

August 14, 2002

Ms. Zulima Farber
Lowenstein Sander PC
65 Livingston Avenue
Roseland, NJ 07068

RE: Deferred Balances Task Force

Dear Ms. Farber:

I am writing in response to your request dated August 8, 2002 for input for the Governor's the Deferred Balances Task Force. I am pleased to provide you with this office's responses to the questions presented in your request.

Please do not hesitate to contact me if my office can be of any further assistance.

Very truly yours,

Seema M. Singh, Esq.
Acting Ratepayer Advocate and Director

SMS:lg
c: Jess Melanson, Policy Advisor to the Governor
Encl.

Division of the Ratepayer Advocate
Response to Inquiries from the Deferred Balances Task Force
August 14, 2002

Did you or your organization take a position on EDECA, and specifically on the issues relating to deferred balances, before the Act was passed? If so, please describe.

RESPONSE:

Under the previous administration, this office developed position papers as to a number of issues raised by the then pending energy restructuring legislation. Copies of the position papers are enclosed. While these position papers did not specifically address the issue of deferred balances, they included a number of recommended measures to minimize energy costs for consumers. These included: requiring utilities to take steps to mitigate the costs of long-term contractual obligations to purchase power at above-market prices from non-utility generators ("NUGs"); continued implementation of demand side management and energy efficiency programs; and establishment of standards for the Board to address market power issues.

2. Were there provisions relating to deferred balances that you or your organization opposed and/or believed should have been included in EDECA but were not? For example, some organizations opposed the imposition of rate caps, while others supported a levelized adjustment clause or a trigger mechanism to prevent mandate rate reductions if savings from competition were not realized.

RESPONSE:

Enclosed are copies of the comments and proposed amendments to the pending legislation developed by this office under the previous administration. This office did not recommend provisions dealing specifically with deferred balances. In view of the high electricity rates prevailing before the enactment of EDECA, this office believed that rate reductions could be accommodated without implementing special ratemaking measures such as deferred accounting.

3. What do you or your organization believe are the principal factors responsible for the accumulation of nearly \$1 billion in deferred balances? Possible explanations include utility management, certain provisions in EDECA, or factors in the energy market unrelated to EDECA.

RESPONSE:

We believe that there are four principal factors that led to the deferred balances

- Rate reductions were implemented without any provision for later modification in the event of unanticipated market changes.

The utilities continue to be obligated to purchase power at above-market rates under long-term contracts with NUGs. These contracts were entered into by the utilities and approved by the Board pursuant to the federal Public Utility Regulatory Policies Act of 1978 ("PURPA").

Beginning in the summer of 2000, sharp increases in natural gas prices along with other factors resulted in high and unstable prices. A copy of a *New York Times* article discussing some of these factors is enclosed.

At the time deferred balance accounts were first established, energy markets were in their infancy and most market participants had little experience operating in competitive energy markets. Since then, energy markets have developed further and participants have gained more experience operating in a competitive environment. For example, PJM expanded its energy-related markets since 1999. Capacity markets were added in 1999, and the day-ahead energy market and regulation market were added in 2000.

- 4 Are there specific remedies that you or your organization support to address the issue of deferred balances? Do you or your organization support the securitization of deferred balances as allowed for by S-869?

RESPONSE:

We believe that deferred balances should be addressed through careful review of the utilities' methods for procuring electricity and NUG cost mitigation strategies, as well as a thorough review of the utilities' cost accounting to assure that any recoveries from ratepayers are in accord with proper ratemaking principles and with no "double counting" of costs already recovered through the utilities' base rates.

This office has concerns about the concept of securitization of the deferred balances, as costs incurred over the relatively short, three-year transition period would continue to burden ratepayers and the State's economy over an extended period of time. If the BPU determines that recovery of the deferrals over a short period of time would impose undue financial hardships on ratepayers, it possesses the authority to amortize these costs over an appropriate period without incurring the costs and administrative burdens involved in issuing bonds.

5. What are your or your organization's views on the process by which deferred balances should be investigated and heard by the Board of Public Utilities?

RESPONSE:

The Board of Public Utilities has directed the utilities to submit, contemporaneously with their base rate filings to establish their post-transition electric distribution rates, filings addressing all components of their unbundled rates, including the deferrals. These filings, which are to include supporting testimony addressing the prudence of their BGS purchases and describing and quantifying their efforts to mitigate their NUG costs, will be considered in evidentiary proceedings along with the utilities proposed distribution base rates. Further, the Board has stated that it plans to conduct audits of the utilities' deferrals. We believe these are the appropriate processes for review and investigation of the deferred balances.