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December 18, 2017

Honorable Bob Smith
Chairman, Committee on Environment and Energy
New Jersey State Senate
Trenton, New Jersey (sent via e-mail)

Subject: ***S. 3560's Many Pitfalls for Consumers and Competition***

Dear Senator Smith:

This letter follows up on the correspondence sent to you on December 5, 2017, which was prompted by the hearing where EPSA and many others were not allowed to testify. In that letter, EPSA outlined in detail the many concerns we had with the sketchy "nuclear power plant profit safety net" that PSEG presented at the December 4 hearing.

EPSA has now had a brief opportunity to review the legislative language you introduced as S. 3560 on December 14, 2017, to create a new and unprecedented way to compensate nuclear power plants, termed in the bill as a "Nuclear Diversity Certificate" program ("NDC"). Even after only the preliminary analysis that the past few days has allowed, it is abundantly clear that EPSA's concerns and those of many other opponents have been confirmed, and then some. Please allow us to elaborate below.

S. 3560 Starts with False Premises that Plants Will Close and Rates Will Rise

The stated purpose of S. 3560 is to avoid "premature" retirement of New Jersey's nuclear plants. Putting aside the validity of the "premature" concept, given that under federal and state law all power plants compete regardless of fuel and face similar challenges, **there is no factual basis to conclude that New Jersey's nuclear plants are in imminent danger.** PSEG has said as much: the plants are profitable for years, they have capacity obligations to PJM, and there are several state, regional and federal initiatives underway that would make them even more profitable. **There is simply no need to rush to make hasty, ill-informed and ill-advised decisions in the remaining days of this session.**

Similarly, despite scare tactics and use of paid-for, self-serving "reports" with blatantly unrealistic assumptions, there is no basis to the wild claims that electric rates will skyrocket in the absence of massive consumer subsidies. We would be glad to walk you and others through the technical deficiencies in the Brattle and IHS Markit work done for the nuclear industry. Suffice it to say that were these claims true, consumer advocates would not be so strongly opposed to S. 3560.

S. 3560 Lets Nuclear Plants Cherry Pick Between Cost-Based and Market Rates

There are two separate and distinct ways to compensate owners of electricity generation: ***EITHER cost-based rates*** that are closely bounded by detailed rules, regulations and procedures ***OR market-based rates*** that rely on competition and market rules to discipline what suppliers can charge for power.

S. 3560 allows PSEG and Exelon to have the best of both worlds at the expense of consumers and their competitors. The bill gives them guaranteed cost recovery, including capital costs and profits, but without the independent NJBPU supervision and profit limitations that accompany traditional cost-based regulation, including weighing alternatives. At the same time, S. 3560 would allow PSEG and Exelon to keep all the upside if market-based rates rise in the future, but without them assuming the higher risks normally part of the bargain with market-based rates (including the risk that costs including capital costs exceed revenues). This would be exacerbated by the anti-competitive effects of letting them bid in wholesale energy and capacity markets with the "head start" of hundreds of millions of dollars in consumer-financed subsidies *each year*. This will let them distort wholesale market outcomes and thus lessen the very competition that is essential to keeping their market-based rates in check.

S. 3560's practical effect is to repeal New Jersey's restructuring law that was designed to shift risks and costs from consumers to investors, *but only for PSEG and Exelon*. However, instead of returning to the pre-restructuring law's traditional approach to cost-based regulation consistent with sound utility rate-making principles, the mechanisms in S. 3560 by-pass those protections. We would be pleased to elaborate as to why this is the case.

S. 3560 Makes It Too Easy for Nuclear Plants to Qualify for Consumer Subsidies

Section 3 is replete with drafting gaps and gimmicks. For starters, **there is no basis as to why the entire structure is forward-looking as opposed to backward looking.** Mere forward-looking corporate projections, especially over multiple years, are ripe for gamesmanship and manipulation or simply making mistakes, especially when the information from a nuclear plant's owners appears to be self-certified and would be treated by the NJBPU as confidential.

Forward-looking approaches require making assumptions about a dynamic, evolving subject (electricity) with a poor track record of even seasoned experts being able to accurately predict all the variables that will impact the financials of a given set of power plants. By contrast, the owners of these plants are profitable, multi-billion dollar companies with strong balance sheets and cash flows, paying hefty dividends to their shareholders. The nuclear plants at issue are but a part of their fleets. Any assistance should occur after the close of each year when results are known to the penny, as opposed to speculating about what costs and revenues may or may not be over a multi-year period such as three years here.

