

I/M/O Provision of Basic Generation Service (“BGS”)  
Pursuant to the Electric Discount and Energy Competition Act  
N.J.S.A. 48:3-57

BPU Docket Number: EX01110754

Comments of the Division of the Ratepayer Advocate

September 23, 2002

## **Introduction**

The Division of the Ratepayer Advocate (“Ratepayer Advocate”) is filing this document pursuant to the procedural schedule established by the Board of Public Utilities (“Board” or “BPU”) in its June 6, 2002 Order. In this document we supplement the comments our office filed with the BPU on July 1, 2002 that outlined the principles and approaches that the Ratepayer Advocate believes are appropriate for the design of the fifth-year acquisition of BGS service and also the comments delivered by Assistant Director Andrew K. Dembia at the public hearing on September 10. Our comments today are based on those original principles and approaches and the subsequent discovery responses and discussions held with other parties. The Ratepayer Advocate intends to review the proposals of BPU Staff and other parties that are to be filed today, conduct discovery and subsequently provide the Board with comments regarding the other proposals.

The Ratepayer Advocate believes that many aspects of the utilities’ basic proposed approach to providing BGS are appropriate, including:

- the provision of hourly market pricing for large customers, and fixed prices for small customers;
- differentiating BGS prices to customers by rate class;
- differentiating BGS prices for suppliers by season.

These aspects of the utility proposal are consistent with the Ratepayer Advocate’s initial comments in this docket.

The Ratepayer Advocate does have a number of concerns about the utilities' proposal, most of which relate to the joint proposal and a few of which are specific to the JCP&L proposal. The areas of concern include:

- The efficiency of the proposed auction fixed-price BGS service.
- Capping the auction price.
- The adequacy of the utilities' rate-design method for differentiating BGS prices to customers by rate class.
- The design of the slices of load that potential BGS suppliers would bid for.
- Which customers should be on hourly pricing.
- The Green Auction proposed by JCP&L.
- The Retail Pilot and Retail Adder proposed by JCP&L.

## **Auction Design**

The Ratepayer Advocate remains concerned that the utilities have proposed to use the same simultaneous, multi-round declining-clock auction design for acquiring next year's fixed-price supply that they used in acquiring BGS supply for the fourth year of competition. That design requires the acquisition of all four utilities' fixed-price BGS supply for the year in a single auction, under complex rules. This approach has never been used anywhere else to acquire any product, so the only real test of its efficiency in acquiring least-cost supply was the Year-4 BGS auction.

The BGS prices produced by the Year-4 auction appear to be higher than contemporaneous wholesale prices, including energy, capacity, transmission, and ancillary services, for the load shape of the BGS loads.

In addition to the empirical evidence that the declining-clock auction appears to have produced high BGS rates in its only prior application, the testimony of JCP&L in its BGS deferral proceeding presents a strong argument for the importance of spreading BGS acquisitions over time, to avoid "driving the wholesale price even higher."<sup>1</sup>

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<sup>1</sup> Direct Testimony of Charles A. Mascari, page 12, lines 3-7.

The Ratepayer Advocate expects that the Board will ensure that a thorough review of the proposed auction design will be undertaken and that the auction, if deemed the appropriate method by the Board, will be modified, if necessary, or replaced by more conventional power-supply acquisition, to avoid potentially high BGS rates for a second year.

## **Capping the auction price**

In their BGS-FP rate design calculations, the utilities have estimated the cost of BGS supply for each rate class that would receive fixed-price BGS, using current market price conditions and specific class load characteristics. However, the utilities do not propose to use their estimates of the market cost of BGS supply to establish class-specific BGS-FP prices. Instead, the utilities propose to apply only the *relative* BGS prices or ratios inherent in their results to the winning auction price to generate class-specific BGS-FP prices.

