Commonwealth of Virginia

State Corporation Commission

Report to the Commission on Electric Utility Restructuring of the Virginia General Assembly

And the Governor of the Commonwealth of Virginia

Appendix III-A

RESPONSES FROM STAKEHOLDERS

August 29, 2003

APPENDIX III-A
RESPONSES FROM STAKEHOLDERS

CONTENTS

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STATE CORPORATION COMMISSION
DIVISION OF ECONOMICS AND FINANCE

April 16, 2003

Dear Market Participant:

As directed by §56-596 B of the Virginia Electric Utility Restructuring Act, the State Corporation Commission is preparing its third annual report to the Legislative Transition Task Force ("LTTF") and the Governor, to be filed by September 1, 2003. That report will cover three topics: 1) the status of competition in the Commonwealth, 2) the status of the development of regional competitive markets, and 3) recommendations to facilitate effective competition in the Commonwealth.

The Commission Staff is once again soliciting ideas from stakeholders (including electric utilities, competitive service providers, consumer groups, natural gas utilities and business associations) to assist the Commission in developing a comprehensive review of methods that may be considered to facilitate effective competition. The statutory language in §56-596 B related to this part of the Commission report provides as follows:

> This report shall include any recommendations of actions to be taken by the General Assembly, the Commission, electric utilities, suppliers, generators, distributors and regional transmission entities it considers to be in the public interest. Such recommendations shall include actions regarding the supply and demand balance for generation services, new and existing generation capacity, transmission constraints, market power, suppliers licensed and operating in the Commonwealth, and the shared or joint use of generation sites.

We ask that you consider the topics detailed in the statute and provide any recommendations or thoughts you may have regarding them. In addition, we welcome your input to the following:

1. What are the current obstacles to the development of a robust competitive retail electricity market for residential customers? For commercial and industrial customers? How can these obstacles be overcome?

2. With respect to potential obstacles, what is the outlook for future natural gas prices and the impact on wholesale electricity prices and a competitive retail market? Please comment on the postulation by several natural gas industry experts of a growing structural demand/supply imbalance with demand outstripping supply over the next several years. What actions, if any, could be taken to mitigate the potential impact of an over-dependence on a single fuel source?

3. In light of recent legislation, how can the Commonwealth be assured of a continuing reliable electricity system when control of transmission is governed by an RTO? What factors should be considered during the cost/benefit analysis required prior to Commission approval?

4. Later this month, the Federal Energy Regulatory Commission is expected to issue its "white paper" addressing certain issues debated the past several months regarding Wholesale Electric Standard Market Design (SMD). Additionally, the Department of Energy is expected to issue the results of its cost/benefit analyses of the impacts of SMD. Please provide your initial thoughts and reaction to such releases and identify any significant issues of concern.

5. Are the Commission's Rules Governing Retail Access to Competitive Energy Services conducive to promoting effective competition in the Commonwealth? If not, how should they be modified? Is there any way in which these rules can or should be improved, in any event?

6. What should be the level of consumer education when the program is resumed on July 1, 2004? Should it be as visible, more visible or less visible than when the campaign was suspended? Upon resumption of the campaign, what focus, theme or message should be communicated? Since TV advertising is the most expensive component of the program, what level of TV advertising should be included in the resumption of the campaign?

7. Are there any other actions that have been taken or are being considered in other states that may be used to advance competitive activity in Virginia?

8. Do you have any ideas that have not been tried elsewhere that may facilitate competitive activity in Virginia?

Please provide your comments to me by May 23, 2003. Such response may be sent as a hardcopy via mail or preferrably, electronically as an attached WORD Document at deichenlaub@scc.state.va.us. Such comments will be posted to our website at http://www.state.va.us/scc/division/eaf/comments.htm. As an important follow-up to your responses, the Commission Staff will host an informal discussion on the development of effective competition on June 6, 2003 at 9:30 A. M. This meeting will be held in the third floor training room at the Commission. If you plan to attend the meeting, please notify me by e-mail or phone by May 30th. Following that meeting we will provide all parties an opportunity to add to their initial comments and react to others, if they so desire. Both the initial set of comments and any supplemental comments will be attached as an appendix to the Commission's September 1st report.

I thank you in advance for your participation in this important effort.

Sincerely,

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May 23, 2003

Mr. David R. Eichenlaub
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Dear Mr. Eichenlaub:

The Potomac Edison Company dba Allegheny Power ("AP" or "the Company") appreciates the opportunity to respond to your letter of April 16, 2003 concerning the Commission's report to the Legislative Transition Task Force ("LTTF") and the Governor under § 56-596 B of the Virginia Electric Utility Restructuring Act ("the Act").

AP commends the Commission Staff on its willingness to solicit and consider ideas from all stakeholders in this process. This facilitative approach has worked successfully with other matters in the past. AP looks forward to continuing to lend its experience with retail access in the states of Pennsylvania, Maryland, and Ohio to the Commission in a constructive way to facilitate effective competition in Virginia.

AP would like to offer the following comments and recommendations in response to the specific questions posed in your April 16, 2003 letter. Each of these questions is listed below, followed by AP's comments and recommendations.

Question 1: What are the current obstacles to the development of a robust competitive retail electricity market for residential customers? For commercial and industrial customers? How can these obstacles be overcome?

Wholesale and retail price dislocation is a significant obstacle to the development of a competitive market. Rate caps serve to protect customers during the transition period, but the same rate caps also insulate retail consumers from the reality of pricing variability that exists in the wholesale market. This obstacle will be removed when rate caps are removed, at which point the generation component of default service rates will be based on competitive market prices.

Another obstacle to the development of competition is the need for a wholesale power exchange, including real-time energy markets. Real-time energy markets provide an alternative to the purchase of load following products when supplying a retail load-shape.

A third obstacle is the absence of demand response to price. Demand response to price is a key fundamental which is missing in the retail electricity markets. The introduction of demand elasticity based on price, such as real-time pricing, will result in lower market clearing prices, as load will diminish as prices rise.

Lastly, as PE's capped rates in Virginia are, for the most part, below current market rates, the transition period, as currently defined, is not facilitating a transition. While PE fully appreciates the need and desire for consumer protections as the market develops, the SCC should continue to seek a balance between price protection (rate caps) and market development.

Question 2: With respect to potential obstacles, what is the outlook for future natural gas prices and the impact on wholesale electricity prices and a competitive retail market? Please comment on the postulation by several natural gas industry experts of a growing structural demand/supply imbalance with demand outstripping supply over the next several years. What actions, if any, could be taken to mitigate the potential impact of an over-dependence on a single fuel source?

As environmental concerns drive natural gas as the fuel of choice for new generating sources, there will be an increasing convergence of electricity and natural gas prices. Traditionally, natural gas-fired peaking facilities set the marginal cost of electricity only during summer peaking conditions. However, with the establishment of NOx regulations, over-firing of coal boilers and the construction of intermediate natural gas generation facilities (combined cycle) have resulted in natural gas setting the marginal cost of electricity more hours of the year, both on-peak and off-peak. Further, with the volatility of summer prices, outages on base-load generation are taken in non-peak periods (spring and fall shoulder peak months), which causes natural gas facilities to supplant this capacity during periods of unseasonal weather in the spring and fall, again increasing the number of hours per year that natural gas sets the marginal cost of electricity.

To reduce single-fuel dependence and convergence into the future, consideration should be given to a revised national energy strategy that encourages fuel source diversity.

Question 3: In light of recent legislation, how can the Commonwealth be assured of a continuing reliable electricity system when control of transmission is governed by an RTO?

FERC's recent "white paper" set out some important intended changes to its proposed Standard Market Design. FERC clarifies that nothing in its Final Rule will change state authority over resource adequacy and regional transmission planning. Although FERC will require public utilities to join an RTO or ISO, it appears the states will continue to play a significant role in the planning and resource adequacy processes.

What factors should be considered during the cost/benefit analysis required prior to Commission approval?

RTO formation and membership is driven conceptually by the need for open and comparative access to the transmission system for all market participants. It facilitates the efficiency of the wholesale electric marketplace, which in turn supports the possible development of localized retail competitive markets. As such the benefits of RTO membership fall to a broader area, beyond the boundaries of any particular state. Accordingly, any cost/benefit analysis should encompass the regional area. Items that should be included are:

- Regional deliverability of the existing transmission infrastructure and the effect of congestion management mechanisms on the broad wholesale market
- Comparison of regional resource adequacy to more local jurisdictional resource adequacy and estimate of cost to equalize same
- Cost of provision of localized redundancy to assure system security as compared to the current reliance on the regional system to provide that backup
- Cost of RTO operation compared against multiple operational staffs in individual utilities

Question 4: Later this month, the Federal Energy Regulatory Commission is expected to issue its "white paper" addressing certain issues debated the past several months regarding Wholesale Electric Standard Market Design (SMD). Additionally, the Department of Energy is expected to issue the results of its cost/benefit analyses of the impacts of SMD. Please provide your initial thoughts and reaction to such releases and identify any significant issues of concern.

AP is currently reviewing the FERC "white paper" regarding Wholesale Electric Standard Market Design as well as the DOE cost/benefit analysis of the impacts of SMD. AP will provide copies of any comments filed with FERC. Attached at the end of this document is a summary of AP's previous positions on SMD, which were filed prior to the recent "white paper".

Question 5: Are the Commission's Rules Governing Retail Access to Competitive Energy Services conducive to promoting effective competition in the Commonwealth? If no, how should they be modified? Is there any way in which these rules can or should be improved, in any event?

The Commission's Rules Governing Retail Access to Competitive Energy Services ("Rules") are conducive to promoting the advancement of effective competition in Virginia. The Rules strike an appropriate balance of all stakeholder interests by providing consumer protections while ensuring equal treatment of all market participants. Based on AP's experience with similar rules in Maryland, Pennsylvania, and Ohio, the Company believes the Rules will serve as an effective framework for retail access. AP recommends no changes to the Commission's Rules.

Question 6: What should be the level of consumer education when the program is resumed on July 1, 2004? Should it be as visible, more visible or less visible than when the campaign was suspended? Upon resumption of the campaign, what focus, theme or message should

be communicated? Since TV advertising is the most expensive component of the program, what level of TV advertising should be included in the resumption of the campaign?

It is AP's understanding that the primary purpose of the initial advertising campaign was to create interest among consumers and inform them that educational materials are available free of charge. AP feels this is an appropriate focus for the campaign again once it is resumed. Given the limited number of suppliers offering service in Virginia, it may be appropriate at this time to utilize less expensive forms of communication than TV advertising. AP recommends the VEC toll-free information line and the VEC website at www.yesvachoice.com remain available for customers to obtain factual and unbiased information on customer choice.

Question 7: Are there any other actions that have been taken or are being considered in other states that may be used to advance competitive activity in Virginia?

AP encourages the Commission to explore wholesale competitive bidding of default service after the rate cap period ends in Virginia. Currently there is a Maryland proceeding underway to define such a procedure for wholesale bidding of default service at the end of the utilities' rate cap periods in that state. The Maryland Public Service Commission recently approved Phase I of the Settlement Agreement in Case No. 8908, *Standard Offer Service*, which was negotiated between Maryland's utilities, the Maryland PSC Staff, consumer groups and various wholesale and retail suppliers. The Settlement Agreement defines a procedure for the provision of default service to customers through the competitive selection of wholesale supply. The settlement makes such services available at market prices, benefiting all stakeholders. Retail suppliers are allowed to effectively compete for load, thereby stimulating the competitive market with no penalty to customers. Customers are afforded protections beyond the assurances required by Maryland's restructuring statute, while permitting utilities to recover their verifiable, prudently incurred costs to procure the electricity plus a reasonable return.

AP is an active participant in the Commission's work group established in Case No. PUE-2002-00645, *In the Matter Concerning the Provision of Default Service to Retail Customers Under the Provisions of the Virginia Electric Utility Restructuring Act,* and as such the Company has and will continue to share its views on this matter in that forum. In addition, a proposed competitive bidding process is also underway in AP's Ohio jurisdiction. As the Commission develops its recommendations on the important issue of default service, AP looks forward to offering its experiences in both the states of Maryland and Ohio.

AP would also like to point out that while the continuation of the capped rate service may provide short-term protection to consumers, it has also insulated the customer from the pricing variability that exists in the wholesale market. As previously recommended, AP believes that the Electricity Supply service provided by the incumbent utility during the period from January 1, 2004 until July 1, 2007 should be more reflective of the current market prices for wholesale supply. AP has previously proposed alternatives to Staff for consideration and again offers its assistance and support in developing solutions to enhance market development during the remainder of the capped rate period.

Question 8: Do you have any ideas that have not been tried elsewhere that may facilitate competitive activity in Virginia?

AP has no response to this question at this time.

Closing

AP appreciates the opportunity to offer its views and recommendations regarding these issues. Thank you for giving us this opportunity, and please feel free to contact me for further information. AP looks forward to working with Staff to further develop and refine the Commission's recommendations on these very important issues.

Sincerely,

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SUMMARY OF ALLEGHENY POSITIONS ON FERC PROPOSED RULEMAKING TO STANDARDIZE MARKET DESIGN ("SMD")

Allegheny Power and Allegheny Energy Supply Company, LLC (Allegheny Companies) support FERC's initiative to standardize transmission access and market design nationally, but suggest that FERC make the following improvements to SMD:

- Protect retail customers against the risk of new transmission congestion costs and service interruptions through allocations of "congestion revenue rights" ("CRRs"). CRRs must "follow the load" (*i.e.*, the right to CRR revenues belong to load and other entities that pay for the fixed costs of the transmission system). CRRs should permit transmission, supply and demand response solutions to compete on an equal footing to resolve congestion.

- FERC must respect the sanctity of contracts, such as pre-Order No. 888 contracts between utilities and their customers. FERC could provide incentives for customers to convert their service entitlements after a four-year transition period (similar to FERC's proposed transition period for placing bundled retail service under the new SMD tariff), as long as FERC provides utilities the opportunity to recover lost revenues.[1]

- FERC generally should not require "participant funding" (*i.e.*, incremental pricing) for new facilities integrated with the AC transmission grid because it is virtually impossible to identify discrete beneficiaries of such projects for the life of the facilities. FERC should permit participant funding for: (1) merchant projects to build DC facilities, and (2) AC projects only when an appropriate load flow study identifies discrete project beneficiaries for the life of the facilities.

- FERC should not mandate immediate implementation of postage stamp rates within the Independent Transmission Provider's ("ITP") system, but instead should encourage a transition from license plate rates over a period of years by permitting transmission owners to recover their lost revenues, or by pricing new construction on a postage stamp basis.

- Concerning resource adequacy, FERC should: (1) require ITPs to adopt reasonable planning horizons of three to five years, (2) permit ITPs to adopt resource adequacy requirements through the stakeholder process, with a minimum default reserve capacity requirement based on application of the North American Electric Reliability Council's

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1 Incentives could include, for example, a stranded cost surcharge for the utility to recover lost revenues similar to the mechanism FERC accepted to allow Allegheny to recover lost through-and-out charges when it joined PJM through PJM West.

one-day in ten year probability of lost load standard, (3) facilitate retail access by permitting ITPs to adopt resource adequacy procurement periods that reflect the rights of retail load periodically to switch suppliers, (4) require ITPs to allocate the resource adequacy reserve requirement to load serving entities ("LSE") based on each LSE's load ratio share of the reserve capacity requirement, (5) require ITPs to develop resource adequacy verification procedures, (6) require ITPs to adopt meaningful deficiency penalties to make it uneconomic for LSEs who fail to meet their reserve capacity obligation, (7) adopt a must-offer requirement for capacity resources to ensure that a contracted resource is actually offered into the market, and (8) require resources (generation or demand response) to demonstrate the ability to perform.

- FERC should promote demand response programs while making clear that: (1) the ITP cannot offer demand response options directly to retail customers because that would make it a market participant, (2) LSEs, not third party aggregators, can sell demand response services so that LSEs will not be saddled with imbalance payment responsibility, and (3) demand response should not be subsidized by above-market payments that are socialized as uplift.

- FERC should delegate only limited ITP functions to independent transmission companies and only on a trial basis because ITCs are, by their nature, market participants whose interests are biased by their profit-making objectives.

- FERC needs to be careful to avoid an improper delegation of exclusive Federal authority over interstate transmission and wholesale power sales to the States through Regional State Advisory Committees

- FERC should not adopt a new definition of "market power" that could undermine confidence in the sanctity of power contracts. FERC should continue to apply the definition of market power that it has used for many years which depends on the ability of a supplier to impose a significant price increase for a significant period of time. FERC should not impose excessive bid caps or market price mitigation because such restrictions distort the market and undermine investment decisions, to the detriment of consumers in the long term. FERC should reexamine annually any mitigation measures it adopts for an ITP to determine whether the mitigation continues to be necessary in light of demand response and resource adequacy developments.

The Allegheny Companies suggested that FERC provide for a comprehensive review of SMD implementation after a reasonable time period.

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May 23, 2003

BY HAND

David R. Eichenlaub
Assistant Director, Economics
Division of Economics and Finance
State Corporation Commission
1300 East Main Street, Fourth Floor
Richmond, Virginia 23218

Re: SCC Report on the Status of Competition in the Electric Industry

Dear Mr. Eichenlaub:

Thank you for your letter of April 16, 2003 inviting comments for the State Corporation Commission's ("Commission" or "SCC") third annual report to the Legislative Transition Task Force ("LTTF") and the Governor under the Virginia Electric Utility Restructuring Act ("Act"). Section 56-596 B of the Act requires the Commission to report on (1) the status of competition in Virginia; (2) the status of development of regional competitive markets; and (3) recommendations to facilitate effective competition in Virginia as soon as practical. In addition, your letter asks for responses to several questions for purposes of the report. On behalf of Appalachian Power Company, d/b/a American Electric Power ("Company" or "AEP"), this letter will respond to the statutory subjects of the report and the questions in your letter.

STATUS OF COMPETITION IN VIRGINIA

The Company reported last year that: "As of January 1, 2002, all of AEP's Virginia customers have a choice of retail suppliers of electric generation services, and the Company stands ready to respond to customers' choices as alternative supply arrangements may become advantageous to them." However, the Company's most current information is that competitive retail electric generation suppliers have not entered the Virginia retail market, perhaps due in part to structural features of the Act. Due to this absence of generation supplier entry, customers have not had a practical opportunity to exercise their legal option to select alternative generation suppliers.

