INVESTIGATION OF RESOURCE ADEQUACY ALTERNATIVES

BPU DOCKET NO. EO20030203

COMMENTS OF THE NEW JERSEY LARGE ENERGY USERS COALITION

REGARDING PSEG'S RPM AND PAY AS BID FRR PROPOSALS

"Curiouser and curiouser! cried Alice"

Lewis J. Carroll
Alice's Adventures in Wonderland

The New Jersey Large Energy Users Coalition ("NJLEUC") appreciates the opportunity to offer these Comments regarding the latest FRR proposals from Public Service Electric and Gas Company ("PSEG") and Exelon Generation (the "Companies") that purportedly seek to avoid application of the Minimum Offer Price Rule ("MOPR") Order issued by the Federal Energy Regulatory Commission ("FERC") to the State's clean energy procurements. NJLEUC incorporates by reference its prior Comments in this proceeding regarding FRR and PSEG and Exelon's prior proposals.

The Companies' latest proposals tacitly concede that PSEG and Exelon have gotten the message that their earlier FRR Integrated Procurement Proposal has completely failed to attract stakeholder support. Tellingly, the Integrated Procurement Proposal could not even muster support from the solar and offshore wind companies that are the proposal's purported beneficiaries. Indeed, with the exception of two environmental groups, all other stakeholders, including JCP&L, PSEG's "chosen" FRR Entity, have uniformly cautioned the Board against adopting FRR, given the significant risks and uncertainties inherent in the FRR structure, particularly in a deregulated, competitive generation environment like ours, and FRR's clear potential to further increase the Companies' significant market power and, therefore, the cost of power to ratepayers. *There* *remains broad consensus that the financial risks associated with the MOPR are minimal and may be mitigated through other, far less draconian measures, particularly when compared with the substantial risks associated with the leap into the regulatory unknown advocated by the Companies. There exists an equally broad consensus that the Companies' proposals are motivated not by a purpose to advance the State's energy policies, but by the Companies' sheer greed and evident purpose to further enrich and insulate the Companies from market and business-related risks by improperly shifting the risks to ratepayers.*

PSEG's new FRR proposals, which have been supported only by Exelon, NRDC and Sierra Club, can most charitably be described as vague and ambiguous, fill-in-the-blank propositions that raise more questions than they purport to answer. Many of these questions remained unanswered after the November 9 webinar. While the Companies freely acknowledge that further study of their proposals is required, they have apparently not produced studies they are willing to share with the public. The Board should insist that the Companies, as well as independent experts, conduct all appropriate studies to assure that the Board's ultimate FRR decision is fully informed, rather than the uninformed and hurried decision the Companies clearly prefer.

In particular, detailed studies should be conducted to determine the likely effects of the Companies' various FRR and Integrated Procurement Proposals on local, statewide and PJM-wide energy costs, whether the proposals will produce the savings and cost avoidance the Companies suggest, the effect on competition and alternative generation suppliers in the relevant product and geographic markets, the Board's regulatory authority, and whether the proposals will facilitate or hinder achievement of the State's clean energy goals. To date, the Companies have offered only unsupported arguments regarding the benefits of FRR and their proposals. The Board and State should therefore insist on receiving significantly more detail regarding the proposals before determinations should be made regarding their merits. As of now, the Companies' FRR proposals remain a leap of faith into the regulatory unknown that the Board would be well-advised to reject.

The Companies' latest proposals purport to focus solely on the capacity procurement component of PSEG's still-pending Integrated Procurement Proposal, and are silent regarding the proposed treatment of the environmental attributes associated with clean energy resources, including the Companies' nuclear plants. However, based on statements made during the webinar, it appears that the Companies have retracted their offer to forego the $300 million annual ZEC payments they currently receive if their integrated approach is adopted. During the webinar, PSEG referred to the ZECs as "another issue" that is outside the scope of the two new FRR capacity proposals. This statement should be considered together with PSEG's recent public statements regarding the Companies' need for more revenues than are currently being recovered through capacity revenues and ZECs to enable the nuclear plants to continue in operation. It is evident that PSEG has begun the public drumbeat to support its arguments regarding the importance of nuclear power and the need for additional financial support. We have already witnessed the lengths to which the Companies will go--here and elsewhere--to further enrich themselves and this lesson should not be lost on decision makers. We are involved in a game of hardball and we should be guided and react accordingly.

Among the questions that emerged from the webinar were: how much do the Companies expect ratepayers to pay to support their *deregulated* nuclear plants to avoid a renewed threat to shut them down (and how would the Board react to such a threat?), and how are the Companies' capacity and environmental attributes procurement proposals, taken together, designed to provide the additional revenues "needed" by PSEG? If we take at face value the Companies' statements that (i) the Companies are not making "enough" from capacity payments and the $300 million in annual ZEC subsidies to support the continued operation of the nuclear plants (and how much is "enough"?), (ii) the suggestion that the new proposals would reduce capacity costs and cap capacity prices at the PJM BRA clearing price, and (iii) the ZEC subsidy would remain unchanged at current levels (unless it is reduced by the Board in the pending ZEC II proceeding), the logical question that must be answered is: taken together, how are the Companies' proposals designed to provide the "needed" additional revenues to the Companies? Is there another shoe to drop, such as an application to increase the ZEC subsidy or create a new funding source? Are we missing something? These questions must also be answered by the Companies before a determination can be made whether the FRR proposals will advance the interests of the State or merely those of the Companies. The continuing, objective input of the PJM Independent Market Monitor ("IMM") regarding these issues will also continue to be important.

