

I/M/O the Implementation of L.2018, c. 16 Regarding the Establishment of a Zero Emission Certificate Program for Eligible Nuclear Power Plants

BPU Docket No. EO18080899

Comments of the New Jersey Large Energy Users Coalition

Pursuant to the Board's November 19, 2018 Order Establishing the Program, Application, and Procedural Process, the following are the generic comments of the New Jersey Large Energy Users Coalition ("NJLEUC") in response to the applications filed by Public Service Electric and Gas Company ("PSEG" or the "Company") and Exelon Corporation ("Exelon") (together, the "Applicants") for Zero Emission Credits pursuant to L. 2018, c. 16 (the "ZEC Act").

I). Due Process Issues

For the first time in its fifteen year existence, NJLEUC, an organization that represents the interests of PSE&G's largest customers, was denied intervention in this proceeding and access to confidential materials regarding the financial condition of the Applicants' nuclear plants. It was determined that PSE&G's largest customers--the New Jersey businesses who face the prospect of paying up to \$1 million a year or more each to subsidize the Applicants' nuclear plants--are not "essential" parties under the ZEC Act and cannot be trusted with access to Applicants' financial information. The denial of intervenor status to NJLEUC stands in stark contrast to the treatment afforded comparable business groups and other diverse stakeholders in I/M/O Public Service Electric and Gas Company's Rate Unbundling, Stranded Costs and Restructuring Filings, 167 N.J. 377 (2001), in which similar issues regarding the profitability of the utility's nuclear and other power plants, market projections and the propriety of stranded costs were considered, and in which all stakeholders, including utility competitors, were granted intervenor status and afforded access to confidential materials pursuant to a standard non-disclosure agreement.

In a word, the "essential party" standard is unknown in administrative law and, as interpreted by PSE&G in its opposition to literally all intervention motions, would exclude all parties other than Board staff. Even Rate Counsel, the statutory representative of ratepayers, had to fight to be included in the case. The refusal to grant NJLEUC intervenor status and afford these businesses access to confidential materials precludes NJLEUC from having a meaningful voice in this proceeding, in which the vast majority of relevant financial documents and information have been withheld from production to all but two parties.

The denial of intervenor status to NJLEUC is a clear violation of NJLEUC's due process rights, which require that NJLEUC members be afforded a meaningful opportunity to speak for themselves to avoid being deprived of their significant property interests in their capital and New Jersey operations. *See, Matthews v. Eldridge*, 424 U.S. 319, 332 (1976); *see also, Greenberg v. Kimmelman*, 99 N.J. 552, 568 (1985) ("The Fourteenth Amendment of the United States Constitution provides that no state shall "deprive any person of life, liberty or property without due process of law. Article I, paragraph 1 of the New Jersey Constitution protects similar interests"). Due process required that NJLEUC be granted intervenor status and afforded an opportunity to review the financial information regarding Applicants' nuclear plants.

As set forth in the following section, NJLEUC members have an extraordinary financial stake in the outcome of this proceeding, property interests that they will largely be unable to properly protect given their “bystander” status in this proceeding.

II). “The ZEC Act Protects New Jersey Consumers”

A. The True Cost of the Proposed ZEC Subsidies to the State’s Large Businesses

In their applications, the Applicants argue that the interests of consumers are protected by the ZEC Act because, among other reasons, consumers would not be required to make ZEC payments unless they are needed. (*See, e.g.* PSEG Salem 1 Application at p. 14) Nothing could be further from the truth.

As a preliminary matter, it is important for the Board to be aware of the true impact that ZEC payments will have on the State’s businesses. It has become common practice for utility regulatory filings to contain a statement regarding the rate impact of proposed programs on an “average residential customer”. In most cases, the numbers portrayed are modest, usually between \$5 and \$10 per year. Similar statements have been made by PSEG to the Legislature and Board in this proceeding. Even Rate Counsel has projected a modest ZEC payment of about \$4 per month for a residential customer with minimal usage.

While rate impact on residential customers is an appropriate benchmark for the Board to consider, it should not be the only one. It is noteworthy that the rate impact of proposed programs on large businesses is never mentioned. This is not surprising because industrial customers pay for these programs based on the large number of kilowatt hours they consume. Thus, while the proposed subsidy is a “modest” \$0.004/kWh, when this seemingly small number is multiplied by the large number of kWh consumed by industrial customers, the result is a very large number that provides a very different lens through which the actual cost of the ZEC program must also be considered.

NJLEUC members were recently polled regarding the anticipated annual cost of the ZEC program to them. The calculation used to determine their cost was a simple one: multiply \$0.004 times their facilities’ annual kWh consumption. The members reported projected costs in the range of \$300,000 at the low end to \$1 million and more annually at the high end. *The cost of the ZEC program to the “average” NJLEUC member would be \$570,000 per year.* Because the ZEC program could last for ten years, or longer if extended, the average NJLEUC member faces the prospect of paying an additional \$5.7 million or more for the same service that they currently receive.

It is worth noting that NJLEUC members have the small “benefit” of knowing that these ZEC payments are potentially looming on the horizon. However, it is likely that many of the State’s businesses, including large users that are not members of NJLEUC, have no idea that they could be exposed to this significant additional annual business expense, which will not have been included in the companies’ annual budgets. Companies that have not been part of this process or have not closely monitored or fully comprehended the reporting of it would have no reason to consider the impact of ZEC payments on their businesses, particularly given the reporting about

the modest impact on residential customers and seemingly microscopic \$0.4 cent charge. However, because the ZEC payments are established by the ZEC Act as a non-bypassable and irrevocable charge, it follows that these companies will be compelled to reduce or reallocate their budgets, or increase the cost of their products to accommodate this additional and unwelcome expense, potentially for ten years or more.

Nor should the very substantial ZEC charge be viewed in isolation. It is no secret that PSE&G's transmission rates have increased more than 450% in recent years due to the Company's aggressive expansion of its transmission infrastructure. At the same time the ZEC bill was pending in the Legislature, the Board approved a second stage multi-billion dollar PSE&G gas main improvement program. PSE&G's distribution rates were significantly increased in the Company's combined electric and natural gas rate case last year. There are also currently pending the Energy Strong II and Energy Efficiency filings that have a combined "ask" of about \$5 billion. These latest filings make clear that they are only the latest installments of a seemingly endless succession of such programs designed by PSE&G to create additional revenue streams to satisfy the growing and apparently insatiable profit expectations of the Company's shareholders and Wall Street. It should also be recognized that the current filings are only the latest in a long succession of multi-billion dollar PSE&G solar and electric and gas infrastructure programs that have already been included in the Company's rates.

This simply cannot continue if the State has any interest in retaining its rapidly depleting industrial base. This is not monopoly money at issue. The dollars spent on these endless programs are just as real, and have the same impact on businesses' bottom lines as taxes and other expenses incurred to do business in New Jersey. High energy costs adversely affect the competitiveness of New Jersey's businesses, particularly those that are national in scope, which compete not only with other companies, but also intra-company with facilities located in other, less costly states for the right to produce certain product lines or for investments of capital. As costs increase here, the companies' New Jersey facilities lose these internal competitions with facilities located elsewhere, resulting in corporate decisions to produce product lines elsewhere. These decisions are generally accompanied by job losses or transfers and reduced capital investments in the New Jersey facilities. If the situation persists long enough, this "industrial death spiral" culminates in the closure of the New Jersey facilities.

NJLEUC has made these arguments countless times and perhaps people are tiring of hearing them. However, the group speaks from hard-won experience that the State ignores at its peril. NJLEUC was founded by companies like Hoffmann-LaRoche, Lenox China, Gerdau Ameristeel (once PSE&G's largest customer), glass and pipe companies and a number of others that remain in business but have long since departed New Jersey. *We are not crying wolf. We can no longer tolerate these continuing wealth transfers and unjustified windfalls to a single, well-connected company that is unquestionably successful, deriving profits on the tired backs of business customers who do not have the option of obtaining rich government subsidies when the markets in which they compete fail to produce desired profit levels.*

We ask the Board to take notice of the true costs of this program and its impact on all ratepayers as a strong basis to deny the pending applications.

B. The ZEC Subsidy Requested by the Applicants is Unjust and Unreasonable.

Each of PSEG's three "interdependent" applications state repeatedly that "absent a material financial change [a term that is nowhere defined in the ZEC Act or the applications], the plants will cease operations within three years unless all three plants receive ZECs that adequately compensate the plants for their costs and risks". (*See, e.g.* PSEG Salem 1 Application at p. 6). While not stated directly, it is clear that PSEG is satisfied that the ZEC subsidy will provide the level of additional compensation that the Company seeks to continue its nuclear plant operations. Because PSEG lobbied hard for the ZEC value in the ZEC Act, the subsidy presumably includes the generous return on investment that PSEG's chairman has publicly indicated he seeks, a return that is nearly double the return currently approved by the Board for utility assets in rate base. In a separate section, NJLEUC will address the issue whether, following the enactment of the Electric Discount and Energy Competition Act, N.J.S.A. 48:3-49 et seq ("EDECA"), ratepayers have *any* obligation to compensate deregulated electric generation plants for their costs and risks. In this section, we address whether the rate PSEG has essentially established for itself is just and reasonable, and demonstrate that it is not.

