

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

**I/M/O THE PROVISION OF BASIC GENERATION)
SERVICE PURSUANT TO THE ELECTRIC) BPU DOCKET NO. EX01050303
DISCOUNT AND ENERGY COMPETITION ACT)**

**FINAL COMMENTS OF THE NEW JERSEY DIVISION
OF THE RATEPAYER ADVOCATE**

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October 17, 2001

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PRELIMINARY STATEMENT

In this proceeding, the Board is faced with issues that will have a pivotal impact on the future of New Jersey's competitive electric marketplace. There is now virtually no competition for New Jersey's residential and smaller commercial energy users. According to the Board's latest statistics, less than two percent of the State's electricity consumers have chosen a competitive supplier. This proceeding presents the Board with an important opportunity to promote two central objectives of the Electric Discount and Energy Competition Act ("EDECA")— reasonable energy prices and improved quality and choices of service for consumers. *N.J.S.A. 48:3-50 (a) (1)*.

Beginning on August 1, 2001, the incumbent utilities no longer have the exclusive right to provide basic generation service ("BGS") to customers who do not choose an electricity supplier in the competitive marketplace. After that date, Section 9(c) of the Electric Discount and Energy Competition Act authorizes the Board to allow non-utility suppliers the opportunity to provide BGS on a competitive basis. As noted by the Ratepayer Advocate at the public/legislative hearing in this matter, this provision is part of an overall legislative scheme to balance the interests of many stakeholders, including utilities, consumers, and energy marketers. *Tr. 100-01*. Thus, the Board's determination in this proceeding should reflect a balance between the objectives of a reliable and reasonably priced energy supply and the development of a vigorous retail energy marketplace.

The utilities, however, have come forward with a BGS proposal that will meet neither of these objectives. The utilities are proposing to procure all of the State's BGS requirements in a single auction held on a single day using a novel and untested auction format, thus subjecting

ratepayers to tremendous risks. As explained by Ratepayer Advocate witness Paul Chernick, this is the equivalent to investing all of one's assets in the financial market at one time. *Tr.* 72. Moreover, the winners of the auction would provide electricity on a wholesale level, with the incumbent utilities retaining their exclusive retail relationships with BGS customers. This is nothing more than an outsourcing program for the utilities, not the competitive BGS program contemplated by EDECA.

The Board should adopt instead a BGS program which is less risky for ratepayers and more conducive to the development of retail competition. The Ratepayer Advocate believes this can be accomplished by directing the utilities to diversify the timing and methods for procuring BGS supply, and to procure a minimum level of BGS at the retail level. Based on the filings made with the Board, and the testimony and statements at the public/legislative hearing held on October 4, 2001, the Ratepayer Advocate recommends that the Board adopt a BGS program containing the following elements:

- C The utilities should be directed to issue requests for proposals ("RFPs") to provide retail BGS to at least 30% of all customer classes, with the exception of their largest commercial and industrial customers. This approach has been successfully implemented in PECO Energy's service territory in Pennsylvania, and is supported by at least two marketers with an interest in New Jersey's retail electric market who testified at the legislative/public hearing. If there is sufficient interest, the retail program could be expanded.
- C If the Board wishes to test the utilities' auction approach, it could conduct an auction to procure no more than 10% of the electricity needed to supply the State's BGS customers. If the initial auction is successful, another auction or auctions could be conducted to procure another 10% or more of the State's BGS needs.
- C Any remaining BGS supply should be procured through requests for proposals to supply BGS load at the wholesale level. New Jersey's electric utilities have substantial experience with this procurement method.

This approach would greatly reduce ratepayers' exposure to the risks of high and volatile BGS prices, while promoting the development of a retail electric marketplace. The Ratepayer Advocate stands ready to work with all stakeholders to implement a BGS program that will bring the benefits of competition to New Jersey's energy consumers.

RATEPAYER ADVOCATE'S FINAL COMMENTS

I. The Utility Proposal Is Contrary to EDECA's Requirements for Competitive BGS.

In enacting EDECA, the New Jersey Legislature sought to lower the high cost of electricity and provide improved quality and choices of service for consumers. *N.J.S.A. 48:3-50* (a) (1). A important component of the Legislature's strategy to achieve these goals is found in the provisions governing BGS. These provisions contemplate a BGS program that will meet the dual objectives of (1) providing a reliable and reasonably priced "backstop" service for consumers during the transition to a fully competitive market, and (2) providing non-utility suppliers with the opportunity to enter New Jersey's retail electricity market.

