



National Energy Marketers Association

STATE OF NEW JERSEY BOARD OF PUBLIC UTILITIES

I/M/O The Provision Of Basic Generation)
Service Pursuant To The Electric Discount)
And Energy Competition Act,) Docket No. EX01110754
N.J.S.A. 48:3-49 et seq. – Post-Transition)
Procedures)

COMMENTS OF THE NATIONAL ENERGY MARKETERS ASSOCIATION ON BASIC GENERATION SERVICE

The National Energy Marketers Association (NEM) hereby submits Comments in response to the Order issued in the above-referenced proceeding on January 10, 2002, pertaining to Basic Generation Service (BGS) being rendered on a competitive basis.

NEM is a national, non-profit trade association representing both wholesale and retail marketers of energy and energy-related products, services, information and technologies throughout the United States. NEM's membership includes: small regional marketers, large international wholesale and retail energy suppliers, billing and metering firms, Internet energy providers, energy-related software developers, risk managers, energy brokerage firms, information technology providers as well as suppliers of advanced metering and distributed generation technologies. Our membership has both affiliated and unaffiliated companies.

This regionally diverse, broad-based coalition of energy and technology firms has come together under the NEM auspices to forge consensus and to help eliminate as many issues as possible that would delay competition. NEM is committed to working with representatives of state and federal governments, large and small consumer groups and utilities to devise fair and effective ways to implement restructuring of electric markets. When consumers can get lower energy bills as a result of price competition rather than price regulation, the nation's wholesale and retail energy markets will be properly designed, and NEM members can serve both consumers and the public interest.

NEM has developed "*National Guidelines for Designing and Pricing Default Energy and Related Services*,"¹ and "*National Guidelines for Restructuring the Electric Generation, Transmission and Distribution Industries*."² NEM submits that in a

¹ The full text of NEM's "National Guidelines for Designing and Pricing Default Energy and Related Services," is available at <http://www.energymarketers.com/Documents/FinalDefaultPaper.pdf>.

² The full text of NEM's, "National Guidelines for Restructuring the Electric Generation, Transmission and Distribution Industries," is available at <http://www.energymarketers.com/Documents/FinalElectricityPaper.pdf>.

restructured environment the utilities' historical obligation to serve should be converted into an obligation to connect and deliver. Therefore, while the utilities should and will continue to provide transportation or distribution service for all customers, it is not necessary or desirable to establish the utilities, on a long-term basis at least, as the default provider of energy supply services. Indeed, the sooner the competitive market can super-aggregate small customers the sooner true price competition can begin. It is from this perspective that the questions set forth in the January 10 Order are addressed below.

I. Should BGS Be Made Available on a Competitive Basis

1. Should BGS be made available on a competitive basis?

NEM strongly supports the competitive provision of BGS. State economic regulation of the true distribution monopoly function reduces costs to society by eliminating duplication and by regulating monopoly profits. Accordingly, limiting regulation to the natural monopoly function, while permitting robust competition for all other functions, products, services, information and technology, should maximize benefits of innovation, reduce prices and provide higher quality service, while minimizing the economic distortions inherent in monopoly economics. The public interest is not served by charging monopoly prices for competitive services. Additionally, as regulated utilities fully unbundle energy supply and service functions, the provider-of-last-resort function can be provided by qualified suppliers and the obligation to serve can be modified into an obligation to connect and deliver.

Retaining the utility as the default provider of energy supply and other competitive services long term in a restructured environment will present a major barrier to the development of competitive markets. The structure and pricing of default service are critically important issues in determining whether consumers will receive the benefits of meaningful price competition. When states mandate the selection of incumbent utilities for all consumers who fail to make timely supplier elections and set a non-competitive price for default service, it perpetuates the same non-competitive energy services that restructuring is designed to replace.

- 2. What benefit(s) would customers realize if BGS were made available on a competitive basis?**
- 3. Would benefits accrue uniformly to all classes?**

When utilities are limited to performing solely monopoly functions and all other competitive services are offered by the marketplace, all consumers will receive the benefits including the potential to receive innovative product, service, information and technology offerings and to benefit from lower prices engendered by competitive market forces.

