacity would be required. The only exception to the five year minimum commitment would occur if the state were to initiate a "State Regulatory Structural Change", defined as one that would materially change the state's retail access or default service rules.

Under the five year scenario, a capacity plan submitted in June, 2020 would have to identify sufficient fixed capacity resources to satisfy the FRR capacity obligation for the 2023/2024

through 2028/2029 Delivery Years. While some updating of the capacity plan would be permitted, the fact remains that *the FRR entity would be required to accurately forecast, three years in advance, the entire fixed load for which it is responsible over a five year period, including the load associated with switching customers.* This would be no small feat, as such long-range forecasting of load requirements is inherently uncertain and difficult, particularly in the current COVID-19 environment. Clearly, a forecast made only last December would not have predicted the significant drop in usage that has occurred in the last three months. Thus the potential is clear for an FRR entity to secure more capacity than necessary and pay unmitigated, market-power driven prices.

The procurement risk is further heightened by the Reliability Assurance Agreement, which establishes several draconian penalties for non-compliance with the FRR requirements or non-performance of the committed capacity resources. Therefore, an FRR entity's failure to obtain commitments to meet 100% of its forecasted load eight years in advance or to properly manage its portfolio of capacity, could subject it to significant penalties, based on a multiple of net-CONE. This is not how load obligations are secured in the normal course. To mitigate the significant risks entailed, FRR entities likely would carry excess capacity to avoid potential imposition of these penalties. Thus, any suggestion that FRR would enable the State to avoid compliance with the PJM reserve margin is misplaced. In these circumstances, risk-averse FRR entities would be expected to procure more, not less, capacity. FRR also would restrict the ability of an FRR entity to sell excess capacity, further complicating matters.

It should also be noted that Schedule 8.1, section D.7 of the Reliability Assurance Agreement authorizes PJM to reject an FRR plan it deems deficient. In such event, the FRR entity would have merely five business days to cure the deficiency or incur an FRR Commitment

Insufficiency Charge, calculated as a multiple of the cost of new entry in the LDA multiplied by the shortfall in megawatts for the remaining term of the plan.

The responsibility for paying any such FRR plan or capacity-related penalties would also have to be resolved. Needless to say, assuming financial responsibility for an FRR entity's non-performance or under-performance certainly would be a tough pill for ratepayers to swallow. Such concerns cannot be dismissed as unduly speculative as the FRR rules are highly inflexible and impose huge penalties on FRR entities that do not strictly adhere to them.

It should also be noted that Schedule 10.1 of the Reliability Assurance Agreement grants PJM broad authority to change any number of rules without advance warning. This discretion includes the rights to (i) define additional LDAs that could include portions of New Jersey, (ii) include the LDAs within the RPM auctions if needed for reliability purposes, and (iii) reject a deficient FRR plan in its entirety. It is also possible that, as occurred with LCAPP, FERC or PJM could react to any capacity-related or other policy initiatives by New Jersey, including withdrawal from the RPM auction under FRR, by further modifying the FRR rules or other PJM structures. Thus, the ongoing Federal treatment of the RPM auction and the FRR alternative could forever remain a moving target.

## **VI. Legal, Policy And Legislative Obstacles To Implementation Of FRR In New Jersey**

It should be underscored from the outset that there appears to be no precedent for the successful implementation of FRR in a state that has deregulated its electric industry. AEP and Duke were able to easily transition to FRR because they are vertically integrated utilities that perform resource adequacy planning on an ongoing basis, own and actively procure capacity resources and satisfy the boundary and metering requirements required by PJM to carve out geographically defined LDAs. The public utility commissions involved have comprehensive

oversight authority regarding these functions, including integrated resource planning and cost of service regulation that is needed to regulate vertically integrated monopolies.