The implementation of the requirements for retail customer choice are, for the most part, in place and in compliance with the Commission's retail choice rules. Rates are unbundled, and incumbent utilities either operate in a functionally separate manner as required by the Commission or have separated or divested their generation assets and operations to separate legal entities. Other factors are slowing progress to widespread switching of customers among alternative generation suppliers.

The expectations created by the Act from its passage in 1999 have been that retail competition would develop during the period between January 1, 2002 and July 1, 2007, and could possibly develop such that capped rates and wires charges could be ended as early as January 1, 2004. Although much of that period remains, a significant portion of it has passed without progress toward the vigorous competition among generation suppliers envisioned in the Act. In addition, a critical element of successful implementation of the Act, entry of Virginia's major utilities into an independent regional transmission entity ("RTE"), has been substantially delayed until well into the period ending July 1, 2007.

While there appears no need for immediate action in the 2004 Session of the General Assembly, the Company has a growing concern that the development of retail competition in Virginia will require closer monitoring by the LTTF. Unless there is significant progress over the next twelve to fifteen months toward fulfillment of the expectations in the Act, including resolution of the Virginia RTE approvals, the LTTF and the General Assembly may be required to consider appropriate changes in the Act.

STATUS OF REGIONAL COMPETITIVE MARKETS

As the Company noted last year: "Open access transmission services and broad access to energy suppliers remain preconditions necessary to allow robust competition to develop for Virginia electricity customers." However, the development of robust, effective wholesale competition has been affected by a lack of progress in implementing RTEs as anticipated in the Act. AEP and its affiliates have sought to join an appropriate RTE since 1999. After initially approving most aspects of, but then ultimately rejecting, AEP's request to join the Alliance Regional Transmission Organization, the Federal Energy Regulatory Commission ("FERC") has now approved AEP's entry into PJM Interconnection, LLC ("PJM").

The Company has an application pending in Virginia for approval to transfer functional control of its transmission facilities to PJM. RTE participation is a fundamental element of the Act, recognized from the beginning as essential to the development of robust competition, that should now be resolved in Virginia promptly.

RECOMMENDATIONS TO FACILITATE EFFECTIVE COMPETITION

The Company recommends continued efforts to implement the Act, including prompt decisions on RTE participation. In light of the certainty concerning PJM and its market structure and operation, and the fact that the FERC has addressed in the "white paper" many of the Commission's jurisdictional concerns on the original SMD proposal, AEP would encourage the Commission to address, more promptly than was previously planned, AEP's RTE application that is currently pending before the Commission.

In its comments last year, the Company said: "…the Commonwealth continues to have an opportunity to observe changes in economic conditions and developing competition in energy markets before further changes in the balanced approach taken in the Restructuring Act are considered." That opportunity remains today, but it is diminishing. Contrary to the expectations in the Act, substantial progress toward robust competition will not likely occur by January 1, 2004, and perhaps not before July 1, 2007. On the other hand, the Act is complex, and every amendment proposed by one specific interest can lead to countervailing proposals by other interests. Careful study by the LTTF and timely actions by the Commission with respect to RTE approval should be given priority over attempts at immediate, issue-by-issue legislation that could have unintended consequences. If the Commonwealth is to change direction through legislation, that change should be based on a comprehensive reconsideration of the expectations embodied in the Act.

Attached to this letter are responses to the questions contained in your letter of April 16, 2003. On behalf of the Company, thank you for the opportunity to provide these views to you, the Commission, and the recipients of the Commission's report.

Sincerely,

Barry L. Thomas
Director, Regulatory Services VA/TN

BLT/cde

AEP COMMENTS ON
SCC REPORT ON THE STATUS OF COMPETITION IN THE ELECTRIC INDUSTRY
2003

<u>RESPONSES TO QUESTIONS IN THE STAFF LETTER OF APRIL 16, 2003</u>

1. What are the current obstacles to the development of a robust competitive retail electricity market for residential customers? For commercial and industrial customers? How can these obstacles be overcome?

RESPONSE:

The Company is concerned that competition has failed to develop in Virginia. It has been suggested that current obstacles to development of widespread customer switching of generation suppliers are wires charges and utility rates capped at levels that are, or are becoming, unrealistically low. Another obstacle has been the uncertainty created by controversy surrounding, and the lack of progress toward, RTE development in Virginia. The Company does not believe that legislation is necessary in the 2004 Session of the General Assembly. However, continued lack of progress toward robust retail competition could trigger the need for a broad re-examination of the entire Act. Moreover, narrow legislative proposals to amend individual provisions of the Act, as have been discussed by others in the past, could necessitate a re-examination of many other provisions. Capped rates, wires charges, RTE participation and other critical provisions of the Act should not be excluded from such a broad re-examination, in the Company's view.

2. With respect to potential obstacles, what is the outlook for future natural gas prices and the impact on wholesale electricity prices and a competitive retail market? Please comment on the postulation by several natural gas industry experts of a growing structural demand/supply imbalance with demand outstripping supply over the next several years. What actions, if any, could be taken to mitigate the potential impact of an over-dependence on a single fuel source?

RESPONSE:

The Company does not have sufficient information to attempt to answer this question from the perspective of other competitors or fuel suppliers. In any event, the inquiry should be broader. AEP has a diverse fuel mix, which includes coal, natural gas, nuclear, wind, hydro, and fuel oil, and is not heavily reliant on natural gas-fired capacity to serve its Virginia electricity customers. Volatility in natural gas prices is not the only determinant of the overall variation in fuel prices or wholesale electricity prices. Supply, demand, transmission congestion, generation and transmission outages, and weather are all factors that play a role in determining the price of electricity. AEP has risk management practices in place so as markets develop and change, fuel procurement can be modified accordingly.

3. In light of recent legislation, how can the Commonwealth be assured of a continuing reliable electricity system when control of transmission is governed by an RTO? What factors should be considered during the cost/benefit analysis required prior to Commission approval?

RESPONSE:

AEP believes that its participation in a RTO, specifically PJM, will enhance the reliability of AEP's transmission network. For instance, PJM will be able to plan and schedule generation and transmission line outages for maintenance over a large region in a coordinated manner, which will reduce the potential for congestion and short term reliability problems. Also, with AEP's participation, PJM will be able to use the most cost-effective and reliable combination of generation across a large region to balance the entire regional grid and adjust the dispatch economically to relieve congestion and enhance reliability. PJM will be able to internalize many of the critical loop flows that impact reliability and congestion and use regional dispatch to manage congestion created by loop flows. This will be important for the portion of AEP's system located in Virginia. Since the Allegheny Power and Dominion Virginia Power systems, along with AEP, will be part of PJM, PJM will be better able to manage congestion by internalizing within PJM needed redispatch and transmission operation. The market-based redispatch to alleviate congestion will mitigate the need for the existing NERC TLR process, thus further improving the reliability of transactions. Furthermore, PJM has a long-term regional planning process that is open, transparent, and focused on the public interest and consumer benefits. This process ensures continued reliability and promotes new competitive alternatives to alleviate congestion and therefore enhance reliability.

AEP will provide information regarding costs and benefits of RTE participation as part of its pending RTE case. That information will address factors such as impacts on power supply costs for retail customers and the costs of participating in an RTE, including RTE administrative costs. A complete discussion of these factors will be provided when AEP submits its cost/benefit data.

4. Later this month, the Federal Energy Regulatory Commission is expected to issue its "white paper" addressing certain issues debated the past several months regarding Wholesale Electric Standard Market Design (SMD). Additionally, the Department of Energy is expected to issue the results of its cost/benefit analyses of the impacts of SMD. Please provide your initial thoughts and reaction to such releases and identify any significant issues of concern.

RESPONSE:

AEP is encouraged that FERC made in its "white paper" significant changes to the original SMD NOPR to address concerns raised by AEP, state regulators, and other stakeholders. For instance, FERC has supported regional flexibility on market design elements and addressed jurisdictional issues that the Virginia Commission and others have raised. AEP currently plans to submit comments on the "white paper" and will address at that time both the areas we support and our continuing concerns with the proposal. Also, AEP intends to participate with other parties, including state commissions such as the SCC, in stakeholder discussions at PJM regarding issues concerning implementation of SMD.

DOE's recently issued cost/benefit report indicates that, in general, retail customers across the country will benefit from FERC's SMD proposal, although customers in some areas will experience higher costs in the short run. The DOE's study, like other studies on SMD, is significantly dependent on the assumptions used in the study.

5. Are the Commission's Rules Governing Retail Access to Competitive Energy Services conducive to promoting effective competition in the Commonwealth? If not, how should they be modified? Is there any way in which these rules can or should be improved, in any event?

RESPONSE:

In its comments for the Commission's competition report last year, the Company noted that the degree to which Commission rules might have discouraged competitive entry is unclear. It remains unclear. However, the Company has insufficient information to answer this question from the perspective of a competitive generation supplier. The burden is on potential new entrants to explain any reticence to enter Virginia based on the Commission's rules.

6. What should be the level of consumer education when the program is resumed on July 1, 2004? Should it be as visible, more visible or less visible than when the campaign was suspended? Upon resumption of the campaign, what focus, theme or message should be communicated? Since TV advertising is the most expensive component of the program, what level of TV advertising should be included in the resumption of the campaign?

RESPONSE:

The Company explained last year that: "After a long history of customer reliance on a single provider of electricity supply, there will likely be no successful customer choice program without customer education." While the Company understands the budget and other considerations that have made the program difficult and caused its temporary suspension, customer education remains essential. To achieve effective results, reactivation of the program should be scheduled closer to the expected onset of widespread customer choice, based on the LTTF's assessment of progress toward a competitive retail market.

7. Are there any other actions that have been taken or are being considered in other states that may be used to advance competitive activity in Virginia?

8. Do you have any ideas that have not been tried elsewhere that may facilitate competitive activity in Virginia?

RESPONSE TO QUESTIONS 7 AND 8:

In the Company's view, it is incumbent upon potential competitive generation suppliers to explain their difficulties in entering Virginia. There may be actions taken or considered in other states, or other concepts that have not been tested elsewhere, that competitive suppliers consider promising and encouraging to their entry into the Commonwealth. AEP has insufficient information to suggest changes that might encourage competitive suppliers. However, any proposed changes should provide for customer switching of generation suppliers on a sound economic basis rather than on regulatory calculations intended to create artificial "headroom" between market prices and utility rates.

May 22, 2003

Mr. David R. Eichenlaub, Assistant Director
Division of Economics and Finance
Virginia State Corporation Commission
P.O. Box 1197
Richmond, VA 23218-1197

Dear Mr. Eichenlaub:

Dominion Virginia Power (the Company) is pleased to respond to your April 16 request for comments and recommendations concerning the status of competition in Virginia, the development of regional markets, and steps that can be taken to facilitate effective competition in the Commonwealth. The annual reports required by Virginia Code § 56-596 provide a valuable opportunity for the Commission to keep the legislative and executive branches fully and fairly informed about important issues in Virginia's transition to a fully competitive market. The reports also offer valuable information to other stakeholders in the restructuring process. We appreciate the opportunity to offer input again to this year's report.

We will begin our comments with a brief overview of our thoughts on the status of competition in Virginia. In developing our comments, we have considered topics detailed in the statute, as well as issues raised by the list of questions in your letter requesting comments. In our comments, the Company will focus on some of the successes achieved by restructuring in Virginia, as well as our concerns regarding the development of competitive markets. We also will note areas of progress. Finally, we will offer suggestions for fostering the development of viable competitive electricity markets, both wholesale and retail, that have the potential to benefit Virginia consumers.

2003 Overview: Reasons for Concern and Optimism

The critical date for Virginia's transition to a restructured electric industry is July 1, 2007, with the end of wires charges and capped rates and the beginning of market-based generation pricing for all retail customers. Even though the phase-in of customer choice across the Commonwealth is to be completed by January 1, 2004, the Virginia Electric Utility Restructuring Act (the Restructuring Act) was not designed to ensure or guarantee a fully competitive retail market before the end of capped rates and wires charges in mid-2007. In fact, the design of the Restructuring Act anticipated that time would be needed for market development. Capped rates were purposely established to mitigate consumer exposure to market volatility that could occur during this start-up period and to provide a "safe haven" in the form of stable prices for electricity supply service. With this in mind, we believe that the Restructuring Act is working in large measure as planned and is already producing many benefits for Virginia consumers. For example, a Chmura Economics and Analytics study found that capped rates will save the Company's residential customers up to $871 million from 1998 through 2007, with average per-household savings of up to $480 for the period. The study, commissioned by the Company, was released in November 2002.

We also believe that the Restructuring Act, through its capped rate provisions, provides clear incentives for Virginia's incumbent utilities to reduce costs and become more efficient. For example, during the capped rate period the Company has or will incur hundreds of millions of dollars in significant additional expenses with no ability to request retail base rate increases. In addition, through steps such as efficiency improvements and the elimination of above-market contracts with non-utility generators, the Company can take steps during the capped rate period to bring its generation costs in line with the market. This is important to our future financial health and financial viability. Other incumbents have the same opportunity.

Even with these successes, it must be noted that the development of a competitive electric supply market in Virginia is proceeding at a sluggish pace. The Company believes there are several factors hindering this development, both at the wholesale and retail levels. Regulatory uncertainty, at both the state and federal levels, is contributing to this lack of development. State-federal jurisdictional issues, especially those regarding oversight of the transmission sector, have slowed progress toward the integrated, regional grid needed to support effective wholesale and retail markets.

Renewed discussions over stranded cost recovery – an issue the Company thought settled years ago - have injected additional regulatory uncertainty this spring into Virginia's restructuring picture. The framers of the Restructuring Act wisely avoided a structure that would involve complex and divisive methods such as up-front quantification of stranded costs. During the 1999 General Assembly, the example of New Hampshire was noted numerous times; stranded cost quantification delayed that state's restructuring program for years. We believe a proposal submitted by Dominion Virginia Power with the support of several other parties is consistent with the provisions of the Restructuring Act and offers a straightforward approach to the calculation of stranded cost over or under-recovery. However, several other proposed methods put forward this spring involve elaborate quantification procedures that would almost certainly prove lengthy and controversial. Such procedures run counter to the Restructuring Act's intent to avoid divisive, front-end stranded cost cases. Adoption of these procedures also would require substantial legislative amendment of the Restructuring Act.

Economic and capital market conditions have retarded the development of competition, at the state, regional and national levels. Economic factors have sharply reduced the number and capacity of new generating projects in the Commonwealth. Encouragingly, more than 8,000 megawatts are still planned or under construction. Erratic wholesale prices, coupled with lack of access to generation through regional transmission management, have also hampered retail competitive service providers' ability to secure power and make attractive offers to consumers in Virginia.

But there are also reasons for optimism. Great progress has been made in implementing the rules and procedures needed to conduct customer choice. This was highlighted by the strong rankings recently given Virginia by the Center for the Advancement of Energy Markets (CAEM), a well-known pro-competition group. CAEM gave Virginia 8 out of a possible 10 points in its Uniform Business Practices category, which corresponds to the regulatory rules that provide the framework for retail access. In addition, CAEM has ranked Virginia 13th among jurisdictions worldwide with respect to the general infrastructure and environment for retail competition.

There are other encouraging developments. Competitive service providers and aggregators continue to show interest in Virginia. The 2003 General Assembly amended the Restructuring Act to permit greater experimentation with municipal aggregation, a promising means to bring the benefits of retail access to large numbers of residential and small business customers. The Company in March asked the Commission for permission to conduct three retail access pilot programs that will help stimulate the development of competition and provide valuable information on effective measures to promote customer choice. The application for these programs is now pending before the Commission. A May 8 seminar conducted by the Company on its proposed municipal aggregation pilot program drew participants from 19 counties, cities and towns, as well as representatives of competitive service providers, aggregators and consultants. Finally, support for customer choice remains strong in the Commonwealth. A survey of Dominion Virginia Power's retail customers conducted last fall found that 82 percent supported energy choice.

In the next sections of our response, we will discuss some of this regulatory uncertainty in more detail and present some recommendations on facilitating the development of a viable competitive retail market.

Regulatory Uncertainty: Jurisdiction Questions Hamper Regional Grid Development

Development of an open-access, non-discriminatory wholesale power market covering a broad region is an essential foundation for successful retail choice. Even most critics of the Standard Market Design (SMD) initiative launched by the Federal Energy Regulatory Commission (FERC) concede the benefits of an open interstate wholesale market.

But FERC's move to standardize market rules has prompted concern from the states, including Virginia, over the possible loss of state control over transmission (and to some extent generation) infrastructure and pricing. In Congress, for example, strong efforts have been made in both houses to attach to comprehensive energy bills language drastically curtailing FERC authority. In fact, a provision of comprehensive federal energy legislation sponsored by Senate Energy Committee Chairman Pete Domenici would prohibit FERC from issuing a final SMD order before July 1, 2005, more than two years from now. The legislation is now pending before the U.S. Senate.

In Virginia, the FERC proposal drew a strong negative reaction from the Commission in an addendum issued last December to its 2002 Status Report on Competition. The Commission in a recent order determined that it could not consider or make a final determination on American Electric Power's (AEP) application to join PJM

Interconnection LLC until FERC has issued a final SMD rule and its impact on PJM operations can be evaluated. (See AEP order at pages 6 and 8.) This process could take years. However, in FERC's recent "white paper" on its SMD proposal, FERC stated that it would not use the SMD rulemaking to overturn prior regional transmission organization (RTO) orders where there is overlap. Therefore, the Commission need not wait for a final SMD order before considering and ruling on applications to join an existing RTO such as PJM.

The jurisdictional issues have had the unfortunate effect of provoking calls for radical revision of the Restructuring Act, either through rate rebundling or suspension of customer choice. Both actions, which were endorsed in the Commission's December 2002 Addendum, would amount to a *de facto* repeal of the restructuring law. Both the General Assembly and the Governor rejected that path, but the controversy has confused the restructuring picture in Virginia. It undoubtedly calls into question, in the minds of some stakeholders, the Commonwealth's long-term commitment to competition. Such uncertainty deters potential retail competitive service providers that may be interested in establishing a business presence in Virginia, as well as developers interested in expending capital dollars to build generation resources. Regulatory uncertainty could also act as a deterrent to economic development in the Commonwealth.

