PART III

RECOMMENDATIONS TO FACILITATE EFFECTIVE COMPETITION IN THE COMMONWEALTH

PART III

Recommendations to Facilitate Effective Competition in the Commonwealth

Part III of the Report includes a discussion of comments advanced by various stakeholders as a means of facilitating effective competition in the Commonwealth and the SCC's continued actions to implement the elements of the Restructuring Act as soon as practicable.

To assist development of a comprehensive list of recommendations to foster effective competition, on April 26, 2004, the Staff sent a letter electronically to 81 interested stakeholders seeking their suggestions and posted such letter to the Commission's website. Although the Staff's distribution list targeted stakeholders thought most affected by electric restructuring issues, it received only eight responses, included as Appendix III-A to this Report. It should be noted that two of these responses were joint comments submitted on behalf of several parties, thus representing suggestions from a total of 15 entities. In a similar survey conducted in 2003, the SCC received twelve such responses.

The Commission appreciates the input it received from those respondents that responded. Although we would have preferred a larger number of participants, we did receive the thoughts of a reasonable cross-section of stakeholders: utilities, competitive service providers, aggregators, consumer representatives, and business associations.

Generally, most of the comments received are similar to those expressed in last year's report and reiterated during the past year via various forums. Respondents' recommendations, generally discussed below, do not provide new ideas as they have already been considered, or are currently under consideration, by the SCC and the EURC.

The majority of the respondents continue to believe that the major obstacles to effective competition in Virginia include the lack of a fully functional RTO and competitive markets, as well as legislative and regulatory uncertainty. Other major issues mentioned include the existence and method of determining wires charges, the recovery of yet-to-be-quantified stranded costs, and the existence of low, capped rates of the incumbent utilities.

Although, the majority of the responses identify the above concerns, these same entities encourage the continued path of restructuring and seek quick resolution to the perceived flaws. The other two responses representing consumer interests remain skeptical. The consumer groups appear to accept the path of continued restructuring, but at a more cautious approach and pace. They seek a slower pace aimed at a better balance of risks and benefits among LDCs, CSPs, and consumers. They caution that competition has been and is likely to continue to be slow to develop and that any opportunity for consumers to save on their energy bills is unlikely. The stakeholder recommendations included in this section are not new; they are similar to those expressed in prior reports.

Section 56-596 of the Act requires the SCC to report its recommendations to facilitate effective competition in the Commonwealth as soon as practicable, which shall include any recommendations of actions to be taken by the General Assembly, the SCC, electric utilities, suppliers, generators, distributors, and regional transmission entities it considers to be in the public interest. Passage of Senate Bill 651 of the 2004 General Assembly and approval by the Governor provides legislative direction to continue implementing the Restructuring Act. The SCC continues to perform its charge to provide

regulatory certainty and put in place the necessary infrastructure to implement restructuring.

As previously discussed in the RTE Development portion of Part II of this Report, proceedings are currently underway regarding the transfer of transmission facilities of the incumbent investor-owned utilities to PJM prior to January 1, 2005. The final outcomes of such transfers are pending before this Commission.

While Virginia has traditionally enjoyed relatively low electricity prices, these low prices continue providing little margin for which alternative suppliers can compete. As was the comments last year, there is tension between believing that price caps are a fundamental flaw of the Restructuring Act and that of requiring consumers not be exposed to market-based prices until effective competition has developed and can be depended upon to regulate prices.

Related to the aforementioned issue, respondents continue to claim that the wires charge mechanism may be as strong a detriment to the development of competition as rate caps. The incumbent utilities share a common view that the wires charge is designed to assure utilities of revenue neutrality during the transition period.

The 2004 General Assembly agreed that rate caps are an essential consumer protection built into the Act and determined to continue such protection by extending the capped non-fuel rates for incumbent utilities until December 31, 2010. It also determined that the wires charge would expire on July 1, 2007 as originally intended.

Additionally, provisions were included to permit a large customer’s choice to be exempt from the current minimum stay provisions or the payment of wires charges in exchange to be charged market-based costs upon any subsequent return to supply service

provided by the incumbent utility. The SCC has initiated a proceeding to establish any requirements to pursue such exemptions as discussed in Part II.

The elimination of the wires charge may help, but certainly will not guarantee, competition. Although there is no wires charge within the service areas of Delmarva, AEP, or Allegheny Power, there still is no shopping. However, as also discussed in Part II, the SCC has approved three pilot programs initiated by DVP to reduce the wires charge in hopes of inducing competition.

Another issue related to those above regard the recovery of stranded costs. Generally, the incumbent utilities believe the Restructuring Act simply requires any stranded costs that exist to be recovered through the utility's capped rates and wires charges without quantifying the amount of such stranded costs. Other respondents contend that one must quantify the total amount of stranded costs to determine an over or under recovery. The 2004 General Assembly charged the Office of Attorney General to oversee any pursuit of identifying and quantifying any stranded costs.

Many believe the underlying premise of the Restructuring Act is that a competitive market will result in lower retail electricity prices for Virginia consumers. Unfortunately, retail competitive activity continues to develop slowly throughout the nation, not just in Virginia or in the Mid-Atlantic region. Consequently, a market has not yet fully developed that can be depended upon to govern prices.

In summary, the status of competition is not encouraging. Though there are isolated instances in other jurisdictions of competitive activity among larger commercial and industrial customers, retail choice is not yet providing meaningful benefits or yielding sustained savings anywhere in the country.

In terms of the existence of retail competition, little, if anything, has changed since last year. There still appears to be universal agreement that before a viable competitive retail market develops in the Commonwealth there must be a robust wholesale market and an operational and independent regional transmission organization. While much work has been done or is in the process of being done, it will take more time before that foundation becomes a reality. We currently have the basic rules, systems, and procedures in place to harmonize retail access and will continue to monitor market conditions and react accordingly.

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

September 1, 2004

APPENDIX III-A
RESPONSES FROM STAKEHOLDERS

CONTENTS

LETTER FROM STAFF SOLICITING COMMENTS

E-MAIL DISTRIBUTION LIST

RESPONSES:

Utilities:

- American Electric Power (May 24, 2004)
- Dominion Virginia Power (May 24, 2004)

Competitive Service Providers/Aggregators:

- Coral Power, LLC (May 28, 2004)
- Joint Statement of Certain Competitive Service Providers (May 28, 2004)
- Joint Statement of Certain Market Participants (May 25, 2004)

Consumer Representatives:

- Virginia Citizens Consumer Council (May 29, 2004)
- Virginia Committee for Fair Utility Rates and
  Old Dominion Committee for Fair Utility Rates (May 24, 2004)

Other:

- PJM Interconnection, LLC (May 24, 2004)
  2003 PJM Annual Report: http://www.pjm.com/about/downloads/pjm-web.pdf
  2003 PJM State of the Market Report: http://www.pjm.com/markets/market-monitor/downloads/mmu-reports/pjm-som-2003.pdf

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STATE CORPORATION COMMISSION
DIVISION OF ECONOMICS AND FINANCE

April 26, 2004

Dear Market Participant:

As directed by §56-596 B of the Virginia Electric Utility Restructuring Act, the State Corporation Commission is preparing its fourth annual report to the Commission on Electric Utility Restructuring ("EURC") and the Governor, to be filed by September 1, 2004. That report will cover three topics: 1) the status of the development of regional competitive markets, 2) the status of competition in the Commonwealth, 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 ideas 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.

Because of recent legislation, pending dockets before the Commission, and the continued lack of competitive activity we are not asking any specific questions at this time. Rather, we invite and encourage anyone to take this opportunity to submit in writing any commentary regarding national, regional, or Virginia restructuring efforts, policies, activities, or events. We ask that you consider the topics detailed in the statute and provide any recommendations or thoughts you may have regarding them, whether positive or negative.

Please provide your comments to me by May 24, 2004. 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. Following such posting, any party may submit additional comments in reaction to those posted, if they so desire, by June 4, 2004. 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 continued participation in this effort.

Sincerely,

Dave Eichenlaub

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May 24, 2004

VIA EMAIL

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 of the Status of Competition in the Electric Industry

Dear Mr. Eichenlaub:

Thank you for your letter of April 26, 2004 seeking comments from stakeholders for the Commission's fourth annual report to the Commission on Electric Utility Restructuring ("EURC") and the Governor under the Virginia Electric Utility Restructuring Act. On behalf of Appalachian Power Company ("Appalachian" or "Company"), this letter will report Appalachian's brief comments in response to your invitation.

1. Status of Competition in the Commonwealth

As the Company has noted in past years, all of Appalachian's customers are eligible to choose an alternative generation supplier, and the Company stands ready to respond to customers' choices as alternative supply arrangements may become advantageous to them. Implementation of the requirements for customer choice are, for the most part, in place and in compliance with the Commission's retail choice rules. Customer switching of suppliers in the Company's service territory has not yet developed, however.

2. Status of Regional Competitive Markets

At least one major feature of the Restructuring Act remains to be implemented. The applications of the Company, and other utilities, to join regional transmission entities (RTE) have yet to be acted upon by the Commission. The broader access to regional markets made possible by the entry of utilities into RTEs is a necessary step toward completing implementation of the Restructuring Act and will further the development of regional competitive markets. As the Company urged last year, the Company's proposal to transfer operational and functional control of its transmission facilities to PJM Interconnection, LLC should be resolved promptly.

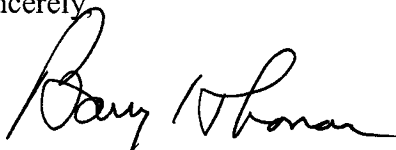
3. Recommendation

The expectations created by the Restructuring Act in 1999 were that retail competition would develop during a period of capped rates between January 1, 2002 and July 1, 2007. Significant competition has not occurred to date, however, more than halfway through that period. The General Assembly has addressed this lack of competitive activity by amending the Restructuring Act to extend capped rates until December 31, 2010. The provisions of the 2004 amendments to the Restructuring Act appear to be adequate at this juncture.

In addition to the entry of Virginia utilities into RTEs, stranded cost monitoring issues remain a subject of current concern. Several existing proposals with respect to stranded cost issues bear all the hallmarks of traditional public utility rate regulation. The Company opposes extensive stranded cost proceedings that would appear to be rate regulation by another name. Consideration of stranded cost monitoring should reflect the unique circumstances of each incumbent electric utility.

The entry of Virginia utilities into RTEs is the most critical issue faced by the Commission to further the expectations in the Restructuring Act. Appalachian recommends that the Commission give priority to the resolution of the RTE issue over other issues, including any stranded cost proceedings that may be undertaken in the next year.

Sincerely,



Barry L. Thomas
Director, Regulatory Services VA/TN

May 24, 2004

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 or Dominion) is pleased to respond to your April 26 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. In this submission the Company will also offer comments on the state of Virginia's restructuring program and the benefits it has already produced for consumers. 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 submit input again to this year's report.

Our comments will include our perspective on the electric industry restructuring movement, both across the nation and in Virginia. We believe that there is strong evidence that the effort to restructure the industry and introduce competition in the supply of electricity continues to make progress and benefit customers.

The Company's comments will discuss the factors that we believe are necessary for the successful continuation of Virginia's restructuring program and the development of competitive retail electricity markets in the Commonwealth. For example, we believe timely approval by the Commission of the applications by Dominion and American Electric Power to join the PJM Interconnection LLC is a prerequisite for the development of competition in Virginia. Successful development of a competitive retail electricity market in the Commonwealth also requires a high degree of regulatory certainty. This is needed to reinforce the legislative certainty reaffirmed earlier this year by the General Assembly's passage of Senate Bill 651 amending the Virginia Electric Utility Restructuring Act.

Electric Industry Restructuring and Competition in 2004

Restructuring: The National Perspective

Currently, 18 jurisdictions (17 states and the District of Columbia) in the United States are pursuing restructuring of their electric industries. Like Virginia, nearly all of these jurisdictions have instituted a multi-year transition period to allow for market development. Capped or frozen rates have been standard features of these transition periods. Jurisdictions undertaking restructuring programs have generally abandoned traditional cost-of-service regulation for generation. Critics of this traditional system assert that this form of regulation

fosters inefficiency, induces utilities to build new assets for the primary purpose of increasing the rate base, and leads to frequent rate increases.

Capped or frozen rates, often called standard offers, have produced sizable customer savings in most states, according to consumer advocates. Customer savings from capped rates have been the initial indicator of a successful restructuring program.

Savings from standard offers were largely responsible for the $3.8 billion in consumer savings cited by former Pennsylvania Governor Tom Ridge three years ago. More recently, Sonny Popowsky, consumer advocate for the state of Pennsylvania, also hailed customer benefits from the rate caps. “With rate caps in place, customers have not suffered as a result of the lack of robust retail competition,” Popowsky told the Pennsylvania House Consumer Affairs Committee on March 4. “In real, inflation-adjusted terms…virtually all Pennsylvania consumers are paying lower rates today than they were in 1996.”

Ohio consumers have also benefited from capped rates, according to former Ohio Consumers’ Counsel Robert S. Tongren. In a January 2003 report, Tongren said Ohio consumers had saved over $250 million during the previous two years because of capped rates and a five percent generation discount that was also part of the state’s restructuring plan.

In early 2003, the Public Utility Commission of Texas reported to the state legislature that "the Commission’s estimates in this report show 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.”

The second indicator of successful restructuring, often coming several years into the transition to retail competition, is customer switching. Although the rate of customer switching to alternative suppliers is not as great as some observers had expected a few years ago, the restructuring movement continues to advance in many parts of the United States. The pro-competition Alliance for Retail Choice recently reported that the load served by competitive providers nationwide has tripled since mid-2001 and reached approximately 52,000 megawatts by the end of 2003. Customer switching has been particularly active in Pennsylvania, with more than 450,000 customers served by alternative providers as of April 1 of this year; Texas, with more than 900,000 customers served by alternative providers as of February 29; and Ohio, with almost 945,000 customers served by alternative providers as of December 31, 2003, according to figures compiled by the states’ public utilities commissions. In Ohio, the overwhelming majority of the consumers served by competitive suppliers belong to aggregations run by groups of municipalities. The success of municipal aggregation in Ohio bodes well for its future in Virginia, especially since the 2004 General Assembly took strong steps to make it easier for cities and counties to form such buying groups.

According to data from state commissions, more than 25 percent of the total electric load is served by alternative providers in four jurisdictions: Maine, 38 percent; Texas, 36 percent; the District of Columbia, 36 percent; and Massachusetts, 29 percent.