The ZEC Act establishes the subsidy rate at \$0.004 (0.4 cents) per kWh of consumption, which purportedly "reflects the emission avoidance benefits" associated with the continued operation of the nuclear plants. The ZEC Act did not attempt to describe or quantify these benefits, or demonstrate how the rate was designed to capture them. Indeed, the derivation of the rate was never formally revealed and the subject was largely treated as an unanswered "mystery" that persisted throughout many of the Legislative hearings on the bill.

NJLEUC provided testimony during one of the Legislative hearings to dispel the so-called "mystery" because, in reality, there was no mystery involved. It was never a secret that PSE&G spared no expense in lobbying in support of the ZEC Act, and made plain the level of the subsidy it wanted to receive: \$300 million per year. With its preferred annual subsidy amount in place, all that was left to do was to divide the \$300 million by the total kilowatt hours of electricity consumed by all customers statewide in the prior year (as all customers would be required to pay the ZEC) to derive a subsidy of 0.4 cents per kilowatt hour.

The fact that the subsidy was fixed in a PSEG-inspired bill, prior to any Board, Legislative or stakeholder study of the current and projected financial condition of the nuclear plants, underscores that the rate was established arbitrarily, with the active involvement of an interested party acting for its own benefit--the antithesis of a process designed to result in a just and reasonable rate. Although PSEG claims that "the ZEC Act was also clear that consumers should not make ZEC payments unless they are needed", the truth is the ZEC Act fails to tie or limit the amount of the subsidy to proven, actual revenue shortfalls, if any, sustained by the nuclear plants. The fact that ZEC eligibility is determined in advance, and would be payable on an irrevocable basis during three year eligibility periods, merely accentuates the likelihood that unnecessary payments will be made, as the plants could be profitable during some or all of these periods and these profits would not be recognized or preclude the payment of the fixed ZEC. Thus, the ZEC Act creates the clear potential for the payment of undeserved and overstated financial windfalls to the Applicants, reminiscent of the payment of billions of dollars in non-existent stranded costs by

ratepayers to support these same profitable nuclear plants as part of the restructuring of the electric industry.

In truth, NJLEUC and others do not require access to PSEG's confidential financial data to know that the Company has no need for a ZEC subsidy. PSEG has repeatedly admitted that the plants currently operate at a profit and will continue to do so for an indeterminate period of time—a time period that will clearly overlap at least the first ZEC eligibility period, in which more than \$1 billion would be paid to ZEC recipients. The continuing profitability of the PSEG nuclear plants is underscored by the PJM Independent Market Monitor's comments in this proceeding:

...there is no evidence that PSEG's nuclear plants are uneconomic and facing a retirement signal from the PJM markets. A plant is economic if it covers the annual expenditures required to operate the unit because it is more profitable to continue to operate the plant than to shut it down. The PSEG units are economic and expected to be economic in the foreseeable future based on market data. (October 22, 2018 IMM ZEC Comments, at p. 2).

If approved, the ZEC applications would produce a scenario in which the Applicants would receive a minimum of hundreds of millions of dollars in ZECs even though, by the PSEG's own admission, the nuclear plants are and will remain profitable on a going forward basis.

Thus, in the totality of these circumstances the ZEC subsidy is an unjust, unreasonable and extortionate rate, designed and applied to enhance the Applicants' profits on their deregulated nuclear plants to benefit their stockholders at the expense of ratepayers statewide, who were long ago relieved of any financial responsibility for these nuclear plants. The ZEC Act adopted PSEG's chosen "plugged" value for the ZEC and a rate regime that would enable eligible applicants to receive a non-bypassable, irrevocable and fixed \$300 million annual subsidy, based only on amorphous and unquantified "emissions avoidance" criteria, and regardless of whether the nuclear facilities are profitable, break even, or incur actual annual losses of only \$300, \$3 million, or the full \$300 million during one or more years of the three year eligibility periods. The applicants further suggest that the ZEC Act prevents the Board from reducing the subsidy until after the first eligibility period, thereby affording no protection to ratepayers against the unnecessary payment of ZECs until after ratepayers have already shelled out \$1 billion in subsidies or more.

So this is a just and reasonable rate?

Clearly not. In the absence of any effort to establish a rate base, a suitable rate of return or any legally cognizable basis to value ZECs, the subsidy cannot be considered just and reasonable and must be rejected. To the extent that applicants seek to characterize the subsidy as a "separate" charge that would simply be added to the applicants' existing utility rates, this would not avoid the long-established ratemaking requirement that "the usual proofs of rate base and reasonable rate of return [establish] the justness and reasonableness of the rates". In re Intrastate Industrial Sand Rates, 66 N.J. 12, 19 (1974). Regardless of whether a base rate or subsidy is at issue, our Supreme Court has consistently observed that utility ratepayers have the right to pay utility rates that are not excessive, *see*, In re Redi-Flo Corp., 76 N.J. 21, 39 (1978), and that "the public is not to be laden

with unreasonable or extortionate rates in order that dividends be provided for the utility's stockholders". In re Intrastate Industrial Sand Rates, *supra*, at 22.

Fortunately, notwithstanding any suggestion of the ZEC Act to the contrary, the Board has been delegated full authority to address the potential injustice to ratepayers that is threatened by the ZEC Act. A long succession of appellate decisions establish the Board's broad authority over all utility rates, a power delegated by the Legislature that is firmly rooted in our Constitution:

The law has thus developed, no doubt, because the system of rate regulation and the fixing of rates thereunder are related to constitutional principles which no legislative or judicial body may overlook. For if the rate for the service supplied be unreasonably low it is confiscatory of the utility's right of property, and if unjustly and unreasonably high...it cannot be permitted to inflict extortionate and arbitrary charges upon the public. *And this is so even where the rate or limitation on the rate is established by the Legislature itself.* (citations omitted) (emphasis supplied). In re Intrastate Industrial Sand Rates, *id.* at 23-24.

Industrial Sand further addressed the Legislative delegation to the Board of expansive ratemaking authority to approve just and reasonable rates:

...rulemaking is a legislative and not a judicial function, and the Board of Public Utility Commissioners, to which the Legislature has delegated its rate making power, is vested with broad discretion in the exercise of that authority... For the delegation of the legislative function to be valid under our Constitution it is essential that adequate standards be prescribed by the Legislature and adhered to by its agent, in this instance the Board... The statutory standard prescribing the rate-making powers of the Board is to be found in R.S. 48:2-21(b)(1), which provides that the Board may "Fix just and reasonable individual rates whenever the Board shall determine any existing rate... to be unjust, unreasonable, insufficient or unjustly discriminatory or preferential." *id.* at 21. *See also*, In re Public Service Electric and Gas Company's Rate Unbundling, *supra* at 384-385.

There can therefore be no question that the Board has the authority, indeed the obligation, to ensure that the ZEC subsidy, as established and administered, is just and reasonable. Nothing in the ZEC Act dictates a different result, particularly given the Board's constitutional obligation to reject unjust and unreasonable rates, and its statutory authority to determine eligibility for ZEC subsidies that flows from the ZEC Act itself. If, after the Board conducts a proper review of the proposed ZEC regime in this proceeding, it determines the subsidy to be unjust, unreasonable or excessive vis-a-vis the amount found to be necessary to continue the nuclear plant operations, the

Board would be well within its delegated authority to reject as unjust and unreasonable the proposed application of a 0.4 cent/kWh subsidy to support the Applicants' nuclear plants.

In a similar vein, there is nothing that obligates the Board to award ZECs that are equivalent to a full 40% of the State's generation fleet (if for no other reason than the fact that nuclear generation currently accounts for only about 33% of the State's fleet). Under the authorities cited above, the Board is unquestionably delegated the power to award less than this amount if the evidence developed in this proceeding does not justify such an award. This is particularly so given the likelihood that awarding the full 40% will likely result in ZECs being awarded to one or more out of state nuclear plants, thereby putting New Jersey ratepayers in the dubious position of subsidizing plants, jobs and local economies in neighboring states. Unfortunately, under the ZEC Act, New Jersey ratepayers will also be forced to subsidize the power exported by the New Jersey nuclear plants to benefit out of state ratepayers who have no obligation to pay ZECs. This results in an additional disadvantage to New Jersey businesses, as they are forced to compete with out of state businesses that are not saddled with paying \$500,000 or more annually in ZECs.