The Ratepayer Advocate is interested in exploring whether those absolute price estimates (i.e., in \$/MWh), updated for more recent forward energy prices and with some allowance for load shape and bidders' risks, can and should be used to set the maximum bid price for the fixed-price BGS. If PSE&G, for example, can buy energy, capacity, ancillary services, and transmission for its residential customers in Year 5 for an average of \$47.18/MWh, as it currently projects, why should PSE&G pay much more than that for power supply from a BGS bidder? The Board should consider using the utility analyses, updated for new forward contracts, to set ceiling prices. If no bidder is willing to provide BGS-FP power below the ceiling price, the Board would be able to determine that the auction was unsuccessful and order the utilities to procure BGS-FP supply in a manner similar to that used by two of the utilities during the first three years of the transition period.

## **Adequacy of the rate-design method**

Regardless of whether the rate design calculations are used to set a ceiling on the bid prices, it seems appropriate to update those calculations a week or two prior to the auction (assuming the Board decides an auction is appropriate), to avoid inter-class

subsidies. Updating the computations for market capacity price and monthly on-peak and off-peak energy prices would probably require minimal effort by the utilities.

The utilities' rate design proposals include many of the cost-determining factors that vary between classes, but exclude:

- the shape of the class's load within the peak period, and within the off-peak period,
- the responsiveness of the class's load to variations in weather,
- the responsiveness of the class's load to variations in economic conditions,
- the likelihood that the customers in the class will switch to another supplier if market prices are low during the BGS period.

The first omission might be reasonably solved by comparing the average historical PJM market prices, weighted by the class's hourly load, to the hourly-average PJM market price. The brokers' bids that the utilities use in their rate design are for the same amount of energy in each hour. It may be reasonable to estimate the cost of energy supply for a future period as the broker-bid price times the historical ratio of the cost of energy for the class load shape to the cost of energy for a constant amount of energy in each hour.

The other three differences are more difficult to quantify. They are all risks that would be borne by the BGS suppliers, and must be reflected in their bids. All three risks arise because the supplier must provide more energy and capacity at high costs when BGS loads are high (due to extreme weather, a booming economy, or high switching) and market prices are high, but leave the supplier with excess to sell into a weak market when loads are low. These risks may vary widely between classes, with commercial loads being more sensitive to the economy than residential ones, and larger commercial customers being much more likely than residential to switch suppliers in response to falling market prices.

If the utilities must procure fixed-price generation for a mix of very different classes, some adjustment to the BGS-FP rate-design methodology may be necessary to recognize these risk differentials. Otherwise, the implicit cost of risk could be shifted among BGS-FP rate classes, thereby creating uneconomical incentives for some customers to switch suppliers (and for others to stay on BGS). Since quantifying implicit class risk differentials would be an admittedly difficult task, the Ratepayer

Advocate believes that this issue would be best addressed by re-examining how ‘tranches’ should be defined for the auction process.

## **Load slices**

The utilities have proposed that each “tranche,” or slice of fixed-price BGS service, be for a percentage of the utility’s entire fixed-price BGS load in each hour. The Ratepayer Advocate believes that taking bids for tranches to serve specific predetermined *customer* classes may result in lower overall prices and a fairer allocation of costs to rate classes. For example, each utility’s proposed BGS-FP rate classes could be grouped along relative risk lines, resulting in perhaps a set of three customer classes: residential, small commercial (including public lighting) and medium commercial. The bid prices for each customer class would incorporate the bidder risks described previously and would reduce the importance of the “rate design” process for the inter-class allocation of risk-related costs. In other words, class prices would be determined by the winning bidders’ expectations about risk and market prices, rather than the utilities’ estimates.

The utilities acknowledge that “bidding by class and awarding class tranches of BGS load is theoretically possible.”<sup>2</sup> They reject this appealing approach on the grounds that they “believe that this would be too radical a change to the Year 4 auction process and that this could discourage maximum participation in the auction.”<sup>3</sup> The utilities’ position appears to be unsubstantiated, since third-party suppliers routinely price supply for specific rate classes, and indeed specific customers. In any event, grouping rate classes along *customer* class lines as discussed above would not necessitate the creation of rate-class specific tranches or auctions.

