BEFORE THE STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

IN THE MATTER OF THE RATE UNBUNDLING	)	**BPU Docket Nos.**
FILINGS BY GAS PUBLIC UTILITIES	)	**GX99030121**
PURSUANT TO SECTION 10, SUBSECTION A	)	**GO99030122**
OF THE ELECTRIC DISCOUNT AND	)	**GO99030123**
ENERGY COMPETITION ACT OF 1999	)	**GO99030124**
	)	**GO99030125**
ELIZABETHTOWN GAS COMPANY	)	
NEW JERSEY NATURAL GAS COMPANY	)	
PUBLIC SERVICE ELECTRIC & GAS COMPANY	)	
SOUTH JERSEY GAS COMPANY	)	

INITIAL BRIEF
OF THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

GENERIC ISSUES

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I. PRELIMINARY STATEMENT

Natural gas is the energy of choice in today's residential, commercial and industrial marketplace. It is clean, efficient, available and environmentally correct. Setting the stage for a competitive retail marketplace for natural gas will put New Jersey at the forefront of its sister states and will encourage new home construction, new businesses and new industry in this State. The Board has the opportunity to create a paradigm for success that will benefit all classes of customers. New Jersey should not follow the path of some of the other states which have maintained a "status quo" retail energy marketplace suffering from a lack of choice. Let us instead look to our border states of New York and Pennsylvania where we will be competing for business and residential growth. This State needs to have the foresight to be creative and sufficiently aggressive so as to create a successful and vibrant retail natural gas marketplace.

The four natural gas utilities have submitted filings which will not achieve the above objectives. They have proposed rates which will not attract competitors to the retail natural gas marketplace so that consumers will have real choices. They have not proposed a full array of unbundled services to be open to competition. The filings include proposals to use the companies' interstate pipeline transportation and storage assets in ways that will impede the development of a competitive market. The filings include numerous deterrents to customers considering shopping for a natural gas supplier, such as switching fees and discriminatory rates for customers who choose an alternative supplier and later decide to return to the utility. Moreover, since natural gas is a commodity that is less costly than electricity, aggregation is essential to reduce the costs of serving smaller consumers, including low-income consumers, so that they will share in the benefits of competition. The utilities, however, have made no proposals to facilitate aggregation.

The utilities have not, however ignored their the concerns of their shareholders, a valid concern when balanced with the concerns of ratepayers. The utilities' proposed rate structures are skewed in favor of corporate earnings, designed to ensure that no revenues are lost as customers choose other suppliers. Moreover, the filings include a variety of proposals for automatic recovery of any lost revenues that may occur, as well as a variety of other costs such as implementation costs, "realignment" costs, and stranded costs. This approach will not achieve a vibrant competitive market, a goal that can bring rewards for both utilities and consumers.

Our Legislature has taken a leadership role in creating a pro-competitive climate in New Jersey's retail energy marketplace. The Board now has the opportunity to implement this objective for New Jersey's retail gas market. The Ratepayer Advocate urges the Board to look beyond the limited views reflected in the utilities' filings and create the structure necessary to bring the benefits of competition to New Jersey's natural gas consumers.

As the Board is aware, natural gas competition is emerging in many other states. Several of these, including Ohio, New York, Maryland, Pennsylvania, and Georgia, are actively encouraging choice for residential consumers, either through regulatory initiatives or legislation. Our Legislature has passed the Electric Discount and Energy Competition Act, 1999 *N.J. Laws* ch. 23 (the "Competition Act" or the "Act"), which mandates full retail natural gas competition in New Jersey. The expectations of the Legislators who voted in favor of the Act and the Governor who signed it should not be disappointed. A "Sleepy Hollow" New Jersey marketplace will not achieve the goals of the Act. The proper signals must be sent that New Jersey is "Open" for Business. With the passage of the Act, the Board now has the opportunity and the duty to make full retail natural gas competition a reality New Jersey.

II. SCOPE AND PURPOSE OF PROCEEDING

The scope and purpose of this proceeding are defined by the policies and objectives set forth in the Act. Section 2 of the Act states that, among other policies, it is the Act's objective to:

> (1) Lower the current high cost of energy, and improve the quality and choices of service, for all of this State's residential, business and institutional consumers, and thereby improve the quality of life and place this State in an improved competitive position in regional, national and international markets; [and]
>
> (2) Place greater reliance on competitive markets, where such markets exist, to deliver energy services to consumers in greater variety and at a lower cost than traditional, bundled public utility service; ....

The purpose of this proceeding is to accomplish the above goals, for the natural gas market, that is, to provide actual choices and savings for all of this State's natural gas users, and thereby create the competitive marketplace that will lead to the lower energy costs, better service, and innovations that the Act seeks to achieve for all energy consumers.

The Ratepayer Advocate urges the Board to review the utilities' filings carefully, and make the modifications that are necessary to assure that there will be a vibrant retail natural gas marketplace in New Jersey. The Ratepayer Advocate believes that the following overall objectives should guide the Board in this process:

- to ensure basic natural gas service at reasonable rates for all residential customers;
- to establish a structure that encourages the broadest possible customer choice;
- to encourage development of a robust natural gas market place attracting competitors and businesses to New Jersey;

- to insure that all natural gas customers share the benefits of competition;
- to maintain existing supply reliability and effective consumer protection;
- to promote use of natural gas as an environmentally sound energy choice.

The Ratepayer Advocate's briefs on the generic and company-specific issues that follow set forth the specific policies and principles which the Ratepayer Advocate believes will achieve these overall objectives. The Ratepayer Advocate urges the Board to follow the recommendations set forth below, and thereby create the competitive marketplace so as to achieve the resulting economic benefits which are contemplated under the Act.

III. PROCEDURAL HISTORY

In 1978, with the passage of the Natural Gas Policy Act of 1978, 15 *U.S.C.A.* §§ 3301 *et seq.*, Congress began a process which deregulated the price of gas at the wellhead, and allowed the local utilities to buy gas directly from producers, while paying the pipelines separately to deliver the gas to the utilities. As a result of these developments, large natural gas users located near the pipelines had the option of buying their own gas and paying the pipelines directly to deliver it, thus bypassing the utilities' distribution systems. This led the New Jersey utilities to begin offering unbundled service to their large industrial customers during the mid-1980s. These customers were given the option of either continuing to buy gas from the utility, or paying alternative suppliers (also referred to as "third party suppliers" or "TPSs") to buy the gas and arrange its delivery to New Jersey, while paying the utility only for transporting the gas to their places of business through the utility's local distribution network.

In 1994 and 1995, New Jersey became one of the first states to make unbundled natural gas service available to all of its commercial and industrial natural gas users. Thereafter, in 1997 unbundled service was offered to residential customers in pilot programs implemented by New Jersey Natural Gas Company ("New Jersey Natural"), South Jersey Gas Company ("South Jersey") and Public Service Electric and Gas Company ("Public Service"). These programs, however, all have enrollment limits; the Public Service pilot program has only a few participants. Unbundled service is not available at all to residential customers of Elizabethtown Gas Company ("Elizabethtown"). Further, the participation of smaller commercial customers in the existing programs lags behind that of larger natural gas users.

The Competition Act established a time frame to bring competition to all of this State's natural gas consumers. Section 10(a) of the Act required the Board to "order each public gas utility to submit a rate unbundling filing no later than May 1, 1999," and to "order that all retail customers of a gas public utility shall be able to choose a gas supplier by no later than December 31, 1999 ...." On March 17, 1999 the Board issued an Order Establishing Procedures (referred to hereinafter as the "Order Establishing Procedures") in which it required each of New Jersey's four natural gas utilities (also referred to as "gas distribution companies" ("GDCs") or "local distribution companies" ("LDCs")) to submit their rate unbundling filings no later than April 30, 1999. Based on the Board Order, among the goals of the proceeding were: (1) the establishment of separate charges for basic gas supply service for each customer class, and the "appropriate amount to be deducted from the bill of a ... customer who chooses a competitive supplier ..."; (2) the establishment of appropriate rates for other "retail-choice related services," including balancing, and (3) the establishment of bill credits for customers receiving billing services from third party suppliers. *Id.* at 2. The Order also specified fourteen categories of cost data and other information required to be included as part of the filing. *Id.* at 3.

The utilities submitted their rate unbundling filings on April 30, 1999. However, as the Board noted in its June 25, 1999 Order of Clarification (cited hereinafter as the "Order of Clarification"), the utilities' filings "set forth neither fully unbundled, embedded cost-based transportation rates nor unbundled rates for metering, billing and customer account services," and this information was not provided in response to parties' discovery requests. Order of Clarification at 2. In the Order of Clarification the Board clarified the intended scope of the proceeding and directed the utilities to provide the appropriate cost data. With respect to the

unbundling of gas supply costs the utilities were directed to provide the cost data needed in order permit "a complete analysis of all cost elements in bundled rates to identify within transportation rates all supply and potentially supply-related costs, including, without limitation, gas commodity costs, upstream transportation costs, upstream storage costs, peaking service costs, and an appropriate allocation of all supply-related overhead, administrative and general costs." *Id.* at 3. Further, the Board ordered that there be a "full examination of the cost of all competitive and potentially competitive customer account services," in order to facilitate the determination in a future proceeding of which customer account services should be opened to competition. *Id.* at 4.

On June 16, 1999 the Board issued a Procedural Order creating a Natural Gas Implementation Working Group, and assigned the following issues to the working group: enrollment, non-competitive metering and billing, data interchange, customer administration, customer information, third party supplier agreements, nomination procedures and reliability, including peak day requirements and penalties. Procedural Order at 2. The working group was directed to "provide recommendations as they become available" and to "provide a list of unresolved issues by Oct. 15, 1999." *Id.*

In accordance with the Order Establishing Procedures, the Ratepayer Advocate and Intervenors submitted prefiled testimony in response to the companies' filings. The utilities subsequently submitted motions to strike portions of the prefiled testimony of the Ratepayer Advocate and Intervenor Shell Energy Services ("Shell"), including all of the prefiled testimony of Ratepayer Advocate witnesses James A. Rothschild, Barbara Alexander and Roger Colton, and portions of the prefiled testimony of Ratepayer Advocate witness Richard LeLash and Shell witness Richard Hornby. These motions were considered at the Board's August 18, 1999 agenda

meeting, where the Board voted to accept Staff's recommendation to deny the motion to strike Mr. Rothschild's testimony, and to hold in abeyance and defer ruling on the motions to strike the remaining testimony.

The companies submitted rebuttal testimony, and the Ratepayer Advocate and Intervenors submitted surrebuttal testimony. Evidentiary hearing were held before Commissioner Frederick Butler on September 27, 28, and 30 and October 1, 4, 5, 12, 14, 15 and 25. These hearings did not include cross-examination of Ratepayer Advocate witnesses Barbara Alexander and Roger Colton.

To date, no issues have been referred to the Board by the Gas Implementation Working Group, and the Board has not ruled on the motions to strike portions of the Ratepayer Advocate and Intervenor testimony.