Rate Increases in States Not Pursuing Restructuring

While capped or frozen rates have been standard features of the transition periods in states undertaking restructuring, there is a pronounced trend toward rate increases and rate increase petitions in states that are not pursuing restructuring or that have deferred their restructuring programs.

Rate increases approved so far during 2004 include the following:

State	Percentage increase granted
Indiana	8.4
Missouri	4.2
Wisconsin	4.7
Wyoming	7.2

Rate increases approved during 2003 include the following:

State	Percentage increase granted
Colorado	15.6
Iowa	3.0
Louisiana	8.5
New Mexico	4.0
South Carolina	5.8
Utah	7.0
Wisconsin (decisions for three utilities)	3.5, 9.1 and 11.8
Wyoming	2.8

Pending petitions for rate increases include the following:

State	Percentage increase proposed
Idaho (two utility petitions)	17.7 and 24.1
Iowa	16.3
Kentucky (two utility petitions)	8.5 and 11.3
Nevada (two utility petitions)	9.6 and 13.1
Washington	13.5

Source: Regulatory Research Associates

The cases cited above include both base and fuel rate increases. Under the Virginia Electric Utility Restructuring Act (the Restructuring Act), capped base rates have been imposed on incumbent utilities since 1999. Senate Bill 651, recently passed by the General Assembly and signed by the governor, freezes Dominion's fuel rate at its current level until July 1, 2007.

The respected trade journal *Public Utilities Fortnightly* has also warned of impending "sticker shock" due to utilities petitioning state utility commissions for the rate basing of billions of dollars of improvements, including new generation and environmental upgrades. *Public Utilities Fortnightly* estimated that utilities could petition to have as much as $5 billion in

environmental equipment rate based, a move that would lead to higher rates in many areas. (Richard Stavros, "Sticker Shock," *Public Utilities Fortnightly*, April 2004, pages 4-5)

Restructuring Protects Virginia Consumers

In contrast, Virginia's restructuring program has produced unprecedented price stability for the Commonwealth's consumers. Senate Bill 651 amended the Restructuring Act and extended its capped rate period for an additional three-and-a-half years, through December 31, 2010. In many cases, base rates for Virginia's incumbent utilities are capped at or near levels set in the early 1990s. Base rates can be adjusted only in a limited number of circumstances set forth in the Restructuring Act.

A January 2004 study by the Richmond consulting firm of Chmura Economics & Analytics quantified savings from the capped rates for many Virginia consumers. The study commissioned by Dominion found that capped base rates would save the Company's residential customers as much as $1.8 billion through the end of 2010. Total savings during the extended 1998-2010 capped rate period would range from $789 to $966 per household, producing average annual savings of from $61 to $74, or up to 7.3 percent of the bill of the typical customer who uses 1,000 kilowatt-hours each month. The study also found that savings from the capped rates would produce about $307 million in additional economic activity in the Commonwealth.

Senate Bill 651: New Protection for Many Customers from Rising Fuel Prices

Senate Bill 651, in addition to extending the capped base rate period, provides new price protection for many Virginia electric consumers. The bill amends the Restructuring Act to freeze Dominion's fuel rate at its current level until July 1, 2007. At that point, the Commission can move the rate either up or down once, depending on expected fuel prices, with the new rate in force through the rest of the capped rate period.

This marks a profound shift of risk in the electric business. Historically, utilities have fully recovered their fuel costs from their customers. The responsibility for meeting rising fuel costs now shifts to the company. A report by Norwood Energy Consulting LLC found that fuel charges for Dominion customers would have likely increased by as much as 20 percent, or approximately $220 million, by 2007 if Senate Bill 651 had failed to pass. The report was commissioned by the Office of the Attorney General's Division of Consumer Counsel and was released on March 9.

Progress on Customer Choice in Virginia

The Commonwealth also continues to make progress toward the ultimate goal of the Restructuring Act: providing Virginia consumers with a wider choice of energy providers.

Dominion Virginia Power Retail Choice Pilot Programs

In September 2003, the Commission approved the Company's request to conduct three pilot programs to stimulate the development of a competitive electricity market in Virginia and bring

the potential benefits of retail choice to a variety of customers. The programs focus on three aspects of retail choice:

- A Competitive Bid Supply Service pilot that will use a bidding process to match blocks of small commercial and residential customers with competitive suppliers. This pilot is expected to provide valuable experience for the provision of default service, defined by the Restructuring Act as service for customers who do not choose an alternative provider, cannot obtain service from one or whose alternative supplier fails to deliver service.

- Increasing mid and large-sized commercial and industrial customers' access to competitive power supplies.

- Forming buying groups, or "aggregations," administered by cities, counties and towns to secure lower prices on electricity for their citizens.

In all three cases, Dominion proposed a significant reduction of wires charges for pilot participants when a customer switches to an alternative supplier. This reduction is designed to give competitive suppliers more opportunity to make attractive offers to retail customers. As of May 20, approximately 89,000 customers had volunteered to participate.

On April 2, 2004, the Company asked the Commission to approve several modifications to the programs to help them move forward successfully. The proposed modifications include a larger wires charge reduction of up to 100 percent of the participant's wires charge for 2004. Other modifications include changes in the bidding process used to select competitive service providers (CSPs) to supply electricity to participants in the Competitive Bid Supply Service pilot. The Company's petition for pilot revisions is now pending before the Commission.

Additionally, to clear another barrier to the pilot programs moving forward successfully. the Company has asked the Federal Energy Regulatory Commission to approve its proposal for offering backup supply service to CSPs. This will allow the providers to continue serving their customers within Dominion's Virginia service area during supply interruptions. Such events could be caused by a number of factors, including emergencies or lack of capacity on other transmission systems. The Company will offer such service only until it is fully integrated into a regional transmission organization (RTO). At that point Dominion's backup supply service will no longer be needed.

The Company is encouraged by the interest shown in the pilots by customers, CSPs and municipalities. It will assist municipal governments interested in forming aggregation programs under the pilot with funding for a feasibility study. Municipalities agreeing to participate in the feasibility study include Charles City County, Chesterfield County, and the cities of Charlottesville, Fairfax and Hampton. Buckeye Energy, an Ohio energy consultant firm with extensive experience with municipal aggregation in its home state, has been retained to perform the study.

Dominion hopes the Commission will approve its proposed modifications to the programs so the pilot price-to-compare can be determined and the pilots can proceed in a timely and successful manner.

Progress toward Customer Choice through Senate Bill 651

Amendments made to the Restructuring Act through the passage of Senate Bill 651 should also greatly facilitate development of viable retail competition in the Commonwealth.

The extension of the capped rate period through December 31, 2010 will provide additional time for market development. During this transition period, customers will be free to buy power from competitive suppliers but will be able to return to the stability and safety of the "safe harbor" of capped rates if market prices rise or become volatile. In short, consumers will have the potential benefits of customer choice and also the stability and certainty of capped rates.

Significantly, the amendments approved by the 2004 General Assembly also reiterated the commitment made by the Restructuring Act in 1999 to end all wires charges on July 1, 2007.

Other amendments should make it easier for municipalities to form aggregations to secure energy for their citizens from CSPs. The amendments allow cities and counties to conduct aggregation programs on an "opt out" basis, in which citizens are automatically included unless they make an affirmative decision not to participate. Amendments to the Restructuring Act in 2003 already authorized opt-out municipal aggregation as part of pilot retail choice programs. Municipal aggregation has proven to be a very successful means of bringing the benefits of retail competition to large numbers of customers in other states. In Ohio, for example, approximately 869,000 customers participated in opt-out municipal aggregation programs as of December 2003.

Two changes to the Restructuring Act proposed by Senator Watkins and included in Senate Bill 651 will free many customers from wires charge and minimum stay obligations ahead of schedule. The first amendment will allow large commercial and industrial customers, as well as aggregated customers in all classes, to become exempt from wires charges if they agree to accept market based rates, instead of capped rates, should they return to their incumbent utilities. The wires charge exemption program will begin in each incumbent's service territory after the Commission has promulgated the necessary rules and regulations and the utility transfers management and control of its transmission assets to a RTO. In the case of the wires charge exemption, approximately 1,000 megawatts of Dominion's peak load will be able to escape wires charges during the first 18 months of the program. Thereafter, the Commission may issue regulations on how much load for each incumbent utility can be exempted from wires charges. The Company has already begun reviewing its policies and procedures for implementing this amendment and anticipates proposing a robust program that will be attractive to all classes of customers. We urge the Commission to take the steps necessary for this program to become effective. This includes timely approval of applications for RTO membership.

The second amendment will allow large commercial and industrial customers that switch to competitive providers to become exempt from minimum stay requirements if they agree to accept market-based rates if they return to service with their incumbents. Here again, the provision's effectiveness is contingent upon an incumbent's transfer of transmission management to a RTO. We also urge the Commission to act promptly and take the steps

necessary for this provision to become effective, including timely approval of RTO membership, since the program cannot be implemented until Dominion has transferred management and control of transmission assets to an RTO.

Prerequisites for Successful Competition in Virginia

While Virginia's restructuring program has made great progress, the Company acknowledges that additional steps need to be taken for the development of robust, successful competition in the Commonwealth. These include a functioning RTO and continued legislative certainty, along with a high degree of regulatory certainty, regarding the future of Virginia's restructuring program.

- ***Necessity of a Functioning RTO***

The transmission systems owned by Virginia's incumbent utilities must be integrated into a functioning RTO before a competitive retail market can develop. Stakeholders in the restructuring process have repeatedly labeled the lack of a functioning RTO in the Commonwealth as the single greatest barrier to retail competition development and a significant barrier to wholesale competition.

In comments submitted to the Commission for its 2003 status report on competition, stakeholders made the following statements regarding the role a functioning RTO must play in successful competition, both wholesale and retail.

"A robust energy market for Virginia's consumers is highly dependent upon transmission assets being placed under the control of a Independent System Operator, or a Regional Transmission Organization (RTO)." – Strategic Energy

"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." – Virginia Energy Providers Association

"A RTO operated transmission network facilitates the movement of bulk power transactions to ensure reliability, economic efficiency and market liquidity." – National Energy Marketers Association

In the 2003 report, the Commission itself made the following observation: "Perhaps the most common issue raised among the comments submitted in response to the Staff's letter regards the lack of a fully functional RTO as the major obstacle" to active competition.

General Assembly Policy Commitments to RTOs

The General Assembly has consistently recognized that a properly functioning wholesale electricity market is vital to the development of effective retail competition. In order to facilitate development of a fair and open wholesale market in Virginia, the Restructuring Act as enacted in 1999 required incumbent utilities to join or form regional transmission entities, conditioned upon Commission approval. In 2003, enactment of House Bill 2453 reaffirmed the Assembly's

commitment to regional transmission organizations. This bill amended the Restructuring Act to require incumbents to enter regional transmission organizations by January 1, 2005, subject to Commission approval. It further required applicants to include comparative cost-benefit studies of RTO membership and its economic impact on consumers.

Since passage of the Restructuring Act in 1999, Dominion has actively pursued RTO membership, initially through the formation of the Alliance RTO and currently through its efforts to join PJM in the timeframe set forth in the Restructuring Act.

In its application to integrate into PJM, filed with the Commission on June 27, 2003, Dominion submitted testimony to show that PJM will provide Dominion's consumers with enhanced reliability, optimized system planning and improved resource adequacy. These reliability benefits cannot be fully measured quantitatively, but their importance cannot be overstated. The Northeast blackout of August 14, 2003 reinforces the need for system operators to be able to monitor across regions and react in real time to prevent the occurrence and spread of outages. In addition, the August 14 blackout affirms the need for optimized system planning to ensure that proper infrastructure investment is made to meet the needs of the economy. Integration of Virginia's incumbent utilities into PJM provides the best means to accomplish these objectives.

In accordance with the Restructuring Act amendments of 2003, Dominion retained Charles River Associates to conduct a cost-benefit analysis of PJM membership and shared this analysis with the Commission in its application. This cost-benefit study affirmed the importance of the qualitative benefits described above, describing significant benefits of PJM integration, including enhanced reliability, optimized system planning and improved resource adequacy. In addition, the cost-benefit analysis measured energy and capacity savings of approximately $470 million for Dominion retail customers over the ten-year study period, net of PJM costs paid by those consumers.

The full quantitative and qualitative consumer benefits that have been presented in Dominion's application, including its cost-benefit study, are dependent upon integration of both American Electric Power (AEP) and Dominion into PJM. The benefits of competition that the Restructuring Act envisions can best be delivered if all incumbent utilities in the Commonwealth are integrated into PJM.

Dominion has complied with the Restructuring Act (as amended) and with the Commission's orders to complete its filing. Participation of Virginia's incumbent utilities in an RTO is essential for development of an active retail market and provides enhanced reliability and savings for consumers.

The Commission has issued a procedural order setting starting dates for hearings on July 27 for AEP and October 12 for Dominion. To ensure timely development of retail competition it is imperative that the Commission complete its review and approve the pending applications of Dominion and AEP to allow integration into PJM in compliance with the January 1, 2005 date in the Restructuring Act.

- ***Legislative and Regulatory Certainty Necessary for Restructuring's Success***

Continued legislative certainty and a high degree of regulatory certainty are another prerequisite for the successful development of competition in Virginia. The passage of Senate Bill 651 by the 2004 General Assembly and its subsequent signing by Governor Warner reaffirmed Virginia's commitment to the restructuring process, as did the General Assembly's rejection of efforts to suspend the Restructuring Act. Passage of Senate Bill 651 marked a clear legislative policy decision to continue the Commonwealth's restructuring program. Prospective competitive service providers and independent power producers interested in Virginia but previously uncertain about its commitment to a competitive market now have the certainty they need to develop solid business plans for entry into the state. Those already doing business here do not have to constantly re-evaluate their decisions to come to Virginia or think about planning exit strategies. Incumbent utilities know with certainty the risks and service obligations they must face between now and the end of 2010.

With legislative certainty now reaffirmed, we believe all parties involved in or affected by the transition to a competitive electric market in Virginia should commit themselves to implementing restructuring and customer choice successfully. Only if all parties work together in a collaborative and constructive fashion can the Commonwealth realize the Restructuring Act's goal of competitive retail markets for the supply of electricity. We are hopeful that the General Assembly's policy decision to proceed with restructuring will be reflected in the Commission's 2004 report on the status of competition.

Sincerely,

E. Paul Hilton

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May 28, 2004

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Virginia State Corporation Commission
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Re: State Corporation Commission Report on the Status of Competition
Comments of Coral Power, L.L.C.