The Company continues to believe strongly that Virginia needs to expand market boundaries to give competitive service providers greater access to additional sources of energy. This open, non-discriminatory access over a broad area is necessary for an active retail market. The General Assembly realized this in 1999, when it included mandatory RTO participation requirements in the Restructuring Act. The Assembly reiterated its commitment to regional markets this year; House Bill 2453 amending the Restructuring Act included provisions requiring all transmission-owning utilities in Virginia to join RTOs by January 1, 2005, subject to Commission approval.

To comply with the provisions of the Restructuring Act, Dominion announced last year that it would apply to join the PJM Interconnection as a separate zone, PJM South. We are optimistic that our participation in an RTO will enhance the development of retail competition. Our participation in a regional organization will give customers and suppliers access to a broader selection of generation assets by eliminating deterrents such as "pancaked" transmission rates.

We recognize that states have the duty to protect their citizens' access to economical and reliable supplies of energy. We do not believe, however, that this goal is furthered by the creation of barriers to regional markets; the development of markets over broad regions would, in fact, greatly assist the states in ensuring energy remains reliable and economical. Healthy regional markets would provide customers and suppliers with access to a greater diversity of generating assets over a larger geographical area; this inherently increases the reliability of service to customers. A broad, regionally controlled transmission infrastructure would also enhance reliability by providing unfettered access to additional, redundant pathways for the movement of energy. Regional management would eliminate artificial barriers such as rate pancaking and seams between separately controlled systems.

Nor do we believe that a proper response to those concerns is a retreat from electric industry restructuring. FERC's recent "white paper" on its SMD proposal indicates federal authorities are listening to state concerns and want the states to play an important role in the development of regional transmission management. House Bill 2453 provides a reasonable timetable for incumbent utilities in Virginia to join an RTO, and Dominion is proceeding in accord with that legislation.

Regulatory Uncertainty: Renewed Controversy over Stranded Costs

Renewed controversy regarding stranded cost over or under-recovery is also fostering uncertainty about the course of restructuring in the Commonwealth. Earlier this year, the Legislative Transition Task Force (LTTF), carrying out its duties under the Restructuring Act, requested the Commission to convene a work group of interested stakeholders to develop a consensus methodology for monitoring the over or under-recovery of stranded costs. This methodology, according to the LTTF resolution, was to be "consistent with the provisions of the [Restructuring] Act."

The Company believes the proposal it submitted takes a straightforward approach to calculating stranded cost over or under-recovery that is consistent with the Restructuring Act's intent and language. The proposal has the support of Old Dominion Electric Cooperative (ODEC), AEP, Allegheny and Virginia Independent Power Producers, Inc. Under this proposal, a utility's actual wires charge revenue (based on Commission-established projected market prices) would be compared to the revenue the utility could have realized had the displaced power been sold at the actual market prices occurring that year. Whether the utility ultimately will experience over or under-recovery will only be known at the end of the capped rate period in mid-2007. The utility would also report its total potential stranded cost exposure annually to the LTTF, as well as the amount the utility has spent on mitigating such costs and any additional expenses that increase these costs.

The Company also believes that any attempt to impose a complicated or front-end methodology to determine stranded cost over or under-recovery would create great uncertainty about the future of restructuring in the Commonwealth. Such approaches could not be conducted without significant legislative amendments that would alter central provisions of the Restructuring Act. Unfortunately, uncertainty has already been injected this spring as several parties have offered complicated, divisive and time-consuming proposals for determining over or under-recovery.

These proposals differ in their details, but all include complex and controversial calculations. The calculations include annual determination of "fair" or "appropriate" rates of return for utilities, a step that would represent the *de facto* return of cost of service rate making. The calculations also include estimations of the net present value of cash flows from existing generating assets over their remaining useful life, a period extending for 30 or more years. The dangers in such approaches are clear. Proceedings to establish “fair” rates of return or determine inflation-adjusted cash flows from generating units over a period spanning decades will be lengthy, controversial and divisive, as well as contrary to the Restructuring Act. The Assembly specifically rejected such complicated, front-end proceedings as it developed the Restructuring Act during the 1999 session, with complex and controversial stranded cost mechanisms correctly viewed as significant threats to the viability of restructuring.

As efforts to develop a methodology for calculation of over or under-recovery continue, all parties should bear in mind warnings heard by the legislative committee that examined alternative approaches to stranded costs in the months leading up to the 1999 session. Testimony correctly described complicated and lengthy litigation that developed in states such as New Hampshire that attempted complex, up-front stranded cost determinations. The Commission’s Staff at that time also opposed such determinations, finding the results of such analyses were highly uncertain and dependent upon assumptions and projections that had to be made decades into the future.

Pilot Programs: Important Steps to Stimulate Competition

While the Company believes that the easing of some of this regulatory uncertainty will be important in promoting retail competition, it also believes that some active steps can be taken to stimulate the development of healthy competitive markets. In March, the Company asked the Commission to approve three pilot programs to help stimulate the development of a competitive electricity market in Virginia and bring the potential benefits of retail choice to a variety of customers. The pilots are designed to provide competitive service providers, customers and other stakeholders with experience in a variety of competitive situations.

As many as 65,000 retail customers are expected to switch to competitive service providers in the pilots. In all three programs, the Company has proposed a significant reduction in the wires charges customers pay when they switch to competitive service providers. The reduction is designed to help competitive providers make attractive offers to consumers.

Municipal Aggregation Pilot

Two or more municipalities will participate in a program to form two buying groups (aggregations) to secure lower prices on electricity for residential, small business and house of worship customers. The aggregation pilot will include about 100 megawatts of load.

One or more localities with a combined total of up to 30,000 customers will use the “opt in” model. In an “opt in” situation, customers must make an affirmative decision to switch to the competitive service provider secured by the local government.

Also, one or more localities with a combined total of up to 30,000 customers will use the “opt out” approach. Customers in these municipalities will be switched to the competitive provider – with some exceptions - unless they make an affirmative choice not to participate.

Competitive Bid Supply Service Pilot

This program will use competitive bidding to select service providers for some customers. It will test the infrastructure and processes needed to provide default service. Under the Restructuring Act, default service will be offered beginning January 1, 2004.

The competitive bid supply service pilot will include up to 43,000 of the Company’s residential and small business customers. Customers will be invited to volunteer to participate, but if the program is under-subscribed, a random selection process may be used to fill the vacancies. The pilot will include about 200 megawatts of load.

The Commission will use its authority under the Restructuring Act to seek competitive bids from service providers that wish to furnish this default service. The pilot will provide valuable real-world information to the Commission’s work group currently studying default service.

Commercial and Industrial Pilot

Commercial and industrial customers with demands greater than 500 kilowatts will be eligible for this pilot. Participation would be limited to a total of about 200 megawatts of load. The pilot will be available anywhere in the Company’s Virginia service area and is expected to include about 150 customers.

We urge the Commission to approve these pilots so they can be implemented on January 1, 2004. The programs could be incubators of innovation for the development of viable retail competition in Virginia.

We also urge the Commission to redirect at least some of the funds used in the Virginia Energy Choice consumer education program to provide public information about these pilots. Tying the education effort to a real opportunity for consumers would increase awareness of restructuring in general, as well as that of the pilots specifically.

Virginia Electric Industry Restructuring: A Work in Progress

Virginia has made considerable progress in restructuring its electric industry. The Commission is to be congratulated for spearheading the difficult task of developing the policies and procedures needed to implement retail choice. The Commission, through reports such as the one now being prepared, also has kept all branches of government, as well as the public, informed about the course of restructuring. Public support for energy choice remains high, and customers throughout the Commonwealth are already reaping substantial benefits due to capped rates.

We are also encouraged by the fact that many policy makers across the country are now working toward resolving issues retarding the development of viable competitive wholesale and retail markets. Congress is dealing with comprehensive federal energy legislation that contains major electric industry reforms. FERC, in its recent "white paper," has demonstrated its willingness to work with the states to address their concerns regarding the SMD initiative. FERC has also indicated it will factor regional concerns into the final development of the rule. In April, a bipartisan group of 70 state utility commissioners endorsed a Statement of Principles that recognized the "benefits that consumers receive due to the establishment of more dynamic wholesale markets." The Statement of Principles also called on Congress and other policy makers "to support current regulatory efforts to further improve the wholesale power markets of our states and of our nation."

While the move toward competitive energy markets has slowed in some parts of the United States, restructuring has made impressive progress in many states. For example, in Maine the Public Utilities Commission reports that almost one-third of the total state load was served by competitive service providers as of January 1. In Ohio, approximately 730,000 residential customers have participated in one of more than 190 community aggregation groups, according to the Ohio Consumers' Counsel. In Maryland, the Public Service Commission has recently approved rules that could serve as a model for many states, including Virginia, for the process through which distribution companies will procure the electricity supply needed to meet default service obligations. The Maryland Commission's rules call for a competitive wholesale procurement process for default service, called Standard Offer Service in that state. The rules are designed to give retail suppliers the opportunity to compete effectively and, at the same time, ensure stable market-based prices for those customers choosing to receive electricity supply service from their distribution utilities. Such progress provides reasons for optimism.

Additionally, a noted consumer group, Citizens for Pennsylvania's Future, in September 2002 released an updated and comprehensive study addressing the status and development of competition in the United States. This study indicates that restructuring, wholesale and retail, is working well for most consumers. A copy of the study is attached.

The Company remains convinced that Virginia's program is fundamentally sound and has great potential to bring benefits to the Commonwealth's consumers and its economy. Restructuring is very much a work in progress in Virginia; bumps and downturns are not unexpected. They should not hide the progress already made nor the potential restructuring holds for even greater gains for Virginia's citizens. The Restructuring Act must be kept intact to maintain confidence in the minds of stakeholders. This confidence is vital to maintaining and accelerating the momentum carrying the Commonwealth toward the robust competitive markets that have the potential to benefit both business and residential consumers.

Sincerely,

(Original signed by)

E. Paul Hilton
Senior Vice President

Attachment

May 23, 2003

David R. Eichenlaub
Assistant Director, Division of Economics and Finance
State Corporation Commission
P.O. Box 1197
Richmond, VA 23218-1197

Dear Dave:

In response to your letter dated April 16, 2003, soliciting informal written comments regarding Staff's review of methods to facilitate effective competition in Virginia, please accept this letter as the preliminary comments of A&N Electric Cooperative, BARC Electric Cooperative, Central Virginia Electric Cooperative, Community Electric Cooperative, Craig-Botetourt Electric Cooperative, Mecklenburg Electric Cooperative, Northern Neck Electric Cooperative, Northern Virginia Electric Cooperative, Prince George Electric Cooperative, Rappahannock Electric Cooperative, Shenandoah Valley Electric Cooperative, Southside Electric Cooperative, Old Dominion Electric Cooperative and the Virginia, Maryland & Delaware Association of Electric Cooperatives (collectively, the "Cooperatives"). The Cooperatives appreciate the opportunity to provide input at this stage of the proceeding, and look forward to participating actively in any further discussions with Commission staff and with the Legislative Transition Task Force.

In addition to providing answers to the specific questions posed by the Staff, the Cooperatives would like to again state that at this time there is no benefit to consumers in further amendments to the Virginia Electric Utility Restructuring Act ("Restructuring Act") and to the Rules Governing Retail Access to Competitive Energy Services ("Retail Access Rules"). Participating in the various proceedings conducted to enact or promulgate the legal framework that will guide the transition to retail access has already caused the Cooperatives to expend tremendous resources, both in staff time and the expenditure of dollars, all of which ultimately come from the cooperative member-consumers. The Cooperatives have relied on the Restructuring Act and the Retail Access Rules while conducting the expensive and time-consuming task of preparing for retail access. At this time, departure from this framework is unnecessary and will only make the transition process even more expensive. Since the members they serve own the Cooperatives, increased expenses will mean increased costs – either directly or through reduced margins - for our consumers.

1. **What are the current obstacles to the development of a robust competitive retail electricity market for residential customers? For commercial and industrial customers? How can these obstacles be overcome?**

Competitive markets cannot be mandated; they emerge with the right combination of market rules and competitive pressures. In Virginia, with the combination of relatively low energy prices and capped rates, consumers are reaping the benefits of a competitive wholesale market, without the competition. If consumers were allowed and capable of responding to changing market prices and those prices were established by the existence of many market sellers and buyers, competitive pressures would exist that could lead to efficient outcomes that benefit all market players. Competitive markets also require informed market players. Information on the prices offered by competitive suppliers is currently of no value because no prices are being offered less than the current capped rates.

As for transmission adequacy, recent experience in PJM both on the Delmarva Peninsula and more recently in the newly added Allegheny Power area demonstrates certain areas of the system are not sufficiently robust to expose consumers to a LMP-based market. This is evidenced by increases in local congestion. More transmission, as facilitated by a collaborative stakeholder process with the stated goal of minimizing congestion costs to the consumer, is required.

2. **With respect to potential obstacles, what is the outlook for future natural gas prices and the impact on wholesale electricity prices and a competitive retail market? Please comment on the postulation by several natural gas industry experts of a growing structural demand/supply imbalance with demand outstripping supply over the next several years. What actions, if any, could be taken to mitigate the potential impact of an over-dependence on a single fuel source?**

The long-term outlook for natural gas prices is one of moderate growth given the increasing demand for the product. Demand will continue to grow because of the product's relative abundance and environmentally friendly qualities. The short-term outlook is one of price volatility. Increased demand for natural gas due to the building of natural gas-fired generation results in supply shortages, which in the short term leads to higher prices. Those higher prices should lead to more exploration and an eventual increase in the supply of natural gas, putting downward pressure on the price increase. As the price of natural gas rises (and the resulting electricity price from natural gas generation), other fuel sources and actions such as demand reduction through conservation or load management become economical.

3. **In light of recent legislation, how can the Commonwealth be assured of a continuing reliable electricity system when control of transmission is governed by an RTO? What factors should be considered during the cost/benefit analysis required prior to Commission approval?**

Reliability should not be a problem exclusively because a utility turns over the operation of the transmission system to an RTO. If an agreement is reached between the RTO and the transmission utility that restricts system outages to only those control areas that caused the reliability problems, no reliability problem exists other than those that were already present. In other words, as long as the transmission system in a control area cannot be expected to assist a reliability problem in another control area, there is no compromise of reliable service. However, this agreement undercuts one of the advantages of having an integrated bulk transmission system from the operator's point of view. In addition, agreement as to what operation reliability standards (i.e. ECAR or MAC) will prevail must be reached before a utility with a transmission system that crosses different reliability zones is permitted to join an RTO.

The Commission's best opportunity to assure reliability after the RTO is in place is to take a proactive role in the planning and stakeholder process envisioned by the Federal Energy Regulatory Commission. The Virginia Commission must use its considerable influence and expertise to assure that the common RTO protocol is reliable.

The Virginia Commission needs to be fully aware of the current costs and benefits of a utility joining an RTO and a reasonable assumption as to the expected costs and benefits over the mid-term (5 to 10 years) future period. Such assumptions should include an analysis of any potential costs and benefits in a competitive retail market scenario. The Commission also needs to consider carefully any utility's present or future plans for transmission expansion. Meaningful analysis will require the Commission to quantify and fully understand the current condition of each participating utility's transmission system and whether such transmission systems are capable of contributing to a viable competitive wholesale market. The Commission must have access to enough information so that any areas of tight transmission capacity (relative to load) can be analyzed to determine the cost impact of such congestion on consumers and the potential cost of "fixing" the situation. The Commission must also determine if transmission-planning processes adequately address economic development and growth. If the transmission system's operation now and in the future does not lead to the realization of economic benefits for all market players, including and even primarily consumers, then the idea of joining an RTO is a bad one.

4. **Later this month, the Federal Energy Regulatory Commission is expected to issue its "white paper" addressing certain issues debated the past several months regarding Wholesale Electric Standard Market Design (SMD). Additionally, the Department of Energy is expected to issue the results of its cost/benefit analyses of the impacts of SMD. Please provide your initial thoughts and reaction to such releases and identify any significant issues of concern.**

The Wholesale Power Market Platform White Paper issued by FERC represents a major retreat from the principles set forth in Order 2000 and with the objectives issued with the original SMD NOPR. The White Paper suggests a departure from the goal of developing consistent market rules across all RTOs and therefore may lend itself to criticism of discrimination by transmission owners. The White Paper properly emphasizes the importance of preserving and clarifying states' jurisdiction, but fails to specify how the states will participate in an RTOs' operation or planning process. The Cooperatives believe that the Virginia State Corporation Commission can play a valuable role in ensuring that the operation of any RTO system is crafted in a manner beneficial to consumers.

The White Paper also suggests that an LMP-type congestion management system is no longer mandatory. While the FERC still clearly favors an LMP-type congestion management system, there are congestion management systems other than LMP and the Commission should fully explore which system provides the greatest benefit to consumers. The White Paper also leaves open the market mitigation tools and the method of market monitoring to be deployed by the RTO. A strong market monitor and effective mitigation procedures are necessary items in order for the RTO to create an effective and transparent market. It should be noted that the White

Paper also removes the notion of auctioning FTRs if an LMP based congestion management system is implemented. Removing the auction requirement is a positive step in providing protection for loads that are native to the transmission system.

Finally, trying to develop a standard market design applicable to all RTOs (markets) no longer seems to be an objective of FERC. Regionalization will create different sets of market rules and prevent "seamless" transactions across different parts of the network. The Cooperatives are concerned that exempting existing RTOs from any review only serves to exacerbate this very problem.

The Cooperatives have conducted a cursory review of the Department of Energy's cost/benefit analysis. It appears to demonstrate modest benefits. The Cooperatives do wish to clarify that, contrary to the report, Old Dominion Electric Cooperative's congestion situation has not been "alleviated" despite such an assertion on page 60 of the report.

5. **Are the Commission's Rules Governing Retail Access to Competitive Energy Services conducive to promoting effective competition in the Commonwealth? If not, how should they be modified? Is there any way in which these rules can or should be improved, in any event?**

The Commission's Rules Governing Retail Access to Competitive Energy Services are conducive to promoting effective competition in Virginia. Competition (in the form of many buyers and sellers) has failed to emerge not because the market rules as established by the Commission are less than adequate, but because no supplier can produce and deliver electric energy at a cheaper rate than the incumbent utility. If there were suppliers capable of producing electricity and delivering such power with an acceptable margin attached at a price that was less than the energy currently available, competition in Virginia would be viable, rather than theoretical as is the case today and for the foreseeable future.

