Agenda Date: 7/15/20
Agenda Item: 1A

STATE OF NEW JERSEY
Board of Public Utilities
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AUDITS

IN THE MATTER OF THE REQUEST FOR PROPOSAL FOR A FINANCIAL AUDIT OF THE NEW JERSEY ELECTRIC DISTRIBUTION COMPANIES' BASIC GENERATION ADMINISTRATIVE EXPENSE AND OTHER RELATED EXPENSES	)	ORDER OF IMPLEMENTATION DOCKET NO. EA17010004

Parties of Record:

Joseph Shea, Esq., Public Service Electric and Gas Company
Joshua Eckert, Esq. Jersey Central Power and Light Company
Margaret Comes, Esq., Rockland Electric Company
Philip Passanante, Esq., Atlantic City Electric Company
Stefanie A. Brand, Esq., Director, New Jersey Division of Rate Counsel
Christopher E. Tokelson, Esq. Eckert Seamans Cherin & Mellon, on behalf of Direct Energy

BY THE BOARD:

On July 27, 2018, Liberty Consulting Group ("Liberty") submitted its audit report ("Final Report") to the New Jersey Board of Public Utilities ("Board" or "BPU") pursuant to the audit of the New Jersey Electric Distribution Companies' ("EDCs") Basic Generation Service ("BGS") administrative expense. The EDCs include Atlantic City Electric Company ("ACE"), Jersey Central Power and Light Company ("JCP&L"), Public Service Electric and Gas Company ("PSE&G") and Rockland Electric Company ("RECO").

The Final Report contained 16 recommendations. At the Board's August 29, 2018 agenda meeting, the Board accepted the Final Report for filing purposes only and authorized the release of the Final Report to the public for comment.

By this Order, the Board considers the recommendations in the Final Report and the comments submitted to the Board regarding recommendations to be implemented by the EDC's.

<u>Background and Procedural History</u>

At its January 25, 2017 agenda meeting, the Board authorized staff of the Audits Division ("Staff") to initiate an audit of the EDCs' BGS administrative expense and other related costs. The Board also authorized Staff to send a Request for Proposal ("RFP") to the seven (7) pre-qualified consulting firms engaged by the State of New Jersey under State Wavier #AJ-050.

Since 2002, the Board has authorized the EDCs to conduct a descending-clock auction process to satisfy the supply needs of who have not chosen an alternate supplier, for the supply period beginning June 1st through May 31st of every year. As part of this annual proceeding, the EDCs file their proposals for the auction, including any proposed modifications to the current auction process, and to each EDCs specific addendum.

The administrative costs include direct and indirect costs incurred by the EDCs. These costs include but are not limited to such items as hiring an auction manager, consultants, confidential on-going patent litigation costs, office space, auction room costs as well as other costs that the utilities incur with respect to the purchase of electricity. Recovery of these costs are generally recovered from each winning bidder through a tranche fee factored into the bidder's price with the balance of these costs recovered through each EDC's BGS reconciliation charges and/or other recovery mechanisms, and in effect, are all recovered from customers.

In the Board's October 31, 2016 Order in Docket No. ER16040337, the Board found that it would be appropriate to have an outside consultant conduct the review of BGS administrative fees and directed Staff to retain a consultant.

In response to the Board's directive, Staff commenced an informal review of the BGS in 2016. After several meetings between Board Staff and the EDCs to collect information, Staff concluded, that a comprehensive financial review of the BGS administrative expenses and related costs was necessary to ensure that they are reasonable and prudent.

Staff drafted an RFP to solicit bids from consultants to review the BGS administrative costs. The Board released the RFP to a list of pre-qualified consultants approved by the Board and the New Jersey Department of Treasury ("Treasury"), Division of Purchase and Property ("DPP") who agreed to the waiver service contract standard terms and conditions. The consultants under #AJ-050 included the following: Boston Pacific Company, Inc., CH2M Hill, Emergency Preparedness Partnerships, Levitan and Associates, Inc., OCI Resources, Inc. (trade name Overland Consulting), Silverpoint Consulting, LLC, and Liberty Consulting Group, Inc. Although Boston Pacific was on the list of pre-qualified consultants under the waiver, for reasons of conflicts, Staff did not solicit their services under the RFP in this matter. Boston Pacific is one of the consultants hired by Staff to provide expert advice in the BGS.[1]

In response to the RFP, two (2) pre-qualified consultants submitted bid proposals to the BPU, Division of Audits by March 17, 2017- Liberty Consulting Group and Overland Consulting. None of the other pre-qualified consultants submitted bids to the BPU. The Division of Audits subsequently forwarded the bid proposals to the Evaluation Committee for review and analysis. The Evaluation Committee consisted of staff members from the Division of Audits (3), the Division of Energy (2), and Counsel's Office (1).

At its May 31, 2017 agenda meeting, the Board approved the Evaluation Committee's recommendation of Liberty Consulting to perform the audits at a not-to-exceed cost of $266,480.

[1] The Board initially contracted with Boston Pacific Company, Inc. to oversee the BGS procurement process. On November 1, 2016, Boston Pacific merged with Bates White, which assumed the rights and obligations under the State Contract. Bates White is the current Board Advisor based on a contract awarded in 2017.

Prior to the filing of the Final Report by Liberty, Audit Staff provided a draft version to the EDCs for their review and comment on factual discrepancies only, and the need for any redactions in the Final Report to protect information claimed to be confidential or business sensitive. On July 27, 2018, Liberty submitted the Final Report.

At its August 29, 2018 Agenda Meeting, Staff recommended that the Board accept Liberty's Final Report for filing purposes only, authorize the release of the report for comment, and the release of the holdback fees owed to Liberty in accordance with the contract. The Board adopted these actions.

Public, redacted versions of the Final Report were available for comment.

In the interim, Direct Energy Business, LLC, Direct Energy Business Marketing, LLC ("Direct Marketing"), Direct Energy Services, LLC, Gateway Energy Services Corporation, and NJR Retail Services Company (collectively, "Direct Energy") raised issues in the BGS proceeding for the period commencing June 1, 2019.