NJLEUC does not share the view of others that because their initial proposal was roundly rejected by most stakeholders the Companies are now "merely throwing spaghetti against the wall to see what sticks" or that the proposals should be accepted at face value. Rather than representing a retreat, we prefer to believe that the Companies' new proposals represent a recalculated effort to advance their financial interests (to the detriment of others), solidify and increase the financial support for the nuclear plants that is "needed" in the current market environment, and afford the Companies greater control of the capacity and clean energy procurement processes while reducing the Board's role.

It appears evident to us that the Companies' new FRR capacity proposals, when taken together with the still-pending Integrated Procurement Proposal, are designed to assure the Companies' a guaranteed capacity revenue stream for the nuclear facilities (akin to MOPR protection, should the MOPR survive in a Biden administration), and leverage the Companies' substantial market power, further enhanced by the creation of narrower FRR product and geographic markets, to enable them to enhance their profits by dominating their proposed capacity and Tiered clean energy procurements.

As further discussed below, the Board should be concerned about the following aspects of the Companies' new RPM and Pay As Bid proposals, among others:

--As proposed, the Companies' "Tier I" procurement would be limited to clean generation, purportedly to advance the State's clean energy goals. However, as discussed in NJLEUC's and P3's reply comments, given the generation supply mix in the relevant markets, Tier I would be dominated by power generated by the Companies' nuclear plants. Further, by committing their New Jersey-based nuclear generation to the Tier I procurement, the Companies would avoid having to contend with both with the MOPR (and any future concern that the nuclear plants might someday be priced out of the PJM capacity market) and PJM's muscular market power mitigation and consumer protection rules.

-While the Companies profess not to have studied the potential effects of their FRR proposals on the PJM capacity market, it is evident the impacts could be considerable and prompt intervention by PJM. For example, the May, 2020 Report prepared by the IMM entitled "Potential Impacts of the Creation of New Jersey FRRs", regarding the Companies' initial FRR proposal, identifies potentially significant "below the radar screen" market effects that would significantly increase the Companies' revenues, even as they purport to cap the revenues in the JCPL LDA at BRA clearing prices.

Specifically, under Scenario 6—which assumed the creation of a JCPL FRR entity utilizing PJM BRA clearing prices as the pricing benchmark—capacity prices within the JCPL FRR would decrease by a modest 2.1%. However, capacity prices in the ACE and EMAAC zones (where the nuclear plants are located) would *increase* 11.6%, while prices in the rest of PJM would *decrease* by 11.7%. The potential for the RPM proposal to reduce prices in the rest of PJM, taken together with the uncertainties associated with bids based on a percentage of future auction outcomes, could cause competing generation suppliers to balk at bidding into the FRR market, resulting in further capacity price suppression. In such circumstances, and in the absence of alternative suppliers, JCPL as FRR entity would have no alternative but to enter into bilateral agreements with the Companies as pivotal suppliers able to exercise market power.

Should FRR ultimately be implemented on a statewide basis under the RPM proposal, it could result in reduced competition and price suppressive effects that could disrupt the PJM capacity market. In such event, PJM would be expected to intervene and adopt rule changes to limit the market suppressive and anti-competitive impacts of the RPM proposal.

-While the Companies portray the FRR rules as "flexible" and easily able to accommodate the Companies' evolving proposals, neither the PJM Tariff nor the Reliability Assurance Agreement ("RAA")—the two foundational FRR documents—lend themselves to this characterization. Rather, as described in NJLEUC's initial comments, FRR represents an intentionally unattractive regulatory option, particularly for deregulated states like New Jersey, which imposes strict guidelines and draconian performance penalties. One searches the PJM Tariff and RAA in vain for any language that even hints at the level of flexibility required to adopt the Companies' proposals, or dilutes the significant regulatory, administrative and financial obligations FRR would impose on the State, the FRR entity and ratepayers. Nor do these documents preclude PJM from amending the FRR rules if New Jersey were to adopt a variation of FRR that PJM finds objectionable.

Finally, despite the change of administration in Washington, which likely will usher in a new era of energy policies that are closely aligned with the State's clean energy policies and goals, the Companies continue to urge haste in adopting their proposals. However, it should be clear that FRR is not a panacea for the State's PJM-related concerns. In reality, the Companies' versions of FRR are largely unstudied and are replete with potential land mines that could cause enormous financial and regulatory harm to the State and ratepayers while creating the potential for windfall profits to the Companies. In contrast, most stakeholders agree that the potential financial fallout from the MOPR would amount to a relatively modest $17 million in lost annual capacity revenues for the first tranche of offshore wind. The Board therefore should proceed with caution, weighing FRR's dubious benefits against the windfall profits and diminished Board authority that would likely be created by the Companies' proposals.