4. Would reliability be maintained? How?

NEM submits that if BGS is properly designed and priced as gold-plated, no notice, reliability service, that market participants will be enabled to render service to customers

when it is needed. Each of these requirements, if deemed necessary, should be part of the RFP. If no one bids on the service, this will demonstrate that the restrictions are not realistic or competitive.

NEM submits that risk management is a core competency for competitive suppliers. Utilities have relied primarily on the BPU to manage risks. The sooner market forces can monetize supply risk, the sooner price competition can occur. Additionally, if the political demands of the state require extra reliability then specific reserve margins can be specified in an RFP for the default supplier so that qualified suppliers can competitively bid for the extra reliability required. Marketers have long been involved in developing and aggregating commodity supply and managing supply risks. Indeed, in many cases, marketers have supplied utilities with energy and related services on an outsourced basis for years.

5. If the Board were to make BGS available on a competitive basis, should the Board allow 100% of utility customers to be eligible, or should there be a transition program?

Basic Generation Service should be a last resort service and not a standard service option. It should be used in emergency or special circumstances. Customers should be eligible to receive BGS when they are no longer being served by a competitive provider, i.e., if the customer's provider stopped doing business in the state.

BGS should be structured to encourage minimum stays not mandated minimum terms. There should not be an incentive for any class of customer to use the BGS option as a long-term standard service option. Accordingly, it is important to prohibit the BGS entity from mandating that a customer enroll for a minimum term as a condition of service in the competitive market. If customers are required to enroll for minimum service terms, the customers will be unable to shop for other competitively priced services or switch to take advantage of other types of services.

In the long term, all consumers in restructured energy markets should be served by competitive energy service providers at competitive prices. It is desirable to get to that end state as quickly as possible following the opening of the market. An example of an approach that holds promise for accomplishing a quick transition to a fully competitive market is to assign customers to competitive providers after a limited period of time. Utilizing this approach, customers who have not selected a competitive supplier during a specified enrollment period are assigned to reliable suppliers based on the market shares of those suppliers. Although there may be some regulatory restrictions and requirements, the price and non-price attributes of the default service offer under this model are determined by individual suppliers and reflect efficient and true market conditions.

II. BGS Pricing

1. What mechanism should be established for market-based pricing of BGS for Year 5 and thereafter?

Whatever default service design model is implemented (see Response to Section III.8), the Board must implement and manage rules regarding the price of default service. The pricing of default service is critically important to the development of a new competitive market because the default service price serves as the “price to compare” – the target against which all competitive offers are judged by consumers. Default service must be priced at retail rates for each customer class. If the default service price is subsidized or set artificially low, true competition on the basis of price and quality of service will not be possible. Competitive suppliers will be challenged to cover their costs and offer products that provide value to customers. If the incumbent utility acting as the default service supplier is permitted to subsidize retail energy services by passing through wholesale price signals and embedding the retail costs of energy-related services in its distribution rate, a competitive marketplace cannot occur. Indeed, permitting utilities to maintain default service and offer false price signals in the process not only distorts energy price signals, but establishes a significant barrier to effective price competition by forcing customers who switch to competitive suppliers to pay twice for retail energy services. Under these circumstances, fewer customers will choose competitive energy service providers, the utilities market share will be maintained, consumers will not benefit to the degree they should, and competitive markets simply won’t develop.

There are four basic models that have been tried or considered for the pricing of default service. They are described below, beginning with the most competitive method and ending with the least competitive.