In the Board's November 29, 2018 Order ("November Order"), the Board stated that "with respect to the comments filed by Direct Energy, the Board finds that they more appropriately belong in the Audit of the BGS Administrative Costs as they pertain to the findings, conclusions, and recommendations set forth in the Audit Report." Additionally, in the November Order, the Board determined that Direct Energy could file comments on the Audit Report in Docket No EA17010004.

On January 15, 2019, the New Jersey Division of Rate Counsel ("Rate Counsel") and the EDCs signed a non-disclosure agreement.

On February 15, 2019, the EDCs filed joint comments in addition to comments filed by Rate Counsel and Direct Energy, on the recommendations included in the Final Report. On March 22, 2019, PSE&G filed reply comments in response to Rate Counsel and Direct Energy. The EDCs responded to the specific recommendations made by Liberty and provided further commentary on various statements made within the audit report. The EDCs concurred with the majority of the 16 recommendations contained in the Final Report, while Rate Counsel agreed with all the recommendations. Direct Energy specifically focused its comments on the inclusion of indirect costs in the BGS price to compare which included such costs as general and administrative.

On March 25, 2020, the EDCs provided an update to the status of their implementation of the recommendations in the Final Audit Report, which is incorporated herein below.

Below is a detailed discussion of the EDCs', Rate Counsel's and Direct Energy's filed comments as they relate to specific recommendations made by Liberty. Staff's position with respect to each of the audit recommendations is also delineated.

Summary of Audit Recommendations

Chapter II: BGS Process Elements

1. **Conduct an analysis of infringement risk that comports with prevailing methods of risk management.**

The Final Report found that utilities have started to use more robust risk management techniques. The EDCs can apply that process to the legal measures it takes to mitigate infringement risk in a straightforward manner, requiring only nominal time and effort. They should apply it to two (2) principal risk sources: 1) defending and winning an infringement action; and 2) defending and losing an infringement action.

Customers bear significant costs each year for these mitigation actions. A calculation that is transparent to the BPU, relies upon substantiated assumptions, and relates dollar benefits gained to expenditures made is important in ensuring that a long-continuing approach in the face of evolving circumstances remains sound.

EDCs: Disagree - The EDCs do not support this recommendation, citing current practice. Furthermore, the EDCs contend, if the proposed analysis were actually performed, it would be privileged and not available for public discussion or disclosure.

Rate Counsel: Agree - The Board should direct the EDCs to conduct an analysis of infringement risk that comports with prevailing methods of risk management.

Direct Energy: No Comment.

Staff: Agree - Staff agrees with Liberty that the EDCs should apply risk management techniques to estimate the probability and the potential dollar impact of a negative outcome in a patent infringement case. Staff finds this action normal in the course of utilities managing any potential risk facing them in general.

2. **Evaluate the net cost and BGS-quality impacts of transitioning to a simpler auction process.**

According to the Final Report, the Descending Clock Auction ("DCA") process is not demonstrably productive of lower contract prices than simpler, less expensive to conduct processes. Liberty stated that other processes do not involve the same kind of risks experienced with a DCA process and thus result in lower expenditures. It is not clear that changing the DCA process would diminish the other, important but difficult to quantify benefits the New Jersey BGS processes combine to produce. However, any consideration of change to the auction process should confirm that lack of diminishment.

EDC: Disagree - The EDC's believe this recommendation is outside Liberty's scope of work developed by the Board for this audit. Liberty was engaged to assess the reasonableness of administrative costs associated with the current BGS auction process, not to provide recommendations or opinions on alternative auction processes.

The EDCs state the Board reaffirmed the continued use of the DCA format in the Board's 2012 BGS proceeding. The EDCs further assert that stakeholders consider proposals on the procurement of BGS supply in each annual BGS proceeding. The Board has heard from stakeholders with many divergent views. Yet none have proposed to replace the statewide DCA with a sealed bid auction process.

The EDCs also dispute the Final Report's claims that all benefits of the DCA can be maintained with a sealed bid process arguing that the Final Report is inaccurate and point to sections of the Final Report that seem to state that there is no one specific auction process that is best in all circumstances. The EDCs would agree with the latter statement. The EDCs and NERA Economic Consulting ("NERA") have consistently shown, through the filings and through the auction results themselves over the course of 17 auctions, that the DCA is best suited to New Jersey's objectives for basic generation service, as set out in the Electric Discount and Energy Competition Act ("EDECA") and the Board's directives.

The EDCs asserted the following benefits of a DCA process:

- Suppliers use round by round information to adjust their bidding strategy in real time and avoid mistakes and realize during the course of bidding that their market view is different than their competitors' and bid lower after revising valuations.
- DCA has resulted in higher participation in New Jersey.
- With a sealed bid auction, bidders would have to choose ahead of time on which EDC or EDCs to bid. The competition for any one EDC is limited to the bidders that chose to place bids on that EDC ahead of time. With a DCA, each EDC is exposed to competition from all bidders initially interested in any one of the EDCs as bidders can switch their bids from one EDC to another as the auction progresses bringing more competition.
- The ability of bidders to switch from on EDC to another also leads to an efficient allocation of suppliers to EDCs, and to relative prices that reflect the realities of serving the different EDCs.

The EDCs stated that there is neither theoretical nor empirical support for any claims by Liberty that bidders in sealed bid auction will accept very small margins in order to win.

The EDCs further stated that there is no basis for the assertion that using a different auction format would eliminate the possibility of prospective infringement claims related to such a different format. The EDCs maintained that Rate Counsel's proposed modifications to the auction rules to eliminate the clearing price feature in the DCA is not a new argument. The Board in the 2004, 2005 and 2007 auctions, disagreed with, and rejected Rate Counsel's criticism and proposed auction rule modifications stating that such changes could "adversely affect prices to BGS customers." The EDCs also argued that any issues raised about the BGS auction process are clearly outside of the scope of the administrative cost audit.