As the case law makes clear, it is the Board's constitutional duty to prevent the imposition of an unjust and unreasonable rate, particularly one that would result in windfall profits to deregulated power plants. The Board must determine for itself whether the proposed ZEC subsidy is just and reasonable and, if found to be unreasonable, the subsidy should be rejected. If the payment of some subsidy is determined to be appropriate in the circumstances, and that one or more applicants are entitled to receive ZECs, the Board must assure that the subsidy awarded is carefully tailored to offset only the proven, annual losses of each nuclear plant and provide only the level of assistance that is truly required to assure the continuing operation of the plants, and nothing more. It is critical that the Board avoid repeating the terrible mistake made years ago--authorizing the payment of excessive, multi-billion dollar stranded costs, on an irrevocable, non-bypassable, long term basis, to compensate PSEG for non-existent "losses" that PSEG had similarly projected for the same nuclear plants.

The Board has the clear authority to prevent the payment of an unjust and unreasonable rate to the Applicants, and the attendant financial windfalls that would benefit their shareholders to the significant detriment of ratepayers. NJLEUC urges the Board to exercise the broad powers delegated by the Legislature and reject or tailor the ZEC to a just and reasonable rate that is justified in the circumstances, and to reject all arguments that would attempt to circumscribe the Board's broad authority to address the justness and reasonableness of the ZEC rate.

III). Ratepayers Have No Obligation To Financially Support Applicants' Deregulated Power Plants

The Applicants argue that the nuclear plants satisfy the "financial needs" requirement of the ZEC Act and provide Board of Directors' resolutions stating that without a material financial change, the plants will cease operations in three years. More specifically, applicants argue that they are eligible to receive ZECs because the revenues projected for the plants "do not fully cover the projected costs and risks over the next three years absent a material financial change" and

would not achieve a “reasonable return” under any standard of comparison. (*See, e.g.* PSEG Salem 1 Application at pp.6-7).

The Applicants would suggest that we have come a long way since the State deregulated utility electric generation plants, a long process that terminated ratepayer responsibility for the costs and risks associated with these plants and shifted that responsibility fully to utility shareholders. However, the ZEC Act does not repeal or amend this twenty year old regulatory compact, which culminated in the enactment of the Electric Discount and Energy Competition Act. EDECA’s primary purpose was to restructure the form of utility regulation from that of a vertically integrated, monopoly model--in which ratepayers were responsible for all costs and risks associated with the generation function--to a competitive model, in which utility shareholders assumed responsibility for these costs and risks in exchange for an award of billions of dollars in stranded costs and an ability to charge the market-based rates established in the wholesale markets.

The following analysis of the restructuring of the electric and natural gas markets by the Board during the period 1995 through 2002 is provided to assist the current Board in placing the relief sought in the applications in this historical context. It bears reiterating that nothing in the ZEC Act purports to overrule any section of EDECA, or evidences an intention to either re-regulate the electric generation industry or return to cost of service rate regulation of utility generating plants.

A. The Restructuring of the Electric Power Industry in New Jersey: The Basics

The restructuring of the electric power industry was the regulatory and Legislative response to high energy costs in New Jersey which, in the mid-1990’s, were 50% above the national average. Contributing significantly to these high costs were the costs associated with long term power production and supply commitments, primarily rooted in the fixed costs of utility-owned generation plant and long term power purchase arrangements with non-utility generators. The primary goal of the restructuring was therefore to reduce utility generation costs and, ultimately, the cost of electricity to retail customers, by tapping into the developing competitive power markets. Retail competition was viewed as the natural corollary to the parallel development of the competitive bulk power markets, open access transmission under FERC Order 888 and the transition from utility power pools to the formation of Independent System Operators like PJM.

The primary initial step in the restructuring process was the unbundling of utility rates. In the vertically integrated monopoly model, utilities provided “bundled” services at a single delivered cost to customers. To facilitate the transition to competition, the costs associated with each of these services--generation, transmission, distribution and customer account services—were functionalized, isolated and “unbundled” to enable the generation and customer account services functions--the services that were not deemed natural monopolies—to be opened to competition. The unbundling of the costs of the competitive services was also intended to avoid the creation of subsidies in rates and cross-subsidization between the utilities’ regulated and non-regulated functions. *See, In re Public Service Electric and Gas Company’s Rate Unbundling, Stranded Costs and Restructuring Filings*, 330 N.J. Super 65, 85 (App. Div., 2000).

The generation-related costs that were removed from utility customers' rates as part of the rate unbundling included the following:

- All generation-related capital and operation and maintenance costs
- All related allocated overheads
- Fuel Costs
- Costs associated with long term power purchase arrangements

See, Restructuring the Electric Power Industry in New Jersey—BPU Findings and Recommendations, Docket No. EX94120585Y, April 30, 1997, at p.148 (excerpt attached). See also, N.J.S.A. 48:3-52.

The BPU's Final Order in I/M/O Public Service Electric and Gas Company's Rate Unbundling, Stranded Costs and Restructuring Filings, dated August 24, 1999, included a Finding that PSEG's generation facilities, including the nuclear power plants, were to be transferred to an unregulated affiliate, and that "customers will no longer be exposed to operational risks associated with these facilities". The Board further explained the risks and rewards that would accrue to the unregulated affiliate with the transfer of the nuclear facilities: "With respect to the transfer of the nuclear generation assets...we noted above the benefits associated with the transfer of not only operational risk but also decommissioning risk and responsibility to (an unregulated affiliate), attendant with the (affiliate's) opportunity to earn non-regulated returns associated with the sale of power and related services from the nuclear units." (Order at 104-105)(excerpt attached)

The transition of the generation function to competition therefore meant that all costs and risks associated with utility generating plants that were previously paid by utility ratepayers would be segregated, and the responsibility for payment of these costs assumed by utility shareholders. PSEG specifically acknowledged this arrangement in the Stipulation that PSEG prepared to settle the restructuring case, which included PSEG's acknowledgement that "the amount of the consideration being received by Public Service is extremely reasonable given the fact that under the Stipulation the electric utility's consumers are insulated from any liabilities associated with the transferred generation facilities". (PSEG Stipulation at p. 47)(excerpt attached).

The transition also marked the end of the Board's economic regulation of the power generation function, terminating the Board's historic and extensive ratemaking and cost of service regulation of power production, the issuance of certificates of need that were then required to authorize construction of new generating facilities and other such regulatory devices. Thus, in this new paradigm, the generation function would no longer be regulated by the Board or supported by ratepayers paying regulated, cost of service-based rates, but would instead be transitioned to competition in the deregulated power markets, with utility generators granted authority to charge favorable market-based rates and with all cost responsibility and risks shifted to utility shareholders. See, N.J.S.A. 48:3-56.

PSEG and other utilities had expressed concern that the market-based rates established by the competitive markets would be lower than the production costs that were embedded in the utilities' regulated rates, thereby potentially exposing the utilities to a situation in which they were

unable to fully recover their embedded costs through the competitive market. These so-called “stranded costs” represented the amount by which the embedded costs of utility generation service incurred by the utility as part of the “regulatory compact” to serve the general public exceeded the competitive market price that could be obtained for the service. Stated differently, stranded costs represented the generation plant costs that the utilities were at risk of losing when the supply markets opened to competition. In re PSE&G Rate Unbundling, Stranded Costs and Restructuring Filings, 330 N.J. Super 65, 90 (App Div, 2000); N.J.S.A. 48:3-61(a).

To address the utility concerns regarding recovery of these costs, the Board convened a separate stranded cost proceeding in which PSEG and others presented the testimony of numerous witnesses, and produced voluminous financial information, including detailed projections regarding the future profitability of the deregulated power plants in the competitive markets. PSEG’s presentation concluded that its plants, including the nuclear plants, would incur substantial losses going forward in the competitive markets and requested commensurate relief from the Board.

As a result of the stranded cost proceeding, and based in large measure on PSEG’s financial presentation, the Board authorized a stranded cost recovery, recoverable through a non-bypassable and irrevocable market transition charge, that was designed to compensate PSEG for the embedded production costs that PSEG projected would be above market and not otherwise recoverable in market-based rates. The stranded costs award was thereafter securitized and recovered through an irrevocable transition bond charge that was paid by PSEG ratepayers for fifteen years. N.J.S.A. 48:3-62(a).¹

B. Let History Be A Guide: Mistakes That Should Not Be Repeated

It should be immediately evident that significant parallels exist between the restructuring proceedings and the ZEC proceeding, making it important that the lessons learned from the restructuring not be forgotten. Some of the more pertinent lessons that are relevant to the ZEC Proceeding are discussed in this section.

- i) Because The Restructuring Completely Absolved Ratepayers Of Financial Responsibility For Deregulated Generation Plants, The Inclusion In ZECs Of Any Costs Or Risks Associated With The Nuclear Plants Would Result In An Unjust And Unreasonable Rate

As previously noted, nothing in the ZEC Act purports to supersede or overrule any portion of EDECA, which deregulated power generation and fully shifted cost responsibility for the deregulated generation plants to utility shareholders. At first blush, Section 3 of the ZEC Act, which addresses the content of ZEC applications to the Board, seemingly blurs responsibility for the costs and risks associated with the nuclear plants as between utility shareholders and

¹ It is noteworthy that in the stranded cost proceeding, a multiplicity of intervenors, including PSEG’s competitors, were permitted access to PSEG’s confidential information—information that was closely analogous to the information denied to interested parties in this proceeding--pursuant to a standard non-disclosure agreement.

ratepayers. However, a closer reading makes clear that Section 3 merely permits applicants to include in their application the delineated cost items to establish their eligibility to receive ZECs.