Dear Mr. Eichenlaub:

Coral Power, L.L.C. ("Coral Power" or "Coral") takes this opportunity to submit to the SCC principles that must be adopted for the development of an effectively competitive wholesale market in Virginia. It offers these principles based on its experience in power markets throughout North America and from its unique perspective as a wholesale competitor with a new 885-megawatt ("MW") gas-fired combined cycle generating facility located near Palmyra, Virginia in Fluvanna County (the "Fluvanna Facility").

Coral believes that the development of effective competition in wholesale and retail electricity markets in Virginia is in the public interest. Moreover, because Coral's business focuses on the development of (and participation in) competitive wholesale electricity markets, Coral offers a unique perspective of the status of competition in Virginia to date. Coral focuses its comments specifically on recommendations for the development of effectively competitive wholesale markets in Virginia.

1. Description Of Coral Power And Its Interest In The Development Of Effectively Competitive Wholesale And Retail Markets In Virgina.

Coral Power is a Delaware limited liability company that is owned by Coral Energy Holding, L.P., which is owned by subsidiaries of Shell Oil Company and Bechtel Enterprises Holdings, Inc. Coral entered into a long-term Energy Conversion Agreement ("ECA") with Tenaska Virginia Partners, L.P. ("Tenaska") in connection with Tenaska's

Fluvanna Facility. The ECA represents a very significant investment by Coral in Virginia's evolving energy markets.

Coral Power is also a supplier and marketer of electricity in markets throughout North America. Coral has experience with centrally dispatched, independently administered markets like those administered by the PJM Interconnection, L.L.C. ("PJM"), as well as with bilateral markets that do not have an independent market administrator.

The Fluvanna Facility is interconnected with the transmission lines of Dominion Virginia Power ("DVP"), and commenced commercial operations on May 1, 2004. Under the terms of the ECA, Coral has the exclusive right to provide natural gas to the Fluvanna Facility, and to obtain all of the electric energy generated by the Fluvanna Facility. Coral will market and sell this output in and around the Commonwealth of Virginia. As a combined cycle plant, the Fluvanna Facility can respond quickly to price signals and dispatch instructions in order to provide electric energy and other generation-related products and services, while supplementing base-load generation resources in the region. The region needs this type of generating resource.

Coral has a significant interest in the terms and conditions under which it can obtain transmission service and market the output of the Fluvanna Facility. Depending upon the ultimate configuration of Virginia's wholesale markets, the terms under which Coral can obtain access to transmission service across the region's transmission systems, the rates it will pay, and opportunities it will have to access energy, capacity, and ancillary service markets will change.

2. Key Principles And Recommendations For The Development Of Effective Competition In The Commonwealth Of Virginia.

Pursuant to Va. Code § 56-596 B of the Virginia Electric Utility Restructuring Act, Va. Code Title 56, Chapter 23 (as amended, the "Act"), the SCC is charged with reporting to the legislative Commission on Electric Utility Restructuring ("EURC") and to the Governor on the status of competition in the Commonwealth, the status of the development of regional competitive markets, and its recommendations to facilitate effective competition in the Commonwealth as soon as practical. The Commission's report is to include any recommendations of 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.

Id. 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. *Id*.

Coral agrees with the observation that "a continued and unwavering commitment to retail choice and wholesale competition is needed to bring [the benefits of competition] to consumers." Joint Statement, p. 2. These comments focus on the key principles for the development of effective competition in the Commonwealth, and recommendations for further action.

a. Virginia's Incumbent Electric Utilities Need to Participate Fully in Fully Functional Regional Transmission Entities.

This issue is of critical significance to Coral, and is critical to the future success of Virginia's energy markets. Full participation in a fully functional RTO is an essential prerequisite for development of robust competitive markets, both wholesale and retail, and delays in the entry of Virginia's incumbent electric utilities into an RTO continue to pose a very significant obstacle to the success of competition in the Commonwealth.

Presently, the Commission has pending before it the applications of Appalachian Power Company ("APCo") and Dominion Virginia Power to join PJM. While § 56-579 of the Act requires Virginia's incumbent electric utilities to transfer control of their transmission assets to a regional transmission entity ("RTE")[1] by January 1, 2005, subject to Commission approval as provided in that section of the Act, it remains to be seen what conditions may attach to such approvals.

Coral is particularly concerned that Virginia's commitment to have its incumbent electric utilities join an RTE will not reach its full potential, or provide the greatest opportunity for the successful development of effective retail and wholesale competition in Virginia, if the participation of one or more of Virginia's incumbent electric utilities in an RTE is anything less than complete, competitive, and non-discriminatory.

Today, DVP and American Electric Power ("AEP") operate fully integrated systems, utilizing a centralized, security-constrained dispatch for their generation, while providing open access to their transmission systems. Like other vertically integrated utilities that are not part of independently-administered, competitive regional markets like

[1] RTEs are also referred to in the industry as RTOs. The terms "RTE" and "RTO" may be used interchangeably.

those administered by PJM, DVP and AEP manage congestion at the so-called "seams" of their transmission systems manually through the use of operating procedures, generation dispatch and redispatch, and transmission loading relief ("TLR") procedures.

The TLR procedure is an Eastern-Interconnection-wide procedure to allow the Reliability Coordinators to mitigate potential or actual transmission operating security limit violations; however, instead of utilizing open and transparent generation redispatch to manage transmission congestion, TLRs cancel power flow transactions rather than allowing parties to "buy through" the congestion. Moreover, because of the time it takes to arrange and implement TLRs (perhaps 30 to 60 minutes), they are not a satisfactory means of handling real-time emergency situations.

With TLRs significant transactions can be curtailed, when generation redispatch would allow the transactions to proceed. TLRs can also cancel energy sales that otherwise might be the most economically efficient means of meeting real-time power needs. They present significant obstacles to effective and efficient regional trading of electricity, which is needed to support the development of effective competition in Virginia. To place the magnitude of this problem in perspective, 19 percent (by volume) of all TLRs called in the United States since 1998 have involved PJM and AEP.

A transmission owner ("TO") that also owns generation and controls dispatch has the ability and incentive to utilize that dispatch to favor its own generation and to capture market opportunities, at the expense of competitors and consumers alike. Many market participants perceive that TLRs are used in a discriminatory manner. By declaring a TLR, a TO can curtail transactions when a redispatch of the TO's generation would allow other economically efficient transactions to proceed. A utility's continued control of these functions can create the perception that markets are less than open, transparent, and effectively competitive. Both the PJM and the Midwest Independent Transmission System Operator, Inc. ("MISO") market monitors have identified gaming and market power issues at the seams between market and non-market areas.

On the other hand, RTOs like PJM that manage congestion on the transmission system through the use of locational marginal pricing ("LMP") utilize an integrated security constrained economic dispatch for generation, but do so in an open, timely, and transparent manner. LMP permits PJM to maintain system reliability more efficiently than through TLRs.

Coral recognizes that there are several dockets pending before the Federal Energy Regulatory Commission ("FERC") that will consider the RTO choices of AEP, DVP, and

other so-called "Alliance Companies" to join PJM. Coral is an intervenor in some of these FERC dockets.

Coral echoes the concerns of others that so-called "partial integration" or "phased integration" proposals may be offered as satisfactory solutions to Virginia's RTE requirement, where a Virginia utility may propose to transfer functional control of transmission facilities to PJM to independently administrator transmission access, calculate Available Transfer Capability ("ATC") and Total Transfer Capability ("TTC"), act as Reliability Coordinator, act as Market Monitor, and conduct regional planning and coordination of the seams between the systems of PJM, Virginia utilities, and other markets, but would *not* propose to integrate into PJM's markets.

While the Commission may not be able to comment directly on such issues, given its need to make decisions on the RTE applications of APCo and DVP and its participation in proceedings pending before the FERC, Coral joins others in expressing its concerns on these critical issues.

Should an RTE application by one or more of Virginia's incumbent electric utilities be approved that involves less than total integration into PJM's markets, this will adversely impact the competitive position of Virginia in the region, and the ability of wholesale and retail competitors to efficiently serve those markets. Moreover, Coral is convinced that this approach would adversely impact reliability, and reduce economic benefits to consumers in the region. In addition, less than full participation in PJM's markets will also present opportunities for gaming and the exercise of market power that may be difficult to monitor and correct. For these and other reasons, Virginia's incumbent electric utilities should be full participants in any Commission-approved RTE choice.

b. Virginia's Market Structure Should Include An Efficient, Liquid Spot Market.

Virginia presently lacks an efficient, liquid spot market. Without an efficient wholesale spot market, prices in the forward market serving Virginia will not be as reliable, transparent, or liquid. Markets that lack transparency and liquidity will cause suppliers to add risk premiums to their offers, resulting in higher-priced electricity for Virginia's consumers.

Coral acts a wholesale supplier to competitive service providers ("CSP") in several markets throughout North America. It is Coral's experience that retail markets

are more successful in regions like that covered by PJM, where a liquid and transparent spot market exits. For Virginia, the lack of a transparent, efficient spot market means that CSPs and other load serving entities will miss opportunities to purchase power on a term basis at the most competitive prices, and suppliers such as Coral will miss opportunities to make otherwise-economic sales. Such risk premiums will create a disincentive for retail CSPs to participate in Virginia's retail markets until more favorable market rules develop.

It is clear that CSP retailers such as the *ad hoc* coalition of retail companies ("Competitive Stakeholders")[2] that submitted comments in response to your letter are interested in entering the Virginia market, but perceive the current wholesale market structure to be a barrier for this to happen in a meaningful way. To the extent that the appropriate design for wholesale and retail markets encourages participation from many entities, customers can realize the benefits that competitive suppliers can offer, such as customized hedging instruments to better match the needs and budgets of business customers.

c. Coral's Fluvanna Facility Is At A Competitive Disadvantage Unless Virginia's Wholesale Markets Are Effectively Competitive.

The Fluvanna Facility is a competitive enterprise that provides jobs and pays taxes like other enterprises in the Commonwealth. Coral's marketing and sale of its output in the region will help secure its long term viability as an employer, taxpayer, and supplier.

Virginia's failure to fully embrace a competitive market structure like PJM's, which includes spot energy markets, capacity, and ancillary services markets, places Coral at a significant competitive disadvantage with respect to its ability to offer these resources in the Commonwealth and to adjoining regions. This disadvantage is not theoretical. From May 1, 2004, the date the Fluvanna Facility commenced commercial operations, Coral has encountered barriers to its ability to effectively market the output from the Fluvanna Facility. Coral's competitors in other regions surrounding the PJM footprint are able to reach the PJM markets without having to pay transmission service export fees, and the opportunity to supply capacity and ancillary services gives them a significant advantage relative to generators like the Fluvanna Facility. As described above, the lack of an efficient spot market also acts as a tremendous obstacle. These

[2] The Competitive Stakeholders include Constellation NewEnergy, Inc., Direct Energy Marketing, Inc., Pepco Energy Services, Inc., Strategic Energy, L.L.C., and Washington Gas Energy Services, Inc.

barriers will remain unless and until Virginia's incumbent electric utilities become incorporated into a competitive regional market.

Competitive wholesale market structures will permit the Fluvanna Facility to be a valuable economic resource for Virginia and the region. The principle is simple. When the markets serving Virginia send a signal that it is efficient for Coral to offer energy, capacity, and ancillary services resources from the Fluvanna Facility to load serving entities (including utilities, cooperatives, and CSPs), it will do so. The Fluvanna Facility also supports local reliability needs. Accordingly, competitive wholesale markets will provide an opportunity for the Fluvanna Facility and Coral to prosper as businesses, while providing load serving entities and the electric consumers they serve with a competitive option to meet their reliability and resource needs.

3. Conclusion.

On behalf of Coral Power, L.L.C., thank you for the opportunity to provide these comments and recommendations. Coral Power believes that its recommendations are in the public interest, and should be adopted.

Very truly yours,

Thomas B. Nicholson

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May 28, 2004

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Re: State Corporation Commission Report on the Status of Competition

Dear Mr. Eichenlaub:

On May 25, 2004, you received a joint statement from Allegheny Energy, Inc., Constellation NewEnergy, Inc., Direct Energy Marketing, Inc., Dominion Retail, Inc., Dominion Virginia Power, Virginia Energy Providers Association, Virginia Independent Power Producers, Pepco Energy Services, Inc., Strategic Energy, L.L.C., and Washington Gas Energy Services, Inc. (the "Joint Statement"). The Joint Statement reiterates the commitment of the signatories ("Joint Statement Signatories") to viable competitive wholesale and retail electricity markets in the Commonwealth of Virginia, and urges the State Corporation Commission ("Commission" or "SCC") to facilitate the process towards fully competitive retail and wholesale electricity markets by completing its review of the applications currently before it for the integration of incumbent electric utilities with a Regional Transmission Organization ("RTO"). The Joint Statement also calls for a re-commitment from stakeholders to strive for the successful development of a competitive market in Virginia.

The Joint Statement Signatories set forth their firm belief that continued restructuring is in the best interests of the consumers in the Commonwealth. While all the signatories agreed with the principles set forth in the Joint Statement, the *ad hoc* coalition of retail companies identified herein takes this opportunity to elaborate on those principles from their unique perspectives as retail competitors of Virginia's incumbent electric utilities.

1. Identification of Competitive Stakeholder Members

The following companies have participated in the development of these comments:

- Constellation NewEnergy, Inc., [Retail Competitive Service Provider ("CSP"), member of the Virginia Alliance for Retail Energy Markets ("VAREM")[1] and Joint Statement Signatory];
- Direct Energy Marketing, Inc. (Retail CSP, VAREM member, and Joint Statement Signatory];
- Pepco Energy Services, Inc. (Retail CSP and Joint Statement Signatory);
- Strategic Energy, L.L.C. (Retail CSP, VAREM member, and Joint Statement Signatory); and
- Washington Gas Energy Services, Inc. (Retail CSP, VAREM member, and Joint Statement Signatory).

These companies (hereinafter the "Competitive Stakeholders") are united in their belief that the development of effective competition in wholesale and retail electricity markets in Virginia is in the public interest. Moreover, because they focus their businesses on the development of (and participation in) competitive wholesale and retail markets, they offer a unique perspective of the status of competition in Virginia to date, and they have several recommendations for the development of effectively competitive wholesale and retail markets in Virginia.