IV. ISSUES

A. Basic Gas Supply Service ("BGSS")

1. Nature of BGSS

The role of Basic Gas Supply Service (" BGSS") is defined in section 3 of the Act as follows:

> "Basic gas supply service" means gas supply service that is provided to any customer that has not chosen an alternative gas supplier, whether or not the customer has received offers as to competitive supply options, including, but not limited to, any customer that cannot obtain such service for any reason, including non-payment for services. Basic gas supply service is not a competitive service and shall be fully regulated by the board;

This definition contemplates a reliable and reasonably priced service to be available to all consumers who, for any reason, do not choose an alternative supplier. Further, as a "non-competitive" service, BGSS must be structured so that it does not impede the development of a competitive retail market.

The utilities have generally proposed to provide BGSS service using the same pricing structure as provided under their existing Levelized Gas Adjustment Clause ("LGAC") mechanisms. For two of the utilities, Elizabethtown and South Jersey, modifications are required in order to eliminate or minimize the over- and under-recoveries which are carried over from year to year under their currently effective LGAC mechanisms. These mechanisms permit the utilities to adjust annually the gas cost components of their rates without having to file a base rate case. T2005:L20 to T2006:L22.[1] In a competitive marketplace, these mechanisms provide an unjust and preferential advantage to the utility.

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[1] Transcripts will be cited by page and line number. "T2005:L20" refers to page 2005, line 20. The appendix to this brief will be cited as "RAA."

Under the traditional LGAC mechanisms, prices have been levelized over annual recovery periods, and the utilities have been permitted to recoup deficiencies in their gas cost recoveries (or credit customers for over-recoveries) in subsequent years. *RA-63*, p. 9-10. These prices have been levelized over the annual recovery periods in order to provide price certainty for consumers. *RA-64,* p. 9. As prices have become more volatile, the utilities have hedged their gas costs to provide greater price stability. Two utilities, Public Service and New Jersey Natural, currently have specific Board authorization to hedge gas prices through the use of physical and financial contracts. In addition, the utilities use their interstate pipeline and in-territory storage capacity as a hedging tool to buy gas during the summer, when prices are generally lower, for use during the winter. *RA-64*, p. 10.

The traditional LGAC mechanisms were a reasonably fair means of recovering gas costs in a regulated monopoly market, providing rate stability for consumers and protection to the utilities from the impact of gas cost increases. However, **the annual reconciliation and adjustment mechanisms will hinder the development of a competitive market, in that alternative suppliers will be required to compete against artificially high or low prices for many months at a time. *RA-64,* p. 10.** Section 10(s) of the Act contemplates the ultimate elimination of the traditional LGAC mechanisms. This provision requires the Board, within three years of the implementation of full retail natural gas competition, to decide whether basic gas supply service should be supplied on a competitive basis. As an interim measure the utilities should be required to implement pricing mechanism which eliminate, or at least quickly phase out, the over- and under-recovery balances which currently are carried over from year to year under the traditional LGAC mechanisms.

As is explained in the generic surrebuttal testimony of Ratepayer Advocate witness Richard LeLash, two utilities, Public Service and New Jersey Natural, have implemented monthly adjustment mechanisms for this purpose. These mechanisms reflect two different approaches. One approach is reflected in the mechanism approved by the Board in 1995 for Public Service's commercial customers. Under this mechanism, the commodity portion of the company's gas cost rates are adjusted every month to reflect current spot market prices, based on a published price index. *RA-64,* p. 11. The other approach is reflected in the mechanism approved by the Board for Public Service's residential customers, and New Jersey Natural's commercial and residential customers. Under this approach, the companies' gas costs are established annually on a levelized basis, but are subject to limited adjustment on a monthly basis. *RA-64,* p. 11-12. The monthly adjustment mechanism, along with these two utilities' hedging programs, encourage customer choice by eliminating or minimizing over- and under-recoveries at the end of the LGAC period, while retaining useful protections against volatile gas prices. *RA-64,* p. 12. The Ratepayer Advocate therefore recommends that the Board require the other two utilities to implement such adjustment mechanisms. *Id.*

The Ratepayer Advocate is not recommending at this time that the other utilities implement spot price index-based adjustment mechanisms such as the mechanism currently in effect for Public Service's commercial and industrial customers. However, as Mr. LeLash observed, these mechanisms should evolve as the competitive market develops. T2080:L10-11. Pricing mechanisms which more closely track market rates may be appropriate as New Jersey's retail natural gas market develops, and a full array of pricing options becomes available from the competitive market.

2. Single vs. Multiple BGSS Options

Two utilities have proposed that they be permitted to offer multiple pricing options to their BGSS customers. New Jersey Natural and Elizabethtown have both included fixed price options as part of their proposed BGSS service.. *RA-21,* p. 21; *P-13*, p. 23-24; *NJ-1*, p. 22. New Jersey Natural has further proposed that it be permitted to offer additional "enhanced pricing options" in the future. *NJ-2,* p. 7-8. These proposals are prohibited by the Act and should be rejected as detrimental to the development of a competitive market.

As noted above, BGSS is a service that is provided to customers who have "not chosen an alternative gas supplier," and is specifically defined as "not a competitive service ...." Thus, the Act contemplates a service that is provided in the absence of another affirmative choiceSnot one which actively competes with the offerings of competitive suppliers.

Under section 10(o) of the Act, gas public utilities which are part of a public utility holding company structure (a category which includes all four of New Jersey's gas utilities) are prohibited from offering competitive gas supply options. This section provides, in relevant part:

> A public utility holding company may offer a gas competitive service to retail customers of a gas public utility that is owned by the holding company, but only through a related competitive business segment of the holding company that is not a related competitive business segment of the gas public utility; ....

A "related competitive business segment" of a gas public utility includes:

> any business venture of ... [a] gas public utility, including, but not limited to, functionally separate business units, joint ventures, and partnerships, that offers to provide or provides competitive services.
>
> Act § 3.

These provisions contemplate a strict separation of gas competitive services from the utility. A public utility holding company that wishes to offer such services must do so through an entity that is separate from the public utility or any business venture in which the utility is involved. Section 10(b) provides for limited exceptions to this prohibition. A gas public utility or its related competitive business segments may, with Board permission, engage in any of five types of competitive services, which are listed in sections 10(b). This list includes metering and billing, services related to safety and reliability, previously approved competitive services, services similar to those previously approved, and competitive services to non-residential customers using utility employees and assets. *Act,* § 10(b)(1) - 10(b)(5). It does not include gas supply services, which, as noted, the gas utilities are required to provide as **non-competitive** services. *Act,* § 3 (definition of "basic gas supply service").

As is explained in the company-specific sections below, the fixed price options proposed by Elizabethtown and New Jersey Natural would compete "head to head" with the offerings of third party suppliers. These options would be affirmatively chosen by customers, who would then remain out of the competitive market for a specified term. T925:L6-14; T1578:L16-19. This clearly is not the role contemplated for BGSS, which, as noted, is defined as a service provided to customers who **do not choose**.

It is also clear that the multiple "BGSS" options being proposed by the utilities would hinder the development of the competitive market. The utilities, as regulated entities, have a number of advantages over competitive suppliers. They have the right to provide monopoly services at rates that provide them with a specified rate of return. They have customers lists and name recognition. Under the utilities' proposals, they will continue to collect the "return"

element of their rates though their charges for monopoly local distribution service. They enjoy margin sharing revenues. They also benefit from gas cost recovery mechanisms which permit them to collect their costs of procuring gas supply on a "pass through" basis, thus eliminating their exposure to risks related to changes in the market price for gas. These factors will make it difficult for third parties to compete against the incumbent utilities, even if they do not offer multiple pricing options.

Finally, the regulatory oversight of multiple BGSS options to prevent cross-subsidization would be difficult or impossible. As Ratepayer Advocate witness Richard LeLash explained:

> As GDC gas supply options proliferate, the allocation requirements and their regulatory oversight become very complex. If a GDC is offering BGSS, fixed price supply, and off-system commodity services from the same supply portfolio, it becomes impossible to determine whether or not preferences are being given to one or another of the offerings. *RA-63,* p. 20.

The utilities engage in numerous spot market purchases and hedging transactions, and selective assignment of these transactions can "create large cross subsidization differentials." *Id.* As Mr, LeLash explained, because of the "sheer number of these transactions, meaningful regulatory oversight is impossible." *Id.* This testimony was based on Mr. LeLash's own personal experience in attempting to review these types of transactions:

> [I]n other instances and other jurisdictions [I have] had to sort through hedging and acquisition transactions.
>
> It is very difficult to be able to assure a Commission, for example, that certain transactions that ended up in one category really started out in that category.
>
> T2088:L22 to T2089:L4.

Thus, the offering of multiple BGSS options would make it difficult or impossible for the Board to assure that costs were properly allocated to each service being offered. This would impose a

substantial regulatory burden on the Board, with no assurance that improper cross-subsidization could be consistently detected or remedied. This is directly contrary to the Act's objective of increasing reliance of competitive markets and decreasing reliance on regulation. *Act,* § 2(c).

In summary, multiple "BGSS" options are prohibited by the Act and would impede the development of a competitive natural gas market in New Jersey. If the utilities' parent corporations wish to offer these services, they may do so through separate marketing affiliates, as permitted by section 10(o) of the *Act*. The Board should reject the utilities' proposals to offer more than one pricing option under the regulated utility structure.

3. Terms and Conditions of BGSS

In order to achieve a competitive market, the Board should carefully review the utilities' proposals and eliminate terms and conditions such as switching fees, enrollment restrictions, discriminatory rates and penalties which will have the effect of limiting or discouraging choice and thereby establishing barriers to competition. The following types of provisions should be **rejected** as impediments to choice.

a. Switching fees

The Act recognizes that switching fees are a deterrent to choice for smaller customers, by prohibiting all such fees for residential customers. *Act,* § 36(a) (5). As is explained in the company-specific sections below, the Act prohibits **all** such fees, including the $15 fee proposed by Elizabethtown for residential customers who switch from one third party supply to another. *P-13,* p. 6; *RA-70,* p. 13. The utilities currently have switching fees of up to $50 for commercial customers. *RA-63*, p. 25. Fees of this magnitude are likely to be a substantial deterrent to choice for smaller commercial customers, which may have usage not much higher than a typical

residential customer. *Id*. p. 25-26. **It is important that the benefits of competition be made available to small businesses, which are an important element in this State's economy. Switching fees therefore should be eliminated for all residential and small commercial customers. T1996:L21 to T1997:L5.**

b. Enrollment restrictions

One utility, Elizabethtown, is proposing a variety of restrictions on enrollment for residential customers. These include limited enrollment periods, minimum aggregation requirement for third party suppliers, a minimum one-year term for customers who choose a third party supplier, and a requirement that customers who return to BGSS remain as BGSS customers for at least one year. *P-13,* p.5-6. These types of restrictions are not being proposed by any other utility. As is explained in more detail in the company-specific discussion below, these proposed restrictions should be rejected as unwarranted impediments to the development of a competitive market for Elizabethtown's residential customers. Choice should not be restricted to certain dates, especially during the summer months when gas prices are typically low and the ability to choose is not meaningful. Enrollment restrictions such as those proposed by Elizabethtown are clearly roadblocks to competition and prohibited by the Act. These types of provisions should be rejected.

c. **Discriminatory rates for returning BGSS customers**

Some of the utilities have proposed that customers who choose to take gas supply service from a competitive supplier and then later decide to return, or are forced to return to BGSS service because of, for example, a supplier default, pay different rates from those paid by BGSS customers who have remained with the utility. Public Service has proposed that returning BGSS customers pay spot market-based rates which fluctuate each month based on a market index, while customers remaining with the utility would continue to pay levelized rates based on the costs of the utility's existing gas capacity and supply portfolio. *RA-63,* p. 23-24; T282:l17 to T285:L6. South Jersey has made a similar proposals for its non-residential customers. *SJ-1,* p. 16-18; T582:L4-10. As a result of these proposals, the rates for returning customers would be less stable and potentially higher than the companies' "regular" BGSS service. *RA-63,* p. 23-24; T1327:L19 to T1328:L6. Elizabethtown has proposed that residential customers who return to BGSS service before the conclusion of the company's proposed one-year minimum term be required to pay 120% of the company's regular BGSS rate through the end of the one-year term. *P-13,* p. 6-7. New Jersey Natural has not proposed higher rates for returning residential customers, but is proposing this for commercial customers. *NJ-2,* p. 12-13.