Section 3(a) provides that as part of such applications, applicants may provide information to the Board regarding the nuclear plants' operation and maintenance expenses, fuel expenses, non-fuel capital expenses, fully allocated overhead costs and other costs and risks. Of course, these are precisely the types of obligations that EDECA assigned to utility shareholders and removed from ratepayers. In accordance with ZEC Act, PSEG's applications each state that the projected revenues for the nuclear plants "do not fully cover the projected costs and risks over the next three years without a material financial change" and argue that even with the ZEC payment, "projected revenues are inadequate to cover and costs and risks of the unit". (*See, e.g.* Salem 1 Application at p. 6). From certain public statements by its Chairman, it is apparent that PSEG has included in its calculation a guaranteed return on capital that is about double the return the Board currently authorizes for regulated utility assets, a cost component that is, by any measure, beyond the pale. The Board should flatly reject the notion that it is somehow appropriate for the Board to include such an exorbitant, guaranteed return on unregulated, competitive assets in a just and reasonable rate.

Given the continuing vitality of EDECA, as well as PSEG's prior commitments in the restructuring dockets, it would be singularly inappropriate to request the Board to shift responsibility for the costs associated with these deregulated plants back to ratepayers through a back door approach that would ostensibly recover these otherwise unrecoverable costs through the ZEC. While the ZEC Act may prescribe the types of information that an applicant can provide to the Board to establish eligibility to receive ZECs--however they are valued--it is clear that EDECA, the BPU Final Order in PSEG's Restructuring dockets, and PSEG's stipulation remain viable and refute any notion that costs associated with the nuclear plants may properly be included as a component of ratemaking or made the responsibility of utility ratepayers in this proceeding.

In a word, PSEG's transparent attempt to lard up a subsidy with a cornucopia of costs and risks that have explicitly been made the responsibility of utility shareholders, together with a shamelessly high guaranteed return on capital, cannot result in a rate that may be considered just and reasonable by any stretch of the imagination.

While PSEG would have the Board believe that it has little choice other than to validate and implement PSEG's preferred subsidy, this is clearly not the case. No authority exists, including the ZEC Act, that requires the Board to merely be PSEG's rubber stamp in this proceeding. Rather, the Board should exercise its broad delegated authority to assure that any rate approved here is not only just and reasonable but also closely tethered to the actual losses, if any, sustained by the nuclear plants each year. If the Board were to act in any other manner, it could result in the establishment of an unjust and unreasonable rate that could unnecessarily burden ratepayers for many years.

ii) Beware Of Market Projections, Windfalls And Irrevocable Rates

In PSEG's Stranded Cost Proceeding, PSEG offered dire projections regarding the future prices that could be obtained for its generation in the competitive wholesale power markets. PSEG's market projections--which are no doubt similar to the ones now being offered to support

its ZEC applications--provided the basis for the Board's decision to award PSEG nearly \$3 billion in stranded costs. The Board also permitted PSEG to securitize a substantial portion of the award with irrevocable transition bonds which, under EDECA, could not be challenged by any party, at any time and for any reason. N.J.S.A. 48:3-62 and N.J.S.A. 48:3-64.²

During the stranded cost proceeding, PSEG produced voluminous financial documents and market projections, as well as substantial expert and fact testimony, to support its argument that it would be unable to recover more than \$3 billion in embedded generation costs in the competitive markets. The financial documents and projections were subjected to a detailed audit, performed for the Board by its consultants, ICF Kaiser, Vantage Consulting, and others, as part of the consultants' attempt to conduct a detailed analysis of PSEG's stranded cost petition.

If one subscribes to the notion that past is prologue, the Board should derive no comfort from the fact that in their Report, the Board's auditors felt compelled to express their displeasure regarding the difficulty they had experienced in their multiple unsuccessful attempts to obtain "necessary information from PSE&G on its mitigation efforts and projected stranded cost recovery":

Despite repeated requests for more detailed information in interviews, individual conversations (including with Mr. Codey [PSE&G's then President]), and formal questions, the company has not provided a projection of how they plan to recover their stranded costs and why they need a seven year transition period. Without this information, and without independent analysis, the Board and its consultants will be forced to rely upon the company's unmitigated financial projections and generic statements about what they expect to be able to recover and the difficulty associated with recovery of their stranded costs.

In order to provide an independent financial assessment of the PSE&G proposal, the Consultants prepared a financial analysis of PSE&G's financial status under various scenarios. With limited information and assistance from PSE&G, the consultants reverse engineered and calibrated their financial model to the PSE&G forecasts. Adjustments to this financial model for alternative demand, market, and mitigation assumptions were used throughout this chapter to analyze PSE&G's proposal. (ICF Kaiser Report, January 21, 1998, at p. 213)(excerpt attached).

² To underscore the point that once established the stranded costs could not be challenged, we refer to a petition brought in 2007, which requested the Board to review PSEG's "over-collection of stranded cost surcharges" and to provide relief as appropriate. Although at the time the petition was filed it was common knowledge that PSEG was reaping large windfalls through its stranded cost recovery, the petition was nevertheless dismissed by the Board essentially for failure to state a claim, a decision that was later upheld on appeal, based on EDECA's irrevocability provisions. *See, I/M/O Petition of Richard G. Murphy II for Mandatory Relief for PSE&G's Overcollection of Stranded Cost Surcharges Pursuant to N.J.S.A. 48:3-61*, BPU Docket No. EO07050516, Order dated April 12, 2011.

Given this background of non-cooperation by PSEG with the Board's consultants in an analogous proceeding, NJLEUC urges the Board to be vigilant against this kind of stonewalling here. Unlike the fully litigated stranded cost proceeding, PSEG has helped create circumstances here in which the Board has precious little time to accomplish a very sophisticated financial analysis of the current and future profitability of multiple nuclear plants. The Board's task is made more difficult by the ZEC Act's adoption of the unprecedented "essential party" standard that has eliminated all but Board staff, Rate Counsel and the PJM Independent Market Monitor from playing a meaningful role in analyzing the Applicants' pertinent financial materials.

To prevent history from repeating itself, the Board should require applicants to comply with all information requests in a complete and timely manner, and treat an applicant's failure to properly comply with such requests as a basis for denying the application. The Board cannot again be placed in a position in which its consultants have no recourse but to reverse engineer critical financial models to fill in missing, but critical information, particularly given the clear potential for modeling errors to result in faulty determinations and unnecessary financial windfalls to ZEC recipients.

With regard to the accuracy of PSEG's stranded cost projections, it should come as a surprise to no one that PSE&G's market projections and dire warnings about the uncertain future of the nuclear plants in the competitive markets proved to be completely unfounded. Rather, literally from the outset of competition, the PSEG generation fleet, and in particular its low operating cost nuclear units, benefited from generous PJM market clearing prices that were driven by high priced natural gas. In fact, PSEG's generation affiliate, PSEG Power, quickly became the cash cow that for many years drove the profits of the Public Service Enterprise Group.³

It is noteworthy that the rich profits being earned by the nuclear plants was a primary motivation for the proposed PSEG/Exelon merger in 2005. The specter of the merger of the companies' large generation fleets caused significant concerns that the combination would create the potential for the exercise of market power and inflated energy costs. Underscoring the significant value of the nuclear plants to the companies, it is noteworthy that the companies rejected all settlement proposals that would have required the companies to divest the nuclear plants. At most, the companies indicated they would agree to "virtually" divest the nuclear plants, an unprecedented arrangement that would have required the companies only to relinquish control of the plants but not the right to share their profits.

Despite the significant windfalls being earned by the nuclear units in the competitive power markets, ratepayers were still required to support the plants with the payment of billions of dollars in stranded costs, even though it was well known that the plants were highly profitable and did not require subsidy. Unfortunately, as noted, ratepayers were precluded from challenging the payment of stranded costs because their collection was secured by the non-bypassable market transition charge and irrevocable transition bonds.

³ It is not a coincidence that it was only after the supply market turned downward years later that PSE&G began proposing its many multi-billion dollar solar and infrastructure investment programs.

To underscore the point that this mistake should not be repeated again, it is important to put the financial impact of the payment of stranded costs on New Jersey businesses in perspective. Throughout the fifteen year stranded cost recovery period, it was common for NJLEUC members to pay market transition charges as high as \$100,000 *per month*. Over the fifteen year recovery period, this meant that each of these members paid a total of \$18 million to PSEG-- an unjustified and unconscionable wealth transfer for which nothing was received from PSEG in return. Ironically, at the end of the stranded cost recovery period, PSE&G sought to leverage the impending expiration of the market transition charge to persuade these same businesses that the implementation of PSE&G's proposed \$4 billion Energy Strong program would not increase their bills over "current" rates, which included the stranded cost surcharge.

