Bill Potter responses

Ms. Zulima Farber, Chairperson
Curtis Fisher, Governor's Office of Policy & Planning
Jess Melanson, Governor's Office of Policy & Planning

RE: Answers to questions on deferred balances of electric utilities

Dear Ms. Farber, Mr. Fisher, Mr. Melanson

Please accept and circulate my responses to your questions as set forth in the attachment to Ms. Farber's letter of August 8, 2002, requesting replies by noon on August 15. Due to the short time allowed for this comment, I would appreciate the opportunity to supplement and, if need be, to correct these comments. Please do not hesitate to contact me with any questions.

Question 1. "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.

During the debates on EDECA, such as they were -- i.e., debate was extraordinarily limited for such an important bill, and any known critic of the BPU or the utilities (such as this writer) was typically shunted to the end of the line in hearings, committee meetings, etc., thus to keep dissent to a minimum -- I (briefly) represented the Coalition for Fair Competition (mostly small businesses doing energy contracting work, later defunct and no longer in existence) and various non-utility "energy service companies" or 'ESCO's' which provide energy conservation services to homes, schools, businesses, etc. I also worked on behalf of the senior citizens in Monroe Township on a strictly pro bono basis.

The CFC argued that any utilities going into these traditionally independent businesses -- such as HVAC work, plumbing and heating, oil distribution, etc. -- should do so strictly by divested, spun off entities and not by utility affiliates or subsidiaries, where favoritism and subsidization were all too likely to occur and all but impossible to police or prevent; but if utilities were allowed to go into these businesses, then the revenues gained from such business activity should be applied to stranded cost reduction. We also argued for lifting the utilities antitrust exemptions.

The ESCO's sought a strong and continuing state commitment to energy conservation as the cornerstone for state policy to reduce pollution, help consumers reduce their utility bills, and as a lower cost alternative to "supply side" sources of electricity which were being deregulated. This was a major point of departure in the EDECA reviews. For example, in one "famous" late night meeting at the legislature, Dolores Phillips (representing solar companies) and I were called into a drafting session by Senator Inverso (R) and Senator Codey (D) to review what became the Societal Benefits Charge (SBC) in the EDECA. We had about 2-3 minutes to make our case for the SBC to continue to promote cost effective, durable, "pay for savings" approaches to conservation ("energy efficiency" or EE") as well as renewable energy ("RE"). When we said the SBC fund should be at least $250 million a year or equal to .4 cents per kwh, a person sitting

in the shadows leaped to his feet and orally assailed us. This turned out to be Herbert Tate, Jr., the president of the BPU! He railed against us until I asked the senators if they were going to let this man bully them. Mr. Tate was asked to sit down. That is when the SBC got divided 75% for EE and 25% for RE, and the BPU was granted virtually total discretion over the fund. There was absolutely no discussions sought or permitted on how to administer or expend this public benefits fund before we were shown out of the room.

The SBC is in Sec. 12a(3) of the EDECA. I won't repeat it here. To summarize, it is supposed to be invested by the BPU with the DEP's consultation in EE and RE programs that will provide for even more environmental benefits than the very successful "standard offer" conservation program -- in which the utilities buy units of "saved energy" at prices set based the utilities' avoided cost of producing or buying the same amount of power themselves. The SBC must also promote market transformation, reduce costs to ratepayers and low income, etc. The BPU was given until Feb. 2000 to set the amount of the SBC which must be at least half of whatever the utilities were currently sending on all DSM programs, and to set up the new EE and RE programs. We felt we could proceed under this general directive -- although we tried to improve the language due to our very serious concerns that the Tate-dominated BPU might hand the money to the utilities and generally continue its efforts to gut effective conservation programs.

OUR WORST FEARS CAME ABOUT. Mr. Tate, joined by new Commissioners Butler and Murphy, and relying on a confidential DEP report (redacted), set the SBC at about $40 million a year less than the statutory minimum, and delegated all control over the SBC to the utilities and their few favored consultants, such as NRDC. All expenditures on new "pay for savings" programs were zeroed out. It was a dark day for conservation and consumers when the BPU handed down its final decision last July.

This tale of woe about the SBC being shanghaied by the utilities is critical to the deferred balances debate. Simply stated: If the SBC had been invested -- and if in the future it is invested -- in conservation and solar programs that will reduce demand for electricity, especially at peak periods when both pollution and prices are at their highest levels, then the utilities could have, and can, reduce their purchases of higher cost electricity which is accumulating as the deferred balances. We commissioned a study by JB/Marcus which considered the importance of conservation as a "public infrastructure investment." JB/M had performed a similar study for Governor Grey Davis in California which recognized quickly that demand reducing conservation will not only prevent black outs and other forms of energy shortage, it will reduce total purchases of electricity at skyrocketing heights, and it will also reduce the actual market price of electricity at these peak periods.

In short, such investments in conservation saves money for all consumers, even as it protects the environment, puts ESCOs to work in NJ, and reduces bills for treated customers. Every dollar spent on demand-reducing conservation returns several dollars to ratepayers in reduced energy purchase requirements and reduced market clearing prices, thus benefiting not only the owners of homes of structures treated or "weatherized" but all consumers.

