

LIGHTS OUT FOR NEW JERSEY:

THE AUGUST 2003 BLACKOUT AND THE END OF ELECTRICITY REGULATION IN NEW JERSEY

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I. Introduction

On August 14, 2003, several areas of New Jersey were plunged into darkness when the full force of the August 2003 Blackout paralyzed the Midwest and Northeastern United States as well as parts of Canada. As soon as electricity was restored, angry lawmakers and

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electricity consumers began looking for answers. The reliability of the nation's electricity grid was called into question and the current federal energy policy was attacked for failing to provide mandatory transmission grid reliability standards. The timing of the blackout could not have come at a more tumultuous time for New Jersey residents, who just two weeks earlier witnessed the state's electric industry go through the final stage of deregulation. Deregulation in New Jersey came as a result of the Electric Discount and Energy Competition Act ("EDECA"),¹ which provided the framework for deregulation of the state's electric industry over a four-year transition period that ended on August 1, 2003. Unfortunately, the end result of deregulation did not meet the lofty expectations promised by its proponents. The potential competition between electric companies never came to fruition, and the lower prices for electricity were not implemented. Consequently, New Jersey's decision to deregulate has been questioned, and the methods used to implement deregulation continue to be criticized.

This note examines the status of New Jersey's electric industry after the two major electricity events of 2003: the August 2003 Blackout and the end of New Jersey's regulated electricity system. Part II provides a brief history of the blackouts that have affected New Jersey and its surrounding states in order to put into context the magnitude of the August 2003 Blackout. Part III discusses the recent August 2003 Blackout, the current status of the nation's electricity system, the changes being made to the current federal energy bill to prevent future blackouts, and the effects of the August 2003 Blackout upon New Jersey. Part IV analyzes the role deregulation played in the August 2003 Blackout. Part V discusses the nation's previously regulated electricity system and explores how and why the states decided to switch to a deregulated system. Part VI discusses New Jersey's transition to a deregulated system via the EDECA. Finally, Part VII offers some conclusions about the EDECA, its impact upon New Jersey, and what can be done to improve the current system.

II. A Brief History of Blackouts In and Around New Jersey

A. The Great Northeast Blackout of 1965

On November 9, 1965, at 5:16 pm EST, a back-up protective relay

¹ N.J. STAT. ANN. § 48:3-49 (West 2004).

was triggered on one of the five transmission lines responsible for carrying power from the Sir Adam Beck Operating Station in Ontario, Canada.² The relay caused the circuit breaker to disconnect the transmission line, and within two and a half seconds, all five of the transmission lines became overloaded.³ The overload caused significant amounts of power to be redirected to a transmission system located in western New York, which then exceeded its capability.⁴ The redirection of power caused the Canada-United States Eastern Interconnection to break apart into four sections.⁵ At first, the separation forced the generation plants in the Niagara area to fail, which led to plant failures throughout the Northeast.⁶ Soon, power outages occurred in parts of Connecticut, Massachusetts, New Hampshire, New Jersey, New York, Ontario, Pennsylvania, Rhode Island, and Vermont. The result was the Great Northeast Blackout of 1965 that left approximately 30 million people without energy for almost 13 hours.⁷ The blackout came as a surprise to several states that, unfortunately, had no contingency plan for supplying power to their residents.⁸

In order to prevent future blackouts and to help explain the cause of the 1965 power failure, President Lyndon B. Johnson immediately ordered a full-scale investigation to study the cause of the blackout.⁹

² See Gordon D. Friedlander, *What Went Wrong VIII: The Great Blackout of 1965*, IEEE SPECTRUM, Oct. 1976, at 83. The transmission line that started the blackout was identified as "Q29BD." *Id.* Two years before the blackout, the protective relay on the transmission line "Q29BD" was set too low to handle the power load required for the United States. *Id.*

³ *Id.* When "Q29BD" became overloaded, the power flow was transferred to the other four power lines, which caused them to exceed their critical level and ultimately fail. *Id.*

⁴ *Id.* at 84.

⁵ *Id.* The four sections were the Ontario Hydro system; the Niagara-Dunkirk region; the Northern New York system that is supplied by the Power Authority of the State of New York; and the remaining portion of the Canada-United States Eastern Interconnection, which includes part of upper New York, the southeast New York region, and the New England systems. *Id.*

⁶ *The Great Northeast Blackout of 1965*, at <http://www.cmpco.com/about/system/blackout.html> (last visited Nov. 11, 2003) [hereinafter *CMPCO*].

⁷ *Id.*

⁸ *Id.* As a result of the power loss, backup generators failed to operate properly, people were trapped in elevators for hours, airports were without runway signals, and traffic jams occurred due to malfunctioning traffic lights. *Id.*

⁹ *Id.* The origin of the 1965 blackout investigation is found in a letter from President Johnson to the chairman of the Federal Power Commission dated November 9, 1965:

This failure should be immediately and carefully investigated in order to

The investigation led to the formation of the Northeast Power Coordinating Council (“NPCC”), which was created to help encourage a more reliable and efficient power system within the northeastern region of the United States.¹⁰ The NPCC is a non-profit, voluntary organization that is responsible for the “regionally specific implementation of broad based industry-wide reliability standards.”¹¹ It is one of ten Regional Reliability Councils throughout the United States that form the North American Electric Reliability Council (“NERC”).¹² The NERC is responsible for ensuring that the North American bulk electric system is adequate, reliable, and secure.¹³ Since its creation in 1968, the NERC has established operating policies and planning standards to maintain the reliability of the electric system.¹⁴ The NERC works with every sector of the electric industry, including electricity consumers and regulators, to report problems that occur throughout the

prevent a recurrence. You are therefore directed to launch a thorough study of the cause of this failure. I am putting at your disposal full resources of the federal government and directing the Federal Bureau of Investigation, the Department of Defense and other agencies to support you in any way possible. You are to call upon the top experts in our nation in conducting the investigation. A report is expected at the earliest possible moment as to the causes of the failure and the steps you recommend to be taken to prevent a recurrence.

Id.

¹⁰ *About NPCC*, at <http://www.npcc.org>. (last visited Feb. 3, 2004) [hereinafter *NPCC*]. The NPCC was formed in 1965 and covers New York, the six New England states, Ontario, Quebec, and the Maritime Provinces of Canada. *Id.* The NPCC serves approximately 54 million people over approximately 1 million square miles. *Id.*

¹¹ *Id.* The members of the NPCC include transmission consumers and providers who serve the northeastern United States and central and eastern Canada. *Id.*

¹² *Id.*

¹³ *About NERC*, at <http://www.nerc.com> (last visited Feb. 3, 2004) [hereinafter *NERC*]. The NERC is a volunteer organization whose members share vital information that is necessary for an adequate analysis of the electrical network and the coordination of its operation and design. *Id.* The NERC relies on “reciprocity, peer pressure, and the mutual self-interest of all those involved.” *Id.* Its members include investor-owned utilities; rural electric cooperatives; federal power agencies; state, municipal, and provincial utilities; power marketers; independent power producers; and end-use customers. *Id.* The members of the NERC account for almost all the electricity supplied and used in the United States, Canada, and a portion of Baja California Norte, Mexico. *Id.*

¹⁴ *Id.* These standards are always changing due to the growth of competition and the structural changes that have taken place in the industry. *Id.* They are strictly monitored by the NERC’s compliance enforcement program. *Id.* Compliance with NERC standards had been voluntary, but in recent years the changes in the electric industry have forced the NERC to adopt a stricter approach to compliance. *Id.*

bulk electric systems in North America.¹⁵ The creation of the NERC and the NPCC reflected the electric industry's attempt at self-regulation rather than deregulation, which would come years later.¹⁶

In July 1967, the U.S. Federal Power Commission ("Commission") issued its report on the 1965 Blackout.¹⁷ The report stressed that the transmission capacity of the interconnected electricity network must be maintained at a high level, and that improved coordination and interconnection between power facilities was needed to create a more reliable network of energy suppliers.¹⁸ The Commission noted that power facilities could improve coordination by forming agreements on proper operating procedures and construction proposals and by reviewing the load projections for each section of the network.¹⁹ The Commission also recommended that additional research should be conducted because the demand for energy was expected to increase significantly over the next twenty years.²⁰ The report concluded with twelve proposals to ensure the reliability of the electricity network.²¹

¹⁵ *Prepared Testimony of Michehl R. Gent - Hearing Before the United States House of Representatives House Committee on Energy and Commerce, available at <http://www.nerc.com/~filez/blackout.html> (last visited Aug. 3, 2004) [hereinafter *Testimony*].*

¹⁶ See Charles G. Stalon et al., *State-Federal Relations in the Economic Regulation of Energy*, 7 YALE J. ON REG. 427, 442 (Summer 1990).

¹⁷ *Prevention of Power Failures Volume I - Report of the Commission: An Analysis and Recommendation Pertaining to the Northeast Failure and the Reliability of the U.S. Power Systems*, at http://blackout.gmu.edu/archive/a_1965.html (last visited Nov. 11, 2003) [hereinafter *Recommendation*].

¹⁸ *Id.* The underlying theme of the commission's report was the transmission of energy. *Id.* The transmission of energy "must be recognized as the principal medium for achieving reliability, both within a system and through coordination among systems." *Id.* The system must act as a cohesive force to withstand the sudden demands of power surges. *Id.*

¹⁹ *Id.*

²⁰ *Id.* The energy supply by 1985 was expected to triple. *Id.*

²¹ *Id.* The twelve goals of the Commission were: (1) the creation of regional organizations to plan, maintain and operate the bulk power supply systems; (2) the formation of a council on power coordination; (3) the creation of a study group to discuss the problems with the electricity network; (4) action to strengthen the transmission system of the Northeast; (5) a critical review of the transmission facilities; (6) attention to special uses of energy; (7) encourage the full participation of interested parties to help the utilities resolve location and environmental problems for their energy facilities; (8) create more opportunities to increase the effective use of computers in power planning and operating; (9) coordinate programs of automatic load shedding; (10) reassess the needs of the utilities for emergency power for system operation; (11) create government requirements for emergency power to protect the public; and (12) facilitate cooperation among utilities and the appropriate public officials and customers to plan and maintain customer standby facilities. *Id.*

B. *The 1977 Blackout*

Despite these primary efforts to prevent another large-scale blackout, New York City and Westchester County, New York experienced a massive blackout on July 13, 1977, at 8:17 pm EST, due to the loss of the entire electric load provided by Consolidated Edison Company of New York (“Con Edison”).²² The 1977 Blackout occurred during a severe thunderstorm when two separate strikes of lightning struck extra-high voltage lines causing the failure of the Con Edison system.²³ Because the utility was unable to restart its generator facilities, about eight million people lost electricity for approximately five to twenty-five hours.²⁴

Con Edison was forced to accept a significant part of the blame for the blackout due to the problems they had with the implementation of its emergency planning, the delay in restarting its generator facilities, and the failure of some of its physical equipment.²⁵ After the blackout, Con Edison prepared its system for emergencies, revised its system design and operating procedures, and strengthened its command and control system.²⁶ While the 1977 Blackout was not as severe as the 1965 Blackout, and it did not directly impact New Jersey, it re-awakened the nation’s worries that a single mishap could still affect an entire network

²² See *The Con Edison Power Failure of July 13 and 14, 1977*, at http://blackout.gmu.edu/archive/a_1977.html (last visited Nov. 11, 2003) [hereinafter *Edison*].

²³ *Id.* The lightning caused the protective equipment on the high voltage lines to operate incorrectly and malfunction. *Id.* As a result, a major generator and many other important transmission lines were shut down. *Id.* The extra burden placed on Con Edison’s available in-city power sources caused them to fail. *Id.* By 9:36 pm, the entire Con Edison system was shut down. *Id.* A combination of equipment malfunctions and incorrect operator action caused the power failure to spread throughout the entire system. *Id.* at 2.

