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DEPARTMENT OF THE PUBLIC ADVOCATE
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JON S. CORZINE
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September 26, 2006

SEEMA M. SINGH, ESQ.
Director

Via Hand Delivery and Electronic Mail

Honorable Kristi Izzo
Board of Public Utilities
Two Gateway Center
Newark, NJ 07101

Re: I/M/O the Provision of Basic Generation Service for the Period Beginning June 1, 2007
BPU Dkt. No. EO06020119

Dear Secretary Izzo:

Enclosed for filing please find an original and ten copies of the Division of Rate Counsel's ("Rate Counsel") comments in the above matter. These comments will also be circulated electronically through the electric list server used by the Board of Public Utilities ("Board") for these types of communications. **We are enclosing one additional copy of the materials transmitted. Please stamp and date the copy as "filed" and return it to our courier. Thank you for your consideration and assistance.**

Rate Counsel understands that the original procedural schedule called for these comments to be filed on September 22. However, the proximity of the filing date with the September 21 hearing made it impossible for our office to complete these comments by that date. Rate Counsel respectfully requests that the Board accept the comments filed today as timely.

Respectfully submitted,

RONALD K. CHEN
PUBLIC ADVOCATE OF NEW JERSEY

SEEMA M. SINGH, ESQ.
Director, Division of Rate Counsel

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c: President Jeanne M. Fox, (via hand delivery)
Commissioner Connie O. Hughes, (via hand delivery)
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**I/M/O Provision of Basic Generation Service (“BGS”)
For the Period Beginning June 1, 2007
BPU Docket No. EO06020119
Comments of the Department of the Public Advocate
Division of Rate Counsel
September 26, 2006**

The Department of the Public Advocate, Division of Rate Counsel (“Rate Counsel”) respectfully submits these comments to the Board of Public Utilities (“Board” or “BPU”) in the above-captioned matter. In this proceeding, Rate Counsel has also filed written comments dated August 18, May 5, and April 6, as well as two sets of comments dated July 14 (concerning respectively the BGS Auction process and the Supplier Master Agreements) along with statements provided at the hearings held in this matter. The issues addressed in our earlier comments included:

- the goals for BGS-FP service,
- pass through of supplier cost changes,
- the BGS Portfolio,
- information concerning BGS-FP supply sources on an after-the-fact basis,
- auction modifications on “pay as bid” and “tick down on ties”,
- Rate Counsel access to the same confidential information available to Board Staff and its consultants to facilitate our statutorily mandated role in rate review matters,
- Board consideration of a group effort with nearby States to review the competitiveness of the electric generation market for Standard Offer Service, i.e., BGS,
- various changes to the Supplier Master Agreements.

Rather than repeat those comments, Rate Counsel invites the Board to review them in the context of these additional comments. In this filing, Rate Counsel will limit its discussion to three issues that arose during the hearing on September 21, 2006 – the pass-through of cost increases, the BGS Portfolio, and information concerning the winning bidders’ sources of supply.

Rate Counsel is appreciative of the Board’s willingness to reconsider the effectiveness of the current BGS procurement process in light of the large increases in the prices of the winning

bids from the February 2006 auctions. Rate Counsel believes that the Board is attempting to find alternative ways to provide the captive BGS customers with affordable electricity, and we have submitted various rounds of comments pursuant to the procedural schedule in our own attempt to provide reasonable answers to the Board's questions and to assist in reforming the process to accomplish the stated goals of the Electric Discount and Energy Competition Act ("EDECA"). The very first declaration of State policy in EDECA is to "[l]ower the current high cost of energy."¹

The statute is clear that EDECA was the Legislature's attempt to reform the electric supply procurement process in effect at that time, so that all customers -- large and small, commercial, industrial, institutional and residential -- could enjoy lower electric rates and "improve the quality of life and place this State in an improved competitive position in regional, national and international markets"² Rate Counsel respectfully urges the Board to make maximum use of this opportunity to once again reform the procurement process to achieve the lower rates that EDECA envisioned for the deregulated electricity supply market. The rate reductions required by EDECA were unfortunately short-lived and not sustainable under the then-current procurement process. The Board and New Jersey are once again faced with the regrettable situation of ever-increasing electricity rates. Failure to change the process for the better will saddle New Jersey customers with unnecessarily high electric rates for at least the 3-year period of the next BGS-FP auction.

