PSE + G

1 Did your company take a position on EDECA, and specifically on the issues relating to deferred balances, before the Act was passed?

PSE&G was supportive of the EDECA legislation that established the framework for the deregulation and restructuring of the electric and natural gas utilities in this State, with the goal of providing all New Jersey consumers with access to competitively priced electricity and natural gas. Before the Act was passed the Company took no specific position on deferred balances, the difference between the wholesale price of electricity and capped rates.

2. When EDECA was passed, did your company anticipate accruing significant deferred balances? Why or why not? If this assessment changed please describe when and why?

The Company did not anticipate accruing significant deferred balances. By the terms of the Board of Public Utilities restructuring Order, which adopted and modified a Stipulation filed by PSE&G and others, PSE&G was required to enter into a Basic Generation Service (BGS) contract. The BGS contract which was in effect through July 31, 2002 provided that an unregulated generation subsidiary of Public Service Enterprise Group (subsequently established as PSEG Power) supply PSE&G for its BGS customers the full requirements for energy, capacity, losses and ancillary services at a price equal to the amount charged PSE&G's retail customers for BGS. This BGS contract removed the risk of price volatility from PSE&G and its BGS customers and resulted in zero deferrals through its term.

3 Please provide, in a matrix, the positive/negative of purchase power costs (i.e., deferred costs) for each month since deregulation commenced up to the present time.

Through the operation of the BGS contract as discussed in the answer to question 2, the Company has recorded or accrued a zero deferred balance reflecting the difference between the wholesale price of electricity and capped retail rates through July 31, 2002.

While the Company has not recorded any such deferred costs through the first three years of the transition period, it will begin to do so during the final year of the transition period. These deferrals reflect the results of the BPU approved statewide BGS auction for year 4 that was conducted in February 2002. A competitive bid process such as the year 4 BGS auction is a common and generally accepted approach to determining the market price for a product or service. The auction process was carefully designed to allow for and to attract maximum participation by competing bidders. Independent observers attested to the strength of the competitive environment, resulting in winning bids that reflect the market price for BGS

supply. The year 4 auction that was approved by the BPU was a competitive process that produced the market price for BGS.

4. Why deferred balances were accrued:
   a. To what degree did the provisions of EDECA contribute to the accumulation of deferred balances?
   b. To what degree was utility management responsible for the accumulation of deferred balances?
   c. How did unanticipated external factors (e.g. changes in the electricity market) contribute to deferred balances?
   d. Why do utilities have such vastly different deferred balances, even on a per customer basis?

a. The provisions of EDECA that contributed to the accumulation of deferred balances are found in Section 4 of the Act. Section 4 in part provided for the following: (i) required that each electric utility reduce its total rate level by at least 5% as of August 1, 1999, (ii) authorized that the Board may adopt a phase-in of additional rate discounts over the ensuing 36 months and (iii) that by no latter that August 1, 2002 the total rate discount reach 10% relative to April 30, 1997 and remain at that level through July 31, 2003. As the Board expressed in the PSE&G Restructuring Order:

> **"These provision of the Act essentially establish a price cap under which all unbundled rate elements must fit during the four year period August 1, 1999 through July 31, 2003. As such, to the extent one unbundled rate component is increased, all other things remaining equal, either one or more other unbundled rate components must be decreased, or the overall aggregate level of rate reduction must be reduced from what it otherwise would or could have been." (Final Decision and Order Docket Nos. EO97070461, EO97070462 and EO97070463, August 24, 1999, page 93)**

Given this statutory framework increases in the wholesale price of electricity could not be reflected in customer rate charges on a current basis.

b. PSE&G's management acted responsibility in the provision of BGS to customers as evidenced by the BGS contract that has resulted in a zero deferred balance through July 31, 2002 and the successful year 4 BGS auction that was highly competitive and produced a market price for BGS supply for the period August 1, 2002 – July 31, 2003.