Proposals such as these will certainly be a substantial roadblock to choice, especially for smaller customers. *RA-63,* p. 23-24. In order to eliminate this deterrent, the utilities' rates for BGSS service for residential and small commercial customers should be the same for returning BGSS customers as for customers who remain with the utility. *RA-63,* p. 24. In a competitive marketplace the expectation is that customers will come and go, that is, there will be a fluid

marketplace. This process should not be impeded by discriminatory rates that will deter smaller customers.

For the same reason, the Board should reject the utilities' proposals to hold residential and small commercial customers responsible for costs incurred in the event a third party supplier fails to meet its delivery obligations. An example of such a proposal is Public Service's proposed "Emergency Gas Service," which is priced at the company's incremental cost of procuring gas, plus an additional charge of 18.1 cents per therm, of which the Company proposes to keep 15 percent. *RA-63,* p. 24-25, T294:L5 to T297:L15; *PS-20* (response to TR-358). Similarly, South Jersey is proposing to hold customers financially responsible if their third party suppliers default. *SJ-5,* p. 8.

The chilling effect of these provisions on customer considering competitive options is obvious. They are particularly unfair for residential and small commercial customers. All of the utilities have provisions in their tariffs which permit them to review the creditworthiness of third party suppliers and, if necessary, to require bonding or other forms of financial assurance. *RA-63*, p. 24-25. T1961:L8 to T1966:L12. The utilities, unlike smaller consumers, have the right to obtain financial information from suppliers, the professional staffs to review the information, and the ability to require financial guarantees. T1966:L22 to T1967:L7. Thus, it is entirely appropriate to hold the utilities, not their residential and small commercial customers, responsible for recovering the costs of a default by a third party supplier. **Residential and small commercial customers who are forced to return to the utility due to a supplier default should pay the same rates as other BGSS customers, and should not be penalized for supplier conduct that is beyond their control.**

The marketplace will clearly become a more fluid one as more third party suppliers are licensed in New Jersey. Customers should be permitted to migrate without the threat of discriminatory rates or penalties should they decide to return, or be forced to return, to the utility.

B. BGSS Rates/Shopping Credits

1. Proposed Rate Unbundling Methodology

a. Objective of unbundling

In order to achieve the lower costs and improved quality and choices of service which are contemplated in the Act, there must be a vibrant natural gas market in which numerous suppliers offer choices to consumers. The crucial element to achieving this objective is the establishment of shopping credits at a level that will attract competitors to New Jersey's natural gas marketplace, by making it possible to offer savings to consumers. Under the Act, a "shopping credit" is defined as:

> an amount deducted from the bill of an electric public utility customer to reflect the fact that such customer has switched to an electric power supplier and no longer takes basic generation service from the electric public utility;

Act, § 3.

While the Act does not specifically define shopping credits for the gas utilities, the Board recognized in its Order Establishing Procedures that one of the primary purposes of the current proceedings is to

> establish .... the appropriate amount to be deducted from the bill of a gas public utility customer who chooses a competitive supplier to reflect the fact that such customer no longer takes basic gas supply service.

Order Establishing Procedures at 2.

Thus, in this proceeding the Board will be establishing shopping credits for each of the four New Jersey gas utilities.

As in the electric industry, the success of a competitive retail market depends on the level of the shopping credits established by the Board. The National Regulatory Research Institute ("NRRI"), in its 1999 report on residential gas competition, concluded that "[a] customer's willingness to switch is driven by the expected savings in gas costs." K. Costello, *Household Participation in Gas Customer Choice Programs: Some Facts, Explanations, and Lessons Learned* at 34 (NRRI 99-05, January 1999) *quoted in RA-78*, p. 2. Similarly, the Staff of the Ohio Public Utility Commission has found, based on customer surveys, that "price comparison was the number one factor in a customer's decision to participate in a choice program." *PUCO Staff Second Report on Ohio's Natural Gas Choice Programs,* p. 4-5 (1999). Without savings, there will be no competitive market. Shopping credits in Pennsylvania have created a vibrant competitive electric marketplace**S**the only one in the country. Adequate shopping credits are just as necessary to achieve the objective of competition in New Jersey's energy markets, both electricity and gas.

In their filings, the utilities have generally proposed minimal "unbundling," which will preserve their revenues but will not accomplish the goals of the Act. For the most part, they have proposed BGSS rates based on their direct costs of gas reflected in their LGACs, with no overheads and profits, and with no allocation of the gas supply costs which are currently embedded in their proposed rates for unbundled distribution service. *E.g.* T196:L11 to T197:L17; T1483:L19 to T1484:L15. Rates determined in this manner will make it impossible for competition to grow in their service territories. Indeed, Public Service's two witnesses

acknowledged that the rates they are proposing in this proceeding are intended to "cover costs," not promote competition. T232:L15-18; T1125:L25 to T 1127: L12. The Board should reject this approach, and establish shopping credits that will create a vibrant retail gas market in this State.

The success of competitive electric retail markets in other states has depended on the establishment of adequate shopping credits. This is apparent from the success of electric competition in Pennsylvania, where meaningful shopping credits were adopted, and its failure in California, which did not adopt meaningful shopping credits. **The success of New Jersey's retail gas marketplace will similarly depend on the adoption of shopping credits that will attract competitors to this State.**

b. Proper allocation of gas supply costs

As explained by Ratepayer Advocate witness John Rohrbach, the first step in creating a shopping credit is to reflect in the utilities' rates for BGSS service the gas supply costs which are presently embedded in their distribution rates. These may include, for example portions of the costs of on-system gas production and storage facilities. *RA-77*, p. 3-4. Two utilities, Public Service and South Jersey, have identified as least some of the gas supply costs embedded in their distribution rates. *RA-77*, p. 4; *RA-65*, p. 14-20; *RA-73,* p. 20-21. These costs should be re-allocated to these companies' proposed BGSS rates.

The other two utilities, Elizabethtown and New Jersey Natural, have not provided the necessary information to identify costs which should be re-allocated to their gas supply rates. *RA-77,* p. 4. These two companies' failed to supply the necessary information despite two Board Orders directing them to do so. The Board's Order Establishing Procedures required the utilities

to provide support for “all unbundled rate components,” including a number of specific items of cost data which were listed in the Order. Order Establishing Procedures at 3. In its Order of Clarification the Board noted the absence of “fully unbundled, embedded cost-based transportation rates” in the companies’ filings, an omission which the reflected an “unduly narrow and restrictive interpretation of the issues in this proceeding.” Order of Clarification at 2. The utilities were therefore directed to provide the unbundled rate information which had been requested in the discovery requests of other parties. *Id.*

Shell witness Richard Hornby has estimated the amounts of various types of gas supply costs embedded in distribution rates proposed by Elizabethtown and New Jersey Natural. Since these companies failed to provide their own cost analyses in defiance of two Board Orders, it is appropriate for the Board to use Mr. Hornby’s analysis as a basis for determining which costs should be reallocated to their BGSS rates. The appropriate re-allocations are explained in Mr. Rohrbach’s surrebuttal testimony. *RA-78,* p. 10, 11.

c. Re-allocation of margin revenues

As explained by Mr. Rohrbach, even if gas cost currently embedded in the utilities’ base rates are re-allocated to gas supply, the resulting BGSS rates may not be sufficient to create a competitive market in the year 2000. *RA-78,* p. 4. This is this case for a number of reasons.

First, the utilities’ gas supply rates currently reflect credits for margins on a variety of transactions engaged in by the utilities to maximize the value of their interstate pipeline transportation and storage capacity during times when the capacity is not needed to serve their firm gas supply customers. *RA-77,* p. 4-5; *RA-78,* p. 3. The utilities release capacity at times when it is not needed, or use the capacity to make on-system or off-system sales. Under existing

margin sharing mechanisms, most of these margins are credited the utilities' firm sales customers. *RA-63*, p. 38. These margins are available to the utilities largely due to their control of both the capacity used to provide gas supply service and their distribution assets. The margins are thus are higher than they would be in a fully competitive market. *RA-78,* p. 3. Second, the cost allocations reflected in the utilities' existing rates are, to varying degrees, outdated, making it difficult to identify all costs that should be re-allocated to gas supply. T1976:L12 to T1977:L8. Finally, an incentive may be needed to overcome the advantages resulting from the utilities' positions as the incumbent suppliers, including name recognition, goodwill, and other factors. T1956:L4-9.

The Ratepayer Advocate therefore is recommending that the Board use a portion of the utilities' margins on transactions using excess capacity to create viable shopping credits. Initially, an amount equal to 15 to 25 percent of these revenues, including both the "ratepayer" and "company" shares, should be removed as credits to the utilities' BGSS rates, and their distribution rates should be decreased by the same amount. *RA-78,* p. 4. The Ratepayer Advocate's testimony includes calculations illustrating this methodology for the each utility's residential customer class. *RA-78,* p. 8-15. Since it is difficult to predict what level of shopping credit will assure the success of New Jersey's competitive natural gas marketplace, each utility's shopping credits should be subject to further adjustment if, after one year, less than one-third a residential customers have shopped. *RA-78,* p. 16.

The Board should also implement the above concepts for the four utilities' small commercial classes. T2971:L8-22. (Large industrial customers have already negotiated

competitive contracts.) Neither residential nor small commercial customers should be locked out of the new competitive marketplace.

The utilities' various criticisms of the above proposal are unfounded. First, the utilities argue that the Act does not **explicitly** provide for gas shopping credits. *PS-4,* p. 2-3; *P-15,* p. 2; *P-16,* p. 5-6; *NJ-2,* p. 24-25. While the Act specifically refers to shopping credits for the electric utilities, it does not prohibit them for natural gas customers, and they are clearly necessary to achieve a central objective of the Act, that is, a competitive marketplace for all of New Jersey's natural gas consumers. *Act,* § 2(a)(1); § 10(a). There is no prohibition on extending the shopping credit concept to the natural gas marketplace. The Board has full authority to do so.

Second, the utilities argue that they are entitled to keep all of "their" shares of the margin revenues under a variety of negotiated settlements. *PS-4,* p. 9-10; *P-15,* p. 3*; SJ-5,* p. 2. However, these sharing mechanisms all were initiated under the old monopoly regime, and the stipulations relied upon by the utilities all pre-date the Act. *RA-78,* p. 4; T1954:L4-12. Further, with a limited exception for South Jersey which is taken into account in the Ratepayer Advocate's recommendations, the margin revenues are not reflected as part of the utilities' revenue requirements. *RA-77,* p. 6; *RA-78,* p. 15. Certainly the Act provides the Board with sufficient discretion to use a portion of these margin revenues to assure the development of the competitive market contemplated by the Legislature. Indeed, this type of decision could have been made by the Board without passage of the Act.