Rate Counsel believes that the recommendations contained in our comments will help to improve the process and reduce rates from what they would have been without these recommendations. Other parties have little to offer other than proposals that would further increase rates with additional pass-throughs and a certain amount of fear-mongering that any change in the current procurement process will drive bidders away from the State of New Jersey. Suffice it to say that it is hardly likely that reasonable electricity suppliers will shun the enormous market for captive customers and profits that New Jersey provides them. The BGS procurement process essentially hands over millions of customers to the suppliers who do not have to make the effort to contact the customers individually to sign them up for service. The suggestion that they would abandon this opportunity to serve such a large base of customers with the related profits simply because the Board may no longer permit them to pass through incremental transmission rate increases is not a credible criticism.

None of these parties has provided even the barest shred of hard evidence to support their claims. They rely entirely on threats to withdraw from the auction process or threats to drive up the cost of electricity to even more unacceptable levels. Rate Counsel respectfully requests that the Board place these threats in their proper context. It is natural for parties to a contract to attempt to shift risk from their own side of the transaction to the other side, and it is natural for parties to attempt to fend off this shift. While New Jersey ratepayers understandably oppose the imposition of additional risk to their already high electricity bills, the Board should view this conflict in this context -- which of the contracting parties has the best opportunity to address and mitigate that risk to their advantage? Rate Counsel believes the clear answer is that the BGS suppliers are in the best position to address and mitigate the risk of additional cost pass-throughs.

¹ N.J.S.A. 48:3-50(a)(1).

² Id.

EDECA's list of policy goals leads to the conclusion that competition among BGS suppliers is a means to reach the goal of lower energy costs to consumers and that this competition is not a goal in itself. The Legislature surely did not mean to foster competition in the electric generation market regardless of the results. EDECA obviously supports competition as a way to lower energy costs. Rate Counsel also vigorously supports competition where it helps to lower energy costs, but it is important to remember the precise language of the statute. The statute maintains the below statement as one of its policies:

Place greater reliance on competitive markets, where such markets exist, to deliver energy services to consumers in greater variety and at lower cost than traditional, bundled public utility service³

For these reasons, it is no criticism of the current BGS auction to say that EDECA was not promulgated to bring us an auction, but rather that the auction was created to bring us closer to EDECA's goals. To the extent that the current auction procedures do not help us reach EDECA's goals, then the Board is clearly correct to reexamine the role that the auction plays in BGS supply procurement and how that auction and the entire procurement process could be improved to help lower electricity costs.

EDECA also makes "universal access to affordable and reliable electric power" a policy goal.⁴ For small customers, electricity is not truly affordable if its price is so volatile that they cannot plan and budget to pay for it. Thus, at least for customers on BGS-FP service, price stability is part of the policy framework articulated in EDECA as well. As Rate Counsel pointed out in comments dated May 5, in procuring BGS-FP service, the Board should balance the two goals -- least cost supply and price stability -- giving each equal weight.

Incremental Cost Pass Through

One item that Rate Counsel would like to clarify and correct from our comments at the September 21 hearing concerns the pass-through of transmission rate increases after the BGS supply contract is implemented. When questioned by Board Staff whether the continuation of this pass through would assure ratepayers of not paying any more than the actual cost of transmission throughout the term of the BGS supply contract, Mr. Ubushin mistakenly stated that the pass through assures customers of only paying the actual transmission costs. His comments should have been limited to saying that the pass through only assures customers of paying the actual incremental transmission rate increases that are implemented after the BGS supply contract begins.

Currently, the BGS auction bid includes the bidder's estimate of its cost components, presumably including its estimate of future transmission expense, plus whatever profit the bidder believes will still allow it to win a BGS contract award. For instance, a bidder could estimate its

³ N.J.S.A. 48:3-50(a)(2).