6. **What should be the level of consumer education when the program is resumed on July 1, 2004? Should it be as visible, more visible or less visible than when the campaign was suspended? Upon resumption of the campaign, what focus, theme or message should be communicated? Since TV advertising is the most expensive component of the program, what level of TV advertising should be included in the resumption of the campaign?**

The Cooperatives actively participated in the Commission's Education Task Force. The Cooperatives believe that continuing to conduct the current Virginia Energy Choice program when there is essentially no competitive market is ineffective and wasteful. The program should be placed on hold until such time as there is an effective competitive market. The Cooperatives also suggest that continuing to run such advertising despite the lack of participating CSPs may unnecessarily raise consumers' expectations.

As noted previously, the Cooperatives will continue to educate their members on retail access through the use of our Association magazine, *Cooperative Living*. Additionally, member systems have produced and distributed handouts and placed educational information on their internet websites.

7. **Are there any other actions that have been taken or are being considered in other states that may be used to advance competitive activity in Virginia?**
8. **Do you have any ideas that have not been tried elsewhere that may facilitate competitive activity in Virginia?**

At the present time, the Cooperatives believe that Virginia should take no further actions, either those tried elsewhere or those yet to be implemented anywhere, in order to advance competitive activity in Virginia. If it is to happen at all, or certainly at any time in the next decade or so, competitive activity in Virginia will occur on its own accord without additional action by the state. Competition will occur when and if it is capable of producing economic benefits for market participants, including both buyers and sellers. Until such economic benefits evolve, any market activity that may develop would be based on weak and unsupportable models and would therefore neither be robust nor long-lived. What Virginia has done is the most appropriate course at this time: having the mechanisms and guidelines in place if competition develops while maintaining safeguards against unregulated monopolies if competition does not develop.

New Era Energy, Inc.

May 23, 2003
Mr. David Eichenlaub
State Corporation Commission
P.O. Box 1197
Richmond, Virginia 23218-1197

Dear Mr. Eichenlaub:

This letter is in response to your 16 April 2003 solicitation for ideas from stakeholders in conjunction with the State Corporation Commission (SCC) Report to the Legislative Transition Task Force (LTTF). Our comments will follow the format of the questions specified by the SCC solicitation.

1. What are the obstacles to the development of a robust competitive retail electricity market for residential customers? For commercial and industrial customers? How can these obstacles be overcome?

We believe that the most important factor is that Virginia enjoys relatively low prices for electricity in the existing monopoly market structure. This means that generation, transmission and distribution assets are generally adequate to meet customer demand and that they are generally operated efficiently. Just allowing these large companies to sell into each other's territories, without other changes from the existing pricing and distribution processes, leaves very little margin to compete on.

Compounding this situation is the authorization for incumbent utilities to recover a wires change. We believe that the recovery of stranded cost is appropriate but it should be for facilities investment and long term supply contracts that cannot be mitigated with reasonable efforts. It should not be a recovery of lost revenue. Considering the projection for shortages of supply over the next several years, we believe that any excess supply capacity could probably be sold on the wholesale market. If that is the case, what is actually stranded?

Even if the wires charge were to be reduced, its unpredictability creates an unnecessary high risk for competitors. Competitors cannot make price commitments to customers beyond the period of the existing wires charge rate. Customers are less likely to shift suppliers when the offer has a short horizon. Competitive markets, under the best of conditions, carry significant risks to the suppliers. Cost uncertainty is one of the biggest issues. The inability to realistically predict the wires charge is a serious obstacle.

Another major obstacle is the reluctance of customers to change. Regardless of the default service provisions, customers have a perception that there is some risk to the

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level of service, billing or customer service. In testimony to the Consumer Advisory Board, the Apartment and Building Owners Association explained the process they went through during the original pilot programs in evaluating potential vendors. The conclusion was that all venders except Dominion Retail had too high a perceived risk. This issue is reinforced when we look at the difficulty the long distance and local service telephone companies have had in prying customers away from AT&T and the Bell operating companies. We think the willingness to accept risk to service will be even harder to overcome in electricity than it is in telephone service. The subsequent success in long distance competition was enhanced because suppliers could get dramatically lower prices. This was not the result of competition per se but because of the huge over-expansion of broadband capacity that was installed to support corporate data transmissions and the Internet. This excess capacity drove prices down. We believe it is highly unlikely that a comparable over-capacity of electricity generation and transmission will facilitate similar price reductions for competitive suppliers of electricity.

We believe that, in the long run, competition will benefit the consumer by creating significant technological advances, new products, alternative rate options and a far more efficient overall industry. This will not suddenly spring up because competition is authorized. Just as the Federal Energy Regulatory Commission (FERC) Standard Market Design (SMD) is intended to correct transmission structural issues that have evolved under the existing industry structure, legislative and regulatory action may be needed to facilitate changes in the retail system. In an atmosphere of "deregulation", it is tempting to step back and assume that the free market will bring all these changes if we are simply patient. It appears to be contradictory to impose new regulations to replace old ones. But "if we don't know where we are going, any road will get us there." We believe that the LTTF, supported by the SCC, needs to create a vision of what new structures and options are desired in the electricity industry and to determine if legislation, regulation or incentives are appropriate to encourage the transition.

The Consumer Advisory Board recommended to the LTTF that an Energy Management Working Group be established to work on one aspect of this effort, demand side management. This is still needed and it is recommended that the SCC take a leadership role in pursuing that effort. Retail distributed generation, retail green power and retail clean power are examples of issues that should be addressed to identify a intermediate term vision of objectives for customer options and government action, if any, needed to facilitate that vision. We believe that these all will become key aspects for product differentiation in an emerging competitive market, especially demand response. These Virginia efforts should not be undertaken in isolation from similar activities underway elsewhere, such as the California demand response case and the PJM Working Groups.

2. With respect to potential obstacles, what is the outlook for future natural gas prices and the impact on wholesale electricity prices and a competitive retail market? Please comment on the postulation by several natural gas industry experts of a growing structural demand/supply imbalance with demand outstripping supply over the next several years. What actions, if any, could be taken to mitigate the potential impact of an over-dependence on a single fuel source?

We are aware of the projections for increases in natural gas prices. Most new generation that has been added recently has been fueled by natural gas. More importantly, the downgrading of utility debt and the economic downturn has combined to cause a drastic reduction in new generation construction. When the economy turns around, which we are confident will happen, it is highly likely that demand/supply imbalances can be expected. Demand can be expected to grow substantially faster than supply. If this combines with extremes in weather, serious shortage may occur. If this happens while we are still in the capped rate period, we could have a similar problem to the one that created massive financial losses for California utilities. The degree of risk of this event needs to be monitored closely be the SCC on an on-going basis.

Conceptually, assuming that Virginia utilities will ultimately become aligned with PJM, it is the responsibility of that organization to assure there are adequate generation and transmission resources. It could be years before the combination of federal legislation and wholesale industry restructuring makes this effective. In the meantime, the state needs to require default utilities to maintain adequate capacity and reserves, either by generation and transmission capacity or by demand response.

Demand response programs exist that are not promoted. Many small and medium-sized businesses are already billed on a demand basis in many jurisdictions but these customers generally do not understand demand. They do not understand that there are actions they can take to reduce their peaks demand. They do not understand how that impacts on their cost. They do not understand that there are products on the market that would assist them in demand response. They do not understand that there are rate options, in some cases, that the utility does not advise them of. In some cases, this extends to residential customers.

If the existing demand response programs for these customers are not effective in the view of the SCC or the incumbent utilities, a serious and high priority effort should be undertaken to change it. If that requires approval by the SCC of new demand response systems, with appropriate rate options specifically for that system, that should be permitted without creating a change to the capped rate structure for all other customers. We understand the reluctance to open a rate case that modifies the agreements to hold existing rates until 2007. At the same time, the urgency to create more effective demand response in the short-term requires some common-sense flexibility.

The utilities have directed most of their demand response efforts toward larger commercial and industrial customers. These customers can potentially drop substantial load and they generally have more technically competent managers. But these customers also have a more level load and there are adverse financial and operational consequences of dropping that load. Reliable participation by these users has been disappointing in most states. More importantly, these are generally not the customers that are creating the problem in the first place. The variation in demand from day to day and hour and hour is primarily the result of residential and small business users. There is extensive experience that these smaller customers will respond to price signals and that many of them desire options to help themselves save on energy costs. Existing programs require demand control action for over 2,000 hours a year, making it more difficult to minimize discomfort and inconvenience. Using 1999 wholesale prices as a measure of supply problems, prices per mWh exceeded $40 for less than 800 hours and exceeded $100 for only about 100 hours. During those 100 hours, prices reached almost $1,000 per mWh. A real-time communication system allowing TOU or critical peak pricing only when actually needed is feasible with today's technology and could help dramatically expand customer acceptance of demand response. Pricing options need to be coordinated to include both supply and distribution rates. The industry has failed to develop options for these customers that reconcile their own interests, their customer's interest and the interests of third party companies that facilitate customer demand response. Strong leadership from federal and state regulatory authority, seeking legislative action when necessary, is needed to change this. For example, Virginia Power is implementing a major Automated Meter Reading (AMR) Program. We believe that the SCC should evaluate the degree to which the selected approach and equipment might create a barrier to entry for new demand response initiatives. The feasibility and upgrade cost to accommodate likely real-time demand response programs should be a consideration in approval of such a program.

Notwithstanding the good intentions of establishing capped rates as a customer protection measure, this is essentially a price controls action. Historically, price controls have not worked in our economy. They impede investment in the quality and quantity of supply. We believe that having these price controls for such an extended period of time is a significant factor in restraining capacity growth.

3. In light of recent legislation, how can the Commonwealth be assured of a continuing reliable electricity system when control of transmission is governed by an RTO? What factors should be considered during the cost/benefit analysis required prior to the Commission approval?

We believe that local control acts to restrain investment by those that create the capacity that is needed to assure adequate supply. The best way to assure a reliable supply in the long run is to encourage a fully robust competitive national market, with adequate reserves of generation and transmission and with adequate reserves required by all participants. The default providers in the state must demonstrate that they have sufficient supply commitments to meet reasonable expectations of demand to an acceptable degree of reliability established by the SCC. There must be a serious financial penalty to any Competitive Service Provider (CSP) that fails to meet the demands of its customers. This penalty should provide part of the resources to reimburse default providers for their potentially excess commitments.

Reliable demand response should be equal in value to supply in meeting these reserve requirements.

Under the FERC proposal, the state is represented in many of the processes that impact this issue. How the state is represented, by whom and with what authority will be vital.

Ultimately, in a completely restructured wholesale and retail market, individual states will have less control over this than has been the case in the monopoly structure of the past. A decision to proceed with restructuring assumes acceptance of this fact.

4. Later this month, the Federal Energy Regulatory Commission (FERC) is expected to issue its "white paper" addressing certain issues debated the past several months regarding Wholesale Electric Standard Market Design (SMD). Additionally, the Department of Energy is expected to issue the results of its cost/benefit analysis of the impacts of SMD. Please provide your initial thoughts and reaction to such releases and identify any significant issues of concern.

We believe that the responsibility for having adequate supply available migrates to the RTO and its member companies. FERC proposes location marginal prices, or something that serves the same purpose, to drive financial consequences down to those causing the imbalance/congestion. The White Paper states, "Efficient market behavior depends heavily on assigning cost responsibility to those who cause the costs and the benefits to those who reduce costs." In the long term, this is an important and valid requirement to support a competitive market but it will not necessarily avoid short-term problems with serious consequences. We believe this can only be mitigated by requiring that sufficient supply and/or demand response be committed to by suppliers such that it motivates construction of the appropriate capacity or the developing and deploying of demand response systems. Financial penalties need to make failure to do this an unacceptable risk.

While FERC and PJM both appear to be strongly encouraging a demand response solution to help solve this problem and to make the industry more efficient, we do not see significant efforts by the individual utilities to respond.

The FERC SMD and federal legislation under consideration in the Congress are key steps in developing an effective competitive wholesale market. It is likely that approval and implementation of this design will take a number of years. In the meantime, the wholesale price risks to retail suppliers also is an obstacle to competitive retail markets.

5. Are the Commission's Rules Governing Retail Access to Competitive Energy Services conducive to promoting effective competition in the Commonwealth? If not, how should they be modified? Is there any way in which these rules can or should be improved, in any event?

We believe that the Rules do not promote or not promote competition. They are permissive in that they provide a structure for how the process works for a competitor to enter the market. The issues that impede development of the competitive market are not a result of these rules.

6. What should be the level of consumer education when the program is resumed on July 1, 2004? Should it be as visible, more visible or less visible than when the campaign was *suspended? Upon resumption of the campaign, what focus, theme or message should be communicated? Since TV advertising is the most expensive component of the program, what level of TV advertising should be included in the resumption of the campaign?*

The Consumer Education Program has been focused on simply advising customers that they have a choice. These customers then went through the very frustrating process of contacting a long list of licensed providers to learn that there are no offers. Even today, when customers inquire of Virginia Power about this programs, they are referred to the SCC website. After they call everyone on the list on that site, they learn that there are no offers. Almost every customer that contacts our company expresses anger and frustration that they have been sent by Virginia Power to a website list as if someone on that list would make them an offer. Local Distribution Companies (LDC) require CSPs to become licensed or registered by them. They can require that these companies advise if they are making offers and they can provide to customers making inquires a list of suppliers only if the are making offers. The SCC site should, likewise, be modified to show licensed companies and whether they are making offers. This requirement can be relaxed after there are numerous companies making offers.

The Customer Education Program should expand its charter to preparing customers for a competitive marketplace. The program should include education about default service, to overcome the concern about risk to service. The program should provide education about the need for and potential benefits of demand response. The purpose is to create a fertile potential customer base for such programs in the future, as well as for those that may exist today from their LDC. This type of education should be on going, regardless of the temporary lack of offers. In geographic areas where existing rates promote demand response, education for customers should include actions they can take to reduce their cost by taking demand reductions actions. We believe that the prospective reduction in the customer's cost for electricity that are likely due to the introduction of competition within the next five years is much smaller than the potential reduction in cost from simply better managing their demand, under either new or existing rates. This education would not only help prepare customers for the demand response programs expected to emerge, it would help to reduce the impact of demand/supply imbalances and to reduce the customer's cost of electricity in the short-term.

TV ads similar to the existing program for announcing choice should not be used until there are at least three suppliers already offering realistic competitive rate choices. Other education programs proposed above should be accomplished with significantly less expensive programs, such as by free brochures, speakers bureau, direct mail targeted to customers most likely to benefit, such as low load-factor businesses and large residential customers, bill stuffers and supplying information for media feature articles.

7. Are there any other actions that have been taken or are being considered in other states that may be used to advance competitive activity in Virginia?

Other states are pursuing the same type of demand response programs proposed herein. California has a Rule Making Case entitled Advanced Metering, Demand Response and

Dynamic Pricing. The situation in California is substantially different than Virginia but we believe that we share the goals of this case, to find cost-effective real-time demand response solutions for all customer classes.

In a May 2003 Draft Report by the Oregon Public Utility Commission entitled "Demand Response Programs for Oregon Utilities", the recommendations were:

"1. The utilities' Integrated Resources Plans (IRPs) should evaluate demand response programs on par with other options for meeting energy and capacity needs.

2. The utilities should bring forward by Sept. 30, 2003, for PUC's consideration at least one voluntary real-time hourly or critical-peak pricing tariff for nonresidential customers with demand of 200 kW or greater.

3. The utilities should bring forward by Sept. 30, 2003, for PUC's approval a program to expand their direct load control efforts for Oregon's small customers beginning January 2004. Programs should target time-of-use customers but allows others to participate. The utilities should also consider testing critical-peak pricing for time-of-use customers that choose utility load control.

4. The PUC should determine whether time-of-use energy rates should be adjusted and whether meter charges should be reduced.

5. The PUC should open an investigation to identify policies that facilitate the adoption of more advanced meters, communication technology and automated meter reading.

We believe that these recommendations should apply to Virginia was well.

Pennsylvania is planning random assignment of large blocks of customers to competitive suppliers as a means to jump-start the transition of residential customers. This approach was used in England.

Ohio and some other areas have encouraged municipal aggregation as a means of bringing large blocks of customers to competitive suppliers, significantly reducing the marketing cost that would otherwise be required to attract that many customers. Monitoring results in these programs over time and testing the concept here with Virginia Power's proposed pilot are appropriate. The fact that this is a pilot of limited duration may act as a restraint on attracting participants. It is also not yet clear whether the proposed reduction in the wires charge will be sufficient to attract multiple suppliers to bid for this business.

We understand that either the Ohio or Pennsylvania approach, or something like them, is be an effective way to migrate large numbers of customers that would otherwise ignore competitive offers. But the "opt-out" version essential represents a slamming program by the local government. It puts the government in the position of selecting a "one size fits all" offer. This contradicts our view of the true value of competition, as we have seen it in every other market. That is that competition creates a proliferation of options benefiting the widely different interests and goals of individual customers. The "opt-out" approach would represent an overwhelming barrier to entry for smaller competitors that want to market a unique feature or capability. The monopoly nature of the local government's role in these programs also creates a fertile ground for passing through local tax increases or other local government overhead expenses. Regardless of whether "opt-in" or "opt-out" is used, we believe that as the competitive market matures, these government aggregation approaches would no longer be needed and should be phased out. We believe that considerably more progress is needed in developing Virginia's wholesale competitive markets before these approaches should be seriously considered beyond pilot programs.

8. Do you have any ideas that have not been tried elsewhere that may facilitate competitive activity in Virginia?

There is nothing that hasn't been addressed in answers to previous questions.

We appreciate the opportunity to contribute our opinions to this very important process.

Jack Greenhalgh
President

PEPCO ENERGY SERVICES, INC.

**RESPONSE TO QUESTIONS
FROM THE STATE CORPORATION COMMISSION STAFF
ON COMPETITIVE ELECTRICITY MARKETS IN VIRGINIA**

Pepco Energy Services, Inc. ("PES") submits the following comments to questions posed by the Virginia State Corporation Commission Staff ("Staff") in its letter of April 16, 2003 seeking comments to assist the Virginia State Corporation Commission ("Commission") in its third annual review of means to facilitate effective competition in Virginia electricity markets.

