

TESTIMONY OF THE ELECTRIC POWER SUPPLY ASSOCIATION

PRESENTED BY JOHN E. SHELK, PRESIDENT & CEO

ASSEMBLY BILL 3442, "LONG TERM IN-STATE GENERATION PILOT
PROGRAM"

NEW JERSEY ASSEMBLY TELECOMMUNICATIONS & UTILITIES
COMMITTEE

DECEMBER 9, 2010

The Electric Power Supply Association (EPSA) respectfully submits these comments on Assembly Bill 3442 with amendments and its Senate-passed counterpart (S. 2381), proposing an unprecedented consumer subsidy for certain in-state generation capacity. For the reasons detailed below, EPSA as an organization strongly opposes such legislation and urges the legislature to carefully analyze any bill's full consequences for the state and the region. EPSA joins a growing and diverse chorus in opposition to the Senate bill, including environmental groups, demand response providers, editorial writers, and financial and energy analysts.

EPSA is the national trade association representing competitive wholesale power suppliers, including generators and marketers. Competitive suppliers account for nearly 40 percent of the installed generating capacity in the United States using a diverse mix of fuels and technologies. This percentage is much higher in states such as New Jersey that restructured its electricity market and in regions served by independent Regional Transmission Organizations, such as the PJM Interconnection. EPSA seeks to bring the benefits of competition to all customers. The views expressed are those of the association and not necessarily the views of any particular member with respect to any specific issue.

EPSA members and other competitive suppliers developed much of the new generation brought on line in the past decade while improving the operation of existing plants, doing so largely at the risk of investors and not on the backs of consumers. EPSA members continue to be leaders in investing in both existing and new generation resources while advancing innovation. EPSA appreciates your keen interest in making sure that New Jersey continues to have access to reliable, affordable, competitively priced electricity from environmentally responsible facilities.

Three critical questions should be probed to determine whether any legislation would actually accomplish its stated objectives without doing significantly greater harm to consumers and the economy: first, what exactly is being proposed; second, is that arrangement actually a good deal for consumers; and third, does the proposal truly represent sound electricity policy?

First, what exactly is being proposed? The legislation is styled as a one-time pilot program, but far from a mere pilot program, the legislation establishes a significant multi-year financial commitment to be paid by consumers. Under the Senate bill tremendous financial upside is reserved for the select developers eligible for special “no bid” contracts.

The key detail that reveals the enormous stakes involved is the legislative mandate, still contained in the Senate bill, dictating by statute the minimum price to be paid for a new plant’s capacity. Without any factual foundation the Senate bill establishes the guaranteed minimum price as \$232.75 per megawatt per day for up to 1,000 megawatts for not less than 15 years. The math tells the story: the Senate bill would direct up to \$1.3 billion of consumers’ money to narrowly defined “eligible generators” on expedited time schedules with no real review by the Board of Public Utilities. The legislation requires that the contracts be “financially settled.” This means that if the market price is actually lower than \$232.75, then consumers cough up the difference, but if the market price is higher the “eligible generators” pocket the difference (up to a whopping \$290 per day). This is a classic “heads I win, tails you lose” proposition.

The proposed Assembly amendments recognize these serious flaws in the Senate-passed version and delete many of the more objectionable features of that bill. Nonetheless, the commitment being placed on consumers even with the proposed amendments will continue to be significant and in the same billion-dollar plus range. Doing so is certainly no panacea.

Second, is the “pilot program” a good deal for consumers? Electricity capacity and energy are generally procured either through a competitive process, such as the wholesale markets independently-administered by PJM and those at work in the Basic Generation Service auction, or under traditional monopoly utility cost-based rate-making principles.

In a competitive process, multiple parties would be allowed to make proposals with an independent process to evaluate them. New Jersey state law wisely requires competitive procurement by state government for contracts as low as \$30,000. By contrast, the Senate bill awards contracts in the hundreds of millions of dollars without such a competitive process.

