

**STATE OF NEW JERSEY  
BOARD OF PUBLIC UTILITIES**

I/M/O Generic Stakeholder Proceeding )  
to Consider Prospective Standards for Gas ) Docket No. GR10100761  
Distribution Utility Rate Discounts and ) ER10100762  
Associated Contract Terms and Conditions )

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**COMMENTS OF NORTH AMERICAN ENERGY ALLIANCE /  
OCEAN PEAKING POWER, LLC**

**January 28, 2011**

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## **PRELIMINARY STATEMENT**

NAEA Ocean Peaking Power, LLC (“NAEA”) owns and operates a 351 MW gas-fired electric generation plant located in Lakewood, New Jersey. NAEA purchases gas delivery service for the delivery of fuel to the plant from New Jersey Natural Gas Company (“NJNG”).

NAEA sells all of the power produced at the plant to the PJM Interconnection LLC (“PJM”) day-ahead and real-time energy markets. NAEA includes its cost for gas transportation service in its bids to sell energy into those markets. Therefore, the price that NAEA pays for gas transportation service affects both its ability to compete in the wholesale markets and the price of energy in those wholesale markets.

NAEA submits the following Comments to encourage the Board of Public Utilities (the “Board”) to adopt policies that will level the uneven playing field that exists now in the competitive wholesale energy markets. In support of its Comments, NAEA submits the Certification of its expert, Robert B. Stoddard, a Vice President and the leader of the Energy & Environment Practice of CRA International in Boston. Mr. Stoddard is an economist with extensive experience and knowledge of electricity market design and operation. Mr. Stoddard’s certification provides a thorough discussion of the facts and statistics that underlie NAEA’s Comments.

## **PROCEDURAL HISTORY**

This stakeholder proceeding arose out of a Rate Case filed by PSE&G in May 2009,<sup>1</sup> in which PSE&G petitioned the Board to authorize, among other things, increases in gas and electric distribution rates. The Board referred the Petition to the Office of Administrative Law, and an evidentiary hearing was held in early 2010. On May 28, 2010, ALJ Braswell issued an Initial Decision in which he adopted the parties' stipulation of settlement regarding PSE&G's rates. Judge Braswell also commented upon arguments raised by Board Staff, Rate Counsel and customers of PSE&G, that PSE&G had been offering its affiliate company, PSEG Power, preferential gas transportation pricing and service terms for decades. For example, PSEG Power paid no monthly customer service charge to PSE&G, and the price PSEG Power paid for gas transportation service was exclusive of the societal benefit charges ("SBC"), the RGGI charge and the capital adjustment charge ("CAC") (the "Surcharges"). Initial Decision, May 28, 2010 at 6-7. Judge Braswell recommended that a contested case proceeding should be conducted by the Board to examine whether "[a]ny preferential pricing or other terms of service provided to PSEG Power" should be extended after July 31, 2010. *Id.* at 15.

### **The Supplemental Proceeding**

By its Order of July 9, 2010, the Board adopted ALJ Braswell's Initial Decision with certain modifications, approved the stipulation of settlement concerning PSE&G's gas service rates, and ordered that a supplemental hearing (the "Supplemental Proceeding") be held to consider the following issues:

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<sup>1</sup> IN THE MATTER OF THE PETITION OF PUBLIC SERVICE ELECTRIC AND GAS COMPANY FOR APPROVAL OF AN INCREASE IN ELECTRIC AND GAS RATES AND FOR CHANGES IN THE TARIFFS FOR ELECTRIC AND GAS SERVICE B.P.U.N.J. NO. 14 ELECTRIC AND B.P.U.N.J. NO. 14 GAS PURSANT TO N.J.S.A. 48:2-21 AND N.J.S.A. 48:2-21.1 AND FOR APPROVAL OF A GAS WEATHER NORMALIZATION CLAUSE; A PENSION EXPENSE TRACKER AND FOR OTHER APPROPRIATE RELIEF; DOCKET NO.: GR09050422

- whether the continued receipt of interruptible gas transportation service pursuant to a non-tariff rate schedule by PSEG Power beyond July 31, 2002 was justified and in the public interest;
- whether the SBC and RGGI charges should apply to PSEG Power retroactively and prospectively;
- whether the rate applicable to PSEG Power is discriminatory to other electric generation customers; and
- whether the TSG-NF rate service should be applicable to PSEG Power and other electric generation customers.