c. The deferred costs to be recorded resulting from the Year-4 BGS auction are the result of unanticipated market price differences from the forecast used to set the rate charges prior to the start of the transition period.

d. **As mentioned in response to question 2 the primary reason for the differences between PSE&G and other utilities results from the BGS contract which removed the risk of price volatility from PSE&G and its BGS customers and resulted in zero deferrals through its term.**

5. Prudency Review / Mitigation

a. Explain the process your company utilized for purchasing power in wholesale markets. Specifically, pleas describe:
    i. the sources of power purchases
    ii. the methods by which prices were bid and/or negotiated
    iii. the types of agreements entered into (e.g. short- or long-term contracts, hedge agreements, etc.)
    iv. identify the sources of the power by quantity and price.

b. Describe all efforts to mitigate or reduce your purchased power costs and deferred balances, particularly at periods of peak demand, and including but not limited to the following mitigation techniques:
    i. negotiation and/or bidding techniques
    ii. the search for alternative supply sources
    iii. attempts at demand side management, particularly at periods of peak demand
    iv. attempts to renegotiate non-utility generation contracts that were above market rates

c. What new or expanded efforts will your company undertake in Year 4 of deregulation (August 1, 2002 - July 31, 2003) to mitigate the accumulation of deferred balances?

a. **and b. i. ii. iii. Please see responses to questions 2, 3 and 4**

b. **iv. The Company has through aggressive mitigation efforts renegotiated over 90% (capacity basis) of the contracts that are deferred in the Non-Utility Generation Transition Charge (NTC). The NTC recovers through customer charges the difference between the payments made in accordance with our agreements to purchase power from non-utility generators and the market value of the power. The restructuring of three of the Company's larger contracts resulted in direct up-front payments from the non-utility generators that were credited directly against the NTC. This process results in a significant over-collected deferred balance (estimated to be $129 million) in the Company's NTC that will be returned to customers after the conclusion of the transition period.**

c. **As outlined in the response to question 3 the Company together with the other New Jersey electric utilities proposed and managed under**

BPU supervision the competitive auction process for supplying year-4 BGS that was approved by the BPU in February of this year. The auction was carefully structured and resulted in winning bids that reflect the market price for BGS supply. Mitigation is not a relevant consideration in this situation when the BPU approved prices are the result of a highly competitive process and the process was thoroughly reviewed and attested to by an independent expert and the BPU.

As discussed in response to 5. b. iv. the Company has restructured over 90% of its Non-utility Generation (NUG) contracts. While some additional NUG restructuring activity may take place, the opportunities for significant mitigation through reductions to the NTC deferred balance are necessarily limited. Previous restructuring of NUG contracts have results in a significant over-collected deferred balance (estimated to be $129 million) in the Company's NTC that will be returned to customers after the conclusion of the transition period.

6. Are there specific remedies that your company supports to address the issue of deferred balances? Does your company support the securitization of deferred balances as allowed for by S-869?

   PSE&G supports the expansion of the securitization process as permitted in S-869 for "Basic generation service transition costs," as defined, as a reasonable tool to mitigate the customer rate impact from those deferrals.

7. Does your company have a position on the process by which deferred balances should be investigated and heard by the Board of Public Utilities?

   The Company believes that the BPU has established a comprehensive process to review the deferred costs and together with its specific and general statutory powers will conduct a full and fair investigation. The BPU, by order issued July 22, 2002, has outlined the process by which the electric utilities deferred costs that were accumulated during the transition period will be analyzed and reviewed. As part of this process the Board and its professional staff will obtain the services of a consultant to audit the deferrals. In addition to the work of this Task Force and the requirements for the securitzation of "Basic generation service transition costs", as defined and provided for in S-869 the BPU's Request for Proposal requires the consultant to determine "at a minimum, if the Utilities pursued a prudent procurement procedure for the acquisition of BGS, and when required, purchased power at reasonable prices consistent with appropriate market conditions in the competitive wholesale marketplace and consistent with appropriate hedging techniques."