The first of these two objectives is reflected in EDECA's definition of BGS, which states that BGS "is not a competitive service and *shall be fully regulated by the [B]oard.*" *N.J.S.A. 48:3-51* (emphasis supplied). Section 9 of EDECA further provides that BGS providers may recover "the *reasonable and prudent* cost" of providing BGS. *N.J.S.A. 48:3-57(a)* and (d) (emphasis supplied). These provisions contemplate that the Board will exercise its full regulatory authority to assure the availability of reliable, reasonably priced BGS until a robust competitive market develops.

While establishing BGS as a non-competitive service, the Legislature also recognized that the public interest required the elimination of the incumbent utilities' traditional monopolies over retail electric service so that all consumers would be afforded access to competitive alternatives. Thus, EDECA provided that after an initial three-year period when the electric utilities were to provide BGS, the Board was to "issue a decision as to whether to make available on a

competitive basis the opportunity to provide basic generation service to any electric supplier, any electric utility, or both. *N.J.S.A. 48:3-57 (c)*.

In its restructuring Orders for New Jersey's electric utilities, the Board recognized the important benefits that can be achieved by allowing non-utility suppliers to compete for the opportunity to provide BGS. In all four of these Orders, the Board approved partial Stipulations contemplating competitive bids for the opportunity to supply BGS during the fourth year of the transition to a competitive marketplace. The Board's electric restructuring Order for Public Service Electric and Gas Company ("Public Service"), included the following findings:

We also **FIND** that the proposed bidding out of BGS for year four of the Transition Period is consistent with [EDECA]. ... We expect that the bidding out of BGS for year four as provided in the Stipulation will have the added benefit of creating substantial competition among third party suppliers for the right to provide this service at the pre-established BGS rate/shopping credit price, thereby potentially producing added benefits to customers consistent with paragraph 17 of the proposed Stipulation.

I/M/O Public Service Electric and Gas Company's Rate Unbundling, Stranded Costs and Restructuring Filings, Docket Nos. EO97070461 *et al.*, Final Decision and Order at 111 (NJ BPU Aug. 24, 1999). Public Service accordingly was required to file a "specific proposal for public comment and review and approval by the Board to implement a request for proposals ("RFP") supply basic generation service for the period August 1, 2001 through July 31, 2003." Id. Similar findings were included in the Final Orders for GPU Energy and Conectiv. *I/M/O Jersey Central Power & Light Company d/b/a GPU Energy - Rate Unbundling, Stranded Cost and Restructuring Filings*, BPU Docket Nos. EO97070458 *et al.*, Final Decision and Order at 95-96 (March 30, 2001); *I/M/O Atlantic City Electric Company - Rate Unbundling, Stranded Cost and Restructuring Filings*, Docket Nos. EO97070455 *et al.*, Final Decision and Order at 78-

79 (March 30, 2001). The Summary Order for Rockland Electric Company (“RECO”), provided that the Board would undertake a review to determine whether, and in what manner, RECO will be permitted to bid out BGS responsibility during year four. *I/M/O Rockland Electric Company’s Rate Unbundling, Stranded Costs and Restructuring Filings*, Docket Nos. EO97070464 *et al.*, Summary Order at 3 (July 28, 1999).

In summary, EDECA and the Board’s own electric restructuring Orders reflect two important objectives for BGS: reasonable prices for consumers and the encouragement of retail competition. *Id.* The utilities’ proposal should be rejected because it does nothing to promote *either* of EDECA’s objectives for BGS.

A. The Utilities’ Proposal Subjects Ratepayers to the Risk of High and Volatile BGS Prices.

The utilities’ proposal is fundamentally at odds with EDECA’s objective of providing reliable and reasonably priced BGS subject to oversight by the Board. The utilities are seeking the Board’s advance approval to procure all of the State’s BGS requirements on a single day, using a novel and untested “Simultaneous Multi-Round Descending Clock” auction process. *Tr.* 75-78. The tremendous risks inherent in this approach were addressed in detail by Ratepayer Advocate witness Paul Chernick. As Mr. Chernick emphasized in his statement to the Board at the public/legislative hearing in this matter, the utilities proposal would subject ratepayers to “many dimensions of risk” (*Tr.* 72), including the following:

- C By holding a single auction on a single day, the utilities would place all of New Jersey’s energy eggs in one basket. The price for BGS for an entire year could be affected by any of a wide variety of potential market disruptions that might occur

on that day. Under the current tight supply conditions within PJM, even a relatively small event could have a significant effect on prices. *Tr.* 73-74.