⁴ N.J.S.A. 48:3-50(a)(4).

future total cost incurrence at 10¢ per kilowatt-hour and then add a 20% profit margin to that. In that case, the bidder has essentially added a 20% margin to all of its cost components including transmission rate expense. In this way, ratepayers could be seen as paying more than the actual transmission rate expense even under the current BGS auction procedure. The pass-through mechanism would only protect ratepayers from paying more than the actual future incremental transmission rate increases, over and above whatever amount the bidders have included for transmission expense in their winning bids. Since the Board can not know exactly what amount that bidders include for transmission rate expense in their bids, there is no way to know that the winning bids only include the actual transmission expense. Bidders are not prohibited from including more than the actual transmission expense in their bids. That is to say, the bidders are not required to itemize their bids for this particular expense. There does not seem to be a way to protect ratepayers that would limit their exposure to paying only the exact expense for transmission rates under the current bidding procedure, although Commissioner Bator did mention the possibility of asking bidders to submit two bids, one with transmission expense included and one without transmission expense included.

Currently the Supplier Master Agreements permit pass through of changes in taxes and in transmission rates. In its initial comments filed April 6, Morgan Stanley proposed that costs for Capacity and Ancillary Services also be passed through. J.P. Morgan Ventures proposed an adjustment for “regulatory changes” in its April 6 comments, in effect passing regulatory risk through to BGS-FP customers. The current and additional pass through proposals are not consistent with the purpose of the BGS-FP Auction -- obtaining service for small customers at a fixed price.

The common factor in all requests to pass through additional costs to captive customers is to relieve the bidders from any risk they can succeed in passing onto the customers. This should not be the over-arching goal of the BGS Auctions. The current pass through situation already burdens customers with risks of higher rates over which they have no control except to reduce usage, to move to a part of New Jersey not served by one of the four investor-owned electric utilities, or leave the State entirely. No party has yet had the audacity to attempt to justify higher rates as a “demand response” initiative, and Rate Counsel respectfully argues that, admitting to customers that New Jersey has no response to the risk of higher rates other than to turn up the thermostat in the summer or just use less electricity year-round, should be an unacceptable response to the increasing cost of electricity. The suppliers’ call to increase the ratepayers’ burden even more than the current pass through already has done is also an unacceptable response to the Board’s decision to revisit the pass through issue. The requests to increase the number of pass through items should be rejected as antithetical to the reason why the Board began the reexamination of this issue.

The suppliers have tried to convince the Board that eliminating this pass through item must inevitably increase BGS rates when the bidders include the price of a risk premium for incremental transmission rate increases in their bids. They would have the Board forget that the BGS auction is still a competitive process in which the bidders must attempt to reduce their bids to an amount that is equal to or less than the eventual clearing price for that auction product. Bidders will surely work hard to avoid the case in which they overestimate a transmission rate increase risk premium so that their bid is too high to succeed. Certainly no bidder wants to go

through the expense of participating in the auction simply to mistakenly out-price itself from receiving an award. The risk of not receiving any award for BGS supply is certainly greater than any risk premium for possible transmission rate increases that might be built into a bid.

Competition among the bidders on the transmission component of their bids can only serve to reduce that cost component of the bids. It is certainly conceivable that a bidder would include no risk premium for incremental transmission rate increases simply because the bidder perceives that this risk is so minimal or nonexistent that any incremental expense would not justify the risk of pricing itself out of the market entirely. Continuing this pass through and relieving the bidders of the requirement to compete on that cost component simply passes all the risk to ratepayers without any associated benefits to the customers of the auction process.