²⁴ *Id.* Con Edison’s facilities were designed to have a restart capability, but the inability to restart the facilities was hampered by several factors. *Id.* These factors were the failure to promptly call for increased generation, the inability to properly assign reserve generation according to the New York Power Pool requirement, the failure to pay careful attention to emergency ratings, the inability to shed load properly, and the failure to notice that a critical connection in the network was ineffective. *Id.* at 2.

²⁵ *Id.* at 3. “The events of July 13 and 14 indicate that management had not exercised the degree of diligence necessary to assure that these requirements would be fulfilled.” *Id.* “There is a general agreement that the complete shutdown of the Con Edison system could have been prevented if all protective equipment had functioned properly or if the system operators had taken timely action to compensate for the lightning-induced transmission-circuit outages.” *Id.*

²⁶ *Id.*

and cause a serious power outage.²⁷

III. The August 2003 Blackout

The 2003 power blackout occurred on August 14th at 4:09 pm EST, when a power outage swept through Eastern Canada, the Midwest, and the Northeastern United States.²⁸ The blackout caused the largest power failure in the history of North America, affecting forty million Americans and ten million Canadians.²⁹ It resulted in the loss of 61,800 megawatts of power and affected 9,266 square miles.³⁰ While an exact figure is still unavailable, the blackout cost the United States somewhere between \$4 billion and \$10 billion.³¹ In Canada, 18.9 million work hours were lost and the gross domestic product was down 0.7 percent in August.³²

President George W. Bush ordered a full-scale investigation to examine the cause of the blackout and to determine how the mishap was able to paralyze such a large area.³³ On August 20, 2003, President Bush and Canadian Prime Minister Jean Chretien created the U.S.-Canada Power System Outage Task Force ("Outage Task Force") to find ways to prevent future blackouts.³⁴ The Outage Task Force was responsible for determining why the safeguards established by the NERC after the 1965 blackout were not implemented.³⁵ The NERC pledged its support for the Outage Task Force and assigned a team of experts to collect and analyze data to help find the cause of the

²⁷ *Id.*

²⁸ See Nancy Gibbs, *Lights Out*, TIME, Aug. 25, 2003, at 31-32.

²⁹ See Edward Iwata, *Blackout Experts Struggle to Shed Light on Darkness*, USA TODAY, Oct. 13, 2003, at B1. The blackout caused 400 flights to be canceled, closed or partially closed 12 airports, and shut down 100 power plants and 35 auto plants. *Id.* One and a half million residents in Cleveland were also without water due to the blackout. *Id.*

³⁰ *Id.*

³¹ *Final Report on the August 14, 2003 Blackout in the United States and Canada – Causes and Recommendations*, available at <https://reports.energy.gov/BlackoutFinal-Web.pdf> (last visited Aug. 1, 2004) [hereinafter *2003 Final Report*].

³² *Id.*

³³ See Gibbs, *supra* note 28, at 33.

³⁴ See Press Release, Energy.gov, Secretary Abraham, Minister Dhaliwal Announce Working Group Members of US-Canada Joint Task Force (Aug. 17, 2003) (on file with the author). The task force is led by Herb Dhaliwal, the Canadian Natural Resources Minister, and Spencer Abraham, the United States Energy Secretary. *Id.* "This investigation is a top priority for President Bush and for Prime Minister Chretien." *Id.* (quoting Spencer Abraham).

³⁵ See Gibbs, *supra* note 28, at 33.

blackout.³⁶

On November 19, 2003, the Outage Task Force released an interim report that stated the causes of the blackout were a combination of human error and computer failure at FirstEnergy, an Ohio power company.³⁷ The report noted that FirstEnergy employees were never aware of its malfunctioning computer systems because the company's computer maintenance department never informed the control room staff of the continuing computer problems.³⁸ As a result, the FirstEnergy workers were unaware that the transmission lines and power plants had failed and therefore were unable to warn the neighboring power companies of the approaching problem.³⁹ The report concluded that the problem could have been avoided if the voluntary reliability standards were followed.⁴⁰ The NERC also issued a report that placed blame upon the Midwest Independent Transmission System Operator, which is the regional organization responsible for operating the transmission system.⁴¹ On March 31, 2004, the Outage Task Force released its final report on the blackout.⁴² The report presented some new information about the details before the blackout occurred, and included some additional violations of the reliability requirements, but it

³⁶ See Press Release, North American Electric Reliability Council, NERC Supports US-Canada Task Force Investigating Causes of 2003 Blackout (Aug. 20, 2003) (on file with author). Michehl R. Gent, NERC President and CEO stated:

NERC is pleased to be an integral part of this important investigation. The NERC has pledged to cooperate fully with any and all official investigations. NERC's investigation will supplement and contribute to the U.S.-Canada Task Force investigation. We will do everything possible to provide clear answers and lessons learned that will help to ensure that reliability is maintained in the future.

Id.

³⁷ See Richard Perez-Pena & Matthew L. Wald, *Basic Failures by Ohio Utility Set off Blackout, Report Finds*, N.Y. TIMES, Nov. 19, 2003, at A1. The computer failure began when FirstEnergy's alarm system froze and failed to give warnings. *Id.* About an hour later, the backup computer failed and the attempts to fix the system did not work. *Id.*

³⁸ *Id.* Due to the computer failures, workers at FirstEnergy were unable to detect that FirstEnergy's Harding-Chamberlin and Hanna-Jupiter lines had failed. *Id.* These line failures caused the blackout. *Id.*

³⁹ *Id.* The report blames FirstEnergy's failure to trim trees below and alongside their transmission lines as part of the reason why the transmission lines malfunctioned. *Id.*

⁴⁰ *Id.* "This blackout was largely preventable. A number of relatively small problems combined to create a very big one." *Id.* (quoting Energy Secretary Spencer Abraham).

⁴¹ See Matthew L. Wald, *Power Violations to Be Listed in Blackout Response*, N.Y. TIMES, Feb. 11, 2004, at A26.

⁴² See *2003 Final Report*, *supra* note 31.

did not change the validity of the interim report.⁴³

After the blackout, increased attention was paid to the vulnerability of the nation's electrical grid. In order to control the distribution of power, the nation's electrical grid structure is currently divided into three regions.⁴⁴ The North American grid, which includes New Jersey, is a series of high-voltage transmission lines and power plants that stretch over 150,000 miles from Canada to Mexico.⁴⁵ The grid is designed to automatically shut down if excessive or inadequate voltage travels through the system.⁴⁶ The automatic shutdown shelters the power plants and transmission lines by separating the equipment from the network, reducing the chances of permanent damage.⁴⁷ Currently, the electricity grid has enough capacity to generate power, but lacks the proper method to distribute it evenly.⁴⁸

A major setback for improving the reliability of the power grid occurred when the Senate rejected a proposed energy bill in November 2003.⁴⁹ President Bush unsuccessfully lobbied the Senate in order to protect the country's economic and national security by passing this

⁴³ *Id.*

⁴⁴ See Iwata, *supra* note 29, at B3. The three regions are the Texan interconnect, the Western interconnect, and the Eastern interconnect. *Id.* Each grid consists of several power plants and high-voltage transmission lines that are powered by nuclear, oil, gas, and coal. *Id.* The electricity that is generated by the power plants flows over thousands of miles from towers to substations to power poles and finally into individual's homes, business, and factories. *Id.*

⁴⁵ *Id.* The North American grid is considered one of the most advanced systems in the world. *Id.* The system has power running more than 99% of the time to millions of residential and business customers. *Id.*

⁴⁶ Department of Energy Initial Blackout Timeline – August 14, 2003 Outage Sequence of Events, at http://www.doe.gov/engine/doe/files/dynamic/1282003113351_BlackoutSummary.pdf (last visited Feb. 3, 2004) [hereinafter *Timeline*].

⁴⁷ *Id.* Physical damage to the power plants and transmission lines would require restoration of the equipment, which would increase the time necessary to repair equipment and would require more money. *Id.*

⁴⁸ *Id.*

⁴⁹ See Carl Hulse, *Senate Blocks Energy Bill; Backers Vow to Try Again*, N.Y. TIMES, Nov. 22, 2003, at A1. The proposed bill passed the House of Representatives by a vote of 286-140, but was filibustered in the Senate. *Id.* The sixty votes required to gain cloture, a device to close the Senate debate, fell short, despite the efforts of Energy Secretary Abraham, who warned that the failure to pass the bill would neglect the reliability problems with the grid. *Id.* See also Carl Hulse, *A Final Push in Congress: Energy Bill*, N.Y. TIMES, Nov. 26, 2003, at A17. The bill was criticized since it “had too much for industry, cost too much, was written with too little Democratic help and was too much in the shadow of the Medicare fight.” *Id.* The proposed bill would have changed a policy that had not been examined for a decade. *Id.*

bill.⁵⁰ A portion of the \$31 billion energy proposal included efforts to make the power grid more reliable by requiring mandatory adherence to the voluntary transmission grid reliability standards of the NERC.⁵¹ In May 2004, the bill was reintroduced to the Senate as an attachment to an unrelated Internet bill, but also failed.⁵² As it stands now, it is likely that the energy bill will be broken up into smaller legislation in order to pass the less controversial sections of the bill.⁵³ Despite the best efforts of lawmakers, consideration of the energy bill will be postponed until after the 2004 presidential election.⁵⁴

A. *The August 2003 Blackout and its Effects on New Jersey*

The blackout had a serious impact on New Jersey.⁵⁵ The governor declared a state of emergency because the power outage left one million home and business owners without power.⁵⁶ The blackout had its greatest impact on northern New Jersey, specifically Essex, Passaic, and Bergen counties.⁵⁷ Of the four major power companies in New Jersey, only Atlantic City Electric (ACE), a subsidiary of Conectiv, escaped the blackout without any loss of power.⁵⁸ Jersey Central Power & Light (JCP&L) reported that less than 10,000 customers were affected by the blackout since the utility was able to “[automatically] cut ties with parts of the main transmission grid . . . seconds after the first surge was felt

⁵⁰ See Hulse, *supra* note 49, at A1.

⁵¹ *Id.*

⁵² See Simon Wardell, *Surprise Attempt to Push Through Energy Legislation Defeated in the US Senate*, WRMC DAILY ANALYSIS (WORLD MARKETS RESEARCH CENTRE), MAY 3, 2004.

⁵³ *Id.* Already the proposed change from voluntary reliability standards to mandatory reliability standards for electric utilities has been broken apart from the main energy bill and introduced as a separate piece of legislation. *Id.* See also Press Release, News from the United States Congress, Democrats Push for Electricity Reliability Legislation to Prevent Future Blackouts (July 20, 2004) (on file with author).

⁵⁴ See Wardell, *supra* note 52.

⁵⁵ See David Kocieniewski, *Economic Toll 'Devastating' a Troubled McGreevey Says*, N.Y. TIMES, Aug. 16, 2003, at B13.