But the utilities recognized the threat of such evidence. So they objected strenuously to the BPU even considering the evidence. Sadly, shamefully, the BPU refused even to admit this study into evidence! The BPU was eager to accept and to validate utility evidence of the cost of these demonstrably effective programs, but the BPU excluded all evidence of the benefits of such investments.

Thus, the issue is of utmost importance to Governor McGreevey's consideration of the deferred balances. This question must be addressed:

To what extent could the utilities have avoided these high cost purchases of power, and to what extent could they have reduced the actual market prices of the power they purchased, if they had promoted more conservation investments?

And to what extent can they now avoid such costs, and reduce future price spikes if the BPU will at last take back the SBC and/or order that it be used for these beneficial purposes -- rather than frittering away tens of millions of dollars of the public's money on programs that, at best, have only the most marginal or distant of benefits for a small portion of the public, while doing nothing to combat deferred balances?

Q. 2: I don't believe we proposed any such specific mechanism. However, my reading of the bill then and the law now -- when coupled by long-standing precedent and law -- reveals this: The BPU must not approve of any deferred balance recovery until it has completed a thorough "prudence" review of the deferred balances petitions. this review must be coupled with a determination of "just and reasonable" rates which examines not only "costs" but also revenues, return on investments, etc. That is, not only should the BPU perform a detailed audit of the claimed balances, as the starting point, but the BPU must also compel the utilities -- which have the burden of proof in all rate cases -- to demonstrate that they could not have avoided some or all of the balances through better purchasing activities, hooking up to lower cost alternatives, or by promoting more demand-reducing energy conservation and other sources of "saved energy."

But, clearly, the utilities do not want to be put to the test of proving any of this. Based on their statements to date, they want to present a "bill" and then demand that it be paid. That would be an abdication of the BPU's responsibility. In 1978 I argued the case of "Redi-Flo v. BPU" in which the Supreme Court ruled that automatic pass through clauses are illegal; the BPU must hold evidentiary hearings on "fuel adjustment clause," imposing the burden of proof on the utilities, and then it must "true up" these recoveries with the overall profits of the utilities to determine what are "just and reasonable rates." EDECA did not repeal any of that. It remains good law. A similar "prudence review," like that long performed on fuel cost pass through petitions, must be performed and with the utilities having the burden of proof as set forth by the Supreme Court in a long line of cases going back to "Public Service v. State," 5 N.J. 196 in 1950. (Sadly, the de facto burden has been eroded and even shifted to anyone objecting to a rate increase. The BPU must return to basic principles.)

Q. 3: I believe my response to Questions 1 and 2 address this one; in the interest of time I will not repeat them here, except to add these few additional comments.

The basic problem has been a BPU under Mr. Tate that behaved like it was a lobbying agent of the utilities for all EDECA matters, including the adoption of the law and its implementation. That must change, and I believe it is changing under BPU President Fox.

A basic assumption behind EDECA was that there was a huge surplus of low cost power that deregulation would free consumers to obtain. But there was never a large surplus. And only the utilities sought deregulation in EDECA; others wanted more competition and lower rates. EDECA and dereg generally did not lead to an explosion of new power plants being built (investors don't like unknowns like risk). Meanwhile, the utilities were gutting the most effective conservation program in the nation, the standard offer, and opposing every single possible improved alternative to it. PSE&G used to boast of all the conservation they were purchasing and promoting on their website (i.e., 650 MWs worth) but withdrew the website information when deregulation came about. They and the other utilities wanted to maximize "throughput" in their wires and pipes; conservation, if it is effective, substitutes for "throughput." And reduces revenues. If the utilities are also in the power generating business, like PSEG, they want to maximize energy sales too.

In short, there is an institutional conflict of interest which can be remedied only by a very vigilant BPU and by a combination of incentives for investing wisely in conservation, and penalties for failing to take advantage of these opportunities for reducing demand for power purchases that substitute for deregulated supply side sources while also reducing the market clearing price. And this goes beyond the SBC: Any CEO knows that if his cost of raw materials goes up (i.e., purchased power) when he cannot charge more than a certain amount for the finished product (i.e., retail electricity), then he should do everything possible to reduce his/her dependence on that higher cost raw material. But this does not appear to have happened with New Jersey utilities; they seem to have gone on purchasing at higher wholesale prices as if they have a secure IOU from consumers to pay it all without holding the utilities accountable in any way for their management. This is "buckpassingitis" with a vengeance.

Thus, all considerations of the SBC aside, rational utility managers should have looked very closely at how to induce consumers to rely less on power needs at peak periods. Various EE programs had been demonstrated to be effective but were phased out, and new ones were opposed or not renewed. ESCO's went bankrupt or left New Jersey in an "energy brain drain" as they went to other states where their New Jersey-gained expertise was wanted (such as California, Wisconsin, Texas, etc.) It is now up to the BPU -- and possibly the political branches -- to assure consumers that the utilities will not be given a green light on the deferred balances. All costs that could have been avoided through demand-suppressing, price-reducing EE should be charged to the companies' bottom lines, and let shareholders hold the management of these companies accountable for their decisions.