Rate Counsel: Agree - Rate Counsel stated that it is not prepared at this time to recommend to the Board scrapping the DCA approach in favor of a sealed bid approach. However, if given what seems to be consensus among the Auditor, the EDCs and the Auction Manager that the DCA does not produce better results than a sealed bid auction, the Board should order a more thorough analysis of the options and alternatives to the present DCA approach and be open to making changes in the DCA approach going forward.

Rate Counsel further suggested that the Board direct all parties, including Liberty, the EDCs, and the Auction Manager, to address Liberty's statement that the DCA approach produces no better result than a sealed bid approach. Rate Counsel stated that due to the DCA's complexity, it is more costly to administer yet may not result in a better outcome for ratepayers than the lower cost sealed bid approach.

Direct Energy: No comment.

Staff: Disagree – While the Final Report suggested that the DCA process does not necessarily result in better contract prices for BGS supply, it also states that there is no consensus on whether DCA or sealed bid auctions prove more effective in achieving the goal of minimizing the purchase price. The Final Report concluded the DCA process is more complex resulting in more administrative and other costs (such as patent litigation related costs and risks) than a simpler process, like the sealed bids approach. However, the Final Report also concluded that the DCA process produces a comparatively high level of structure, transparency, objectivity and control, is very sound and particularly commendable in providing a highly and in some respects uniquely participative auction in terms of potential suppliers, resulting in a strongly supportive robust bidder participation. Liberty further asserted the DCA approach is also a well-understood means for securing BGS supply.

For the past 19 years, the Board has adopted a process to determine how to procure electric supplies for BGS customers that has provided an opportunity to all interested parties, through both written comments and at public hearings to weigh in on the process. These proceedings have resulted in a wide range of BGS suggestions, timely Board decisions and ultimately a successful procurement process. During these 19 years, parties have had the opportunity to present alternative methods to procure electric supplies for the BGS as a replacement to the current DCA process. No parties have ever suggested abandoning the DCA process completely. The Board initiates a proceeding in every year to determine the best procurement process for the BGS-Residential and Small Commercial Pricing ("BGS-RSCP") and BGS-Commercial and Industrial Pricing ("BGS-CIEP") requirements. The present proceeding (BPU Docket No. ER20030190), like prior annual proceedings, included an invitation for parties to propose how to procure BGS Supply. Staff does not view the potential increase in administrative costs on a per-EDC level or in total under a DCA vs. sealed bid procurement approach significant enough to scrap a well-vetted approach to purchasing supplies at this time.

<u>Chapter III: Administrative Cost Definition, Formulation, and Application</u>

3. **Through the next EDC [Company Specific Addendum] ("CSA") filings, establish a formal, documented definition of Commonly- and Directly-Incurred BGS Administrative Costs.**

The EDCs should develop a single, clear and comprehensive definition of commonly-incurred administrative costs, explicitly treating each component, and detailing treatment of actual costs in Reconciliation Charge Mechanisms. According to the Final Report, this will help ensure consistency and provide for a review of the costs that is transparent and practicable. Documentation will also provide a sound basis for determining how future cost sources that may arise in connection with the BGS should be treated and comport with those costs to be included in the Tranche Fee and Reconciliation Charge Mechanism.

EDC: Partially Agree - The EDCs agree in part and disagree in part with this recommendation. Generally, the EDCs agree that it is reasonable for them to develop a definition of Commonly-

Incurred BGS Administrative Costs and will provide a listing of each EDC's categories of direct costs. However, the EDCs do not agree that each EDC should be bound by a uniform list of "direct" cost categories.

Rate Counsel: Agree – In addition to agreeing with Liberty's recommendation, Rate Counsel was disappointed that the Final Report which identified specific differences in each EDCs Reconciliation Charge filing procedures, made no specific findings or recommendations regarding the non-uniformity of the BGS Administrative Cost Reconciliation procedures and filings. Similarly, Liberty offered no findings or recommendations as to whether or not it would be desirable to use the same basis among the four (4) EDCs for establishing interest rates on deferred Reconciliation Charge balances. Therefore, Rate Counsel recommended that the Board direct Liberty to provide guidance as to whether efficiencies and cost savings can be achieved through more standardized BGS Administrative Cost Reconciliation and interest rates procedures.

Direct Energy: Agree - Direct Energy agrees that there should be a documented definition of the commonly incurred BGS Administrative Costs. Direct Energy's comments relied upon its position and recommendations presented in its Direct Testimony of Frank Lacey filed on August 6, 2018 in a PSE&G distribution rate proceeding. Under Direct Energy's proposal, PSE&G would allocate costs from several areas of the company to BGS. Direct Energy stated the Final Report did not address the lack of allocation of indirect costs to the BGS. This would include such costs as administrative and general. Direct Energy believes the lack of inclusion as BGS related costs creates a barrier for competitive retailers to compete in the market. Direct Energy believes that there should be a shift of costs from the distribution side of the bill to the supply side of the bill to include such costs as information technology ("IT") costs.

EDC Reply Comments: The EDCs took exception to the comments submitted by Rate Counsel regarding their recommendations that the Board direct Liberty to make findings and recommendations, on whether there should be a more standardization and uniformity in the BGS Administrative Cost Reconciliation Charge including whether there should be uniformity in the interest rate calculation. The EDCs argued that it is beyond the scope of the audit. The EDCs state that the Board already has the authority to review such mechanism in the context of the annual BGS proceedings and has done so in the past in the context of the 2012 and 2015 BGS proceedings in Docket No. ER14040370.

Status of Implementation: In the individual CSAs, the EDCs included definitions of commonly incurred and directly incurred BGS Administrative costs. The EDCs filed their CSAs as part of their most recent BGS filings under the BPU Docket No. ER19040428 for PSE&G, ACE, JCP&L and RECO. With respect to having consistency between the categories of directly incurred costs that are similar to ACE, PSE&G, JCP&L and RECO made no attempt in their recent annual BGS filings to consider examining similar costs incurred that are directly related to the BGS.

