

**I/M/O the Provision of Basic Generation Service (“BGS”) for
The Period Beginning June 1, 2006
BPU Docket No. EO06020119
Comments of the Division of Ratepayer Advocate**

**Presented at a
Hearing at the Board of Public Utilities
in Newark, New Jersey on
April 28, 2006, 10:00 a.m.**

Good morning. My name is John Stutz. Today I am appearing on behalf of the Ratepayer Advocate who filed initial comments in this case on April 6, 2006. I will explain and support those initial comments. Diane Schulze and I are also available to respond to any questions you may have about any of the Ratepayer Advocate’s comments.

These comments address the seven issues raised by the Board. Each issue is addressed in a separate section. The Board has indicated that parties may provide additional comments on the philosophy, structure or implementation of a BGS procurement process. Comments related to the procurement process are included as part of the discussion of the Board’s issues. Some of the Ratepayer Advocate’s comments are general rather than detailed in nature. As we continue to work through this process, more detailed comments may be provided.

The goal of the Board’s BGS procurement process

Goals may differ for the two BGS services—CIEP and FP. Here, and in the remainder of the comments, the focus will be on BGS-FP. It is the Ratepayer Advocate’s position that, in procuring BGS-FP service, the Board should balance two goals—least cost supply and price stability—giving each equal weight.

The type of procurement process that will best achieve the goal

The Ratepayer Advocate recommends development of a **BGS Portfolio** which would permit BGS-FP service from a variety of resources including 3-year contracts procured using a modified version of the auction used currently in New Jersey. The design and rationale for the BGS Portfolio is addressed in the following comment dealing with “the appropriate term for bids.” The remainder of the comment addresses two modifications in the BGS-FP auction which the Ratepayer Advocate recommends be adopted whether or not the BGS Portfolio proposed is implemented. The two modifications are “tick down on ties,” and limited “pay as bid,” options raised initially by the Ratepayer Advocate in year 3 BGS comments filed August 20, 2004.

In the BGS auction, prices “tick down” throughout the auction, starting high and moving down gradually until the supply bid is just sufficient to meet the load to be procured. However, prices do not tick down when the number of tranches freely bid equals the number of tranches desired. (Such equality is the “tie.”) It is the Ratepayer Advocate’s recommendation that the auction rules be modified

so that, when there is a tie, the price for that product does “tick down.” To allow benefits to accrue from “tick down on ties,” the Board should also change the procedure for paying those selected to serve tranches of BGS-FP service. Currently winning bidders receive the **highest price** that had to be accepted to fill the tranche target, even when some bidders have freely bid a lower price. This is unfair to the customers who will pay the prices determined in the auction. Instead, the Ratepayer Advocate recommends pay as bid, that is, winning bidders be paid the lowest price they freely agreed to accept, not the highest price accepted.

Why should “tick down on ties” and “pay as bid” be reconsidered now? The most recent auction produced a very substantial increase in the average price of BGS-FP service. Looking ahead, due to 3-year contract averaging, even a continuation of last year’s auction prices will produce continuing increases in the average price. Electricity is a necessity of modern life. For all practical purposes, there is no alternative to BGS-FP service for small (i.e., low monthly usage) customers. Adopting tick down on ties and pay as bid now could help offset the increases small customers saw this year and may see in the future. The Ratepayer Advocate urges the Board to adopt tick down on ties and pay as bid as described above, unless it is presented with **compelling evidence** that these changes will cause bids to rise enough to fully offset the reductions in cost which, on their face, these two options could provide.

The appropriate term for which bids should be sought

Through the BGS-FP auction, the current system of 3-year contracts provides some balance between least cost supply and price stability. However, there has been substantial price volatility recently in the 3-year contract market. To provide greater price stability for BGS-FP customers, the Ratepayer Advocate recommends development of a BGS portfolio which includes other resources—Demand Response, Long-Term (i.e., 10 to 25 years or even “Life of Plant” Contracts, etc.)—in addition to 3-year contracts procured through the auction. Each resource included in the portfolio should be subject to a separate procurement process which allows its characteristics to be fully taken into account. Within the portfolio, the auction would function as it does now. However, 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. The only changes to the auction operation would be “tick down on ties” and “pay as bid” as discussed previously.

Transparency in the BGS procurement process

A physical object is transparent if what lies beyond is visible. The BGS-FP procurement process should, to the extent possible, be transparent in exactly that sense. There are two key aspects to transparency. These involve the details of the BGS-FP auction process, and the supply arrangements of the auction winners. Here the first aspect will be addressed. The second provides the focus for the Ratepayer Advocate’s comments on bidders’ underlying supply arrangements provided below.

Today there are only three groups that have knowledge of the details of the BGS auction: NERA Staff who run the auction, BPU Commissioners and Staff who work closely with NERA, and CRA Staff who review the auction conduct and results. For all others, the auction is a “black box.” This year the black box produced a price increase of over 50 percent, compared to last year’s auction prices. As the government agency with the express mandate to advocate for rights of the ratepayers

who must ultimately pay the electric prices the auction produces, the Ratepayer Advocate needs to be given more information about the details of the auction process. Such information should include, at a minimum, complete, unredacted copies of all reports on the auction received by the Board. The Ratepayer Advocate should also have the right to ask the authors of those reports questions, should the need arise. As a condition for obtaining this information, Ratepayer Advocate Staff would be willing to sign the same confidentiality statement as Board Staff.