Third, the utilities argue that customers who choose not to shop will experience higher rates. *PS-4,* p.8*; P-16,* p. 6-7, *NJ-2,* p. 17*; SJ-5,* p. 2. The impact, however, is slight, and will be

far exceeded by the benefits that will flow to all consumers from the creation of a competitive market. *RA-78,* p. 4. *RA-83* (response to TR 2978).

Finally, the utilities criticize the Ratepayer Advocate's proposal as a "subsidy" to out-of-state suppliers. *PS-4,* p. 3-4; *P-16,* p. 8; *NJ-2,* p. 17. As Mr. Rohrbach explained, the purpose of the Ratepayer Advocate's proposal is not to provide a "subsidy" but "merely to assure that marketers will be able to enter this marketplace and provide competitive choices and savings to consumers." *RA-78,* p. 5. The Ratepayer Advocate's proposal is no more a "subsidy" than the existing margin sharing mechanisms, which were put in place to provide an incentive for the utilities to maximize the value of their interstate transportation and storage capacity for the benefit of their ratepayers. As Mr. LeLash observed during cross-examination by Public Service's attorney:

> When capacity release became effective under FERC Orders, the Company said, I['ve] got a proposal, I'll take 20 percent of those capacity release credits but you will get more because I have done a really good job.
>
> And we did it. And surprisingly enough the Company didn't talk about subsidies at that time. They didn't jump up and down. They took their 20 percent and walked off.
>
> T1954:L4-12.

The utilities have received millions of dollars in margin revenues over the years the existing margin sharing incentives have been in effect. It is not unreasonable to use a modest portion of these revenues, along with a portion of the "ratepayer" shares of the margin revenues, to create a competitive market that will benefit all consumers. The Board should not lose sight of the fundamental goals of the Act and this proceedingSretail choice in a competitive marketplace.

d. Alternative proposal to re-allocate earnings

As an alternative to re-allocating margin revenues, a shopping credit could be created by transferring the revenue requirement associated with a 1 percent (100 basis point) return on equity from each utility's distribution rates to its rates for gas supply. *RA-57,* p. 5. As was explained by Ratepayer Advocate witness James A. Rothschild, since the utilities' last base rate cases, the level of interest rates on long-term U. S. treasury bonds has dropped, on average, by more than 150 basis points. *RA-57,* p. 6 & Schedule JAR-1 (included in *PS-6*). The cost of equity has dropped even more, because the risk premium, that is, the difference between the cost of equity and the cost of debt, has also dropped. *RA-57,* p. 6, 7. While the utilities' operating expenses or revenues may have changed since that time, the utilities, at least on a consolidated basis, are expected to have prospective earnings that, on average, exceed their allowed returns on equity. *RA-57,* p. 6 & schedule JAR-2 (included in *PS-6*). Based upon the above analysis, it is reasonable for the Board to give the utilities the option of transferring the revenue requirement associated with 100 basis points of return on equity, in lieu of the re-allocation of margin revenues proposed above. *RA-57,* p. 7.

The utilities appear to concede that interest rates have dropped since their last base rate cases, but argue that their risk premiums have increased. *NJGU-1*. However, as Mr. Rothschild explained in his surrebuttal testimony and during cross-examination, the utilities' arguments are based on unfounded criticisms of Mr. Rothschild's analysis, and are contrary to convincing evidence that the cost of equity applicable to New Jersey utilities "has really dropped considerably more than the very conservative 100 basis point revenue shift [Mr. Rothschild has] proposed." *RA-58*, p. 11, 5, 13-14. As explained by Mr. Rothschild and acknowledged by the

utilities' own cost of capital witness Dr. Roger Morin, based on an analysis of "betas," a commonly used measure of risk, risk premiums have been stable or even dropped slightly since the utilities' last base rate cases. T1726:L4 to T1728:L5; T43:L13 to T46:L5; T57:L12 to T58:L24; T86:L14-22.

Further, it appears that even Dr. Morin apparently does not dispute Mr. Rothschild's primary conclusionSthat the cost of equity has dropped since the utilities' last base rate cases. As noted in Mr. Rothschild's surrebuttal testimony, nowhere in Dr. Morin's testimony does he deny that the cost of equity has, on average, dropped since the dates of the utilities' last base rate cases. *RA-58*, p. 11. Indeed, as noted by Mr. Rothschild:

> It would be rare indeed for a cost of capital witness to deny that the cost of equity has dropped over this period. Based upon my readings of prior testimonies filed by Dr. Morin, I know he thought the cost of equity was considerably higher as of the time of the last rate cases than was allowed by the Board, but it would be irresponsible of him not to at least acknowledge that the cost of equity has dropped.
>
> *RA-58*, p. 11-12.

Clearly, costs of equity have dropped significantly since the utilities' last base rate cases. Dr, Morin's suggestion to the contrary should be rejected.

Mr. Rothschild's proposal would initially be revenue neutral. Utilities would contribute to the shopping credit only as customers actually chose competitive suppliersSand this would be offset customer growth resulting from the competitive environment. T1738:L7 to T1739:L5; T1801:L23 to T1802:L14. Thus, the actual impact on the utilities would be substantially less than 100 basis points. Given the apparently undisputed reduction in interest rates since the

utilities' last base rate proceedings, Mr. Rothschild's proposal is a reasonable option for creating viable shopping credits and the opportunity for a competitive retail marketplace.

2. Lost Revenue Recovery Proposals

The utilities assert that, if the above recommendations are implemented, they will incur "lost revenues" as customers choose competitive supply options. As noted above, the utilities have proposed that the Board adopt "full margin" rates which will allow them to recover through their distribution rates all of the costs currently embedded in their base rates. T200:L6 to T202:L11; T548:L13 to T550:L7; T998:L20 to T999:L25; T1481:L11 to T1484:L22. The utilities assert that, if any costs are re-allocated from their proposed distribution rates to their proposed gas supply rates, they will incur "lost revenues." *P-13,* p. 33*; SJ-5,* p. 10-11. The utilities have proposed that the Board allow them to implement a variety of automatic adjustment mechanisms which would recover the asserted "lost revenues" without regard to their overall levels of revenues and expenses. *E.g. PS-2,* p. 9-10; T213:L22 to T214:L5; *P-13,* p. 32, 34*; NJ-1,* p. 36-37 & attached ex. KAM-2, p. 14; *SJ-3*, p. 5-6 . Some of these mechanisms also include recovery of various "incremental" costs which the utilities assert they will incur as a result of the implementation of competition. *P-13,* p. 30, 34, *NJ-1,* attached ex. KAM-2, p. 14; *SJ-3,* p. 6.

The utilities' proposals for recovery of lost revenues and incremental costs are inconsistent with the objectives of the Act, which include a move toward competition and away from regulation. *Act* § 2(a)(2); § 2(b)(1). In a competitive environment, companies which lose customers cannot rely on automatic adjustment mechanisms to make up revenues lost when customers choose other suppliers. T202:L21 to T203:L10. They must find other ways to generate revenues or reduce costs. The utilities' proposals would not only insulate them from

this usual business risk, but would also place them in a better position than before, by adding new provisions to guarantee revenue streams without a comprehensive review of the level and prudency of their overall revenues and costs. Instead of **reducing** energy costs as contemplated by section 2(a) of the Act, the utility proposals would create rate **increases**. Further, this would occur at the same time the utilities' corporate affiliates are being afforded greater opportunities to profit in the competitive market.

Utilities have a remedy if they believe their overall revenues are insufficientSthey may file a base rate case. If any utility incurs lost revenues or non-mitigable incremental costs associated with the implementation of the Act, it can make a claim for these costs in a base rate proceeding. T2180:L20 to T2181:L18. As was explained by Ratepayer Advocate witness Richard Galligan:

> My understanding [is] that the practice in New Jersey is that the rates that are in effect now are deemed just and reasonable until there's a showing that they have become unjust or unreasonable and utilities experience cost increases, cost decreases, revenue increases, revenue decreases between rate adjustments and all I'm suggesting here is that in between rate cases, a, we're not certain that there's going to be incremental costs and we can go into that; b, if there are, any time your rates become unjust or unreasonable in your mind, you can always file for rate relief.
>
> T2286:L18 to T2287:L6.

The Act nowhere provides that it was intended to implement a change in the fundamental ratemaking principles for those services which continue to be provided as regulated monopoly services. The proper mechanism for recovery of asserted lost revenues and incremental costs for regulated monopoly services will continue to be a base rate filing.

C. Unbundling of Gas Supply Service

1. Services Unbundled

Gas supply service actually consists of a number of component parts, including the actual gas commodity, upstream transportation over the interstate pipelines, storage, peak shaving and balancing. The Board's procedural orders in this proceeding recognize that these component parts of gas supply are potentially competitive services. In the Order Establishing Procedures, the Board stated that, in addition to establishing rates for distribution and gas supply service, the Board would establish "appropriate charges for other choice-related services provided by gas public utilities such as balancing services." Order Establishing Procedures at 2. The Board's Order of Clarification further confirmed the Board's intention to examine services, including balancing services "that have the potential to be competitively priced," Order of Clarification at 3. The utilities' current proposals would introduce competition for some but not all of the component parts of gas supply.

As was explained by Ratepayer Advocate witness Ralph Miller, each of New Jersey's four natural gas utilities owns and operates a distribution system which is connected to one or more interstate pipelines. *RA-72,* p. 4-5. Each of the utilities owns and operates at least one facility in its service territory which is capable of storing relatively small quantities of gas. *RA-72,* p. 5. Except for these small amounts of stored gas, gas must be provided at the city gate in the quantities and at the times it is required by consumers. *RA-72,* p. 6.

At the present time, only the largest gas customers are permitted to arrange to have competitive suppliers deliver gas to the city gates at the times it is actually needed. These customers, which are required to have electronic metering devices capable of monitoring their

usage on a “real time” basis, must maintain a daily balance between the gas they use and the gas that is delivered to the utility on their behalf. *RA-72,* p. 10-11.