C The “simultaneous multi-round descending clock auction” format is completely untested. Simultaneous multi-round auctions have been used for sales, but never for purchases. *Tr.* 75. The utilities have provided only three examples of “simultaneous auctions” in energy-related markets. *Tr.* 55-56.¹ As explained by Mr. Chernick, all three of these examples involved *sales*, not purchases, of generation capacity. *Tr.* 76-78; *see also* attached articles. To date, the utilities have not provided any example of the use of simultaneous auctions, descending clock or otherwise, to purchase anything. *Tr.* 75.

C The scale of the proposed auction, representing about a third of the capacity in PJM is enormous, and the supply of generation available to provide BGS in New Jersey is limited. The available supplies do not appear sufficient to create vigorous price competition if all of the State’s BGS requirements are procured in a single auction. *Tr.* 79.

C The market for uncommitted generation in PJM during year four is dominated by a few generation owners, primarily PSEG Power and Reliant Resources, creating the potential for the exercise of market power. *Tr.* 82-84.

¹ Simultaneous auctions have been used most widely in a non-energy context, to sell rights to telecommunications frequencies. *Tr.* 106, 109.

- C Generation owners would not participate directly in the auction, but would provide generation to marketers through bilateral contracts. Thus, the operation of the generation market would be entirely hidden from the Board. *Tr.* 81-82, 86.
- C The utilities have not proposed to establish any benchmarks for evaluating the reasonableness of the prices resulting from the auction. This would make it virtually impossible for the Board to reach a reasoned determination whether to accept or reject the auction results within the 24-hour time frame proposed by the utilities. *Tr.* 89-90.
- C The utilities are proposing that the Board commit in advance to acquiring any BGS supply that is not procured through the auction in the PJM spot markets. The risks of this approach are clearly apparent from the market disruptions that occurred in California's electric market, which occurred in part because of heavy reliance on the spot market. *Tr.* 87-89, 110-11.

In short, the utilities are proposing that the Board commit to procuring the State's entire BGS needs under an untested auction format, which could well result in high and volatile BGS prices. This proposal does not meet EDECA's requirements that ratepayers have access to reasonably priced BGS under the oversight of the Board.

B. The Utility Proposal Does Not Allow Non-Utility Suppliers the Opportunity to Provide BGS.

The utilities' proposal also does not meet EDECA's objective of promoting the development of a retail electric marketplace. The utilities' proposed auction would be, in essence, a wholesale auction. The auction winners would have no opportunity to establish direct retail relationships with consumers. *Hempling Testimony* at 16; *Chernick Testimony* at 15. This proposed structure defeats one of the key objectives of competitive BGS procurement. As noted by Ratepayer Advocate witness Scott Hempling, a major barrier to energy competition is the incumbent utilities' longstanding relationships with their customers, which have resulted from many years of state-sanctioned monopoly status. *Hempling Testimony* at 14. A wholesale BGS auction such as that proposed by the utilities would do nothing to address this crucial entry barrier. *Id.* At 16.

The utility proposal also is inconsistent with EDECA's provisions concerning competitive bidding for BGS. EDECA specifically defines BGS as a form of "electric generation service," a term which is defined to mean "the provision of retail electric energy and capacity" *N.J.S.A.* 48:3-51. Thus, when the Legislature provided non-utility suppliers with the "opportunity to provide basic generation service," it clearly intended to allow competition for the opportunity to provide service at the retail level. *N.J.S.A.* 43:3-57(c). The utility proposal does not meet this important EDECA objective. The present energy marketplace is devoid of choice for consumers, and less than 2 percent of New Jersey consumers have switched to competitive suppliers. The utility auction proposal will continue to be a roadblock to competition.

II. THE BOARD SHOULD REQUIRE THE UTILITIES TO IMPLEMENT A BGS PROGRAM WHICH MITIGATES RISKS TO RATEPAYERS AND PROMOTES RETAIL COMPETITION.

