IEPNJ
INDEPENDENT ENERGY PRODUCERS OF NEW JERSEY

ADAM KAUFMAN • EXECUTIVE DIRECTOR 609·514·2700

August 15, 2002

Mr. Jess Melanson
Policy Advisor to the Governor
Office of the Governor
State House
West State Street
P.O. Box 001
Trenton, New Jersey 08625-0001

Dear Mr. Melanson:

On behalf of the Independent Energy Producers of New Jersey (IEPNJ), I am pleased to provide the attached responses to the questions posed on August 8, 2002 by the Governor's Deferred Balances Task Force. The IEPNJ is a not-for-profit trade association representing New Jersey's wholesale power producers.

Please do not hesitate to contact me for clarification or for additional information.

Sincerely,

Adam Kaufman
Executive Director

cc: IEPNJ Executive Board

Attachments

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Response of the Independent Energy Producers of New Jersey To Questions Posed by The Governor's Deferred Balances Task Force

August 15, 2002

Introduction

A leading industry advocate for a competitive and environmentally responsible wholesale power industry, the Independent Energy Producers of New Jersey (IEPNJ) is a not-for-profit trade association representing New Jersey's electric power producers.

IEPNJ represents generators of electricity. Members include companies that provide electricity for on-site use at academic, governmental, industrial and commercial facilities, as well as national and international corporations which own power plants that sell electricity into the wholesale market for retail consumption by New Jersey's homes and businesses.

IEPNJ and its members have been in the forefront of the dramatic changes that are continuing to transform New Jersey's power industry. Since 1992, IEPNJ has worked with state policy makers, as well as utilities and environmental and consumer groups to promote sound energy policy in New Jersey.

IEPNJ appreciates this opportunity to respond to the following questions, which have been posed by the Governor's Deferred Balances Task Force, and looks forward to assisting the Task Force in its deliberations.

Q1: Did you or your organization take a position on EDECA, and specifically on the issues relating to deferred balances, before the Act was passed? If so, please describe.

A: The IEPNJ has been an active participant in all aspects of industry restructuring, from Board of Public Utilities' (BPU) restructuring working groups in the mid-1990s through the current BPU proceeding that will establish procedures for obtaining supply to serve Basic Generation Service (BGS) customers from August 2003 and thereafter.

IEPNJ supported electric restructuring as a whole and took strong positions during the legislative process on matters specifically affecting members' interests. As such, the Association actively worked with the Governor's Office, BPU, state legislators, New Jersey's energy utilities, and other stakeholders with regard to the Electric Discount and Energy Competition Act ("EDECA") on issues affecting on-site generation and members' power purchase agreements, including the buyout and buydown of such contracts. IEPNJ's efforts did not focus specifically on issues associated with utility deferred balances. IEPNJ supported the passage of the final version of EDECA as it addressed the issues most directly affecting its members' interests

Q2 Were there provisions relating to deferred balances that you or your organization opposed and/or believed should have been included in EDECA but were not? For example, some organizations opposed the imposition of rate caps, while others supported a levelized adjustment clause or a trigger mechanism to prevent mandated rate reductions if savings from competition were not realized.

A As stated in response to Question 1, IEPNJ's efforts with regard to EDECA did not focus specifically on the issue of utility deferred balances The final version of the EDECA represented the product of a complex and lengthy give-and-take process amongst many diverse interest groups and stakeholders While undoubtedly, like other groups, IEPNJ could have taken issue with individual provisions of this lengthy piece of legislation, IEPNJ supported the passage of the final version of the EDECA as a compromise bill that represented sound public policy and that addressed the issues of greatest importance to its members

Q3: What do you or your organization believe are the principal factors responsible for the accumulation of nearly $1 billion in deferred balances? Possible explanations include factors in the energy market unrelated to EDECA, certain provisions in EDECA, or utility management.

A: At the most basic level, utility deferred balances have accumulated, because, to varying degrees, the actual costs incurred by the electric utilities during the Transition Period have exceeded the level of recovery provided for under the rates charged by utilities after the imposition of the mandated rate reductions and price freezes. When one examines the various components of the electric utilities' rate structure, IEPNJ believes that the principal factor that can be identified as being responsible for deferred balances is the significant increase in wholesale energy prices in the Mid-Atlantic region beyond levels that were forecasted in the electric restructuring proceedings conducted before the BPU during the 1997-99 timeframe.

The various unbundled components of electric utility rates include generally two categories: wires charges and the cost of power. The wires charges include the cost of operating and maintaining the distribution system and the cost of various social programs. These costs were generally known at the time rates were set in 1999 and are fairly predictable. Similarly, the costs associated with existing long-term power purchase arrangements with non-utility generators are largely predictable; they were known and taken into account at the time unbundled rates were established in 1999.

