I/M/O the Provision of Basic Generation Service ("BGS") for the Period Beginning June 1, 2006
BPU Docket No. EO05040317
Comments of the Division of Ratepayer Advocate
Presented at a
Hearing at the Board of Public Utilities
in Newark, New Jersey on
September 7, 2005, 10:00 a.m.

Good morning, Commissioner. My name is John Stutz. Today I am appearing on behalf of the Ratepayer Advocate who filed initial comments in this case on August 19, 2005. I will explain and support those initial comments. I and Diane Schulze are also available to respond to any questions you may have about any of the Ratepayer Advocate's comments.

Revenues from the Retail Margin

Retail Margin revenues collected from customers over the past two years amount to approximately $25 million. The Ratepayer Advocate recommends that funds these be returned to all customers in the rate classes from which they were collected through a new Retail Margin Adjustment Clause (RMAC). The proposed RMAC would flow Retail Margin revenues back through a rate class-specific, mills-per-kWh credit set annually.

The Retail Margin provides an incentive for customers to obtain and retain competitive electricity supply. Retail competition is a means, not an end. The end is the provision of safe, reliable electric service to New Jersey ratepayers at the lowest reasonable price. The Ratepayer Advocate understands that energy prices need to rise somewhat in the short run so that a retail market, which will hopefully provide lower prices to consumers in the long run, has a fair opportunity to develop. However, in the long run, the market must be able to "beat" the price of BGS if retail competition is to provide lower prices over the long run for New Jersey energy consumers. With this point in mind, the Ratepayer Advocate suggests that the Board consider setting a date by which the Retail Margin will be abolished.

ACE Proposal: Profit from BGS

Atlantic City Electric Company ("ACE"), in its Company Specific Addendum, has proposed that the Retail Margin be extended to all rate classes and that ACE be allowed to retain a portion of the resulting revenues, to compensate the Company's shareholders for providing BGS. The Ratepayer Advocate urges the Board to reject ACE's proposal.

There are basic conceptual problems with the ACE proposal. The provision of service by a distribution utility with a monopoly franchise, such as ACE, is paid for at cost. ACE argues that, like an unregulated retail business, it should be allowed to earn a "margin," that is a mark-up on wholesale (i.e., BGS supply) costs. Unregulated businesses do not provide a reasonable basis for comparison with a regulated utility. ACE also claims that there are "risks" associated with the provision of BGS. The risks identified by ACE focus on the possibility of a legislative or Board-approved disallowance. As a matter of regulatory policy, ACE need not and should not be protected from or compensated for the asserted risk of unfavorable regulatory or legislative decisions. Further, there is the very practical problem that ACE has not provided a reasonable basis for the specific charges it proposes to impose or the revenues it expects to receive. In particular, ACE has not produced an analysis showing that the revenues requested are reasonable given any risks it might face. The range of mark-ups cited by ACE is very wide. ACE offers no basis on which to select the "right" mark-up for BGS, assuming any mark-up is warranted.

Finally, it is important to note that ACE's proposal extends the Retail Margin to residential and commercial customers, raising the cost of BGS-FP to them by about $13 million per year. There is no evidence that the amounts proposed will do what the Retail Margin was intended to do—move customers into the competitive retail market. In fact, there is no evidence, and no reason to think that residential or commercial retail supply would be available at the BGS-FP price plus 2 to 4 mills. Use of the Retail Margin in a situation where it is very likely to fail in its intended purpose will weaken the public's support for the Board's ongoing efforts to develop a retail market.

Expansion of the CIEP Class

It has been suggested that the CIEP class be expanded to include all customers with a peak load share of 750 kW or above. Two arguments have been put forward to support this proposal:

- CIEP service has proved to be an effective inducement for very large customers to take competitive retail service. Thus, it is suggested, expansion will help develop the retail market.

- It is suggested that expanding CIEP service will increase demand responsiveness, and so help the electricity markets function better.

The Ratepayer Advocate has considered these arguments and the evidence offered to support them. With each argument, there are serious problems. The Ratepayer Advocate recommends that, at least until these problems are addressed satisfactorily, the CIEP class not be expanded.

Turning to the first argument, the Ratepayer Advocate notes that expansion of the CIEP class would make BGS-CIEP the only non-market alternative for customers with lower demand, usage and electricity costs than those previously on BGS-CIEP service. In response to discovery, PSE&G provided data showing that while 63 percent of all CIEP eligible customers have gone to a Third Party Supplier (TPS), only 34 percent of the "new" CIEP eligible customers, added due to the reduction of the CIEP threshold in June 2005, have gone to TPS. This shows that lowering the threshold is becoming less effective as a means of moving customers to the market. In addition, the New Jersey Food Council (NJFC), the only party speaking directly on behalf of smaller customers who might eventually be added to BGS-CIEP service, opposed BGS-CIEP extension. The NJFC pointed out that the customers they represent can neither obtain service in the retail market at the cost of BGS plus the Retail Margin, nor do they have the ability to efficiently manage their load in response to price signals. Thus, in NJFC's view, extension of CIEP to those they represent would create "pure hardship." In light of this information, the Ratepayer Advocate is concerned that shifting smaller customers to BGS-CIEP may produce little movement to the competitive service and result in increased customer dissatisfaction. Similar concerns were raised by PSE&G.