For smaller customers, the utilities do not currently offer fully unbundled gas supply service. One utility, New Jersey Natural, has filed in a separate proceeding a proposal to offer alternative suppliers the option of delivering gas for smaller customers in amounts that approximate their customers’ actual usage each day. *RA-72,* p. 11. The other three utilities are proposing that alternative suppliers deliver gas on a fixed schedule, either a fixed amount each day of the year, or an amount that changes each month but is fixed for each day of the month. Elizabethtown is proposing that suppliers serving its residential customers be required to deliver a fixed amount of gas every day of the year, based upon the estimated average daily usage of their customers. Elizabethtown would provide the service of storing the gas during the summer, to be used during the winter when customers use more than their average daily usage; suppliers would not have the option of providing this service. *RA-72,* p. 11-12. Public Service and South Jersey are proposing that suppliers deliver a different quantity of gas each month, with larger quantities in the winter months. Elizabethtown also uses this approach for its commercial and industrial customers. *Id.* While this approach allows suppliers to more closely match deliveries with usage, the utility still maintains the responsibility for matching deliveries with daily variations in usage. *Id.* This “monthly requirements” approach allows competition for components of gas supply which represent approximately two-thirds of the total cost of a correctly timed gas supply service. *RA-72,* p. 12. As recommended by Mr. Miller, the utilities should be required, **at a minimum**, to offer suppliers a the option of providing monthly requirements service when full retail competition commences on January 1, 2000. *Id.*

This approach, however, still leaves the "storage" and "balancing" components of gas supply service bundled with the utility's monopoly distribution service. *Id.* It is not the complete unbundling that is contemplated by the Act. In order to permit competition for these services, the utilities will have to offer additional options to suppliers. **For all residential and smaller commercial customers, all of the utilities should offer suppliers the option of providing "daily requirements" service, such as is being proposed by New Jersey Natural. *RA-72,* p. 14-15. In order for this option to be available for the 2000-01 winter season, the utilities should be required to file proposals by March 1, 2000. *RA-72,* p. 15.**

2. Format of Tariffs

Under section 10(a) of the Act, the unbundled components of the utilities' rates are required to be "separately identified and charged in [their] tariffs." As recommended by Ratepayer Advocate witness Ralph Miller, properly unbundled tariffs are essential in order promote the goal of competition. They should offer customers the ability to choose to buy gas from an alternative supplier in an administratively simple fashion. *RA-72,* p. 7. Rates for distribution and supply service should be set forth separately, so that the customer can choose an alternative supplier without a change in the distribution service provided by the utility. *RA-72,* p. 8. Further the tariffs should be made "clear and understandable to the consumer, for otherwise their very complexity may operate as a barrier to competition." *RA-72,* p. 9. The information contained in the utilities' tariffs should be easily accessible to both customers and competitive suppliers. Tariffs must therefore be posted on the utilities' websites. *RA-72,* p. 10. Finally, the utilities' separate rates for distribution and supply service must be clear and easily understandable on customers' bills. *Id.* **Customers now complain about confusion in**

understanding utility bills. For retail competition to work, customers must understand the "prices to compare."

With regard to balancing services, the utilities' tariffs should reflect the manner in which balancing options will actually be selected. While the unbundling of balancing services is of importance to the development of a competitive market, most smaller customers have neither the ability nor the resources to arrange directly for balancing services. *RA-72,* p. 17. These customers will buy balancing services as part of a package from suppliers, who will decide whether to buy balancing from the utility or make other arrangements to provide this service. *Id.* Therefore, in a competitive marketplace for residential and general service customers, balancing should be offered as an option to **suppliers** rather than offered directly to consumers.

D. Capacity Assignment

1. Voluntary/Mandatory Assignment

a. The need for voluntary assignment

As explained above, most of the gas used to supply New Jersey consumers is transported from the wellhead to this State over the facilities of the interstate gas pipelines. Unlike the supply of gas at the wellhead, the market for the interstate pipeline and storage services that bring gas to the State is not a fully competitive market. As was explained in the prefiled generic testimony of Ratepayer Advocate witnesses Richard Galligan and Jerome Mierzwa, the number of pipelines serving New Jersey, and the amount of gas storage space, are both limited. *RA-67,* p. 6. The incumbent gas utilities control a significant portion of the interstate pipeline transportation and storage resources serving New Jersey. *RA-67,* p. 7. In order to provide a full range of service for New Jersey consumers competitive suppliers need access to these resources,

which will no longer be needed as much by the utilities as their customers choose alternative suppliers. *RA-67,* p. 6. As customers choose third party suppliers, the capacity which utilities no longer need to serve these customers should be made available to third party suppliers, on a voluntary basis, before it is offered to anyone else. *RA-67,* p. 7-8. Capacity should be offered to affiliates only on a non-discriminatory basis, to the extent they are providing gas supply service to the utility's customers. *RA-67,* p. 8. This will provide third party suppliers with access to the transportation and storage capacity they will need to serve New Jersey consumers, an essential ingredient of a competitive marketplace.

In order to provide customers with the benefits of the capacity on a non-discriminatory basis, the capacity should be offered to third party suppliers at the utility's weighted average cost of capacity. *RA-67,* p. 8. In other words, the price charged for the released capacity should be the average of the rates paid for capacity under each utility's existing contracts with the interstate pipelines.

A policy of requiring utilities to offer capacity to third party suppliers on a voluntary basis was recently adopted by the New York Public Service Commission. As is explained below, the New York Commission has recently prohibited utilities from **requiring** third party suppliers to take assignments of capacity. However, the Commission still requires the utilities to "continue to offer the [utilities'] own upstream capacity to the customers who desire it." *Re Issues Associated With the Future of the Natural Gas Industry and the Role of Local Gas Distribution Companies,* Order Concerning Assignment of Capacity, Case Nos. 97-G-1380 *et al.* at 8 (March 24, 1999) (cited hereinafter as *"New York Capacity Assignment Order")* (RAA8). Consistent with the

Ratepayer Advocate's recommendation in these proceedings, the New York utilities are further required to price the capacity at their weighted average cost of capacity. *Id.*

Access to the limited interstate pipeline transportation and storage capacity serving New Jersey is essential to allow third party suppliers to serve this State's retail natural gas market. Consistent with the recent decisions of the New York Commission, New Jersey's utilities should be required to make these resources available to third party suppliers as they become unnecessary to serve the utilities' remaining gas supply customers.

b. Utility proposals to require mandatory assignment and related issues

While capacity should be made available to third party suppliers, they should not be compelled to take it. In order to be able to offer the best prices to consumers, competitive suppliers should be free to make other arrangements when more economic alternatives are available. *RA-67,* p. 6. For this reason, the Board should reject the proposals of two utilities, Elizabethtown and South Jersey, to *require* competitive suppliers to take, or pay for, the utility's capacity.

The New York Public Service Commission, has recently decided, after a three-year trial period in which mandatory assignment was required, that the mandatory assignment of capacity is an obstacle to competition. Mandatory assignment was initially permitted in New York during a three-year transition period in order to avoid the creation of stranded costs related to the utilities' existing long-term contracts for interstate pipeline capacity. *Re Restructuring of the Emerging Competitive Natural Gas Market,* Policy Statement Concerning the Future of the Natural Gas Industry in New York State and Order Terminating Capacity Assignment, 189 PUR 4th 1, 6 (1998) (Cited hereinafter as "*New York Natural Gas Policy Statement*"). However, the

New York Commission also found that mandatory assignment "would also limit the ability of marketers to find and use cheaper capacity and prevent customers from realizing savings." *Id.* Therefore, in order to "continue the movement to a competitive market," the Commission ordered that New York's gas utilities no longer be permitted to "require capacity assignment or inclusion of capacity costs in transportation rate beyond April 1, 1999 to customers migrating to marketers except where specific operational and reliability requirements warrant." *Id.* at 6-7.

As in New York, mandatory assignment of the New Jersey gas utilities' interstate pipeline capacity would restrict the ability of third party suppliers to make their own arrangement to deliver gas to the utilities' city gates, and thereby hinder their ability to offer lower prices to New Jersey consumers. This is contrary to the Act's objective of lower energy prices and greater consumer choices. *Act,* § 2(a)(1).

The utilities have asserted two justifications for mandatory assignment: that it is necessary to assure reliable service, and to avoid stranded costs. Neither justification is valid.

With regard to reliability, Elizabethtown and South Jersey believe that competitive suppliers cannot be trusted to acquire the interstate pipeline capacity resources needed to provide reliable service, unless they are forced to acquire these resources from the utility. *RA-67,* p. 12. This point of view is inconsistent with the reliance on the competitive market which is contemplated by the Act. Many tools other than mandatory assignment are available to utilities to maintain system reliability. These include short-term gas supply purchases, storage services, no-notice service, the use of peak-shaving facilities, and the recall of released interstate pipeline capacity under certain conditions. *RA-67,* p. 13. In addition, economic penalties, including penalty charges for failures to deliver and potential suspension or revocation of supplier licenses,

provide suppliers with an incentive to perform responsibly. *Id.* Two New Jersey utilities, Public Service and New Jersey Natural, rely on these types of tools to maintain reliable service on their systems. *RA-67,* p. 13-14.

In addition to the above tools, the Board can allow a utility to require suppliers to show that they have "comparable capacity," that is, capacity that reasonably compares to the utility's existing arrangements for delivering gas to its city gates. Such provisions could require that suppliers demonstrate that they have reserved pipeline transportation and storage capacity which is the functional equivalent of the utility's capacity. For example, suppliers could be required to show that they have capacity with the same primary delivery points, flexibility, and line pressures as the utility's existing capacity. In addition, the supplier can be required to make its comparable capacity available to the utility in the event it ceases providing service to some or all of its customers. *RA-67,* p. 15. If Elizabethtown and South Jersey believe that additional measures are needed to assure reliable service, they should be required to implement comparable capacity requirements rather than mandatory capacity release, which, as discussed, is an impediment to competition. *RA-67,* p. 16.

In New York where, as noted, mandatory assignment is permitted only under limited circumstances, comparable capacity requirements have been approved as a means of assuring reliable service. Following the issuance of the *New York Natural Gas Policy Statement,* a number of New York utilities proposed that marketers serving human needs, core or firm customers be required to "demonstrate that they have sufficient firm, non-recallable, primary delivery point capacity to the citygate." *New York Capacity Assignment Order* at 9 (RAA9). The New York Commission "endorse[d] this concept," as a means to assure reliable service. *Id.*

Comparable capacity should not, however, be required for the two utilities that are not proposing mandatory assignment, Public Service and New Jersey Natural. Under the Act, by virtue of their obligation to provide BGSS, the natural gas utilities are suppliers of last resort and are therefore responsible for maintaining system reliability. Public Service and New Jersey Natural believe that they can assure reliable service by using the types of economic incentives and other tools which are described above. *RA-67,* p. 13-14; T1182:L23 to T1184:L3. This will provide third party suppliers with more flexibility in arranging for gas supply service. Since these two utilities bear the responsibility for providing reliable service, and are willing to undertake this responsibility without comparable capacity requirements, they should be permitted to do so.

An issue related to mandatory capacity assignment is raised by the proposal of one utility, South Jersey, to continue its present practice of retaining "backup" capacity sufficient to meet the requirements of customers who choose to buy gas from third party suppliers. *SJ-3,* p. 12-18; T589:L25 to T590:L6. Elizabethtown also proposes to continue its present practice of requiring backup capacity for some customers. T867:L7-17. This practice in effect requires customers to pay for capacity twiceSonce to the third party supplier, and then again to the utility for the backup capacity. This creates an insurmountable barrier to choice. If customers who choose a third party supplier are required to pay for duplicative "backup" capacity, this will eliminate any possibility of savings. This approach also is contrary to the Act's goal of increasing reliance on competitive markets, because it presumes that the marketplace cannot be relied upon to provide reliable service. *RA-67,* p, 16-17.

For the reasons explained above, reliable service can be assured through comparable capacity requirements, along with a system of appropriate economic penalties. *RA-67,* p. 17-18. The utilities therefore should have no need to retain capacity for the sole purpose of "backing up" customers who are buying gas from third party suppliers. Utilities should be permitted to retain limited amounts of "backup" capacity only if this is required by unique operational considerations which are not related to the migration of customers to third party suppliers. T2236:L17 to T2237:L8; T2241:L21-25.