New Jersey is in a far different position. As a deregulated state, implementing FRR would involve significant legal, policy and administrative hurdles, financial and other risks, and many uncertainties regarding whether and how FRR-type capacity procurements could be conducted within our current regulatory paradigm. The largest and most obvious distinction between New Jersey and regulated states like Kentucky and West Virginia is that the 1997 restructuring of the electric industry required the Board to relinquish its authority over power generation.

Thus, for more than two decades, the Board has not been involved with integrated resource planning or oversight or regulation of the cost of generation. For their part, the electric utilities divested their generation or, in the case of PSEG, transferred the generation facilities to an unregulated affiliate. Today, the electric utilities operate and are regulated solely as local distribution companies that deliver power provided by third party suppliers or BGS suppliers. The utilities are no longer directly involved in procuring energy or capacity to serve customer load. Decisions to develop or retire generating plants, formerly made by the Board with utility input, as well as transmission facilities, are now made almost entirely by power plant and transmission developers largely in response to market pricing signals, subject to limited oversight by PJM and FERC.

Deregulation has spurred the entry of numerous licensed third party suppliers into an active retail market, and these marketers currently serve a significant number of customers, particularly commercial and industrial customers, who have switched to competitive supply. Non-switching customers obtain their energy supply through the Basic Generation Service auction, in which BGS suppliers, including financial institutions like Goldman Sachs, compete for the right to acquire and

sell energy and capacity to serve the full supply requirements of designated tranches of customer load.

It should therefore be obvious that implementation of FRR would require a significant number of changes to this paradigm, requiring the passage of new laws or the amendment of existing laws and rules. Several likely changes that would be needed are discussed below. The list is not exhaustive, but rather highlights certain threshold issues that appear at first blush. It is likely that other, currently unanticipated, issues will emerge and require attention at that time.

First, a threshold issue presented is who would be the “FRR entities” responsible for the procurement of capacity for either the individual New Jersey LDAs or the statewide load? It is evident that the FRR entities would either have to be the electric utilities or the State itself, likely through the formation of a statewide power authority. While it is evident that PSEG would readily agree to be an FRR entity within its LDAs, what if the other utilities are unwilling to assume these significant obligations and risks, a scenario that is not unlikely? While there are references in the IMM Report to the State being able to “require” all LSEs located in the State to elect FRR status, (IMM Report at 5), in fact the Board’s authority to do so is by no means clear. What happens if one or more utilities that have been out of the generation business for two decades balk at being FRR entities and challenge the Board’s authority to require them to do so? Could the Board compel a cooperating utility to service the territory of a non-cooperative utility to fill this void? If so, how would responsibility for payment of capacity costs and any performance-related penalties should be allocated between ratepayers, marketers and others? These questions represent only the tip of the iceberg and the answers to them are by no means apparent.

Second, while the Board’s general delegation of authority over “public utilities” pursuant to N.J.S.A. 48:2-13 has consistently been broadly interpreted, the fact remains that the current

definition of an “electric public utility” refers only to an entity that “transmits and distributes electricity to end users within this State”. N.J.S.A. 48:2-13(a) and N.J.S.A. 48:3-51. These sections do not purport to grant the Board authority over public utilities beyond the distribution function, which clearly does not include the procurement of capacity for the load associated with switching and non-switching customers. While N.J.S.A. 48:2-13 (d) reserves for the Board certain residual jurisdiction “with regard to the production of electricity and gas to assure the reliability of electricity and gas supply to retail customers in the State as prescribed by the board or any other federal or multi-jurisdictional agency responsible for reliability and capacity in the State”, it is evident that this authority is limited.

The Board’s authority over power generation is set forth in Section 8 of EDECA, N.J.S.A. 48:3-56 (a), which states “the board shall not regulate, fix, or prescribe the rates, tolls, charges, rate structures, rate base or cost of service of competitive services”. N.J.S.A. 48:3-56 (b) makes clear that “electric generation service is deemed to be a competitive service”. The same section describes the Board’s residual authority over power generation as limited to seeking Legislative authorization to reclassify generation as a regulated service should the Board determine that insufficient competition exists for generation. If reclassification were to occur, the Board’s authority over generation rates would be reinstated. N.J.S.A. 48:2-56 (d). This section likely would provide the Board authority to revisit whether generation deregulation has accomplished EDECA’s cost reduction and environmental goals and, if not, and found to be appropriate, to re-regulate the generation function.