⁵⁶ *Id.*

⁵⁷ See *US-Canada Blackout*, available at http://en.wikipedia.org/wiki/2003_US-Canada_blackout#New_Jersey,_USA. (last visited Nov. 11, 2003) [hereinafter *Wikipedia*]. Essex county was one of the first areas to have their energy restored for fear of looting and riots. *Id.*

⁵⁸ See Martha McKay & Lewis Krauskopf, *In the Dark on How it Happened; Investigators Look for Blackout's Cause*, THE RECORD (N.J.), Aug. 16, 2003, at A1.

and escape the cascading blackouts.”⁵⁹ Orange and Rockland Utilities (Rockland) reported that 70,000 customers in north Bergen, Sussex, and Passaic Counties were without power for up to eight hours after the blackout because the blackout wiped out the utility’s power source.⁶⁰ Public Service Electric & Gas (PSE&G), the state’s largest power utility, was unable to provide power to almost one million customers as its power generators in Jersey City and Ridgefield Park automatically shut down to prevent severe equipment damage.⁶¹

Even though the blackout only directly impacted certain areas of New Jersey, the loss of energy was felt throughout the state. The Atlantic City casinos reported that casino business decreased because of the inability of tour buses to transport gamblers from New York City.⁶² The Oyster Creek Nuclear Reactor was shut down as a precaution against the possible loss of off-site power until energy was restored.⁶³ Several flights were delayed at Newark Airport, and the New Jersey Office of Emergency Management was mobilized.⁶⁴ Even the IRS waived late penalties for New Jersey taxpayers who received three-month filing extensions, but were unable to file their taxes because of the blackout.⁶⁵

State officials were quick to react to the blackout. New Jersey Governor James McGreevey ordered seven hundred National Guard soldiers and an extra three hundred state troopers to mobilize throughout the state.⁶⁶ He also suspended tolls on the New Jersey Turnpike and Garden State Parkway for almost twenty-four hours.⁶⁷ During this time, these roadways experienced heavy traffic due to the

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.* PSE&G reported that by Friday afternoon only 5,000 customers in Bergen and Passaic Counties were without power. *Id.* Fairview, Cliffside Park, North Bergen, Totowa, Montclair, Maplewood, East Orange, West Paterson, Haledon, Prospect Park, and Secaucus were some of the last towns to have their power turned back on. *Id.* See also Kocieniewski, *supra* note 55, at B13. PSE&G asked its customers to conserve energy and not to run their air conditioners despite the hot weather. *Id.*

⁶² See Kocieniewski, *supra* note 55, at B13.

⁶³ See *Blackout by the Numbers*, THE RECORD (N.J.), Aug. 16, 2003, at A4.

⁶⁴ See Canadian Press Newswire, *Areas Affected by Thursday’s Massive Power Blackout*, Aug. 15, 2003.

⁶⁵ See Joseph Busler, *Late Tax Filers Get Week’s Reprieve*, COURIER-POST, Aug. 16, 2003, at G6. Taxpayers who wanted their late fees waived had to mark on their tax returns “NORTHEAST BLACKOUT” in red ink. *Id.*

⁶⁶ See *Blackout by the Numbers*, *supra* note 63, at A4.

⁶⁷ *Id.* The tolls were reopened by Friday afternoon. *Id.*

limited rail service provided by New Jersey Transit and Amtrak.⁶⁸ New Jersey Senators Frank R. Lautenberg and Jon S. Corzine commended New Jersey police officers, firefighters, and emergency workers for their quick response in handling the blackout.⁶⁹ They also praised the people of New Jersey for dealing with the blackout with patience and perseverance.⁷⁰ Senator Lautenberg called for an inquiry to determine the causes of the blackout and sought financial disaster assistance from the Federal Emergency Management Agency (“FEMA”).⁷¹ Governor McGreevey, along with the governors of Connecticut and New York, demanded a federal investigation to determine the cause of the blackout.⁷²

IV. Deregulation and the August 2003 Blackout

The deregulation of the nation’s electric industry is considered by some to be one of the contributing factors to the August 2003 Blackout. Opponents of deregulation note that due to the deregulation of the electric industry,⁷³ the transmission of electricity is no longer under the jurisdiction of the states and there is no longer any “government oversight of the reliability of this country’s electric transmission system.”⁷⁴ Opponents have also called for mandatory reliability standards for the nation’s electric grid to reduce the regulatory uncertainty that has troubled the electric industry since the decision to

⁶⁸ See Kocieniewski, *supra* note 55, at B13.

⁶⁹ See Lois A. Kaplan, *Senators Call for Blackout Inquiry*, OCEAN COUNTY OBSERVER (N.J.), Aug. 18, 2003, at 3.

⁷⁰ *Id.* “Our citizens, our communities, and our first responders all answered the call. Although the power loss was very frustrating, everyone should feel a sense of pride at our conduct. New Jersey is a State that hangs together in a crisis.” *Id.* (quoting Senator Lautenberg).

⁷¹ *Id.* Senator Lautenberg stated that the economy could not handle another blackout and reminded the federal government that it had a duty to help state officials in a situation like this. *Id.* See also Millie Guerrero, *Blackout Boosts Shore Tourism; Crowds Flock to New Jersey*, OCEAN COUNTY OBSERVER (N.J.), Aug. 16, 2003, at A1. Governor McGreevey also asked for federal assistance: “Mr. President, while our emergency management and disaster control efforts worked admirably, the costs to the State and to our communities have been extraordinary. In fact, this disastrous event taxed State and local emergency response capabilities to their limits. Our emergency management agencies are currently tabulating the costs.” *Id.*

⁷² See Kocieniewski, *supra* note 55, at B13.

⁷³ See *infra* Part V.A.

⁷⁴ See Matthew L. Wald, *Hundreds of Rule Violations Tied to Possible Blackouts*, N.Y. TIMES, Sept. 4, 2003, at A20.

deregulate more than a decade ago.⁷⁵ The Federal Energy Regulatory Commission (“FERC”) has volunteered to enforce such mandatory standards, but the Senate has yet to pass an energy bill that includes such standards.⁷⁶

Deregulation is often blamed for the lack of investment in new transmission lines, which has become a priority in the aftermath of the blackout. Deregulation allowed electric companies to set their prices for electricity generation based on market rates, which provided a financial motive for them to build additional power plants instead of new transmission lines.⁷⁷ The decision to build more power plants turned out to be a mistake.⁷⁸ Utility companies soon realized that by failing to invest in new transmission lines, they would not have the ability to transmit extra power or be able to profit from it.⁷⁹ As a result, there is an abundance of power plants stymied by a transmission network that is not sophisticated enough to handle all of the generated energy.⁸⁰

Furthermore, the promise to reduce prices, which was advertised as a benefit of deregulation, prevented companies from investing in new transmission lines.⁸¹ A rate increase was proposed by some companies, with the hope of generating additional money to fund improvements in their transmission lines, but was disallowed because it contradicted the primary goal of deregulation to reduce prices.⁸² Finally, investors noted the problems that California experienced after the state decided to deregulate.⁸³ An examination of the consequences of California’s

⁷⁵ See Thomas F. Armistead & Tom Ichniowski, *Battles for Future Power Shape Up in Blackout’s Wake*, ENGINEERING NEWS-RECORD, Aug. 25, 2003, at 17.

⁷⁶ See Neela Banerjee & David Firestone, *New Kind of Electricity Market Strains Old Wires Beyond Limits*, N.Y. TIMES, Aug. 24, 2003 at A1. See also Hulse, *supra* note 49, at A1.

⁷⁷ See Banerjee, *supra* note 76, at A1.

⁷⁸ *Id.*

⁷⁹ *Id.* Since companies were hesitant to set money aside to upgrade transmission line reliability, some of the extra power generated by the numerous power plants could not be transferred and remained at the power plants. *Id.* For example, several power plants in Mississippi have about 30,000 megawatts of excess capacity, but no way to transmit the electricity since companies do not have the incentive to build additional transmission lines. *Id.*

⁸⁰ *Id.*

⁸¹ See James C. McKinley Jr., *Blackout Tests a Different Kind of Power in Albany*, N.Y. TIMES, Aug. 17, 2003, at A1.

⁸² *Id.*

⁸³ See Armistead, *supra* note 75, at 17.

deregulation generated uncertainty about the success of the deregulation process and caused investors to shy away from pouring money into the electrical grid.⁸⁴

Whether or not there is a significant connection between deregulation and the recent blackout, it is clear that additional funds need to be set aside to improve the electric grid. In 1988, when the electric industry was operating under a regulated system, the amount of money spent on transmission lines was \$304 million.⁸⁵ In 1999, under a deregulated system, the money spent on transmission lines dropped dramatically to \$90 million.⁸⁶ Consequently, the electricity grid has not been sufficiently upgraded and transmission wires are now forced to carry electricity loads that they were not designed to handle.⁸⁷

The need for electricity compared to the growth and improvement of the grid is proof that an upgrade of the grid is necessary to meet the needs of today's electricity consumers. Between 1992 and 2002, the transmission infrastructure only grew by 18 percent, while the demand for electricity increased by 35 percent.⁸⁸ In 2003, the Electric Power Research Institute ("EPRI")⁸⁹ predicted that there will be a 17 percent increase in the demand for electricity by 2007, but only a 4 percent increase in the capacity of the transmission infrastructure.⁹⁰ In order to prevent future blackouts, the EPRI estimates that \$100 billion is needed to improve and modernize the electricity network to meet the needs of

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ See McKinley, *supra* note 81, at A1. The reduction of money spent on transmission lines caused the system to become "an outdated, overtaxed delivery system with plenty of bottlenecks . . . it [was] a frail system at best." *Id.* (quoting N.J. State Assemblyman Paul D. Tonko, Chairman of the Energy Committee).

⁸⁷ See Banerjee, *supra* note 76. The overuse of the transmission lines stems from the federal utility laws of the 1970s. *Id.* See also Gibbs, *supra* note 28, at 33. The utility laws allowed transmission lines to be available to any company that generated electricity. *Id.* In an effort to save money, utilities chose to receive their power from the cheapest source. *Id.* As a result, the transmission lines were forced to carry electricity over longer distances and this placed a strain on the lines. *Id.*

⁸⁸ See Armistead, *supra* note 75, at 17.

⁸⁹ *Electric Power Research Institute*, available at http://www.epri.com/corporate/discover_epri/societal.html (last visited Aug. 1, 2004) [hereinafter *EPRI*]. The EPRI is a California-based nonprofit consortium of utility companies that focuses on science and technology research. *Id.* EPRI's mission is to discuss, develop and deliver high value technological advances through networking and partnership with the electrical industry. *Id.*

⁹⁰ See Armistead, *supra* note 75, at 17.

today's consumers.⁹¹ The EPRI released a report which explained that the existing "infrastructure is not being expanded or enhanced to meet the demands of wholesale competition in the electric power industry, and does not facilitate connectivity between consumers and markets."⁹²

V. *Before Deregulation – The Regulatory System*

Despite the current complaints about deregulation, the previous regulatory system also had its share of problems. In the beginning of the twentieth century, an agreement to regulate the American electric utility system between the investor-owned power companies and several key politicians led to the monopolization of the system.⁹³ In order to promote efficiency, the agreement allowed one company to provide electricity on a statewide level, instead of allowing several competing producers.⁹⁴ The electric utility functioned as a natural monopoly and had the ability to produce and sell electricity at a cheaper rate than a handful of smaller producers.⁹⁵ After the electric utilities obtained monopoly status, each state was required to have its own regulatory agency monitor the utilities and preserve service standards and prices, assuring a fair deal for consumers.⁹⁶ The regulation of the electric industry began successfully, and considerable efforts to strengthen the

⁹¹ See Dan Verton, *Power Industry Unveils \$100b Upgrade Plan*, COMPUTERWORLD, Aug. 25, 2003, at 20. See also Iwata, *supra* note 29, at B3. If a significant amount of money is not dedicated to the electricity network, "[w]e'll be doing more investigations of blackouts." *Id.* (quoting Terry Boston, Executive Vice President of Tennessee Valley Authority, a producer of public power, steward of the Tennessee River system, and a regional economic development agency).