PES is a licensed supplier of electricity in the Commonwealth and other states in the Mid-Atlantic region. In Virginia, PES is the only licensed competitive service provider ("CSP") currently serving residential customers. PES has experience with competitive retail markets in various jurisdictions and respectfully submits the following comments for the Commission's consideration.

Question 1:

What are the current obstacles to the development of a robust competitive retail electricity market for residential customers? For commercial and industrial customers? How can these obstacles be overcome?

The most significant obstacle to the development of a competitive retail market in Virginia for all customer classes is the artificially low price to compare ("PTC") set annually by the Commission on a customer class basis. As many parties to this discussion noted last year, use of wholesale market prices for calculation of the PTC establishes a benchmark that makes it all but impossible for competitive suppliers to enter and compete in Virginia markets and fails to further the intent of the Virginia Electric

Utility Restructuring Act ("the Restructuring Act") to foster retail competition. Projected market prices for generation used by the Commission to set wires charges—which, in turn, affect the calculation of the PTC (the wires charge and the PTC have an inverse relationship)--should reflect a retail market price rather than a wholesale market price.

For purposes of this discussion, PES defines "wholesale market price" as one that includes only costs associated with purchasing electricity to serve retail customers from the wholesale market. A retail market price would include a number of other costs that determine the end-use price of electricity, including the wholesale market price; billing, customer service, and general and administrative costs; and costs associated with credit worthiness, including bonding requirements established by both the Commission and incumbent utilities. Additionally, the retail price of electricity offered by a CSP includes customer acquisition costs and the retailer's margin. In sum, a retail market price concept includes all of the costs that a supplier must incur to serve customers. Use of wholesale market prices for setting the PTC makes it impossible, by definition, for CSPs to offer a retail price at or below the PTC.

The Restructuring Act supports use of this retail market price concept. Section 56-583(A) of the Restructuring Act states as follows:

> To provide the opportunity for competition and consistent with § 56-584, the Commission shall calculate wires charges for each incumbent electric utility, effective upon the commencement of customer choice, which shall be the excess, if any, of the incumbent electric utility's capped unbundled rates for generation over the projected market prices for generation, as determined by the Commission…. (§56-577 et seq. of the Code of Virginia, emphasis added.)

Given the range of costs that any supplier must incur, as discussed above, and the fact that the Restructuring Act is silent on whether wholesale or retail market prices are to be used when calculating projected market values for generation, PES believes that the only reasonable interpretation of the Restructuring Act is that retail market prices for generation should be used in the calculation of wires charges and, correspondingly, setting the PTC.

Several recent developments support the position that an unrealistic PTC is the single greatest barrier to competition in Virginia. In its recent filing for approval of retail access pilots, Dominion Virginia Power ("DVP") tacitly admits that CSPs cannot compete against current PTCs and that some action, namely a reduction or, in this case, a partial waiver, of the wires charge is necessary to promote competition:

> Importantly, with each of the Pilots, the Company is proposing to waive a portion of the wires charge for all participating customers in order to create additional "headroom" for CSPs to cover their costs of doing business and to offer savings to customers. (Section III, "Common Pilot Elements," page 9, line 8)

In seeking to create "headroom" for suppliers, DVP acknowledges the same point that PES made earlier—that a realistic PTC should include all supply costs, including the "costs of doing business," an item excluded from a PTC calculated from wholesale market prices.

PES intends to participate in the pilot programs and has been an active participant in preliminary meetings to discuss their development. We are hopeful but cautious, given that at the expiration of prior pilot programs competitive suppliers returned their customers to the incumbent utility due to the transition to an unrealistic standard for the calculation of the PTC. PES also notes that the PTC of the first pilot programs was three to four mills higher than the current pilot programs' projected PTC (after adjustments for the proposed 50% reduction in wires charges).

Recently, the Commission itself has begun to examine factors that influence calculation of the PTC. The Commission has initiated investigations into both standard offer service (also known as "default" service) and stranded costs. In the latter proceeding, the Commission is exploring methodologies for identifying stranded costs and actual calculation of a stranded cost amount. PES believes that a determination by the Commission of the total amount of stranded costs to be recovered by each utility and the specification of a transition period over which each incumbent will be permitted to recover its stranded costs will greatly enhance the current process for establishing PTCs.

With respect to remedies that will foster the development of competition in the commercial and industrial ("C&I") segments, PES supports proposals similar to those introduced earlier this year by Senator Watkins. While the Legislative Transition Task Force tabled discussion of the Watkins' proposals until a later date, PES encourages the Commission's consideration of similar measures. Specifically, the first proposal would have waived wires charges for C&I customers that switch to a competitive supplier, provided that the incumbent utility could charge market-based rates to any previously switched customers that return to default service. The second proposal eliminated minimum stay requirements for customers returning to default service, again with the provision that incumbent utilities could charge market-based rates to these customers. These proposals would encourage C&I customers to participate in the competitive market and allow incumbent utilities to be fully compensated, through market-based rates, for all costs incurred to serve those customers returning to the incumbent's service.

In summary, the use of wholesale market generation prices in the Commission's process for establishing the wires charge understates the PTC and results in three adverse consequences that unreasonably impede the development of competition in Virginia:

- CSPs are forced to compete in a retail environment against wholesale PTCs, establishing a *de facto* entry barrier for suppliers;

- Consumers are denied the economic and environmental benefits of a competitive market--electricity bill savings and innovation in energy services, respectively; and

- Overstated wires charges misallocate ratepayer resources, potentially rewarding incumbent utilities for costs that are not stranded.

Question 5:

Are the Commission's Rules Governing Retail Access to Competitive Energy Services conducive to promoting effective competition in the Commonwealth? If not, how should they be modified? Is there any way in which these rules can or should be improved, in any event?

As mentioned last year, PES has found the Commission's Rules Governing Retail Access to Competitive Energy to be a reasonable attempt to create a level playing field on which suppliers can compete. Certain steps should be taken, however, to improve the Rules in ways that will foster the growth of competition.

In 20 VAC 5-312-70(B), the Commission requires that suppliers

> [P]rovide to a prospective residential customer, by mail or by electronic means, prior to, or contemporaneously with, the written contract, an estimated electricity supply service or natural gas supply service annual bill assuming average monthly usage of 1,000 kWh of electricity or 7.5 Mcf or 75 therms of natural gas, including all fees and minimum or fixed charges, exclusive of any non-recurring financial incentives, and the total average price per kWh, Mcf, or therm based on the annual bill.

Based on PES' experience in serving residential electricity and natural gas customers in Virginia, customers sometimes find this information confusing for several reasons.

First, many residential customers are not accustomed to thinking about their energy bills on an annual basis and therefore do not have a reference for comparison when provided the information required by the regulations. Second, most customers' usage is not "average." Customers with significantly higher usage may find that the estimated cost of service looks like a bargain while the low usage customers may think they are not getting a very good deal.

Even if a customer uses the annual average amount of electricity, that consumption is not evenly distributed throughout the year. If pricing is seasonally differentiated, then a customer with heavy summer usage and gas heat will have an annual cost that is quite different from a customer with electric heat and lower summer usage. As a consequence, the average cost per kWh calculation requirement may not be reflective of the customer's usage pattern.

Finally, average cost is not directly comparable to the average PTC that the incumbent utility provides and which is based on actual usage. In short, the use of a generic average cost, either on an annual basis or on a $/kWh basis, is often confusing and in many cases misleading.

April 22, 2003

David R. Eichenlaub
State Corporation Commission
1300 E. Main Street
Richmond, VA 23218

Mr. Eichenlaub,

On April 16, 2003 you issued a solicitation of "ideas from stakeholders" in preparation for the State Corporation Commission's annual report on the status of competition. Strategic Energy is a competitive service provider active in seven states, currently serving over 3,000 MW of retail load. Strategic Energy appreciates the opportunity to provide comments for the Commission's report, and will participate in the informal discussions on June 6, 2003. Below are the initial responses of Strategic Energy.

1. What are the current obstacles to the development of a robust competitive retail electricity market for residential customers? For commercial and industrial customers? How can these obstacles be overcome?

   Strategic Energy's target market is Commercial and Industrial (C&I) customers, therefore, we will limit our comments to those customer classes. The current obstacles to serving C&I customers in Virginia are largely due to the stranded cost recovery mechanism in place. As the stranded cost methodology allows most Virginia utilities to charge any retail access customer for its total lost revenue, there is little or no opportunity to offer customers a discount on the utilities rate. The wires charge roughly equals the difference between the revenues that the utility expects to receive from the customers, minus the spot market price in PJM west. This will ensure that the wires charge overstates the stranded cost of the utility because it assumes the minimum value for energy in the wholesale market (spot prices reflect short-run marginal cost, and not the long-run value of energy delivery service) and no cost avoidance from losing a customer. For some customers with flexible production processes or demand response capabilities it might still be possible to provide added value (and thereby get a customer to switch) even with the wires charge penalty. However, because Virginia does not belong to a Regional Transmission Organization, and therefore lacks an active bilateral market and a balancing energy market, there is little or no opportunity to offer value-added services.

Given the provisions of the Restructuring Act there may be little that the Commission can do on the retail rate structure. The Commission can review the calculation of the wires charge to determine whether utilities are over-collecting stranded costs, and lower the wires charge if appropriate. The Commission should also develop a methodology for fixing the wires charge so that consumers can better evaluate the potential costs and benefits of switching to a competitive supplier. The Commission should also actively promote a process either having Virginia utilities join an active RTO (such as PJM) or create a Virginia RTO.

2. With respect to potential obstacles, what is the outlook for future natural gas prices and the impact on wholesale electricity prices and a competitive retail market? Please comment on the postulation by several natural gas industry experts of a growing structural demand/supply imbalance with demand outstripping supply over the next several years. What actions, if any, could be taken to mitigate the potential impact of an over-dependence on a single fuel source?

   Future natural gas prices are unpredictable, as the price swing in the past four years are shown. However, there are valid reasons for assuming that natural gas supplies will not keep pace with demand in the long-run as domestic resource continue to be depleted. Strategic Energy firmly believes that the market is best able to determine the appropriate fuel mix, as fuel cost and reliability are key components to planning and new generation. However, market forces can sometimes be distorted by regulatory overlays, and the Commission should take care that regulation does not overly promote one technology or one fuel source to the detriment of reliability. One example of a distorting regulatory overlay is the resource adequacy mechanism used by PJM. The Installed Capacity or "ICAP" requirement in this control areas is designed to subsidize all generation, irrespective of fuel type. The nature of this subsidy provides an incentive for building the least-capital intensive resources (i.e. low capital costs with high energy costs). While firmly believing that Virginia should join the PJM RTO, and adopt the PJM energy market rules, Strategic Energy strongly recommends that the Commission consider adopting an alternate resource adequacy mechanism. The alternate is to adopt the ECAR/MidWest ISO reserves-based reliability mechanism. In addition the Commission should with a resource adequacy mechanism that can directly invest in new resources in the event of a market failure. By direct investment in new resources the Commission can place requirements on the new resource, including fuel-source, to ensure that an appropriate level of fuel diversity can be maintained.

3. In light of recent legislation, how can the Commonwealth be assured of a continuing reliable electricity system when control of transmission is governed by an RTO? What factors should be considered during the cost/benefit analysis required prior to Commission approval?

   A robust energy market for Virginia's consumers is highly dependent upon transmission assets being placed under the control of an Independent System Operator, or a Regional Transmission Organization ("RTO"). The purpose of an RTO is to maximize consumer welfare by eliminating the discriminatory behavior that is endemic of transmission systems where the system operator has business interests in the wholesale and retail markets. Furthermore, by joining a larger RTO, Virginia will become more firmly a part of a larger planning process to ensure reliability. Larger control areas not only create more robust markets, but improve reliability by better the coordinating the use of transmission facilities. It is worth noting that the creation of larger, multi-state control areas such as PJM was prompted by the need to reduce the threat to reliability inherent when interconnected transmission operators do not adequately coordinate dispatch. The economic benefits of centralized dispatch and open access to the transmission system came later.

4. Later this month, the Federal Energy Regulatory Commission is expected to issue its "white paper" addressing certain issues debated the past several months regarding Wholesale Electric Standard Market Design (SMD). Additionally, the Department of Energy is expected to issue the results of its cost/benefit analyses of the impacts of SMD. Please provide your initial thoughts and reaction to such releases and identify any significant issues of concern.

   The FERC's white paper on SMD is aimed at eliminating, as much as possible, lingering discrimination in access to the nation's transmission system, and at providing some market standardization to reduce the transaction costs and increase the liquidity of the wholesale energy market. All consumers will benefit from a reduction in discrimination and transaction costs. Strategic Energy will wait until it has seen the white paper before identifying specific "significant issues of concern."

5. Are the Commission's Rules Governing Retail Access to Competitive Energy Services conducive to promoting effective competition in the Commonwealth? If not, how should they be modified? Is there any way in which these rules can or should be improved, in any event?

   The Rules Governing Retail Access are generally similar to rules that are in jurisdictions where retail markets are active and do not impose a substantial barrier to competition. The extent to which the rules will need to be modified will largely be determined after retail competition becomes active in Virginia.

6. What should be the level of consumer education when the program is resumed on July 1, 2004? Should it be as visible, more visible or less visible than when the campaign was suspended? Upon resumption of the campaign, what focus, theme or message should be communicated? Since TV advertising is the most expensive component of the program, what level of TV advertising should be included in the resumption of the campaign?

   Resuming a consumer education program while competitive suppliers are kept out of the market by the wires charge will only create unrealistic consumer expectations.

7. Are there any other actions that have been taken or are being considered in other states that may be used to advance competitive activity in Virginia?

   Strategic Energy recommends that the Commission research the rules and regulations governing retail competition in Texas. Texas retail competition began on January 1, 2002, and already approximately 30% of all customer load is served by alternative suppliers. Strategic Energy believes much of the success in Texas is because the default rates in Texas are market-based. The Price to Beat (default rate available to customers with a peak demand less than 1 MW) in Texas can be adjusted up to twice a year to reflect an increase or decrease in natural gas or electricity prices. This adjustment mechanism provides alternative suppliers a greater opportunity to compete by preventing the default rate from becoming a below cost rate. The Texas structure also promotes competition by requiring all customers over 1 MW to negotiate contracts for competitively priced electricity. Finally, Texas created a solid foundation for competition by requiring vertically integrated investor-owned utilities to structurally unbundled generation, retail services, and transmission and distribution functions into separate corporations. The transmission and distribution utility in Texas is truly a "wires" only company specifically prohibited from providing generation service with a strong code of conduct that governs the relationship between the utility and its affiliates.

   Strategic Energy also recommends that the Commission consider the rules and regulations for Default Service in New Jersey (Basic Generation Service) and Maryland (Standard Offer Service.) These states are also providing a variable rate Default Service for the largest customers, and a more stable, market-rate service for smaller commercial residential customers. These states are not requiring the level of utility restructuring as in Texas, but are adopting measures that will also promote robust competition.

8. Do you have any ideas that have not been tried elsewhere that may facilitate competitive activity in Virginia?

   Not at this time.

Respectfully Submitted,

-/s/-

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May 13, 2003

Mr. Howard M. Spinner (attn: Mr. Dave Eichenlaub)
Division of Economics and Finance, SCC

Dear Mr. Spinner:

Your letter of April 16 asks for comments in connection with upcoming 3d Annual Report to the Legislative Transition Task Force (LTTF), pursuant to Sect. 56-596 B. The report is expected to cover three topics. As one of the very limited voices on behalf of the general public, I submit my comments and recommendations, as follows:

(A) In spite of my extensive involvement in this subject for over 2 years in the General Assembly, and in the hearings before the SCC in the Dominion Virginia Power case, I am not able to provide in depth comment on the several issues raised in your letter, but will do my best..

It should be recognized that the general public cannot deal with the simple aspects of electric deregulation and Choice, much less with the technical issues such as wires charges, stranded costs, etc. which are far more complex.

Most of the impetus, and emphasis, and the Stakeholders, in deregulation arise from the desire of the utilities to sell their power generated in Virginia to consumers in other areas who are now paying higher rates than we do in Virginia, and to avoid their obligation to their present customers, and from the desires of larger industrial interests to benefit from possible lower rates.. The proposed protections of the public are inadequate !!! (See my response to Mr. Williams, of last June 15, 2002, copy attached, which remains appropriate.)

We need to stop deregulation, and rebundle and roll-back to the fully regulated status. The details and views set forth in the large 2 Vol. Annual Report of the SCC last Aug. 30, and in the Blue Cover report as per SB 684 dated Nov. 30, 2002, and in the Addendum (yellow cover) report filed Jan 3, 2003, are strong supporting reasons, and have been further reinforced by subsequent events and information.

(B) Reponding specifically to the questions raised in your letter of April 16, as follows:

(1) The current obstacles to development of a robust (or any) competitive retail electricity market for Virginia residential customers are that we now have low rates, good service, and a fine prosperous major power company (Dominion). The only way this can be overcome is to increase the amount that Virginia residential users have to pay for electricity !!

(2) Natural gas prices are probably going to stay relatively high, and that fuel is of greater importance for home heating and other uses. Large use for electric generation, and other heavy industrial purposes should be discouraged. We should promote increased use of neuclear, coal, and water power, and perhaps oil, for electric generation.

(3) The only way we can be assured of reliable generating capacity for Virginia residents is for the SCC to have full regulatory control, as it had for about 100 years.

(4) FERC has apparently issued its paper, and I am not able to find any assurance of protection of the Virginia general public. What I have read increased my concern !!!

(5) The Commission's rules governing retail access are not doing any good. They are too complicated for the public to handle. The way to improve the rules is to eliminate the need for them, by stopping deregulation.

(6) The consumer education program has been almost a total waste, and the public has paid no attention to the material which they have been receiving for about 2 years. The program should be stopped, or largely curtailed, until there is some real lower cost "Choice" available to the general public.

(7) I have not heard of any other successful deregulation programs in any state. I have read that legislators in California are proposing to stop deregulation and go back to the old system.

(8) I have no suggestions to facilitate competitive activity in Virginia.

I will try to attend the meeting at 9:30 on June 6.

Respectfully yours,

Urchie B. Ellis,
Va. State Bar No. 5422

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June 15, 2002

Mr. Richard J. Williams, Director
Division of Economics and Finance, SCC

Thank you for your letter of June 12, attaching copy of your letter of April 24 which went to many parties interested in electric deregulation, but somehow seems to have missed the public and consumer interests (somehow I was left out even thought I played a major part in the recent Dominion Virginia Power case, and in hearings at the General Assembly the past 2 years). I am glad your procedure will admit further comments, and hope you have notified other possible public consumer interests.