This recommendation is consistent with the policy of the New York Commission, which does not allow utilities to back up the full loads of customers who buy their gas from third party suppliers. The New York Commission explained this as follows:

> We note that the LDCs currently have the provider of last resort responsibility and therefore must be prepared for the possible return of customers that have converted transportation, However, this does not mean that they must maintain full back-up capacity for those customers. It is highly unlikely that large numbers of customers will return to LDC sales service; if they do, their former capacity should become available in the primary or secondary markets, albeit at a market price.
>
> *Motion of the Commission to Address Issues Associated with the Restructuring of the Emerging Competitive Natural Gas Market,* Order Clarifying April 1998 Excess Capacity Filing Requirement. at 3-4 (Sept. 4, 1997) (RAA20-21).

The Commission further stated that some backup capacity would likely be required if a large number of customers were to convert, but the level of backup capacity "would be expected to be substantially less than what would be required to serve the entire load." *Id.* at 4 (RAA21). This was reaffirmed in the *New York Natural Gas Policy Statement,* which, in addition to prohibiting mandatory capacity assignment, prohibited the "inclusion of capacity costs in transportation rates" after April 1, 1999. *New York Natural Gas Policy Statement,* 189 PUR 4th at 6.

The practice of maintaining "backup" capacity for customers who have chosen an alternative natural gas supplier is an impediment to competition and is not necessary to maintain reliable gas service. As recommended by the Ratepayer Advocate's witnesses, the New Jersey utilities should not be permitted to maintain backup capacity unless they show that limited amounts of such capacity are required for unique operational reasons other than merely the migration of customers to third party suppliers.

With regard to stranded costs, mandatory assignment is proposed as a means of avoiding stranded costs related to the utilities' existing long-term contracts for pipeline transportation and storage services. To the extent third party suppliers make their own capacity arrangements, utilities may find that they have more capacity than they need to serve their remaining gas supply customers. If a utility is unable to shed capacity at the same rate it is losing gas supply customers, the fixed demand costs associated with the excess capacity may become "stranded." *RA-67*, p. 19-20.

At this time, however the utilities have not shown that they will incur any stranded costs. There are many means available for utilities to avoid or mitigate stranded costs. Some of the "excess" capacity may be needed to serve customer growth. The utility may have the opportunity to assign the capacity to another entity. It may have the option to terminate or reduce the amounts of capacity under its contracts with the interstate pipelines, under existing contract terms or through renegotiation. *RA-67,* p. 20. It appears that, to date, New Jersey's gas utilities have been successful in avoiding or mitigating stranded costs. After five years of customer choice for commercial and industrial customers, no utility has made a claim for stranded costs, and none of the filings in these proceedings contain any projections or estimates of stranded costs.

As recommended by Mr. Galligan and Mr. Mierzwa, the Board should adopt a policy that requires utilities to pursue all available measures for avoiding and mitigating stranded costs before mandatory assignment and other stranded cost recovery mechanisms are considered. In the event stranded costs remain despite these measures, the utility should be required to file a petition in which it demonstrates that it has pursued all available measures to avoid and mitigate stranded costs. The Board should then evaluate possible remedies, including, as a last resort, mandatory capacity assignment. *RA-67,* p. 22. Further, any utility that requests stranded costs should not be permitted to benefit from revenues derived from capacity releases and off-system sales. *Id.* As was explained by Mr. Galligan during his cross-examination, this is a matter of fairness. Customers should not be asked to pay for stranded costs at the same time the utility is collecting an "incentive" derived from the use of its capacity contracts. T2244:L2 to T2245:L10. These amounts should be used to further mitigate stranded costs.

The New York Commission has established similar strict requirements for the recovery of stranded costs. A utility seeking the recovery of stranded costs is required to "evaluate and aggressively pursue options to address strandable costs ...." *New York Natural Gas Policy Statement,* 189 PUR 4th at 7. With regard to the continuation of sharing mechanisms for utilities seeking stranded cost recovery, the New York Commission has determined that this would result in "unfair compensation" to the utilities. *Re Restructuring of the Emerging Competitive Natural Gas Market,* Order Denying Petitions for Rehearing, 193 PUR 4th 1, 2 (1999).

The Board should likewise establish strict standards for the recovery of stranded costs. Mandatory assignment and other stranded cost recovery measures should not be permitted in the

absence of a convincing showing that such costs exists despite aggressive measures to avoid and mitigate them.

2. Other IssuesSReview of Existing Margin Sharing Mechanisms

As noted, all four of the New Jersey gas utilities have in effect mechanisms which provide them with incentives to lower the effective cost of gas for their firm customers. These mechanisms apply when the utilities release capacity at times when it is not needed, or use the capacity to make off-system sales. In order to provide utilities with incentives to aggressively pursue such transactions for the benefit of their firm customers, the mechanisms allow the utilities to retain a share of the margins realized from these transactions. *RA-63*, p. 38. Two utilities have recently agreed to modify their sharing mechanisms to reduce their share of the margins realized from capacity release and off-system sales, and include incentives linked to permanent reductions in their capacity costs. *RA-63,* p. 39. **Nevertheless, to differing degrees, all of the existing mechanisms are antithetical to competition. As Mr. LeLash explained in his generic testimony, so long as the utilities retain a share of margins on capacity release and off-system sales, there will be an economic incentive for them to retain capacity not needed to serve their remaining gas supply customers, *RA-63,* p. 38-40.**

In order to promote a viable competitive marketplace, the existing incentive mechanisms should be reviewed and modified as necessary so that they encourage utilities to make excess capacity available to other market participants, rather than retaining it so that they can profit from capacity releases and off-system sales. *RA-63,* p. 41. The Board should initiate this review by March 1, 2000, so that any modifications could be placed in effect by October 1, 2000, in time for the 2000-01 winter season. *Id.*

As noted in Mr. LeLash's generic surrebuttal testimony, some of the utilities have asserted that the above recommendation is contrary to existing stipulations. These stipulations, however, all pre-date the passage of the Act. *RA-63,* p. 38; *RA-64,* p. 2. With the passage of the Act we are in a new paradigm of competition. The Act, together with as the Board's established authority under *N.J.S.A.* 48:2-40 to reconsider its own orders at any time, certainly provide the authority to review these mechanisms and modify any provisions found to be inconsistent with the Act's objectives. *Id.* Further, as Mr. LeLash explained during his cross-examination, the utilities' claims that they are entitled to certain shares of margin revenues under existing stipulations can be considered as part of the Board's review of the sharing mechanisms. T2018:L21 to T2019:L9. The Act has substantially modified the regulated environment in which the existing mechanisms were created. As Mr. LeLash observed, the Act requires that the Board "revisit decisions that were made under the outdated framework." *RA-64,* p. 3.

E. Societal Benefits Charge

1. Items Recoverable Through the SBC

Section 12 of the Act lists the items that may be recovered through the societal benefits charge. The items that apply to gas utilities are:

1. The costs of social programs for which rate recovery was approved prior to April 30, 1997;
2. The costs of demand side management ("DSM") programs approved pursuant to Board regulations prior to April 30, 1997;
3. Manufactured gas plant ("MGP") remediation costs, which are to be determined initially in accordance with the mechanisms contained in the

utilities' current board-approved remediation adjustment clauses ("RACs"); and

4. The gas utilities' appropriate share of the costs of the consumer education program established pursuant to section 36 of the Act.

Act, § 12(a) (1), (3), (4) and (5). (Section 12(a)(2), which provides for the recovery of nuclear plant decommissioning costs, does not apply to gas utilities.) The utilities all have included the costs of DSM programs and MGP remediation in their proposed SBCs. **However, the utilities' filings did not quantify, or improperly quantified, the costs of existing social programs, and they did not attempt to specify or quantify the consumer education costs proposed to be included in the SBC. *RA-63,* p. 29-30.**

a. Identification and quantification of social programs costs

Section 3 of the Act includes the following definition of the "social programs" that should be included in the SBC:

> "Social program" means a program implemented with board approval to provide assistance to a group of disadvantaged customers, to provide protection to customers, or to accomplish a particular societal goal, and includes, but is not limited to, the winter moratorium program, utility practices concerning "bad debt" customers, low income assistance, deferred payment plans, weatherization programs, and late payment and deposit policies, but does not include any demand side management program or any environmental requirements or controls.

Three utilities, Elizabethtown, New Jersey Natural, and South Jersey, have not quantified any social programs for inclusion in their SBCs, and should be required to do so. Under the above definition, the cost should also include uncollectibles, to the extent they are attributable to Board-approved social programs. *RA-63,* p. 30.

Public Service has proposed a "social program" component for its SBCSbut the proposed initial amount consists in its entirety of **all** of the company's uncollectibles. This is improper, as section 12 of the Act permits the inclusion on only that portion of the utilities' uncollectibles that are attributable to Board-approved social programs. *RA-63,* p. 32. In addition as explained in more detail in the company-specific discussion below, inclusion of all uncollectibles in the SBC would create an unjustified windfall for the company, because it would guarantee collection of **all** uncollectible costs, including those attributable to wealthy individuals and large corporations. T221:L4 to T223:L20. This would also be extremely unfair to customers who would be required to pay for guaranteed recovery of uncollectibles for customers wealthier than themselves.

The utilities should be required to identify and quantify their social programs, including the proper level of uncollectibles, so that these may be included in their SBCs. Otherwise, they should not be permitted to pass through these costs.

b. Identification and quantification of consumer education costs

As noted, none of the utilities' initial filings specified which consumer education costs they are proposing to recover through the SBC, or attempted to quantify amounts proposed to be recovered. However, all of the utilities have started to incur costs for the statewide consumer education program that is being conducted under the auspices of the Board, and some have started incurring costs for their own "grass-roots" campaigns. Public Service, for example, states that it has already spent $3.9 million on consumer education, and that a significant portion of that cost will be allocated to the company's gas customers. T343:L21 to T344:L2; *PS-20* (responses to TR 350 and TR 352). The Board's June 25, 1999 Order in Docket No. EX99040242 permitted the electric and gas utilities to begin deferred accounting for consumer education costs.

This Order, at page 2 provides for a "presumption of consumer education cost recovery" as long as the measures of success to be established by the Board are met. **As Mr. LeLash observed in his surrebuttal testimony regarding Public Service, if the utilities are to have a presumptive right to recover the costs at a future date, "there is a real, immediate need for accountability, specifically to describe the programs and quantify their costs for review by the parties."** ***RA-66,*** **p. 7.** In order to provide this accountability the Board should require the utilities to provide, as soon as possible, detailed descriptions of their education programs and detailed itemizations of costs that have been incurred to date and detailed projected future costs.

c. Other proposed SBC components

Some of the utilities' filings seek to recover a variety of costs not specified in section 12 of the Act. These include lost revenues, realignment costs, stranded costs, and costs associated with the implementation of the Act. *RA-63*, p. 31. Section 12(a) is clear in permitting the inclusion of only "some or all of the following costs," which are then specifically listed in sections 12(a)(1) through (5). These do not include any of the above-mentioned costs sought by the utilities. There are also important policy reasons for limiting the SBC to the specifically listed items. Since the SBC is non-bypassable and subject to reconciliation and true-up, it provides a high level of assurance that the cost elements it includes will be recovered. *RA-63,* p. 31-32. The Act's clear intent was to provide this level of assurance, as well as the universal recovery mechanism contemplated for the SBC, for a limited number of cost components that were determined by the Legislature to be social benefits of sufficient importance to justify this approach. The inclusion of other cost components within the SBC is contrary to the specific

language and purpose of section 12 of the Act and should therefore be rejected. The SBC should not be used as a "catchall" fund by the utilities.