In addition, the Board announced that it would conduct a separate, generic proceeding (the “Generic Proceeding”) for all stakeholders and parties interested in rate discount and special contracts issues. In the Generic Proceeding, interested participants would explore

- issues of statewide impact relating to the provision of discounted gas utility distribution rates and contracts based upon a customer’s ability to by-pass the utility’s gas distribution system;
- the applicability of the Societal Benefit Charge to such instances of by-pass potential that may inform rulemaking;
- a review of “evergreen” provisions in gas utility distribution contracts and discounted gas utility distribution rates; and
- the applicability of the SBC, RGGI and CAC prospectively to customers with an ability to by-pass the utility’s gas distribution system

On August 3, 2010, the Board issued a scheduling order for the Supplemental Proceeding and PSE&G customers were invited to seek permission to intervene. NAEA is not a customer of PSE&G, but nevertheless, NAEA moved to intervene in the Supplemental Proceeding on the grounds that it was substantially harmed by preferential pricing and other discriminatory service terms PSE&G continued to provide to NAEA’s competitors, such as PSEG Power. NAEA’s motion to intervene was granted on October 18, 2010. Shortly thereafter, the Intervenors settled the issues presented in the Supplemental Proceeding, The settlement was approved and entered by the Order of the Board dated December 22, 2010.

## **The Generic Proceeding**

On October 25, 2010, the Board issued a notice opening a new docket for the Generic Proceeding. The stated purpose of the Generic Proceeding was for

soliciting input on the justness and reasonableness of allowing Board regulated natural gas distribution utilities to offer reduced gas distribution/delivery rates from Board approved gas distribution/delivery charges to those customers who may qualify, based upon certain criteria, for such gas distribution/delivery rate discounts.

The participants in the Generic Proceeding attended hearings on November 15, 2010 and December 2, 2010, and agreed that the following specific issues would be addressed in the Proceeding:

- The legality of permitting discounted gas utility distribution rates (a) based on a customer's ability to bypass the utility's gas distribution system, (b) based on the impact on wholesale and retail electricity markets, or (c) for other policy reasons.
- The legality of establishing discounted gas utility distribution rates through contracts and whether current or future contracts may be "evergreened", i.e. extended for additional terms, without Board approval; and, if it is determined that evergreen provisions are permissible, whether a utility should be required to file advance notice with the Board or obtain approval before determining not to exercise a termination right in a discounted contract.
- The criteria and process that the Board should establish to determine whether or not an entity has an ability to bypass the utility's gas distribution system and what rates should be charged to such entities; and whether the criteria and process must be established in a rulemaking.
- Regardless of an entity's ability to bypass the utility's gas distribution system, the criteria and process that the Board should establish to determine (a) whether other policy considerations justify discounts, (b) if so, what rates should be charged; and (c) whether the criteria and process for such discounts must be established in a rulemaking.
- The legality of and policy considerations of applying SBC, RGGI and CAC charges (the "Surcharges") prospectively to electric generating customers that purchase gas delivery services from the utility to produce electricity sold to electric public utility customers.
- The applicability of SBC, RGGI and CAC charges prospectively (a) to customers with an ability to bypass the utility's gas distribution system, (b) based on the impact

on wholesale and retail electric markets, or (c) for other policy reasons, and the legality of any waiver or reduction of those charges.

### NAEA

NAEA owns and operates a 351 MW gas-fired electric generation plant located in Lakewood, New Jersey. NAEA purchases Board-regulated gas transportation service for delivery of natural gas to its Lakewood facility from NJNG. The service purchased from NJNG is at full tariff rates rather than under a Board-approved Special Contract that either discounts NJNG's tariff rates or waives portions of the Surcharges.