I have reviewed the April 24 letter, and seen several of the extensive replies by major business representatives---e.g. Delmarva, Pepco, Virginia Power, and the Coops.

My comments are as follows:

(1) Most of the questions, and the responses, are concerned with details to benefit the utilities and independent generators, and there is little to reflect concern for the public interest. Even though I have had heavy involvement in the subject, most of the questions and responses are too complicated for me to understand or to deal with. I urge that another list of questions be sent out which ask for comments and suggestions to adequately protect the public in Virginia to ensure that we have adequate, easily available electric power at low rates and with great reliability, and with a minimum of confusion or literature to read and understand. The list should go to many public entities, and a good sample of residential and small business consumers for a broad response.

The language from Sect. 56-596B quoted in the April 24 letter directs that the SCC report have recommendations "in the public interest". Developments in the past year around the U.S. in connection with electric deregulation demonstate that the "public interest" needs greater SCC regulation and supervision, not less. The underlying concept of the Task Force, and the deregulation law to date has been to benefit the utilities, and to allow them to sell their Virginia generated power to consumers in other areas of the U.S. who would pay more for it----and the proposed arrangements thus far have imposed nearly all of the serious risk on the residential consumer and small business in Virginia. The SCC recommendation "in the public interest" should be for a 5 year moratorium, and any needed reregulation, to preserve the status quo to allow us to see what happens elsewhere.

SOME OF THE SPECIFIC QUESTIONS PERMIT RESPONSE, AS FOLLOWS

1. The major obstacle to development of a robust competitive retail electricity market retail residential customers in Virginia is the fact that we now have low rates and good service. No residential customer wants any change. We want the SCC to continue to have full authority to supervise electricity and regulate rates and service. Deregulation only serves the purposes of the

utilities, who have developed trading floors and want to sell their generated power elsewhere for higher revenues, and be relieved of most of their obligations to the Virginia public!!!

2. and 3. deal with RTOs and transmission service, and are too complicated for me to try to comment, and are of little importance to the residents of Virginia. for the reasons stated in No.1

4. The SCC rules are too complicated, and the public cannot understand or deal with them. I suspect that few, if any , of the Task Force Committee, or the General Assembly, can understand the several pamplets and various notices on CHOICE, etc. and admit that I cannot, and I am sure that few residential consumers have even read them. We need the SCC.

5. In the light of the many complications that have arisen around the U.S. and with several of the power trading companies, it is clear that Virginia "public interest" requires a 5 year moratorium.

6, 7, 8, 9, are too complicated, but in general we need steps to protect the public, not the utilities, because the whole program and the details are not working, and are too complicated for the public to understand and deal with.

10---14 are too complicated for me to try to deal with, except to urge that rate caps need to be kept low and not exceed current rates in Virginia, and we should stick with SCC regulation.

15, 16 Some other states are not progressing deregulation, and that is the pattern Virginia should follow. Nothing will facilitate competitive activity in Virginia because we now have low rates and good service.

I hope these comments will be useful, and I will supplement them by reference to my letters of Nov. 27, 2001, and Dec. 24, 2001, to the Task Force, where I urged a moratorium!!!

Respectfully yours,

Urchie B. Ellis
Virginia State Bar No. 5422

May 20, 2003

By E-mail and U.S. Mail

David R. Eichenlaub
Assistant Director, Economics
Division of Economics and Finance
State Corporation Commission
1300 East Main Street
Richmond, VA 23218

Re: Comments on Topics to be Addressed in Third Annual Report to LTTF

Dear Mr. Eichenlaub:

These comments are submitted by the Municipal Electric Power Association of Virginia ("MEPAV") in response to your letter of April 16, 2003 to Market Participants soliciting ideas to assist the Commission in developing a comprehensive review of methods that may be considered to facilitate effective competition.

MEPAV is an organization formed to meet the needs of its members by providing information, support and group advocacy on legislative and regulatory issues for the 16 localities that operate electric distribution utilities in the Commonwealth:

City of Bedford
Town of Blackstone
City of Bristol
Town of Culpeper
City of Danville
Town of Elkton
City of Franklin
Town of Front Royal
Harrisonburg Electric Commission
City of Manassas
City of Martinsville
City of Radford
Town of Richlands
City of Salem
Virginia Polytechnic Institute & State University
Town of Wakefield

MEPAV has been active in the electric restructuring legislative process in Virginia. In addition, MEPAV's members have participated in a coalition representing transmission dependent utilities that has participated in working group committees and stakeholder meetings in connection with RTOs and other forms of RTEs which have included the investor-owned utilities that provide transmission service in Virginia and has also participated in related proceedings at the Federal Energy Regulation Commission ("FERC"). In addition, all but one are members of the Transmission Access Policy Study Group ("TAPS"), an organization of transmission dependent utilities in 33 states across the U.S. that has participated actively in FERC rulemaking proceedings regarding transmission issues. Although some of the 16 MEPAV localities own and operate generation, none has sufficient generation to meet its total loads. Thus, all must purchase their energy needs from the wholesale market and are dependent on the transmission systems of others to get the energy from the suppliers' resources to their systems.

Because MEPAV's members are wholesale electric customers of their suppliers, the rates they pay for purchases of power supply are either regulated by FERC (or are not regulated) and the rates and service conditions for transmission and related services they receive are subject to FERC regulation, these comments will focus on the third and fourth items for which you have sought input.

MEPAV's members have supported the development of independent RTOs of sufficient size and scope to provide benefits to consumers and have been supportive of the concept of Standard Market Design for wholesale electric markets. MEPAV's members have actively participated before FERC as members of a coalition of transmission dependent utilities (currently called the "Coalition of Municipal and Cooperative Users of New PJM Companies' Transmission") and through TAPS in proceedings raising substantial issues with respect to specific RTE proposals and particular elements of SMD. With respect to FERC's orders dealing with RTEs, MEPAV has been pleased with much of what FERC has done, but has been disappointed in other respects. Our principal disappointment has been with FERC's past attitude of giving great deference to each utility's decision on which RTE to join and FERC's unwillingness previously to consider whether a particular RTE selection was the optimal selection. MEPAV supported the 2003 amendments to Sections 56-577 and 56-579 of the Virginia Electric Restructuring Act as related to regional transmission entities. Particularly important to MEPAV are the provisions of Sections 579.A.2.d and 579.F. The first requires that the Commission, in developing rules and regulations for the transfer of control, ownership or responsibility to an RTE that generally promote the public interest, ensure that consumers' needs for economic and reliable transmission are met. The second is the requirement that the Commission find that any request for approval of transfer of ownership or control of or responsibility for transmission facilities shall include a study of the comparative costs and benefits thereof, which study shall analyze the economic effects of the transfer on consumers, including the effects of transmission congestion costs.

MEPAV is cautiously optimistic as a result of FERC's April 28, 2003 White Paper on Wholesale Power Market Platform that FERC will be receptive to considering costs and benefits in evaluating regional transmission entity issues and that it will consider the interests of all market participants in market design.

MEPAV believes that the transmission owners' selection regarding participation in an RTE should have the principal objective of maximizing the benefits to all consumers, including providing the lowest cost of energy delivered to its customers on a reliable basis. In general, MEPAV believes that consumer benefits will be maximized by the RTE selection that is most conducive to creating a robustly competitive market for energy in which all load-serving entities may participate. However, the ultimate criterion must be the delivered cost of reliable power supplies to all retail customers, including the customers served by transmission dependent utilities such as MEPAV's members.

Among the questions that should be addressed by an incumbent electric utility in a request for approval of transfer of ownership or control of or responsibility for transmission facilities are the following:

- What is the "natural market" of which the utility considers itself a part? What is the basis for that view?
- What are the predominant patterns of historical energy trade in which the utility has participated?
- What are the utility's strongest interconnections with adjacent systems?
- Does the utility agree that benefit to customers should be the principal criterion for evaluating its RTE-participation alternatives? If not, what other standard(s) does the utility believe are more important than benefit to customers?
- What measures does the utility believe it should put in place to ensure that customers are protected from any adverse economic impact of RTE participation?
- What analyses has the utility performed to evaluate and compare the economic impacts on retail and wholesale customers of its participation in various RTEs? What did those analyses show?
- What analysis has the utility made comparing the costs of entry it would incur to join each of the RTEs in which participation was considered? If so, what does that analysis show?
- Has the utility analyzed the costs that would ultimately be borne by ratepayers under each of the alternative RTE-participation options that were considered? What does that analysis show?

- Has the utility conducted any analysis of its system to determine whether its system is well-suited to the application of market rules of the RTE it proposes to join? What does the analysis show?
- Has the utility compared the impact that participation in various RTEs would have on the transmission congestion costs incurred by the utility and transmission dependent utilities located within their transmission systems? Has the utility analyzed whether participation in one RTE or another would be more likely to lead to an increase in transmission congestion costs? If so, what do these analyses show?
- Has the utility analyzed the additional transmission expansion or other alternatives required to fully integrate the utility into the RTE it proposes to join without incurring significant congestion costs.
- If PJM is the RTE the utility proposes to join, does the utility agree that the PJM pricing model should be modified to resolve the problem of high prices in load pockets? What modifications does the utility believe should be adopted to hold its transmission dependent utility customers as "cost neutral" as possible?
- If the utility were to join PJM, would it be willing to cooperate with stakeholders to seek resolution of the problems that have arisen under PJM's pricing approach within transmission-constrained areas?
- Is the utility willing to commit to absorbing any congestion-related costs of serving transmission dependent utilities if those costs are incurred as a result of joining PJM?
- What does the utility consider to be the most significant "seams" issues between RTEs?
- Among the RTE-participation options open to the utility, which option does the utility believe is most conducive to minimizing seams issues? What is the basis for that belief?

As the Commission is aware, the cost of congestion that Old Dominion Electric Cooperative ("ODEC") and other transmission dependent utilities experienced in the Delmarva Peninsula under PJM's system of locational marginal pricing and fixed transmission rights was a major factor driving the 2003 legislation. As reflected in many of the above questions, MEPAV is concerned that the experience in assigning congestion costs in the Delmarva Peninsula not be repeated in other areas. Part of the potential problem arises from the fact that the existing transmission systems of utilities were not planned or constructed under an LMP/FTR regime, but one in which costs were socialized over a broad area. It is important that any shift to a new cost allocation and pricing regime be attentive to this problem and adapt to it, such as by providing a sufficiently long transition period, to avoid hardship on particular customers and a pricing scheme that does not penalize or unduly burden customers located in load pockets. MEPAV also believes that an equitable allocation of FTRs, rather than an auction, is necessary and most equitable for those utilities who have had and will continue to have an obligation to serve the loads they now serve.

We note that FERC on May 12 established a fact-finding proceeding to be facilitated by an administrative law judge concerning transmission congestion in the Delmarva Peninsula (Docket No. PA03-12-000). MEPAV regards this as a favorable indication that FERC recognizes the problem that has been faced by ODEC and other customers on the Delmarva Peninsula and may be willing to deal with those problems more proactively than it has in the past. The information to be developed by the Commission in its cost/benefit analysis may interface well with the FERC fact finding proceeding.

MEPAV appreciates the opportunity to present its views on matters on which you have sought input.

Sincerely yours,

Allen Todd
President

NATIONAL ENERGY MARKETERS ASSOCIATION

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May 23, 2003

Dave Eichenlaub
Assistant Director, Economics
Virginia State Corporation Commission
Division of Economics and Finance
Tyler Building
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Dear Mr. Eichenlaub:

The National Energy Marketers Association (NEM) hereby submits comments pursuant to the April 16, 2003, letter that posed questions related to: 1) the status of competition in Virginia; 2) the status of the development of regional competitive markets; and 3) recommendations to facilitate effective competition in the Commonwealth.

The National Energy Marketers Association (NEM) is a national, non-profit trade association representing wholesale and retail marketers of energy, telecom and financial-related products, services, information and related technologies throughout the United States, Canada and the U.K. NEM's Membership includes wholesale and retail suppliers of electricity and natural gas, independent power producers, suppliers of distributed generation, energy brokers, power traders, and electronic trading exchanges, advanced metering and load management firms, billing and information technology providers, credit, risk management and financial services firms, software developers, clean coal technology firms as well as energy-related telecom, broadband and internet companies.

This regionally diverse, broad-based coalition of energy, financial services and technology firms has come together under NEM's auspices to forge consensus and to help resolve as many issues as possible that would delay competition. NEM members urge lawmakers and regulators to implement:

- Laws and regulations that open markets for natural gas and electricity in a competitively neutral fashion that bring suppliers and consumers together at the lowest possible cost;
- Standards rates, tariffs, taxes and operating procedures that unbundle competitive services from monopoly services and encourage true competition on the basis of price, quality of service and provision of value-added services;
- Accounting and disclosure standards to promote the proper valuation of energy assets, equity securities and forward energy contracts, including derivatives; and
- Policies that encourage investments in new technologies, including the integration of energy, telecom, digital communications and Internet services to lower the cost of energy and related services.

1. **What are the current obstacles to the development of a robust competitive retail electricity market for residential customers? For commercial and industrial customers? How can these obstacles be overcome?**

The most significant obstacles to the development of a robust competitive retail electric market in Virginia are the current artificial price caps and the existing wires charge. Lifting price caps and allowing consumers to see and respond to changing prices for energy and related energy services, information and technology is critical. Finally, the removal, or at a minimum, a revision in the methodology for the calculation and assessment of the wires charge is also necessary for the development of the Virginia retail market. Stranded costs should be collected in a competitively neutral manner to foster competition.

A. Price Caps Impede the Development of a Robust Competitive Retail Electricity Market

Price caps do not facilitate energy competition and do not permit consumers to modify their consumption levels in response to price. Utility pricing mechanisms must reflect changes in wholesale prices and the true costs of serving retail load. NEM is cognizant of the concern that consumers should be protected from erratic price swings and the ability to mange price risks and offer fixed or variable priced contracts should be a competitively offered retail product. If utility consumers are permitted to respond to accurate pricing signals they could adjust their consumption thereby lessening the impact of price spikes or choose competitive offerings from alternative suppliers.

NEM submits that capped utility rates do not reflect the fully embedded costs of serving retail load and undermine the ability of competitive suppliers to invest in serving Virginia consumers. Staff, in its May 2003 Report in Case No. 2002-00645, stated that there is substantial uncertainty as to the feasibility of an entity other than the incumbent utility providing default service until the end of the capped rate period. The Report indicated that a factor contributing to its view was the current capped rate and wires charge structure that severely undermines competitive pricing. NEM urges the Commission to open the market for default service because requiring the utilities to provide default service at capped or artificially subsidized rates sends distorted and normally cross-subsidized price signals to consumers. NEM submits that it is the structure of Virginia's energy market and not current marketer competence that is restricting marketers from supplying these services. Marketers have the ability and experience to supply default services to customers. Marketers have long been involved in developing and aggregating generation and providing utilities with energy related services and technologies. In many cases, marketers have supplied utilities with energy and related services on an outsourced basis for years.. Consequently, marketers have the ability to provide default service and should be allowed the opportunity to do so in the Commonwealth.

If the Commission decides that the utilities should continue to provide default service, the requirements of section 56-585(C)(1) that, "the rates for default service provided by a distributor shall equal the capped rates" until the expiration or termination of capped rates, presents a significant obstacle for the market. As has been evidenced by lackluster customer participation in choice programs in the state, the capped rates instituted for the utilities have stifled competition. Capped rates are set artificially low and competitive suppliers cannot offer competitive prices when utility offered competitive services are cross-subsidized. Additionally, since capped rates do not change to reflect changes in the wholesale market or the added costs of serving last minute, no notice default services, there is little opportunity for retail suppliers to compete on the basis of price or quality of service provided. Default service pricing mechanisms that allow prices to change over time in response to wholesale market conditions as well as the true costs of delivering "last resort," no notice default retail services better reflect real competitive markets, provide more accurate price signals, and help level the competitive retail playing field.

The provision of default service based on capped or subsidized rates will not foster the development of the competitive market. If the Commission mandates the selection of the incumbent utility for all customers who fail to make timely supplier elections and sets a non-competitive price for no notice default service, it will create a significant barrier to new suppliers while perpetuating the same non-competitive energy services that restructuring is designed to replace.

B. <u>Wires Charge Must be Competitively Neutral</u>

NEM submits that the wires charge is a significant barrier to entry in the Virginia market. The manner in which the wires charge is calculated and implemented makes it virtually impossible for competitive suppliers to compete with the utilities. NEM recognizes that the recovery of prudently incurred and aggressively mitigated stranded costs is a valid concern for the utilities. However, NEM urges that a competitively neutral means of collecting stranded costs should be instituted. NEM recommends that any costs that are unavoidable because utilities must incur such costs to perform Provider of Last Resort (POLR)-related services should be recovered through adjustments to the rates charged for POLR related services. Any costs and/or lost revenues not connected with the utilities' provision of POLR-related services and fully bundled sales service should be added to distribution rates in a competitively neutral fashion.

NEM is encouraged by the current proposal to allow large commercial and industrial (C&I) customers who are willing to commit to market-based pricing, should they ever return to the incumbent utility, to switch to a competitive supplier without having to pay a wires charge. NEM encourages Virginia legislators to propose the required amendment to the Restructuring Act to allow large customers the ability to avoid a wires charge and receive the benefits of competition.

True price competition benefits all customers; not just those who shop for lower prices. The first and foremost benefit provided is the economic stimulus provided by economically efficient competitively priced energy as well as the ability to exercise choice beyond the regulated service they have traditionally received. Imposing a wires charge on switching customers is unfair and unwise because it penalizes those customers who attempt to lower their energy costs and defeats the entire purpose of permitting price competition in the first instance. If a charge applicable only to retail access customers is set too high, no one will be able to participate in the market. Assessment of stranded cost charges only against retail access customers will not only punish migrating customers, thereby slowing migration and the development of functional retail markets, but it will also encourage utilities to continue to invest in competitive services thereby further increasing future potentially "stranded" costs. In the end, society will pay a far higher transition cost the longer utilities provide competitive services.[1]

2. With respect to potential obstacles, what is the outlook for future natural gas prices and the impact on wholesale electricity prices and a competitive retail market? Please comment on the postulation by several natural gas industry experts of a growing structural demand/supply imbalance with demand outstripping supply over the next several years. What actions, if any, could be taken to mitigate the potential impact of an over-dependence on a single fuel source?

