



## State of New Jersey

DIVISION OF THE RATEPAYER ADVOCATE  
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May 5, 2006

### **Via Hand Delivery**

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 the Ratepayer Advocate's Final Comments in the above-referenced matter.

Also, as directed in the Board's March 24, 2006 Order, these comments will be circulated electronically through the electric list server used by the 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.

Sincerely yours,

SEEMA M. SINGH, ESQ.  
RATEPAYER ADVOCATE

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**I/M/O the Provision of Basic Generation Service (“BGS”) for  
The Period Beginning June 1, 2007  
BPU Docket No. EO06020119  
Final Comments of the Division of Ratepayer Advocate**

**May 5, 2006**

The Division of the Ratepayer Advocate (“Ratepayer Advocate”) is filing these final comments pursuant to the procedural schedule established by the Board of Public Utilities (“Board” or “BPU”) in its Order dated March 24, 2006. The 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 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.

The basic purpose of this submission is to present the Ratepayer Advocate’s suggestions and recommendations, not to argue against or make common cause with other parties. Positions taken by other parties are addressed only to the extent that they are directly relevant to points central to the Ratepayer Advocate’s positions. Some of the Ratepayer Advocate’s suggestions are general in nature. As discussed in the body of the comments, if its suggestions are accepted, the Ratepayer Advocate stands ready to work with Board Staff and other parties, to work out the detailed procedures and requirements where they are required.

**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.

Least cost is central to the policy goals set forth in the Electric Discount and Energy Competition Act (EDECA). *N.J.S.A. 48:3-49 et seq.* The very first declaration of state policy is to “[l]ower the current high cost of energy.” *N.J.S.A. 48:3-50a.(1)*. The statute makes it clear that competition is a means to lower energy costs to consumers, not a goal in itself. *N.J.S.A. 48:3-50a.(2)*. The same section of EDECA makes universal access to affordable electric power a policy goal. 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.

## **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 this comment addresses two modifications to the BGS-FP auction rules which the Ratepayer Advocate recommends be adopted whether or not the BGS Portfolio proposal 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-FP auction, prices “tick down” throughout the auction, starting high and moving down gradually. Currently prices do not tick down when the number of tranches bid exactly 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 until at least one bidder “drops out,” at which point that bidder would be retained and the tick down would stop. To allow benefits to accrue from tick down on ties and generally to lower auction costs, 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 adopted? As noted by President Fox in a recent article in *Public Utilities Fortnightly*, one of the goals of the auction is “to extract the lowest price” for New Jersey ratepayers. 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 lower costs in future auctions, and so help offset the increases small customers saw this year and may see in the future.

It is no longer enough to say, as critics of tick down on ties and pay as bid have in the past, that there is a risk that bids will rise if these proposals are accepted. One needs evidence that such increases, were they to occur, would be sufficient to offset any gains from these policies. Without such evidence the Board is put in the position of conducting an auction that, on its face, pays BGS suppliers more than they have requested, without evidence that this “unintuitive approach” minimizes costs. 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. In the face of a 55 percent increase in auction prices, 3-year contracts alone do not strike an equal balance between least cost and price stability. At the Legislative-style hearing held by the Board on April 28, Comverge stated that it enters into 10-year, fixed-price contracts for demand-side services. It is reasonable to assume that other longer-term resources are also available. If it is feasible and economic to do so, longer-term resources need to be added to the supply mix. Each resource included in the portfolio should be subject to a separate procurement process which allows its characteristics to be fully taken into account. In deciding whether to add resources to the BGS portfolio, possible adverse impacts such as stranded costs, and possible benefits such as demand-side resources flattening the auction load and so reducing auction prices, should be considered. Resources should be added only if a net benefit is the clear likely result.

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. The procurement of resources other than those obtained via the BGS auction would need to be timed so that the residential load would be clear at the time of the auction. More generally, the “positioning” of the auction within a BGS portfolio would need to be carefully considered.

It is the Ratepayer Advocate’s recommendation that the Board endorse the BGS Portfolio as a reasonable approach for obtaining BGS-FP supply in the future, and subject the portfolio concept to further study and analysis over the next 6 months by a working group. Based upon input from the working group and its members, the Board could decide how best to proceed.