Were local distribution companies to propose to invest in transmission or distribution such proposals would be subject to approval by regulators. This would include whether a project’s costs are prudent, the project is used and useful, and the rate of return is commensurate with the lower risks of consumer-guaranteed investments, usually ten to twelve percent. The rates of return for the Senate bill’s projects are likely double that range.

The proposed amendments are a step in the right direction by using a process more consistent with competition than in the Senate bill (assuming that procuring capacity out-of-market is the best way to proceed, which EPSA does not believe to be the case).

The Senate bill claims that its benefit is a combination of “in-state” capacity and a discounted price. The Assembly amendments delete some references to “in-state” generation. However, definitions of “eligible generator” and “electric public utility” indicate that only in-state capacity would still qualify with no requirement that the electricity remains in-state. In fact, Section 3(l) of the Senate bill and Section 3(c)(10) of the Assembly amendments require that a plant’s output be offered into PJM’s wholesale markets. This means the electricity could go as far as Chicago to serve 42 million people in PJM outside New Jersey.

As to capacity prices, supporters of the Senate bill stress that \$232.75 is a discount today and would drive down capacity prices tomorrow. This implies, incorrectly, that the bill would require the capacity to be priced below market for the entire term of the contracts. While the minimum price is less than the most recent PJM capacity auction, that is only true for the most recent auction. Furthermore, PJM posted its Capacity Price Scenario Analysis on November 1, 2010. Future prices could be as low as \$100, **less than half** what the Senate bill obligates consumers to pay. To be sure, future prices are difficult to predict because auctions take account of many variables. This is precisely why a high minimum price is problematic. The amendments seek to address these concerns, exposing the flaws in the Senate bill.

Third, does the proposal truly represent sound electricity policy? EPSCA welcomes a discussion of how to make sure that public policies are consistent with necessary investments, particularly with several extensive and expensive environmental regulations on the horizon that will lead to a combination of retrofits and replacement power as plant retirements occur.

While the Assembly amendments recognize many of the serious problems with the Senate bill, both versions essentially stem from the common premise that out-of-market subsidies are justified because doing so will increase supply to drive down capacity prices. The exercise of such state-sanctioned buyer-side market power to manipulate prices would have an artificially depressing impact on short run prices. However, there are at least three reasons why such an approach is mistaken: first, there are several ways to challenge the legislation on constitutional and other legal grounds; second, the bill may very well run afoul of federal requirements governing wholesale power markets; and third, any short run savings could well be offset by higher energy prices and higher longer term capacity prices while distorting the regional price signals necessary for future private sector investment and jobs.

As to the first two reasons, the proposed amendments add Section 4 to authorize the BPU to suspend the legislation in the event challenges are brought. Even the amendments would require that eligible projects participate in and clear PJM's RPM auctions. As a result, the bills seek to dictate bidding behavior in a federally-overseen regional wholesale electricity capacity auction that must, under the Federal Power Act, be conducted consistent with being just and reasonable and not unduly discriminatory or preferential.

As to the third reason, policies subsidizing select new generation and upgrades at existing plants invariably impact both the current and future economics of all existing and all potential new resources. Other market participants will factor the existence of such legislation and the potential for future market intervention here and elsewhere into their decision-making. As a result, future energy and capacity prices could well end up higher as a result of the bill.

EPSA submits that consumers are best served by acquiring the least cost resources within applicable environmental requirements, regardless of location or vintage. While some of the more egregious language is changed in the Assembly amendments, the proposal still arises from the faulty premise that regional supply issues should be addressed by state-specific remedies. If RPM results are accurate market signals, then no additional resources are needed at this time. If the results are incorrect due to a flaw in RPM, then changes should be implemented for all market participants.

In conclusion, EPSA appreciates the opportunity to share these views on the various proposed legislation and looks forward to being constructive participants in the debate on these important matters. EPSA respectfully suggests there is no pressing need to rush to judgment. There is ample time to continue to work together on a regional basis to address the concerns that give rise to these legislative proposals.