The second argument concerns the enhancement of demand responsiveness. When considering this argument, it is useful to note that hourly pricing is not the only, and may not be the best, way to improve demand responsiveness. The Literature Search performed by the Rutgers' Center for Energy, Economic & Environmental Policy, ("CEEEP") and filed by the Retail Energy Supply Association made this point quite clearly. The Ratepayer Advocate notes that the Board is currently exploring various time of use rate options and suggests that the Board keep an open mind as to whether such options may be preferable to hourly pricing for some customers over the long run.

At this time, the evidence supporting expansion of the mandatory BGS-CIEP class is unconvincing. Expansion runs the risk of creating customer dissatisfaction with competition as a whole. There are useful things to be learned from on-going rate experiments, things which may affect the choice of limits for CIEP service. Accordingly, the Ratepayer Advocate urges the Board not to lower the BGS-CIEP threshold at this time.

BGS-FP Supply Contract Duration

One-third of the electricity required for BGS-FP service is currently procured each year in the form of three-year contracts. This minimizes the exposure of those small customers taking BGS-FP service to abrupt shifts in the market price of electricity. To see the importance of protection from such shifts, the Board need only consider the events of the last year, in New Jersey and elsewhere.

In New Jersey, when last year's BGS-FP auction prices increased by about 20 percent, the impact on customers was limited because the increase only affected one-third of the supply. In other jurisdictions which rely on short-term supply arrangements, the impact of abrupt increases in the cost of electricity was far different. In Maine, where supply is procured on a six-month basis, rate hikes of 22 to 27 percent will be seen by customers of the two largest utilities in the state. In Rhode Island, customers taking Last Resort Service supplied via short-term contracts, will see increases of 41 percent between September 2005 and February 2006.

It is the Ratepayer Advocate's position that the approach taken by the Board is appropriate, and indeed necessary to provide reasonable price stability to the small customers taking BGS-FP service. The Ratepayer Advocate urges the continued use of hedging such as the use of "rolling" sets of three-year contracts as the basis for BGS-FP supply.

Bidding Arrangements

In its initial proposals, the New Jersey Large Energy Users Coalition (NJLEUC) pointed out that PSE&G may have the ability to "game" the BGS-FP and BGS-CIEP auctions. The NJLEUC asked the Board to require each qualified BGS bidder to disclose to the Board and its auction consultant, on a confidential basis, the source(s) of power to be bid into the auction; and to authorize the Board to take appropriate remedial action if the disclosures reveal that a supplier, in the dual capacity as qualified bidder and common supplier to other qualified bidders, may be able to "game" the auction, adversely affect competition or exercise market power in the auction, or artificially inflate auction prices.

The Ratepayer Advocate lacks sufficient evidence to join in this recommendation. However, it is clear to the Ratepayer Advocate that the issue raised by the NJLEUC is worthy of careful Board consideration before the pending PSE&G merger is ruled on by the Board.

Pass-Through of Transmission Rate Increases

The Master Supply Agreement filed jointly by the EDCs embodies current Board policy, allowing the automatic pass-through of transmission rate increases to BGS customers. However, the Board has expressed an intent to re-examine this policy. The Ratepayer Advocate appreciates the Board's willingness to review this policy and would like to express its concern that the current "pass-through" policy will have an adverse effect on the development of retail competition in the state.

Retail electricity suppliers are affected by changes in transmission charges which current Board policy allows wholesale suppliers to directly "pass through" to BGS customers. This creates an advantage for wholesale suppliers, allowing them to avoid a risk that retail suppliers cannot avoid. It is the Ratepayer Advocate's position that the current policy is harmful to the development of a retail market in New Jersey. If instead the Board were to require the BGS suppliers to absorb the transmission rate risk, this would allow retail suppliers to offer "competitive" fixed price service which includes the cost of the transmission rate related risks, and to offer lower priced service on which the customer accepts the transmission rate risk. This change is similar to, but broader than, a proposal made by the EDCs, that suppliers to the CIEP class bear the risk of changes in OATT rates. It is the Ratepayer Advocate's position that anti-competitive effects are minimized if all suppliers—BGS-FP, BGS-CIEP, and retail providers—face the same risks associated with transmission rate charges. This can best be accomplished by eliminating any pass-through of such charges by BGS suppliers.