The re-regulation of generation would be a monumental undertaking and may ultimately not be achievable on terms acceptable to all affected stakeholders. It should be recalled that the deregulation of the electric and gas industries took five years to accomplish and involved the

resolution of a long list of significant issues, many of which would have to be revisited if the industry were to be re-regulated. In particular, the Board would have to address, among other things, the impact of re-regulation on retail competition, the provision of Basic Generation Service, reliability issues, responsibility for FRR-related performance projections, costs and penalties, consumer protections, and how renewables development, demand side management and efficiency programs would be handled under the FRR alternative requirement that fixed load projections be made up to eight years in advance. A huge issue that would have to be addressed is the return of the \$3 billion paid by ratepayers as stranded costs as part of the deregulation process.

We urge that all of this and more would have to occur in order to provide the Board with the authority needed to implement the FRR alternative, including the authority to (i) direct utilities to become FRR entities, (ii) resume integrate resource planning, cost of service regulation and prudence reviews, (iii) conduct or oversee FRR-type capacity procurements, (iv) monitor and mitigate market pricing and potential exercises of market power, (v) restrict capacity offer prices and, more generally, (vi) play a direct role in any generation or capacity procurement-related issues that would be required under an FRR structure.

The State has mentioned the possible formation of a state power authority which could serve as the FRR entity for all or a portion of the State load and assume some of the now-absent powers that FRR would require the Board to exercise. The State has twice briefly considered the idea of creating a power authority as a potential solution to generation adequacy-related issues. As envisioned, a power authority would enter into FRR-like long-term power purchase agreements for energy and capacity and engage in a comprehensive resource investigation and planning process in accordance with the Board's supervisory and investigative powers granted pursuant to the Public Utility Law, N.J.S.A. 48:2-1 *et seq.*

There should be no question that the creation of a state power authority would require an expansive act of the Legislature as it would create a new agency and require significant changes to existing law, including limitations on the scope of the Board's jurisdiction. It is for this reason that the power authority idea has historically been greeted with considerable skepticism, in recognition of the level of difficulty associated with the creation of an expansive new governmental bureaucracy in an area that requires considerable expertise. In this case, such an effort would have to address the daunting challenges and huge financial risks associated with the FRR alternative, as well as the practical problems inherent in locating and retaining key personnel having the requisite expertise with large-scale procurements in the intra and interstate power markets, long-term resource and load planning and the other skill sets that an FRR regime would require. These types of concerns led the Corzine and Christie Administrations to abandon their fledgling plans to develop a power authority. These and other concerns remain present, and the current COVID-19 economic environment would only make that much more difficult the development of a new government bureaucracy staffed by new personnel.

Adoption of FRR would also require the State to address a host of issues regarding the provision of Basic Generation Service. In its April 16, 2020 Rehearing Order, FERC not only reaffirmed its earlier MOPR Order, but also made clear that FERC included "state-run auctions" like the BGS auction to fall within the MOPR requirements. We are unaware what effect the Rehearing Order will have on the existing BGS auction structure, if any, but it is evident that the issue will be the subject of further study.

As BGS is currently structured, Section 9 of EDECA requires the utilities to provide a default service to non-switching customers "at prices consistent with prevailing market conditions" and authorizes the Board to regulate BGS prices, based on the reasonable and prudent cost to the



utilities to provide the service. N.J.S.A. 48:3-57 (a). Under the simultaneous descending clock auction format developed under this section, each successful bidder is required to assume PJM LSE obligations to provide full requirements service for its portion of the total load served in accordance with the PJM Reliability Assurance Agreement and other agreements.