NAEA sells the energy from its plant into the PJM day-ahead and real-time energy markets. NAEA competes for its sales into the PJM market with other gas-fired electric generators who receive their gas transportation service from New Jersey gas utilities at Board-approved discounted rates. These discounts are achieved either through a waiver of the Surcharges, a discount to the tariff rates, or both. Initially, the issue of the discounts achieved through waiver of the Surcharges was significant, both with respect to the Board's authority to waive the Surcharges, and the indirect consequences of the waiver upon gas-fired electric generators for whom the Surcharges are not waived, and upon retail electric rates. It appears, however, that these issues may become moot because Senate Bill No. 2381, approved by the New Jersey State Legislature on January 10, 2011, exempts natural gas-fired power plants from payment of the Surcharges. Notwithstanding the implications of Senate Bill No. 2381, an issue remains as to whether gas-fired generators who do not have access to bypass should be eligible for discounted gas transportation rates and whether such discounts should be achieved through waiver of the Surcharges (if Senate Bill No. 2381 is not signed by the Governor) or through discounts to the otherwise applicable tariff rates.

## SUMMARY OF NAEA's COMMENTS

The following is a summary of NAEA's Comments concerning the Identified Issues:

- Gas utilities may afford their customers discounted rates based upon the customers' specific situations, subject to Board approval. *See N.J.A.C. 14.3-1.3(e) and 14.3-1.3(f)*. NAEA asserts that discounted rates should be permitted in all circumstances when they are in the public interest.
- The Board should consider evergreen provisions in gas transportation contracts on a case by case basis, and should only approve them if they are in the public interest. If the Board determines that periodic review of a contract containing an evergreen provision would serve the public interest, the Board should condition its approval on incorporation of such review in the terms of the Special Contract. However, if such a condition was not imposed at the time of approval it should not be imposed after the fact.
- The BPU should not establish specific criteria and processes, either in this case or in a rulemaking proceeding, to determine whether a customer with bypass potential should receive service under a Special Contract with discounted rates. Instead, the Board should continue to review such proposed Special Contracts on a case by case basis. For purposes of the review<sup>2</sup> the gas utility (with the support of the customer) should be required to show
  - that it is economically beneficial for the customer to bypass the utility;
  - the size of the discount required to compete with the bypass opportunity; and
  - how the potential benefit (such as continuing contribution to fixed utility costs) associated with the discount outweighs the potential costs (such as reallocation of a portion of the cost of service to other gas ratepayers.)

As discussed below, the "public interest" should not be limited to the impact of discounted gas transportation rates on other gas customers. The "public interest" may also be impacted by the indirect benefit of reduced costs to electric ratepayers.

- Bypass potential should not be the sole grounds upon which the Board approves a Special Contract with discounted rates. Instead, Special Contracts should also be approved in all cases where they can be justified by the public interest. The gas utility (or the customer seeking the discount) should be required to show<sup>3</sup>

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<sup>2</sup> Board review may be subject to confidentiality protections.

<sup>3</sup> Board review may be subject to confidentiality protections.

- without the proposed Special Contract the gas-fired generator will be operating at a competitive disadvantage to other similar gas-fired generators with the same technology in generally the same location; and
  - how the benefit of the Special Contract (such as deferral of increases in LMP) outweighs the cost of the Special Contract (such as reduced revenues paid to the gas utility).
- Surcharges such as the SBC, RGGI and CAC, like all other costs incurred by the gas utility, are subject to discounts for customers with bypass potential if the Board finds that such discounts are in the public interest.
  - Surcharges such as the SBC, RGGI and CAC, like all other costs incurred by the gas utility, are subject to discounts for gas-fired generators if the Board finds that such discounts are in the public interest.



## DISCUSSION

### **I DISCRIMINATORY AND PREFERENTIAL RATES ARE PERMISSIBLE UNDER THE LAW IF THE DIFFERENCES ARE REASONABLY BASED UPON DIFFERENT CIRCUMSTANCES OF SERVICE**

When a gas utility provides gas transportation service at discounted rates to certain customers, but not to all customers, the rates may be described as discriminatory or preferential, because the services provided are the same while the rates favor some customers over others. New Jersey law generally prohibits preferential or discriminatory rates. *N.J.S.A.* 48:3-1 provides that

“No public utility shall:

a. Make, impose or exact any unjust or unreasonable, unjustly discriminatory or unduly preferential . . . rate, toll, fare, charge or schedule for any product or service supplied or rendered by it within this state.

b. Adopt or impose any unjust or unreasonable classification in the making or as the basis of any individual or joint rate, toll, fare, charge or schedule for any product or service rendered by it within this state.”