Staff: Agree - Staff agrees with the recommendation and further believes that the EDC's should develop a list of common and direct expenses related to the provision of BGS service. This is not binding the EDCs to expenses. Expenses incurred to procure BGS supplies should not vary much among EDCs. ACE charged approximately $1 million of directly-incurred costs in 2016 which included such cost items as personnel performing functions in the areas of energy management system, IT, customer care, load settlements, market settlements, power procurement services and supply customer energy, while the other EDC's incurred none. Although the EDCs provided detail of the commonly incurred and directly incurred costs in their respective CSAs, the EDCs did not implement the recommendation to include similar costs to ACE's directly incurred costs.

It is Staff's opinion that these costs appear to be standard-type costs that could be incurred directly by any EDC in the procurement of supplies whether through a BGS Auction process or other type of supply procurement process.

Staff recommends that PSE&G, JCP&L and RECO re-examine their costs to determine if there is an appropriate amount of similar directly incurred common costs that have directly resulted from the BGS which could be included as BGS administrative costs and to provide Staff with this analysis by September 1, 2020 for implementation in the next base rate cases for the respective EDCs and next annual BGS filings implemented after the conclusion of the base rate case.

With respect to Rate Counsel's recommendation regarding the lack of consistency between the EDCs with respect to the Reconciliation Mechanism, Staff agrees with the EDCs that the Board made edits to the BGS reconciliation process whereby the reconciliation charge calculation would potentially more accurately calculate the BGS reconciliation charge. Liberty identified the differences in the reconciliation mechanisms and did not identify concerns relating to the non-consistency. Each EDC balances monthly, but changes the rates at different times during the year, one monthly, one seasonally, two quarterly with interest rates for two (2) EDCs that reflect their specific short-term debt and two using the 2-year constant maturity treasury rates plus 60 basis points. Two (2) EDCs have caps and two (2) do not. These differences did not concern Liberty. Some companies apply their short-term debt while others who do not incur short-term debt, apply public short-term debt interest rates published by the Federal Reserve. Although Liberty raised no concerns regarding these differences, Staff sees merit in Rate Counsel's suggestion that Staff conduct a review of these specific differences, and make recommendations, if necessary, on whether consistency among the EDCs is possible and whether consistency will result in a better BGS process for ratepayers.

4. **Establish a practice of conducting periodic reviews of the Auction Manager's charges for BGS services.**

A single firm has served the EDCs as the Auction Manager since BGS inception. The EDC's should periodically audit the invoices as permitted by the agreement. The Auction Manager's charges are in the range of $1.5 million per year.

EDCs: Disagree - As a general matter, the EDCs disagree with this recommendation. The EDCs already review and approve invoices from the Auction Manager and raise issues as needed. The EDCs' subject matter experts involved in the BGS auction process are well equipped to identify discrepancies in the Auction Manager's invoices, and they do so by following their own internal controls and processes for approving invoices. Adding another layer of review would add cost to a process that is not broken—as evidenced by the absence of a specific finding by Liberty that costs invoiced by the Auction Manager were inconsistent with its agreement with the EDCs.

Rate Counsel: Agree

Direct: No comment

Staff: Agrees and recommends that the EDCs be directed to conduct an audit to review Auction Manager charges and services by the 2022 BGS procurement process. Staff recognizes that on an annual basis the EDCs conduct internal controls and processes to review and approve invoices. Staff believes it behooves the EDCs to periodically conduct a more thorough reviews of Auction Manager costs and services. The EDCs shall examine the types, the necessity and reasonableness of such costs going forward providing a basis for future agreement negotiations with the Auction Manager so the EDCs manage these administrative costs more effectively. Staff suggests that prior to entering into a subsequent contract with the Auction Manager the EDCs should conduct a thorough review of the services and costs to determine whether they can be effective in negotiating them down for subsequent contracts.

5. **Correct JCP&L's under-inclusion of patent-related legal expenses.**

Liberty found that JCP&L failed to include most of its patent-related legal costs for the 2013, 2014, and 2015 BGS periods. JCP&L's management began to correct this situation by deferring these costs for the 2013-2015 BGS and the 2012 BGS periods. It plans to address the combined amount in a future BGS reconciliation filing. That filing should include a detailed report and reconciliation of its share of the costs involved, how management accounted for them, and how it will improve controls to avoid similar omissions in the future.

EDCs: JCP&L Agrees - There was a one-time accounting error that caused this issue during the 2013 - 2015 BGS periods. As the Final Report reflects, JCP&L has corrected that error on its books, and implemented steps to prevent the issue from recurring. Accordingly, JCP&L has corrected the one-time issue with respect to accounting for BGS patent-related legal costs.

Rate Counsel: Agrees

Direct: Agrees No Comment

Status of Implementation: JCP&L corrected the under-inclusion of patent related legal expenses in October 2016. This was done via a journal entry by the Company's accounting department, which moved what had been booked for patent-related legal expenses in distribution rates to BGS rates. The accounting department advised the legal department about the correct accounting and coding of future patent-related legal expense invoices.

Staff: Agrees - Staff is satisfied that JCP&L corrected the accounting error however, as part of the implementation of this order, JCP&L shall share with Staff and Rate Counsel the detailed report, reconciliation and accounting treatment for these costs to be recovered in future BGS filings. This detailed report shall also be included with the annual BGS and quarterly reconciliation filing to ensure that the proper amount of patent related legal expenses are included in each reconciliation period.

6. **Correct ACE's under-inclusion of patent-related legal expenses.**

ACE did not include any patent-related legal costs in the 2013 through 2016 BGS period as BGS administrative costs. ACE included them in accounts whose costs it recovers through delivery rates. ACE included patent-related legal costs in those other accounts over the 2013-2016 periods. Liberty asserted that ACE needs to provide a detailed report and reconciliation of its share of the expenses, how it accounted for them, and how to provide for reconciliation and recovery through the BGS process.