<u>Overview</u>

PSEG unveiled its latest FRR proposals for the first time at the September 18, 2020 Technical Conference. Citing FRR's purported "flexibility" and the "many" FRR designs that purportedly could be implemented consistent with the requirements of the PJM Tariff and the RAA, PSEG urged adoption of the so-called "RPM Derivative Pricing" or "Sealed Bid Marginal Pricing" approaches. While offering scant details regarding the new proposals, PSEG argued that unlike the Companies' prior Integrated Procurement Proposal, which PSEG properly conceded would require legislation to implement, the new proposals could be adopted under "current" law and the Board's existing regulatory authority. PSEG argued that this was critical to the RPM and Pay As Bid proposals, because the State needs to move expeditiously to mitigate the problems associated with the MOPR. The RPM and Pay As Bid proposals were described in greater detail in PSEG's October 2, 2020 Post-Technical Conference Comments ("Comments") and during the November 9, 2020 webinar hosted by Board staff .

The Companies' RPM and Pay As Bid Proposals

In a recent October 2 press release, PSEG stressed the importance of the nuclear plants to the State, but argued that they are threatened because since the plants began receiving ZECs, the "power markets have deteriorated significantly, thus the financial needs of New Jersey's nuclear plants have continued to grow". This and other statements made during the webinar and elsewhere make clear that *the Company does not believe its nuclear plants are making enough money and it wants them to make more*. Logic therefore dictates that any interpretation of the Companies' proposals that assumes the Companies are willing to accept less money than they currently receive or to maintain the financial status quo is clearly not what the Companies intend. Does anyone believe that the Companies would aggressively pursue FRR proposals designed to produce *lower* or equivalent revenues when the Companies are dissatisfied with their current returns and fret that their "financial needs" will only "continue to grow"?

Therefore, it is necessary to take the proverbial look under the hood of the RPM and Pay As Bid proposals, individually and in combination with the earlier Integrated Procurement Proposal, to obtain a greater understanding of what is being proposed and how the Companies and others would be affected by the proposals.

NJLEUC believes that the anticipated effect of the proposals on the PJM markets is an important consideration in the current inquiry. We therefore inquired during the webinar whether PSEG had conducted a study of how their proposals would affect PJM and the LDAs outside the proposed JCPL LDA. We were advised that PSEG had not conducted such a study. We suspect that such a study, if conducted, would evidence adverse impacts on the EMAAC and MAAC zones, including lowering and raising capacity prices in specific delivery areas outside the JCPL LDA and that these results could cause various types of market-related issues and distortions.

Thus, for example, the IMM's May, 2020 Report determined that under the Companies' original FRR proposal, the establishment of a JCPL FRR using capacity prices capped at the PJM BRA clearing price would result in a 12% increase in capacity costs in the delivery areas in which the Companies' nuclear plants are located and elsewhere, representing a potential hidden windfall for the Companies. While these findings would not necessarily be the same for the Companies' RPM and Pay As Bid proposals, they underscore the potential for unanticipated outcomes that could be detrimental to the interests of ratepayers, competitors and regulators, or the exposure of unidentified benefits to the Companies. One outcome that is certain in such circumstances is that PJM would amend the FRR rules if it perceives that the Companies' proposals would interfere with the smooth functioning of the capacity markets.

We also asked whether PSEG expected the nuclear plants to clear future PJM capacity auctions if the MOPR remained in place. The Company responded that the nuclear plants are expected to clear the next auction but that PSEG was awaiting additional FERC guidance regarding MOPR floor prices to determine whether the plants would clear in future auctions. PSEG's equivocal response regarding future auctions evidences that a primary purpose of the Companies' RPM proposal is to guarantee a future capacity revenue stream for the nuclear plants by creating an FRR structure that would remove the nuclear plants from the PJM auction, thereby avoiding the risk the plants could someday fail to clear the auction due to the MOPR. Thus viewed, the RPM proposal would provide the Companies with a form of "auction clearing insurance" that would enable them to obtain the benefits of the PJM auction clearing prices without having to deal with the MOPR or comply with the rules applicable to the PJM auction.

It should also be underscored that the RPM proposal would provide the Companies with optionality regarding how they choose to sell their capacity, as bidding into the FRR would be *voluntary* under their proposal. Accordingly, the Companies would be free to sell their nuclear output outside the FRR procurement (or threaten to do so to obtain financial concessions under the Integrated Procurement Proposal). Thus, while the PJM rules contain a "must bid" requirement as an essential market power mitigation tool designed to prevent the strategic withholding of capacity, RPM would have no such restriction. Given that the Tier I procurement would be comprised largely of capacity from the Companies' nuclear plants, the Companies' refusal to offer this capacity into the procurement could have serious consequences, including a significant capacity shortfall that could trigger enormous FRR performance penalties. Given the Companies' past threat to shutter the nuclear plants to obtain the ZEC subsidies, the potential for such action should be taken seriously. The Board should be wary of adopting an amorphous procurement structure that could again place the Board in the position of having to contend with a threat to strategically withhold nuclear capacity, a threat that was aptly described by the Commissioners in the ZEC I proceeding as a "hostage taking" and "highway robbery".

The Companies further suggest that the RPM procurement could easily be conducted by the Board, aided by an independent auction manager, analogizing the proposed RPM procedure to the Board's supervisory role in the conduct of the annual basic generation service auctions. (PSEG Comments at 11). The analogy does not survive even cursory analysis.

