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Remarks of Stefanie A. Brand, Director of the N.J. Division of Rate Counsel Regarding A3442 (Establishes a long-term capacity agreement pilot program to promote construction of qualified in-State electric generation facilities.), Presented at the Assembly Telecommunications and Utilities Committee Meeting

December 16, 2010

Good morning. My name is Stefanie Brand. I am the Director of the Division of Rate Counsel. I would like to thank Chairman Chivukula and Members of the Assembly Telecommunications and Utilities Committee for the opportunity to testify today regarding Bill A3442 (Establishes a long-term capacity agreement pilot program to promote construction of qualified in-State electric generation facilities.)

The Division of Rate Counsel represents and protects the interest of all utility consumers—residential customers, small business customers, small and large industrial customers, schools, libraries and other institutions in our communities. Rate Counsel is a party in cases where New Jersey utilities seek changes in their rates or services. Rate Counsel also gives consumers a voice in setting energy, water and telecommunications policy that will affect the rendering of utility services into the future.

Rate Counsel is generally supportive of the goals of this legislation to spur the construction of more generation facilities in New Jersey, and provide some much needed relief from high capacity prices. Overall, we believe this bill could save ratepayers hundreds of millions of dollars in the coming years if we succeed in fostering new baseload generation.

First, I would like to start by discussing what this bill does and why Rate Counsel supports it. When a power plant is built, it has two commodities to sell - energy, and "capacity," which is the ability to provide energy when a customer turns on the light. A utility must have sufficient energy <u>and</u> capacity to meet its load, because energy cannot be stored and at any given time a utility does not know for sure how much energy they will need. Capacity, just like energy, is bought and sold in a market that is run by PJM, our regional grid.

In New Jersey, especially in the northern part of the state, we have transmission congestion and not enough capacity to meet our growing demand, so capacity prices are very high. By way of example, in the most recent base capacity auction, the clearing price for capacity in the area that includes New Jersey was $245 per Megawatt Day. In the western portion of PJM, the clearing price was about $28 per Megawatt Day. Because capacity accounts for 10-20% of the supply costs on a New Jersey customer's bill, high capacity prices contribute significantly to high electricity prices for New Jersey ratepayers.

The methodology that PJM uses to run the capacity markets is called the Reliability Pricing Model ("RPM"). Unfortunately, we believe, the model is flawed so that the generators who are in a position to build new capacity directly benefit from the high prices that result if no new capacity is built. While the theory is that if the price goes high enough, generators will build, we have not seen that happen yet. Since RPM was instituted there has been no new baseload capacity built to benefit New Jersey. There have been some upgrades to existing plants, but the only new plants that have been built have been dedicated to serving New York, where the prices are even higher.

This bill is aimed at encouraging new companies to come to New Jersey and build new plants. It establishes a program where the company selected would get a guaranteed capacity price in exchange for committing the capacity from the plant in a way that will benefit New Jersey. The developer is required to sell the capacity in the PJM auction and they are required to clear the auction. This should bring capacity prices down. According to charts prepared by PJM, building a new 1000 MW plant in our area could lower capacity prices by $50.

With the guarantee, these companies can get financing to build their plants. Ratepayers don't pay anything unless we succeed in reducing the capacity prices below the figure set in the Agreement, at which point we would pay the difference between the lower price and the set price. If that happens, it would mean that we have been successful and that we will be saving more overall than we would be paying to these plants. According to our expert, if the $50 reduction estimate is accurate, ratepayers could save around $300 million gross per year. Although we do not know yet what the fixed price would be under the terms of this bill, at the price set in the Senate version, the net savings to ratepayers is estimated at $275 million per year. This would start 3 years out and we don't know how long this savings would last as we don't know exactly where the market will be after that. At least for some period of time, however, we could see a 20% savings off of the current capacity prices. We also know that if we do nothing to encourage new capacity, prices will continue to rise which will cost ratepayers even more. If capacity prices drop, ratepayers will pay something to these plants, but they will still come out ahead.

The amendments in the Assembly version of this bill do make the bill much better. Instead of establishing the capacity price in the bill, the amendments establish a process at the BPU to set the price. The process would require the applicants to say what they are willing to take and sets up some degree of competition among the applicants which will hopefully lead to a realistic price. The amendments have the Board determining the winners, based on a variety of important factors, and this I believe is appropriate given the complexity of the issues and the need to tap into the expertise of the BPU to make these choices. The bill also ensures that ratepayers will receive refunds on the "upside," that is, if capacity clearing prices are higher than what these plants are guaranteed. This should reduce costs that ratepayers are asked to bear. The amendments also extend some timeframes and expand some definitions that should result in a broader pool of applicants, which will also hopefully increase competition for the program and benefit ratepayers.

Rate Counsel does have a few lingering concerns. I am concerned that the bill as written does not make it completely clear that the agent retained to evaluate the SOCA applications and pre-qualify the applicants would be acting on behalf of the Board. While it is fine to ask the utilities to procure the contract and pay the agent, as they do with the BGS auction manager, the utilities cannot be permitted to review the SOCA proposals that would be coming from their competitors or in some cases their affiliates. I believe the intent is for the agent to assist the Board, but urge that this intent be perfectly clear.

I also urge further consideration of the appropriate term of the SOCA and number of megawatts in this program. It's important to note that while many excellent changes that have been made to this bill open the process up and allow more companies to compete and participate, the 1000 MW provision only allows for full approval of one project. These facilities are generally sized at 650 – 700 MW, and thus a 1000 MW limitation will not permit approval for more than one total facility. While the Board certainly could go forward under its existing authority with a similar program to encourage other facilities, the more facilities we build the greater the savings to ratepayers. I therefore urge an expansion of that limit to allow the Board to award more than one SOCA as part of this program if more than one worthwhile project is presented.

With respect to the term, we do not yet know that 7 – 10 years will be sufficient for these projects to attract financing. It may that 10 – 15 year terms are needed. I support amendments that would allow the BPU to set the term as part of the approval process. That way we can be assured of having the most up to date information on what is needed to obtain financing at the time the term is set, thereby enhancing the likelihood of the program's success.

Thank you for the opportunity to testify today. I know this bill has been through many versions and is very complicated. However, the principles are simple – find a way to encourage the development of new generation to increase our supply and reduce prices. New Jersey's ratepayers are bearing the burden of high capacity prices and this bill is a first step toward easing that burden. The amendments keep making it better and I urge you to pass the bill out of the committee with the amendments I have suggested today. Thank you very much for the opportunity to testify. I am available to answer any questions.