EDCs: ACE Agrees - ACE agrees with this recommendation. ACE corrected the under-inclusion of patent related legal expenses. ACE will provide a report and reconciliation of this correction as a part of ACE's next BGS Reconciliation Charge filing, which ACE filed with the Board on or prior to April 30, 2019.

Rate Counsel: Agrees

Direct: Agrees - Direct believes that all costs related to the acquisition of BGS supplies including an allocation of overhead charges should be included in the BGS price.

Status of Implementation: As part of the April 25, 2019 BGS reconciliation Charge filing for rates effective June 1, 2019, ACE indicated on Schedule 6 of that filing that it corrected the journal entry made in its books and records to correct the under-inclusion of patent related legal expenses in December 2018. It moved them from distribution to BGS recovery. This was made as part of the Company's last base rate case so that these costs were removed from base rates to the specific BGS clause for which they relate. Staff is satisfied that ACE implemented the recommendation. Staff is requesting that ACE provide Staff and Rate Counsel supporting documentation within 15 days of the effective date of this order to show that it removed these costs from delivery rates.

Staff: Agrees - Patent litigation costs are incurred in direct relation to the BGS auction and the responsibility of all the EDCs that participate in the auction and thus ACE's share of these costs should be included in the BGS as administrative costs. Staff is pleased that ACE corrected the under-inclusion however, as part of the implementation of this order, ACE shall share with Staff and Rate Counsel the detailed report, reconciliation and accounting treatment for these costs to be recovered in future BGS. This detailed report shall also be included with the annual BGS and reconciliation filings to ensure that the proper amount of patent related legal expenses are included in each reconciliation period.

7. **Correct RECO's under-inclusion of patent-related legal expenses**.

RECO failed to properly reclassify patent-related legal costs for inclusion in the BGS reconciliation process. RECO did reflect patent related legal costs on its books, but did not properly reclassify the underlying yearly amounts for inclusion in the BGS reconciliation process. RECO indicated that it was seeking to correct the misclassification. It should continue its corrective efforts to completion. In comments on the Final Report, RECO stated that, upon switching to a different accounting system, it "picked up" "certain patent costs." RECO further stated that it properly coded the costs, corrected the error, and charged the costs.

EDCs: RECO agrees - When RECO switched to a different accounting system, certain patent costs were not picked up. RECO is now properly coding the patent costs, the error has been corrected, and the patent costs have been properly charged.

Rate Counsel: Agrees

Direct: No comment

Status of Implementation: RECO states that it corrected the coding for patent litigation costs.

Staff: Agrees Patent legal costs have a direct correlation with the BGS auction and should be properly tracked and coded as such and thus included as a cost in the BGS. Staff is satisfied that RECO corrected the under-inclusion, however, as part of the implementation process in this audit, RECO shall share with Staff and Rate Counsel a detailed report of these legal costs, reconciliation and accounting treatment for these costs to be recovered in the BGS. This detailed report shall also be included with future annual BGS and reconciliation filings to ensure that the proper amount of patent related legal expenses are included in each reconciliation period.

8. **Correct the methods and calculations for allocating lease costs for Newark offices used by the Auction Manager.**

Under allocations to the other three (3) EDCs left PSE&G responsible for too great a share of the lease costs for office space used by the Auction Manager. This cost element accounted for about 4.5 percent of commonly-incurred costs during the audit period. Therefore, the consequences of not allocating it correctly have only nominal cost impact, but correction should prove a straightforward matter.

EDCs: Agrees - The EDCs agree with this recommendation. Although such costs are relatively small, and the referenced discrepancies are even smaller, the EDCs will create a true-up mechanism to provide for the "corrected" allocation of the lease costs across the EDCs.

Rate Counsel: Agrees

Direct: No comment

Status of Implementation: PSE&G is in the process of developing a methodology to invoice the other EDCs for the BGS Auction viewing room costs for February 2019 and to true up the BGS Auction Manager's office space at One Gateway Center for Energy Year 2019. The other EDCs expect to complete their review of the costs and methodology by the end of the second quarter in 2020 and will appear in a NERA invoice no later than the third quarter in 2020.

Staff: Agrees - The lease for the Newark offices benefits all the EDCs that participate in the BGS Auction thus they should all pay for the leasing costs. As part of implementation, the EDCs shall share with Staff the allocation method used to improve the allocations for these costs so ultimately less of the cost burden falls on PSE&G's BGS customers and more appropriate shares are paid for by the remaining EDCs. Staff shall confirm that this recommendation has been completed by the end of 2020.

9. **PSE&G should allocate the costs of auction viewing and bidder information session facilities**.

PSE&G has borne the full costs, failing to allocate shares to the other EDCs because of the nominal costs. Implementing this recommendation will have minimal dollar impact, given that the category accounted for less than one percent (1%) of commonly-incurred BGS Administrative Costs during the audit period. However, implementing it should prove a straightforward matter. In comments on the draft of this report, PSE&G reported that it no longer bears the costs of bidder information sessions, stating that NERA runs them and allocates their costs to the EDCs through its Auction Manager invoices.

EDCs: Agree - The EDCs agree with this recommendation in relation to the auction viewing room and will begin allocating these costs across all the EDCs in 2019. With respect to the costs associated with the bidder information session facilities, as these sessions are now all done via webcast, all related costs are currently included in the Auction Manager's invoices and thus are already allocated across the EDCs.

Rate Counsel: Agrees

Direct: No comment

Status of Implementation: PSE&G is in the process of developing a methodology to invoice the other EDCs for the BGS Auction viewing room costs for February 2019 and to true up the BGS Auction Manager's office space at One Gateway Center for Energy Year 2019. The other EDCs expect to complete their review of the costs and methodology by the end of the second quarter in 2020 and the reallocation will appear in a NERA invoice no later than the third quarter in 2020.