There can be no question that basic generation service is specifically authorized by EDECA as a regulated procurement to support the non-competitive, default service provided by the utilities to customers who do not switch to a competitive supplier and that is supervised by the Board. *See*, N.J.S.A. 48:3-57. Likewise, there can be no question that under EDECA, generation, including the procurement and sale of capacity, is a deregulated, competitive service over which the Board lacks jurisdiction. *See*, N.J.S.A. 48:3-56. Therefore, the thought that the Board has the current authority to exercise the same type of oversight over an RPM *generation* procurement by a *distribution* utility in the same manner as BGS has no basis in law and is simply wrong. This would be tantamount to the Board conducting a regulated procurement of a deregulated service. As will be set forth at length below, there is a world of difference under the current statutes and case law between competitive and non-competitive energy services, and there is a clear bright line that separates the two for jurisdictional and regulatory oversight purposes.

The alternative Sealed Bid Marginal Pricing Approach is a bid mechanism that is not tethered to the outcome of PJM BRA auctions, so that bid clearing prices could be higher or lower than BRA clearing prices. PSEG acknowledges that depending on the auction year, "this price disparity could be significant". (PSEG Comments at 13). In other words, the cost of capacity could skyrocket, particularly in light of the market dominance the Companies would be free to exploit in the Tier I and subsequent procurements.

The rationale for the Sealed Bid approach is unclear in terms of how it would advance the State's clean energy goals, as the procurement would accept bids from fossil generators, with only coal plants (coincidentally no longer part of the PSEG fleet) barred from participation. The Board should also be clear-eyed that none of the consumer protection and market power mitigation rules that safeguard the results of the PJM BRA would apply to the Sealed Bid approach. The approach would epitomize the leap into the regulatory unknown, and would require the Board to step into the shoes of PJM and the IMM and assume responsibility for capacity regulation and oversight for the first time in decades. As we have stated elsewhere, the Board currently lacks the authority over generation that would be required by this approach, which would be fraught with risks to be avoided.

The Companies assert that the large volume of resources available to serve this relatively small load under the Sealed Bid approach provides a check against the potential exercise of market power. However, we again note that as proposed by the Companies, the Tier I procurement would be dominated by the Companies, which control the vast majority of Tier I clean energy located in New Jersey. Therefore, the Companies' significant market power would only be amplified in the context of a procurement devoid of consumer protection rules and market power pressure valves. The Companies' market power arguments are addressed below.

The Companies' New FRR Proposals Cannot Be Adopted Under Existing Law

It is noteworthy that PSEG's primary argument for the adoption of its new proposals is that, unlike the Companies' Integrated Procurement Proposal, the new proposals are merely "procurement mechanisms" that "could be adopted by the Board under its existing statutory authority". (PSEG Comments at 2). In support of PSEG's portrayal of the Board's "current" regulatory authority, the Company argues that "since at least the late 1960s", New Jersey "EDCs"[1] were responsible for the procurement of capacity resources to meet PJM's resource adequacy requirements and that, during this period, load serving entities have either owned or procured capacity bilaterally in a bilateral market that did not include a centralized capacity auction". (PSEG Comments at 4). According to PSEG, during this period the Board "regularly exercised oversight

[1] References to EDCs are in quotation marks because electric distribution companies did not exist prior to 1999, when these entities were created by the Electric Discount and Energy Competition Act. *See*, N.J.S.A. 48:3-51.]

of the manner in which the EDCs under their jurisdiction performed these procurement activities". (PSEG Comments at 4-5).

PSEG cites several authorities that purport to establish the Board's "existing" legal and regulatory authority to direct EDCs to procure energy and capacity to serve their customers under an FRR regime. (PSEG Comments at 5). However, the cited authorities not only fail to support PSEG's arguments, but actually highlight the clear absence of current Board authority to implement any of the PSEG FRR proposals. Indeed, notwithstanding PSEG's arguments to the contrary, it remains clear that expansive legislation would be required to re-establish the Board's authority over the planning and procurement of electric generation resources for the FRR LDA and to re-institute cost of service regulation to establish just and reasonable capacity prices. In short, such legislation would result in the partial re-regulation of the State's electric industry, and open a Pandora's box of regulatory issues and the potential for protracted administrative proceedings and litigation, as occurred in the deregulation proceeding.

<u>The Way We Were: Utility Regulation Prior to EDECA</u>

It is astonishing that PSEG's arguments regarding the Board's "existing" regulatory authority are based entirely on outdated, decades-old precedents that pre-date the restructuring of the electric and natural gas industries and enactment of EDECA in 1999. The Company's reliance on these clearly outdated precedents renders ludicrous PSEG's further contention that "nothing has occurred to eliminate or diminish the Board's oversight authority" as it was described in the cited 1993, 1994 and 1995 precedents. PSEG's argument is both breathtakingly off the mark and unquestionably wrong. In fact, what "occurred" after the cited cases were decided was the eight year-long restructuring of the electric industry and passage of EDECA, exercises that completely altered the regulatory paradigm described in the cases cited by PSEG, and transitioned the vertically integrated utility monopolies of the 1990s to a competitive structure in which electric generation was declared to be a competitive service that would no longer be subject to the Board's jurisdiction.