## **Which Customers should be on Hourly Pricing?**

Putting more large customers on hourly pricing would tend to increase the potential for load response, and thereby mitigate price spikes. Unfortunately, it is not

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<sup>2</sup> Utilities’ Joint Proposal for Basic Generation Service Beyond July 31, 2003, filed July 1, 2002, page 27.

<sup>3</sup> Id.

clear how strong that response might be, or whether the savings would exceed the cost of the metering upgrades that are necessary to implement hourly pricing. As the utilities have not provided any information on the cost-effectiveness of hourly metering, there is no evidence regarding an appropriate “size” cut-off for hourly pricing.

At least some of the utilities already plan to install many new hourly meters before August 2003, and may not be able to put additional customers on hourly meters for year 5, even if it were cost-effective. In addition, the cost of an *accelerated* meter installation program for Year 5, assuming such a program were technically feasible, may or may not be adequately covered by the additional meter charges that the utilities’ would collect from the newly metered customers. ACE, in particular, is also limited by the difficulty of hourly billing under its current billing system, and therefore proposes to limit the number of customers on HEP. However, the Board should make every effort to determine, by August 2003, whether the utilities should continue adding meters for additional customer classes (and if necessary upgrade billing software), or stop with those installed by that date.

In addition, the utilities are not necessarily putting their largest customers on hourly pricing, since they select customers for hourly billing by rate class or code, rather than size. The largest customers in a commercial class that the utility has proposed for fixed pricing may be considerably larger than the smallest customers in a class that the utility has proposed for hourly pricing. This is especially true where the definition that separates the classes is based on the voltage at which the customer is metered, rather than the customer’s usage.

If the utilities picked a size threshold, and put all customers over that threshold on hourly pricing, the same number of meters would be metering more energy than under the class-by-class approach. On the other hand, there may be administrative problems with putting some customers in a rate code onto hourly pricing, while others are on fixed pricing. The Board should investigate whether the utilities can better allocate their limited metering ability in the short term.

## **JCP&L’s Green Auction**

JCP&L proposes to acquire three of its 46 tranches in a separate “Green” auction before the main statewide FP auction. Only 15% of the energy in these tranches would have to be renewables, and they could be Class 1 or Class 2 renewables. Thus, this

option would add only about 1% (i.e., 3/46 times 15%) of renewables to the BGS-FP supply above the Board's Renewable Portfolio Standards ("RPS") requirement, and that part could be mostly or all Class 2. As the Green auction bids would be for the *premium* that bidders would receive, Green bidders would not know the final price they would receive until the main auction was completed.

The Ratepayer Advocate has some concerns about this proposal.

First, the Board's RPS promulgated pursuant to EDECA require 3.25% of a supplier's energy be from renewable sources (0.75% Class I plus 2.5% Class I or II renewables) for the years 2003 and 2004.<sup>4</sup> JCP&L's proposal would allow all of a bidder's 15% renewable energy to be from Class II.<sup>5</sup>

Second, the proposal is very complicated and may be too difficult for bidders to price. The Board should consider simplifying the renewable energy acquisition in one of two ways:

1. Require each successful bidder for fixed and hourly pricing to provide the targeted percentages of renewable energy on a monthly basis; or
2. Do not ask the bidders to provide any renewable energy, but separately bid out renewable energy swaps, in which the bidders would guarantee to swap renewable MWhs for non-renewable MWhs, for the bid fee.

## **JCP&L's Proposed Retail Pilot and Retail Adder**

The Ratepayer Advocate does not see any need or justification for transferring customers to other suppliers via a retail pilot program as proposed by JCP&L. JCP&L's proposal would allow winning bids for the retail pilot to be up to 25% higher than the winning bids for other BGS load.<sup>6</sup> This would add to the costs of all JCP&L

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<sup>4</sup> N.J.A.C. 14:4-8.3, N.J.S.A. 48:3-87(d).

<sup>5</sup> However, JCP&L has stated informally at discussion sessions that it does not intend that a BGS supplier should not comply with the RPS.