NEM is aware of the current projections for higher natural gas prices and their potential impact on gas fired generation. However, government intervention or mandates as to fuel sources have normally had unintended significant adverse impacts. Promoting a competitive energy market in Virginia will help to mitigate the potential impact of higher fuel prices by permitting customers to see and select the lowest cost alternative supplies including properly priced demand reduction, load shifting and energy efficiency products and services. . Additionally, in markets that are open to competition, "green suppliers" have entered the market to provide renewable energy to customers who desire this niche product. Customer demand should determine the types and varieties of competitively provided products, services, information, and technology offered in the Virginia marketplace. NEM recognizes that some consumers will be interested in reducing demand or purchasing power from green sources, and the market should give them both the opportunity and accurate price signals to do so. NEM urges the SCC to avoid costly mandates on competitive suppliers (such as mandatory renewable portfolio standards) that could impede the growth of competition and consumer choice.

Additionally, retail competition will allow customers to shift the risk of higher gas prices on to competitive service providers who are in a position to better manage the risk. Without retail access, bundled utility customers are bearing the risk and cost of higher gas prices through fuel adjustment clauses or other mechanisms imposed to take the risk off of the utility.

3. In light of recent legislation, how can the Commonwealth be assured of a continuing reliable electricity system when control of transmission is governed by an RTO? What factors should be considered during the cost/benefit analysis required prior to Commission approval?

RTO membership effectively addresses reliability concerns. When the transmission network is operated regionally under independent management, without financial conflicts of interest among the owners of affected transmission, distribution, and generation assets, operational decisions can be made solely upon operational considerations. NEM urges the Commission to require the utilities to transfer control of their transmission systems to an RTO as soon as possible in light of FERC's White Paper on a Wholesale Power Market Platform, which proposes mandatory RTO membership.

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[1] See Also, NEM's Initial Comments In the Matter of Developing Consensus Recommendations on Stranded Costs, PUE-2003-00062, www.energymarketers.com/documents/NEM_stranded_cost_cmts_final.pdf

An accurate cost/benefit analysis of RTO membership should recognize that a key element in linking geographically separate electricity markets is the integrity of the transmission network. A RTO operated transmission network facilitates the movement of bulk power transactions to ensure reliability, economic efficiency and market liquidity. Given the current commercial bottlenecks in transmission service, transmission owners should be monitored to avoid the use of these constraints unfairly as market power to their own financial advantage. The Commission can also consider incentive based rates to accelerate recovery of investments made to eliminate congestion.

4. **Later this month, the Federal Energy Regulatory Commission is expected to issue its "white paper" addressing certain issues debated the past several months regarding Wholesale Electric Standard Market Design (SMD). Additionally, the Department of Energy is expected to issue the results of its cost/benefit analyses of the impacts of SMD. Please provide your initial thoughts and reaction to such releases and identify any significant issues of concern.**

NEM is concerned that without nationwide standards for data exchange, ATC determinations, delivery terms, operating procedures and practices, interconnection standards, etc., the full value to consumers of true price competition will be harder to achieve. NEM believes that the following steps should be part of any plan to restructure the U.S. energy markets:

- **Uniform, national technology standards** can and should be implemented as soon as possible.
- **Transparent, auditable, transactional price data must be available on an equal, non-discriminatory basis to all market participants**.
- **All electricity should be treated as native load.**
- **Regions and utilities must eliminate seams** that are created by differences in information and operating standards and protocols.
- **Wholesale generators, marketers and traders must know precisely what practices are proscribed before, not after, transactions are completed.**
- **Local distribution rates must be unbundled to permit consumers to see the actual, fully allocated, embedded costs they are paying for each element of bundled utility service or default services.**
- **Consumers must be empowered to use these embedded costs as credits against their utility bills to shop for competitive supplies and services.**
- **Utilities must be incented to outsource competitive services and to reinvest in upgrading infrastructure, delivery services and reduced congestion.**
- **Lastly, energy efficiency and demand side resources must be priced competitively.**

5. **Are the Commission's Rules Governing Retail Access to Competitive Energy Services conducive to promoting effective competition in the Commonwealth? If not, how should they be modified? Is there any way in which these rules can or should be improved, in any event?**

The Commission's rules governing the various aspects of retail access to competitive energy service should be adjusted as described below to more effectively promote competition in Virginia.

A. <u>Default Service Should Be Priced To Reflect The Fully Embedded Costs of Serving No-Notice Retail Load</u>

Default energy suppliers must stand ready to serve any customer, new or old, at any time, twenty-four hours a day, seven days a week, 365 days a year without any advanced notice. This is an important obligation and it requires a number of important assets and supplier skill sets. However, such no no-notice service is far more expensive than other types of service and it is critical that consumers understand and see the real costs of relying on no-notice default service.

The pricing of default service is also critically important to the development of a competitive market because the default price serves as the "price to compare" - the target against which all competitive offers are judged by consumers. Therefore, default service should be priced to reflect the fully allocated embedded costs associated with no notice retail related services for each customer class. If a subsidized or artificially low rate is set, true competition will not develop. NEM submits that default pricing for electricity should at a minimum include transmission charges, scheduling and control area services, and distribution system line losses, a share of pool operating expenses, risk management premiums, load shape costs, commodity acquisition and portfolio management, working capital, taxes, administrative and general expenses, the costs of metering, billing, collections, bad debt, information exchange, compliance with consumer protection regulations, and customer care.

NEM submits that if a bid process is properly structured it could encourage a competitive market. NEM believes that bids should not be based solely on the wholesale price of the energy commodity. NEM submits that bids should include all of the energy supply and related costs plus all the commercial costs of rendering this type of service. NEM urges the SCC to design a bid process that selects suppliers to directly serve retail customers because implementation of a bid system for wholesale contracts will not contribute to the ultimate development of a competitive retail market. Under a wholesale only bid process consumers will be unaware of the competitive suppliers serving their supply needs and prevent direct supplier-customer relationships which are vital to building brand awareness.

Additionally, the Commission should allow alternative suppliers to provide default service as soon as reasonably practicable and convert the utilities' obligation to serve into an obligation to deliver.[2]

B. <u>Competitive Advanced Metering Should Be Instituted for All Customers As Soon As Practicable</u>

[2] <u>See</u> NEM's Answer to Question 1, Paragraph A, and NEM's National Guidelines for Designing and Pricing Default Energy and Related Services, http://www.energymarketers.com/Documents/FinalDefaultPaper.pdf

The Commission issued an order in Case No. PUE 010298 on Aug 19, 2002, approving rules regarding competitive electricity metering services for the elements of meter data availability and accessibility effective January 1, 2003. The Commission is currently considering proposed rules regarding financial ownership of meters by large C&I customers. The Commission stated in its December 10, 2002 Order on Electricity Metering, that it is premature to develop rules for additional elements of competitive metering, beyond meter ownership for large customers, at this time. NEM agrees that the opening of customer choice in metering services depends on the operational readiness of the associated support systems. However, NEM submits that affordable advanced metering and related information technologies are currently available to bring consumers and small businesses the benefits of advanced real-time data collection and energy supply and cost management.

The competitive unbundling of advanced metering and related technologies will enable efficient management of both energy supply and demand through timely, accurate dissemination of critical real-time energy usage information. Additionally, advanced meters will permit suppliers to more accurately match supplies to meet demand and avoid imbalance penalties ultimately reducing costs and bringing customers savings on their energy bills. Therefore, NEM urges the SCC to implement a timeline, which provides utilities with targeted, time-sensitive, performance-based incentives to implement the operational systems necessary to support competitive metering so the benefits of these upgrades can be realized at the earliest possible date.

C. Competitive Billing Should Be Implemented As Soon As Practicable

Competitive Service Provider (CSP) consolidated billing, was scheduled by the Act to become effective January 1, 2003. The Commission's August 21, 2002, Order adopted final rules to govern the implementation and provision of CSP consolidated billing. With respect to implementation, the Commission has accepted an interim system workaround approach that will be replaced with standardized business practices and EDI protocols as the competitive market develops and the volume of competitive billing increases.

NEM submits that CSP consolidated billing should be implemented as soon as reasonably practicable. Encouraging the development of a competitive market for billing services will allow competitive marketers to provide consumers with enhanced, value-added services. Suppliers should be able to present bills in order for consumers to have better access to innovative product offerings. It normally is not possible for CSPs to provide many of these choices to consumers when the LDC presents the bill. Without the option for suppliers to present bills to consumers, consumers are prevented from enjoying these innovative possibilities in product choice.

Billing is an important point of contact for a CSP because it enables the supplier to promote and market its energy services. Inasmuch as consumers cannot choose their distribution company, billing simply does not serve the same function for the regulated utilities. Therefore, NEM urges the SCC to fully implement the provisions of CSP consolidated billing at the earliest possible date.

D. Minimum Stay Requirement Should Be Eliminated

Under the Commission's current regulations, customers with a demand of 500 kW or higher are subject to a twelve-month minimum stay period upon returning to their incumbent utilities for capped rate service after receiving service from an alternative supplier. NEM asserts that minimum stay requirements unnecessarily restrict customers from exercising the option to choose another supplier. NEM urges the Commission to eliminate the minimum stay requirement for all customer classes. NEM is encouraged by the current proposal to eliminate the minimum stay requirement for returning customers that agree to purchase electric energy at market based rates from the incumbent electric utility.

6. What should be the level of consumer education when the program is resumed on July 1, 2004? Should it be as visible, more visible or less visible than when the campaign was suspended? Upon resumption of the campaign, what focus, theme or message should be communicated? Since TV advertising is the most expensive component of the program, what level of TV advertising should be included in the resumption of the campaign?

Consumer education about customer choice is an invaluable component of implementing successful choice programs. NEM submits that upon implementation of the recommendations set forth in NEM's responses to foster market development, customer education initiatives must be redoubled to overcome customer inertia that may have developed due to lack of initial competitive offerings because of current market structure and conditions.

NEM submits that an appropriate message to promote the competitive energy market is that in every market that has opened for competition and provided customers with choice, consumers have received the benefits of lower prices and access to innovative new offerings of products, services, information and technology.[3] NEM urges the Commission to work with NEM and the marketer community to fashion an effective, accurate and competitively neutral public educational message.

7. Are there any other actions that have been taken or are being considered in other states that may be used to advance competitive activity in Virginia?

NEM urges the SCC to implement innovative programs similar to the ones Orange and Rockland Utility (O&R) is using to stimulate competition in New York. O&R customers have switched at nearly four times the statewide average switch rate for residential gas customers. A significant reason for this level of activity is their Switch and Save Program. Under this program the utility actively solicits customers to volunteer for the program and guarantees them a certain percentage of savings over the utility commodity price for two months. O&R assigns the customers to an Energy Supply Company (ESCO) on the basis of the ESCO's program participation level. The customers in the program can switch to another ESCO or back to utility commodity service after the two months if they so choose. ESCOs have been able to continue delivering savings to

[3] See Text for NEM's Ad, "ABCs of Energy Competition, Attached as Exhibit A.

customers after the initial two-month period. The Switch and Save program has proven to be highly effective for customers and participating ESCOs.

Another innovative program O&R uses is its guaranteed payment for ESCO services. Except for O&R, other New York utilities have opted to allocate customer payments to their receivables before the ESCOs. The result has been the streaming of nearly all bad debt related to serving energy choice customers to the ESCOs. Bad debt rates among ESCOs in excess of 10% have been common and have made the business environment in New York State very expensive while the ESCO's ability to provide savings to customers has been severely damaged. However, ESCOs participating in the O&R program have a bad debt rate of 0%. Since O&R's delivery service rates include an allowance for bad debt on commodity service, the utility is at no more risk for non payment from ESCO commodity service customers than for customers receiving utility commodity service. In effect, O&R is not harmed from a bad debt perspective by migration of customers to energy choice. On the other hand, most other utilities are benefiting to some degree by collecting an allowance for ESCO commodity bad debt while they have no exposure.

NEM encourages the SCC to incorporate innovative programs, similar to the ones O&R uses, to facilitate competition in the Commonwealth.

Conclusion

NEM appreciates this opportunity to comment on the facilitation of effective retail electric competition in Virginia and reiterates our commitment to working with the Commission and the other stakeholders to devise fair and effective ways to implement competitive restructuring in the state.

Sincerely,

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Dated: May 23, 2003.

EXHIBIT A

Choice - In every market that has opened for competition and provided consumers with a choice, consumers have received the benefits of lower prices and access to innovative new offerings of products, services, information and technology.

Offerings - There are a host of energy information and technology providers that have developed products such as real-time meters, home control systems and distributed generation that allow consumers to control the amount of energy they use so they can control how much they pay.

Monopoly - Monopoly pricing is never lower than competitive pricing. It's just that simple.

Price Reduction - It is estimated that wholesale power markets are already saving customers $13 billion per year. As a result of federal legislation and regulation opening wholesale gas markets, the price of natural gas to LDCs and large industrial consumers declined on average by as much as 50%. In Texas, it is estimated that retail customers have saved, at a minimum, over $1.5 billion in electricity costs during the first year of competition as compared to the regulated rates in effect during 2001. In Pennsylvania, it is estimated that consumers have saved $3.8 billion from rate reductions since the beginning of the electric choice program in 1997 through 2001. In Massachusetts, since the passage of the electric restructuring law in 1996, the retail price of electricity for commercial customers has dropped 12%.

Energy - Energy is the lifeblood of the economy. All consumers benefit when competitive forces are brought to bear on energy prices.

Technology - When competitive forces enter energy markets, it results in an array of technological advances.

Innovation - Real-time meters are the "cash registers" of the new energy economy. Distributed generation is the portable, cost-effective "cell phone" of the emerging energy industry.

Time-of-Use - New time-of-use offerings give customers control over their bill by allowing them to vary their usage based on rate differentials throughout the day.

Information - New energy services provide consumers with the information they need to take control of their energy bill.

Options - As more alternative energy suppliers enter the market, competition will be enhanced to provide consumers with better price and service options.

New Jobs - Lower energy prices offered by competitive suppliers permit states to attract new businesses, increasing job opportunities and state tax revenues.

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May 28, 2003

David M. Eichenlaub
Division of Economics and Finance
State Corporation Commission
1300 East Main Street
Richmond, VA 23219

Re: Comments Concerning the Status of Competition -- Compliance by the State Corporation Commission with § 56-596.B of the Code of Virginia

Dear Mr. Eichenlaub:

Thank you for your letter of April 16, 2003, requesting comments on various topics pursuant to Virginia Code § 56-596.B relating to the status of competition in Virginia.[1] We respond on behalf of the Virginia Committee for Fair Utility Rates and the Old Dominion Committee for Fair Utility Rates (collectively, "the Committees"), which consist of large industrial customers of Virginia Power and AEP-Virginia, respectively. The Committees have a vital interest in the development of competition in Virginia and in the region.

I. INTRODUCTION

In Virginia at present, retail competition for generation services essentially does not exist. With the exception of a miniscule number of customers that purchase power at above-market rates from a competitive service provider ("CSP") that has stopped offering the service to new customers, there is no retail competition at all. Thus, in terms of the existence of retail competition, little, if anything, has changed since last year, when, in response to the Commission's inquiry into the status of competition, the Committees submitted comments, dated May 28, 2002 ("Committees' 2002 Comments"), that offered a number of suggested remedies for the dearth of retail competition in Virginia. The chart below summarizes key suggestions in those comments and their subsequent disposition.

[1] Section 56-596.B of Virginia's Electric Utility Restructuring Act ("Restructuring Act"), Va. Code § 56-596.B, requires the Commission to recommend actions to be taken by the General Assembly, the Commission, electric utilities, suppliers, generators, distributors and regional transmission entities that the Commission considers to be in the public interest, including actions regarding the supply and demand balance for generation services, new and existing generation capacity, transmission constraints, market power, suppliers licensed and operating in the Commonwealth, and the shared or joint use of generation sites.

COMMITTEES' PROPOSALS	DISPOSITION
***Wires Charges.* Remedy the lack of headroom for customers of Virginia Power by reconsidering the legal conclusions on which the present methodology for the calculation of wires charges is based.** **Adopt a new methodology using projected retail market prices for generation.**	The SCC reiterated its prior legal conclusion in its report to the General Assembly, dated August 30, 2002 ("2002 Report"), and, in its Final Order in the wires charges case, dated October 11, 2002.[2] In the latter order, the SCC declined to adopt a new methodology that uses projected retail market prices for generation.
***Wires Charges.* If, upon reconsideration, the SCC reached the same legal conclusions, it should recommend to the General Assembly amendment of the Restructuring Act to clarify that its discretion in determining the projected market price of generation is not constrained by the goal of achieving "revenue neutrality."**	The SCC declined to make such a recommendation in its 2002 Report. The SCC recommended in the 2002 Report that the General Assembly consider amending the Act to allow a large commercial or industrial customer that is willing to commit to market-based pricing should it ever return to its incumbent utility, the ability to switch to a CSP without paying a wires charge.[3] (Legislation, SB 891, subsequently was introduced in the General Assembly but did not pass.)
***Wires Charges.* Deny requests by utilities to subtract from the Commission's projected market prices for generation the cost of transmission that could have been avoided if they had joined or established a regional transmission organization ("RTO" or "RTE).**	The SCC denied AEP-Virginia's request on other grounds but granted Virginia Power's request for a transmission cost adjustment. Neither utility has joined or established an RTO.[4] (The General Assembly later amended the

[2] *Commonwealth of Virginia at the Relation of the State Corporation Commission Ex Parte: In the matter of considering requirements relating to wires charges pursuant to the Virginia Electric Utility Restructuring Act*, SCC Case No. PUE-2001-00306 ("Wires Charges Case"), Final Order, dated October 11, 2002, at 5, 6; 2002 Report at 20-23.
[3] 2002 Report at 65.
[4] Wires Charges Case, Final Order, dated October 11, 2002, at 22.