Similarly, *N.J.S.A.* 48:3-4 provides that

“No public utility shall make or give, directly or indirectly, any undue or unreasonable preference or advantage to any person, locality or particular description of traffic, or subject and particular person, locality or particular description of traffic to any prejudice or disadvantage.”

Notwithstanding, the Board is authorized to approve varying rates for the same service if a discounted rate is justified by the circumstances, because the courts have consistently held that reasonable differences in customer rates based upon differences in situations does not constitute discriminatory or preferential treatment in violation of *N.J.S.A.* 48:3-1 or -4. *See, e.g., Curtiss-Wright Corp. v. Passaic Valley Water Comm.*, 84 N. J. Super. 197 (Div. 1964). Thus, it appears that unreasonable discrimination in rates is prohibited, but reasonable discrimination in rates is permitted (and, indeed, routinely approved by the Board). The question, then, is under what circumstances is a request for discounted gas transportation rates reasonable.

## **II DISCOUNTED GAS TRANSPORTATION RATES FOR CUSTOMERS WITH BYPASS POTENTIAL ARE A LAWFUL DIFFERENTIATION IN RATES BASED UPON DIFFERENT CIRCUMSTANCES OF SERVICE.**

Pursuant to *N.J.A.C.* 14.3-1.3(e), a utility may seek approval to enter into a special, non-tariff agreement, that is, a Special Contract, with a particular customer or group of customers. *N.J.A.C.* 14.3-1.3(f) requires a utility to provide cost and benefit information to the Board in support of such a request. The gas utilities have relied for decades on these regulations to obtain Board approval for Special Contracts with discounted rates for gas transportation customers who, in the absence of the discounts, threatened to bypass the utility and take deliveries directly from an interstate pipeline company. Generally, the Board has held that discounted rates for customers with bypass potential promote the public interest, because it is preferable to keep these customers on the system where they will continue to contribute at least something towards the utility's fixed costs, than it is to lose them altogether. *See e.g. In Re: The Filing of a Special Contract by Pivotal Utility Holdings, Inc. d/b/a Elizabethtown Gas*, BPU Docket No. EO08090829 (Decision and Order January 28, 2009).

*N.J.A.C.* 14.3-1.3(e) does not address which of the utility's cost of service components will be reallocated to other customers to achieve the discounts offered in a Special Contract. Instead, upon reviewing the proposed discounted rates, the Board may identify and reallocate any utility cost component to achieve the discounts, so long as it finds that the identification and reallocation are in the public interest. Accordingly, discounted rates for customers with bypass potential have been approved and implemented by the Board by reducing otherwise applicable tariff rates, or the Surcharges, or a combination of both. In other words, the Board has found that discriminatory gas transportation rates that might not be permitted under *N.J.S.A.* 48:3-1 and 48:3-4 are permissible, and may be approved under *N.J.A.C.* 14.3-1.3(e), so long as the rates are associated with a benefit to the gas utility's other customers.

### **III THE RATES THAT GAS-FIRED GENERATORS PAY FOR GAS TRANSPORTATION SERVICE CAN SIGNIFICANTLY AFFECT THE RATES PAID BY NEW JERSEY RETAIL ELECTRIC RATEPAYERS.**

NAEA submits that in reviewing a proposed Special Contract to determine whether it is in the public interest, the Board should not limit its consideration to the impact of the Special Contract on other gas utility customers. Rather, the Board should expand its review to consider whether the Special Contract benefits New Jersey's electric ratepayers.

Gas transportation costs are a cost of operation for gas-fired electric generators. In a prior era, when electric rates were based upon a utility's cost of service, a \$1.00/Dth charge for gas transportation would translate directly into increased costs passed through in the rates of retail electric ratepayers. However, electric rates are no longer based strictly upon the cost of operating generating facilities. The commodity component of New Jersey retail electric rates is based upon the wholesale electric rates determined in the wholesale power markets managed by PJM.<sup>4</sup> PJM dispatches the lowest-cost generating units first, followed by the dispatch of the more expensive generating units later, as (and if) required to meet increasing load requirements. The price that PJM pays for generation in any hour.<sup>5</sup> i.e., the LMP, is equal to the price it pays for the highest-cost unit dispatched during that hour. Thus, during the hours when an expensive gas or oil unit is running, all generation on line – wind, nuclear, coal or gas – will be paid a per MWh price based