- **Wholesale Prices Adjusted to Reflect Retail Service Costs** - This approach starts with either a periodic rate or an index rate to determine a wholesale price and then includes the additional costs of providing retail energy services. (See Section I.5 for a discussion of the energy supply and commercial costs of serving retail load).
- **Periodic Rate** – A periodic rate is a pricing mechanism that relies on regulators, auctions or market mechanisms to set prices (either wholesale or retail) annually or at some other interval that allows for changes in market conditions.
- **Fixed Rate** – Under a fixed rate mechanism the default service rate schedule is administratively determined for some period of years. The rate, which usually escalates over time, may be based on the embedded cost of utility generation, a speculative forecast of wholesale or retail prices over time, stranded cost recovery considerations and other factors.
- **Index Rate** - The index rate relies on the wholesale marketplace to set the price of default service. Customers generally pay a monthly or billing period average of the spot market price. Under this pricing mechanism, customers do not avoid the overall higher costs associated with being served by a monopoly because the retail service component remains embedded within the distribution rate.

2. How can a market-based BGS pricing mechanism best support retail choice?

The BGS pricing mechanism can best support retail choice if it is, in fact, market-based, as opposed to a long-term fixed price. The BGS pricing mechanism should be flexible enough to accommodate and reflect changes in price in the wholesale market. As discussed in Section II.1, the BGS pricing mechanism must reflect the full energy supply and commercial costs of serving retail load. The Board may also determine that BGS pricing should reflect a risk premium for rendering the gold-plated, no-notice service.

- 3. What components should the BGS price reflect?**
- 4. Should BGS pricing reflect the wholesale pricing of electricity or should it also include the retail cost of serving that customer?**
- 5. What cost should the retail adder reflect?**

BGS pricing must reflect the full energy supply and commercial costs of serving retail load. If it does not, then consumers will receive artificially low price signals. Default pricing mechanisms must not hide the true costs of providing retail energy services. Correct price signals are critical to both lower prices and conservation. Merely showing the "price to compare" as the wholesale cost of power does not benefit default service customers because they are sent a false price signal and are still paying other costs to provide electric sales service in the distribution component of the bill. Default service pricing must be designed to reflect retail prices to avoid producing artificial or cross-subsidized price signals.

Suppliers of competitive BGS service will incur costs in addition to the wholesale cost of the energy commodity including transmission charges, scheduling and control area services, distribution line losses, a share of pool operating expenses, risk management premiums, load shape costs, commodity acquisition and portfolio management, working capital, taxes, administrative and general expenses, the costs of metering, billing, collections, bad debt, information exchange, compliance with consumer protection regulations, and customer care. These costs must be reflected in the default service rate.

- 6. Should BGS pricing be the same for all customer classes?**

There must be a separate BGS entity for each customer class. The costs of providing BGS vary by customer class and service prices should be structured to reflect those differences. Additionally, it is vital that the full costs associated with each class of service be included in the BGS price.

- 7. Should BGS be priced hourly, monthly, seasonally, on a yearly average, or in some other way?**

BGS pricing mechanisms must allow prices to change over time in response to wholesale market conditions to more accurately reflect real competitive markets, provide more accurate price signals, and help level the competitive playing field.

- 8. Could market-based BGS lead to a rate increase once the rate caps are removed? If so, can the Board limit ratepayers' exposure to market-based**

BGS rate increases? Should the Board do so and if so, how should this be done?

If the Board limits consumers exposure to market-based BGS rates, in the form of a price ceiling or some other mechanism, there is the danger that the price ceiling will be set artificially low. If that is the case, it will function as a barrier to competition because competitive suppliers will be unable to compete with below-market BGS rates. Imposing a price cap simply will not foster the growth of the competitive market.

Additionally, if the Board limits consumers exposure to market-based BGS rate increases it will send false price signals and therefore undermine the possibility of any sort of demand side response. Consumers should be provided with the opportunity to see and respond to price signals, by modifying their consumption levels and/or choosing a lower-priced competitive provider.

9. How often should the Board consider the structure of BGS?

NEM asserts that default service pricing mechanisms must be designed to account for changing market conditions. There is a huge inherent risk for the State and the market if a "price to compare" is fixed and does not change over time in response to changes in wholesale markets. Such set prices put tremendous pressure on retail suppliers during periods of wholesale price volatility and provide opportunity and motivation for entities to game the wholesale market for competitive advantage. Default service pricing mechanisms that allow prices to change over time in response to wholesale market conditions better reflect real competitive markets, provide more accurate price signals, and help consumers better manage their energy consumption decisions. If, for example, BGS is awarded based on revenue bids, BGS should be reconsidered frequently enough such that the Board can reset the default service price and rebid the service periodically due to the difficulty and risk of forecasting prices into the future.