Staff: Agrees - As part of the implementation stage of the audit, the EDCs shall provide Staff with the methods used to allocate these costs more appropriately to each of the EDCs. The EDCs shall provide Staff and Rate Counsel a detailed report showing the basis for the method of allocation in the annual BGS and reconciliation proceedings. Staff is satisfied that the webcast costs are now being shared by all of the EDCs, but this should be reviewed by Staff and Rate Counsel. Staff shall confirm that this recommendation has been completed by the end of 2020.

10. **ACE should adopt the practice of explaining more fully out-of-period adjustments in the future.**

ACE made adjusting entries in June 2013 in the amount of approximately $2.5 million to capture employee expenses that were incurred. ACE made a corresponding adjustment to offset these costs of approximately $3.1 million in revenues, resulting in a net impact of approximately $600,000, which was assigned to the 2014 BGS reconciliation process, but incurred across the preceding 10 years. Although Liberty found adequate support for these adjusting entries, ACE should have explained such accounting entry adjustments of this magnitude more fully at the time of the adjustments.

EDC: ACE Agrees - with this recommendation and will adopt the practice of explaining more fully out-of-period adjustments in the future.

Rate Counsel: Agrees - The Board should direct all of the EDCs, not just ACE to highlight and adopt the practice of explaining more fully out of period adjustments to BGS Administrative costs for review in the EDC's next and subsequent BGS filings.

Direct: No comment

Status of Implementation: ACE has agreed on a going-forward basis, to explain more fully when out of period adjustments occur. In its schedules submitted in July 2019 BGS ACE provided explanations of adjustments resulting from the Audit.

Staff: Agrees - Staff agrees with Liberty's recommendation and Rate Counsel's comments. As part of the implementation of the audit recommendations, all EDCs shall highlight, and fully explain in detail, each out of period adjustment in the EDCs' next BGS and future BGS filings. The EDCs shall provide all supporting documents and information for these adjustments. Staff expects that ACE will continue to provide explanations of out of period adjustments so that Staff and Rate Counsel have enough information to determine whether those adjustments are fair and reasonable.

11. **Enhance standardization of the categories of uniquely-incurred costs of the EDCs for performing and supporting BGS functions**.

At a minimum, the EDCs should develop a common, clear categorization of costs subject to inclusion through the reconciliation mechanisms, and support that categorization with detailed itemizations of the cost types to be included. These costs have been nominal but should be commonly defined and applied.

EDCs: Partially Agrees - The EDCs agree that commonly-incurred administrative costs should be standardized. They disagree with respect to standardizing directly-incurred administrative costs which vary across the different utilities or are unique to a specific EDC. The EDCs do not have identical internal processes for administering BGS.

Rate Counsel: Agrees

Direct: No comment

Status of Implementation: In the individual EDCs' CSAs, the EDCs included definitions of commonly incurred and directly incurred BGS Administrative costs. The CSAs were filed as part of their most recent BGS filings under the BPU Docket No. ER19040428 for PSE&G, ACE, JCP&L and RECO.

Staff: Agrees - Staff agrees with the recommendation and while the EDCs may not have an identical internal process, Liberty stated that there are many similar costs and a list of commonly incurred costs at a minimum can be constructed to bring more clarity to BGS Administrative costs. In addition, although there may be differences between the utilities, services provided by other departments and affiliates directly related to that EDC's BGS or the BGS process, whether for the state or specific EDC, should be identified and categorized. Liberty stated that the ACE affiliate costs involve functions and support that are reasonably necessary for the other EDCs. Liberty stated that all utilities that use structured regulatory and bidding processes to secure BGS-type supplies from the market likely need similar support. Thus, Staff recommends that the EDCs be directed to implement Liberty's recommendation, which would include not only commonly incurred administrative costs but also uniquely incurred costs, which are similar to the ACE costs in relation to their genesis, function and service provided to the BGS. These costs would include costs that resulted directly from the BGS process related to legal, regulatory, accounting and support functions.

Staff considers this recommendation only partially implemented and recommends that within six (6) months, these definitions be included in the annual BGS filings and shall be subject to review by the parties in that proceeding. Staff further recommends that PSE&G, JCP&L and RECO re-examine their costs to determine an appropriate amount to be allocated to the BGS administrative costs that would include similar common costs to ACE in addition to their unique company incurred direct costs and to provide Staff with this analysis within six (6) months of this order.

<u>Chapter IV: Allocation of BGS Administrative Costs</u>

Liberty has no recommendations regarding the allocation of common BGS Administrative Costs except for the rental and facilities cost addressed in other recommendations. Overall, Liberty concluded that the process for setting and collecting tranche fees provided, throughout the audit period, a clearly defined, consistently applied, and appropriate single method for allocating common BGS Administrative Costs. Furthermore, Liberty concluded that the information supporting the allocations was accurate and sufficient.

Chapter V: Mechanisms for Recovering Administrative Costs

12. **Provide for EDC filings with the BPU of periodic reports identifying BGS Administrative Costs at a reasonably-detailed categorical level, to support direct review of the accuracy and appropriateness of the components subjected to reconciliation**.

The lack of periodic reporting of estimated versus actual administrative costs on a reasonably detailed category basis unduly complicates review and testing of actual versus estimated costs and revenues. Combining many cost types and elements into a single line item without detail hinders the process of identifying specific costs sources and testing them.

EDCs: Partially Agree - The EDCs agree in part and disagree in part with this recommendation. The EDCs already provide certain aggregate information identifying BGS administrative costs in response to discovery requests in the annual BGS proceeding. In addition, the EDCs do not favor an additional reporting requirement relating to BGS. However, the EDCs would not object to providing a more detailed breakdown of BGS Administrative Costs that are presently or planned to be recovered through a BGS recovery mechanism, in conjunction with the annual BGS filing made on July 1st of each year.

Rate Counsel: Agrees - Recommends that the Board direct the EDCs to comply.