PSEG cited these outdated cases as authority for the proposition that the Board could (i) exercise jurisdiction over power purchase agreements with non-utility generators ("NUGs") that included provisions regarding sales of capacity, In re Jersey Central Power & Light Co., 150 P.U.R. 4th 207 (Mar. 4, 1994); (ii) direct "EDCs" to procure energy and power to serve their customers at prices consistent with market conditions, In re Jersey Central Power & Light Co., 154 P.U.R. 4th 431 (July 29, 1994); and (iii) include a "market test" in "EDC" decisions to enter into long-term power contracts with non-utility generators, In re Proposed Supply Side Procurement Procedures, No. EX94120578, 1995 WL 387804 (June 14, 1995). A 2003 case, In re Jersey Central Power & Light Co., No. EO02070417, 2003 WL 21961993 (August 1, 2003), was cited for the proposition that the Board has the authority to exercise oversight of how the EDCs under its jurisdiction had previously procured capacity resources to meet PJM resource adequacy requirements. In the 2003 case, the Board disallowed certain NUG-related deferred cost balances based upon its finding that JCP&L's energy and capacity purchases, which were obtained through forward contracts negotiated prior to the restructuring of the electric industry, were excessive when compared with energy and capacity prices available in PJM.

PSEG concludes that these cases, taken together with the broad general grant of regulatory authority delegated to the Board, constitute existing authority for the Board to implement the various FRR structures proposed by PSEG without the need for legislation. PSEG's conclusion that "nothing has occurred (since the cited cases were decided) to eliminate or diminish the Board's oversight authority", (PSEG Comments at 4-6), can only be described as farcical. It is noteworthy that during the webinar, when questioned regarding the Board's "current" authority to implement FRR, and in particular the authority to compel a reluctant JCP&L to assume the role of FRR Entity, PSEG's counsel indicated that he "was not prepared to discuss the BPU's authority".

The restructuring of the State's electric and natural gas utilities from regulated monopolies to deregulated electric and gas distribution companies began in 1995 and continued through 2003, which marked the end of the transition to competition. The restructuring occurred, in part, in response to the high energy costs associated with the type of long term power production and supply commitments associated with the NUG contracts addressed by the cases cited by PSEG, and the fixed costs associated with utility-owned generating plants. The primary goal of the restructuring was to reduce utility generation costs through deregulation of the generation function and to tap into the developing competitive power markets. To state the obvious, the restructuring process fundamentally changed the regulatory paradigm that PSEG curiously suggests still exists.

How were utilities regulated in 1994 when the cases cited by PSEG were decided? As noted, the utilities were vertically integrated monopolies that controlled all aspects of utility service, including power generation, transmission and distribution and all customer services. PSEG Power, PSEG's generation affiliate, did not yet exist as the generation function remained a monopoly function within the utility. The utilities charged customers "bundled" rates that represented the all-in price for all services rendered by the utility, including the costs associated with generation. There were no third party suppliers, and energy competition was limited to NUG arrangements with third party generators that received limited authorization under the federal Public Utilities Regulatory Policies Act ("PURPA") to offer competitive power in narrowly defined circumstances. As the JCP&L case underscored, PURPA contracts became a big issue for utilities like JCP&L because their price terms were revealed over time to be considerably above market, established on the strength of faulty forward cost projections, and these excessive costs were generally passed through to ratepayers.

For its part, in 1994 the Board regulated all of the economic aspects of utility operations, with extensive ratemaking and cost of service regulation applicable to all utility services--including generation. The Board also played a primary role in utility resource planning for reliability purposes. The Board's approval was required for new utility generation facilities and expansions of existing facilities, which could not proceed until the Board issued a Certificate of Need under the Electric Facilities Need Assessment Act, which was later repealed by EDECA. Facility approval proceedings were typically multi-year processes that entailed the Board's detailed review of the need for a proposed power plant, with the Board's approval based upon a finding that the proposed plant represented the most efficient, economic and environmentally sound option available.

During this period, the competitive power markets were only in their incipient stages of development. There was no liquid ISO market for capacity, let alone an established PJM capacity auction. In fact, during the restructuring, the absence of a liquid and visible competitive capacity market in PJM throughout most of the 1990s was cited by PSEG as the rationale for its argument that competition should be restricted only to energy, with no capacity component, because no viable competitive benchmarks for capacity existed at the time. Similarly, open access transmission tariffs were only in their initial stages of development and ISOs were not yet in a position to afford suppliers equal and open access to the interstate transmission grid.

The restructuring process and enactment of EDECA changed much of this. The restructuring heralded the end of the Board's economic regulation of the utilities' power generation function, terminating the Board's historic and extensive ratemaking and cost of service regulation of power generation. In the new paradigm, the generation function was no longer regulated by the Board or supported by ratepayers through regulated, cost of service-based rates, but was instead transitioned to competition in deregulated power markets, with utility generators granted the significant authority to charge lucrative, uncapped market-based rates. Notably, all responsibility for the costs and risks of operation of the deregulated power plants was shifted from ratepayers to utility shareholders.

EDECA limited the Board's previously broad regulatory authority over all aspects of the utilities' integrated operations to only the distribution function and non-competitive customer services. Therefore, the Board was no longer authorized to "regulate, fix or prescribe the rates, tolls, charges, rate structures, rate base, or cost of service of competitive services". N.J.S.A. 48:3-56 (a). EDECA specifically defined electric generation service as a competitive service. N.J.S.A. 48:3-56 (b).