Information about the bidder's underlying supply arrangements should be available to the Board

It is the Ratepayer Advocate's position that information on underlying supply arrangements should be available to the BPU, and to those who are privy to detailed auction information. Ideally this information would include the source, cost, quantity, and terms and conditions for the sources of supply used to provide BGS service. The Ratepayer Advocate is prepared to work with interested parties to develop reasonable reporting requirements. For example, reporting might be limited to the bidder's "largest" sources of supply or to certain "critical sources." To minimize confidentiality issues, information could be limited initially to quantity and source of supply. Ideally information would be communicated as soon as it becomes available, and updated when it changes significantly. However, to limit confidentiality issues and minimize reporting burdens, information could be reported initially on a semi-annual basis with a 6-month lag.

Information on supply arrangements would be used to evaluate the concentration in the sources of supply for BGS-FP service, and to see if such concentration might affect the cost of that service. These two concerns are an integral part of auction regulation. In an article in *Public Utilities Fortnightly* of September 2005, you (President Fox) discussed the BGS auction, commenting, in part, as follows:

Of course, we have rules and safeguards to protect against collusion and gaming. We also have a limit on the amount of load for which a bidder is eligible. These load caps, however, exist as much **to limit the utility's exposure to default as they do to address market share.** (emphasis added)

Without knowing how winning bidders obtained their supply, there is no way to assess the extent to which a utility is at risk of default by a supplier which may affect one or many winning bidders. Nor is there any way to assess the underlying concentration of the supply upon which the ability to exercise market power rests. If the Board is to regulate the auction effectively, it has to establish and exercise its right to examine the sources of supply for the many billions of dollars in electricity that New Jersey purchases via the BGS auction each year.

Willingness to provide complete, accurate supply information on a reasonable basis should be a requirement for auction participation. Failure to meet reasonable information requirements should result in disqualification from participation in future auctions, and perhaps loss of current tranches. To keep the requirements for compliance reasonable and to minimize the issues related to disclosure, the steps discussed earlier should be taken.

Some of the initial comments filed April 6, 2006 suggest that generators may not trust the Board to treat their information as truly confidential. The Board should make it clear that this view is inappropriate. To do so, the Board should establish the same level of confidentiality for supply information as is currently in place for other key auction information.

Under the Open Public Records Act, proprietary or financial information obtained from any source is specifically excluded from the statutory definition of a government record *N.J.S.A. 47:1A-1.1*. Information which, if disclosed, would give an advantage to competitors or bidders is also exempt. Accordingly, any supply information provided by bidders in the BGS-FP auction would not be subject to the public access requirements of the Open Public Records Act.

Power procured for BGS-FP service should be purchased at prices consistent with the operation of a competitive wholesale marketplace

Concern about competition raises two issues: first, are the prices resulting from the BGS-FP auction consistent with prices in the broader market for Standard Offer Service; and, second, is the market itself competitive? To address the first issue, one needs to make careful comparisons, to prices seen in other recent procurements and to the PJM spot market. Such a comparison could be prepared by NERA, by Board Staff or by CRA as part of their auction review.

The BGS-FP auction is part of a market for Standard Offer Service which could be subject to market power even if the underlying PJM markets are competitive. New methodologies and data sources may be needed to determine whether the market for Standard Offer Service is competitive. Assessment of the extent of competition in the market for Standard Offer Service would best be addressed jointly by those who rely substantially on procurements from that market (i.e., NJ, DE, MD, and DC) and the PJM-MMU. The Ratepayer Advocate recommends that the Board investigate the possibility of such a joint effort.

Issues to be revisited as part of a Board review of the Supplier Master Agreements

Currently the Supplier Master Agreements permit pass-through of transmission rate increases to ratepayers. Such pass-through is not consistent with the Ratepayer Advocate's previously stated goals for BGS-FP service—least cost supply and price stability. The likelihood of least cost supply is enhanced without pass-through because suppliers are better motivated to make the effort required to win cases before the FERC in which transmission rate increases can be opposed. Price stability will also be enhanced because the rates for BGS-FP service cannot fluctuate due to “pass through” as they can now. In order for the Board to change its policy and require suppliers to take the transmission rate risk, the Board must amend the FP Supplier Master Agreement.

The Ratepayer Advocate also notes that changes will likely be required to address the issue of transparency of supply. At a minimum the BGS-FP Supplier Master Agreement should be amended to require reasonable disclosure of the supply arrangements for BGS-FP suppliers, and to provide appropriate penalties if such disclosure does not occur.

Concluding Remark

A key difference in the initial comments filed April 6, 2006 arises in relation to Transparency and Disclosure of Bidder's Supply Arrangements. The Ratepayer Advocate, the NJLEUC, and Citizen Action —the parties representing customers who pay for BGS service—saw transparency as related to both the conduct of the auction and the ability of the Board to examine the supply arrangements for BGS service. The Ratepayer Advocate, the NJLEUC and Citizen Action called for disclosure of Bidder's Supply Arrangements to the Board. All of the parties who might bid into the auction (the Bidders), as well as the EDCs and NERA who commented jointly, saw transparency as related only to the auction process. They all opposed disclosure of Bidder's Supply Arrangements to the Board.¹ In considering this difference the Ratepayer Advocate would ask the Board to consider carefully whose interests the BGS auction ultimately needs to serve. In the Ratepayer Advocate's view, it is the interest of the customers for whom BGS is the source of an essential commodity.

¹ Among the "Bidders" comments there were two made on behalf of Pepco affiliates. One opposed disclosure, the other took no position. All other "Bidders" opposed disclosure.