2. Proposed Two-Way Interest

Two utilities, Public Service and Elizabethtown, have made specific requests that the Board allow them to recover interest on under-recovery balances under their SBCs. *PS-1,* p. 4; *P-13,* p. 27-28, 30, 31. As discussed by Mr. LeLash in his prefiled generic testimony and during cross-examination, this issue should be addressed on a component-by component basis, and "one-way" interest should be preserved at least for those components on which the utility is not now permitted to recover interest, including the MGP recovery component as it applies to Elizabethtown, New Jersey Natural and South Jersey. *RA-63,* p. 33; T2012:L10-15; T2181:L24 to T2184:L10. In this regard, section 12 (a)(4) of the Act specifically provides that MGP remediation costs "shall be determined initially in a manner consistent with the mechanisms in the remediation adjustment clauses for the electric public utility and gas public utility adopted by the board ...." **Accordingly, the Board should, at a minimum, provide that the three gas utilities that do not now receive interest on unrecovered MGP remediation costs, Elizabethtown, South Jersey, and New Jersey Natural, should not be permitted to recover interest on this component of their SBCs. *RA-63,* p. 33; T2185:L17 to T2186:L18.**

3. Interest Rate

One utility, Public Service, has sought to recover interest on SBC under-recoveries at the company's authorized rate of return. *RA-65,* p. 24. If the Board allows two-say interest, the Ratepayer Advocate submits that it would be more appropriate to use a short- or intermediate-term debt rate. The only SBC component for which utilities are now permitted to recover interest

at their authorized rates of return is DSM component. T1934:L7-14. However, in the electric restructuring proceedings, the Board has issued orders providing that interest on all SBC components will be at the 7-year treasury rate, plus 60 basis points. *In the Matter of Public Service Electric and Gas Company's Rate Unbundling, Stranded Costs and Restructuring Filings,* BPU D.t. Nos. EO97070461 *et al.*, Final Decision and Order at 116 (Aug. 24, 1999); T2183:L17-21; T2184:L11-17. Consistent with the electric restructuring orders, to the extent two-way interest is allowed on the SBC components for the gas utilities, the rate should be a short or intermediate-term debt rate, rather than the utilities' authorized rates of return.

4. Deferred Accounting

At least one utility, Public Service, has requested broad authorization from the Board to begin deferring all costs which the company believes to be recoverable under the SBC. *RA-63*, p. 32. Because of the ratemaking implications of deferred accounting, the Board should not grant this type of broad authorization. Deferred accounting should be allowed initially only for those SBC components for which there is an existing Board Order authorizing deferred accounting. Any further requests for deferred accounting should be made as part of the periodic reconciliation and rate proceedings to be established for the SBC. *RA-63,* p. 32.

5. Mechanics of the SBC (establishment and true-up)

Section 12 of the Act appears to contemplate periodic proceedings to review and reconcile the costs incorporated in the SBC. However the Act does not specify the nature and timing of these proceedings. The SBC incorporates the DSM and MGP remediation costs, which are currently reviewed and reconciled on an annual basis as part of the utilities' annual LGAC proceedings. It would therefore be reasonable to incorporate the review and reconciliation of the

SBC into any successor proceedings established by the Board to review BGSS costs under section 10(r) of the Act. *RA-23,* p. 33.

6. Applicability of the SBC

The utilities currently have in effect a variety of exemptions and special rates for certain customers and customer classes. *RA-63,* p. 33. Section 12 of the Act requires that these exceptions and special rates be eliminated. This requirement is found in section 12(a) of the Act, which provides, in relevant part:

> Simultaneously with the starting date for the implementation of retail choice as determined by the board pursuant to subsection a. section 5 of this act, the board shall permit each electric public and gas public utility to recover some or all of the following costs through a societal benefits charge that shall be collected as a non-bypassable charge imposed on **all electric public utility customers and gas public utility customers**, as appropriate.
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> *Act,* § 12(a) (emphasis supplied).

The only exemption found in the Act is for certain on-site power generators, which are exempted from paying the **electric** SBC. *Act,* §28. With this limited exception, the Act clearly and specifically states that the SBC applies to **all** electric and gas utility consumers, and the Board should apply it accordingly. Intervenor North Jersey Energy Associates argues that the provision that the charge is to be applied "as appropriate" means that the Board may exempt some customers from the SBC. *NJEA-1*, p. 5-6. However, it is clear in context that this provision means that the costs should be recovered from **electric or gas customers, in the appropriate proportions**. If the Legislature had intended this language to permit exemptions and special rates, it would not have specifically provided that the SBC is a "non-bypassable" charge.

Universal application of the SBC also does not violate the prohibition on cost reallocations among customer classes found in section 10(a) of the Act. As Mr. LeLash explained during his cross-examination, the prohibition on cost re-allocations included in section 10(a) relates only to the unbundling of rates for the services provided by the utilities. T2108:l2-13; T2111:L7-16; *NJEA-7*. Thus, "the SBC stands apart from the rate unbundling procedure because first of all, it does not result, because of unbundling, and secondly it is not a service. It is a surcharge that's being imposed by the Act." T2111:L12-16.

Under the clear provisions of the Act, the SBC is a **universal** charge that applies to **all** gas and electric customers. This provision requires the elimination of the currently existing exemptions and special rates. The SBC was establish to provide an assured and fair source of funding for cost components deemed beneficial to society as a whole**S**including a "safety net" to assure that disadvantaged consumers share in the benefits of the competitive market. Clearly, these costs should be funded by everyone who does business in New Jersey.

F. Customer Account Services

1. Required Cost Data

Metering, billing and other services relating to customer account administration, which the Act refers to as "customer account services," are potentially competitive services. Opening these services to competition could greatly expand choices available to customers and encourage technical innovation that could reduce costs and improve service. Competition in the market for these services would create the potential for expanded customer choice and additional savings.

Other states, such as New York, Pennsylvania, Maine and the California Public Utilities Commission Division of Strategic Planning have endorsed opening customer

account services to competition. In August 1997 the New York Public Service Commission declared **natural gas metering** to be "a potentially competitive service that could further promote robust, effective retail competition. The provision of competitive metering would not only expand customer choice, but would also offer customers numerous additional services ...." *In the Matter of Competitive Opportunities Regarding Electric Service,* Case No. 94-E0952, Opinion and Order Establishing Regulatory Policies for Competitive Metering at 3 (NYPSC Opinion 97-13, Aug. 1, 1997) (RAA25). More recently, in June 1999, the New York Commission issued a request for comments concerning customer billing arrangements in which it noted that "[e]xisting customer billing arrangements may not be optimal in a competitive environment. To maximize benefits to consumers, we will reexamine these existing arrangements with a view toward adopting a billing environment appropriate to the evolving competitive market." *In the Matter of Customer Billing Arrangements,* Case No. 99-M-0631, Notice Requesting Comments at 1 (NYPSC June 9, 1999) (RAA38).

In 1998 the Pennsylvania Public Utilities Commission issued an order authorizing the implementation of competitive electric metering and billing, allowing third party suppliers to provide consolidated billing and provide, install, maintain and read advanced remote electric meters. *See, PECO Energy Co.,* 186 PUR 4th 388 (Pa. PUC 1998).

In a report entitled *Strategies for Natural Gas Reform* dated January 21, 1998, the California PSC Division of Strategic Services recommended unbundling metering and billing in the gas industry, declaring that:

> Gas revenue cycle services (RCS) such as metering, billing, and after-meter services are not inherent monopolies. Retail providers can offer billing options, remote meter reading technologies and after-meter services and unbundling these

> services from utility rates will be important to the continued evolution of energy technology and competition for several reasons. First, unbundling RCS will increase value to consumers by providing the market with the opportunity to create innovative individualSas well as combinedSgas and electric service offerings, and energy management technology and products. Second, RCS unbundling allows retailers to offer important customer interface services and create and maintain a market presence. In essence, RCS are an important component to the energy product and the ability to directly provide them may help to encourage and retain potential competitors. Finally, consolidated billing and metering of gas and electric services can result in cost efficiencies and synergies in markets where lower volumes might otherwise provide less of an opportunity to profit from the sale of the commodity alone. These efficiencies will encourage market entry, competition and a great range of customer choice.
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> *Strategies for Natural Gas Reform: Exploring Options for Converging Energy Markets,* Ch. IV (Ca. PUC Div. of Strategic Planning Jan. 21, 1998) (RAA63).

The Act recognizes the potential benefits of competition in these markets, by directing the Board to initiate a proceeding not later than three months after the start date for competition to determine whether there should be alternative suppliers for some or all customer account services. *Act*, § 6(b). Even though these markets for customer account services will not be open to competition immediately, determining unbundled costs now will facilitate the process of implementing choice when the Board determines which customer account services should become competitive. As stated in the Order:

> Further, in the interest of administrative economy, the Board deems it appropriate to direct at this time that a record be developed and that there be a full examination of the cost of all competitive and potentially competitive customer account services in order to avoid the necessity of having to engage in further rate unbundling proceedings in the future.
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> Order of Clarification at 4.

Thus, the Board has made it clear that unbundled costs for customer account services should be determined in the current proceeding.

As noted in the Order of Clarification, none of the utilities submitted unbundled cost data for customer account services in their original filings. Some data was submitted with the utilities' rebuttal testimony, but this data is incomplete. Public Service, South Jersey and New Jersey Natural presented analyses of their claimed avoidable cost of metering, billing, and other customer account services. Elizabethtown presented a report, but this report focused on asserted difficulties in determining costs properly, rather than on the results of such a determination. *RA-75,* p. 4. None of the utilities presented a study of its average embedded or fully allocated costs of metering, billing and other customer account services, though some of them presented pieces of information in these areas. *Id.*

The utilities' unwillingness to present cost data for customer account services is in contrast to their eagerness to present cost data when it is in their interest to do so. For example, as the Board is aware, Public Service voluntarily presented a voluminous cost of service study in the electric restructuring proceedings.

In order to remedy these deficiencies, Elizabethtown should be required to present a complete avoided cost study, and all of the utilities should be required to submit complete average embedded or total cost studies. *Id.* As Mr. Miller explained in his generic surrebuttal testimony, both embedded and avoided cost information will be needed when the Board determines which customer account services to unbundle and establishes rates for those services. *RA-75,* p. 5. Because of the potential benefits of opening these services to competition, the utilities should be required to submit the necessary information promptly, to avoid any delay in the Board's determinations regarding these services. The utilities have all "stonewalled" the

Board's Order of Clarification in refusing to fully comply. A date certain should be established for the submission of complete cost data, with sanctions for non-compliance.

2. Unbundled Bill Credits

[No Ratepayer Advocate position at this time]

G. Other Recommendations

1. Aggregation Data Requirements

The Ratepayer Advocate has consistently expressed concern that residential and small commercial customers my not realize the benefits of competition, because they do not have the large usage levels and load profiles that are attractive to third party suppliers. Smaller customers can benefit from aggregation programs, which make them more attractive to suppliers. Under sections 42 through 45 of the Act, municipalities or counties can act as aggregators for business and residential consumers within their territorial jurisdictions.