Conclusion

It is beyond dispute that utility ratepayers already have paid for the Applicants' nuclear units several times over. The costs associated with the nuclear units were first included in utility rate base under cost of service regulation for more than twenty years before the advent of competition. As the "price" for retail competition, ratepayers were required to PSEG billions of dollars in unnecessary stranded costs, even as the unregulated nuclear units reaped windfall profits attributable to high energy market prices that were nearly double today's levels. Now, with the proposed ZEC payments--yet a third bite at the nuclear funding apple--ratepayers are asked to shower still more money on these units, not merely to cover their operating expenses, but to prop up their desired profit margin because the windfall profits have diminished, at least for now, threatening the 18% return that is coveted by the Company's chairman and shareholders.

Applicants' latest request for a ratepayer bailout is both unjustified and unconscionable. Do Applicants' believe that market-based rates are only valid when they yield windfalls and high profits and can be abandoned at the first sign of trouble? Did PSEG ever share any of its windfalls with ratepayers, or refuse to accept the billions in stranded costs because it turned out they really weren't needed? Regulated New Jersey business ratepayers should never be forced to guarantee the profits and exorbitant rates of return of unregulated businesses that far exceed the returns attainable in competitive markets for themselves?


History should be a guide. The decisions made in this proceeding made in this proceeding will be enormously consequential in terms of the financial impact on ratepayers and potential long term implications for the competitive energy markets. We have attempted through these comments to point out the potential landmines that lie ahead and explain the impact these issues will have on the State's largest businesses, as they are considerable. We know this because we have been here before and need to learn from past mistakes.

In a word, PSEG&G ratepayers are not, and should not be used as a regulatory rainy day fund, to be tapped at will by PSE&G for the benefit of an unregulated affiliate (or for itself). ZECs represent precisely the sort of cross-subsidization that EDECA went to great lengths to prevent. Rather, EDECA's message could not be clearer--unregulated affiliates performing competitive services must compete without any financial assistance from their regulated utility affiliates. Having eagerly basked in sky high unregulated returns for many years, the Applicants' nuclear

plants must now take their medicine and accept the reality that they may have to accept more profit margins that are more in line with those that are achieved by the businesses that pay Applicants' bills.

NJLEUC urges the Board to deny the Applicants' ZEC applications.

Respectfully submitted

A handwritten signature in black ink, appearing to be 'SG', written over a horizontal line.

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Restructuring the Electric Power Industry in New Jersey

Findings and Recommendations

Docket No. EX94120585Y

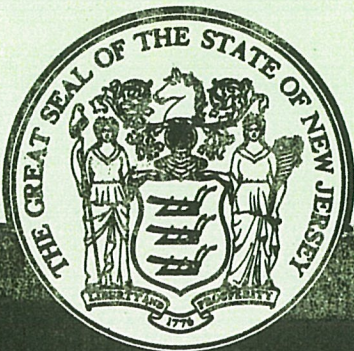
New Jersey Board of Public Utilities

Herbert H. Tate, President

Carmen J. Armenti, Commissioner

Division of Energy

Robert Chilton, Director



April 30, 1997

NEW JERSEY BOARD OF PUBLIC UTILITIES

to be provided on a monopoly basis by the electric utility, regulated by the BPU. As well customer services, at least initially, will be provided by the electric utility at prices regulated by the BPU.

B. Unbundled Services

1. Generation Service:

The specific industry model for the introduction of retail competition has been hotly debated in this proceeding, as it has in other state proceedings across the country. What is generally agreed among the commentators, and what we conclude, is that the generation (production) function is no longer a natural monopoly, and that power suppliers can and should compete directly against one another. For this to occur, the current vertically-integrated industry structure must be unbundled at a minimum into separate generation, transmission, and distribution functions as will be addressed below.

As the power production and supply segment of the industry is opened up to competition, economic regulation of generation as the Board has historically applied it will be ended. Rather, generating assets will be subject to market forces, with production from those facilities fetching market prices, based upon spot markets or individual negotiations between buyers and sellers as described below⁹.

While economic regulation of generation would be eliminated, we emphasize that there is a need to continue environmental regulation, including siting and permitting, of

⁹ As will be described in a later section of this report, net revenues produced by existing utility-owned generation sources will be determined for a transitional period of time by a combination of market forces and regulation, as exercised through the establishment of a stranded cost or market transition charge.

generating facilities in the State. Such siting and permitting regulations should be the same and applied equally to all generation facilities in the State in order to ensure a fair competitive market¹⁰.

With respect to creating a level playing field for the siting of power plants, we do not envision this entailing any State-mandated changes to local zoning and land use ordinances. These should continue to be developed and applied at the local level. However, at present, electric utilities, as provided for in N.J.S.A. 40:55D-19, may file with the Board for an override of a siting denial by a municipality per local zoning ordinances, and the Board may so grant, if it is shown that a proposed power plant (or other proposed utility facility such as a transmission line) is "reasonably necessary for the service, convenience and welfare of the public." The intent of the law is essentially to provide the Board with the ability to override decisions made in a particular locale, which do not best serve the larger public benefit. Non-utility generators (NUGs) do not enjoy similar State-sanctioned redress against adverse local decisions. In order to provide for a competitive generation market, there must be equal treatment of all generators with respect to siting. N.J.S.A. 40:55D-19 must either be expanded to include NUGs, or must be amended to eliminate a utility's ability to seek override of local ordinances for purposes of constructing a generating plant.

On the other hand, the Electric Facilities Need Assessment Act (EFNAA) provides that, prior to the construction of a new electric generating plant of 100 MW or more; or the addition to an existing electric generating plant that will increase its capacity by 25% or by more than 100 MW (whichever is smaller), a public utility must apply for and obtain

¹⁰ There is as well a critical issue with respect to the application of environmental standards to generating plants located in different States, which is addressed in a later section of this Order.

a Certificate of Need (CON) with the BPU. The EFNAA, adopted in the early 1980's in the wake of large and costly nuclear power plant construction programs, provides for a lengthy and detailed review by the Board of the need for a planned power plant prior to construction. This process is estimated to take up to three years to complete. In addition to addressing the need for the additional generating capacity, the EFNAA requires as a condition to issuing a CON that the proposed plant is determined to be the most efficient, economic and environmentally sound option available. NUGs are not covered by the EFNAA, and accordingly are not required to seek nor obtain a CON prior to construction. While in a regulated, monopoly electric utility industry structure the EFNAA provided important public protections against wasteful and unnecessary utility power plant construction projects, in a competitive marketplace, where the project owner and not the ratepayer is taking the risk of a poor investment, such a requirement is unnecessary. Moreover, imposition of CON requirements on one segment of the industry (i.e. utilities) and not another, results in an unlevel playing field. We therefore recommend that, concurrent with the transition to a competitive retail electric marketplace, that the EFNAA be repealed.

For economic regulation of power supply to be ended, the power supply market must be fully competitive. As previously described, this requires the formation of an entity such as an ISO to operate the transmission system in an unbiased manner. Moreover, in order for the electric power market to function in an efficient and fully competitive manner, it is imperative that no individual seller or group of sellers be able to influence the market price for power. Were such market power to exist, a cessation of economic regulation of supply could lead to unintended and unwanted results, as will be described.

Two types of potential market power have been referenced in this proceeding; and in the restructuring debates throughout the country: vertical and horizontal. Vertical market power can occur when a single firm controls successive stages of production in an industry.

In the electric industry, this could occur when a firm or firms actively competing in the generation/supply business control(s) the delivery system, i.e. transmission and distribution. Quite obviously, such an industry structure is fraught with the potential for abuse by the firm(s) controlling access to the delivery network. In short, a transmission-owning utility seeking to sell power to consumers in an unregulated market, could restrict its competitors' access to the wires and thereby "hold out the competition." Without effective competition, such a utility could then charge inflated prices to customers.

As described previously, it is envisioned, and indeed it is a precondition to the introduction of a competitive retail market, that an ISO will be in place to operate the transmission system and take control out of the hands of utilities that also own generating assets. Accordingly, the ISO will have no interest in any market participant. This will ensure that all suppliers have equal and open access to the interstate transmission grid, and that vertical market power as described above cannot be exercised.

As well, utility-owned generating assets and related generation operations should, at a minimum, be functionally separated from the transmission and distribution services of the electric utilities in the State. In this manner, while an entity may still own assets in various stages of the industry, such shared ownership cannot be translated into undue preference or unfair competitive advantages in competitive markets, through hidden subsidies provided through monopoly services. It has been argued by a number of participants in this proceeding that functional separation still requires substantial regulatory oversight to prevent such hidden subsidies from occurring, and that divestiture of generating assets by utilities is required to provide the most certain protection against cross-subsidization between non-competitive transmission and distribution services and competitive generation offered by utilities.