As mentioned in our previous comments and at the September 21 hearing, eliminating the pass through will enhance the likelihood of least cost supply because suppliers are better motivated to make the effort required to win cases before the Federal Energy Regulatory Commission (“FERC”) in which transmission rate increases can be opposed. It is certainly correct that any of the parties to the BGS procurement process has the opportunity to appear at the FERC to help mitigate transmission rate increases. However, it is also an undeniable fact that the Board and Rate Counsel are state agencies with limited resources that need to be marshaled most effectively in the regulation of public utility rates in this State. To that end, it can only improve the transmission rate review process at the FERC if the BGS suppliers are given additional incentive to appear at that agency in those dockets. JCP&L filed comments that also mentioned reasons why it would be helpful for the suppliers to assist in that effort at the FERC.⁵ JCP&L also stated that it opposes the suppliers’ requests to add to the number of cost items subject to the pass through mechanism.

The suppliers have also complained that they see no method through which they could hedge the risk of future transmission rate increases. Their complaints seem to allege that transmission rate increases apparently “come out of the blue” and are totally unexpected. Their statements ignore the fact that transmission projects traditionally have long lead times especially when they require the acquisition of new rights-of-way. The process to site and construct new transmission lines is certainly one which the suppliers can discover even through the use of a minimum of curiosity, let alone the exercise of due diligence. This publicly available information can then be used in order to assist them in their hedging activities.

The BGS Portfolio

Rate Counsel has recommended developing a BGS Portfolio that would receive BGS-FP supply from a variety of resources including the BGS-FP auction. Our office recommended that

⁵ At the September 21 hearing, JCP&L also clarified that it supports no change in the current pass through process, but that if the BPU were to change that part of the process, it would prefer Rate Counsel’s proposals over the proposal to shift the transmission cost responsibility to the utilities. That nuance was not readily apparent from JCP&L’s comments, but Rate Counsel’s misunderstanding of the utility’s comments has now been resolved. JCP&L also stated its belief that Rate Counsel’s proposal would work. Rate Counsel respectfully submits that the several reasons JCP&L has given to support our proposal are persuasive enough to justify the Board’s eliminating the pass through process.

the Board endorse the BGS Portfolio concept and designate a working group to provide recommendations to the Board for a BGS Portfolio approach that the Board would act on for next year's BGS procurement process. That recommendation was motivated by a concern about recent developments affecting the stability of BGS-FP prices. To provide greater price stability for BGS-FP customers, the BGS portfolio would include resources such as Demand Response and Long-Term Contracts (i.e., 10 to 25 years or even "Life of Plant" Contracts, etc.), in addition to 3-year contracts procured through the auction. If it is feasible and economic to do so, longer-term resources need to be added to the supply mix. The size and/or number of tranches sold at auction would be based on load net of the contribution from the other resources in the portfolio. For example, if the EDCs procured 10% of the BGS-FP load through longer-term resources, the BGS-FP auction would apply to the remaining 90% of the load in 3-year contracts which is the current contract term for the Auction.

The results of recent auctions have led the Board to investigate alternatives to the auctions and improvements in the auctions. Rate Counsel believes that longer term contracts and alternatives that would reduce load through more efficient use of electricity or encourage load reductions are reasonable methods to investigate through the working group mentioned. It is also noteworthy that Governor Corzine's recent release, An Economic Growth Strategy for the State of New Jersey 2007 (pages 23-24) outlines his policy to meet "20% of New Jersey's energy needs through energy efficiency improvements and conservation gains by 2020."⁶ Increasing the BGS-FP load requirements that are met through longer term demand response offerings would be consistent with this strategy.

Information Concerning Sources of BGS-FP Supply

Rate Counsel has requested that the Board direct BGS suppliers to provide, on an after-the-fact basis if necessary, information on their underlying supply contracts. The information would be provided to the BPU and to those who are privy to detailed auction information. In addition to assuring the competitiveness of the BGS auction, Rate Counsel's interest in the source of electricity is based on concerns regarding the safety and reliability of the source of electric supply procured through the BGS auction. Without adequate information regarding the source of New Jersey's electric supply, the Board is hindered in meeting its obligation to protect the State's ratepayers from the increasing risks associated with the restructured generation market.

