I/M/O the Provision of Basic Generation Service ("BGS") for the Period Beginning June 1, 2006
BPU Docket No. EO05040317

Initial Comments of the Division of the Ratepayer Advocate

August 19, 2005

Introduction

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 May 5, 2005 Order.[1] These comments address issues raised by the Board in its May 5 Order as well as issues raised by various parties in their submissions filed with the Board on or about July 1, 2005. The Ratepayer Advocate also intends to file a final set of comments by the required date, currently September 13, 2005.

Revenues from the Retail Margin

It is the Ratepayer Advocate's understanding that the uncommitted portion of the Retail Margin revenues collected from customers over the past two years has grown to approximately $25 million. The Ratepayer Advocate recommends that these funds 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 to the rate classes which provided them through a class-specific, mills-per-kWh credit, set annually to clear the beginning year balance for each rate class.

To see why this is preferable to other alternatives—retention of the funds for Board-approved purposes or return of the funds in some other fashion—it is useful to review briefly the impact of the Retail Margin. Generally, the price of BGS is the level against which a customer of utility-procured generation service will evaluate competitive service offers from third party suppliers. Imposition of the Retail Margin raises the price below which competitive service is economically attractive, from the price of the applicable utility procured service (BGS–CIEP) to the price of that service plus 5 mills per kWh. Both those taking BGS-CIEP and those going to the market have their price for electricity raised by the operation of the Retail Margin. Unlike most Board- approved charges, there are no costs to be covered by the Retail Margin. The purpose for the charge is to help retail competition to develop, not to cover costs.

With these points in mind, it is not hard to see the appropriateness, equity, and efficiency of the Ratepayer Advocate's proposal:

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[1] *I/M/O the Provision of Basic Generation Service for the Period Beginning June 1, 2006*, BPU Docket No. EO05040317, Decision and Order, May 5, 2005.

- The Retail Margin was not established to cover costs or fund activities. It is inappropriate to use its revenues to do so just because they are "conveniently available."

- All customers in those rate classes subject to the Retail Margin have their price for electricity raised by it. Thus, the Retail Margin revenues should be returned to all customers in those rate classes.

- Returning the revenues to all customers in rate classes subject to the Retail Margin, both those customers who take BGS and those customers who have gone to the market, maintains the basic function of the Retail Margin, that is as an incentive for customers to obtain and retain competitive electricity supply.

The Ratepayer Advocate's proposal preserves the incentive created by the Retail Margin for the development of retail competition in New Jersey. However, this incentive need not and should not be preserved forever. 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 may need to rise somewhat in the short run so that a retail market, which will lower prices to consumers in the long run, has a fair opportunity to develop. The price of BGS-FP and BGS-CIEP service provides benchmarks for the cost of energy in New Jersey. In the long run, the market must be able to "beat" the price of BGS if retail competition is to achieve the goal of providing lower prices over the long run for New Jersey energy consumers.

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. There are conceptual problems with this proposal:

- The provision of service by a distribution utility with a monopoly franchise, such as ACE, is paid for at cost. There is no basis in standard regulatory practice for ACE's proposal.

- ACE argues that, like an unregulated retail business, it should be allowed 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 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.

There is also 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:

- 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. 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.

In light of all of the points discussed above, the Ratepayer Advocate urges the Board to reject ACE's proposal that it be allowed to "mark up" the BGS price for the benefit of ACE's shareholders.

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 concerns. The Ratepayer Advocate recommends that, at least until these concerns 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. For these "smaller" customers, one must ask whether movement to BGS-CIEP will provide an effective and generally accepted inducement to move to the retail market as it did for very large customers. There are reasons to believe the answer to this question is "no."

For example, 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." The Ratepayer Advocate is concerned that moving customers just a bit larger than those represented by NJFC to BGS-CIEP may have the same sort of negative results: little movement to the competitive service with higher rates and increased customer dissatisfaction. Similar concerns were raised by PSE&G.

The second argument in support of the proposal to expand the BGS-CIEP class 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 makes that point quite clearly:

> Pricing options that impact demand response include the following:
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> - Fixed price tariffs: based on average costs that include seasonal or time-of-use (TOU) rates.
> - Monthly tariffs: prices vary monthly based on the previous month's market price.
> - Day-ahead pricing: customers learn the price a day in advance.
> - Critical period TOU pricing: consists of standard TOU prices and pricing periods but adds a critical peak period or periods.
> - Occasional real-time pricing; includes variable hourly prices during the critical hours.
> - Real-time pricing (RTP): customers pay hourly market based prices.
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> The above list represents a continuum from no to little signaling of wholesale prices to customers to real-time changes in prices that customers pay. In theory, each of these pricing options will result in different levels of demand response since each sends a different price signal to end use customers. However, CEEEP was unable to identify any studies or literature that analyzed the different levels of demand response that could be expected from implementation of these various pricing options available. *Assessment of Customer Response to Real Time Pricing, Task 1: Literature Search* 7 (Rutgers - The State University of New Jersey, Edward J. Bloustein School of Planning and Public Policy, Center for Energy, Economic & Environmental Policy, June 30, 2005).

The Ratepayer Advocate notes that the Board is currently exploring options such as those listed above 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. For example, in the Board's Decision and Order setting the schedule and issues in this proceeding, the Board directed the EDCs to file proposals for alternative rate designs to introduce larger commercial and industrial BGS-FP customers to the hourly variations in energy costs without the uncertainties and volatility of hourly-pricing. A second example is the current PSE&G Energy Information and Control Network Pilot Program, BPU Docket No. EO04060395. According to PSE&G, this program is designed to test the effectiveness of load management offerings to residential and small commercial customers. Thus, any determination regarding mandatory expansion of the BGS-CIEP class should not be made before the results of these and other voluntary load management programs in the State can be evaluated.

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 and until such programs can be evaluated, the Board should not expand the BGS-CIEP class. 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. Thus, 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 has been 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. The Ratepayer Advocate urges, at a minimum, the continued 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 take the following action:

> Amend the BGS-FP and BGS-CIEP auction rules to require each qualified 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.

At this point, 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, in the two recent "pass-through" filings, expressed an intent to re-examine this policy. In both the Seams Elimination Charge ("SECA") filing[2] and the Reliability Must Run ("RMR") filing[3] the Board envisioned a "revised implementation process" for future transmission related rate increases. The Ratepayer Advocate appreciates the Board's willingness to review this policy and would like to express in these initial comments its concern regarding the effects the current "pass-through" policy has on retail competition in the state.

Retail electricity suppliers are similarly 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. The Ratepayer Advocate recommends that current policy be reversed. If 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.

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[2] *I/M/O the Petition of Atlantic City Electric Company, d/b/a Conectiv Power Delivery, Jersey Central Power & Light Company and Rockland Electric Company for Authorization to Increase the Transmission Related Charges to BGS-FP Customers*, BPU Docket No. ER05010025, Decision & Order, April 11, 2005.

[3] *I/M/O the Petition of Atlantic City Electric Company, Jersey Central Power & Light Company and Public Service Electric & Gas Company for Authorization to Increase the Transmission Related Charges to BGS-FP and BGS-CIEP Customers*, BPU Docket No. ER05040368, Decision & Order, June 22, 2005