For the reasons explained above, the utility proposal is in clear violation of EDECA's policies and objectives for the competitive procurement of BGS. Instead, the Board should require the utilities to adopt an approach which furthers EDECA's objectives of providing reasonably priced BGS, while promoting retail competition. As noted by Ratepayer Advocate witness Paul Chernick, the tremendous risks inherent in the utilities' BGS proposal could be minimized through a diversified approach to procurement. *Tr. 72-73.* Instead of procuring all of the State's BGS needs in one day, the utilities could conduct their procurement programs over a longer period of time, using a variety of procurement methods. By adopting a diversified program which includes a significant share of retail-level procurement, the Board can minimize risks to ratepayers, while at the same time promoting the development of a retail energy marketplace.

The Ratepayer Advocate recommends that the BGS program for New Jersey contain three elements: (1) procurement of BGS for at least 30% of the state's residential and smaller commercial customers through a retail level RFP process ; (2) an auction to procure no more than 10% of the State's BGS requirements, with additional auctions to be conducted only if the first one is successful, and (3) procurement of any remaining BGS supply requirements through a wholesale RFP process. These three elements are discussed below.

A. The Utilities Should be Directed to Issue RFPs to Provide Retail BGS for at Least 30% of Their Residential and Smaller Commercial Customers.

Three energy marketers, Enron Corporation (“Enron”) Green Mountain Energy (“Green Mountain”) and Shell Energy Services Company (“Shell”), have appeared in this proceeding to urge the Board to allow non-utility suppliers the opportunity to provide a portion of the State’s BGS requirements directly to consumers at the retail level. These proposals are based on the successful retail BGS programs that are now underway in the PECO Energy service territory in Pennsylvania. Under these programs, over 200,000 of PECO Energy’s residential customers are currently receiving retail BGS from the New Power Company (an Enron affiliate) and 45,000 are receiving retail BGS from Green Mountain. *Tr. 179; PECO Energy Company: Competitive Default Service Program Bidding: Joint Petition for Approval of a Competitive Default Service Coordination Agreement*, Docket No. A-110550 F0147 (Nov. 29, 2000); *PECO Energy Company: Competitive Default Service Program Bidding: Joint Petition for Partial Settlement and Approval of a Competitive Default Service Coordination Agreement Filed by PECO Energy Company and Green Mountain Energy Company*, Docket No. A-110550 F0147 (Feb. 22, 2001).

At the public/legislative hearing in this matter, Clifton Payne, Green Mountain’s President–Eastern Region, described the operation of Green Mountain’s BGS program in Pennsylvania:

C Fifty thousand of PECO’s residential customers were randomly selected to receive BGS from Green Mountain. These customers were permitted to “opt out” of the program and continue receiving BGS from PECO. *Tr. 174-76.*

- C Shortly before the initiation of the program, Green Mountain mailed simple postcards providing the selected customers with advance notice of the program. These customers subsequently received another notice with a postage paid “opt out” form. *Tr.* 176-77.
- C Customers participating in the program receive a single combined bill, which is provided by PECO on behalf of both PECO and Green Mountain. *Tr.* 187.
- C There are no minimum term limits. Customers may shop for a competitive supplier at any time. *Tr.* 176.

Based on Mr. Payne’s testimony, the Green Mountain BGS program has been well accepted by consumers. Green Mountain worked collaboratively with other stakeholders to determine how the program should be presented to consumers. *Tr.* 177-78. In addition to the postcard and “opt out” notifications described above, toll free numbers, dedicated call centers, and websites were established to make information available to consumers. *Tr.* 178. These efforts appear to have succeeded. According to Mr. Payne, customer complaints have been minimal, and only about 10% of the selected customers chose to opt out. *Tr.* 170; *Statement of A. Clifton Payne* at 3.

This proceeding presents the Board with an important opportunity to educate consumers and provide non-utility suppliers with the opportunity to establish retail relationships with New Jersey’s energy consumers. The successful retail BGS programs in Pennsylvania provide the Board with an ideal model for a retail program in New Jersey.

Enron has proposed that a retail BGS be established for a minimum of 30% of BGS customers in each customer class for each utility, excluding the largest commercial and industrial customers. *Tr.* 137-38. The Ratepayer Advocate believes this is a reasonable minimum level for

New Jersey's retail BGS program. Consistent with the Enron proposal, the utilities should be required to issue RFPs to provide retail BGS service for at least 30% of their residential and smaller commercial customers. The actual size of the program should depend on the level of interest by marketers and customers. If there is sufficient interest, the program should be expanded beyond the 30% minimum.