10. Should BGS be structured to provide multiple pricing options for customers?

III. General

1. What should be the role of the regulated electric distribution company if the opportunity to provide BGS becomes available on a competitive basis?

If the opportunity to provide BGS becomes available on a competitive basis, the role of the regulated electric distribution company will be limited to an obligation to connect and deliver. Qualified suppliers can bid on emergency supplies at competitive prices.

2. If a third party supplier providing BGS defaults, who should be the "backstop" BGS provider?

If the RFP for BGS is properly structured to include the full energy supply and commercial costs of serving retail load in addition to any risk or hedging premiums

deemed necessary by the Board, NEM submits that the competitive providers that submit bids and are subsequently selected will be able to fulfill the responsibilities of rendering BGS service.

- 3. How should BGS be supplied?**
- 4. Is it necessary that one supplier provide BGS to all customers of a particular utility?**
 - a. If not, is it necessary that all similar customers be priced the same?**
 - b. If not, should BGS be divided as a “slice of the system,” or on some other basis?**

It is not necessary to have one supplier provide BGS to all customers of a particular utility. The BGS entity could be different by customer group. Inasmuch as the costs to provide services vary by customer class, the BGS entity and BGS pricing should be structured to reflect those real price differences, and as a result, encourage competition for all customer classes. Furthermore, NEM asserts that the BGS function should reflect all of the political, social and reliability concerns of providing last resort service. The BGS function can include a hedging requirement as well as a reserve requirement as part of the request for competitive proposals.

NEM also urges that specific programs be designed to address low-income needs rather than trying to utilize default service for this purpose. Often, concerns that low-income individuals will be unwelcome in the competitive market drives, explicitly or implicitly, the design and pricing of default service. This approach serves neither low-income customers nor the development of a competitive market well. Specific programs should be designed to serve low-income needs and to facilitate the targeting of public benefits funds. Such programs might include aggregation of low-income customers to access lower prices in the competitive market, perhaps with subsidies or guarantees of payment that would ensure the lowest-cost supply for these customers.

- 5. Should there be any restriction on EDC affiliates participating in a competitive BGS process?**

Automatically presuming that an entity affiliated with the incumbent utility should act as the default supplier in lieu of the utility itself grants that entity an unfair competitive advantage and violates the important principle that all market participants should be treated in a competitively neutral fashion. In contrast, the representative assignment of default service customers to competitive suppliers, or the award of default service to one or more suppliers through a bidding process, will result in increased market diffusion and an improved ability on the part of suppliers to aggregate customers, spread costs and compete on the basis of price.

- 6. Should billing and metering be a part of a competitive BGS service?**

NEM submits that all metering services, including ownership, installation, servicing of equipment, maintenance, testing, reading, data management, validation, editing,

estimations, providing pulse output and billing services are services that should be rendered by the competitive marketplace. Accordingly, competitive suppliers, and not the regulated monopoly, should be responsible for rendering these services.

7. What creditworthiness provisions need to be applied to BGS providers?

NEM submits that unreasonable creditworthiness standards constitute an artificial barrier to competition and as such should not be implemented. Companies with certain S&P or Moody ratings should already meet reasonable standards. Others should be able to meet a creditworthiness standard with a reasonable bonding requirement. Excessive creditworthiness requirements will increase the costs associated with energy delivery and limit competition.

8. How should customers be permitted to participate (voluntary sign-up or assignment)?

NEM believes that the assignment alternative to default service holds promise for customers and the competitive market. We also recognize that other methods will be considered. Regulatory bodies may not be prepared to implement such an approach at the opening of the market and will evaluate other alternatives to satisfying their own state's unique set of circumstances regarding default service. Other options for approaching default service fall into four general models and may be used in varying combinations and permutations, preferably for a brief interim period of time before all customers make the transition to a competitive market.