⁹² See *Power Delivery System and Electricity Markets of the Future*, EPRI, Palo Alto, CA: 2003. 1009102. See also Banerjee, *supra* note 76, at A1. The NERC submitted a report to Congress that had findings similar to the results of the EPRI research. *Id.* The report stated that several utilities were testing the limits of the rules for reliability in order to make money. *Id.*

⁹³ See RICHARD F. HIRSH, *POWER LOSS: THE ORIGINS OF DEREGULATION AND RESTRUCTURING IN THE AMERICAN ELECTRIC UTILITY SYSTEM* 11 (Mass. Inst. of Tech. 1999). There is no single document that details the agreement between the electric utilities and politicians to treat the electric utility as a monopoly. *Id.* Instead, through the political process, the managers of the utility companies effected a tacit agreement that the government would oversee the industry and the electricity supply companies would provide electricity at a low cost. *Id.* The terms of this agreement were incorporated into state laws and they created regulatory commissions designed to monitor the regulatory system. *Id.*

⁹⁴ See LEONARD S. HYMAN ET AL., *AMERICA'S ELECTRIC UTILITIES: PAST, PRESENT AND FUTURE* 4 (2000).

⁹⁵ *Id.* This scheme is often referred to as "economies of scale." *Id.*

⁹⁶ *Id.*

system were made by investors who saw unlimited potential in the industry.⁹⁷

Despite the level of optimism generated by investors, the industry began to decline as the 1970s approached.⁹⁸ One of the main factors for the deterioration of the regulatory system was the failure to raise electricity prices when the costs of operation increased.⁹⁹ As the demand for electricity grew throughout the 1960s, the electric utilities continued to lower the price of electricity even though other energy sources increased in price.¹⁰⁰ As a result, the utilities had difficulty generating profits and were eventually forced to raise the price of electricity.¹⁰¹

The regulatory system also experienced problems due to the increased cost of building power plants, the increased cost for equipment that had to meet environmental requirements, and the transition to more expensive nuclear power plants.¹⁰² Other events of the mid-1960s and 1970s, most notably the Northeast Blackout of 1965,¹⁰³ also helped to unsettle the foundation of the electric utility system and show its vulnerabilities.¹⁰⁴ The utilities' mistaken belief in nuclear power as an economical and safe source of energy led to the decline of the industry because companies were forced to abandon their nuclear

⁹⁷ See HIRSH, *supra* note 93, at 33. Investors included investment bankers who realized considerable profits from investing in the utility industry. *Id.* The manufacturers of the electrical equipment also realized a profit. *Id.* Universities added to the surging momentum of the industry by offering electrical engineering programs, which became responsible for training students for careers in electrical engineering. *Id.* at 37.

⁹⁸ See HYMAN, *supra* note 94, at 163.

⁹⁹ *Id.* at 164.

¹⁰⁰ *Id.* at 163.

¹⁰¹ *Id.*

¹⁰² *Id.* at 167. The Nuclear Age was upon the electric industry and the cost of producing nuclear generating plants and the unfamiliarity about the new source of power created an additional economic expense that helped mark the end of the regulated system. *Id.*

¹⁰³ See *supra* Part II.A.

¹⁰⁴ See HYMAN, *supra* note 94, at 177. Several other traumatic events in the 1970s added to the deterioration of the regulated framework. *Id.* The Arab Oil Embargo of 1973-1974 led to reduced consumption of electricity. *Id.* The dividend omission of Con Edison in April 1974 destroyed the faith of utility investors and the average utility stock declined by 36% by September 1974. *Id.* The nuclear accident on March 28, 1979 at Three Mile Island in Pennsylvania also scared investors away from nuclear-oriented electric utility securities. *Id.* Many people feared if a nuclear power plant were to shut down, the power companies would be forced to use more expensive power. *Id.* The notion that nuclear power was safe and cheap disappeared after the Three Mile Island incident and many nuclear projects were cancelled as a result. *Id.* at 177-78.

plans due to the high cost of constructing nuclear facilities.¹⁰⁵ When the 1980s arrived, several electric utilities were losing money because of the high interest rates paid on funds borrowed to complete the construction of unnecessary power plants.¹⁰⁶

The U.S. Supreme Court abandoned the strict regulatory approach of the electricity generation market for the first time in a decision that upheld the legality of the Public Utility Regulatory Policies Act ("PURPA") of 1978.¹⁰⁷ PURPA¹⁰⁸ allowed unregulated electricity producers, known as qualifying facilities, to sell their output to utilities.¹⁰⁹ This was the first sign of the industry's deregulation.

Both the end of the regulatory system and the start of competition were triggered by the passage of the Energy Policy Act ("EPA") of 1992.¹¹⁰ The EPA promoted the adoption of market-based principles as a method to provide more efficient energy supplies.¹¹¹ The EPA opened the door for competition and let new electric producers enter the power generation business by removing the restrictions set forth in the Public Utility Holding Company Act of 1935.¹¹² The EPA gave the FERC authority to implement its provisions and to allow the transmission lines of existing utilities to be used by new companies in order to reach additional customers and to increase competition.¹¹³ Additional reform on the national level came in May 1996, when the FERC issued Order Number 888, setting forth the rules for wholesale competition and allowing utilities open and free access to each other's transmission lines.¹¹⁴ Order Number 888 formed standards to create a large regional

¹⁰⁵ *Id.* at 178. The nuclear energy plans which many utilities had placed their faith in were abandoned due to environmental concerns, construction delays, cost overruns, and the constant need to change their nuclear plans to meet safety regulations. *Id.* The last nuclear power station was ordered in 1973. *Id.* at 179.

¹⁰⁶ See HYMAN, *supra* note 94, at 181.

¹⁰⁷ *Id.* at 182.

¹⁰⁸ 16 U.S.C.A. § 2601 (West 2003). Congress passed PURPA on November 9, 1978. *Id.*

¹⁰⁹ See HYMAN, *supra* note 94, at 182.

¹¹⁰ *Id.* at 184. The Energy Policy Act became law on October 24, 1992. *Id.* Passage of this law was considered the beginning of competition in the electric supply industry. *Id.*

¹¹¹ See HIRSH, *supra* note 93, at 243.

¹¹² See HYMAN, *supra* note 94, at 184. The Public Utility Holding Company Act of 1935 restricted new companies from competing in the power generation business. *Id.*

¹¹³ *Id.*

¹¹⁴ *Id.* at 185. The FERC attempted to stop utilities from charging fees for using their transmission lines. *Id.*

transmission organization to eliminate multiple charges to utilities when electricity travels over the lines of other utilities.¹¹⁵ The passage of the EPA, and the reform that followed, was the start of competition in the electric industry. Thereafter, states were encouraged to draft their own restructuring policies to encourage competition.

A. *The Road to Deregulation*

The electric utility industry began the process of deregulation based on the notion that equal and competitive markets dispensed goods and services more efficiently than a regulated market.¹¹⁶ The transition to deregulation ended the electric utilities' dominance as a monopoly in the electricity market and removed the protection provided by the government.¹¹⁷ At the outset, the goals of deregulation were numerous¹¹⁸ and its proponents looked to the deregulation of other major industries for guidance and optimism.¹¹⁹

California is often credited with taking the first major step to deregulate the electric industry.¹²⁰ In 1993, the Division of Strategic Planning of the California Public Utilities Commission issued the "Yellow Book," a report examining California's regulatory system and its inability to govern the electric utility system due to "technological change, competitive pressures and emerging market forces."¹²¹ The

¹¹⁵ See Denise Warkentin, *FERC Hands Down Historic Rules*, 74 *ELECTRIC LIGHT AND POWER*, 1 (June 1996).

¹¹⁶ See CONSUMER ENERGY COUNCIL OF AMERICA RESEARCH FOUNDATION'S *ELECTRIC UTILITY RESTRUCTURING FORUM, RESTRUCTURING THE ELECTRIC UTILITY INDUSTRY: A CONSUMER PERSPECTIVE 1* (1998) [hereinafter *RESTRUCTURING*].

¹¹⁷ See HIRSH, *supra* note 93, at 240.

¹¹⁸ See *RESTRUCTURING*, *supra* note 116, at III. The goals of deregulation include: allowing the customer as many choices as possible; distributing the benefits of competition equally among customers including low-use customers who do not have the advantage of bargaining power; maintaining and improving the level of reliability of service; preventing monopolies from providing unregulated affiliates with preferential treatment; allowing customers access to basic electricity services; protecting the environment through enactment of environmental protection laws; and providing lower market-priced electricity to all consumers without sacrificing the current level of service. *Id.*

¹¹⁹ *Id.* at 6. A study conducted by George Mason University showed that deregulation of five industries (natural gas, telecommunications, airlines, trucking, and railroads) led to lower prices, did not reduce the quality level, promoted innovation, and produced gains for society. *Id.*

¹²⁰ See HIRSH, *supra* note 93, at 248. The methods used in California provided lessons for legislators and regulators in other states who considered taking advantage of the Energy Policy Act. *Id.*

¹²¹ *Id.* at 249. The Yellow Book also went on to state that the electric utility could no

report discussed the problems with California's electric industry and recommended that competition would help improve the state's situation.¹²² This report was followed by the release of the "Blue Book" on April 20, 1994, which proposed a timetable for deregulation and emphasized competition at the retail customer level.¹²³ The scope of the proposal left many utility company executives, environmental and consumer advocates, investors, and state legislators in a state of shock¹²⁴ because it sought to rely on the discipline of the market instead of a normal regulatory approach.¹²⁵

After several months of debate about restructuring, former California Governor Pete Wilson signed Assembly Bill 1980 on September 23, 1996, which effectively ended California's utility monopoly and created the nation's first plan to deregulate electricity via competition.¹²⁶ Several major newspapers and commentators were quick to announce California's restructuring proposal as groundbreaking.¹²⁷ Other states used California's regulatory plan as a model to deregulate

longer function as a monopoly. *Id.* Several ideas for fixing the utility service were offered including retail wheeling. *Id.* Retail wheeling is the sale of power to local customers from distant producers (also referred to as customer choice). *Id.* at 243.

¹²² See HYMAN, *supra* note 94, at 184-85.

¹²³ *Id.* at 185. Even though the "Blue Book" report emphasized competition, the customer was still free to stay with their formerly regulated local power utility. *Id.*

¹²⁴ See HIRSH, *supra* note 93, at 254. Amory Lovins, in a letter to the President of the California Public Utilities Commission, stated that the Blue Book publication date "one way or another, will be long remembered in the annals of utility regulation." *Id.* See also Mark Maremont, *Shock Treatment for California Utilities?*, BUS. WK., Mar. 9, 1994, at 32. The proposal "sent shock waves through the staid utility industry." *Id.* at 259.

¹²⁵ See HIRSH, *supra* note 93, at 253.

¹²⁶ See HYMAN, *supra* note 94, at 185. "We're doing more than signing a new law . . . we are shifting the balance of power in California. We've pulled the plug on another outdated monopoly and replaced it with the promise of a new era of competition." *Id.* (quoting Pete Wilson, Former Governor of California).