In your April 26, 2004 letter to stakeholders ("April 26 Letter"), you state (p.2)

> Because of recent legislation, pending dockets before the Commission, and the continued lack of competitive activity we are not asking any specific questions at this time. Rather, we invite and encourage anyone to take this opportunity to submit in writing any commentary regarding national, regional, or Virginia restructuring efforts, policies, activities, or events. We ask that you consider the topics detailed in the statute and provide any recommendations or thoughts you may have regarding them, whether positive or negative.

[1] VAREM is an *ad hoc* coalition of retail energy marketers. VAREM members participated in the last legislative session of the General Assembly, and voiced their views concerning Senate Bill 651 and the impact of that bill on the prospects for retail competition in Virginia.

Consistent with your invitation, the Competitive Stakeholders offer the following comments and recommendations to assist the SCC in developing a comprehensive review of ideas that may be considered to facilitate effective competition in Virginia.

2. Identification and Further Discussion of Key Principles and Recommendations for the Development of Effective Competition in the Commonwealth of Virginia.

Pursuant to Va. Code § 56-596 B of the Virginia Electric Utility Restructuring Act, Va. Code Title 56, Chapter 23 (as amended, the "Act"), the SCC is charged with reporting to the legislative Commission on Electric Utility Restructuring ("EURC") and to the Governor on the status of competition in the Commonwealth, the status of the development of regional competitive markets, and its recommendations to facilitate effective competition in the Commonwealth as soon as practical. The Commission's report is to include any recommendations of 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. *Id*. 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. *Id*.

In Part II of its August 2003 Status Report[2] to the EURC and the Governor, the Commission noted (p.2) a continuing lack of competitive options for Virginia's electric consumers:

> As we reported last year, the right to choose has not yet evolved into the ability to choose. While it is clear that the SCC, the utilities and the various stakeholders have effectively enabled almost universal retail access in Virginia, there is little competitive activity in the Commonwealth. We understand that many suppliers still perceive little economic incentive to enter the Virginia retail market. No competitive service provider is offering

[2] Report To The Commission On Electric Utility Restructuring Of The Virginia General Assembly And The Governor Of The Commonwealth Of Virginia Status Of Retail Access And Competition In The Commonwealth, *Status Report: The Development of a Competitive Retail Market for Electric Generation within the Commonwealth of Virginia Pursuant to Section 56-596 of the Code of Virginia* (August 29, 2003)("2003 Status Report"). Part II of the 2003 Status Report is entitled "Status Of Retail Access And Competition In The Commonwealth."

> energy priced so that switching customers may save money.

The Competitive Stakeholders anticipate that the Commission's 2004 Status Report is likely to include the same observation with respect to the status of retail access and competition in Virginia. This observation is likely to cause some to ask a fundamental question: *viz*., Is it appropriate or acceptable public policy to permit a continuation of the *status quo* with respect to the level of competition in Virginia?

While some may continue to argue that Virginia is on the wrong course with respect to the introduction of competition in the electric utility industry, the Competitive Stakeholders, like the Joint Statement Signatories, believe that this is not the case. The fundamental question that the Competitive Stakeholders wish to address is as follows: "What is preventing the benefits of competition from reaching Virginia's consumers?"

The Competitive Stakeholders agree with the Joint Statement's observation that "all parties agree that a continued and unwavering commitment to retail choice and wholesale competition is needed to bring [the benefits of competition] to consumers." Joint Statement, p. 2. The Competitive Stakeholders also agree that "individual market participants may disagree as to the methods of successfully developing competitive markets in Virginia[.]" *Id*.

These comments focus on the key principles for the development of effective competition in the Commonwealth, and recommendations for further legislative and regulatory action.

a. Virginia's Incumbent Electric Utilities Need to Participate Fully in Fully Functional Regional Transmission Entities.

The Competitive Stakeholders agree with the Joint Statement (p. 2) that "[p]articipation in a fully functional regional transmission organization is an essential prerequisite for development of robust competitive markets, both wholesale and retail[, and that "[d]elays in the entry of incumbent Virginia utilities into an RTO continue to pose a very significant obstacle to the success of competition in the Commonwealth." *Id*.

Presently, the Commission has pending before it the applications of Appalachian Power Company ("APCo") and Dominion Virginia Power ("DVP") to join the PJM Interconnection, L.L.C. ("PJM"). While § 56-579 of the Act requires Virginia's incumbent electric utilities to transfer control of their transmission assets to a regional

transmission entity ("RTE")[3] by January 1, 2005, subject to Commission approval as provided in that section of the Act, it remains to be seen what conditions may attach to such approvals.

The Competitive Stakeholders are concerned that Virginia's commitment to have its incumbent electric utilities join an RTE will not reach its full potential, or provide the greatest opportunity for the successful development of effective retail and wholesale competition in Virginia, if the participation of one or more of Virginia's incumbent electric utilities in an RTE is anything less than complete, competitive, and non-discriminatory.

The Competitive Stakeholders note that there are several dockets pending before the Federal Energy Regulatory Commission ("FERC") that will consider the RTO choices of American Electric Power ("AEP")[4], DVP, and other so-called "Alliance Companies" to join PJM.

In particular, the Competitive Stakeholders are concerned that so-called "partial integration" or "phased integration" proposals may be offered as satisfactory solutions to Virginia's RTE requirement, where a Virginia utility may propose to transfer functional control of transmission facilities to PJM to independently administrator transmission access, calculate Available Transfer Capability ("ATC") and Total Transfer Capability ("TTC"), act as Reliability Coordinator, act as Market Monitor, and conduct regional planning and coordination of the so-called "seams" between the systems of PJM, Virginia utilities, and other markets, but would *not* propose to integrate into PJM's markets.

While the Commission may not be able to comment directly on such issues, given its need to make decisions on the RTE applications of APCo and DVP and its participation in proceedings pending before the FERC, the Competitive Stakeholders want the CEUR, the other members of the General Assembly, and the Governor to understand their perspective on this critical issue.

Should an RTE application by Virginia incumbent electric utility be approved that involves less than total integration into PJM's markets, the Competitive Stakeholders believe that such an approach will adversely impact the competitive position of Virginia in the region, and the ability of wholesale and retail competitors to efficiently serve those markets. They are also concerned that this approach would adversely impact reliability, and reduce economic benefits to consumers in the region. In addition, less than full participation in PJM's markets will also present opportunities for gaming and the exercise

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[3] RTEs are also referred to in the industry as RTOs. The terms "RTE" and "RTO" may be used interchangeably.
[4] APCo is one of the AEP operating companies.

of market power that may be difficult to monitor and correct. For these and other reasons, Virginia's incumbent electric utilities should be full participants in any Commission-approved RTE choice.

b. Virginia Still Must Come To Grips With The "Stranded Costs" Issue And Resolve It Expeditiously, Or Provide All Of Virginia's Consumers The Opportunity To Avoid A Utility's Wires Charges.

In enacting Senate Bill 651, 2004 Acts of Assembly Chapter 827, the General Assembly and the Governor have articulated a need to protect Virginia consumers from exposure to non-competitive electricity markets. Without debating here whether this approach to consumer protection is optimal, each of the Competitive Stakeholders believes that underlying flaws in Virginia's market structures remain that prevent competitors from bringing the benefits of competition to consumers. The changes needed to address these are not dramatic, nor do they require abandonment of the rate cap and fuel cost protections approved in Senate Bill 651.

The primary flaw has to do with the wires charge that Va. Code § 56-583 allows utilities to charge their customers in order to take service from competitive suppliers. This surcharge is supposed to be a mechanism for utilities to collect costs that are "stranded" by retail competition. The problem with this surcharge mechanism is twofold. First, no Virginia utility has ever had these costs documented or quantified, and there continues to be widespread disagreement on whether these costs exist at all. Second, since retail customers presently have little opportunity to avoid paying these undocumented surcharges, competitors have to absorb these costs if they hope to offer savings to customers and stay in business.

While a utility may propose to forego part or all of any wires charges it otherwise is authorized to charge,[5] such a mechanism permits a utility to dictate the terms of competition within its service territory. It is hardly surprising that such an arrangement is met unenthusiastically by competitive providers.

The new subsection E to Va. Code § 56-583, enacted as part of Senate Bill 651, authorizes industrial and commercial customers, as well as aggregated customers in all rate classes, to switch to a competitive service provider without paying a wires charge if they agree to pay market-based prices if they ever return to the incumbent electric utility (the "wires charge exemption program").

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[5] Dominion Virginia Power has made such a proposal a part of its retail access pilot programs pending before the Commission in Case No. PUE-2003-00118.

The biggest drawback to the wires charge exemption program is that it is limited for each utility to customers totaling not more than 1,000 MW or eight percent of the utility's prior year Virginia adjusted peak load within 18 months after the commencement date of the wires charge exemption program, and thereafter according to the SCC's regulations that are to be developed. Customers who make this commitment and obtain power from suppliers without paying wires charges are not entitled to obtain power from their incumbent utility at its capped rates.

This limitation is fundamentally at odds with the premise of open competition, because it unfairly limits the number of customers that would be eligible to make this choice. It also reduces the likelihood that competitors will be interested in participating in Virginia's retail electricity markets. The Competitive Stakeholders support the right of *all* consumers to have a realistic opportunity to choose a competitive supplier as soon as possible.

The Competitive Stakeholders also believe that a utility's just and reasonable net stranded costs should be quantified, and a recovery period established for any utility that is found to have such costs. In the alternative, the CEUR and the Governor should revisit the version of the wires charge exemption program that was originally endorsed by the CEUR. This version would have allowed all customers the opportunity to purchase electric energy from competitive suppliers without the obligation to pay the wires charge surcharge, as long as they were willing to accept market-based pricing if they returned to their utility for generation service.

Finally, the wires charge exemption program does not place a limitation on a customer's loss of capped rate protection in exchange for a limited avoidance of wires charges. As presently enacted, the wires charge exemption program requires a customer to choose between the avoidance of wires charges through July 1, 2007, and the continued protection of capped rates through December 31, 2010, the date Senate Bill 651 set for rate cap protections to end. The Competitive Stakeholders believe this will create a disincentive to select an alternative supplier until the authority of a utility to collect wires charges expires in July of 2007, and will undermine the development of effective competition in the Commonwealth. On the other hand, an amendment to the Act that permits a customer to return to capped rates at the expiration of the wires charges collection period in July of 2007 would provide a fair balance of risk and reward for customers, utilities, and competitors alike.

c. Distribution Cost Treatment Should Not Be Tied To Restructuring, Especially After The End Of The Stranded Cost Collection Period (July 1, 2007) - Distribution Has Not Been Deregulated.

In extending the rate cap period, Senate Bill 651 did not address an underlying issue associated with that extension. Specifically, the rate cap extension may deny to consumers the opportunity to enjoy savings that are expected if the Commission were to exercise its continuing authority to regulate on a cost-of-service basis the monopoly transmission and distribution services of Virginia's utilities. Contrary to the arguments of some, this is not a pretext for a return to regulation, or for greater SCC control over the competitive market. Rather, it represents sound public policy that has been part of the Act since it was passed in 1999.

The enactment of Senate Bill 651 raises questions concerning the continued viability of the legislative intent behind the Act when it was adopted—and the original legislative and regulatory compact between utilities, consumers, and competitors—with respect to the rates utilities charge consumers for transmission and distribution service, and the Commission's ability to regulate such rates and service.

Specifically, Va. Code § 56-580 A directs (emphasis added) that "[t]he Commission is to *continue* to regulate pursuant to [Va. Code Title 56] the distribution of retail electric energy to retail customers in the Commonwealth and, to the extent not prohibited by federal law, the transmission of electric energy in the Commonwealth. Moreover, "[n]othing in [the Act] shall impair the Commission's *existing* authority over the provision of electric distribution services to retail customers in the Commonwealth including, but not limited to, the authority contained in Chapters 10 (§ 56-232 et seq.) [which contains the Commission's ratemaking authority] and 10.1 (56-265.1 et seq.) of [Va. Code Title 56]." Va. Code § 56-580 E (emphasis added).

The Competitive Stakeholders recommend that the original legislative intent of the Act, embodied in existing language found in Va. Code § 56-580, be reaffirmed in the coming legislative session. The Commission should be given clear guidance that it has the authority to assure that the rates of a utility's regulated transmission and distribution service do not artificially subsidize the price of its generation service, which is subject to competition. Subsidies of this sort put a damper on competition, and the Act recognizes the continuing authority of the SCC to make these important adjustments.

These changes and others will go a long way toward getting competitors excited about participating in Virginia's retail electricity markets. Consumers are interested in competition—that much is evident from the over-subscription of customers wanting to

participate in Dominion Virginia Power's pilot programs. Removing artificial barriers to competition will ensure that another critical component of retail competition—competitors—also will be encouraged to invest in Virginia. If the rules of competition are fair and open, competitors can bring the benefits of competition—downward pressure on prices, more choices, and better service—to Virginia's consumers.

On behalf of Constellation NewEnergy, Inc., Direct Energy Marketing, Inc., Pepco Energy Services, Inc., Strategic Energy, L.L.C., and Washington Gas Energy Services, Inc., thank you for the opportunity to provide these comments and recommendations.

Very truly yours,

Thomas B. Nicholson

May 25, 2004

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:

The attached joint statement reiterates the commitment of the signatories to a viable competitive electricity market in the Commonwealth. This joint statement from the parties represents agreement on the principles contained therein. Importantly, this statement urges the Commission to facilitate the process towards a fully competitive retail and wholesale electricity market by completing its review of the applications currently before it for the integration of incumbent electric utilities with a Regional Transmission Organization. It also calls for a re-commitment from stakeholders to strive for the successful development of a competitive market in Virginia. It is the firm belief of the participants to this joint statement that continued restructuring is in the best interests of the consumers in the Commonwealth.

Allegheny Power
Constellation NewEnergy, Inc.
Direct Energy Marketing, Inc.
Dominion Retail, Inc.
Dominion Virginia Power
Pepco Energy Services, Inc.
Strategic Energy
Virginia Energy Providers Association
Virginia Independent Power Producers
Washington Gas Energy Services, Inc.

JOINT STATEMENT ON COMPETITION AND RESTRUCTURING 2004
May 25, 2004

The electric utility industry in Virginia is undergoing significant changes. Restructuring and retail competition hold the potential to aid consumers through innovation, downward pressure on prices and enhanced reliability. In the Commonwealth, retail and wholesale competition can provide benefits to consumers.