Divestiture of generation assets by the utilities has also been advocated as a means of alleviating horizontal market power concerns¹¹, by dispersing ownership of generating assets. Currently, the vast majority of the approximately 57,137 MW of generating capacity located within the Mid-Atlantic region is owned by electric utilities. However, that ownership is spread among the eight utility companies comprising the PJM power pool, with the largest ownership share by any one company being about 19.0%. Moreover, substantial blocks of power from generating sources outside the PJM region are being and will be sold into this region. On the other hand, with one merger of PJM utility companies (BG&E and PECO) already pending approval before both state and federal regulators and another proposed merger (ACE and Delmarva) recently filed before the FERC as well as State commissions, concerns regarding market concentration quite naturally increase.

Finally, divestiture has been supported by some as a means of providing a market valuation of utility generating assets for purposes of quantifying potentially stranded generating costs. This will be described more fully in the "Stranded Cost" section of this report.

It has been argued by utility companies, on the other hand, that the offering for sale of large blocks of utility-owned generating capacity in New Jersey as a result of forced divestiture (a so-called "fire sale") could depress market value and thereby exacerbate the stranded cost problem. Moreover, an issue was raised in this proceeding as to the impact which large-scale divestiture of utility-owned generating plants in the State would have on the labor force at those facilities. Finally, substantial question has been raised regarding whether the Board has the authority to order a divestiture of utility assets, raising the

¹¹ Horizontal market power can exist when a single firm or firm(s) own or control a high concentration of assets in a given market. For these purposes, this can be taken to mean a high concentration of generating assets in the regional or local power market.

prospect of protracted litigation were such a directive to be issued.

We are committed to assuring that a fully competitive marketplace exists, prior to the cessation of economic regulation of power supply. Accordingly, we reiterate our precondition that a fully independent ISO, consistent with the FERC's ISO principles be in place prior to the introduction of retail competition. Moreover, we reiterate our conclusion that, at a minimum, utility generating assets and functions must be separated and operate at arms length from the transmission, distribution and customer service functions of the electric utilities. Such separation is best achieved, we believe, through the formation of separate affiliated generation companies.

It is undeniable that a divestiture would provide the most definitive means of addressing concerns regarding cross-subsidies and mitigate the need for regulatory oversight of dealings between the competitive and regulated sides of utility operations in order to prevent vertical market power abuse. However, there are numerous legitimate concerns raised with regard to forced divestiture, as described above, and there is real potential for delays which resolution of these issues may cause. The elimination of potential unfair dealings does not provide a sufficient basis in and of itself to take this drastic measure, and we judge such action at this time to be premature. Moreover, the retail market we are proposing, as described below, we believe provides protections for customers against self-dealing between the distribution utility and its affiliated generation and other vertical power abuse. Moreover, within the rate unbundling proceeding to be discussed in a later section of this report, there will be a full opportunity to appropriately allocate all direct and indirect utility generation-related costs, including an assignment of all appropriately allocable shared overheads such as salaries, office space, supplies, etc., to the generation charge, thus preventing hidden subsidies in charges for regulated services.

We would therefore direct that each electric utility restructuring plan provide a plan for,

at a minimum, functionally unbundling its generation assets from other parts of its business. Such functional unbundling plan must include sufficient protections to ensure that the generation company is essentially functioning as a separate business unit, with the distribution company treating the affiliate generation company no differently than other competitive suppliers. The burden will be on the utility to demonstrate why such functional unbundling should not entail the formation of a separate affiliated generation company. Moreover, in order to ensure a level competitive playing field we will develop within the context of the restructuring filings codes of conduct for relationships between the distribution company and generation and marketing affiliates, including mechanisms for imposing penalties for any proven violations thereof.

However, we would reserve final judgment on the issue of mandatory divestiture of generating assets until such time as specific and detailed market power analyses have been performed and analyzed. We would direct each electric utility to submit, as part of its restructuring plan filed in response to our final Order in this matter, a comprehensive market power study for Board scrutiny. Such an analysis will have to include not only an assessment of the regional power market, but it must also examine the impact of transmission constraints on the formation of more localized markets, which could lead to undue market concentration in specific geographic locations. Indeed, given New Jersey's geographic position on the eastern end of periodic west-to-east transmission system constraints, and the relative concentration of generating assets in New Jersey under the ownership of relatively few entities¹², this issue will require particular attention. In the event that such analysis demonstrate that there are legitimate market power concerns which may adversely impact the formation of a fully competitive marketplace, and thereby expose consumers to higher prices than would be the case in a competitive marketplace, we would

¹² We emphasize that this is largely a qualitative observation, and no conclusions should be drawn from this observation without appropriate empirical analysis.

take additional action. As the regional power market and transmission grid are to a large degree common to PSE&G, JCP&L and ACE, upon the receipt of the individual market power studies these will be combined into a generic review process.

Moreover, we would entertain proposals within the restructuring plans filed by each utility for appropriate incentives for the utility to divest itself voluntarily of certain generating assets.

We further emphasize that, even in the event that mandatory divestiture is ultimately deemed necessary to address horizontal market power issues, such an action without appropriate safeguards is not necessarily a foolproof solution to these market power concerns. If a particular non-utility entity or small group of entities were to purchase all generating assets put out for sale, it is possible that market concentration may not be resolved, only transferred. Safeguards would have to be put in place to protect against such occurrences. Moreover, given our concern that electric industry restructuring impact positively on the retention and creation of jobs in the State's economy, the potential impact on the utility labor force of a divestiture would have to be addressed.

We would also note that we would expect that other agencies, including FERC, the Federal Trade Commission and the Department of Justice, will be assessing the potential for anti-competitive activities in power markets throughout the country as the industry transitions to full competition.

2. Transmission Service:

As described earlier, electric transmission is defined generally as the movement of power from the point(s) of generation to the distribution system. Very generally, transmission facilities encompass high voltage (such as 500 and 230 kilovolt) wires

We will solicit filings only from the electric utilities on July 15, 1997. Parties to the proceedings will have the ability and opportunity, under the procedural guidelines and timetables to be determined by the BPU, to present testimony supporting modifications or alternatives, to the filings.

We direct each electric utility in the State to formally submit to the Board, no later than July 15, 1997, formal filings as described below, and otherwise consistent with the determinations in this Report. It is our intent to complete our review of each filing, and render final decisions, by no later than October 1998, in order to meet our recommended date for the introduction of retail competition in New Jersey.

FILING 1A: Rate Unbundling

A prerequisite to the establishment of retail competition is an unbundling of the rate structures for the electric utilities.

The following guidelines are intended to provide the minimum filing requirements and framework for rate unbundling filings to be submitted to the Board for review and approval by the State's investor-owned public electric utilities.

Services listed below are meant as a guideline for developing a rate structure that can accommodate and be the precursor to a restructured electric power industry where end use electric customers will have the option of procuring electricity (energy and/or capacity) from other than the native utility company. This list is not intended to be all-inclusive or to necessarily foreclose the proposal of other unbundled or competitive services.

Timing & Process

Unbundling filings would be subject to the BPU's administrative procedures, including intervention, discovery, and public and evidentiary hearings. The filings may be accepted, rejected or modified by the BPU.

The unbundled rates approved as a result of this filing would be implemented for a utility concurrent with the date of introduction of retail competition in its service territory.

Rate Unbundling

The filing would, at a minimum, include a **separate charge for customer, distribution, transmission, production and societal benefit services** for each existing customer rate class.

The **production charge** would include **all generation capital and operation and maintenance costs, related allocated overheads, fuel costs and power purchase costs.**

The **customer charge** would be a **flat monthly charge which reflects the capital and operating and maintenance cost, and an appropriate allocation of overheads, associated with metering, billing and account maintenance.**

The **distribution charge** would be a unit (per Kwh and/or per kw) charge that reflects **the capital and operating and maintenance cost associated with distribution facilities, and an appropriate allocation of overheads, required to provide distribution service to a customer.** This charge would also reflect the rate recovery of regulatory assets.

The **transmission charge** would be a unit (per Kwh and/or kw) charge which reflects **the capital and operating and maintenance cost associated with transmission facilities, and an appropriate allocation of overheads, required to provide transmission service to a**

customer. This charge could also reflect the rate recovery of regulatory assets.

The **societal benefits charge** [(SBC)] would be a **per unit charge** that separately collects the costs currently embedded in rates, associated with the current provision of DSM, gas plant remediation, nuclear decommissioning and societal programs including winter moratorium, "bad debt" customers, low income assistance and weatherization and existing late payment and deposit policies. To the extent that certain of these costs could not be readily identified and separated from the bundled cost of utility service, a utility may propose to keep such costs bundled within the distribution charge.

A utility or other party to the proceeding would be provided the opportunity to propose, subject to review and consideration by the Board during the proceeding, that some of these charges could be rebundled for billing purposes. Rate rebundling for billing purposes would be considered by the Board in order to avoid customer confusion or for other appropriate reasons.

