

Descending Clock Auction for New Jersey BGS Power Procurements

**Workshop to Support RGGI on the Topic:
Implementing the Minimum 25% Public Benefit Allocation**

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Background – Basic Generation Service (“BGS”) Auction in New Jersey

- BGS is power supply service provided by utilities to customers who do not switch or do not have access to competitive retail suppliers
- Electric utilities divested their generating assets in the late 1990's and early 2000's, and needed to obtain power supply in the open market to meet their BGS obligations
- Electric utilities proposed the descending clock auction in 2001 as the best means of obtaining BGS supply for residential and commercial customers at the lowest possible price.
- New Jersey has conducted 5 state-wide Auctions for BGS power, annually each February 2002-2006.
- Similar auction has been approved and will be used in Illinois (Com Ed and Ameren) in Fall 2006 to procure POLR supply.

Public Process

- Authorized by NJ legislature through the Electric Discount and Energy Competitive Act in 1999
- NJ Board of Public Utilities conducts annual proceeding to adjust program if necessary
- Input by all stakeholders

BGS Auction Overview

- NJ electric utilities initially procured a mixed portfolio of 1 to 3 year contracts. By the third year (2004), the utilities had a staggered portfolio of 3-year contracts, with contracts covering 1/3 of total BGS expiring each year.
- Now in each year the utilities seek offers for a 3-year contract term covering 1/3 of their load, to replace expiring contracts.
- Staggered 3-year contracts provide term-averaging to 'smooth-out' volatility in market prices.
- The load being put out to bid in any one year is broken into 'tranches' of about 100mw each (each slice approximately 1- 4% of total load depending on utility).

BGS Auction Public Protection

- Qualification criteria and processes, auction rules, Master Supply Agreement, are submitted by the utilities to the BPU for review and approval; are subject comment by interested parties and possible modification; and are ultimately approved by the BPU.
- The auction is conducted via internet by an Auction Manager that is hired by, but independent of, the utilities.
- BPU staff is permitted to observe in the bid room.
- BPU hires an auction expert (consultant) that advises the BPU during each stage of the bid prep and bid implementation process, and is also present in the bid room to oversee the process
- The BPU auction expert provides a report to the BPU with respect to the final results and whether the auction was competitive and conducted in a manner consistent with the approved auction rules.

Steps Leading up to the Auction

- In advance of the qualification stage, detailed data related to the BGS load to be served is made available to prospective bidders on an auction website
- Utilities/auction manager conduct information sessions for prospective bidders: make presentations; provide information; answer questions
- No later than 10 days before date for interested parties to first apply to participate in the Auction, the auction manager will announce utility-specific load caps; statewide load caps; and statewide maximum and minimum starting prices.
 - Load caps are maximum amount of load (# of tranches) that any one supplier can be awarded. Intended to mitigate dependence on any one supplier (to approximately 30% total load).
 - Max and min starting prices represent the range of actual possible starting prices in the first round of the auction

Part 1: Qualification Process

- All interested parties that can meet PJM LSE requirements can submit a Part 1 application.
- No state licensing requirement
- Interested parties must submit financial information to permit utilities to assess creditworthiness
- Interested parties must agree to comply with auction rules and with the BGS Supplier Master Agreement (Master Agreement contains standard terms and conditions that are approved in advance by the BPU, that are uniform (i.e. same for each supplier), and that are not subject to negotiation.
- Applicants notified within 3 days whether they have successfully met criteria. If so, they become *qualified bidders*.

Part 2 Application Process

- Only qualified bidders may submit Part 2 application
- Qualified bidder must certify that it is bidding independently from all other qualified bidders; and must agree the submission of any bid creates a binding and irrevocable offer to provide the service under the terms of the Master Agreement
- With their Part 2 applications, qualified bidders must submit an indicative offer and a financial guarantee in proportion to their indicative offer (ex. bid bonds, letters of credit, parent guarantee of sufficiently creditworthy)
- An indicative offer specifies two numbers of tranches: the first is the # of tranches the bidder is willing to serve at the maximum starting price on a statewide basis; and the second is the # of tranches the bidder is willing to serve at the minimum starting price on a statewide basis

Final Auction Preparation

- Indicative offers determine the qualified bidder's initial eligibility: a bidder will never be able to bid in the Auction on a number of tranches $>$ the initial eligibility.
- The Auction Manager uses the indicative offers (in consultation with the BPU) to inform the decision in setting round 1 (starting) prices
- Indicative offers used to determine excess supply. An oversupply ratio formula is applied to determine if initial competitiveness test is met. If not, Auction Manager can reduce total load volume in Auction (this has never been triggered in 5 years of the auction for the BGS-FP load)

Auction Mechanics

- Three days before beginning of auction, The Auction Manager informs registered bidders of each utility's starting price (the price in round 1 of the auction) and load caps
- In each round of bidding, bidders provide the number of tranches of BGS load they are willing to serve for each utility at the announced prices (subject to load caps)
- If the number of tranches bid is greater than the number of tranches needed by a utility, the prices reduced in the next round.
- In each round bidders can move tranches between utilities (subject to load caps), but cannot increase total tranches offered statewide from previous round
- Prices 'tick down' in each round in decrements pre-determined by a specific formula representing a percentage of the previous price. The auction closes when the supply bid (# tranches bid) is just equal to the load to be procured.
- Bidders holding the final bids when the Auction closes are the winners

Post-Auction

- All bidders that win receive the same price per kwh of load served by the utility during the contract term
- Prices provides that the BPU votes up or down on the auction results by the end of the 2nd business day following the calendar day on which the auction closes
- If the BPU approves the Auction results, each winner will have 3 days to demonstrate compliance with the creditworthiness requirements and winners and the utilities have 3 days to execute the Master Supplier Agreement.
- A winner's financial guarantee posted before the Auction may be forfeited if the winner does not execute the agreement within 3 days.

NJ - Auction Results

- The first auction was conducted in February 2002. NJBPU has approved, and the state has conducted, 4 additional state-wide BGS auctions: in 2003, 2004, 2005 and 2006.
- Participation and competition has been healthy. Amount of power initially offered by suppliers has consistently exceeded the amount needed to supply customers.
- There have been no complaints lodged by bidders, no instances of winners failing to execute the Agreement, and no BGS supplier defaults.

NJ - Auction Results (Cont'd)

- Has proven to be an attractive product for suppliers/generators:
 - Regulatory and contractual stability/predictability in rules and decision-making
 - Large market
 - Multi-year bilateral contracts provide attractive option
- Has proven to be an attractive product for ratepayers:
 - Greater price stability due to 3 term averaging
 - Effective competition
 - Fixed prices from financially secure suppliers