While some of the supplier parties have complained that our office is raising this issue despite the fact that the Board has decided not to require this disclosure in this auction, they conveniently forget that the Board explicitly decided to continue to review this issue in this and other proceedings. As stated in the July 10, 2006 Order:

It is also fair to suggest that the Board should consider the competitiveness of the wholesale market and have additional information with which to make its decision with respect to the appropriateness of the auction results. The Board, however, is

⁶ A copy of this document is available at www.nj.gov/njbusiness/home/egs_final.pdf.

aware of its obligation to make an informed decision and remains confident in its ability, as it has done before, to request additional information when it believes such information is warranted. It also has availed itself of the resources of the PJM Market Monitoring Unit to consider market power issues in the past and will not hesitate to do so again.

The Board concurs with the general goals expressed by most parties that the Board needs to have the necessary information to assure that the auction results reflect a competitive bidding process and competitive market conditions. Therefore, while the Board will not impose additional requirements on Auction participants at this time, it will explore further, in this or other proceedings, the details of the information that it will require to meet the above goals. Each year, information is produced by both the Auction Manager and the Board's Advisor to indicate the state of the market leading up to the auctions. This information is discussed with Staff who then briefs the Board. The Board will likely further formalize this aspect of the process. Also included in this process will be consideration of the assistance that the PJM Market Monitoring Unit might provide to the Board. Additional details of the data and information that the Board will require and how and when it will be obtained will be developed and released in the Board's Final Auction Order.

I/M/O the Provision of Basic Generation Service for Period Beginning June 1, 2007, Dkt. No. EOO6020119, Decision and Order, dated July 10, 2006, pages 4-5 (emphasis added). Contrary to the suppliers' unfounded accusations, Rate Counsel is not attempting to relitigate an issue that has already been decided for this auction process. Our office is undertaking its statutory duty to participate in this matter to help create an informative record in which the Board has already decided it wishes to seek additional information on this issue. Rate Counsel believes that the additional comments provided herein and at the September 21 hearing will assist the Board in exploring the details of information that it will seek, if any.

It is undeniable that when the Legislature decided to give the Board the authority to move New Jersey toward a more competitive electric generation market, it also wanted the Board to help assure the reliability and diversity of the electric power supply in this State. Among the other policy goals of EDECA are "universal access to affordable and reliable electric power and natural gas service . . . [and] diversity in the supply of electric power throughout this State. . . ."⁷ The supply information that Rate Counsel has described can only serve to assist in that process.

The Board should have information regarding the sources of the electricity obtained through the BGS auctions, the diversity of those sources, and any risk associated with those various sources. Rate Counsel's earlier comments outline the specific information the Board should receive. In response to supplier claims that information regarding source of supply is not

⁷ N.J.S.A. 48:3-50(a)(4) and (a)(7) (emphasis added).

known at the time of bidding, Rate Counsel proposed that the Board require the information regarding sources of supply be provided on an after-the-fact basis. Rate Counsel recommended that the Board direct winning BGS bidders to provide the source of supply information for the first six months of their BGS contract, and for each six month period thereafter, until the termination of their BGS contract, and the information would be provided no later than three months after the end of the six month period in question. Thus, for example, for a 3-year BGS contract entered into beginning June 1, 2007, the first report would be due March 1, 2008 and would cover the six months from June 1, 2007 through November 30, 2007. The proposed after-the-fact reporting requirements address suppliers' express concerns about confidentiality and timing of information availability while, at the same time, protecting ratepayers by opening the process to additional scrutiny.

Some suppliers have alleged that the Board should play no part in ensuring the reliability of electric supply used in this State because PJM is the entity which plays that role. Rate Counsel respectfully requests that in the Board's final order in this matter, it specifically reject the suppliers' disregard for the Board's proper review to ensure the reliability of our electric supply. As stated above, the Legislature has specifically directed that the Board play this particular role. If the Legislature had intended for the Board to cede this role to PJM, it would certainly have stated that in EDECA. Rate Counsel believes that the suppliers' position on this issue violates EDECA and that the Board should expressly disavow that position and restate without ambiguity that the Board will continue to review and examine the reliability of New Jersey's electric supply.