¹²⁷ Seth Mydans, *California Nears Competition Among Electricity Suppliers*, N.Y. TIMES, Apr. 21, 1994, at A14. The "Blue Book" proposal was deemed "a national model." *Id.* See also Andy Pastor and Dave Kansas, *Regulators Propose Direct Competition for Providing Electricity in California*, WALL ST. J., Apr. 21, 1994, at A5. California's proposal was considered "a crucial step on the road to wider deregulation of the industry." *Id.* See also Greg Lucas, *State Electricity Rates to Drop 20% by 2003-Wilson Signs Bill that Ends Utilities' Monopoly*, S.F. CHRON, Sept. 24, 1996, at A1. The bill makes "California the first state in the nation to dismantle its electric monopoly." *Id.* (quoting Pete Wilson, Former Governor of California). See also Chris Kraul, *Radical Changes in Power Industry Pass Legislature*, L.A. TIMES, Sept. 1, 1996, at A1. Assembly Bill 1980 was described as historic. *Id.* California set a national precedent since other states watched how California deregulated their electric industry. *Id.* As a result, California was ahead of the rest of the nation in the decision to deregulate. *Id.*

their own electric utilities.¹²⁸ As of September 2003, twenty-two states and the District of Columbia started the process of deregulation.¹²⁹

VI. *The Beginning of Deregulation in New Jersey*

New Jersey residents watched and grew impatient as other states made the transition to a competitive market for electricity generation, while New Jersey's electric system remained regulated.¹³⁰ The price of electricity in New Jersey, which was considerably higher than the national average before the state decided to deregulate, led residents to push the state legislature to change their electric power industry.¹³¹ The majority of consumer complaints were directed toward the New Jersey Board of Public Utilities – Division of Energy (“BPU”), which bore the traditional regulatory duties of the electric industry, as well as the responsibility of transitioning New Jersey to a deregulated system.¹³²

The first step taken to change the electric industry was the

¹²⁸ See HYMAN, *supra* note 94 at 185. A few months after California began the deregulation process, Arizona, Massachusetts, Michigan, New York, Pennsylvania, and Rhode Island had all introduced or installed industry restructuring plans to begin competition in their retail markets. *Id.* See also HIRSH, *supra* note 93, at 260. By February 1996, sixteen state legislatures began to look at measures for increasing competition in their electric utility networks. *Id.*

¹²⁹ See Banerjee, *supra* note 76, at A1.

¹³⁰ See John A. Hoffman et al., *The Electric Discount and Energy Competition Act – A Landmark in the Evolution Toward Retail Choice*, N.J. LAWYER, THE MAGAZINE, June 1999, at 13. Thirteen states had already enacted legislation to restructure their electric industry by the time the decision to deregulate became law in New Jersey. *Id.*

¹³¹ See *New Jersey Energy Deregulation Background Paper*, available at <http://www.rpa.state.nj.us/electric.htm> (last visited Jan. 20, 2004) [hereinafter *Background Paper*]. In 1990, the cost of electricity in New Jersey was 9 cents per kilowatt hour (kWh) while the national average was 6.5 cents per kWh. *Id.* In 1998, the cost of electricity reached 10 cents per kWh, compared to the national average, which only rose to 6.75 cents per kWh. *Id.* See also Randy Diamond, *Shifting Power Lawmakers OK Utility Deregulation*, THE RECORD (N.J.), Jan. 29, 1999, at A01. At the time of the enactment of the EDECA, New Jersey's rates averaged 10.5 cents per kWh, which was about fifty percent higher than the national average. *Id.*

¹³² See *New Jersey Board of Public Utilities Energy Division*, available at <http://www.bpu.state.nj.us/home/energyDescription.shtml> (last visited Jan. 20, 2004) [hereinafter *BPU Home*]. The Division of Energy is broken up into four groups: the Bureau of Revenue Requirements, which is responsible for rate-related functions associated with revenue requirements; the Bureau of Rates and Tariffs, which deals with stranded costs and deferred balances; the Bureau of Market Development and System Reliability, which oversees restructuring issues and market development; and the Bureau of Conservation and Renewable Energy, which deals with energy efficiency and renewable energy programs. *Id.*

formation of the New Jersey Energy Master Plan Committee (“Committee”) in 1988, which was responsible for drafting the New Jersey Energy Master Plan.¹³³ The Committee’s work resulted in the preparation of the “Phase I Report,” which was introduced in March 1995.¹³⁴ The report recommended that the BPU look into restructuring the electric power industry in order to lower the price of electricity in the state.¹³⁵ The report “presented a vision for [New Jersey] that was based on energy markets guided by market-based principles and competition” and “provided a policy framework for the transition from power industry monopolies to competitive markets.”¹³⁶

The first piece of legislation that stemmed from the Committee’s recommendations was the Rate Flex and Alternative Regulation Act (“Rate Flex Act”), which became law on July 20, 1995.¹³⁷ The Rate Flex Act reflected New Jersey’s new stance on its energy policy to lower electricity rates, to advance the quality and types of services available to residents, and to ensure competition statewide, nationally, and internationally.¹³⁸ The Rate Flex Act called for alternative forms of regulation to help achieve the goal of lowering rates for consumers.¹³⁹ The Act also recommended that the BPU “should implement programs that promote a transition to a market-based, competitive environment for the production and delivery of natural gas and electricity.”¹⁴⁰ In order to monitor the switch to a market-based competitive environment,

¹³³ *Id.* The Energy Master Plan Committee was established pursuant to N.J. STAT. ANN. § 52:27F-14. *Id.* The committee consisted of seven members of the governor’s cabinet: the President of the Board of Public Utilities, and the Commissioners of the Departments of Environmental Protection, Transportation, Community Affairs, Treasury, and Health and Human Services. *Id.* Governor Whitman added the Director of the Division of the Ratepayer Advocate to the committee pursuant to Reorganization Plan No. 001-94. *Id.*

¹³⁴ See NEW JERSEY ENERGY MASTER PLAN COMMITTEE, NEW JERSEY ENERGY MASTER PLAN: PHASE I REPORT/NEW JERSEY ENERGY MASTER PLAN COMMITTEE (1994).

¹³⁵ *Id.*

¹³⁶ See NEW JERSEY BOARD OF PUBLIC UTILITIES, RESTRUCTURING THE ELECTRIC POWER INDUSTRY IN NEW JERSEY – FINDINGS AND RECOMMENDATIONS (1997) [hereinafter FINAL REPORTS].

¹³⁷ N.J. STAT. ANN. § 48:2-21.24-30 (West 2003).

¹³⁸ *Id.* § 48:2-21.24.

¹³⁹ *Id.*

¹⁴⁰ *Id.* In order for the BPU to implement market-based competitive programs, the BPU was required to “implement short-term measures to promote and enhance economic development . . . adopt guidelines to ensure that the transitional regulation produces tangible benefits for ratepayers as compared to the traditional form of regulation . . . [and] continue to regulate the price and quality of electricity.” *Id.*

the Rate Flex Act required the BPU to report on the progress made by programs designed to restructure the electric power industry.¹⁴¹

In mid-1995, the BPU initiated a formal "Phase II" proceeding to explore the long-term structure of New Jersey's electric power industry.¹⁴² The results of the BPU's findings and recommendations culminated in a final report, "Restructuring the Electric Power Industry in New Jersey – Findings and Recommendations" ("Final Report"), which became available on April 30, 1997.¹⁴³ The Final Report included the BPU's mandate that the electric utilities of New Jersey present thorough findings about their restructuring proposals.¹⁴⁴ The Final Report aimed to eliminate any problems associated with the switch to a competitive generation market by ensuring that all retail consumers have access to power regardless of their decision to change electricity suppliers.¹⁴⁵

A. *The Electric Discount and Energy Competition Act (EDECA)*

Based on the findings of the BPU's Phase I and Final Reports and the desire to reduce electricity costs in New Jersey, former Governor Christine T. Whitman set a January 12, 1999 deadline to deregulate the traditionally regulated 80-year-old electric industry.¹⁴⁶ The origins of deregulation of New Jersey's electric industry were found in the Electric Discount and Energy Competition Act ("EDECA"), which set forth the parameters for deregulation.¹⁴⁷ Both the New Jersey State Senate and the Assembly approved the EDECA on January 28, 1999, after many years of concentrated efforts and several debates among legislators, regulators, utilities, ratepayer and environmental interest groups, and non-utility energy suppliers and marketers.¹⁴⁸ Almost a

¹⁴¹ *Id.* § 48:2-21.29.

¹⁴² See Hoffman, *supra* note 130, at 14. The "Phase II" public participation included the creation of informal working groups and a negotiating committee to further explore restructuring issues. *Id.*

¹⁴³ See FINAL REPORTS, *supra* note 136. A substantial amount of the report was based on the written comments and testimony from the public. *Id.*

¹⁴⁴ See Hoffman, *supra* note 130, at 14.

¹⁴⁵ *Id.*

¹⁴⁶ *A Mayor's Briefing on the Electric Discount and Energy Competition Act*, at <http://www.njmayornet.com/electricity.htm> (last visited Jan. 2, 2004) [hereinafter *Mayor's Briefing*].

¹⁴⁷ N.J. STAT. ANN. § 48:3-49 (West 2003).

¹⁴⁸ See Hoffman, *supra* note 130, at 12. See also Anthony S. Twyman, *Energy Bill Will Force Rate Cuts – Legislature Passed Deregulation of Electricity and Natural Gas*, THE

month after the January 12th deadline has passed, the EDECA was finally signed into law by Governor Whitman.¹⁴⁹ The 123-page document mandated a four-year transition period from a regulated to a deregulated electricity market beginning August 1, 1999, and ending August 1, 2003.¹⁵⁰ The EDECA was created to improve the quality and increase the options of electricity services for New Jersey's residential, business, and institutional customers.¹⁵¹ Many state residents and legislators considered the signing of the EDECA as historic and revolutionary.¹⁵² The legislation replaced the old system that allowed individual state-approved utilities to monopolize certain regions of the state.¹⁵³ The EDECA, which was the first bill in the nation to deregulate both natural gas and electricity for all residents and businesses, placed more emphasis on competitive markets to allow consumers the opportunity to choose the cheapest generation source.¹⁵⁴ It was the initial belief of EDECA drafters that the switch to a competitive market would lower electricity prices, improve service, and keep New Jersey on track with the other states that had improved their electrical services.¹⁵⁵

At the beginning of "retail access,"¹⁵⁶ the EDECA required electric

STAR-LEDGER (N.J.), Jan. 29, 1999, at 01. The bill was approved 27-6 by the Senate in less than five minutes and 59-5 by the State Assembly after only an hour of debate. *Id.*

¹⁴⁹ See *Deferred Balance Task Force Report*, available at http://www.state.nj.us/deferredbalances/pdf_s/deferred%20balances%20task%20force%20report.pdf (last visited Feb. 3, 2004) [hereinafter *Task Force Report*].

¹⁵⁰ See Hoffman, *supra* note 130, at 12.

¹⁵¹ See *Mayor's Briefing*, *supra* note 146, at 1.

¹⁵² See Michael Raphael, *Pound for Pound, It's a Weighty Measure*, THE STAR-LEDGER (N.J.), Jan. 29, 1999, at 22. "It represents one of the most important pieces of consumer legislation to come out of the Legislature in years." *Id.* See also Diamond, *supra* note 131, at A01. "This is historic . . . we believe electric rates will come down and stay down." *Id.* (quoting State Senator Peter A. Inversion).

¹⁵³ See Steve Strunsky, *Questions Remain as Deregulation Nears*, N.Y. TIMES, July 25, 1999, at 6. The old energy system separated New Jersey into four regions. *Id.* Rockland Energy Company was responsible for parts of northern New Jersey, PSE&G was responsible for northern and central New Jersey, GPU Energy was responsible for central New Jersey, and Conectiv Power Delivery was responsible for southern New Jersey. *Id.*

¹⁵⁴ See *Mayor's Briefing*, *supra* note 146, at 1.

¹⁵⁵ See Hoffman, *supra* note 130, at 13-14.