<sup>6</sup> *I/M/O Petition of Jersey Central Power and Light Company Seeking Expedited Approval of a Retail Pilot Program for the Provision of Basic Generation Service*, BPU Docket No. EO02070324, Petition, page 14, para. 13.

BGS-FP customers since JCP&L proposes to blend the retail pilot bid costs into its final BGS-FP rates for all BGS-FP customers including the pilot program customers.<sup>7</sup> The Ratepayer Advocate also sees no advantage to increasing BGS-FP prices via the imposition of a “retail adder.” Such an adder may cause customers to switch to other suppliers, only to receive an average price higher than the cost of utility-procured BGS-FP supply. In addition, because BGS should be a least-cost refuge for customers who do not choose another supplier, such customers should not be punished with higher rates for seeking that refuge.

The Ratepayer Advocate’s position on these two proposals stems from our belief that BGS should be as simple and affordable a service as possible for those customers who choose not to shop for alternate suppliers and for those customers who have no practical alternatives. The retail adder would increase the cost of BGS without a commensurate benefit to competition in the New Jersey electric market. The retail pilot could increase BGS costs and also add complications to the terms and conditions of BGS beyond what small customers have realistically been shown to handle.

As stated in our previous comments, BGS is a “safe harbor” for customers who do not wish to take on yet another responsibility in their daily lives in searching for a reputable, affordable and accessible competitive energy supplier. This being the case, Basic Generation Service should be designed to ensure that customers who do not want to “shop” for energy, who are unable to obtain reasonably priced service from alternative suppliers, or who are not targeted by mass-market retail providers, can continue to receive electricity in a stable, seamless, and affordable manner. Basic Generation Service should be designed to assure stable, predictable, and affordable prices for customers who do not shop. The Basic Generation Service rate should reflect stable prices based on balanced and fixed term contracts to assure the greatest degree of stability and affordable rates for residential and small commercial customers.

## **Load Reduction Programs for BGS**

The Ratepayer Advocate would like to amend our original proposal to include the provision of utility load reduction programs in BGS and move them out of the Comprehensive Resource Analysis (“CRA”), i.e., Demand Side Management (“DSM”)

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<sup>7</sup> Id.; Transcript of September 10, 2002 public hearing, pages 32-33.



programs. Currently, PSE&G, JCP&L and Conectiv Power Delivery offer appliance cycling programs within their CRA/DSM programs. These programs pay customers a small monthly fee in the four summer months to permit the utilities to attach remote control equipment to their central air conditioners and allow the utilities to cycle the equipment off and on during hours of peak summer electricity usage. The programs are funded by the assessments within the Societal Benefits Clause.

The load reductions from these programs serve to reduce the costs of providing electricity by reducing peak demands. The Ratepayer Advocate believes that the beneficial effects of these programs on BGS energy costs justify their inclusion in BGS. The Ratepayer Advocate also urges the Board to consider requiring Rockland Electric Company to offer such a program. Also, PSE&G and JCP&L have capped the total number of customers eligible for the appliance cycling programs. The caps should be lifted and additional residential customers should be permitted to join. Indeed, the utilities should be urged to solicit additional membership. Even commercial customers should be solicited to join these programs.

The Ratepayer Advocate also urges the Board to consider requiring the utilities to explore adding more load reduction programs for inclusion in BGS. For example, JCP&L has operated a Voluntary Load Reduction Program (“VLRP”) wherein the Board permitted the payments to customers who curtail loads during peak periods to be included in the utility’s BGS costs.<sup>8</sup> The Ratepayer Advocate’s July 1 comments mentioned not including load reduction programs in the auction bidding process because that would unnecessarily complicate the auction, if the Board should decide to use an auction again. However, this comment was not meant to imply that load reductions programs are inappropriate for inclusion in BGS. On the contrary, load reduction programs would benefit BGS customers and service by helping to reduce the cost of this service.

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<sup>8</sup> *I/M/O Jersey Central Power and Light Company Seeking Approval of a Voluntary Load Reduction Pilot Curtailment Program*, BPU Docket No. ET00050303, Decision and Order, dated June 22, 2000, pages 3-4.