To the extent not already done in current utility tariffs, a utility would also be required to **propose separate charges for all competitive services** (other than production services -- already addressed in the production charge) offered to customers.

A separate charge or charges would also be proposed for **load balancing** or similar **reliability-related services** being offered by the utility pursuant to its filed restructuring plan.

In addition to the charges identified above, provision would be made for an additional unbundled charge referred to here as a **non-bypassable stranded cost or market transition charge**" (MTC). Such a charge would reflect that component of a utility's current production costs which is "above market," but nonetheless ultimately deemed recoverable in rates, consistent with the proposed findings and recommendations in section VII. of this

report. The production component of unbundled rates would accordingly be adjusted such that it reflected the removal of such "above market" costs. Indeed once retail competition begins, the production charge would simply be the price for power agreed upon between the customer and the supplier or the market price charge by basic generation service by the utility.

To the extent that a utility has filed or is filing simultaneously a base rate case, for purposes of regulatory efficiency it is appropriate to merge the unbundling filing and the stranded cost filings with such base rate case.

Cost Allocation and Rate Design

There has been discussion in this proceeding regarding the possibility of "restructuring" rates within the context of a rate unbundling proceeding. For these purposes, rate restructuring is defined as a reallocation of existing cost responsibility and revenue recovery among and between customer classes to address perceived subsidizations built into the existing rate structure. We are quite concerned with rate restructuring. As articulated throughout this report, it is our principal aim in this entire undertaking, consistent with other important goals, to bring about relief for all customers in the State from the current high level of rates being paid. It is our conclusion that all classes of customers are in need of relief from the high cost of electricity in the State. Any attempt at rate restructuring could, we believe, by shifting existing cost responsibility, have the effect of actually increasing rates for certain groups of customers. Such a result is undesirable, to the say the least.

Accordingly, in these filings, it is our determination that each utility be required to file unbundled rates, based upon an embedded cost of service analysis, which would achieve complete revenue neutrality on a company-wide basis relative to existing rates and, inter-class and intra-class revenue neutrality vis-a-vis existing bundled rates. Such

revenues neutrality is critical, we believe, because rate unbundling filings are not intended as base rate cases and, as such, there will be no opportunity afforded in these proceedings for a utility or other party to propose a change in the overall revenue requirements of the company²³. Nor, as will be described below, is it our desire that these filings produce a shifting of cost responsibility between customers. In those instances where a full base rate case is filed and merged with the unbundling proceeding, a utility would be required to file new unbundled rates which result in a similar rate impact on all customer classes.

In its filing, each utility must disaggregate the current bundled rate for each rate class into its functionalized components; that is, by production, transmission, distribution and customer functions. Except as otherwise noted, the cost of service study utilized, consistent with BPU-approved cost allocation methodologies, in the last base rate case when current base rates were established, should be employed to functionally disaggregate current bundled rates. To the extent that transmission charges currently paid by the utility pursuant to FERC-approved transmission tariffs are different than those suggested by the cost of service study, the current FERC charges would supercede. Once rates were disaggregated as described, the next step for the utility is to remove from the appropriate functionalized charge the costs associated with societal benefits, for purposes of setting the SBC, and the costs associated with other services for which a separate charge is being proposed.

The utility will be further required to provide bill impact analyses for customers of various sizes within each rate class, to demonstrate that the bill paid under the proposed unbundled rates is the same as that currently paid under existing bundled rates. Note: These “revenue-neutral” unbundled rates are for reference purposes, to which the rate reductions required by Section VII, will subsequently be applied.

²³ The only possible exceptions to this being the application of a MTC which resulted in some alteration in the current recovery of generation costs or, as indicated, if the utility unbundling filing is merged with a base rate case proceeding.

A utility may also file alternative unbundled rates, supported by an embedded cost of service analysis, that propose a reallocation of inter-class or intra-class revenue recovery vis-a-vis existing bundled rates. Other parties to the proceeding will also have the opportunity to present evidence and argue that some particular service(s) within the existing utility rate structure is, based upon embedded cost of service analysis, the object of a cross-subsidy. However, the utility or other party making such proposals would have a substantial burden of proof to demonstrate that the current rate design as approved by the Board is not reasonable. Further, it would be a basic principle that the final unbundled rate design approved by the Board would not result in any shifting of inter-class or intra-class revenue responsibility relative to current rates for equivalent service unless the utility or other moving party demonstrates and the BPU so finds that:

- 1) existing rates reflect cross-subsidies which, if perpetuated, will adversely impact the functioning of competitive markets; and
- 2) any identified and proven cross-subsidies are not otherwise appropriate for public policy reasons.

Again, we emphasize in this regard our strong aversion to any reallocation of rates within an unbundling filing that would result in an increase in rates, relative to bundled rates, for any group of customers.

FILING 1B: Stranded Cost Filing

The portion of a utility's stranded costs determined to be appropriately recoverable from ratepayers must be the net of all reasonable transition cost mitigation efforts available to the utility. The recoverable portion of the utility's non-mitigatable stranded cost should be collected via a non-bypassable charge, which will be referred to here as a market transition charge. It is further proposed that this market transition charge be assessed on all end users connected with the power grid in that distribution utility's service territory, regardless of the voltage level at which the customer takes service from the grid.

Absent a divestiture of generating assets by the utilities, in order to assess currently the magnitude of potentially stranded cost, it is necessary to estimate the market value of utility production. As the market develops and matures over time, it is likely that the precision of stranded cost quantification will improve. The market transition charge should therefore be subject to true-up, to reflect the realized market value of utility production through the transition period, either via market sales of power or from asset divestiture.

There will need to be a formal filing by each utility to determine a specific initial level of the market transition charge, consistent with our conclusions in Section VII. of this report. In essence, this market transition charge would become one element of the unbundled rate structure of the local distribution company; essentially a sub-component of the unbundled production charge. It is anticipated that the market transition charge, once established and implemented, will be phased out over a period of 4 to 8 years. The precise initial level of the market transition charge, as well as duration and rapidity of the phase-out, should be proposed by each electric utility and ultimately established by the Board based upon the policy findings set forth in Section VII. of this report.

FILING 1C: RESTRUCTURING/SEPARATION PLANS

The utilities must file for BPU review and approval specific plans to implement retail competition, consistent with the findings in this report. Such filings would include, but not necessarily be limited to the following, consistent with the conclusions in this report:

- a) plans to functionally unbundle generation operations from the transmission, distribution, customer and energy service operations to ensure against anti-competitive behavior and/or plans to voluntarily divest of generation assets; plans for the operational and cost treatment of nuclear generating facilities; a horizontal market power analysis, a review and the establishment of specific standards of conduct aimed at specific proposed competitive services;
- b) the establishment of procedures for customers to choose their supplier of generation service, including the provision on a timely and non-discriminatory basis of customer load profiles to customers and/or suppliers, as well as

**IN THE MATTER OF PUBLIC SERVICE ELECTRIC AND GAS COMPANY'S RATE
UNBUNDLING, STRANDED COSTS AND RESTRUCTURING FILINGS
FINAL DECISION AND ORDER
BPU DOCKET NOS. EO97070461 EO97070462, AND EO97070463**

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Accordingly, we **FIND** the assertion that under the terms of the Stipulation PSE&G will overrecover the agreed upon level of stranded costs by over \$1 billion to be based upon a flawed analysis and plainly incorrect.

As described herein, the Board received voluminous comments with respect to the asset valuation associated with the proposed transfer of generation assets to the affiliated Genco, with emphasis on the underlying support for the transfer itself, and particular emphasis on the value to be assigned to the non-nuclear generating units. At the outset, we **FIND** that the proposed transfer of generating assets from PSE&G to Genco and the proposed BGS supply arrangement from Genco to PSE&G are amply supported by the record in this proceeding. The Company's filing proposed that the Company would remain in the generation business throughout the then-proposed seven-year transition period, with PSE&G utilizing its generation assets to backstop capacity and reliability in New Jersey and the PJM grid during this period, and then transferring its generation assets to an affiliate of the holding company at the end of the transition period. This proposal was submitted in the context of PSE&G's assertion that a liquid and visible capacity market did not yet exist in the PJM control area, and the resultant proposal by PSE&G that the retail electric market be opened to competition on an energy-only basis, with PSE&G being responsible for continuing to provide capacity for all retail customers. It is clear, and PSE&G has since acknowledged, that a liquid and visible capacity market has, in fact, been developed by the PJM ISO, and that the PJM now conducts regular capacity auctions. Accordingly, we **FIND** that the conditions which were originally assumed to prevail at the end of the then-proposed seven year transition period, and which supported the proposal to transfer the generation assets at that time, are currently in place, and therefore support the immediate transfer of the assets.