	Restructuring Act to prohibit utilities from transferring control of transmission assets to an RTO prior to July 1, 2004.)
***Alleged Stranded Costs.* Analyze whether the existence and amount of "just and reasonable net stranded costs" warrant the recovery of such costs through wires charges.**	The LTTF adopted a resolution requesting the Commission to establish and convene a work group to develop "consensus" recommendations among interested persons regarding a definition of just and reasonable net stranded costs and methodologies for their calculation and recovery; however, utility members of the work group have urged, in essence, that neither just and reasonable net stranded costs nor their recovery under capped rates and wires charges be estimated.
***RTOs.* Consider instituting show-cause hearings to require compliance by Virginia Power and Appalachian Power Company with their obligations, as incumbent electric utilities under the Restructuring Act, to join or establish a regional transmission "entity" on or before January 1, 2001.**	The SCC recommended, in a supplement to the 2002 Report, that the General Assembly decide promptly whether to proceed with or delay implementation of the Act (including retail customer choice), citing the FERC's proposed standard market design ("SMD") rulemaking, worsening financial distress among utilities subject to restructuring, merchant generators, and competitive retail suppliers, as well as the lack of development of retail electric choice in the U.S., including Virginia. The General Assembly enacted HB 2453, which, *inter alia*, eliminated the January 1, 2001, deadline and prohibited utilities from transferring control of transmission to an RTO prior to July 1, 2004.
***Fuel.* To ensure that CSPs have sufficient advance knowledge of the "price to beat," establish fuel factors and wires charges well in advance of September 1 of each year.**	The 2002 Report does not propose to change the schedule for establishing fuel factors and wires charges, and the SCC has not adopted any changes in the schedule previously adopted in its wires charges and fuel factor orders.[5]

[5] Id., Final Order, dated November 19, 2001, at 27; Final Order, dated October 11, 2002, at 13; 2002 Report at 24 (explaining that the annual July 1 filing date for fuel factor applications and applications for wires charges for utilities wishing to impose them is to allow wires charges determinations to be "finalized" in October).

***Fuel.* Discontinue annual re-calculation of fuel factors and wires charges; consider fixing them for two or three years.**	While acknowledging that the proposal "may have merit," the 2002 Report stated that "it is unclear" that the proposal would "accomplish the goal of advancing competition" and further stated that legislation "appeared" to be required to allow a fuel factor to be set for more than one year.[6] The SCC in its order authorizing Virginia Power's 2003 fuel factor later rejected a proposal to "freeze" Virginia Power's fuel factor stating that the proceeding "did not encompass the notice required by § 56-249.6 prior to dispensing with the adjustable fuel factor"; however, the SCC noted that "such a fixed fuel factor may have certain merits, including increased judicial economies, changed incentives on the part of DVP, and increased electricity cost certainty for customers during the freeze period. As such we remain open to proposals of this nature."[7]
***Fuel.* Consider time-of-use fuel factors – *e.g.*, fuel factors that would vary by season – as an alternative to the use of single fuel factor as a means of "matching" more closely wholesale and retail prices, allowing CSPs more opportunities because their headroom during each season would be more closely tied to the wholesale market.**	The 2002 stated that the SCC "stands ready to investigate reasonable proposals that may provide improved regulated price signals," and it noted that, in a recent order, it encouraged a work group assisting Staff to study the possibility of utilities establishing (and/or expanding) voluntary time-of-use rate programs.[8]

[6] 2002 Report at 25. The report quotes from the provisions of Va. Code § 56-249.6, which requires each utility that purchases fuel for generation of electricity to submit to the Commission its estimate of fuel costs for the twelve-month period beginning on the date prescribed by the Commission and requires the Commission, upon investigation, to direct each company to put in place tariff provisions designed to recover the fuel costs determined by the Commission to be "reasonable for that period …" *But see* Va. Code § 56-582.B, which authorizes the Commission, "[n]otwithstanding § 56-249.6," to "authorize tariffs that include incentives designed to encourage an incumbent electric utility to reduce its fuel costs by permitting retention of a portion of cost savings resulting from fuel cost reductions or *by other methods determined by the Commission to be fair and reasonable to the utility and its customers*." (Emphasis added.)

[7] *Application of Virginia Electric and Power Company to revise its fuel factor pursuant to Va. Code § 56-249.6*, SCC Case No. PUE-2002-00377, Order Establishing 2003 Fuel Factor, dated October 16, 2002, at 5.

[8] 2002 Report at 42. The SCC also noted that it would be hesitant to reallocate fuel cost responsibility among rate classes in light of the Restructuring Act's capped rate provisions.

***Transmission.* Obtain data on transmission constraints and load pockets for Virginia's utilities.**	The 2002 Report stated that, in accordance with § 56-578 G of the Restructuring Act, the SCC "would be responsible for monitoring market power over the sale of electric generating capacity or energy to retail customers." It noted, however, that, "to the extent that market power is exercised by a generating facility dispatching into a wholesale market, the mitigation of that market power will likely be the responsibility of the" FERC.[9] The Report stated that the SCC "will perform its statutory obligations under § 56-578 G with respect to market power exercised in Virginia's retail markets. In doing so, it might retain the use of a consultant." The 2002 Report also described the Energy Infrastructure Study underway pursuant to Senate Bill 684, which was enacted in the 2002 Session of the General Assembly and which required the SCC to convene a work group to "…study the feasibility, effectiveness, and value …" of collecting information relative to energy infrastructure facilities, including electric transmission facilities.[10] The SCC's report of November 20, 2002, to the LTTF, submitted pursuant to SB 684, stated that "given the ongoing evolution of the electric utility industry and potential for significant jurisdictional shifts relative to the oversight of Virginia's generation/transmission reliability, it is "difficult to make absolute statements as to the *value/effectiveness* of collecting this information."[11] The report further stated that "basic information" relative to *generation* adequacy could be collected;

[9] 2002 Report at 64.
[10] Id., at 56.
[11] *Report to the Legislation Transition Task Force of the Virginia General Assembly: The Feasibility, Effectiveness, and Value of Collecting Data Pertaining to Virginia's Energy Infrastructure Pursuant to Senate Bill 6684 Enacted by the 2002 Session of the General Assembly of Virginia, dated November 20, 2002*, at 17.

	[d]ata relative to transmission facilities could also be provided if the need for more detailed information arises." The report stated that this "flexible approach may be more practical in the current environment and would certainly be less burdensome to those entities providing the information."
Minimum Stay. **Permit customers that shop and return to the incumbent to pay the incumbent a market-based price, instead of capped rates, upon return in order to avoid the 12-month minimum stay requirement.**	The 2002 Report agreed that the proposal has merit, concluded that legislation may be required to implement it, and recommended that the General Assembly consider whether an amendment is needed to permit it.[12] (Legislation, SB 892, subsequently was introduced in the General Assembly but did not pass.)
Demand side options. **Permit customers to receive, on a voluntary basis, more accurate price signals so that they may adjust their demand accordingly and receive market-based compensation for doing so.**	The 2002 Report does not adopt the recommendation.
Generation. **Grant expeditious and favorable treatment to applications for the construction of new generation that will assist in the development of competition.**	The 2002 Report reviews the signing of the memorandum of agreement between the SCC and the Department of Environmental Quality regarding coordination of reviews of the environmental impact of electric generating plants and associated facilities. Since the report, the SCC has issued a number of orders approving the construction of additional generation in Virginia.[13]

[12] Report at 26, 65.

[13] See, for example, *Application CPV Cunningham Creek, LLC, For a certificate of convenience and necessity pursuant to Va. Code § 56-265.2 for an exemption from Chapter 10 of Title 56, and for interim authority to make financial expenditures*, SCC Case No. PUE-2001-00477, Final Order, dated October 7, 2002; *Application of Tenaska Virginia II Partners, L.P., For a certificate of convenience and necessity pursuant to Va. Code § 56-265.2, an exemption from Chapter 10 of Title 56, and interim approval to make financial commitments and undertake preliminary construction work*, SCC Case No. PUE-2001-00429, Final Order, dated January 9, 2003; *Application of CPV Warren, LLC, for a certificate of convenience and necessity for electric generation in Warren County, Virginia*, SCC Case No. PUE-2002- 00075, Final Order, dated March 13, 2003.

II. COMMENTS AND RESPONSES TO QUESTIONS

We address below the questions posed in your letter that appear to be of particular importance to the Committees.

1. ***What are the current obstacles to the development of a robust competitive retail electricity market for residential customers? For commercial and industrial customers? How can these obstacles be overcome?***

As indicated, the Committees' 2002 Comments identified and discussed key obstacles to the development of a robust competitive retail electricity market in Virginia. Obstacles included the lack of "headroom" for CSPs, transmission constraints, the adequacy of generation not owned by incumbents, and the lack of a regional transmission entity ("RTE" or "RTO"). Such obstacles remain. As indicated above, the Committees' 2002 Comments suggested a number of remedies for alleviating or removing them. With the possible exceptions of the working group on stranded costs, commenced pursuant to the LTTF's resolution of January 27, 2003, which has begun investigating that subject, and the recent orders granting approval to the construction of generation, none of the suggested remedies has been implemented.

Importantly, the Committees' 2002 Comments contended that the current methodology for the calculation of wires charges represents a significant obstacle for Virginia Power's customers and that that methodology is flawed because it requires would-be competitors to provide generation at retail prices significantly below prevailing wholesale prices. The comments urged the Commission to reconsider the legal conclusions on which the present methodology is based and adopt a new approach that would permit competition to develop.

In the Commission's 2002 Report, and in its Final Order, dated October 11, 2002, in the Wires Charges Case, the Commission reiterated its prior position that "revenue neutrality" is intended by the Act. Accordingly, it has left the current methodology essentially undisturbed.

The Committees recommended in their 2002 comments that if upon reconsideration the Commission reached the same legal conclusion, it should recommend amending the Restructuring Act to clarify that its discretion in determining the projected price of generation is not constrained by the goal of achieving "revenue neutrality." The Commission's 2002 Report, however, did not include such a recommendation. The Report instead suggested that wires charges be eliminated for large customers willing to forego their current right to return to the incumbent's capped rates upon terminating service with a competitive supplier. While the Commission's recommendation, if adopted, probably would have improved the outlook for competitive entry, no such legislation was enacted.

In a supplement to its 2002 Report, the Commission recommended that a decision by policymakers be made on whether customer choice should be suspended, along with Virginia utilities' then-existing obligations to join regional transmission entities. While the General

Assembly did not suspend customers' right to choose under the Restructuring Act, it did enact House Bill 2453, which amended the Act, among other things, by (i) eliminating the January 1, 2001, deadline by which incumbent electric utilities with transmission capacity were to join or establish an RTO; (ii) prohibiting such utilities from transferring ownership or control of, or operational responsibility over, any transmission system to any person prior to July 1, 2004; and (iii) modifying the standards to be applied by the Commission in approving such transfers.

Enactment of HB 2453 may delay RTO membership for Virginia utilities that have not already joined an RTO; it is unlikely to hasten the development of competition. Recommendations for suspension of customer choice will not do so. In sum, with the major obstacles identified by the Committees still in place, with few efforts underway to alleviate or remove them, and with enactment of HB 2453 and proposals for suspending the right to choose, the present absence of retail competition is likely to continue.

2. ***With respect to potential obstacles, what is the outlook for future natural gas prices and the impact on wholesale electricity prices and a competitive retail market? Please comment on the postulation by several natural gas industry experts of a growing structural demand/supply imbalance with demand outstripping supply over the next several years. What actions, if any, could be taken to mitigate the potential impact of an over-dependence on a single fuel source?***

The Committees have not prepared a projection of future natural gas prices; however, they are acutely aware of the recent increases and the views of some observers that a structural change in the natural gas market has occurred such that higher-than-historic prices can be expected in the future. Virginia's Restructuring Act does not provide for a remedy, other than market forces, for over-dependence upon a single fuel source.

3. ***In light of recent legislation, how can the Commonwealth be assured of a continuing reliable electricity system when control of transmission is governed by an RTO? What factors should be considered during the cost/benefit analysis required prior to Commission approval?***

The new Virginia legislation, House Bill 2453, requires the Commission to develop rules under which incumbent electric utilities owning, operating, controlling, or having an entitlement to transmission capacity in Virginia, may transfer control or ownership to an RTO upon such terms and conditions that the Commission determines are consistent with, among other things, "ensuring that consumers' needs for economic and reliable transmission are met."[14] The Commission's procedural order in response to AEP-Virginia's application to join the PJM

[14] Va. Code § 56-579.A.2.d.(i)

includes a number of requirements that address reliability issues.[15] The order also contains specific requirements for a cost/benefit analysis. The order represents a good start in fulfilling the Commission's revised responsibilities under the new legislation.

As a general matter, membership in an RTO should enhance reliability by easing access to generation sources across an entire region. For that reason, among others, utilities' membership in RTOs has been an important element in Virginia's Restructuring Act.[16]

4. ***Later this month, the Federal Energy Regulatory Commission is expected to issue its "white paper" addressing certain issues debated the past several months regarding Wholesale Electric Standard Market Design (SMD). Additionally, the Department of Energy is expected to issue the results of its cost/benefit analyses of the impacts of SMD. Please provide your initial thoughts and reaction to such releases and identify any significant issues of concern.***

The Committees have not taken a position on the recent "white paper" or reviewed the Department of Energy analysis.

5. ***Are the Commission's Rules Governing Retail Access to Competitive Energy Services conducive to promoting effective competition in the Commonwealth? If not, how should they be modified? Is there any way in which these rules can or should be improved, in any event?***

The Committees have no suggestions at this time for changes in the Commission's Rules Governing Retail Access to Competitive Energy Services.

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[15] *Commonwealth of Virginia At the Relation of the State Corporation Commission Ex Parte: In the matter concerning the application of Appalachian Power Company (d/b/a American Electric Power – Virginia) for approval of a plan to transfer functional and operational control of certain transmission facilities to a regional transmission entity*, SCC Case No. PUE-2000-00550, Order for Notice, dated March 7, 2003, at 11; *see also*, 20VAC5-320-40.

[16] We note that the Federal Energy Regulatory Commission's ("FERC's") recently issued "white paper" in its standard market design rulemaking proceeding addressed resource adequacy and transmission planning. It states that "nothing in the Final Rule will change state authority over these matters [referring to resource adequacy requirement and the regional transmission planning requirement in the proposed standard market design]." *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design*, FERC Docket No. RM01-12-000, White Paper, Wholesale Power Market Platform, issued April 28, 2003, at http://www.ferc.gov. According to the white paper, the RTO or ISO may implement a resource adequacy program "only where a state (or states) asks it to do so, or where a state does not act." (Id.) The white paper states that RTOs and ISOs will be directed to develop a periodic regional transmission plan *for submission to relevant state and local siting authorities* and *to assist* states in whatever manner they desire, including evaluating the impact of new generation, transmission, energy efficiency and demand response on regional reliability and resources adequacy. (Id.) (Emphasis added.)

6. ***What should be the level of consumer education when the program is resumed on July 1, 2004? Should it be as visible, more visible or less visible than when the campaign was suspended? Upon resumption of the campaign, what focus, theme or message should be communicated? Since TV advertising is the most expensive component of the program, what level of TV advertising should be included in the resumption of the campaign?***

The Committees recommend that the consumer education program be less visible until competitive entry of retail suppliers has real prospects to develop in Virginia. No such prospects exist today.

7. ***Are there any other actions that have been taken or are being considered in other states that may be used to advance competitive activity in Virginia?***

See the Committees' response to question 1.

8. ***Do you have any ideas that have not been tried elsewhere that may facilitate competitive activity in Virginia?***

See the Committees' response to question 1.

III. CONCLUSION

The Committees appreciate the opportunity to comment, and they look forward to continuing to assist the Commission in its response to the mandate contained in Va. Code § 56-596.B.

Sincerely,

Louis R. Monacell

Louis R. Monacell

Edward L. Petrini

#637394

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May 23, 2003

Mr. David R. Eichenlaub
Assistant Director, Economics
State Corporation Commission
Division of Economics and Finance
1300 E. Main Street
Richmond, VA 23218

VIA EMAIL

Dear Mr. Eichenlaub:

The comments of Virginia Energy Providers Association (VEPA) in response to your letter of April 16, 2003 follow.

In addition, we do plan to attend the June 6th informal discussion on the development of competition.

Very truly yours,

/s/ /s/

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Comments of Virginia Energy Providers Association (VEPA)

May 23, 2003

VEPA continues to observe that the most significant obstacle to the development of robust competition in Virginia is the delay of Virginia's incumbent electric utilities in gaining state approval to join an approved Regional Transmission Organization (RTO) to serve wholesale markets, ultimately to the benefit of retail customers. Without the participation of Virginia's incumbent utilities in a fully functioning, truly independent, unbiased regional transmission organization, effective wholesale competition can not develop. And without effective wholesale competition, retail competition is impossible.

Since the Commission's last annual report on competition, a vigorous national debate has occurred involving the Federal Energy Regulatory Commission's (FERC) proposed Standardized Market Design (SMD). FERC's vision of SMD is to encourage electric utilities to combine their high-voltage transmission systems into regional and super-regional power grids operating with standardized rules and procedures. FERC's proposed rules, however, generated considerable opposition from some Western and Southern states, leading FERC to announce recently that it will wait until after the federal Congress adopts pending energy legislation before finalizing its SMD approach.

VEPA's primary suggestion, therefore, is for the SCC to work cooperatively with neighboring states in the region and with FERC to resolve all issues in dispute, so that a satisfactory market design can be agreed to, leading to the entry of our incumbent utilities into regional transmission organizations as quickly as possible. This approach, reflected in FERC's recent "White Paper," can be used to address state and regional issues and to provide additional local implementation flexibility, where necessary.

Particularly important is the need for FERC and the states to work cooperatively to establish clear and definite agreements on jurisdictional responsibilities, so that wholesale restructuring under federal supervision and retail policies of the states are coordinated to yield clear benefits to wholesale and retail customers. RTOs with responsibility for administering both transmission service and standard market rules within regions are necessary to support the investment in and provision of efficient and advanced electric infrastructure and services, efficient development and use of energy resources, and lowest cost of supply to consumers in the long run.

VEPA urges the Commission and the Commonwealth to support development of a standard market design in Virginia and this region that includes the following elements, at a minimum:

- A congestion management system using both day-ahead and real-time Locational Marginal Prices (LMPs) and financial congestion charges.

- Flexible financial tools which allow hedging of day-ahead congestion charges, and a mechanism for getting those tools into the hands of market participants in order to promote an open, transparent and liquid market.
- Stable capacity requirements to assure the existence of reliable levels of capacity over the long run.
- Economically efficient demand response programs in all appropriate markets.

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