## **Transparency in the BGS procurement process**

A physical object is transparent if what lies beyond it is visible. The BGS-FP procurement process should 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 know 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 roughly 55 percent. As the government agency with the express mandate to defend the rights of the ratepayers who must ultimately pay

the prices the auction produces, the Ratepayer Advocate needs to be given more information about the details of the auction. 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 receiving 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 information on the BGS-FP auction. Such information is required for the Board to effectively pursue the policy articulated in EDECA, "Provide diversity in the supply of electric power throughout this State." *N.J.S.A. 48: 3-50 2.a.(7)* Without information on the underlying supply arrangements for winners in the BGS-FP auction, there is no way for the Board to determine if and to what extent diversity exists. Information on the diversity of supply within PJM alone does not help because, without information on the BGS-FP winners' supply arrangements, the Board cannot determine if the supplies for BGS-FP service are similar to or different from the PJM system as a whole. Nor are financial guarantees against default by winning BGS-FP bidders any help in meeting the requirements in EDECA which are for "diversity of supply of electric power," not diversity in financially sound resellers of electricity whatever their ultimate source of supply.

*What information should winning BGS-FP bidders provide? When should they provide it?*

Ideally the information provided would include the source, cost, quantity, and terms and conditions for the sources of supply used to provide BGS service. Information would be communicated as soon as it becomes available, and updated when it changes significantly. This being said, there may be sound reasons to accept something less than this as a starting point for reporting by bidders. 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," with this information to be provided initially on a semi-annual basis with a 6-month lag.

Developing "reasonable" reporting requirements, that is requirements that are workable for the bidders but provide sufficient information to the Board, is a task best addressed collaboratively by Board Staff, the bidders and other interested parties including the Ratepayer Advocate. To ensure fruitful collaboration, it is essential that the Board make it clear that it needs information upon which to base an assessment of the "diversity of supply of electric power," and that, if a reasonable proposal is not developed collaboratively, the Board will set reporting requirements of its own making. The Board is well aware of the phenomenon that a tribunal can, by alerting the parties to the risks of litigation if they don't achieve consensus, push the parties into constructive settlement discussions. The recent example of the LICAP negotiations in New England is a case in point.

As the Board is aware, ISO-NE in March 2004 proposed the so-called LICAP system intended to encourage the building of additional capacity where and when needed in the region.<sup>1</sup> Many in New England, particularly those representing load, objected strenuously to the ISO-NE proposal. A FERC ALJ upheld the essential components of proposal, and a political uproar broke out. FERC received a strongly-worded letter from every New England member of Congress and Governor, of both parties. All New England regulatory commissions objected to the LICAP plan approved by the ALJ, as did numerous other parties. FERC responded by delaying the implementation of the LICAP plan, and assigning an eminent ALJ to oversee settlement talks.<sup>2</sup> What is most instructive about this action, however, is the fact that the FERC and its Chair, Joseph Kelliher, also warned the parties to the effect that the FERC would go ahead and decide the case (and kept the ALJ's LICAP approval alive as an apparently likely outcome if the settlement talks failed).<sup>3</sup> Chair Kelliher also warned in a FERC News Release issued along with the Interim Order on settlement that the political pressure being put on the FERC would not budge it from what it determined was the right course. By the deadline for settlement, an agreement in principle was reached that would avoid litigation, and would resolve all outstanding issues. Over sixty parties signed the agreement. All but 8 parties formerly opposed to LICAP signed on to the new agreement.<sup>4</sup> Only one state commission in the region ended up opposing the settlement.<sup>5</sup>

*What is the purpose of collecting information on bidders' supply arrangements? What use might be made of such information?*

The purpose is to evaluate the concentration in the sources of supply for BGS-FP service, to see how such concentration might affect the risks of default and the exercise of market power. These two concerns are an integral part of auction regulation. In an article in Public Utilities Fortnightly of September 2005, 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.

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<sup>1</sup>Devon Power LLC, *et al.*, Interim Order Regarding Settlement Procedures and Directing Compliance Filing, 113 FERC ¶ 61,075, Docket No. ER03-563-030 (Issued October 21, 2005)(Interim Order), para. 5.

<sup>2</sup> Interim Order, 113 FERC ¶ 61,075.

<sup>3</sup> *Id.*, , para. 7, 10.

<sup>4</sup> Devon Power LLC, *et al.*, Docket Nos. ER03-563-000, -030, -055, Report On Contested Settlement By Settlement Judge (Issued April 11, 2006).

<sup>5</sup> *Id.*

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 assure “diversity of supply of electricity,” 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-FP auction each year.