Continued legislative and regulatory certainty is a necessary component for the ultimate success of restructuring in Virginia and the successful development of the competitive retail market. While individual market participants may disagree as to the methods of successfully developing competitive markets in Virginia, all parties agree that a continued and unwavering commitment to retail choice and wholesale competition is needed to bring these benefits to consumers.

With these factors in mind, we jointly offer the following comments on restructuring and competition in response to the Commission Staff's April 26 letter of invitation.

- Participation in a fully functional regional transmission organization is an essential prerequisite for development of robust competitive markets, both wholesale and retail. Delays in the entry of incumbent Virginia utilities into an RTO continue to pose a very significant obstacle to the success of competition in the Commonwealth.

The General Assembly has twice recognized that functioning RTOs are necessary for the successful development of competitive markets in Virginia. In 1999 the Restructuring Act directed all transmission-owning incumbents to join or form RTOs (called Regional Transmission Entities in the Restructuring Act). The 2003 General Assembly reiterated this directive, passing amendments to the Restructuring Act that directed all incumbents to transfer control of their transmission assets to regional entities no later than January 1, 2005, subject to Commission approval.

In comments submitted to the Commission in 2003, a wide range of stakeholders reiterated the view that membership by all transmission-owning incumbents in a functioning RTO is critical to successful competition in Virginia. The Commission's annual report on the status of competition released on August 29, 2003 acknowledged these comments. "Perhaps the most common issue raised among the comments submitted in response to the Staff's letter regards the lack of a fully functional RTO as the major obstacle" to an active competitive market in Virginia, the report said. (*2003 Status Report: The Development of a Competitive Retail Market for Electric Generation within the Commonwealth of Virginia*, Part III, page 10)

Membership by all transmission-owning incumbents in a functioning RTO would promote market transparency and reaffirm nondiscriminatory access to the interstate transmission grid for competitive suppliers and their customers. Access to a wider generation asset pool will enhance reliability, facilitate both wholesale and retail competition and provide savings opportunities for consumers. To promote the orderly development of Virginia's restructuring initiative, it is imperative that the Commission complete its review of these PJM membership applications of American Electric Power and Dominion Virginia Power and make appropriate recommendations

to require these utilities to join the PJM Interconnection LLC in compliance with the January 1, 2005 date in the Restructuring Act.

- Continued legislative certainty – and a high degree of regulatory certainty – are necessary components for the success of Virginia's restructuring program and the successful development of the competitive market.

Electric restructuring and retail competition are functioning in other parts of the country such as the District of Columbia, Maryland, New Jersey, New York, Texas, Maine, and Massachusetts. The General Assembly has now reaffirmed that continued restructuring is in the best interests of Virginia consumers. In light of that reaffirmation, we believe that by working together in a collaborative and constructive fashion during the transition we can bring restructuring's benefits to consumers and realize the General Assembly's goal of a competitive retail electricity market in the Commonwealth. To this end, consumer representatives, merchant generators, competitive service providers, incumbent utilities – and the Commission and its Staff – should recommit themselves to implementing restructuring and customer choice successfully. These stakeholders should further commit to ensure that effective competition is promoted in Virginia through operational flexibility, systems changes and incremental rule changes that allow consumers ready access to the competitive market. Additionally, these commitments should be clearly stated in the Commission's 2004 report on the status of competition in Virginia.

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Philip J. Bray, Esq.

Allegheny Power

(signature)

Edward F. Toppi (name)

Constellation NewEnergy, Inc.

James Steffes TBN ______ (signature)

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Direct Energy Marketing, Inc.

Jeffrey L. Jones (signature)

Jeffrey L. Jones (name)

Dominion Retail, Inc.

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E. Paul Hilton (signature)

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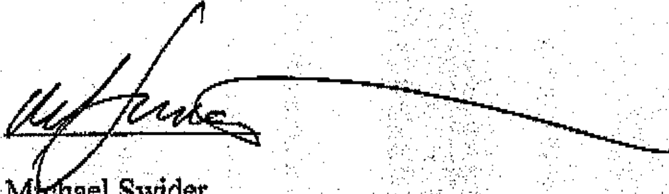
Senior Vice President
Dominion Resource Services, Inc.

Mark S Kumm (signature)

Mark Kumm
President, Asset Management Group
Pepco Energy Services, Inc.



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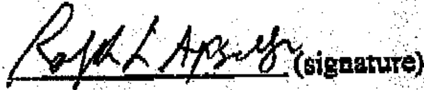
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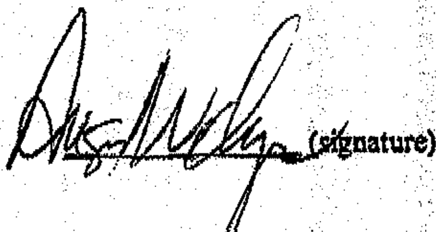
Virginia Energy Providers Association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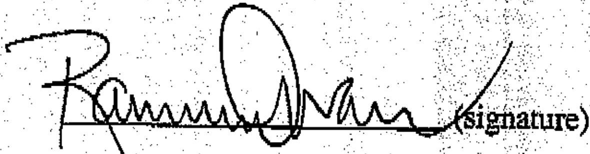
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Ransome E. Owan, Ph.D.
Director, Regulatory & External Affairs
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Virginia Citizens Consumer Council

2004 Status of Electric Restructuring in Virginia: The Consumer Perspective

Virginia decision makers have concluded that our future for the provision of electricity lies in the developing competitive market. For a competitive market to truly be competitive, there must be a level playing field among competitive providers, and the "power" of consumers as a whole and providers as a whole must be balanced. If this does not happen, then the competitive market will not work effectively. Historically, government regulation, mostly at the state level, has been the tool used to balance the power of consumers and providers. Virginia began the restructuring process under the perceived push of either doing it ourselves or having it done "to" us by federal entities unlikely to fully consider the unique needs of Virginia. We knew that historically our electricity prices have been considerably lower than the national market price, and definitely lower than the prices in states to our north and west. Today we are on the verge of voluntarily giving up state jurisdiction over key aspects of the electric system without the guaranteed protection we claimed to seek at the outset of this venture.

Unfortunately for Virginia consumers, the promise of even a net no-loss situation, much less any potential benefit, will never be fulfilled. To consumers, real competition means genuine choice among a variety of reliable providers without huge financial or service quality risk. Over the next few years consumers are going to realize that our leaders have given away the low electricity prices that have been critical to our economic progress as individual families and communities. Maybe this would have eventually happened anyway, but Virginia did not have to be the first low cost energy state to voluntarily give up such a crucial benefit. Investor owned utilities stand to gain much at the expense of consumers. Over the last year, this has become increasingly evident.

Prices are going up and will not go down. One of the ways that the imbalance of power between Virginia's utilities and its consumers is clearly demonstrated is the fact that currently there is no way for consumer rates to go down – no matter what happens in the marketplace.

Virginia's 2004 electricity legislation failed to allow consumers to call for a rate case under any circumstance. Only the utilities can petition for rate changes. While these opportunities are somewhat limited, the reality is that utilities have a significant advantage since no entity can require that prices go down, regardless of what happens with costs, and they are guaranteed that prices will go up if costs do. Now that this promise has been made, it is going to be hard for legislators to take it back. Any attempt will be met with cries of harm due to regulatory uncertainty and / or distress from loss of guaranteed income. <u>However, the SCC should make the case for rebalancing the power of utilities and consumers, and the administration and legislature should take action to fix the problem.</u>

When the original restructuring legislation was passed in Virginia, it was anticipated that a way would be found to calculate the stranded costs incurred by utilities. The intent was to assure that incumbent utilities were not put into a non-competitive situation by the costs related to the

transition and there was a promise to consumers that we would not have to overpay for these costs. This promise has been broken.

Our incumbent utilities have adamantly refused to prove these costs, because they do not exist. They know that if they opened their books, everyone would see that they have made such high profits that they would be forced to return some of them to rate payers. Thus they have refused to provide the proof that they deserve this income because of specific costs expended and proof that they will not be paid off either before the capped rate period ends or in the competitive market. No decision maker has stepped up to force them to do it.

Worse, incumbent utilities have managed to change the original intent of the law by convincing enough decision makers that the original legislation did not promise rate payers any money back under any circumstance and that it really promised that they could keep any profits as a carrot to move to competition that they requested. *As a result, the General Assembly has allowed incumbent utilities to unfairly strip dollars from consumers' pockets in quantities that far surpass the small tax increases that have caused so much turmoil within the Commonwealth*. The legislation passed in 2004 adds insult to injury by allowing the cost of tax breaks lost by utilities to be passed to consumers. <u>The State Corporation Commission and/or legislature must help level the playing field between the utilities and their customers concerning these issues.</u>

Craig-Botetourt Electric Cooperative, which serves my home, is already facing significantly higher prices for electricity. AEP sent us notice on the last day of February that effective March 1, 2005, they were terminating the service contract that has existed since August 15, 1984. Currently we are purchasing our electricity for a *wholesale* price of approximately 3.75¢ per KWH. As of March 1, 2005, our wholesale price will become approximately 4.5¢ per KWH. Both the current price and the new price are significantly higher than any of the *retail* prices AEP is charging its customer groups. Based on load, the customer group that we're closest to is large power subtransmission, currently charged a retail price of 2.7¢ per KWH. AEP refused our request to be served at that retail rate and acknowledged for customers served above their native load, future contracts will be at open market prices at the highest rate possible. Taking into consideration the difference in retail and wholesale rates and rounding a little, Craig Botetourt customers are going to be paying roughly *twice* what a similar load pays on the AEP system and facing a significant increase in cost. Family budgets, local government budgets and business budgets will be stretched by this increase.

This is the kind of situation that all Virginians can expect to face by the time the rate caps are removed. Unfortunately, the rural areas of our state, which are among the areas with the lowest income levels, are already facing these increases. Cooperatives have no choice but to pass on increased costs like these and there are no lower cost alternatives since the power must be purchased. There should be no surprise in the future when rural areas' financial problems increase and the number of companies offering jobs in rural areas declines compared with other areas of the state and there are increased demands on the state budget to assist stressed areas.

From the Blackouts last year, it is clear that *our country needs to significantly upgrade our transmission grid*. Also, in the post 9-11 world, there is a need to increase system security.

Obviously, costs will have to be paid and we should expect to pay them. This means that transmission costs will increase regardless of other decisions that may be made.

On May 20, 2004, AEP CEO Michael Morris told participants at the Edison Electric Institute conference in New York: "It's illogical for us to believe that rates are coming down. We need to start telling the world that this is one hell of a bargain." *Until now, utility executives have been telling Virginia decision makers that we could expect savings from restructuring – even in very low cost AEP territory.* We've been had. All efforts now must focus on regaining Virginia's benefit from historical decisions that kept our rates lower than the national average. The goal of any action should first be maintaining our historical low comparative cost for electricity.

Effect of the extended price caps on consumers. *Dominion Customers:* The price caps that exist today have been extended until 2010. For Dominion customers, this means that they only have the future risk of possibly paying more for fuel when the rates are re-examined in 2007. However, they are now paying the highest fuel rate in history. The legislation was passed under the threat by utility officials that these historically high rates would increase again this year if they were not guaranteed to keep at least the current rates until 2010. This was done in the face of documented long term projections that energy costs will go down by the end of the decade. Before the legislation was even signed by the Governor, analysts in New York were touting the magnificent deal that Dominion and its stockholders got from Virginia. Although energy prices are high right now, analysts project huge earnings for Dominion in a few years and they specifically noted that these will not be shared with rate payers. Since there was no rate case for Dominion shortly before or at the time restructuring began, and at that time rates were generally declining, Dominion customers are overdue for a rate reduction. The fuel increase that occurred recently was done through unfair single rate rate making that only benefits the utility. Ratepayers should share in any savings if fuel rates go down. It is not fair to make rate payers responsible if prices rise if they cannot possibly benefit when fuel rates go down. This unleveled playing field must be fixed.

AEP: For AEP customers, the 2004 legislation is far more devastating. AEP, the largest electricity generator in the nation and one of the largest electric utilities in the nation, has not sought a fuel rate increase in Virginia, recently. In fact, its last attempt to achieve a rate increase resulted in a decrease. Now, in addition to facing higher fuel costs, it is under heavy pressure to make expensive environmental and security improvements across its system. Comparatively, Virginia is a small segment in AEP's system, its administrative presence in Virginia is minimal, and it is unlikely that Virginia will ever again be a critical part of AEP's system. However, the 2004 legislation essentially gave powerful AEP a blank check signed by its Virginia rate payers for any environmental or security improvements.

While these can be assessed only once a year, any costs incurred can be passed straight to Virginia rate payers. AEP is a smart company and we can expect it to take full advantage of this opportunity and get as much paid for by Virginians as possible. Because Virginia has long been served by out-of-state generation and AEP has not been forced to specify which units serve Virginia, the Company can easily decide to now assign the expensive improvements to their Virginia customers. They can also charge these costs in an accelerated manner so they are paid

off when the rate caps are removed. The SCC must carefully scrutinize these expenses and assure that Virginians ONLY pay for the portion that are based on a fair allocation of improved facilities across the AEP system. It must also assure that costs for investments with long term benefit are properly charged so Virginia consumers only pay the portion due for the percentage of the useful life of these improvements that they will actually use between now and 2010.

There is no competition and it is unlikely to occur well beyond 2010. From a consumer perspective, there is no effective competition anywhere in the nation. If there was, consumers would have multiple choices of retail level providers vying for their business in a transparent, fair and reliable manner. Nationwide, consumers have received few competitive bids and even in states with widely advertised successful restructuring, large groups of consumers, especially in rural areas, have not received competitive offers.

Again, speaking to the Edison Electric Institute conference in New York, AEP CEO Michael Morris said that the merchant power sector is "dead as a doornail." Plans for a national competitive market depend upon a vibrant merchant power sector. Virginia has expedited approval processes and made every attempt to accommodate the needs of merchant power. However, until national change occurs, which we cannot influence greatly, Virginia's market will not work.

Recognizing that the market is not ready, our 2004 legislation extended the life of our rate caps. In the process our incumbent investor owned utilities got a greater long-term advantage over potential competitors than already inherently existed because of their incumbency. As described above, Dominion has the opportunity to make investments with excess earnings that will allow it to position itself at further advantage to new competitors when price caps are removed. Likewise, by guaranteeing AEP that Virginia rate payers will shoulder the burden of their environmental and security expenditures (and it seems that these categories are broad enough to include just about any possible expenditure), AEP has a tremendous opportunity to position itself ahead of future potential competitors.

