



State of New Jersey

DIVISION OF THE RATEPAYER ADVOCATE
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JON S. CORZINE
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SEEMA M. SINGH, Esq.
*Ratepayer Advocate
and Director*

April 6, 2006

Via Hand Delivery

Honorable Kristi Izzo
Board of Public Utilities
Two Gateway Center
Newark, NJ 07101

Re: I/M/O the Provision of Basic Generation Service for
The Period Beginning June 1, 2007
BPU Dkt. No. EO06020119

Dear Secretary Izzo:

Enclosed for filing please find an original and ten copies of the Division of the Ratepayer Advocate's Initial Comments in the above-referenced matter.

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

We are enclosing one additional copy of the materials transmitted. Please stamp and date the copy as "filed" and return it to our courier. Thank you for your consideration and assistance.

Sincerely yours,

SEEMA M. SINGH, ESQ.
RATEPAYER ADVOCATE

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Diane Schulze, Esq.
Assistant Deputy Ratepayer Advocate

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c: President Jeanne M. Fox, (via hand delivery)
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**I/M/O the Provision of Basic Generation Service (“BGS”) for
The Period Beginning June 1, 2007
BPU Docket No. EO06020119
Initial Comments of the Division of the Ratepayer Advocate**

April 6, 2006

The Division of the Ratepayer Advocate (“Ratepayer Advocate”) is filing these initial comments pursuant to the procedural schedule established by the Board of Public Utilities (“Board” or “BPU”) in its Order dated March 24, 2006. These comments address the seven issues raised by the Board. In Attachment A to the Order, the Board noted that “Parties may provide additional comments pertaining to the philosophy, structure or implementation of a BGS procurement process.” Limited additional comments related to the procurement process are included in these comments.

1) What should be the goal of the Board’s BGS procurement process?

Response: Goals may differ for the two BGS services—CIEP and FP. Here, and in all other responses, the focus will be on BGS-FP. In procuring BGS-FP service, the Board should balance two goals—least cost supply and price stability—giving each equal weight.

2) What type of procurement process should be employed to best achieve this goal?

Response: The goals for BGS-FP procurement can be met using a variety of procurement processes, including a modified version of the auction used currently in New Jersey. The Board should reconsider “tick down on ties” and “pay as bid,” two options raised by the Ratepayer Advocate in its initial, year 3 BGS comments filed August 20, 2004. In addition, the Board should consider supplementing the auction as discussed in response to 3) below.

In the BGS auction, prices “tick down” throughout the auction, starting high and being reduced gradually until the supply bid is just sufficient to meet the load to be procured. However, prices do not tick down when the number of tranches freely bid equals the number of tranches desired. (Such equality is the “tie.”) It is the Ratepayer Advocate’s recommendation that the auction rules be modified so that, when there is a tie, the price for that product does “tick down.” The reason for proposing this change is quite simple: failure to tick down on ties is unfair to the customers who pay the prices produced by the auction. The auction process should attempt to determine if the supply needed can be procured at a price lower than the one accepted when there is a “tie.” In that way, the EDC’s customers would receive their BGS supply at the lowest price acceptable to the bidders and the Board. The current process does not attempt to determine if there is a lower acceptable price. That “flaw” can be cured by ticking down when there is a tie.

The Ratepayer Advocate also recommends that the Board adopt a “pay-as-bid” procedure for compensating the winning bidders. Winning bidders should be paid the lowest price they freely agreed to accept, not the highest price accepted for the product. This is more appropriate for the BGS auction where the goal is to minimize prices for customers who essentially have no alternate suppliers available to them. In the past there has been controversy concerning the view of “pay-as-bid” in the economics literature. In this regard the Ratepayer Advocate would draw the Board’s attention to the testimony of Dr. Arthur B. Laffer, a well-known economist who has worked professionally in the area of auctions. In the hearing in Illinois, dealing with a proposed auction similar to that conducted in New Jersey, Dr. Laffer commented as follows:

I recommend a pay as bid approach to be used in order to make ComEd’s proposed auction both more competitive and more likely to achieve a lower cost of electricity supply.¹

The most recent BGS auction produced a very substantial increase in the average price of electricity. Looking ahead, due to 3-year contract averaging, even a continuation of last year’s auction prices will produce continuing increases in the average cost. Adopting tick down on ties and pay as bid could help offset these increases. The Ratepayer Advocate urges the Board to make these changes unless it is presented with compelling evidence that these changes will have an effect which fully offsets the reductions in cost which, on their face, these changes could provide.

3) What is the appropriate term for which bids should be sought?

Response: As a basis for an auction, the current system of three-year contracts provides a reasonable balance between least cost supply and price stability. The key issue is whether there should be a BGS portfolio which includes other resources—Demand Response, Long-Term (i.e., 10 to 25 year or even “Life of Plant” Contracts, etc.) —in addition to contracts procured through an auction. The Ratepayer Advocate recommends that such a portfolio approach be considered. Each resource included in the portfolio should be subject to a separate procurement process which allows its characteristics to be fully taken into account. With the portfolio, the auction would work exactly as it does now. However, the size and/or number of tranches sold at auction would be based on load net of the contribution from the other resources in the portfolio.

¹ Direct Testimony of Dr. Arthur B. Laffer on behalf of The Building Owners and Managers Association of Chicago, *I/M/O Commonwealth Edison Company Petition to Implement a Competitive Procurement Process by Establishing Rider CPP, Rider PPO-MVM, Rider TS-CPP and revision Rider PPO-MI*, Docket No. 05-0159.

In considering the proposed BGS Portfolio, the Ratepayer Advocate asks the Board to take into account the fact that, in 2004, Comverge, a commercial provider of DSM, provided comments suggesting that Demand Response be part of “New Jersey’s overall energy portfolio.” The Ratepayer Advocate would also ask the Board to consider carefully the desirability of longer-term contracts, even if they prove hard to secure, given the volatility seen recently in the shorter term (i.e., 3-year contract) market.