Possible uses for the information to be developed include modification of the auction rules and/or improvement in the auction monitoring by NERA and the Board’s consultant. At this point it is not possible to be more specific because the information in question is yet to be fully specified, collected or evaluated. The situation is similar to that before the audit, for tax or other purposes. Audits are conducted when there is “reason for concern.” Today there are ample reasons for concern about BGS-FP supply: (1) In the past Public Service played a more important role than its status as a winning bidder indicated; (2) the Enron trial reminds us that unregulated suppliers have in the past taken unreasonable actions, at great risk to themselves and the market, and (3) the prices produced by the auction have increased dramatically. These are not reasons to conclude there are problems with BGS-FP supply. However, they are good reasons for the Board to obtain information about the “diversity of supply of electricity,” and to evaluate that information carefully.

*What should the consequences be for incomplete or erroneous information?*

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, particularly the use of a collaboration process to develop the requirements and reporting procedures.

*Should this information be considered an exception to the Open Public Records Act?*

Yes. 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.

Some of the initial comments filed April 6, 2006 suggest that electricity generators and suppliers 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 bidder supply information as is currently in place for other key auction information. To provide context for the Board’s consideration of the trust issue, the Ratepayer Advocate offers two observations: (1) Section 10.11 of the standard Edison Electric Institute (EEI) Master Power Purchase and Sale Agreement contains provisions for the release of

data to regulators, and (2) a recent FERC order making it clear that PJM can release confidential data to “authorized parties” such as the Board with appropriate guarantees of confidentiality.

As the Board is aware, in 2004 state regulators in the PJM area worked with PJM and PJM member companies to develop a process by which states could gain access to confidential materials needed for states to monitor wholesale markets. These provisions were overwhelmingly endorsed by the PJM Members Committee. New provisions were added to the PJM Operating Agreement. FERC approved these provisions in its Order Accepting Tariff Modifications Subject to Modification, 107 FERC ¶ 61,322 (June 28, 2004). Under these provisions, state regulators designate staff or consultants as Authorized Persons to receive specific confidential information identified by the State.

### **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: (1) are the prices resulting from the BGS-FP auction consistent with prices in the broader market for Standard Offer Service; and, (2) 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. From their comments at the Legislative-type hearing held on April 28, it was clear that, at least for the most recent auction, NERA had undertaken some comparisons of this type. Here the Ratepayer Advocate would again emphasize a point made earlier in the discussion of transparency: as the government agency with the express mandate to protect the rights of those who pay for BGS-FP service, the Ratepayer Advocate must have access to information such as the comparative analysis under discussion.

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), perhaps with assistance from the PJM-MMU. The Ratepayer Advocate recommends that the Board investigate the possibility of such a joint effort.

Successful multi-state efforts have been undertaken in the PJM area. The negotiation with PJM and its member firms by the PJM Member States of a FERC-authorized mechanism for states to gain access to confidential market information, discussed above, is one such recent example. It may be that the place to start is to work with one or two other states that share a common interest in the specific questions facing the Board. The Board is best positioned to determine the most productive approach to developing a multi-state approach to pool analytical resources and insights, understanding as it does from its participation in regional market monitoring activities, the particular interests of its fellow state commissions.



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

Currently the Supplier Master Agreements permit pass through of changes in taxes and in transmission rates. In their 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 change,” in effect passing regulatory risk through to BGS-FP customers. The current and proposed pass through is not consistent with the purpose of the BGS-FP auction: obtaining service for small customers at a **fixed price**.

Pass through is also inconsistent 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 without pass through because the rates for BGS-FP service cannot fluctuate due to “pass through” as they can now. Finally, the Ratepayer Advocate would point out that allowing pass through deprives those who wish to compete to serve BGS-FP customers at a truly fixed price against which customers might compare their offerings. Making competition to serve BGS-FP customers more difficult is alone reason enough for the Board to reject current and proposed pass through arrangements.

For all of the reasons given above, it is the Ratepayer Advocate’s recommendation that the Board amend the FP Supplier Master Agreement to remove existing pass through. The recommendations to extend pass through should likewise be rejected.

### **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 —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.<sup>6</sup> 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 which must be given priority.

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<sup>6</sup> Among the “Bidders”, comments were filed by two Pepco affiliates. One opposed disclosure, the other took no position. All other “Bidders” opposed disclosure.