¹⁵⁶ See N.J. STAT. ANN. § 48:3-51 which defines retail access as:

[T]he ability of retail customers to shop for electric generation or gas supply service from electric power or gas suppliers, or opt to receive basic generation service or basic gas service, and the ability of an electric power or gas supplier to offer electric generation service or gas supply service to retail customers, consistent with the provisions of the [EDECA].

utilities located in New Jersey to reduce their current rates by five percent and allowed further reductions of ten percent by the year 2002.¹⁵⁷ In order to create an open market where consumers could choose their energy supplier, the EDECA prevented utilities from owning and operating generation facilities and required that they either divest their generation capacity or transfer it to a separate entity.¹⁵⁸ The four major utilities in New Jersey each made substantial efforts to sell their generation capacity and to fulfill the mandates of the EDECA.¹⁵⁹

As enacted, the main purpose of the EDECA is to encourage competition among utilities by allowing New Jersey electricity consumers their choice of electricity suppliers.¹⁶⁰ As of August 4, 1999, out-of-state electric companies could compete with the four main utilities to generate and sell electricity.¹⁶¹ They were also permitted to compete for customers in the areas of metering, billing, and account administration during the second year of the transition period.¹⁶² In order for consumers to switch utilities, the new supplier must receive a signed agreement from the customer.¹⁶³ The signed agreement must list a notice of any fees, the price per kilowatt-hour, and a local or toll-free

Id.

¹⁵⁷ See Hoffman, *supra* note 130, at 12. The ten percent reduction at the end of three years is relative to the rates as of April 30, 1997. *Id.* See also Mayor's Briefing, *supra* note 146, at 1. The ten percent discount must be maintained by the electric utilities until June 2003. *Id.* See also Task Force Report, *supra* note 149, at 5. The BPU can permit distribution of the rate reductions to any part of the electric bill. *Id.*

¹⁵⁸ See Task Force Report, *supra* note 149, at 5.

¹⁵⁹ *Id.* at 14. Conectiv sold nearly all of its generation capacity, including its interests in the Hope Creek, Salem, and Peach Bottom nuclear units. *Id.* But the company was unable to sell its fossil-fueled generation units. *Id.* JCP&L also sold nearly all of its generation capacity, which included the Oyster Creek Nuclear Plant. *Id.* at 15. PSE&G transferred all of its generation assets to PSEG Power, its unregulated affiliate. *Id.* Rockland divested all of its generation assets, including its Bowline and Loveyy fossil-fueled plants. *Id.* at 16.

¹⁶⁰ *Id.* at 1. See also Associated Press Newswire, Ralph Siegel, *Governor Signs Bill Deregulating Utilities, Opening Power World* (Feb. 9, 1999). "The bottom line is the people of New Jersey will finally have the opportunity to choose among energy providers . . . [c]onsumer choice means consumer savings." *Id.* (quoting former Gov. Christine T. Whitman).

¹⁶¹ See Strunsky, *supra* note 153, at 6. Even before the August 4, 1999 deadline, fourteen companies had signed up to sell power in New Jersey. *Id.*

¹⁶² See Mayor's Briefing, *supra* note 146, at 1. See also Diamond, *supra* note 131, at A01. An integral part of the EDECA allows municipal governments to choose a power supplier on behalf of their residents, businesses, schools, and other groups within their borders. *Id.*

¹⁶³ *Id.* at 2. A signature is also required from the customer for contract renewal and disclosure of customer information. *Id.*

customer service number if the consumer should have any questions.¹⁶⁴ If a signature is not received, a fine of up to \$10,000 can be levied upon an energy supplier who switches a customer without proper authorization.¹⁶⁵ Most utilities provide their customers with an option to switch back to their original supplier within a certain period of time.¹⁶⁶ The customer is also entitled to an environmental summary about the type of electricity they purchase, which is to be included on the company's bills, contracts, and marketing materials.¹⁶⁷ The environmental summary includes an "environmental characteristic" label that is required to disclose information about the level and type of emissions from each energy source and whether the electricity was generated by coal, natural gas, oil, nuclear reactors, or renewable sources such as solar energy and wind.¹⁶⁸ Electricity consumers are also entitled to information about how much air pollution is connected with the production of the electricity they purchase, as well as the history of the electric utility's efforts to conserve energy.¹⁶⁹

The EDECA prohibits utilities from discontinuing social initiatives such as winter moratorium programs, low-income assistance programs, "bad-debt customers" programs, and conservation programs.¹⁷⁰ The EDECA also establishes a fund for senior citizens who reside in homes with electric heat to help them switch to natural gas heat.¹⁷¹ Furthermore, the EDECA initially authorized \$230 million for energy efficiency programs and allowed up to a \$140 million increase for new conservation programs.¹⁷²

After the decision to deregulate, the BPU gained several additional

¹⁶⁴ *Id.*

¹⁶⁵ *Id.* See also Kevin G. DeMarrais, *PSE&G Says Imposters Trying To Lure Customers State Checking For Deceptive Tactics*, THE RECORD (N.J.), Oct. 9, 1999, at A4. Switching a consumer's energy supplier without their authorization is known as slamming. *Id.* Receiving a written agreement is known as a "wet signature." *Id.* This requirement was added to specifically prevent customers from being tricked into switching utilities. *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ See Kevin G. DeMarrais, *The Power of Choice: Energy Deregulation*, THE RECORD (N.J.), Oct. 6, 1999, at B1.

¹⁶⁸ *Id.*

¹⁶⁹ *Id.* The environmental characteristic label is updated every six months and contains detailed information about how much carbon dioxide, nitrogen oxide, and sulfur dioxide is generated. *Id.*

¹⁷⁰ See *Mayor's Briefing*, *supra* note 146, at 1.

¹⁷¹ *Id.*

¹⁷² *Id.*

responsibilities, most importantly, the implementation of the EDECA.¹⁷³ In order to maintain low electricity prices, the EDECA required the BPU to approve an electric utility's attempt to increase prices.¹⁷⁴ The BPU also guaranteed that basic generating services are provided to customers regardless of their energy supplier.¹⁷⁵ The BPU must offer a basic generating service "to any customer [who] has not chosen an alternative electric power supplier . . . including . . . any customer that cannot obtain such service from an electric power supplier for any reason, including non-payment for services."¹⁷⁶ The EDECA asked the consumer's local utility to serve as a last resort for the supply of electricity to ensure that customers continue to receive electricity services.¹⁷⁷

The EDECA required that each utility separate its basic generating service fee from the remainder of the charges on a customer's bill.¹⁷⁸ The basic generating service fee should include "customer account services and charges, distribution and transmission services and charges, and generation services and charges."¹⁷⁹ Before deregulation, each service was grouped together as one charge on a customer's bill.¹⁸⁰ This separation allows customers to easily identify the price of each service so they can make a more informed choice when deciding between the different pricing packages of the competing electricity suppliers.¹⁸¹ The EDECA required that each electric public utility continue to provide a basic generating service at a price that does not deviate from market conditions.¹⁸² The BPU is responsible for determining a reasonable and prudent cost for the basic generating

¹⁷³ See Hoffman, *supra* note 130, at 12.

¹⁷⁴ See Strunsky, *supra* note 153, at 6.

¹⁷⁵ See Hoffman, *supra* note 130, at 14.

¹⁷⁶ N.J. STAT. ANN. § 48:3-51(3) (West 2003).

¹⁷⁷ See Hoffman, *supra* note 130, at 15.

¹⁷⁸ N.J. STAT. ANN. § 48:3-52(a) (West 2003). The EDECA provides that all competitive services offered by an electric public utility are charged separately from non-competitive services. *Id.*

¹⁷⁹ *Id.* § 48:3-52.4(a). The basic generating service is referred to as a "bundled" electricity service, which was "unbundled" due to the EDECA. *Id.* See also Hoffman, *supra* note 130, at 14. The customer service aspect refers to metering, billing, and other miscellaneous administrative activities. *Id.*

¹⁸⁰ See Hoffman, *supra* note 130, at 14.

¹⁸¹ *Id.* The "unbundling" of the rate schedules identified the discrete services and charges that were often overlooked by the average customer. *Id.*

¹⁸² N.J. STAT. ANN. § 48:3-57(9)(a) (West 2003). The EDECA provides that the basic generating service is non-competitive and must be separated from other services. *Id.*

service and for maintaining the price level for the service.¹⁸³

The BPU also sets the price of the “shopping credit” that appears on the consumer’s electricity bill¹⁸⁴ and which the BPU grants to consumers who elect to purchase generation service from a third-party supplier.¹⁸⁵ The BPU determines the shopping credit based on their estimate of what it costs the utilities to generate electricity.¹⁸⁶ The consumer’s electricity bill must reflect the amount of the difference “between what the customer’s total charges would have been without the reduction and the total charges in that bill.”¹⁸⁷

Even though the EDECA allows retail competition, it does not affect the utilities’ monopoly of energy distribution and transmission. The four main electric utilities in New Jersey: PSE&G, Rockland, Conectiv, and JCP&L still control the distribution and transmission of energy services.¹⁸⁸ In order to make it easier for third party energy generators to enter New Jersey, companies entering the state’s competitive market can use existing power lines and are not required to build their own power lines to transmit and distribute energy.¹⁸⁹ Instead of paying to build new lines, existing utilities charge an approved distribution fee to carry electricity for new suppliers.¹⁹⁰

The cost of deregulation and a competitive market does not come without a high price tag. As a result of the EDECA, consumers will have to pay utility companies a large amount of “stranded costs,” which are expenses that are deemed unrecoverable by the utilities in a deregulated system.¹⁹¹ These costs are recovered from consumers

¹⁸³ *Id.*

¹⁸⁴ N.J. STAT. ANN. § 48:3-52.4(b) (West 2003). The credit *must* be included in the electricity bill when the consumer decides to switch service providers. *Id.* (emphasis added).

¹⁸⁵ See Hoffman, *supra* note 130, at 15. See also N.J. STAT. ANN. § 48:3-51(3) (West 2003). The credit shows that the “customer has switched to an electric power supplier and no longer takes basic generation service from the electric public utility.” *Id.*

¹⁸⁶ See Mayor’s Briefing, *supra* note 146, at 1. See also Hoffman, *supra* note 130, at 15. The BPU determines the correct level of shopping credits for each utility in a manner “consistent with the findings of and declarations of the Legislature” which is seen throughout the EDECA. *Id.*

¹⁸⁷ N.J. STAT. ANN. § 48:3-52.4(b) (West 2003).

¹⁸⁸ See Hoffman, *supra* note 130, at 14.

¹⁸⁹ See Strunsky, *supra* note 153, at 6.