The SCC should convince the legislature to change the imbalance between incumbent utilities and potential competitors so that there is potential for competition.

Distribution line maintenance and repair. In the competitive market, the bottom line cost matters a whole lot more to utilities than does customer service, especially in an environment where consumers really have no choice. Local distribution companies have little incentive to attempt to hold on to customers for their generation colleagues by providing high level service in today's environment. During September and October 2003 many Virginians discovered the hard way how few resources are allocated to line maintenance and repair by our utilities. Even some Dominion customers who live in the city of Richmond found themselves without power for a week or longer. Consumers widely believe that some of the efficiencies that utilities have obtained have occurred at the expense of careful maintenance to prevent outages and sufficient staff and equipment to complete repairs in a reasonable time.

The problems are not just related to major storms, however. Once again, I will use my Cooperative, Craig Botetourt, as an example. The average hours that our power has been off

because of power supplier issues increased from an average of .71 hour in 1999 to 12.94 hours in 2003. We did not lose power during Hurricane Isabel, so that does not explain the tremendous difference. By far, power supplier problems account for most of the time service was interrupted on the system. It appears that Dominion's actions to improve efficiency are the root cause. Now crews that repair problems have to drive several hours since their offices have been consolidated out of our area. A number of skilled repair workers have retired and the replacement workers lack their skill and experience.

Fair and adequate consumer representation in the decision making process. Recognizing the systemic problem of inadequate consumer involvement and consideration in the process of creating a restructured electric market in Virginia, Urchie Ellis requested effective consumer representation within the SCC. This was denied on the basis that the Attorney General's Consumer Counsel has that responsibility. Unfortunately, the Consumer Counsel sided against consumers and with investor owned utilities during the 2004 legislative session to get extremely anti-consumer legislation passed. This proves that consumers have no dependable advocate in state government.

The original electric restructuring act provided for a consumer panel to advise the process as a means of assuring appropriate consideration of consumer issues. That group has had little autonomy. It has been held to addressing only issues of comparatively small import and prohibited form addressing the most critical issues. It has not been taken seriously by decision makers and the counsel it has provided has been largely ignored in the legislative agenda. It did not even meet during 2003.

Further, investigation of the 2003 minutes of the Commission on Electric Utility Restructuring reveals that while utilities were prominently involved in every meeting, consumer groups and individual consumers were not granted a single opportunity to address the group. Further, the issues included have not been considered from a consumer point of view. This is not surprising since in the past most members appeared to be largely uninterested in even listening to the consumer perspective.

If we are to have a fair competitive market, consumers must obtain equal representation and consideration in the decision making processes. Elected officials must depend upon the financial support of business to get into and stay in office and Virginia's large businesses dominate decision making processes. <u>Virginia currently has a systemic problem that makes it impossible to achieve a fair balance between the needs of business and the needs of consumers. This must be changed.</u> Creating a fair balance is not anti-business. In fact, leveling the playing field between consumers and big business will actually help small businesses that want to compete in our market. It will also assure that the families of even the dominant businesses will find the marketplace to be fair.

Regional transmission organization. Currently there is tremendous pressure for Virginia to accept our incumbent utilities' demand to make an irrevocable decision and immediately join PJM. Consumers are opposed to such a move at this time. VCCC is not convinced that the basic structure planned will provide for a transparent and fair marketplace. Very large regional transmission organizations are a new concept that has not been proven to work effectively so

joining now would mean joining an experimental venture. While the concept allows multi-state utilities ease of operation, it significantly diminishes the influence of individual states and consumers, systemically increasing the already imbalance between utilities and consumers.

Although Virginia is geographically on the edge of the area proposed to be the ultimate PJM network and should therefore have the opportunity to choose among both a northern and a southern network, at this time the only viable network is PJM's. Researchers are evaluating its structure among a number of other options and there is no broad-based agreement that it is the best one. Thus, there is no opportunity for choice unless this decision is delayed. From the state's perspective, once made, it is an irrevocable decision.

PJM has been rapidly expanding its reach in recent years. The concept of operating such a large segment of our nation's electric grid as one unit is still experimental. It has never been done. Some observers believe that the magnitude PJM is seeking is beyond its effective managerial reach. Others note that from a security standpoint, creating such large and highly integrated networks could make us more vulnerable to terrorist attack.

There are structural market issues that need to be resolved so that the needs of consumers and business are fairly balanced if PJM's system is to work in the long run. If we accept the PJM strategy of LMP, owners of transmission will have *no incentive to build additional transmission* to reduce congestion. In fact, owners will earn significantly more if transmission is tight. No reasonable company will voluntarily build new transmission when doing so reduces its potential earnings. PJM has clearly stated that it will not force building of additional transmission for only economic reasons. Already, the eastern shore of Virginia is suffering from this problem. PJM has not taken action, nor does it plan to.

For areas seeking to obtain new electricity intense industry, there will be huge up-front costs to get the transmission needed and this may make it economically impossible for power constrained areas to get new jobs. Only existing congestion is proposed to be protected from price spikes for transmission if we move to PJM and consumers are not convinced that the protection is adequate.

PJM's system of large committees that meet hundreds or thousands of miles from Virginia and its dominance by utilities in decision making processes guarantees that neither consumer groups nor representatives of state government will have potential to adequately influence decisions. Virginia will have only one vote among many, losing prominence in critical decision making processes. On the other hand, PJM's structure will allow individual incumbent utilities to gain prominence. There is no systemic balance of the perspectives and motives of business and consumers in PJM. It is designed to first meet business needs. It is highly unlikely that Virginia will have any means of influencing a redesign that more fairly balances perspectives unless it happens before Virginia joins the organization. Virginia should not join PJM until its decision making structure fairly balances perspectives.

A decision to join PJM is not only a decision to join a transmission organization, it is an irrevocable decision to join a market. VCCC does not understand how Virginia's energy costs can decline if we join a market with a higher average cost than ours. *Economics indicate that if we join a market with higher cost than ours, our costs will increase* even if overall costs in the

market decrease. If our utilities join PJM, we need to be prepared for higher prices. When Delaware joined PJM its energy prices more than doubled. Pennsylvania is said to have excess energy that could cause our prices to decline. However, if that is true, why haven't Pennsylvania's prices dropped? They are higher than ours. Prices in the south are more like ours. It would be better for consumers if our utilities joined a regional transmission organization to our south. Since one does not exist today, it seems short-sighted for Virginia to make an unchangeable selection. Virginia should avoid taking irrevocable radical action of prematurely joining to the only existing regional transmission organization, opting for the conservative path of waiting until more options exist or until PJM's system resolves the existing imbalance of power between utilities and consumers.

Other issues. From the outset of Virginia's restructuring process, VCCC has clearly stated that *consumers do not want to pay more* ***just*** *to have a choice of providers*. That has not changed. We prefer to pay less. If we must pay more, we want an increase in value.

Consumers remain concerned about how the competitive electric market will assure that *low income people will be guaranteed at least a minimum supply of electricity at a price they can afford*. We know that a purely competitive market does not assure that everyone gets some of every product. Electricity is a basic necessity of modern life. Our restructuring legislation assumes that providers will make sure that everyone has service. Specific, enforceable plans need to be made to assure there is affordable, dependable electricity for those who because of income level, geographic location or other reasons are less desirable targets for competitive providers.

Consumers are also interested in the effect of our energy decisions on the environment. Virginia does not adequately promote Energy Star products. We lack an effective strategy for consumers to experiment with and select distributed generation and other new technology. Our system is being designed primarily around the needs of large corporate entities that sell electricity. Opportunities are needed for meeting the needs of others, as well.

Decision makers should keep these issues in mind and address them when there is an opportunity. They remain important to consumers and cannot be ignored forever.

Until the powers of consumers and all energy providers are balanced so that no entity has a huge advantage over another, the competitive electric market is not going to be successful. In the last year, the balance has swayed decisively in the direction of incumbent investor owned utilities, to the detriment of consumers and potential competitors. Significant changes must be made to create a fair marketplace.

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May 24, 2004

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 26, 2004, requesting comments regarding the status of competition in Virginia pursuant to Virginia Code § 56-596.B.[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.

In response to last year's request of the Commission Staff for comments on the status of competition, the Committees observed that retail competition for generation services had failed to develop in Virginia. With the exception of a miniscule number of customers purchasing at prices above "capped rates" from a competitive service provider that had stopped offering the service to new customers, there was no retail competition at all. In terms of the existence of retail competition, we stated, little, if anything, had changed since the prior year.

That situation remains unchanged; electric competition still has failed to develop in Virginia. Restructuring in Virginia has fallen below expectations in other respects as well, as demonstrated by the attachments, which are intended to assist in evaluating progress to-date and prospects for future success. They include:

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[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.

Attachment 1: Report Card on Virginia Electric Restructuring. The report card evaluates progress on key issues related to competition and restructuring. It reveals low or failing grades on the degree of retail competition, prospects for future customer savings from competition, customer rates during the transition to competition, the assessment of stranded costs and benefits (*i.e.*, whether power plants are worth more or less than book value), functioning of a regional transmission entity, and entry of independent power producers. The only "A" grade is utility earnings. While "capped rates" may provide incentives for reduced distribution and transmission reliability, that category receives no grade because it is still being assessed.

Attachment 2. Implications of Maryland Wholesale Bid Prices for the Future of Electric Restructuring in Virginia. Attachment 2 discusses the end of Maryland's capped electricity supply rates and the implications for Virginia. Capped electricity supply rates in Maryland end this summer, at the end of its transition period to retail competition. This will mean significant rate increases for Maryland electric customers. Maryland's experience does not bode well for prospects for customer savings from customer choice in Virginia. Retail customers of electric utilities in Virginia may remain on their respective utility's "capped rates" until 2011, so they will not be forced to pay market prices prior to that year.[2] If, however, such customers were forced pay market prices now, or if market prices in 2011 were similar to, or higher than, they apparently are now in PJM, it appears that, based on the wholesale bid prices in Maryland for standard offer service, electric rates for customers in Virginia would increase significantly.

Attachment 3: "Dominion: Capped Rates Equal Profit." DVP's earnings do not appear to have suffered as a result of restructuring. In fact, the SCC Staff's review last summer of DVP's 2002 earnings showed that it was overearning under "capped rates" and that its rates would be reduced by about 10%, or $400 million per year, if they were re-set based on its cost of service. Staff's review of 2003 earnings has not commenced. Recent amendments to the Restructuring Act extend DVP's capped rates through 2010 and freeze its fuel factor through June 30, 2007. Dominion Resources, Inc. ("DRI"), DVP's parent holding company, projects earnings increases of 5% to 7% in coming years, emphasizing the positive earnings impact of the recent amendments. Attachment 3 includes excerpts from DRI's presentation at a meeting in New York earlier this month between DRI officials and financial analysts and DRI's projected earnings increases. The excerpt indicates, *inter alia*, that enactment of the recent amendments "opens doors to increased earnings" for DRI. The attachment also includes a news article containing highlights of the meeting.

Attachment 4: Dominion Virginia Power's Request to Defer $280 Million of RTO Costs until 2011. Attachment 4 discusses DVP's request to the Federal Energy Regulatory Commission ("FERC") to defer $280 million in estimated RTO-related costs until after 2010, when its "capped rates" are scheduled to expire. DVP seeks the deferral in order to allow such

[2] The State Corporation Commission ("SCC") has the authority to terminate "capped rate" service prior to the end of 2010 if it determines that an effectively competitive market for generation services exists; however, in view of the progress of competition to-date and recent trends, such an SCC determination must be regarded as highly unlikely.

costs to be passed through to its customers. DVP represented to the General Assembly, however, that the recent amendments to the Restructuring Act, which extend its "capped rates" through 2010 and freeze its fuel factor until July 1, 2007, would benefit its customers by imposing on DVP the risks of new costs.

Attachment 5: Presentation of Jeff Pollock on behalf of the Virginia Committee for Fair Utility Rates and the Old Dominion Committee for Fair Utility Rates before the Commission on Electric Utility Restructuring. The Restructuring Act's wires charges and "capped rates" are intended to permit utilities to recover "stranded costs," *i.e.*, unrecoverable costs resulting from electric restructuring and competition in Virginia. On behalf of both Committees, Mr. Pollock presented the results of an analysis of stranded costs for DVP and Appalachian Power Company ("APCo") at a meeting of the General Assembly's Commission on Electric Utility Restructuring on November 24, 2003. (Attachment 5) He concludes that neither utility has any stranded costs and that, using a methodology for measuring stranded costs developed by Moody's Investors Service, AEP-Virginia and DVP would have stranded benefits of $874 million and $1.2 billion, respectively.

In formulating the Commission's findings regarding the status of competition, and in developing recommendations to the General Assembly, the Committees urge the Commission to consider the above comments. Electric restructuring has not worked so far in Virginia, and current developments do not bode well for its future success.

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 Virginia Code § 56-596.B.

Sincerely,

Louis R. Monacell

Edward L. Petrini

#678047

ATTACHMENT 1

REPORT CARD
VIRGINIA ELECTRIC RESTRUCTURING

ISSUE	GRADE	COMMENT
Degree of retail competition	F	Retail competition has produced no customer savings. A significant portion of Virginia's retail customers has had the legal right to choose since January 1, 2002. With the exception of one supplier that temporarily offered to sell "green" power at prices higher than the utility's capped rates, no supplier has offered to serve any retail customers.
Prospects for future savings from retail choice	D	Present market prices and trends suggest that American Electric Power's ("AEP's") customers have no prospect for future savings. Most of Dominion Virginia Power's ("DVP's") customers' prospects for such savings are dim in view of the likelihood of market prices exceeding capped generation rates by 2007.
Customers rates during the transition to competition	D	The State Corporation Commission ("SCC") Staff has issued a report indicating that DVP's rates are excessive by 10% and would be reduced by approximately $400 million per year if its rates were to be reset based on cost of service. Rates for customers of AEP may not have been excessive; however, 2004 amendments to the Act encourage unfair single issue rate increases for AEP without the ability to review the total cost of service to determine whether there are any cost reduction offsets. Rates of DVP's customers have soared since the Act the passed in 1999 because the Act has permitted rate "adjustments" to reflect increased fuel costs, and such costs have increased. A 2004 amendment to the Act freezes DVP's 2004 fuel factor through June 2007.