Below are just some of the ways in which Section 3 as drafted makes it too easy to qualify for unprecedented and unjustified access to subsidies:

- **Everything is confidential** as submitted by those who stand to gain hundreds of millions of dollars per year, without any explicit requirement for independent audits, public comment or analysis by the NJBPU;

- **"Risk of loss" is not defined in the legislation**, and the "loss" that would trigger the NDC payments is **not** the risk of the plants closing as properly defined, but the broader and more subjective risk of loss of "fuel diversity" (also not defined) and air quality attributes, but only from these plants and without regard to whether the NDC payments would be the least cost means to maintain those benefits for New Jersey;

- **The look-ahead in Section 3(a) alternates between a three-year forward period and references to financial measures on an *annual* basis** during that three-year period; in other words, the legislative language is subject to the interpretation that if a plant has a financial shortfall in only one of the forward three years under review, the plant would receive the NDC payments for the full three-year period;

- **The section has an overly loose and ill-defined test – or really a series of multiple pathways – for PSEG and Exelon to qualify for NDC payments from captive consumers**. Simply stated, Section 3(a) would allow them to load up the projected expenses to justify subsidies well beyond what is considered prudent based on traditional utility and wholesale market practices and principles. As drafted, the allowed costs are not just operation and maintenance including fuel expenses, but "non-fuel capital expenses" (potentially including those already recovered), a new undefined category termed "cost of operational and market risks that would be avoided by ceasing operations" and "any other information, financial or otherwise." In other words, non-financial information and unspecified "other" information could be injected to justify why the plants ***might*** retire even if the numbers themselves do not.

- The tests are that the power plant is cash negative on an annual basis "or alternatively is not covering its costs including its cost of capital on an annual basis." **This is a telling example of mixing and matching between cost-based and market-based rates.** Power plants in competitive wholesale markets and restructured state power systems such as New Jersey are not supposed to be guaranteed their costs of capital, especially when their competitors have no such guarantees. Furthermore, the bill has no limits on what that amount could be, and whether it includes sunk costs or previously recovered stranded costs. The bill does not expressly require that the NJBPU determine that the costs claimed were prudently incurred or for used and useful facilities.

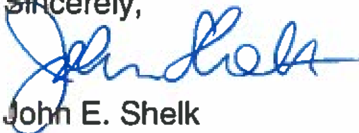
S. 3560 Over Compensates Nuclear Plants to Inflate their Owners' Profits

Even if one accepts that New Jersey's nuclear plants are at risk of closing soon (and they are not), and even if one tolerates the toggling between cost-based and market-based rates (which you should not), **the most glaring flaw is the disconnect between how much a nuclear plant "needs" to stay open and the much larger amount plants would receive as NDC payments.** In other words, even if the triggers to qualify were fixed, the subsidy paid is not limited or tailored to the projected gap between costs and revenues. **This is because once a plant meets one of the loose tests to qualify for an NDC, the amount of the payment is not limited to the amount of the gap between costs and revenues used to qualify for an NDC payment in the first place (see below).**

Instead of leaving it to the NJBPU to determine an amount using traditional cost-of-service principles, **S. 3560 is very generous to plant owners by paying them based on the rigid formula spelled out in section 3(g), (h) and (i).** As best we can tell, the formula collects from captive consumers $4 per megawatt-hour (MWh) applied to all nuclear and non-nuclear generation consumed. It then pays eligible nuclear plants **(regardless of the amount of their projected shortfall)** the equivalent of $10 per MWh as a bonus (at a time when market prices are $30 per MWh, for a one-third premium over market prices). This comes to around $300 million annually (roughly $200 million to PSEG and $100 million to Exelon) ***even if*** the projected or actual difference between a plant's generous definition of costs and its revenues is far less than the large fixed NDC payments. While captive customers share in the "losses", they get none of the upside in years when the plants are profitable above the new "safety net" NDC levels. This could be addressed by netting profits and losses over multiple years. The bill does not adequately protect against "double dipping" (under section 3(e)(5) federal and other non-NDC payments for the same "attributes" *do not* reduce NDC payments dollar for dollar in all instances as should be required).

There are many other questions, including whether out of state plants would be eligible, whether New Jersey consumers would subsidize plants but the power goes out of state, and whether FERC and PJM will act to protect wholesale markets in a manner that could effectively disallow nuclear plants armed with NDC subsidies from counting toward PJM capacity requirements and being dispatched to meet electricity demand. **Thus, it is a mistake to rush to judgment but helps explain why those who stand to receive very sizeable NDC payments are pushing to rush to judgment anyway.**

Sincerely,



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CC: Senate and Assembly Committee Members