¹⁹⁰ *Id.*

¹⁹¹ See Task Force Report, *supra* note 149, at 6. An example of a stranded cost is the unrecovered investment in power plants. *Id.* See also N.J. STAT. ANN. § 48:3-51(3) (West 2003). The EDECA explains that when the “net cost of an electric public utility’s electric

through transition bond charges¹⁹² and market transition charges.¹⁹³ The

generating assets or electric power purchase commitments . . . exceed the market value of the assets or contractual commitments in a competitive supply marketplace,” the utilities are left with stranded costs. *Id.* See also N.J. STAT. ANN. § 48:3-61(a)(1)-(4) (West 2003). The types of stranded costs that can be recovered include: utility generation plant stranded costs; stranded costs related to long-term and short-term power purchase contracts with other utilities; stranded costs related to long-term power purchase contracts with non-utility generators . . . the costs of new power contracts approved by the board, which are the result of the renegotiation, restructuring, or termination of previous non-utility generator power purchase contracts; and restructuring related costs deemed appropriate by the BPU for recovery in a market transition charge. *Id.*

¹⁹² N.J. STAT. ANN. § 48:3-62(14)(a) (West 2003). A transition bond charge is defined as “a charge, expressed as an amount per kilowatt hour, that is authorized by and imposed on electric public utility ratepayers pursuant to a bondable stranded costs rate order, as modified at any time pursuant to the provision of the [EDECA].” *Id.* The EDECA was amended to allow the BPU to permit electric utilities to issue transition bonds to be “used, directly or indirectly, to recover, finance or refinance bondable stranded costs and which are, directly or indirectly, secured by or payable from bondable transition property.” N.J. STAT. ANN. § 48:3-51(3). “Transition bonds can be in the form of bonds, notes, certificates of participation or beneficial interest, or other evidences of indebtedness or ownership issued pursuant to an indenture, contract or other agreement of an electric public utility or a financing entity.” *Id.* The EDECA requires the electric utility to use the net proceeds from the sale of transition bonds for the sole purpose of diminishing the amount of its stranded costs. N.J. STAT. ANN. § 48:3-62(14)(a). An electric utility will reduce its stranded costs via transition bonds “through the refinancing or retirement of electric public utility debt or equity, or both, or the buyout, buydown or other restructuring of a power purchase agreements if such buyout, buydown or restructuring leads directly to substantial customer benefits over the term of the power purchase agreement.” *Id.* In order to more accurately determine transition bond charges, “each electric public utility shall maintain separate accounting for transition bond charges so that the [BPU] can determine, at any time, the amount of each type of charge that has been assessed and collected by the electric public utility.” *Id.* The BPU also has the authority to issue the transition bonds for the electric public utilities and to determine the correct amount of the bonds. N.J. STAT. ANN. § 48:3-62(14)(a)-(b). In order for the BPU to issue transition bonds, utilities must include the following statement in their stranded cost filing:

The electric public utility has taken reasonable measures to date and has the appropriate incentives or plans in place to take reasonable measures to mitigate the total amount of its stranded costs; [t]he electric public utility will not be able to achieve the level of rate reduction deemed by the [BPU] to be necessary and appropriate; [t]he issuance of such [transition] bonds will provide tangible and quantifiable benefits to ratepayers, including greater rate reductions than would have been achieved absent the issuance of such bonds and net present value savings over the term of the bonds; [and t]he structuring and pricing of transition bonds assure that the electric public utility’s customers pay the lowest transition bond charges consistent with market conditions and the terms of the bondable stranded costs rate order. If so authorized in the financing order by the [BPU], the structure and pricing of the transition bonds shall be conclusively deemed to satisfy this requirement if so certified by a designee of the [BPU] upon the pricing of the transition bonds.

Id.

BPU can approve, reject, or require modification of the requested stranded costs if it determines that the costs do not comply with the provisions of the EDECA.¹⁹⁴

The expected savings for the average household after deregulation was not intended to be as substantial as the savings for large consumers, such as big manufacturers and utilities, who use more energy.¹⁹⁵ In order to receive greater benefits from deregulation, individuals have formed alliances and created power-buying pools.¹⁹⁶ For example, the New Jersey Business & Industry Association (“NJBIA”), the largest employer organization in New Jersey with over 16,500 members, joined with the AES Corporation (“AES”) of Arlington, Virginia to have AES provide power to NJBIA members at a lower rate.¹⁹⁷ The NJBIA created

¹⁹³ N.J. STAT. ANN. § 48:3-61(13)(a) (West 2003). The EDECA defines market transition charges as:

[C]harges imposed pursuant to section 13 [of the EDECA] by an electric public utility, at a level determined by the [BPU] on the electric public utility customers for a limited duration transition period to recover stranded costs created as a result of the introduction of electric power supply competition pursuant to the provisions of [the EDECA].

N.J. STAT. ANN. § 48:3-51(3). Market transition charges are implemented for costs that are unrecoverable as a result of the customers’ ability to choose between electric power supplies. N.J. STAT. ANN. § 48:3-61(13)(b).

¹⁹⁴ N.J. STAT. ANN. § 48:3-61(13)(b)-(c) (West 2003). In order to be compensated, the electric utility must submit a stranded cost filing to the BPU. *Id.* Once the stranded cost filing is approved by the BPU, a stranded cost recovery order will be issued, which will include how the utility is to be compensated. *Id.* N.J. STAT. ANN. § 48:3-61(13)(e). The BPU determines the magnitude of eligible stranded costs by requiring the electric utility to show the full market value of eligible assets and commitments. *Id.* N.J. STAT. ANN. § 48:3-61(13)(f). The BPU also requires the electric utility to mitigate the quantity of stranded costs by “reducing the cost of power purchase commitments and the on-going capital and operations costs of the generating plant, maximizing the market value of the generating asset or purchase commitment, or undertaking other reasonably achievable cost reductions.” *Id.* N.J. STAT. ANN. § 48:3-61(13)(g). The BPU prevents electric utilities from receiving additional money that would surpass its actual stranded costs by conducting a periodic review of the market transition charges. *Id.* The EDECA prohibits the BPU from fixing the market transition charges to a level that would stop the achievement of the rate reductions and prevent the utilities from continuing to fulfill their public service obligation. *Id.* See also Hoffman, *supra* note 130, at 16. The market transition charge is limited to a period of eight years and is granted to an electric utility regardless of a customer’s decision to take basic electric service from their original utility or from an alternate supplier. *Id.*

¹⁹⁵ See Twyman, *supra* note 148, at 01.

¹⁹⁶ *Id.* Power-buying pools give groups more opportunities to negotiate volume discounts with power suppliers. *Id.*

¹⁹⁷ See Kevin G. DeMarrais, *Business Group Buying Cheap Power*, THE RECORD (N.J.), Nov. 9, 1999, at B1.

a “buying pool,” Power New Jersey, which allowed members to choose either a six or eighteen-month contract in order to combine their purchases of electricity to take advantage of the deregulated system.¹⁹⁸ Depending on the amount of money spent per month on electricity and the type of contract entered into, members receive power from a subsidiary of AES located in either Virginia or Los Angeles.¹⁹⁹ Estimates show that NJBIA members spend \$1 billion a year on electricity and could save up to twenty percent if they enter the buying pool.²⁰⁰

As the transition period ended, both the consumers and providers of electricity sought a report on the status of deregulation. On July 31, 2002, former Governor McGreevey signed Executive Order Number 25, which created the Deferred Balances Task Force (“Task Force”).²⁰¹ The Task Force’s main responsibility was to examine the progress of the EDECA’s four-year transition period.²⁰² The Task Force prepared a report examining the estimated \$1 billion in deferred balances²⁰³ that three of New Jersey’s major electric utility companies accumulated since the enactment of the EDECA.²⁰⁴ Pursuant to the EDECA, ratepayers are responsible for paying the deferred balances at the end of the four-year transition period.²⁰⁵

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ See Tom Johnson, *Electric Rate Cut in '99 Comes Back to Zap Some Customers*, THE STAR LEDGER (N.J.), Sept. 9, 2001, at 13.

²⁰² *Id.*

²⁰³ See *Task Force Report*, *supra* note 149, at 6. “Deferred balances are losses accumulated by utilities when the cost of purchasing wholesale electricity exceeds the capped retail rates they are allowed to charge customers.” *Id.* Deferred balances include losses incurred by utilities for administering consumer-paid and EDECA-mandated energy conservation programs and public education campaigns to inform consumers about deregulation. *Id.*

²⁰⁴ *Id.* See also Tom Johnson, *Electric Rate Cut in '99 Comes Back to Zap Some Customers*, THE STAR LEDGER (N.J.), Sept. 9, 2001, at 13. JCP&L, Conectiv, and Rockland have combined to accumulate \$1 billion in deferred balances due to their purchase of power at prices higher than they were able to sell. *Id.* PSE&G has no deferred balances because of its contract with PSEG Power to provide energy at the BPU’s basic generating service rate. *Id.* See also *Task Force Report*, *supra* note 149, at 13. As a result of PSE&G’s contract with PSEG Power, PSE&G’s customers are expected to save \$1.4 billion. *Id.*

²⁰⁵ *Id.* Deferred balances differ from stranded costs in two ways. First, stranded investments are sunk costs that occur because of decisions made to the enactment of the EDECA. *Id.* Second, deferred balances are costs that have occurred after the enactment of the EDECA, such as the EDECA-mandated programs or the providing of basic generating

The Task Force issued its report on August 30, 2002, which addressed how the electric utilities sustained their deferred balances, what steps they took to mitigate the deferred balances, and how the consumer should be protected from an increase in deferred balances.²⁰⁶ To prepare its report, the Task Force distributed detailed questionnaires to utilities, wholesale power generators, industry experts, consumer groups, business groups, and legislators to obtain the most complete range of data about the EDECA.²⁰⁷ The results of the report foreshadowed the problems the EDECA would cause New Jersey.²⁰⁸ The report showed that New Jersey was the only state to create inflexible rate caps for four years and then force consumers to reimburse the electric utilities for the amount of their deferred balances, with interest.²⁰⁹ The report showed that New Jersey's inflexible rate caps resulted in the highest amount of deferred balances in the nation.²¹⁰

The Task Force's report listed the BPU's restructuring orders, the EDECA's artificially low rate caps, the utilities' failure to completely divest their generation capacity, and the utilities' power purchasing decisions as reasons why the deferred balances of the utilities became so large.²¹¹ The increase in the market price for electricity also contributed to the size of the deferred balances, but without the EDECA's artificially low rate caps, the increase would not have had such a

services. *Id.* at 6. Ratepayers will not have to pay deferred balances until after August 2003, but stranded costs are paid in a timely fashion. *Id.* See also N.J. STAT. ANN. § 48:3-50(2)(c)(4) (West 2003). The EDECA grants the utilities "the opportunity to recover above-market power generation and supply costs and other reasonably incurred costs associated with the restructuring of the electric industry in New Jersey." N.J. STAT. ANN. § 48:3-50(2)(c)(4).

²⁰⁶ See *Task Force Report*, *supra* note 149, at 4.

²⁰⁷ *Id.* The Task Force also sought input from energy experts and economists from the BPU. *Id.* After distributing the questionnaires, a second round of information was requested via phone or writing. *Id.* All four major utilities responded to the original questionnaire, as did Senator Leonard Connors, Jr.; Seema Singh, Ratepayer Advocate; William Potter, energy expert; New Jersey Utilities Association; New Jersey PIRG; New Jersey Citizen Action; New Jersey Chamber of Commerce; and the Independent Energy Producers of New Jersey. *Id.* at 34.

²⁰⁸ *Id.*

²⁰⁹ *Id.* at 1. Arizona, Connecticut, Delaware, District of Columbia, Illinois, Maryland, Massachusetts, Michigan, Montana, New Hampshire, Ohio, Pennsylvania, Rhode Island, Texas, and Virginia all have imposed a cap on retail rates, but none have inflexible rate caps. *Id.* at 23.

²¹⁰ *Id.* at 1.

²¹¹ See *Task Force Report*, *supra* note 149, at 19.

significant impact.²¹² The reliance by JCP&L, Conectiv, and Rockland on wholesale power markets also led to the utilities' high deferred balances.²¹³ The report criticized the BPU for increasing the aggregated rate reductions in the second and third years of deregulation from the mandatory five percent to levels as high as nine percent, and in the fourth year from the required ten percent to levels as high as 13.9 percent.²¹⁴ As a result of raising the mandatory aggregated rate reductions, the deferred balances were increased to levels higher than the EDECA demanded.²¹⁵ The Task Force also questioned the BPU's failure to implement the EDECA's emergency clause, which is designed to stop any scheduled rate reduction in an emergency situation when a utility is in financial trouble.²¹⁶ Instead of using the emergency clause, the BPU disregarded the utilities' requests for relief from their high deferred balances.²¹⁷

The Task Force's report made five recommendations addressing the deferred balance problem: (1) the enactment of Senate Bill 869, later enacted on September 9, 2002, giving the BPU another method to help reduce the impact of the deferred balances on customers; (2) the application of strong consumer protections that would place the burden of proving the amount of deferred balances on the electric utilities; (3) the dissemination of information to consumers about the issue of deferred balances; (4) the examination of other aspects of the EDECA to determine if deregulation will ultimately benefit consumers and legitimately encourage retail competition; and (5) the use of aggressive mitigation methods to reduce the accumulation of deferred balances.²¹⁸

²¹² *Id.* at 24-25.