Utility earnings	A	DVP's annual report to the U.S. Securities and Exchange Commission ("SEC") shows that, on a total company basis, it earned more than 12 % on equity in 2003, down from more than 17% in 2002. DVP's holding company, Dominion Resources, Inc. ("DRI"), acknowledges now earning a 14% return on equity while emphasizing the importance of the recent extension of DVP's capped rates through 2010 and the freezing of its fuel factor until July 1, 2007, in its projected increases in DRI's earnings by 5% to 7% per year. Appalachian Power Company's Virginia electric business appears to have produced modest over-earnings during 2002 according to a recent SCC Staff report. Comparable earnings data for 2003 are not available.
Assessment of stranded costs and stranded benefits (whether power plants are worth more or less than book value)	F	The Virginia Electric Utility Restructuring Act ("Act") requires an assessment of whether utilities have over- or under-collected "stranded costs" (*i.e.*, costs rendered unrecoverable as a result of restructuring and competition). Despite the likelihood that no stranded costs exist, no such determination has been made. In fact, the existence of significant stranded benefits is more likely. According to the SCC Staff, since DVP's rates were capped by the Act effective July 1, 1999, DVP has earned more than $800 million toward stranded cost recovery, yet no stranded costs may even exist.
Functioning of Regional Transmission Entity (RTE)	D	The Act initially required utilities to join an RTE by January 1, 2001. Neither DVP nor AEP met the statutory deadline. In 2003, two years after the deadline, the General Assembly eliminated the original deadline and enacted a *new* deadline that requires utilities to join an RTE by January 1, 2005, subject to approval by the SCC. Both utilities now propose to join the PJM Interconnection, LLC ("PJM"), and they may join in late 2004 or during 2005. Neither has yet joined the PJM.
Entry of independent power producers	D	Generation owned or controlled by DVP and AEP continues to dominate Virginia's generation market. Independent power producers have built little new generation since passage of the Act. In fact, DVP has added to its generation fleet more MWs than the independents. As a result, market power has not been eliminated and possibly has been enhanced.
Reliability of distribution and transmission system	No grade yet	Capped rates could motivate Virginia utilities to decrease expenditures on reliability in order to increase profits and thereby reduce reliability. The SCC is collecting data on the number and duration of outages in order to assess trends.

ATTACHMENT 2

Implications of Maryland Wholesale Bid Prices for the Future of Electric Restructuring in Virginia

Maryland's frozen ("capped") electricity supply rates for electric utilities end this summer, at the end of its transition period to retail competition. The capped rates are based upon each utility's cost of providing generation, transmission, and ancillary services as part of its bundled service to its customers. Rates for standard offer supply service from the local utility to customers that do not choose a competitive service provider will replace the current capped electricity supply rates. Utilities have solicited and accepted bids from wholesale suppliers seeking to provide the new standard offer service, and have awarded contracts to wholesale suppliers based upon the bid prices. This change in Maryland from capped rates based upon the local utility's cost of service to standard offer service based upon wholesale suppliers' bid prices will result in significant increases in electricity rates to Maryland's citizens and businesses.

Rates for electricity supply in Maryland for larger industrial and commercial customers – defined as customers with a demand greater than 600 kW – could increase by 45% or more if such customers have received electricity supply service from their local utility and continue to do so. Total electricity bills could increase on the order of 35% or more. Such customers, moreover, will receive the option of standard offer service at a fixed price for only one year, until the summer of 2005. If they take electricity supply service from their local utility after the summer of 2005, their *only* standard offer service option will be an hourly priced service based upon locational marginal prices ("LMP") in the PJM Interconnection.

For a perspective on the level of the standard offer service electricity supply rates for larger industrial customers in Maryland pursuant to its wholesale bidding procedure, one can assume an industrial customer with an 88% load factor, with a demand above 600 kW, which takes service at primary voltage and uses 50% of its energy during on peak hours and 50% during off peak hours. Such a customer of Delmarva Power, for example, would pay an average of 6.909¢ per kWh for electricity supply, which includes generation, transmission, and ancillary services – that is everything but distribution service. In addition, such a customer must pay an "administrative charge" for receiving the standard offer electricity supply service. The charge is 0.65¢ per kWh.

In comparison, a similar Virginia Power customer presently would pay 4.057¢ per kWh, on average, for electricity supply service (generation, transmission, and ancillary services – that is, everything but distribution service) under capped rates. If such a customer were required to pay 6.909¢ per kWh for electricity supply service (and assuming it were required to pay no "administrative charge"), its rate would increase 70% for electricity supply service and 67% for electricity service overall.

A similar customer of AEP in Virginia presently would pay 2.6184¢ per kWh on average for electricity supply service (including generation, transmission, and ancillary services – that is, everything but distribution service) and 2.8772¢ per kWh for all services, including distribution service, under capped rates. In contrast, a similar customer of Delmarva Power in Maryland would pay 6.909¢ per kWh for electricity supply service, or 4.2906¢ per kWh more than what a

similar customer would pay AEP here. That is, the Maryland customer would pay 164% above what an AEP customer in Virginia would pay for electricity supply service and 140% above what that customer would pay in total rates.

Both Virginia Power and AEP propose to join PJM later this year. When such utilities are part of PJM, they will be part of the same PJM market and, presumably, market prices available in the service territories of AEP and Virginia Power will be similar to market prices in Maryland, which is also part of PJM.

The Staff of the Maryland Public Service Commission ("Maryland PSC Staff") filed a report, dated April 29, 2004, with the Maryland Public Service Commission describing the process and the results of the competitive wholesale procurement process used to determine prices for standard offer supply service at the end of Maryland's capped rate service. The Maryland PSC Staff found evidence of robust competition as shown by the large number of bidders, the large number of bids received, and a wide range of bid prices. The number of megawatts offered was nearly five times greater than the number of megawatts awarded. Of twenty five wholesale bidders, fourteen won contracts to provide some portion of the wholesale supply for full requirements service to Maryland customers who do not choose a competitive service provider.

The Maryland PSC Staff calculated the projected rate increases for residential and small commercial customers. Rates for standard offer power supply service for residential customers of PEPCO, for example, would increase 24% above capped rate power supply rates, and total bills (which include the distribution portion of the bill as well) would increase 15%. Residential customers of Delmarva Power in Maryland would see increases of 17% to pay for standard offer service power supply rates, as compared to capped rate power supply rates, and total bill increases of 11%.

In Virginia, retail customers of electric utilities may remain on their respective utility's capped rates through 2010, so they will not be forced to pay market prices prior to then.[1] If, however, customers in Virginia were forced to go to the market now, or if market prices in 2011 were similar to, or higher than, they apparently are now in PJM, it appears that, based on the wholesale bid prices in Maryland for standard offer service, customers in Virginia could see significant increases in their electricity costs. As suggested above, such increases for larger customers of Virginia Power might be on the order of 65% and for larger customers of AEP on the order of 140%.

The SCC and the General Assembly in Virginia should investigate Maryland's wholesale bid prices to assess their implications for Virginia's public policy of moving toward market based rates.

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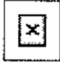
[1] The State Corporation Commission ("SCC") has the authority to terminate "capped rate" service prior to the end of 2010 if it determines that an effectively competitive market for generation services exists; however, in view of the progress of competition to-date and recent trends, such an SCC determination must be regarded as highly unlikely.

ATTACHMENT 3



Dominion: Capped rates equal profit

Gains of up to 7 percent a year expected under extension through 2010

BY GREG EDWARDS
TIMES-DISPATCH STAFF WRITER
Friday, May 7, 2004

Virginia's extended capped electricity rates should mean higher profit for Dominion Resources Inc., executives of the Richmond-based utility told Wall Street analysts yesterday.

The governor, attorney general and boosters including Dominion Virginia Power, a Dominion subsidiary, sold a 3½-year extension of capped electricity rates to the General Assembly this year as a way to protect consumers from the failure of electric deregulation to produce competition.

Virginians may be happy with the extension, which will keep electric base rates - which do not include overall rate adjustments for fuel, reliability and environmental costs - at their mid-1990s levels through 2010.

Dominion, however, should do well under capped rates, too, increasing profit from 5 percent to 7 percent a year, Dominion executives said.

Dominion can better increase its profit with frozen rates than it could under the old system of state-regulated rates, Chairman and CEO Thomas E. Capps said. "We've always made money when things freeze."

Thomas F. Farrell II, Dominion's president and chief operating officer, described the capped-rate extension as the last component needed for Dominion to become the most competitive and profitable integrated energy company in the country.

Dominion was earning an 11.5 percent return on shareholder equity in 1999 when rates were capped. It is earning 14 percent today because deregulation and capped rates caused the company to become more efficient and improve service, Farrell said. Uncertainty about rates has been eliminated through 2011, he said.

The capped-rate extension legislation also froze until mid-2007 the amount of power-plant fuel costs that Virginia Power can pass along to its customers. Fuel rates are frozen at $17.56 per megawatt hour, an all-time high, and any fuel savings boosts the bottom line.

Farrell enumerated several potential areas for savings. Dominion can reduce its costs for coal, which makes up 46 percent of its fuel costs, by negotiating favorable long-term contracts. The company can also increase the service time of its nuclear units from 91 percent to as much as 96 percent, which could add $20 million to earnings next year, he said.

Virginia Power - with no capital investment required - is making software changes in the way voltage is managed that could save up to $4 million a year by reducing the power lost through the transmission system, Farrell said.

Dominion is looking at up to $9 million in additional revenue from oil and coal sales at Tidewater facilities, and will use earnings from its oil and gas exploration and production business to offset

increases in the cost of fuel to generate electricity.

Virginia Power has cut by $160 million the annual amount it pays to independent power plants but still has contracts with independents that cost $580 million yearly. Since the passage of this year's legislation, the company has never been more active in cutting those costs, Farrell said.

Dominion will not see a higher profit until next year. This year, it expects less profit because of the frozen fuel rate. The company took a $20 million loss on unrecoverable fuel costs in the first three months of 2004 and expects to lose millions more on fuel through the rest of this year.

Farrell described the capped-rate law as a win for consumers and an opportunity, but no guarantee, for Dominion to increase profit. "We must perform," he said.

He said the company is not concerned about electric competition developing in Virginia and hopes it does.

Capps, responding to a question, said he does not expect the state legislature to change or reverse deregulation or seek a rate cut for power companies. Lawmakers have tried and failed before, and the legislature has been solidly behind competition for nearly a decade, he said.

It would take a big number of Virginians calling up their lawmakers to force a change in the law, he said. "That ain't going to happen," he said. "Nobody in Virginia is picking up the phone, writing a letter or sending e-mails complaining about electric rates because they've been flat since 1992."

In answer to another question, Capps indicated that Dominion may increase its dividend this fall. The dividend has not been raised in roughly a decade, but Capps indicated that Dominion's cash-flow situation may allow an increase.

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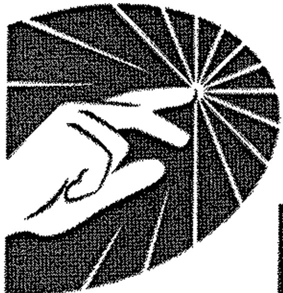

Dominion®

Spring 2004 Analyst Meeting

Update on Electric Deregulation in Virginia - SB 651

New York

May 6, 2004

Dominion's Got What it Takes

Dominion has consistently demonstrated earnings growth by building a balanced portfolio and developing competencies in operational, financial and risk management excellence. The latest Virginia Restructuring Law is one more piece of the strategic puzzle.

***Note:** For a reconciliation of GAAP to non-GAAP financial measures, please go to our website at www.dom.com/investors under "GAAP Reconciliation".*

Performance & Stability

- SB 651 opens doors to increased earnings
- The Rate Cap extension provides revenue certainty for additional 3 1/2 years
- Fixed fuel factor lowers Dominion's consolidated risk profile

ATTACHMENT 4

Dominion Virginia Power's Request to Defer $280 Million of RTO Costs Until 2011

Dominion Virginia Power ("DVP") urged the General Assembly to amend the Virginia Electric Utility Restructuring Act by enacting SB 651, effective July 1, 2004. It argued that the bill would benefit its customers by freezing their rates at the current level and by imposing upon DVP all of the risks of new costs.

On May 11, 2004, however, DVP and the PJM Interconnection LLC ("PJM") filed with the Federal Energy Regulatory Commission ("FERC") a joint application to establish PJM South and transfer control of DVP's transmission assets to PJM. In the application, DVP asks FERC to permit it to defer approximately $280 million in costs that DVP estimates it will incur from seeking to join and joining a regional transmission organization ("RTO"). DVP argues in the application that it should be entitled to defer such costs and collect them after the expiration of the "capped rate" period in Virginia because "a state imposed rate cap will prevent Dominion from being able to recover any of the RTO-related costs."[1] The "capped rate" period is scheduled to end January 1, 2011. DVP further states that it should be entitled to defer and collect such costs from its customers because "Dominion is not eligible for any rate cases or any of the aforementioned rate adjustments. It is subject to the rate cap which became effective January 1, 2001, and which now will extend through December 31, 2010."[2]

Further, DVP states: "Given that RTOs provide significant customer benefits, it is appropriate for such customers to bear the associated costs of developing and participating in an RTO."[3] This statement is inconsistent, however, with the fact that "capped" base rates and frozen fuel rates prevent DVP's customers from receiving benefits from DVP joining the RTO, *i.e.*, benefits resulting from reduced fuel costs or avoidance of the need to build new generating units. With "capped" based rates and frozen fuel rates, DVP's shareholders, not it customers, will receive such benefits.

DVP should not be permitted to argue to the Virginia General Assembly that it is willing to bear the risk of all new costs during the "capped rate" period and, at the same time, argue to the FERC that, because of the "capped rates," it should be permitted to defer $280 million of RTO costs so that all such costs will be borne by its customers after the expiration of "capped rates."

#677881

[1] Joint Application at 20.
[2] Joint Application at 21, fn. 45.
[3] Joint Application at 19.

ATTACHMENT 5

Presentation of Jeff Pollock
on behalf of the
Virginia Committee for Fair Utility Rates
and the
Old Dominion Committee for Fair Utility Rates
before the
Commission on Electric Utility Restructuring
November 24, 2003

Introduction

- Jeff Pollock is a principal with BAI (Brubaker & Associates). In his 29 years of practice in the utility industry, Mr. Pollock has participated in regulatory issues both in Virginia and in 19 other states, primarily in the southeast. He is especially active in Texas, which thus far has the most successful retail customer choice program in the nation.
- Mr. Pollock's firm, BAI, has been active in regulatory and legislative matters in many other states across the country. BAI has participated in or assisted over 30 other customer groups similar to the Old Dominion Committee for Fair Utility Rates (ODCFUR) and the Virginia Committee for Fair Utility Rates (VCFUR) in transitioning from regulation to customer choice.
- The Committees have retained BAI to render an opinion whether Appalachian Power Company (APCo) and Dominion Virginia Power Company (DVP) have stranded costs.
- As Mr. Pollock will explain, the short answer in both cases is a resounding NO!