- 4) *Please provide your opinion on the meaning of and need for transparency in a BGS procurement process. What, if any, additional features should be added that do not currently exist?*

Response: According to Webster’s *New Collegiate Dictionary*, something is transparent if what lies beyond it is entirely visible. The BGS procurement process should, to the extent possible, be transparent in exactly that sense. Such transparency is particularly important for BGS-FP service. Electricity is a necessity of modern life. For all practical purposes, there is no alternative to BGS-FP service for small (i.e., low monthly usage) customers. There are two key aspects to transparency as it relates to the BGS-FP auction. These involve the details of the auction process, and the supply arrangements of the auction winners. The remainder of this response addresses the first aspect. The second is addressed in the response to 5).

Today there are only three groups that have knowledge of the details of the BGS auction: NERA who runs the auction, BPU Staff who work closely with NERA, and CRA which reviews the auction conduct and results. For all others, the auction is a black box. This year the black box produced a price increase of over 50 percent. This dramatic price increase struck hard at the credibility of the auction, and more generally at the credibility of restructuring. As the government agency with the express mandate to advocate for rights of the ratepayers who must ultimately pay the electric prices the auction produces, the Ratepayer Advocate needs to be given more information about the auction process. Such information should include, at a minimum, complete, unredacted copies of all reports on the auction received by Board Staff. The Ratepayer Advocate should also have the right to ask the authors of those reports questions, should any arise. Without at least this level of information, the Ratepayer Advocate has no way to tell if the auction was implemented appropriately and if the results can be accepted as the basis for just and reasonable charges to New Jersey’s ratepayers.

- 5) *Should information about the bidder’s underlying supply contracts be available to the Board? Should this be a requirement of future BGS procurements? If you respond in the affirmative, you must answer questions 5a-e.*

Response: It is the Ratepayer Advocate’s position that information on underlying supply contracts should be available to the BPU, and to those who are privy to detailed auction information. Having made an affirmative response, the Ratepayer Advocate will, as requested, respond to the BPU’s specific questions:

a. *What information should be provided to the Board?*

Response: The source, cost, quantity, and terms and conditions for the supplies used to provide BGS service.

b. *When should this information be supplied?*

Response: It should be communicated as soon as the information becomes available, and updated whenever it changes.

c. *What is the purpose in having this information available to the Board?
How would you expect the Board to use this information?*

Response: The information would be used for two related purposes: to evaluate the concentration in ultimate sources of supply for BGS, and to see if such concentration is sufficient for the exercise of market power which could affect the cost of BGS service.

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

Response: Willingness to provide complete, accurate information on a timely basis (i.e., as it becomes available), should be a requirement for auction participation. Failure to be accurate, complete or timely should result in disqualification from participation in future auctions, and perhaps loss of current tranches for which information is not provided.

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

Response: Under the Open Public Records Act, proprietary or financial information obtained from any source is specifically excluded from the statutory definition of a government record. *N.J.S.A. 47:1A-1.1*. Information which, if disclosed, would give an advantage to competitors or bidders is also exempt. Accordingly, any such information provided by bidders in the BGS auction would not be subject to the public access requirements of the Open Public Records Act.

- 6) *How can the Board best ascertain and assure that power procured for BGS is purchased at prices consistent with market conditions in a competitive wholesale marketplace?*

Response: This question raises two separate issues: first, are the prices resulting from the BGS-FP auction consistent with prices in the market, and, second, is the market itself competitive? To address the first, one needs to make careful comparisons, to prices seen in other recent procurements and to the PJM spot market. The Ratepayer Advocate routinely conducts such an assessment. As part of an improved sharing of auction information between the Board and the Ratepayer Advocate, along the lines discussed in response to issue 4) above, the Ratepayer Advocate would be willing to make available to the Board, the auction report prepared annually for the Ratepayer Advocate by its consultant.

Determining if the market is competitive is a more difficult issue. The BGS-FP auction is part of a market for Standard Offer Service Supply which could be subject to market power even if the underlying (i.e., PJM) markets are competitive. New methodologies and data sources may be needed to determine whether the Standard Offer Service Supply market is competitive. Assessment of the extent of competition in the market for Standard Offer Service Supply might best be addressed jointly by those who rely substantially on procurements from that market (i.e., NJ, DE, MD, and DC) and the PJM-MMU. The Ratepayer Advocate recommends that the Board initiate such a group effort.

- 7) *If the Board were to initiate a review of the Supplier Master Agreements, which issues would you want the Board to revisit? Please identify the areas of the Supplier Master Agreement, by Article and Section, which may be impacted. Do not include detailed arguments on the issues, at this time.*

Response: The Ratepayer Advocate has in the past, submitted comments concerning the pass-through of transmission rate increases to ratepayers. Such pass-through violates the Ratepayer Advocate's previously stated goals for BGS—least cost supply and price stability. The likelihood of least cost supply is enhanced without pass-through because suppliers are better motivated to participate in FERC proceedings and therefore more likely to win on the merits of cases where transmission rate increases are reviewed. Price stability will also be enhanced because the rates will not fluctuate during the contract period as they do now. In order for the Board to change its policy and require suppliers to take the transmission rate risk, the Board must amend the FP Supplier Master Agreement.

In addition to the preceding comments, the Ratepayer Advocate notes that changes might be required to address the issues of transparency of supplies discussed above in the response to the BPU issue 5). At a minimum the FP Supplier Master Agreement would have to be amended to require accurate and complete disclosure of the

supply arrangements for BGS-FP suppliers, and to provide appropriate penalties if such disclosure does not occur.