²¹³ *Id.* at 25. JCP&L's reliance on short-term and spot markets also drove up their deferred balances. *Id.*

²¹⁴ *Id.* at 21.

²¹⁵ *Id.*

²¹⁶ *Id.* The emergency clause was designed to prevent rate reductions from impairing the electric public utility's financial integrity. *Id.* at 21-22.

²¹⁷ See *Task Force Report, supra* note 149, at 21-22. JCP&L contacted the BPU in April 2000 to inform the board of its mounting, deferred balances. *Id.* at 20. It was clear to several members of the BPU that the utilities deferred balances were increasing at an alarming rate, and the BPU in April 2000 required each utility to submit a monthly report of their deferred balances in order for it to determine just how bad the situation had become. *Id.* Despite the BPU's apparent concern over the increasing deferred balances, it ignored Rockland's petition for relief in December 2000, which asked the BPU to not increase the aggregated rate reduction an additional two percent in order to prevent customers in 2003 from suffering financial shock due to a substantial increase in their electricity bill. *Id.*

²¹⁸ *Id.* at 2-3.

Furthermore, the report criticized the BPU for not stressing to the utilities the importance of mitigating their own deferred balances.²¹⁹ In an effort to help the utilities, the report discussed mitigation tactics that a utility could use to slow the accumulation of deferred balances.²²⁰ These tactics include negotiating power contracts to reduce costs, engaging in energy efficiency and conservation programs, and promoting competition to decrease the basic generating service requirements of the utilities.²²¹

VII. Conclusion

On August 1, 2003, New Jersey's four-year transition from a regulated system to a deregulated system ended.²²² As a result, the electric utility rate caps imposed by the EDECA were removed and the commodity portion of electricity costs is open to market forces, but the cost of delivery, service, and reliability is still regulated by the BPU.²²³ The results of deregulation have not appeared to benefit the electricity consumers of New Jersey. The competition between utilities that was supposed to reduce electricity prices did not occur and consumers, for various reasons, did not take advantage of their ability to choose energy suppliers.²²⁴

²¹⁹ *Id.* at 1-2.

²²⁰ *Id.* at 16. Despite the large amount of deferred balances, the four major utilities did take steps to mitigate the accumulation of deferred balances. *Id.* Conectiv renegotiated two of its energy contracts saving its customers about \$92.4 million. *Id.* at 17. Even though JCP&L has the largest deferred balance total of the four utilities, it has failed to renegotiate fourteen of its fifteen long-term energy contracts. *Id.* JCP&L did implement a voluntary load reduction pilot program and a seasonal savings pilot program to help customers reduce energy use. *Id.* PSE&G renegotiated over 90% of its pre-existing energy contracts. *Id.* at 18. Rockland, which claims its deferred balances are high because customers use too much electricity, has included with its bills a pamphlet that stresses the value of energy efficiency to reduce energy demand. *Id.* Rockland has also attempted to include alternate providers of electricity generation to help reduce its basic generating service requirements. *Id.*

²²¹ *Id.* at 16-17. Utilities can also reduce the price they pay for power by "purchasing strategies that hedge against unexpected fluctuations in market prices" and "entering into parting agreements with the purchaser of those assets . . . when a utility sells generation assets." *Id.* at 16.

²²² See *Background Paper*, *supra* note 131.

²²³ See Kevin DeMarrais, *Beating the High Cost of Heat*, THE RECORD (N.J.), May 18, 2003, at B1.

²²⁴ *Status of State Electric Industry Restructuring Activity as of February 2003*, at www.eia.doe.gov/cneaf/electricity/chg_str/new_jersey.html (last visited Jan. 20, 2004) [hereinafter *Restructuring Activity*]. During the first year of deregulation, only about two percent of New Jersey's residential customers switched to alternate energy suppliers. *Id.*

Deregulation also caused financial difficulties for the electric utilities that will ultimately result in higher electricity bills for consumers. Under the EDECA, consumers have been buying electricity on credit, and now the deferred balances must be paid off with interest. As of August 2003, three of the four major utilities in New Jersey announced that the total amount of their deferred balances would equal an estimated \$1 billion.²²⁵ Ultimately, consumers are responsible for the payment of these deferred balances because the EDECA allows the utilities to recover the costs of providing basic generating service.²²⁶ The BPU has the authority to determine if the utilities reasonably and prudently incurred their deferred balances in accordance with the EDECA before it allows the utilities to file for recovery.²²⁷ PSE&G is the only major utility that did not accrue a deferred balance because it divested its energy generating capacity.²²⁸ In spite of this, the BPU determined that PSE&G will have to raise its electricity bills by fifteen percent, resulting in an eight dollar increase per month.²²⁹ Due to Rockland's deferred balances, its 71,000 customers are expected to pay an additional \$12.95 a month, an increase of 15.4 percent.²³⁰ JCP&L

Of the 3.1 million residential customers, 73,133 made the switch to another utility and only 410,886 commercial and industrial consumers decided to choose another utility. *Id.* The amount of electricity users who changed utilities peaked at over 100,000 in November 2000, but dropped dramatically to less than 10,000 by the end of 2001. *Id.* See also *Task Force Report*, *supra* note 149, at 9. By July 2002, only 0.2 percent of New Jersey's residential consumers switched energy suppliers. *Id.* The amount continued to decrease and by April 2003, only 1,800 residential electric customers out of 3.1 million had switched to another electricity supplier. *Id.* See also *Background Paper*, *supra* note 131, at 2. Only 632 out of 465,000 industrial and commercial consumers made the switch from their local utilities in 2003. *Id.*

²²⁵ See *Task Force Report*, *supra* note 149, at 10.

²²⁶ N.J. STAT. ANN. § 48:3-57(9)(c) (West 2003).

²²⁷ See *Task Force Report*, *supra* note 149, at 7.

²²⁸ See Tom Johnson, *Powerful Lineage – After a Century Spent Building its Empire PSE&G Focuses on Winning in the Deregulated Marketplace*, THE STAR LEDGER (N.J.), June 15, 2003, at 1. PSE&G sold its power plants to an unregulated subsidiary, PSEG Power. *Id.* Unlike the other three major utilities, PSE&G's contract with PSEG Power enabled them to obtain prices equal to the cost of basic generating service from its power-generating subsidiary. *Id.* This allowed the utility to cut customer rates by 14%. *Id.* As a result of its contract with PSEG Power, the BPU allowed PSE&G to securitize \$2.4 billion of its stranded costs. *Id.*

²²⁹ See Tom Johnson, *North Jersey Electric Customers to Pay 15.4% More to Rockland*, THE STAR LEDGER (N.J.), July 17, 2003, at 20.

²³⁰ *Id.* The BPU determined that Rockland should have entered into long-term contracts to lower its deferred balance. *Id.* Since Rockland chose not to enter into long-term contracts, the BPU ordered \$18.2 million of Rockland's deferred balances to be removed in

will increase the rates of its one million customers by only 3.3 percent, raising the average monthly residential bill from \$86 to \$89.²³¹ Conectiv will increase the price of electricity for its 500,000 customers by eight percent and raise the average residential bill by eight dollars.²³² Moreover, the EDECA also assigned to electricity consumers the responsibility of paying the interest accrued on the money used to purchase power during the four-year transition period.²³³ The major utilities have declared \$63.4 million in total interest charges.²³⁴

The repayment of the deferred balances and interest charges is expected to impact ratepayers for several years and will result in an even greater increase in electric bills for consumers.²³⁵ As the four major utilities are in the process of determining their new permanent rates, the electricity consumer must be asking if the situation will get any worse. While an increase in electricity bills was not the goal of New Jersey lawmakers, the future of New Jersey's electric system is not completely doomed. If Congress is able to revise the current energy bill to ensure greater transmission grid reliability, future blackouts can be prevented. The current transmission system must embrace new technology and equipment to create a more exact system to protect the grid from blackouts. It is clear that the problem of blackouts still has not been solved. On July 5, 2003, the Jersey Shore experienced another blackout that left more than 35,000 JCP&L customers without electricity.²³⁶ In some areas, customers were without electricity for almost three days and many local businesses were unable to operate.²³⁷

order to protect customers. *Id.* Rockland's deferred balance total is more than twelve times its entire 2001 net income and almost equals the company's net worth. *Id.* See also *Task Force Report*, *supra* note 149, at 18. On a per customer basis, Rockland has the largest deferred balances of the major utilities. *Id.*

²³¹ See Tom Johnson, *State Board Pares Size of JCP&L Rate Increase – Commissioners Approve Only a 3.3% Hike in Light of Utility's Recent Power Outages*, THE STAR LEDGER, July 26, 2003, at 17. JCP&L attempted to recover \$618 million in deferred balances, but the BPU disallowed \$222.7 million from the total. *Id.*

²³² *Id.*

²³³ See *Background Paper*, *supra* note 131, at 2.

²³⁴ *Id.* JCP&L has requested \$40 million in interest, PSE&G has requested \$5.5 million in interest, Rockland has requested \$9 million in interest, and ACE has requested \$8.9 million in interest. *Id.*

²³⁵ See *Task Force Report*, *supra* note 149, at 10.

²³⁶ See Press Release, New Jersey Board of Public Utilities, BPU Actions should Ensure a Blackout-Free Holiday Weekend at the Jersey Shore (June 30, 2004) (on file with the author).

²³⁷ *Id.*

A mandate by Governor James McGreevey and a BPU directive ordered JCP&L to make more than \$10 million of improvements, which included the installation of new transmission lines.²³⁸

If such improvements to the transmission grid occur, New Jersey electricity consumers will regain confidence in their electric industry and paying their electricity bills will be a little easier. New Jersey should take comfort that JCP&L was able to fix their transmission grid so quickly after the July 5, 2003 blackout, and that both the Governor's office and the BPU were quick to force JCP&L to correct their mistakes. When the deferred balances of the utilities disappear, customers may finally see some benefits from the decision to deregulate. However, no specific timetable has been set for this to occur. In the meantime, consumers should try to take advantage of the competitive marketplace and the opportunities it still provides. Utilities must make consumers aware of the possibilities that exist in the restructured energy marketplace.

Furthermore, it is also up to the utilities to educate consumers that the increased electricity bills are a temporary fix. The utilities must emphasize that the high bills are a means of solving the current deferred balances problem and not simply a rate increase to line the pockets of the utilities. The BPU must continue to work with the utilities to fix the mistakes made during the transition period and to assure customers that the utilities will charge a fair price for electricity in the future. The Governor should also look into whether the EDECA could be revised to increase competition and to better protect the customers from higher electricity bills. The mistakes made during the deregulation process can be overcome as long as the utilities and the BPU remain mindful of their past mistakes. Hopefully, consumers will be willing to bear the financial burden for the next few years, while remaining confident that the benefits of deregulation are yet to come.

²³⁸ *Id.* "The blackout at the Jersey Shore last year was unacceptable ... the BPU is dedicated ensuring [sic] that New Jersey's electric transmission systems are safe and reliable, and I am pleased that JCP&L has worked cooperatively with the BPU to make these improvements, particularly in time for the busy July 4th weekend." *Id.* (quoting Governor James McGreevey).