Under EDECA, the Board retains only limited residual jurisdiction regarding generation-related issues. While N.J.S.A. 48:3-56 eliminated the Board's authority to regulate generation and the costs of generation, it provided the Board with the following limited authority over the generation function: "The board is authorized to determine, after notice and hearing, and after appropriate review by the Legislature…whether to reclassify as regulated any electric service or segment thereof that it has previously found to be competitive, including electric generation service, if it determines that sufficient competition is no longer present…. Upon such a reclassification…the board shall determine such rates for the electric service which it finds to be just and reasonable". N.J.S.A. 48:2-13 (d) also provides: "The Board shall also maintain the necessary jurisdiction with regard to the production of electricity to assure the reliability of electric supply to retail customers in the State as prescribed by the board or any other federal or multi-jurisdictional agency responsible for reliability and capacity in the State".

No finding of non-competitiveness has been sought or made by the Board or Legislature. Therefore, generation remains a deregulated, competitive service having only narrowly and specifically prescribed Board oversight and regulation.

With regard to the Board's authority over generation capacity and how the law contemplates that the rates charged for capacity are to be established, the restructuring process and EDECA—which reflect the actual state of current law--are again instructive. Because generation was determined to be a competitive service, the first step in the restructuring process was the "unbundling" of utility rates. To facilitate the transition to competition, the costs associated with the formerly bundled services—generation, transmission, distribution and customer account services—were functionalized, isolated and unbundled to enable the generation and customer account services functions—the functions that were determined not be 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). For present purposes, it is noteworthy that the generation-related costs that were removed from utility customers' rates as part of the rate unbundling included all generation-related capital and operation and maintenance costs, all related allocated overheads, fuel costs and the costs associated with long term power purchase agreements.

The transition of the generation function to competition 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. As noted, the transition also marked the end of the Board's economic regulation of the power generation function, terminating the Board's historic and extensive planning, ratemaking and cost of service regulation of power production, issuing certificates of need for new facilities and other such regulatory devices. Thus, rather than being regulated by the Board and supported by ratepayers, generation was 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.

It is therefore beyond debate that under current law, the Board has no authority to engage in the resource planning of generation, including capacity, to establish the cost of generation, including price caps, or to regulate or conduct active oversight of the generation function. Nothing in the ZEC Law, or any other law, purported to supersede or overrule any portion of EDECA. Therefore, EDECA remains the governing law.

Despite these precedents, PSEG's characterization of the law necessarily suggests that under its "existing authority" the Board has the authority—authority that the Board clearly has not exercised for more than two decades—to, among other things, (i) authorize the creation of an FRR entity and adopt procurement, consumer protection and market power mitigation rules and guidelines (ii) engage in generation-related resource adequacy analysis and planning and develop long-term projections of the total capacity load for the JCPL LDA; (iii) establish and approve capacity costs and rate caps, (iv) compel an electric *distribution* utility subject to the Board's jurisdiction –here an obviously reluctant JCPL—to assume the responsibilities of an FRR entity, (v) negotiate the terms of a JCPL-administered FRR LDA, including accommodating JCPL's stated requirement that it be held harmless against all risks and capacity performance penalties associated with its service as FRR entity and to be compensated for that service; and (vi) require ratepayers to financially support deregulated generation facilities, including responsibility for the facilities' operational and business risks and potential FRR performance penalties, and (vii) supervise the procurement and sale of capacity by the FRR entity, including entry into bilateral supply contracts with generators.

A review of current law (as well as the Board's practices for the last twenty years) reveals that this is clearly not the case and the Board has no such powers absent the enactment of paradigm-shifting legislation. The Board should entertain no doubt why PSEG was compelled to dust off 1993 vintage cases to support its arguments, as the "current" law—e.g. the laws enacted and cases decided as part of the 1999 restructuring and thereafter--provides no support for PSEG's disingenuous arguments. The Board should also appreciate that it took eight years of stakeholder proceedings, contested cases and litigation that was finally resolved by our Supreme Court for the Board to finally resolve related issues of similar import to accomplish the deregulation of generation. Reregulation would have the Board travel a similar path.

Here and in PSEG's other arguments in support of the Companies' FRR proposals, PSEG's positions get "curiouser and curiouser" in the words of Alice in Wonderland. The Board should not make the mistake of following PSEG down this obvious rabbit hole. There should be no question that the Board does not have the current authority to implement the Companies' FRR proposals and would require expansive legislation to do so.

Market Power

Despite PSEG's continuing attempts to minimize or explain away the issue, the market power that the Companies could wield under FRR is necessarily a significant issue to be addressed by the Board. As discussed at length in our reply comments, market power represents the ability to artificially raise prices that customers pay for power over a sustained period of time. Because New Jersey customers already pay rates that are among the highest in the nation, the threat that the Companies' market power could cause rates to rise still further under FRR is a great concern to customers, particularly in this COVID environment.