We further **FIND** that the proposed BGS supply arrangement between Genco and PSE&G provides known rates and assurances during the transition period. Rather, than having PSE&G and its customers solely and immediately dependent on the wholesale marketplace for the procurement of BGS energy and capacity, the Genco arrangement provides a price guarantee and a capacity backstop, similar to the assurances which PSE&G originally proposed that it provide during the transition period via the retention of the generation assets within the utility. Since all the PSE&G generation facilities, including its nuclear power plants, will be transferred to the unregulated Genco affiliate, customers will no longer be exposed to operational risks associated with these facilities. Until BGS is bid out for year four of the Transition Period, Genco will assume all risks associated with providing BGS service at the pre-determined BGS prices. We **FIND** this reduction of risk and the fixed price to be a substantial benefit to customers. We are also of the view that the provisions of paragraph 29 of the Stipulation, which require that the transferred generation capacity be maintained by Genco as a capacity resource within PJM for at least the duration of the Transition Period is a significant benefit to consumers during periods of heavy demand. We **FIND** this restriction to be consistent with the intent of the originally-

which become the responsibility of Genco) in PSE&G's rates, and because the transfer of assets will result in the generation employees remaining employees under the holding company, we **FIND** that the transfer will not adversely impact PSE&G's ability to meet its pension obligations to its employees.

We note that, as a result of the transfer of all generating assets to Genco, Public Service Enterprise Group will likely have non-regulated assets in excess of 20%. The Board's Decision and Order implementing the results of the Focused Audit (Docket No. EA92040459) ("Focused Audit Order") required the Company to notify the Board if the non-regulated assets exceeded 20% to allow the Board to assess the potential adverse financial effects of under-performing non-regulated businesses on the credit-worthiness of PSE&G, and thereby prevent possible impairment of the utility's ability to render safe, adequate and proper service. Due to significant changes in the industry and in particular, the changes in the Company's corporate structure being brought about as a result of this Final Decision and Order, modifications to the Board's June 17, 1986 Order Authorizing Transfer of Stock and Approving Merger, Docket No. EM8507774, ("Holding Company Order") and relief from or modifications to the Focused Audit Order may be warranted. The Company is **HEREBY DIRECTED** to file a petition to either maintain the existing regulatory parameters or to propose modifications thereto, by no later than the end of the first quarter of 2000. In the interim period, the Board will deem Public Service Enterprise Group and PSE&G not to be in violation of the non-regulated asset ratio established by the Board in May 1993. However, the Board will continue to monitor this issue and reserves the right to make further rulings in this matter as warranted.

With respect to the transfer of the nuclear generation assets (and the related transfer of the decommissioning trust funds in accordance with paragraph 33 of the PSE&G Stipulation), we noted above the benefits associated with the transfer of not only operational risk but, also, decommissioning risk and responsibility to Genco, attendant with Genco's opportunity to earn non-regulated returns associated with the sale of power and related services from the nuclear units. In order to ensure that the risk and responsibility of decommissioning is fully transferred to Genco along with the transfer of the assets and the decommissioning trust funds, recognizing that funding for decommissioning will remain in the SBC paid by PSE&G customers, we believe it necessary to place parameters on such continued funding by ratepayers and we shall do so. We, therefore, **DIRECT** that, within ninety (90) days of the date of this Order, PSE&G submit to the Board for its approval, a specific proposal a limit to its financial responsibility for funding, and, in turn, for ratepayers' obligation to fund through the SBC, the cost of decommissioning the nuclear units transferred to Genco. We **ADDITIONALLY DIRECT** PSE&G to submit all accounting entries that will be made upon the transfer of the decommissioning trust funds to Genco.

With regard to the level of securitization of stranded costs, the ALJ concluded that PSE&G's proposal in the case to securitize \$2.5 billion of its total net of tax stranded cost

STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

In The Matter Of The Energy Master Plan
Phase II Proceeding To Investigate The
Future Of The Electric Power Industry

Stranded Cost Proceeding	BPU Docket No. EO97070462 OAL Docket No. PUC 7347-97N
Unbundled Rate Proceeding	BPU Docket No. EO97070461 OAL Docket No. PUC 7348-97N
Restructuring Proceeding	BPU Docket No. EO97070463

COMMENTS IN SUPPORT OF THE STIPULATION OF
PUBLIC SERVICE ELECTRIC AND GAS COMPANY;
NATURAL RESOURCE DEFENSE COUNCIL; NEW JERSEY COMMERCIAL USERS;
INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS, LOCAL 94;
NEW JERSEY TRANSIT CORPORATION; ENRON CAPITAL AND TRADE RESOURCES;
TOSCO/BAYWAY; AND THE, INDEPENDENT ENERGY PRODUCERS OF NEW JERSEY

On Behalf of
Public Service Electric and Gas Company

April 5, 1999

separation of generation from regulated utility operations. See, e.g., Exhibits Enron-17 (R), pp.27-28, Enron-29(R), pp.16-17, IEPNJ-1, pp.5, 12; TR-2887-2890 (R).

The Stipulation also provides that at the time of transfer of the electric generating assets to Genco, Genco will include as a component of the transfer price of the generating assets the \$600 million MTC payment to be received as compensation for price stability service provided under the BGS contract. Board approval of the amount of the payment for this right to receive revenue would certainly be reasonable and in the public interest, given the fact that Public Service will have the cash available to retire debt and reduce the utility's capitalization, which will benefit the utility and customers.

In addition, at the time of transfer, materials, supplies, and fuel inventories related to the electric generation assets being transferred will also be conveyed to the Genco at book value, along with the necessary contractual rights that will facilitate the reliable operations of the generating plants.

The amount of the consideration being received by Public Service is extremely reasonable given the fact that under the Stipulation the electric utility's consumers are insulated from any liabilities associated with the transferred generation facilities. From day one, the Stipulation provides that auditable accounting protocols will be in place to assure that all expenses and capital expenditures related to generation are borne by Genco. Lastly, it ensures that the transfer does not include land held for future use (Stipulation, Paragraph 20).

Finally, Paragraph 33 of the Stipulation provides for the transfer of the nuclear decommissioning trust funds to Genco. This is necessary because subject to Nuclear Regulatory

REDACTED FINAL REPORT

Audit of Public Service Electric & Gas's Unbundling and Stranded Cost Filings of its Electric Restructuring Proposal


Docket No. EA97060397

*Prepared for the
New Jersey Board of Public Utilities*



Prepared By:

⇒ **ICF KAISER**

 **Vantage Consulting, Inc.**

Utility & Economic Consulting

Princeton Economic Research, Inc.

Filed:

January 21, 1998

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PUC 7347-97

X. FINANCIAL ANALYSIS

A. PURPOSE

The potential for mitigation in costs and the financial implications for PSE&G of over or under recovery of its stranded costs are critical and fundamental to the evaluation of PSE&G's "implicit MTC" proposal. The Consultants have had difficulty in obtaining necessary information from PSE&G on its mitigation efforts and projected stranded cost recovery. In response to interrogatories, PSE&G did provide projections of high-level financial measures and costs, e.g., net income and O&M expenditures, for the combined electric and gas company. These projections do not include any mitigation beyond depreciation changes for distribution and securitization, and do not include any explicit recovery actions, e.g., accelerated depreciation levels.

Despite repeated requests for more detailed information in interviews, individual conversations (including with Mr. Codey) and formal questions (particularly MA-PS-SC-22), the company has not provided a projection of how they plan to recover their stranded costs and why they need a seven year transition period. Without this information and without independent analysis, the Board and its consultants will be forced to rely upon the company's unmitigated financial projections and generic statements about what they expect be able to recover and the difficulty associated with recovery of their stranded costs.

In order to provide an independent financial assessment of the PSE&G proposal, the Consultants prepared a financial analysis of PSE&G's financial status under various scenarios. With limited information and assistance from PSE&G, the consultants reverse engineered and calibrated their financial model to the PSE&G forecasts. Adjustments to this financial model for alternative demand, market, and mitigation assumptions were used throughout this chapter to analyze PSE&G's proposal.

In addition, to assist the Board in the development of its response to PSE&G's proposal, the consultants have assessed the impact of alternative rate reduction levels. The financial model presented in this chapter provides the Board a tool for assessing policy and regulatory positions.

B. BACKGROUND

As was discussed in *Chapter II*, PSE&G's restructuring and stranded cost filings do not conform to the Board's Green Book guidelines. Instead of providing a specific market transition charge (MTC), PSE&G has proposed an "implicit MTC." According to PSE&G, its proposed rate freeze after a 5.6 percent rate reduction along with an energy credit over a seven-year transition period, provides the opportunity to recover stranded costs. PSE&G has indicated a willingness to be at risk for non-recovery during this transition period. Conversely, the implicit MTC also provides PSE&G the full upside potential if favorable market conditions occur or if PSE&G substantially mitigates existing stranded assets.

A fundamental question that the Board should ask about PSE&G's stranded cost filing is the level of recovery of stranded costs under the implicit MTC proposal. If PSE&G had chosen to implement the approach as directed by the Green Book, the level of MTC recovery would have been apparent.