Some suppliers have also alleged that because PJM determines the dispatch of various generating units, then their source of supply information is somehow irrelevant. Rate Counsel has been aware long before any of the suppliers exhibited an interest in this State that PJM determines the dispatch of generating units. Despite the suppliers' incorrect statements to the contrary, the actual dispatch of generating units does not make the suppliers' contract information irrelevant. The rates which customers pay to the BGS suppliers are still determined according to those contract terms. To the extent that the actual dispatch of generating units affects how much customers in New Jersey pay for electricity, the effect of that dispatch on the supply that we use, including its cost, safety and reliability are extremely important facts that Rate Counsel believes the Board should review. For instance, if suppliers have underlying contracts with generators for the output of plants that ultimately do not run for a reason other than economic dispatch, such as forced outages, and PJM needs to dispatch more expensive units to cover this failure to operate and that dispatch increases our cost of electricity, then the Board should be aware of this problem. The source of supply information can provide the Board with this necessary knowledge.

Contrary to the suppliers' intimations, Rate Counsel is not asking them to trace after the fact where the actual electrons come from that supply our electricity. Our office believes that the Board should have at its disposal the contract information regarding the source of supply that affects the reliability, safety and eventual cost of our electricity. The Board cannot complete such a review without the supply information mentioned. The suppliers have previously made the claim that this information is too proprietary, important and confidential to trust to the Board, but now make the contradictory claim that this information is somehow inconsequential to the

BGS contracts and the reliability of our electric supply simply because PJM determines the dispatch of the generating units that ultimately supply our electricity. Rate Counsel respectfully urges the Board to disregard these contradictory claims and to implement our proposal.

Another concern raised by the suppliers' comments is that if the suppliers' portfolios are so fluid and uncertain that even nine months after the BGS contracts begin, they cannot provide the requested information, this high degree of uncertainty, doubt and risk to customers' enjoyment of reliable and affordable electricity should be examined by the Board. The days are long gone when our EDCs built generators dedicated to supply New Jersey customers. If the current electricity market has morphed to a condition wherein the Board (and New Jersey customers) has no idea where the electricity comes from and cannot protect customers from unreliable sources of power, then the Board and customers need to know that fact as well. We also need to know how to remedy that situation, if it actually exists. However, Rate Counsel is not of the opinion that the situation is as unknowable as the suppliers would have the Board believe.

We fully understand and sympathize with the suppliers' reluctance to provide this information. Nevertheless, that reluctance should not control this issue without specific and hard evidence to prove the harm to New Jersey electric prices and the reliability and safety of our electric supply that would come directly from the provision of such information to the Board. The suppliers have failed to provide such evidence despite several opportunities to do so. However, being mindful of the suppliers' adamant position, Rate Counsel respectfully requests that the Board keep this issue open for future discussion in a working group that will continue to address this issue for resolution in next year's BGS procurement process docket. In that working group, Rate Counsel expects that the parties can overcome the suppliers' fear of providing this information and establish the specific limited uses that the Board would make of it. While Rate Counsel believes that our previous comments have established the specific reasons why the Board should review this information for this year's procurement process, the working group can play an important role in limiting the use of that information to only that which is necessary for the Board to perform its duty.

In summary, Rate Counsel believes that our recommendations will in fact move the BGS procurement process forward in a beneficial way. Ours is not an idle curiosity that seeks to know information simply because it is interesting. Our sincere belief that these recommendations will help to safeguard the affordability, reliability and safety of our electric supply informs our comments. We do not recommend these actions in order to place the suppliers in a less advantageous position than that in which they find themselves today. We obviously do not make these recommendations lightly, and we would not recommend any action that would make the BGS Auctions less competitive. Rate Counsel agrees with the Board that recent auction results justify a closer look at what part of the procurement process the auctions should play and how the auction process and the procurement process in general could be changed to improve the results. Rate Counsel respectfully submits these comments in the cooperative effort that the Board has determined is appropriate for this matter and is grateful to the Board for the opportunity.