In its latest filing, PSEG argues that the market power alarms sounded by the IMM, Rate Counsel, P3 and others are "sensationalistic" and "could only occur if the Board abdicated its responsibilities and adopted inefficient procurement mechanisms". PSEG claims that the IMM's market power analysis contains "many errors" because a "large volume of resources" would be available to serve the relatively small load represented by the JCPL LDA. (PSEG Comments at 14). PSEG now offers the affidavit of John Morris, who questions the IMM's conclusions regarding the Companies' projected broad market power under an FRR regime, and argues that if the FRR procurement is designed to allow gas-fired and clean resources located in the EMAAC and MAAC zones to participate in the procurements, there would be no market power concerns under either the Herfindahl-Hirschman Index ("HHI") or three pivotal supplier anti-trust screens (Morris Affidavit at pp. 6-9).

As we previously noted, in a long succession of State of the Market Reports, the IMM has consistently concluded that "structural market power is endemic to the capacity market" and that the aggregate PJM market structure is not competitive. *See*, *e.g.*, IMM Quarterly State of the Market Report for PJM, January through June 2020, pp. 256-257). In this proceeding, the IMM raised the following red flags regarding the Companies' enhanced ability to exercise market power under FRR:

> Creation of an FRR creates market power for the small number of local generation owners from whom generation must be purchased in order to the meet the reliability requirements of the FRR entities. All participants in the New Jersey, JCPL and PSEG FRRs fail the one and three pivotal supplier test which reinforces the conclusion that there is structural market power in each case. A fundamental point about the FRR approach is that the FRR approach is a nonmarket approach. In the FRR approach, there is no PJM market monitoring of offer behavior by generation owners, there are no market rules governing offers, and there are no market rules requiring competitive behavior. In the absence of a competitive market that includes the FRR area(s), there is no competitive market reference point to define what a competitive offer would be from the FRR generation owners in a bilateral negotiation or what the competitive market price would be.

"Potential Impacts of the Creation of New Jersey FRRs", May 13, 2020 Report of IMM, at p. 4.

As further described by the IMM in the cited State of the Market Report, the monitoring and market rules governing offers and competitive behavior established and enforced by PJM for the capacity markets include a "must offer" requirement for existing generation resources, performance incentives and market power mitigation rules, including offer caps applied to sell offers for resources that are subject to mitigation, and minimum price offers. (SOM Report at 258-259) These are the mechanisms that have been developed by PJM to contain and control the endemic market power in the PJM capacity markets and are apparently the types of rules that PSEG assumes the Board will develop and enforce so as not to "abdicate it responsibilities" by adopting "inefficient procurement mechanisms". Needless to say, the Board has no such rules or requirements currently in place as there has been no need for the Board to do so. The Board has long been out of the business of capacity resource planning, procurement, cost development and oversight, having relied upon the PJM rules and the IMM to perform this role since the enactment of EDECA.

We continue to note the irony that PSEG and Exelon elected to jointly advance the FRR and Integrated Procurement Proposals. The proposed combination of the two companies in large-scale generation-related procurements is reminiscent of the circumstances surrounding the rejection of the Companies' proposed merger in 2005. The merger would have created the country's largest public utility, with the largest portfolio of generation in the world, comprised of 52,000MW of domestic generation capacity and more than 20,000MW of nuclear generation from 20 nuclear reactors, which then represented 56% of the total generation assets within PJM East.

The proposed PSEG/Exelon merger was unique in that unlike other mergers considered by the Board—in which the issue to be decided was *whether* the merger could result in market power—the Companies' combined market power was treated as a *given*. Therefore, the primary issue addressed in the proceeding was whether the Companies' market power mitigation proposals—which offered to physically divest 4,000MW of generation and "virtually" divest another 2,600MW of nuclear power—were sufficient to allay the State's significant concerns regarding the impact of the merger on the PJM markets. Ultimately, the Board and the Governor's Office rejected the merger, largely on the basis of their substantial, unresolved concerns regarding the Companies' combined market power.

Against this background, the Companies now argue that the Board need not be concerned about their market power because a "large volume of resources would be available to serve a relatively small load". The Companies argue that neither the HHI nor pivotal supplier screens would raise market power concerns "if the procurement is designed to allow gas-fired and clean resources to participate" in a procurement for the JCPL LDA. (PSEG Comments at 14-15).

Consistent with their broad approach to the procurement, the Companies include within the category of eligible suppliers the gas-fired and clean resources located in MAAC and EMAAC. When these additional potential suppliers are included in the mix, the analysis results in HHI scores of 1,117 and 1,475 respectively, reflective of moderate levels of concentration.

It is understandable why the Companies attempt to define the relevant product and geographic markets as broadly as possible--the time-honored tactic of experts like Mr. Morris--as market power is necessarily diluted the more broadly the relevant markets are defined. However, the markets described by Mr. Morris, and the eligible suppliers to serve those markets, do not coincide with the far more limited FRR market that would be created here and the narrow scope of eligible suppliers that would be permitted to serve that market if the State's clean energy goals are to be advanced. It was in the more narrowly and accurately defined FRR product and geographic markets that the IMM found considerable market power to exist under both the HHI and the pivotal supplier screens.

As the Companies have defined it, the relevant product market —initially the Tier I procurement--is limited to only renewable and clean forms of generation. The Companies' proposal to limit the Tier I procurement to clean generation purports to further the State's 2050 goals and to counteract the MOPR's emphasis on fossil generation. Because fossil generation is not a viable supply substitute for clean energy in Tier I—and should be excluded from the procurement--it cannot be considered part of the same product market for market power analysis purposes. *See*, Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission, April 8, 1997, pp. 4-8.