It is noteworthy that N.J.S.A. 48:3-57 (b) restricts the ability of a utility to purchase power for BGS through a bilateral contract with the utility's generation affiliate, unless the Board deems the purchase necessary to insure reliability of service to BGS customers or to respond to "extraordinary circumstances". Even in such cases, the section mandates that the purchase price should "not exceed the market price for such power or the power was procured through a competitive bid process subject to board review and approval". It is evident that this provision was motivated by concerns regarding the potential for "sweetheart" or market power-influenced deals between a utility and its affiliate that would result in above-market costs, something that would clearly be a concern in the FRR context.

The continuing provision of BGS in an FRR structure would therefore create a host of complicated issues. For example, the BGS provision only addresses the full requirements service provided to tranches of non-switching customers by third party suppliers procured through the auction process. The BGS auction winners typically include financial institutions like Goldman Sachs that may not own generation and have resisted past efforts to compel disclosure of the sources of the power that they bid. For switching customers, the procurement of their full requirements service requirements are the responsibility of the third party suppliers that serve them.

By way of contrast, the FRR rules would require FRR entities—in all likelihood the utilities-- to be responsible for the procurement of sufficient capacity to encompass *all* load within

an FRR region, including the load associated with switching customers that do not take BGS service. Therefore, not only would FRR entities be responsible for the procurement of capacity now provided by BGS auction winners for tranches of non-switching customers, but also the capacity now being provided by third party suppliers for customers who switched to competitive supply. A host of issues would present themselves that would have significant ramifications and be difficult to resolve, including:

--What effect would FRR have on the competitive retail market if marketers are denied the ability to sell capacity to customers? We note that historically, marketers rejected utility proposals that would have limited them to sales of energy-only as too limiting to support a viable competitive market.

--Would FRR end or limit the scope of the BGS auction, given that FRR entities would supplant competitive auction winners as the providers of capacity? What effect would the removal of capacity from the "full requirements" bid have on the auction and the willingness of bidders to participate?

--How would the prices paid for capacity by non-switching customers through the competitive BGS auction format compare with those paid to FRR entities compelled to negotiate bilateral arrangements with generators having significant market power?

--How would the timeline associated with the BGS auction (3 years total, with one third of the load bid each year) be reconciled with the 5 year timeline (and 3 year lead time) associated with the FRR alternative?

--Do the tranches of load utilized in the BGS auction correspond to LDAs or specific metered geographic areas? If not, how would the loads be reconciled with the LDAs or metered areas used for the FRR alternative?

--What responsibility would third party suppliers, BGS auction winners and their customers have for FRR-related costs, including penalties, and how would these costs be assigned?

--Under what authority would the utilities as FRR entities be permitted to sell capacity to customers?

As noted, this list of issues is not exhaustive, and it should be recognized that there is a clear potential for a host of issues to arise in connection with the integration of FRR into the existing competitive retail market and BGS auction structures. As these examples suggest, the approaches are not consistent and, therefore, the potential for issues, anticipated and unanticipated, to arise is significant. The implications of the effect of FRR on the Board's retail competition and BGS policies should be given serious consideration.

## Conclusion

For the foregoing reasons, the New Jersey Large Energy Users Coalition urges the Board and State to reject the FRR alternative available under the PJM tariff and Reliability Assurance Agreement. While we share the State's angst as it relates to the potential frustration of the State's energy policy and goals by FERC, this is quite clearly a case where the remedy touted by FERC and PSEG has the potential to be far worse than the problem to be cured and could open a veritable Pandora's box of challenging legal, policy and regulatory issues. FRR would be fraught with uncertainty in many respects and would introduce the potential for financial harm to ratepayers stemming from an exercise of market power or imposition of draconian PJM performance penalties, either one of which could more than offset any potential cost savings or program benefits that could be gained by adoption of FRR. For these reasons, NJLEUC opposes the FRR alternative and looks forward to continued participation in this process.

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