The major variable creating uncertainty in the utilities' cost structure during the Transition Period has been the cost of purchasing power to provide basic generation service to those customers that did not switch to a third party supplier. This cost represents roughly half of a customer's bill under the rate cap.

As it turned out, the cost to the utilities of purchasing power has been volatile, and has increased to levels above that provided for under the capped rates. Forecasts upon which New Jersey's rate reductions and shopping credits were based anticipated that spot energy prices on a per megawatt hour basis in 2001 would reach about $22/MWh on an annual basis in the PJM region. In fact, actual energy costs for PJM east in 2001 averaged over $40/MWh. (See Attachment)

In turn, the cost of wholesale power rose as, among other reasons, the cost of fuel needed to generate that electricity increased more dramatically than anticipated in 1998, when New Jersey's rate reductions were being formulated. The cost of natural gas, which fuels the production of electricity at many power plants, rose to $4.39/MMBtu on average in 2001, compared with 1998 forecasts that anticipated natural gas would cost $2.44 at the wellhead in 2001.

As energy prices rose, so, too, did the levels of rate discounts utilities were obligated to pass on to retail customers under EDECA and the restructuring settlements the utilities and other parties had negotiated. As the Task Force is aware, EDECA mandates that each electric utility provide at least a 10% reduction in rates to all customers. Restructuring settlements approved by the BPU authorize those reductions to be phased-in over a three-year period, with the maximum reduction extended through July 2003. This increasing discrepancy between reduced retail prices and increased wholesale prices has led to rising deferred balances.

The impact of the cost of purchased power on the level of deferred balances can best be demonstrated by the discrepancies in the magnitude of deferred balances among the various electric utilities. To the extent a utility was able to lock-up its power supply at a fixed price for the first three years of the Transition Period (at prices consistent with the forecasts conducted in 1998), its deferred balance will be relatively small. New Jersey utilities that were required to purchase power in the open market as wholesale prices escalated now face relatively larger deferred balances.

It should be noted that much of the volatility and price spikes occurred during the early part of the Transition Period. Wholesale prices have abated more recently, as demonstrated by the results of the state-wide auction conducted to procure BGS supply for the August 2002 through July 2003 period.

It is also important to emphasize that New Jersey's electric utilities employ different mechanisms to account for the deferred balances. In some cases, these accounting mechanisms result in the deferred balances showing up as deficits in stranded cost recovery, such as deficits in the Non-utility Generation Transition Charge ("NTC") clause designed to recover costs associated with long-term power purchase agreements between non-utility generators and utilities.

What is important to understand is that such circumstances are a product of these accounting conventions, and do not reflect the actual causes of the deferred balances. The simple fact is that NUG costs associated with long-term contracts have come in largely as predicted, while recent wholesale power costs have been higher than forecasted. The costs associated with long-term power agreements between New Jersey utilities and non-utility generators were known and accounted for in utility rate structures established in 1998 and have not risen significantly since then Indeed, IEPNJ members and New Jersey utilities have thus far renegotiated six existing long-term power purchase agreements, resulting in a reduction of $323.7 million in the Market Transition Charge paid by all utility customers (on a net present value basis based on BPU projections) Absent these renegotiations the deferred balances would have been even larger than they are today.

Q4 Are there specific remedies that you or your organization support to address the issue of deferred balances? Do you or your organization support the securitization of deferred balances as allowed for by S-869?

A: IEPNJ does not oppose the securitization of deferred balances as allowed for by S-869, to provide the BPU with an additional tool to mitigate the impacts of the deferred balances on customers.

Q5: What are you or your organization's views on the process by which deferred balances should be investigated and heard by the Board of Public Utilities?