Accordingly, the listings of EMAAC and MAAC "Gas-Fired and Clean Unforced Capacity Available for JCPL FRR" set forth in the Morris Affidavit (at pages 6 and 7) are, by definition, overly broad as both listings contain a significant amount of fossil generation that is ineligible for the Tier I procurement. Mr. Morris' listings are, however, noteworthy in that they clearly confirm PSEG and Exelon's dominance in EMAAC (a combined 49.8% share of total generation) and MAAC (a combined 39.7% share). All other competitive companies that are included have comparatively minor shares in comparison, a further indication of the continuing market power the Companies could potentially wield if not properly mitigated.

The same analysis pertains to the Companies' definition of the relevant geographic market, which is broadly delineated as the EMAAC and MAAC zones. However, as the IMM observed above, FRR *shrinks*, rather than expands the relevant geographic market by reducing the number of largely localized generation owners from whom generation must be purchased in bilateral arrangements to meet the reliability requirements of the FRR entity. Because of existing transmission constraints, it can be assumed that the proposed JCPL LDA would be subject to the Minimum Internal Resource Requirements ("MIRR"), which *mandate* that a designated portion of the procured capacity be procured from within the LDA for reliability purposes. This *inflexible* FRR rule could dramatically increase the potential for an exercise of market power by PSEG and Exelon, which have concentrated ownership of the local clean generation facilities that would be mandated for purchase by the FRR entity. Mr. Morris does not address this inflexible rule and its implications for purposes of pivotal suppler analysis. Accordingly, because the JCPL LDA is not separately metered or modeled, the geographic market would more appropriately be limited to the EMAAC zone.

As a practical matter, Dr. Paul Sotkiewicz, formerly Chief Economist in the Market Service Division of PJM, stated in his June 24, 2020 Comments for P3, that if the Companies' Tier I proposal were adopted, the Companies would hold *all* the eligible Tier I capacity up to the

2024/2025 BRA and, thereafter, would control 94% of eligible capacity in a broader Tier II procurement. (The balance of eligible clean capacity available in the JPCL LDA is limited to the Yardsville pumped hydro facility and numerous solar projects having a combined capacity of 470MW, representing only a fraction of the total JCPL FRR load requirement).

Dr. Sotkiewicz concluded that together, taking into account their joint ownership of the nuclear plants, the PSEG/Exelon units would have a Tier I HHI of 10,000—a score indicative of monopoly concentration-- for the 2022/2023 and 2023/2024 BRAs. As monopolists, unless restrained in some manner, the Companies would be empowered to name their price for their clean capacity (and their environmental attributes). This clearly could also be the case under the Companies' Pay As Bid proposal, which as proposed includes no market power mitigation rules or policies. Beginning in 2024/2025, the HHI would reduce to about 8900, or near monopoly, with the addition of the Orsted offshore wind project, although the number would increase if PSEG obtains partial ownership of the Orsted project.

The inclusion of the Companies' Peach Bottom and Limerick nuclear plants in Pennsylvania as eligible Tier I or Tier II resources would exacerbate the market power problem. Dr. Sotkiewicz concluded that if JCP&L is selected as FRR entity, the Companies' nuclear plants plus either all of Limerick or all of Peach Bottom could effectively satisfy the entire FRR capacity requirement. (Sotkiewicz Comments, at 30-33). Moreover, the Companies' market power could be exacerbated if alternative eligible suppliers, that are not subsidized by ZECs, ORECs or otherwise, elect not to participate in the FRR procurement processes due to concerns regarding the uncertainties inherent in the mechanism and reluctance to offer binding offers that are contingent on the outcome of future PJM auctions. A more ideal environment for the exercise of supply-side market power would be hard to imagine.

As monopoly suppliers, it follows that the Companies' capacity would be required to meet the JCPL LDA's load, making the Companies "pivotal" suppliers. In these circumstances, JCPL as FRR entity would have no alternative other than to negotiate a bilateral capacity supply arrangement with an empowered PSEG and Exelon, without any of the competitive and bid constraints, independent oversight or ratepayer protection rules that are part of the PJM capacity auction. It would be extraordinarily difficult for the Board to provide the "efficient" procurement mechanisms" the Companies suggest would be needed to mitigate exercises of market power in such circumstances, particularly where the Companies have already successfully resorted to threats to close their nuclear plants if their demands are resisted.

The State should be extraordinarily careful to avoid adopting a procurement regime that has the clear potential to put the Board, the State and ratepayers in such a position of weakness.

Conclusion

For the reasons set forth in these comments and the earlier comments submitted by the New Jersey Large Energy Users Coalition in this inquiry, we urge the Board to reject the FRR alternative as well as the various FRR proposals submitted by the Companies.

Respectfully submitted,

Steven S, Goldenberg
Giordano, Halleran & Ciesla, PC
125 Half Mile Road, Suite 300
Red Bank, New Jersey 07701
sgoldenberg@ghclaw.com
and
Paul F. Forshay
Eversheds-Sutherland
700 Sixth Street, NW, Suite 700
Washington, DC 20001
paulforshay@eversheds-sutherland.com

Attorneys for the New Jersey
Large Energy Users Coalition

Dated: November 23, 2020
Docs #4707183-v1