In order to implement these provisions, however, government aggregators and consumers will require certain information from the utilities. A government aggregator's request for supply must include some form of load profile information since TPSs can only make a meaningful price bid if they have load profile data. Furthermore, section 45(a) of the Act requires a government aggregator to notify its residential customers of their affirmative right to decline participation in the government energy aggregation program and thereafter determine the number and the identity of the residential customers who did not decline to participate. However, the governing body cannot notify all energy customers within its jurisdiction or identify the customers who did not opt out unless it has a list of utility customers within its borders.

In order to facilitate aggregation as contemplated in the Act and in implementation of the Board's Interim Government Energy Aggregation Program Standards, the utilities should be required to make the following information available to government aggregators and consumers:

! Within two weeks of receipt of a customer's request, natural gas utilities should provide the usage data (for residential) or load profile (for commercial and industrial customers) for the past 12-month period to any customer making such a request.

! Gas utilities should provide aggregate load profiles and an address listing of gas customers by rate class and by municipal or county jurisdiction to government aggregators. At a minimum, the gas utilities must agree to provide such data by zip code classifications, and any provided data should be in electronic form.

! Natural gas utilities should maintain and disseminate a list of licensed third party suppliers operating in their service area to their customers twice a year, and they should maintain a current TPS listing on their Internet web site.

RA-63, p. 26-29.

2. Universal Service Proposals

Section 12(b) of the Act provides for the Board to establish a Universal Service Fund ("USF") to fund such social programs as the Board finds appropriate. Section 12(b) contemplates a separate proceeding to determine the programs and funding levels to be included in the USF. It is, however, of the utmost importance to assure that universal programs be in place as soon as possible, to assure that New Jersey's low-income consumers and other consumers with special needs share in the benefits of competition.

The importance of maintaining universal service as the natural gas market is restructured has been recognized in other states, including Pennsylvania, Georgia and Ohio. Pennsylvania's natural gas restructuring legislation requires the Pennsylvania Commission to "ensure that

universal service and energy conservation policies, activities and services are appropriately funded and available in each natural gas distribution service territory," and each utility's restructuring filing is required to include "an initial proposal to meet its universal service and energy conservation obligations." *Pa. Cons. Stat.,* §§ 2203(8) and (9). Under the Georgia legislation, the Georgia commission is required to create and establish appropriate funding for a universal service fund for each gas utility that elects to implement competition. *Ga. Code Ann.* § 46-4-160. The recently enacted Ohio energy restructuring legislation establishes a universal service fund within the State Treasury effective six months **before** the starting date for competition for Ohio's electric utilities. Am. Sub. S.B. No. 3, 123rd General Assembly, §§ 4928.01(A) (29); 4928.51 (1999).

A number of states are pursuing aggregation as a means of assuring that low-income consumers receive the benefits of competition. Vermont, in November 1999, received a grant from the United States Department of Health and Human Services to fund development of a "Consumerco," a not-for-profit buyers' cooperative offering comprehensive energy services to all consumers regardless of income. In New York, Chautauqua and Erie Counties have aggregated 8,000 low-income customers of National Fuel Gas. Ohio also has been active in promoting aggregation of low-income consumers. The Ohio Commission in 1998 directed three of its gas utilities with unbundling programs to issue requests for proposals to provide gas supply service to their Percentage of Income Payment Plan ("PIPP") customers on an aggregated basis. *In the Matter of Commission's Investigation of the Customer Choice Program of Columbia Gas of Ohio*, Case Nos. 98-593-GA-COL *et al.* Finding and Order at 24-26 (June 18, 1999) (RAA75-77). The Ohio Order required the utilities to request bids based on alternative forms of pricing

other than straight percentage discounts. *Id.* at 25-26 (RAA76-77). Columbia Gas Company has also implemented an aggregation project for its low-income consumers in Pennsylvania. The recently enacted Ohio energy affirms the soundness of this approach by authorizing the Director of Development in the Ohio State Treasury to aggregate low-income electric consumers. Am. Sub. S.B. No. 3, 123rd General Assembly, § 4928.54 (1999) (RAA79).

Universal service is equally important for the citizens of New Jersey. Natural gas service for New Jersey's disadvantaged consumers, through comprehensive programs, should include aggregation and other innovative approaches to accomplish this objective in the most economic manner. The Board should therefore establish a specific timetable for the submission and consideration of universal service proposals, and their implementation.

IV. COMPANY-SPECIFIC RECOMMENDATIONS

[See separate company-specific briefs.]

V. CONCLUSIONS

For the foregoing reasons, the Board should adopt the following generic policies and standards to be applied to the company-specific filing under consideration in these proceedings.

1. BGSS service should be subject to monthly adjustments in order to eliminate or minimize over- and under-recovery balances that are carried over from year to year under the currently existing LGAC mechanism, and the utilities should engage in hedging to protect against volatile gas prices. As the competitive market develops, BGSS should evolve to a mechanism which more closely tracks market rates.

2. The utilities should be prohibited from offering fixed price and other "enhanced pricing" options as part of "BGSS." The Act prohibits the utilities from offering such options, which would hinder the development of a competitive market. Under the Act, competitive pricing options may be offered by a marketing affiliate, but not through the utility.

3. Switching fees are a roadblock to choice which should be eliminated for residential and small commercial customers.

4. Enrollment restrictions including limited enrollment periods, minimum aggregation requirement for third party suppliers, a minimum terms for customers who return to BGSS should be eliminated because they will obstruct customer choice.

5. For residential and small commercial customers, the BGSS rate should be the same for customer who remain on BGSS service and those who return to the utility after taking service from a third party supplier. Discriminatory rates for returning BGSS customer, and provisions which hold customers responsible for third party supplier defaults, are roadblocks to competition which should be prohibited.

6. The objective of unbundling should be the creation of a vibrant competitive market, which will attract competitors to New Jersey by making it possible to offer savings to consumers. BGSS rates should include the gas supply costs that are currently embedded in the utilities' base rates. In addition, a share of margin revenues from on-system and off-system sales and capacity release should be used to create viable shopping credits. Alternatively, a shopping credit could be created by transferring the revenues associated with a 1 percent (100 basis point) return on equity from each utility's distribution rates to its BGSS rates.

7. The utilities' proposed mechanisms for automatic recovery of "lost revenues" and incremental costs claimed to be associated with the implementation of competition should be rejected as an unwarranted windfall for the utilities. The proper mechanism for the recovery of lost revenues and incremental costs for regulated monopoly services continues to be a base rate filing.

8. The utilities should be required to implement options that will open more of the component parts of gas supply service to competition. For residential and small commercial customers, the utilities should be required, at a minimum, to offer "monthly requirements" service by January 1, 2000, and an additional "daily requirements service" option by October 1, 2000.

9. The utilities' tariff should set forth distribution gas supply rates separately, and in a clearly understandable manner. Customers should be able to easily ascertain their shopping credits. The utilities' tariffs should be available on their websites. The utilities' unbundled rates and shopping credits also should be clearly understandable on customers' bills. In order to reflect the way balancing services will actually be selected, balancing should be offered and billed to third party suppliers rather than directly to residential and small commercial customers.

10. Third party suppliers will need access to the utilities' interstate pipeline and storage capacity in order to be able to provide a full range of services to their customers. As customers choose third party suppliers, capacity which the utilities no longer need to serve these customers should be made available to third party suppliers on a non-discriminatory basis at the utilities' weighted average cost of capacity.

11. The utilities should not be permitted to require third party suppliers to take assignments of capacity. Mandatory assignment impeded competition by restricting third party suppliers from making their own capacity arrangements when more economic alternatives are available.

12. Mandatory assignment is not necessary to ensure reliable service. If a utility believes that economic penalties and tools such as short-term purchases, storage services, no-notice services, the use of peak-shaving facilities, and recall of released capacity are not sufficient to maintain reliable service on its system, the utility can be implement "comparable capacity" requirements rather than mandatory capacity assignment.

13. The Board should adopt a policy that requires utilities to pursue all available means for avoiding and mitigating stranded costs before mandatory assignment and other stranded cost recovery mechanisms are considered. In the event stranded costs occur despite these measures, the utility should be required to file a petition demonstrating that it has pursued all such measures, and only then should the Board evaluate possible remedies, including, as a last resort, mandatory capacity assignment.

14. The utilities' existing margin sharing mechanisms for off-system sales and capacity releases are, to differing degrees, antithetical to competition, because they contain incentives for the utilities to stockpile unneeded capacity. The Board should initiate a proceeding to review, and modify any provisions found to be inconsistent with the Act's objectives.

15. The utilities should be required to identify and quantify the cost of their existing social programs for inclusion in their SBCs, including that portion of their uncollectibles that is attributable to Board-approved social programs. Public Service's proposal to include all of its uncollectibles in its SBC should be rejected as an unjustified windfall for the company.

16. In order to provide accountability for consumer education costs, the utilities should be required to provided detailed descriptions and quantifications of the consumer education costs they are proposing to include in their SBCs.

17. The utilities' requests for two-way interest their SBCs should be considered by the Board on a component-by-component basis, and one-way interest should be preserved at least for those components as to which utilities are not now allowed to recover interest on under-recovery balances.

18. To the extent the Board allows two-way interest on SBC components, the rate should be a short- or intermediate-term debt rate.

19. Deferred accounting should be allowed initially only for those SBC components for which there is an existing Board Order authorizing deferred accounting.

20. The review and reconciliation of the utilities' SBCs should be on an annual basis, as part of the proceedings to be established by the Board to review the utilities' BGSS rates under section 10(r) of the Act.

21. The Act establishes the SBC as a universal charge for all gas and electric customers. This requires the elimination of the currently existing exemptions and special rates applicable to some SBC components.

22. The utilities should be required to submit, by a date certain and with penalties for non-compliance, complete studies of unbundled costs for customer account services, on both an avoided and embedded cost basis.

23. The utilities should be required to make available to government aggregators and to consumers the information that is needed to facilitate government aggregation in accordance with the Act and the Board's Interim Government Energy Aggregation Program Standards.

24. The Board should establish a specific timetable for the submission, consideration and implementation of the utilities' universal service proposals. These should include proposals to facilitate the aggregation of low-income customers.

The above 24 points reflect the Ratepayer Advocates' generic portions on gas unbundling and restructuring of the natural gas industry in New Jersey pursuant to the Competition Act. The company-specific recommendations which are being submitted in as part of this brief set forth those aspects of the utilities' filings which are inconsistent with the above policies and standards, which have been identified based upon the Ratepayer Advocate's review of the filings. In addition to the specific changes recommended in the company-specific recommendations, the Board's Order should include findings on the above generic issues, and the utilities should be directed to ensure that the tariffs to be implemented on January 1, 2000 are consistent with the Board's generic determinations. Our goal should be a healthy, robust natural gas marketplace

with choices for all consumers and with the opportunity for both utilities and third-party suppliers to provide more efficient and lower cost services.

Respectfully submitted,

BLOSSOM A. PERETZ
RATEPAYER ADVOCATE

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By: Sarah H. Steindel
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Date: November 16, 1999