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<sup>4</sup> It would not be entirely accurate to suggest that the wholesale rates paid in the PJM market are directly passed through in the commodity component of retail electric rates. In fact, the commodity component of retail electric rates is set either by a customer's competitive supplier or through the results of the BGS auction conducted by the electric utilities. Because both the competitive suppliers and the successful BGS suppliers purchase their supplies in the PJM market, the costs ultimately find their way into retail electric rates. See Affidavit of Robert B. Stoddard, paragraph 24, attached hereto as Appendix A.

<sup>5</sup> The wholesale price paid by retail electric suppliers, which ultimately finds its way into retail electric rates.

upon the operating costs of that most expensive gas or oil unit. *See* Certification of Robert B. Stoddard (“Stoddard Cert.”) pars. 7-8.

Gas-fired generators that take service directly from the interstate pipeline do not pay gas transportation charges to a local gas utility. Because of their lower operating costs, they are dispatched earlier than other gas-fired generators. When they are the most expensive unit on line, those lower operating costs are reflected in the LMP paid by electric ratepayers. However, LMP increases as soon as the next, more expensive unit is dispatched.

When the BPU approves discounted gas transportation rates for gas-fired generators with bypass potential, those generators are moved closer to the dispatch position of gas-fired generators who take service directly from the pipeline. As a result, the dispatch of more expensive, less efficient, units is deferred and increases in LMP are delayed or eliminated. This is an indirect benefit to electric ratepayers, which the Board should take into account in reviewing proposed Special Contracts for gas-fired generators with bypass potential.

**IV RETAIL ELECTRIC RATEPAYERS WILL BENEFIT IF GAS TRANSPORTATION RATE DISCOUNTS ARE MADE AVAILABLE TO ALL GAS-FIRED ELECTRIC GENERATORS, WHETHER OR NOT THEY CAN SHOW BYPASS POTENTIAL.**

Special Contracts for gas-fired generators with bypass potential are of immediate concern to New Jersey gas-fired generators like NAEA because the Special Contracts exacerbate the uneven playing field. New Jersey gas-fired generators without discounts must increase their offer price to PJM to recover the increased cost and, thus, will have reduced run times no matter how much they attempt to manage factors within the control to reduce costs or increase efficiencies. Stoddard Cert. par. 15.

The impact, however, is not solely upon the relative competitive positions of gas-fired generators like NAEA. The fact is that the lower operating costs of gas-fired generators that do not pay the Surcharges, or receive Board--approved gas transportation rate discounts (or both) should

provide the indirect benefit of reduced wholesale and retail energy rates. Unfortunately, this indirect benefit is mitigated, if not eliminated, if the discounts are not also made available to New Jersey gas-fired electric generators without bypass potential. If these other gas-fired generators' costs are not competitive, they will be compelled to increase their bids for the sale of energy, LMP will increase, and wholesale electric costs will increase accordingly.<sup>6</sup> Only if all New Jersey gas-fired generators have access to discounted gas transportation rates will they all be dispatched at approximately the same time and at approximately the same cost. The dispatch of all these units at the same cost will defer the dispatch of more expensive, less efficient generating units.

**V GAS TRANSPORTATION DISCOUNTS SHOULD BE PROVIDED TO GAS FIRED GENERATORS IF THE GENERATORS CAN SHOW THE DISCOUNT WILL LEVEL THE PLAYING FIELD AND BENEFIT ELECTRIC RATEPAYERS.**

NAEA does not recommend that the Board establish rules that attempt to circumscribe when gas-fired generators should receive gas transportation service at discounted rates. Instead, discounted rates should be approved only when Special Contracts are submitted and approved by the Board pursuant to *N.J.A.C.* 14.3-1.3(e) and 14.3-1.3(f). NAEA submits that any request for approval of a Special Contract should be supported with evidence that shows:

- that without the proposed Special Contract the gas-fired generator will be operating at a competitive disadvantage to other similar gas-fired generators with the same technology in generally the same location; and
- how the benefit of the Special Contract (such as deferral of increases in LMP) outweighs the cost of the Special Contract (such as reduced revenues paid to the gas utility).<sup>7</sup>

NAEA recommends that the Board encourage the gas utilities to cooperate with gas-fired generators to create Special Contracts that are in the public interest. NAEA further recommends

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<sup>6</sup> Wholesale power costs will increase by \$12,000.00 if LMP increases \$1/MWH during an hour when load is at 12,000 MWH. Stoddard Cert. par. 17.