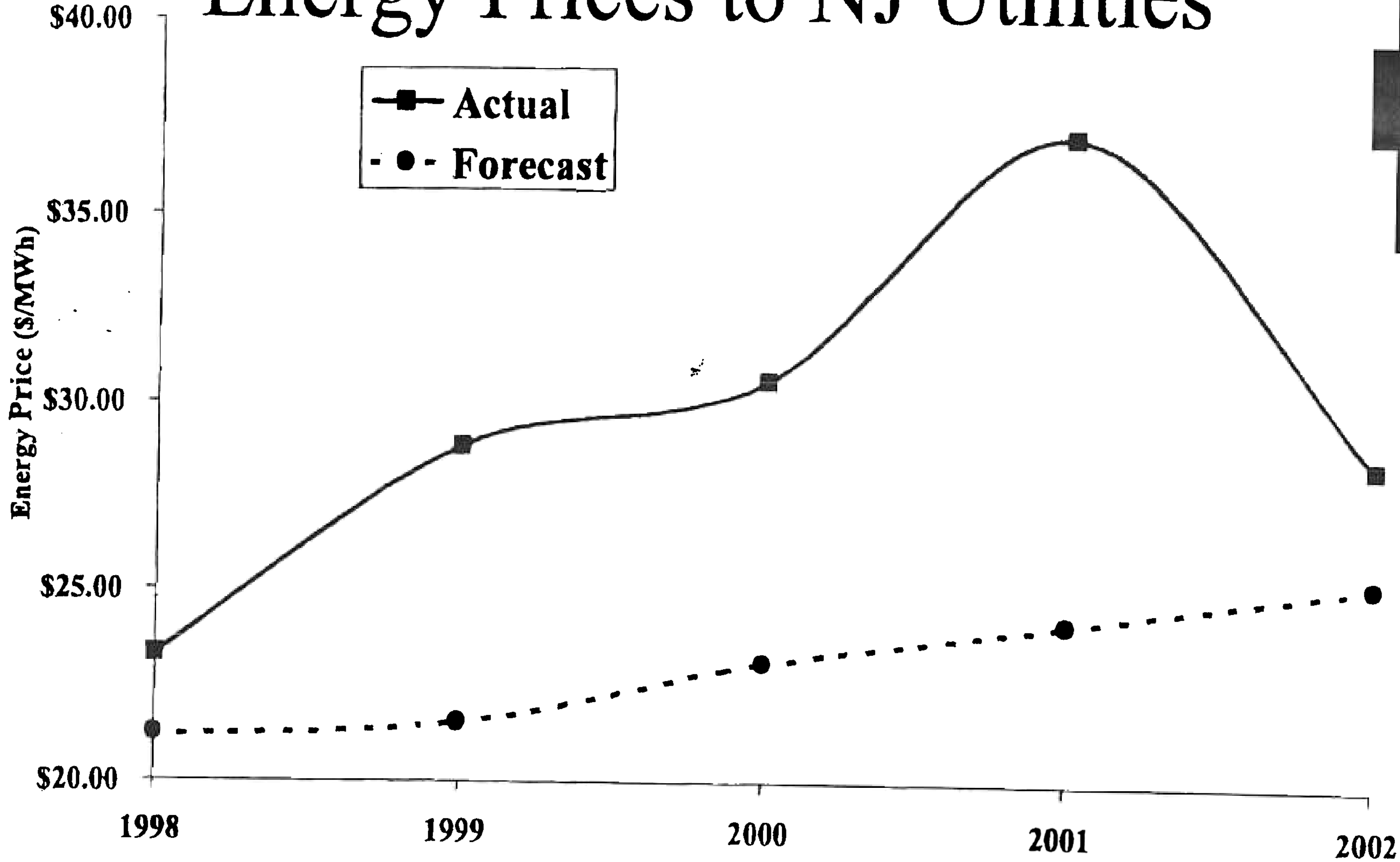
A: IEPNJ supports the process thus far established by the BPU to investigate and to establish proceedings to evaluate utility requests for recovery of deferred balances.

The BPU has issued an RFP to retain an independent consultant to audit each utility's deferred balances. IEPNJ understands that stakeholders will have the opportunity to review the audit results and question the auditors – as well as utility witnesses - as part of the cross-examination that is an integral component of the BPU's deferral proceedings. The IEPNJ supports this measure and believes that it will provide much needed transparency to the Board's review of utility deferrals

IEPNJ also understands that the BPU will evaluate in tandem utilities' requests for recovery of deferral balances and separate petitions seeking increases in base rates (i.e., wires charges). IEPNJ also supports this decision, because there is no other way in which the BPU can estimate total utility rate increases requested and their impact on customers.

It should be noted that the BPU will be evaluating four requests for increases in base rates and four requests for recovery of deferred balances, which all must be decided before August 2003. Given the intensity and voluminous nature of the work associated with developing and reviewing testimony, discovery and briefs for these eight proceedings, IEPNJ would support any requests by the BPU to retain additional staff to assist the Board in its decision making

Actual vs. Forecasted Wholesale Energy Prices to NJ Utilities



Source: Utility forecasted energy price in 1997 based on average of PSE+G, ACE, and GPU.

Actual energy costs for PJM East (based on average Locational Marginal Pricing data through Aug 12, 2002).