At the same time, the BPU must -- repeat, MUST -- reclaim control over the SBC; the DEP must also be involved and it must pull back the cloak of secrecy over its "consultations" with the BPU. It is not too late to start using the SBC to reduce future deferred costs. The court has recently remanded the appeal I filed back to the BPU for it to reconsider its prior Tate-era approvals of the SBC which were then and are now a prescription for waste as found by the Davies Associates audit that was made public in April of this year. But will the BPU wait too

long? Every day that SBC money is not redirected into real demand-reducing conservation is a day of higher rates, higher deferrer costs, higher bills for consumers, increased air pollution, greater energy dependence, etc.

SPECIAL ISSUE: SENIOR CITIZENS RESIDING IN ALL ELECTRIC HOUSES: On June 7, 2002 I proposed to the BPU the adoption of the SENIOR WEATHERIZATION PILOT PROGRAM to weatherize some of the all-electric homes in which seniors are living. I proposed the SWPP on a pilot basis to focus first on the Clearbrook and Roosmoor senior retirement communities in Monroe Township; these seniors have been seeking rate relief fro many years. By reallocating just $4.6 million of the $200+millin SBC, we can get bill-reducing benefits from the SBC for the direct benefit of over 4,000 senior citizens while also jump starting the decimated ESCO industry. We are still awaiting the BPU's response to this petition.

Q. 4: Yes

The primary remedies are (1) redirect the SBC into pay-for-savings and "direct install" weatherization and conservation programs, as discussed above, (2) adopt the SWPP to jump start this effort, (3) announce that not one dollar of the balances will be permitted until the thorough prudence review discussed above is completed, and with the utilities having to bear the burden of proof, as discussed above that they could not have avoided all of their claimed deferred balances and that their rates are not "just and reasonable" without such a pass through. In this way the process is consistent with decades of learning about the needed role of the BPU as a "police force" to protect consumers.

Securitization should be a last resort, permitted only AFTER the above process is described. It is no panacea. It means borrowing money and paying it back with the state acting as a collection agency for the utilities. It locks the State into a single decision that cannot be reconsidered or revised even if later proven to be incorrect. It means paying substantially more over the term of the bond. Even after a "bottom line" of deferred balances is determined, i.e., following the "prudence"/ "just and reasonable" review described above, the public utilities should at most be permitted to amortize the deferred balance over several years. This is how the BPU used to deal with the costs of utility investments in power plants (nuclear) that produced no public benefits. It is also how President Tate said he intended to deal with the deferred balances when he testified that it could be $1.8 billion! In such an amortization process, the utilities obtain the return OF their investments over several years (10-20) but not necessarily the return ON (profits) related to all of those expenditures.

Q. 5: I have already addressed the process for review of these claimed deferred balances.

Legislation should also be considered which would extend the price cap period for a year or more and even to prevent some or all of the balances form being recovered, inasmuch as not all "deregulated" states even permit a utility to file for deferred balance recovery. I do not believe that Pennsylvania, Maryland, New York, or other mid Atlantic states permit such recovery (needs to be verified).

To be sure, utilities are entitled to charge "just and reasonable rates," such that they can provide "safe and adequate service" and raise the capital necessary to continue to do so. Property cannot be confiscated. Also, BPU-approved contrast for purchased power cannot be abrogated. But even with these conditions, the "pay now IOU" attitude as sought by the utilities, as I understand their positions to be, must be addressed and corrected.

In addition, the SBC should be modified by statute to clarify legislative intent; this fund must be expended in ways that maximize public benefits for current ratepayers through demand-reducing, price reducing energy conservation and renewable energy programs. Senior citizens should be specifically targeted for "direct install" weatherization programs.

The BPU should also be brought up to full complement by the appointment of a fifth BPU commissioner who will be someone who has a demonstrated history in consumer protection, and expertise in these areas. For some reason, we have a "tradition" in New Jersey of treating BPU appointments -- not always but far too often -- as a "plum" political appointment. Expertise seldom counts. To be sure, Governor Florio (who appointed Scott Weiner as BPU president) and Governor McGreevey(who named Jeanne Fox as president) showed that they will consider expertise, experience and strong consumer and public concerns in naming BPU commissioners. But this should be the norm and not the exception. No governor would name as DEP commissioner someone who has no expertise, or history of demonstrated interest, expertise or at least some commitment to environmental values, so why is the BPU treated any differently?

The Ratepayer Advocate or Public Advocate must become more aggressive and assertive on these matters. The advocate was a strong supporter of valid SBC programs and funding but did not appeal the BPU's ill advised decision. I had to do this on behalf of the NJ Public Interest Research Group; the result is that the BPU rulings have been remanded for BPU reconsideration.

We also need legislative oversight hearings. The Congress had much to do with bringing the FERC into line with reality on the manipulation of the California energy markets. The legislature should be reminded of their investigative and oversight functions.