<sup>7</sup> Discounted gas transportation rates can result in significant reductions to wholesale electric costs which far outweigh the associated reduced gas utility revenues. Stoddard Cert. par. 29.

that the Board permit gas-fired generators, who cannot reach agreement with their local utility, to present their own proposals for Special Contracts to the Board, with sufficient evidence to show that the Contracts would benefit electric ratepayers.

**VI THE BOARD SHOULD CONSIDER EVERGREEN PROVISIONS IN GAS TRANSPORTATION CONTRACTS AT THE TIME THE CONTRACT IS SUBMITTED FOR BOARD APPROVAL.**

One of identified issues in this proceeding is whether “evergreen” provisions should be permitted in approved Special Contracts and, if so, whether the contracting gas utility should be required to seek Board permission prior to extending the Special Contract term.

NAEA submits that when reviewing a proposed Special Contract, the Board has the authority to require the parties to include the terms and conditions the Board deems necessary for the Special Contract to be in the public interest. The Board, therefore, may require the deletion of an evergreen provision, or the inclusion of an evergreen provision with the proviso that renewal or extension of the term of the Special Contract is not automatic, but is subject to Board approval.

Nevertheless, any approved Special Contract that contains an “evergreen” provision but no requirement that the utility seek Board approval prior to extending the term must be presumed to have been approved on its own terms because the BPU found that it was in the public interest. The parties to an approved Special Contract have a right to rely upon the Board’s approval and to invest funds and make their business plans based without the threat that the Board will subject the Special Contract to review in the future and possibly alter some of its provisions.

The United States Supreme Court’s *Mobile-Sierra* Doctrine,<sup>8</sup> as it applies to the FERC, provides guidance in determining whether the Board has authority to revisit approved Special Contracts and revise their terms. *Mobile-Sierra* concerns contracts between public utilities and their customers that are filed with the FERC. Such contracts are not subject to pre-approval by the

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<sup>8</sup> Most recently affirmed in *Morgan Stanley Capital Group, Inc. v. Public Utility District No. 1 of Snohomish County*, 128 S.Ct. 2733, 554 U.S. 527, 171 L.Ed.2d 607 (2008).

FERC. Instead, they are effective upon filing and acceptance by the FERC. Like the Special Contacts approved by the Board, once these contracts are filed and accepted by the FERC, they are treated as an approved utility tariff. The *Mobile-Sierra* Doctrine holds that the rates in such contracts cannot be unilaterally modified by the parties on the grounds that they do not meet the “just and reasonable” rate standard. The rates can be modified only in the event the FERC finds that an unequivocal public necessity or extraordinary circumstances require their modification.

Thus, the *Mobile-Sierra* Doctrine holds that approved utilities contracts (or, as applied to FERC, filed and accepted contracts) should not be disturbed unless extraordinary circumstances compel their reconsideration. NAEA recommends that the Board apply the *Mobile-Sierra* rationale to Special Contacts, and hold that they should not be amended or modified unless extraordinary circumstances require their review and possible revision.

## **CONCLUSION**

Based on the foregoing Comments and the supporting Certification of Robert B. Stoddard,

NAEA recommends that the Board issue an Order that provides as follows:

- Special Contracts for gas transportation service, whether for customers with bypass potential or otherwise, shall be approved by the Board if they are found to be in the public interest.
- To determine whether a Special Contract is in the public interest, the Board shall consider the impact of the Special Contract on electric ratepayers.
- Discounted rates provided for in Special Contracts can be achieved either through discounts to tariff rates, waiver of otherwise applicable surcharges, or a combination of both.
- Once a Special Contract is approved, the Board shall not subject it to further review or revision except in the event of extraordinary circumstances.

Respectfully submitted,

**DeCotiis, FitzPatrick & Cole, LLP**

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Date: January 28, 2011