At the public/legislative hearings in this matter, the Board's Staff expressed concerns that assigning customers to a non-utility BGS provider would violate EDECA's "anti-slamming" provisions. The Ratepayer Advocate believes these concerns are misplaced. As discussed in detail at pages 4-5 above, section 9 (c) of EDECA specifically authorized the Board to select a non-utility electric supplier or suppliers to provide BGS, which is specifically defined in section 3 of EDECA as a retail service. The "anti-slamming" provisions in section 37 of EDECA are specifically directed to "unauthorized changes of a consumer's electric power supplier or gas supplier" *N.J.S.A.* 48:3-86 (a). As explained by Ratepayer Advocate witness Scott Hempling, selection of a BGS supplier through a Board-approved process, and subject to Board regulation, is not slamming. *Hempling Testimony* at 11. This important difference has been recognized in other states. In Maine, customers not choosing a competitive supplier are receive "Standard Offer Service," which is mandated to be obtained from non-utility suppliers through competitive bidding. *Me. Rev. Stat. Ann.*, T. 35A, § 3212. Nevada's original restructuring legislation permitted the Nevada Commission to assign customers to non-utility suppliers for default service. *Nev. Rev. Stat.* 704.982 (1).²

² The implementation of electric competition in Nevada has been halted by the Nevada Legislature due to ongoing disruptions in the electricity markets in the western United State. AB 369 (Nev. 2001).

The Ratepayer Advocate believes that EDECA authorizes the Board to assign customers to non-utility BGS providers. However, the Ratepayer Advocate acknowledges the importance of consumers' perceptions of the BGS program. The Ratepayer Advocate therefore supports the inclusion of an "opt out" provision in the retail BGS program. In addition, the suppliers selected to provide BGS should be directed to work with all stakeholders to develop materials and strategies for informing consumers about the program. As noted, this approach enhanced consumer acceptance of the Green Mountain BGS program in Pennsylvania.

In summary, the utilities' BGS program should include a significant retail component in order to facilitate the development of a retail energy marketplace. A retail program similar to programs already implemented in Pennsylvania would provide the important benefits contemplated in EDECA and in the Board's own restructuring Orders.

B. The Board Could Allow the Utilities to Procure No More Than Ten Percent of Their BGS Requirements Through an Auction, With Additional Auctions to be Conducted if the Initial Auction is Successful.

For the reasons explained above, the Ratepayer Advocate strongly opposes a single auction to procure all of New Jersey's BGS requirements. However, as explained by Ratepayer Advocate witness Paul Chernick while a single auction is unacceptably risky, a smaller-scale auction could provide the Board with the practical experience needed to evaluate the "descending clock" auction format. *Tr.* 80, 109-10. The Ratepayer Advocate would support an initial auction for no more than 10% of the utilities' BGS requirements. If the initial auction is successful, another 10% or more could be procured through another auction or auctions.

If the Board wishes to pursue a BGS auction, it is essential to establish a "benchmark" price that will allow the Board to evaluate the results of the auction within a short time frame. *Tr.*

90. As recommended by Mr. Chernick, a “benchmark” price should be established approximately two weeks before the auction. *Id.*

C. Any Remaining BGS Requirements Should Be Procured Through Wholesale Bilateral Contracts.

Any remaining BGS requirements should be procured through bilateral contracts using a wholesale RFP process. The Board has already gained substantial experience with this procurement method through its oversight of Conectiv’s procurement of BGS supply. *See I/M/O Petition of Atlantic City Electric Company for Approval of a Request for Proposal, Authorization of a Competitive Procurement and to Enter Into a Contract for Basic Generation Service Supply*, Docket No. EM01030162, Decision and Order at 3-4 (Aug. 27, 2001) The Ratepayer Advocate believes this is an appropriate method of procuring any BGS supply that is not procured through retail level RFPs or through an auction or auctions.

CONCLUSION

For the reasons stated above, and in the Ratepayer Advocate's prefiled testimony public hearing statements, and oral testimony, the Board should reject the utilities' proposal to procure all of the State's BGS needs in a single, wholesale auction. The Board should instead adopt the approach recommended above. This will greatly reduce risks to ratepayers and provide non-utility suppliers with the opportunity to provide retail BGS service.

Respectfully submitted,

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Dated: October 17, 2001