- **Default service awarded based on price bids.** This approach can represent significant progress toward establishing default service charges that reflect the competitive market for energy supply services. If it is utilized, however, it is important to ensure that the default service provider is responsible to the maximum extent possible for all of the retail functions and costs that impact competitive suppliers. Since a default service provider can avoid certain costs (such as marketing costs) and enjoy certain advantages (such as instant economies of scale), it is important to ensure that these advantages are recognized in order to allow a competitive market to flourish.
- **Default service awarded based on revenue bids.** This option puts the responsibility on the Commission to set the default service price. Suppliers then bid a dollar amount for the right to serve default customers at the price established by the commission. This revenue bid amount is then available to reduce stranded costs or offer other benefits to all distribution customers. While there are a number of benefits to this approach, an inherent problem with this option is the difficulty and risk of forecasting prices into the future. From a competitive market perspective, the greatest risk is that the price will be set too low, presenting substantial risk to potential default service providers and limiting opportunities for the competitive market to offer pricing benefits to customers. If this approach is utilized, it is important that these dynamics are considered and that Commissions provide themselves with opportunities to reset the default service price (and rebid the service) periodically.

- **Default customers transferred to another supplier.** Under this approach default service is granted to an entity other than the utility, such as an affiliate or the buyer of the utility's generation assets. An automatic non-competitive transfer of customers to any other single entity (affiliated or unaffiliated) grants a substantial and unfair competitive advantage to one market participant and violates the concept of competitive neutrality. In addition, automatic transfer to a utility affiliate offers few, if any, advantages to the competitive market over leaving customers with the incumbent utility itself.
 - **Utility retains default customers:** From a default service customer's perspective, competition has changed nothing. Customers continue to deal with the utility for all aspects of service. As indicated above, this approach is not a long term solution. When it is employed on a transitional basis, Commissions should insure that the transition plan:
 - **maximizes** appropriate incentives for customers to choose competitive suppliers by allocating retail costs appropriately between the distribution rate and the energy supply service (i.e., default service) rate, thereby preventing customers who switch to competitive suppliers from paying the retail cost component twice.
 - **minimizes** incentives for utilities to retain default service customers by ensuring that revenues in excess of commodity costs benefit all customers via lower stranded costs or distribution rates.
 - **educates** consumers on the benefits of competitive energy supply service options, including the potential for: innovative product offerings, including flexible pricing, billing and delivery options, and cleaner and renewable energy resources; multiple supply and purchase alternatives; and lower costs as the result of price competition among suppliers.
- 9. Should the same type of competitive BGS program be implemented with regard to customers in each electric public utility's service area, or are there unique utility situations that should result in different BGS programs?**

Regardless of whether there are separate programs, each program should be designed to incorporate the above principles.

- 10. Should BGS suppliers be licensed as electric power suppliers, or should there be a separate BGS license?**
- a. If a separate BGS license is required, what standards should the Board establish?**

A potential BGS supplier should demonstrate compliance with whatever political or social requirements that are necessary to be a BGS as set forth in an RFP.

- 11. What additional consumer protections should be adopted by the Board, if any, for customers served by competitive BGS providers?**

In the marketplace, there are numerous laws and regulations that are designed to protect consumers from invasion of privacy, fraud and all manner of improper commercial practices. These laws provide reasonable protection. Reference to the Uniform Commercial Code (UCC), state privacy laws and local laws against unfair trade practices imbues the marketplace with meaningful and enforceable guidelines to implement the restructuring of the electric industry. Incorporating these laws and the years of court cases interpreting these laws protects all purchasers of energy without imposing new and costly regulations, licensing requirements, paperwork and administrative burdens. In addition, NEM strongly endorses standards of conduct and self-policing rules to protect customers against unwanted sales tactics.

IV. Conclusion

NEM urges the Commission to implement competitive Basic Generation Service in accordance with the recommendations set forth above.

Sincerely,

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