Direct: No comment

Status of Implementation: In the individual EDC CSAs, the EDCs included definitions of commonly incurred and directly incurred BGS administrative costs. The CSAs were filed as part of their most recent BGS filings under the BPU Docket No. ER19040428 for PSE&G, ACE, JCP&L and RECO. ACE indicated that it broke down monthly BGS Administrative costs into categories. The stakeholders who participated in the BGS reviewed the definitions and raised no issues.

Staff: Agrees - Staff agrees with Liberty that the EDCs should provide a more detailed breakdown of each estimated BGS Administrative cost that is included in the reconciliation charge and Tranche Fees and corresponding actual BGS administrative costs rather than a single line aggregate of these costs in their annual BGS and periodic reconciliation filings. There should be sufficient detail with regard to the breakdown of the costs to allow for the ease of tracing the costs back to their origin so that no additional time needs to be built into the proceeding. Thus, the EDCs should provide clear detail in the additional information provided so that Staff and Rate Counsel can efficiently and effectively review the additional information in the annual BGS proceedings. Staff's goal is to avoid the issues regarding any mismatch of the costs with the revenues in the future and to provide a venue, which allows Staff and Rate Counsel sufficient time to review the costs to determine whether they are sufficient, reasonable, prudent and directly related to the BGS. Detail was provided in the BGS filing in Docket No. ER19040428, and Staff considers this recommendation implemented except that these definitions should be included in each annual BGS and periodic reconciliation filings and shall be subject to review by the parties in that proceeding.

Chapter VI: Allocation of Administrative Costs to Customers

13. **Provide to the BPU supporting information sufficient to demonstrate that patent-related legal costs originally included in delivery rates were charged to BGS customers per the established allocation factors**.

The EDCs generally applied well-defined and appropriate allocation principles during the audit period, with two (2) exceptions, involving ACE. As discussed earlier in Recommendation 6 under Chapter III, ACE did not include patent-related legal costs in its BGS Administrative Cost Recovery process.

EDCs: Partially Agree - ACE agrees with this recommendation and has corrected the under-inclusion of patent- related legal expenses. A report and reconciliation of this correction will be provided as a part of ACE's next BGS Reconciliation Charge filing, which will be filed with the Board on or prior to April 30, 2019.

Rate Counsel: Agrees

Direct: No comment

Staff Agrees: Staff confirmed that ACE made the correction in the BGS Reconciliation charge filing to move patent litigation costs from the delivery charge to the BGS. ACE must provide supporting documentation within 15 days of the effective date of this order to show that it removed it from delivery rates.

14. **Adjust ACE charges to the BGS-RSCP and BGS-CIEP to reflect the appropriate allocation of Auction Manager and Staff/Board Consultant Charges for the 2013 to 2016 BGS periods.**

Prior to February 2014, ACE allocated Auction Manager and Staff/Board consultant costs to the BGS-RSCP and BGS-CIEP customers on an 80/20 basis. ACE then began to allocate 100 percent of these costs to the BGS-RSCP customers. The 80/20 split for 2014 would reduce charges to BGS-RSCP customers by $88,337, with costs to BGS-CIEP customers increasing by this same amount. ACE will determine the amounts based on actual factors applicable for the 2014 through 2016 BGS periods, which the auditors found to be an appropriate approach.

EDC: ACE Agrees - ACE agrees with this recommendation and has corrected the ACE charges to the BGS- RSCP and BGS-CIEP to reflect the appropriate allocation of Auction Manager and Staff/Board Consultant Charges for the 2013 to 2016 BGS periods. A report and reconciliation of this correction will be provided as a part of ACE's next BGS reconciliation filing, which was filed with the Board on April 25, 2019.

Rate Counsel: Agrees

Direct: No comment

Status of Implementation: ACE corrected the allocation of the Auction Manager charges in December 2018. This was done via a journal entry by ACE's accounting department, which re-classed the charge between the RSCP and CIEP classes for the 2013 through 2016 BGS period to reflect the appropriate allocation for those time periods. The April 25, 2019 BGS Reconciliation Charge filing reflected this change for rates effective June 1, 2019.

Staff: Agrees - Staff confirmed that ACE made the correction in the BGS Reconciliation charge filing.

Chapter VII: Review of Auction Manager Costs

15. Periodically subject Auction Manager services procurement to meaningful competition.

While Liberty concluded that the Auction Manager spent a large quantity of person-hours on the New Jersey BGS Process, making its costs more expensive than those typical of other jurisdictions, it also concluded positive results of examining these costs. Hence, Liberty concluded the decline in audit period costs for Auction Manager Services was positive, and reasonable overall. Liberty also concluded that the system costs associated with a DCA reasonable and the costs of the consultant to staff and the BPU reasonable.

Liberty did however conclude that the EDCs have not opened the services provided to competition. Liberty stated that the methods used to introduce more competition need not rise to a formal RFP process, recognizing the nature of the specialized, professional services involved. Additionally, Liberty believed that the services provided by the Auction Manager do not need to be acquired via a competitive process on an annual basis but rather periodically and suggests a three-year period to be appropriate at the outset. With respect to extending the life of the competitive cycle with the Auction Manager, Liberty suggested negotiating cost reductions under the contract in exchange for an extension of the one-year contract.

EDCs: Disagree - The EDC's believe it is reasonable and prudent to treat NERA as a sole-source provider, with all of the necessary controls over their charges and invoices, while acknowledging that the Board reviews the EDCs' proposal for the designation of an Auction Manager on an annual basis. The EDCs point to the Auction Manager's extensive experience and expertise in serving at Auction Manager for the New Jersey BGS auction. During the seventeen 17 years that NERA has been in managing the BGS auction, the BGS auction has overwhelmingly been deemed successful which the EDCs state that Liberty has recognized in its Audit Report.