Summary

- The purpose of our analysis is to determine whether APCo or DVP have stranded costs as a result of allowing retail competition. Our analysis reveals that neither

APCo nor DVP have stranded costs. Using a methodology first developed by Moody's Investors Service, a highly reputed firm that specializes in rating bonds and other securities, we have calculated that APCo would have $874 million of stranded benefits. Coupled with other evidence, we conclude that APCo does not have stranded costs.

- We obtained a similar result for DVP - $1.2 billion of stranded benefits – under the Moody's methodology. This study, coupled with the more detailed asset valuation presented to the State Corporation Commission and intervening changes, has led us to conclude that DVP does not have stranded costs.
- These results are based on the same 2003 market prices used by DVP and APCo and approved by the State Corporation Commission to set wires charges.
- We know that projected market prices for 2004 are significantly higher. Using these significantly higher market prices, stranded benefits would increase still further.
- Asset valuation is the appropriate method of administratively quantifying stranded costs. This was the approach used by DVP in a 1997 regulatory proceeding and used by VCFUR and the Attorney General in 1998. Further, the SCC Staff has recommended asset valuation. The Moody's methodology is another example of an asset valuation and it provides a "snapshot" of stranded costs.
- DVP's proposed method for quantifying stranded costs fails because, unlike an asset valuation, it doesn't compare book value with the market value of its generating assets over their remaining useful lives.
- Before elaborating further about our conclusions, allow me put our analysis in perspective.

Background on Stranded Cost

- The stranded cost debate arises in those states allowing retail customers to choose their electricity supplier. Stranded costs are *revealed* by retail competition because if customers can choose an alternative electricity supplier, the former regulated utility *might* not be able to fully recover the prudently incurred investments that it made under regulation.
- This is consistent with the definition of stranded costs in the State Corporation Commission's July 2003 Report to the Commission on Electric Utility Restructuring of the Virginia General Assembly, which I have adopted. Specifically, stranded cost is defined as the utility's net loss in economic value arising from electric generation-related costs that become unrecoverable due to restructuring and retail competition.
- In other words, unless customers switch from their current regulated suppliers, stranded costs are zero. Without suppliers vigorously competing for retail business, there can be no competition, and without competition, there can be no customer choice, and therefore, no stranded costs.
- In Virginia, to date, only very few customers have switched suppliers. Therefore, even though current law allows retail competition for all customers, no costs have been stranded. Despite this fact, DVP has been allowed to accumulate hundreds of millions of dollars in excess earnings for the sole purpose of stranded cost recovery.
- The irony here is that the longer it takes before all retail customers switch suppliers, the less likely a utility will incur stranded costs. At the earliest, significant switching will not begin until July 1, 2007, when wires charges expire and all customers must pay market prices.

Definition and Quantification of Stranded Cost

- As mentioned previously, BAI has been involved in many states during the transition from regulation to customer choice. Although each state has approached the stranded cost issue somewhat differently, we have learned that there are appropriate and reasonable methods of quantifying stranded costs.
- Though concerns have been raised that quantifying stranded costs requires making assumptions, many of the key variables used in a conventional asset valuation can be fully vetted. For this reason, regulators in customer choice states have been empowered to determine stranded costs for their regulated utilities in contested proceedings. The good news is that the SCC need not begin from scratch. There is a wealth of experience and regulatory precedent that can be used to quantify stranded costs in the Commonwealth.
- First, we can agree that stranded cost is the difference between the regulatory book value and the corresponding market value of a utility's generation fleet. If the market value exceeds book value, then a utility is said to have stranded benefits.
- Second, determining book value is relatively easy. The more challenging task is quantifying the market value. This process is no different in principle from a conventional asset valuation. Asset valuation is widely used by appraisers, financial analysts, investors, and consumers.
- Asset valuation is not rocket science. In an asset valuation, we calculate the net present value of the free cash flows (that is, future revenues less future cash expenses) derived from the use of the assets over their remaining useful lives.

- DVP used similar valuation techniques in the "Transition Cost Report," which it filed with the SCC in 1997. DVP is also using these techniques to conduct asset impairment tests for financial reporting purposes.
- The Moody's approach to valuing utility assets and determining whether a utility is likely to have stranded costs, which I have used in my analysis presented here, is an excellent example of a simplified, but reasonably accurate, asset valuation technique. It is a snapshot based on current conditions.
- The "Moody's" methodology uses publicly available data to determine whether the regulatory net book value of generation assets can be sustained in a competitive market environment. The analysis also takes into account reported payments made to independent third parties for purchased power and any remaining regulatory assets.
- Using the Moody's methodology, we calculated that APCo and DVP would have stranded benefits of $874 million and $1.2 billion, respectively. There is, however, other evidence to support our conclusions that neither utility has stranded costs.

<u>APCo</u>

- First, with respect to APCo, not only does APCo enjoy very low rates, APCo has not asked the SCC to implement a wires charge under the Act.
- APCo's rates are the lowest for industrial customers in the southeast. A recent BAI survey of industrial electricity rates revealed that APCo ranks 28th out of 30 utilities in the Southeast, where 1 is most expensive and 30 is the least expensive. The survey includes investor-owned utilities and the TVA.

- Wires charges, along with capped generation rates, are the tools through which utilities are allowed stranded cost recovery under the Act.
- A wires charge is the amount of revenue that APCo would lose if customers were to switch suppliers. It is the difference between capped generation rates and the current market price.
- A zero wires charge means that market prices are higher than the capped rates. In other words, there are no stranded costs, only stranded benefits for APCo.

DVP

- The results we obtained for DVP comport with a prior study that was filed by DVP in a 1997 regulatory proceeding before the SCC. I am referring to the Transition Cost Report.
- The Transition Cost Report was an in-depth and detailed asset valuation. DVP determined the market value of its entire generation fleet, along with its substantial NUG purchases, to quantify potentially stranded costs. Based on its analysis, DVP contended that it would have $2.5 billion of potentially stranded costs.
- BAI conducted an in-depth analysis of the DVP study and in particular the underlying assumptions. We were very impressed with the detail and thoroughness of the study. DVP's asset valuation study estimated the free cash flows from the generation fleet operating in fully competitive markets through 2015. It was in nearly all respects a bona fide asset valuation.
- One of DVP's key assumptions was that competitive suppliers would serve all customers on January 1, 2003 – a fact we know today to be wrong. Ignoring this obvious hindsight, our analysis revealed several major flaws.

- Correcting only two of these flaws, and using DVP's method otherwise, my firm determined that DVP would have $2.7 billion of stranded benefits.
- The two major flaws that we corrected to arrive at the opposite conclusion as DVP were:
  - Employing a cut-off date of 2035, rather than 2015, to recognize the fact DVP's generation fleet will have many years of useful life beyond 2015.
  - Using a capacity value that would encourage competition.
- By prematurely cutting off the study at 2015, DVP failed to fully capture the much greater market value of its generating assets during a period when they would generate the most profit.
- Undervaluing capacity means understating the cost of maintaining reliability. We would all agree that maintaining reliability is critical regardless of the regulatory environment.
- Despite the 1997 vintage of the DVP study and our two corrections to it, the conclusions would be the same if a similar study were conducted today – DVP has no stranded costs. Consider the following:
  - Market prices for electricity are much higher than the Company assumed due to higher natural gas prices. This increases the market value of DVP's generation fleet, thereby reducing any potential stranded costs and increasing stranded benefits.
  - DVP has extended the lives of its nuclear plants by 20 years. This will reduce costs under capped generation rates (due to lower depreciation expense). Further, the Company will be able to profit handsomely in competitive markets

because the operating cost of a nuclear plant is 15% or less of the wholesale market price of electricity. This would further increase stranded benefits.

  - The Company has renegotiated several of its NUG contracts, and several contracts have expired since 1998. As a result of the passage of time, the Company's commitment under purchased power contracts is about $1 billion lower on a net present value basis.

- Finally, as I previously stated, DVP is using asset valuation techniques for financial reporting purposes to determine whether it will have to write-off investment or recognize losses under its purchased power contracts. Thus far, the Company has not had to write down any plant investment or recognize any contract losses. In essence, the Company is conceding, based on its own assessment of future market prices, that it has no stranded costs.

Stranded Cost
Summary

- No evidence that either APCo or DVP have stranded costs
- Asset valuation is the appropriate methodology
  - ➢ Used by DVP in 1997 ($2.5 Billion stranded cost)
  - ➢ Used by Attorney General in 1998 ($1.3 Billion stranded benefits)
  - ➢ Used by VCFUR in 1998 ($2.7 Billion stranded benefits)
  - ➢ Recommended by the SCC Staff
  - ➢ Used by Moody's ("snapshot")

Estimated Stranded Costs Using Moody's Methodology

Stranded Benefits ($Millions)

$0
($200)
($400)
($600)
($800)
($1,000)
($1,200)

APCo	($874)
DVP	($1,182)

1997 Transition Cost Report
DVP Analysis

	Transition Cost Report
Fossil & Hydro	($463)
Nuclear	$608
NUG Contracts	$2,322

Estimated Stranded Costs (Benefits) With VCFUR Corrections

	Corrected
Fossil & Hydro	($4,855)
Nuclear	$102
NUG Contracts	$2,032

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May 24, 2004

David Eichenlaub
Assistant Director, Finance
State Corporation Commission
1300 E. Main Street
Richmond, VA 23218

Response of PJM Interconnection, L.L.C. to the Virginia State Corporation Commission's April 26, 2004 Request for Market Participant Comments on the 2004 Report to the Commission on Electric Utility Restructuring

Dear Mr. Eichenlaub:

PJM Interconnection, L.L.C. ("PJM") is pleased to provide these comments in connection with staff's review of the status of electric restructuring in the Commonwealth.

The electric restructuring legislation enacted by the General Assembly has recognized the importance of a strong regional transmission organization ("RTO") in the Commonwealth. PJM believes it is well-suited to meeting the General Assembly's requirements. PJM has over 75 years of experience in regional coordination and centralized security-constrained dispatch to balance the output of a wide variety of electric generating resources with load. Since 1997, PJM has served as an independent entity that both ensures the reliability of the electric power grid and operates a competitive wholesale market. Indeed, the SCC was one of the original signatories to a Memorandum of Understanding between PJM's Board and its state regulatory commissions, and was one of the founding members involved in the formation of PJM as an independent transmission grid operator.

The critical test of the suitability of any RTO is the test of use. Since its inception, PJM has met or exceeded all applicable NERC reliability criteria. Since 1999 and in conjunction with PJM's regional planning process over 10,000 MW of new generation has been placed in service and over 15,000 MW of additional generation is currently being studied. Approximately $700 million of transmission upgrades have been approved by the Board of Managers, including $100 million in investment on the Delmarva Peninsula. These substantial additions to the bulk power facilities in PJM increase reliability and contribute to a robust wholesale market. PJM has seen a five year decline in the forced outage rate of generators, reflecting a trend toward greater

efficiency. As proven with the integration into PJM of Allegheny Power and Commonwealth Edison, the PJM model can be introduced readily into regions that were not part of PJM's original power pool and that are served by other reliability councils. The integration of Allegheny Power into PJM enabled it to save over $40 million in an initial eight month period as a result of its full participation in PJM's regional energy market.

PJM believes that the integration of Dominion and Appalachian Power into PJM will provide a solid foundation for the SCC's ongoing efforts to implement the restructuring statutes of the Commonwealth. As one large entity with many resources and tools at its disposal, PJM is able to "see the big picture" and take appropriate action to address reliability issues in real time and prospectively. As a result, the integration of Virginia's utilities into PJM will enhance reliability in the Commonwealth. The August 14, 2003 event in the Midwest proved the need for such an entity to monitor the grid and take necessary remedial action before problems cascade.[1]

PJM is keenly aware of the Commission's perception that it may lose jurisdiction if the electric utilities it regulates join PJM. In fact, the SCC will retain ultimate retail ratemaking authority, and in other respects its ability to exercise its jurisdiction will be enhanced. Because PJM's markets are voluntary, Virginia electric utilities will have the option to self-schedule their load employing their lowest-cost resources, to arrange for bilateral transactions, or to rely as is appropriate on the PJM LMP-based energy market. These options provide assurance that Virginia native load will be protected from higher prices elsewhere, as the Commission's enhanced access to the cost information provided by the marketplace provides a basis for regulators to assess the reasonableness of default service pricing.

From a planning perspective, the Commission will retain its siting authority while enjoying access to more comprehensive and robust information developed in PJM's regional planning process. Both AEP and PJM have identified a number of points on our respective systems where congestion could better be addressed through a regional planning process (*see* the testimony of AEP witness Craig Baker in Case No. PUE-2000-00550.) In many cases, the "fix" for transmission problems might be an upgrade that is beyond the SCC's authority to order as it involves upgrades in another state or on a system outside the SCC's jurisdiction. A regional planning process with active participation by the SCC would help assure that the appropriate upgrades are made, whether for reliability or economic considerations (or both), at the most reasonable cost.

PJM is committed to working with the SCC to ensure a successful restructuring of the industry in the Commonwealth. We attach to this document a copy of our 2003

[1] On August 14, 2003 PJM identified certain problems on the First Energy system which it communicated to First Energy and MISO, First Energy's reliability coordinator. Once the cascade began, PJM was able to isolate the PJM system to prevent the blackout from encroaching and spreading to the PJM region, Virginia, and the rest of the Eastern Interconnection. The facts demonstrate that a large entity with market tools and independence from market participants is best able to maintain reliability with such tools and established communication protocols.

Annual Report, as well as the PJM Market Monitor's State of the Market Report. We welcome further discussion of the issues raised in this submittal and look forward to working with you in the days and weeks to come.

Very truly yours,

/n/

Craig Glazer
Vice President—Government Policy

RESPONSE FROM PJM INTERCONNECTION, LLC

Although not reprinted here, the response from PJM Interconnection, LLC, included two attachments that may be found in its entirety at:

2003 PJM Annual Report:
http://www.pjm.com/about/downloads/pjm-web.pdf

2003 PJM State of the Market Report:
http://www.pjm.com/markets/market-monitor/downloads/mmu-reports/pjm-som-2003.pdf