Rate Counsel: Agrees

Direct: No comment

Staff: Disagrees – Staff does not concur with the recommendation to subject the Auction Manager services to competition at this time. Because of the unique expertise of NERA, the successful DCA process and management thereof, and patent issues related to the current DCA process, this recommendation poses a unique circumstance that must be considered when deciding to open the Auction Manager of the current DCA procurement approach to competition. Given this unique relationship, selecting another Auction Manager would most likely require changes to the electric supply procurement approach. Moreover, with Staff not recommending any changes or abandoning the current DCA mechanism of procuring electric supplies, and the Audit Report indicating findings that set forth benefits resulting from the DCA auction, Staff does not recommend that the Board direct the EDCs to solicit bid proposals for a new Auction Manager of the DCA or subject the Auction Manager to competition at this time.

<u>Chapter VIII: Timing of Charges for Services</u>

16. Move Auction Manager billing into conformity with a 45-day benchmark.

The Auction Manager's monthly invoices that exceed the 45-day benchmark make it more difficult and complicate measures to reconcile estimated to actual costs according to Liberty. Liberty stated that this change would not impose burdensome changes to the Auction Manager, and would enhance accounting and charging for BGS administrative costs.

EDCs: Agree - The EDCs agree with this recommendation and will coordinate with NERA on its implementation.

Rate Counsel: Agrees

Direct: No comment

Status of Implementation: As of June 1, 2019, NERA and the EDCs reached an agreement so that invoices will be timely submitted.

Staff: Agrees - Staff concurs with Liberty that lags in the Auction Manager's invoices could make it difficult to reconcile estimated costs with the actual costs since, at times, the reconciliations were done in subsequent auction years. Staff agrees with the recommendation. It will assist in the review process and help streamline the review since it will be easier to compare actuals with the estimates from the appropriate energy years. Staff confirmed that the EDCs have coordinated with NERA to provide for more-timely invoice submittals. Staff reviewed the specific language between NERA and the EDCs and it meets the intent of the recommendations and is satisfied that the EDCs and NERA have reasonably implemented the recommendation.

<u>Reply Comments to Initial Comments</u>

EDCs: The EDCs reaffirmed their initial comments filed with the Board with regard to each of Liberty's specific recommendations and respectfully request that only comments and issues that are within the scope of this administrative cost audit be considered in this matter.

Rate Counsel: No Reply Comments

Direct: No Reply Comments

Staff: Disagrees with the EDC's reply comments. Staff evaluated the EDCs' reply and initial comments with respect to the scope of the audit and asserts that Liberty's recommendations all relate to expenses incurred during the acquisition of BGS supply and are within the scope of the audit. Any BGS policy recommendations herein are related to the BGS administrative expenses incurred as a result of using the DCA approach to acquiring supplies. Therefore, Staff does not concur with the arguments and positions taken by the EDCs.

DISCUSSION AND FINDINGS

As noted above, there are 16 recommendations in Liberty's Final Report for improvement in the management and accounting for BGS Administrative Expenses. The EDC's agree with 8 recommendations (Nos. 5, 6, 7, 8, 9, 10, 14, and 16), partially agree with 4 of the recommendations (Nos. 3, 11, 12, and 13) and disagree with 4 of the recommendations (Nos. 1, 2, 4, and 15). As also noted above, with respect to recommendations 2 and 15, Staff agrees with the EDC's and does not recommend implementation by the Company at this time.

Staff recommends implementation of the remaining 14 recommendations as recommended or modified by Staff. Staff confirmed that the EDCs generally implemented recommendations: 5, 6, 7, 8, 9, 12, 13, 14, and 16 and partially implemented or are in the process of implementing recommendations 3, 6, 8 and 9. The EDCs do not agree with recommendations 1, 2, 4, 11 in part and 15.

After review of the Final Report, the comments filed by the EDCs, Rate Counsel, and Direct Energy and Staff's recommendations, the Board agrees with Staff's recommendations. Therefore, upon careful review of the Final Report recommendations and the comments received, the Board **HEREBY ORDERS** the EDC's to implement the 14 recommendations in the Final Report, as modified above if not already implemented. With respect to the recommendation #3, the Board **DIRECTS** that the EDC's establish a schedule of common direct and indirect expenses no later than September 1, 2020.

Specifically, the Board **HEREBY DIRECTS** EDCs, with the assistance of the Division of Audits, to formulate detailed implementation plans for the 14 recommendations as modified above, within 60 days from the date of this Order. The EDCs shall implement all recommendations as soon as possible but no later than one year from the date of this Order unless otherwise directed in this Order above.

Furthermore, the Board **HEREBY DIRECTS** the EDCs to file quarterly reports with the Division of Audits, by the fifteenth day of the month following the conclusion of each calendar quarter, regarding the status of all recommendations. The Division of Audits shall monitor, evaluate, and modify, as necessary, the implementation of the recommendations. Although the EDCs state they have implemented various recommendations as discussed above, and it appears that appropriate adjustments have been made, the EDCs have a continuing obligation to demonstrate to Staff and Rate Counsel that the approved recommendations have been implemented in the implementation stage of this audit, or any BGS or base rate case proceedings, depending upon the adjustment.

The recommendations of the Final Report shall not be dispositive of issues raised in any other proceedings before this Board.

This Order shall be effective on July 25, 2020.

DATED: July 15, 2020

BOARD OF PUBLIC UTILITIES
BY:

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PRESIDENT

MARY-ANNA HOLDEN
COMMISSIONER

DIANNE SOLOMON
COMMISSIONER

UPENDRA J. CHIVUKULA
COMMISSIONER

ROBERT M. GORDON
COMMISSIONER

ATTEST:

AIDA CAMACHO-WELCH
SECRETARY

IN THE MATTER OF THE REQUEST FOR PROPOSAL FOR A FINANCIAL AUDIT OF THE NEW JERSEY ELECTRIC DISTRIBUTION COMPANIES' BASIC GENERATION ADMINISTRATIVE EXPENSE AND OTHER RELATED EXPENSES

DOCKET NO. EA17010004

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