

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 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 March 17, 2005, the Staff sent a letter electronically to 84 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 five initial responses and one additional reply to others' comments, included as Appendix III-A to this Report. It should be noted that one of these responses was a joint comment submitted on behalf of three competitive suppliers, thus representing suggestions from a total of 7 entities. In similar surveys conducted in both 2004 and 2003, the SCC received eight and twelve such responses, respectively.

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

Generally, most of the comments received are similar to those expressed in prior years' reports and reiterated during the past year via various forums. Respondents'

recommendations do not provide new ideas as all suggestions have already been considered, or are currently under consideration, by the SCC and the CEUR.

Most perspectives indicate a major milestone was reached this past spring as DVP integrated into PJM. This action completed the transfer of operational control of transmission lines to an RTO for the investor-owned utilities as required by the Restructuring Act. After only a few months of RTO operation, it is premature to determine if the anticipated benefits to customers will be realized. Other major issues mentioned in the comments, and considered to be obstacles, include the continued existence of wires charges and the low, capped rates of the incumbent utilities and default rates not yet reflecting market prices.

Although the majority of the responses identify the above concerns, these same entities encourage the continued path of restructuring to facilitate a well-developed competitive retail market in Virginia. The two responses representing consumer interests remain skeptical. The large consumer group cites examples of competitive wholesale markets resulting in significantly higher retail prices. They caution that electric restructuring has not yet worked in Virginia and current expectations do not look promising for the future. Although their concerns are articulated, and they believe a better balance of risks and benefits among all stakeholders is needed, they stop short of suggesting a stop or reversal to electric restructuring. The small customer representative contends that deregulation is not working, will not work in the future, and urges a reversal of direction back to a regulated environment. 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.

SCC Assessment

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 the SCC considers to be in the public interest. In last year's report, the SCC noted that passage of Senate Bill 651 by the 2004 General Assembly and approval by the Governor provides legislative direction to continue implementing the Restructuring Act. In the year since the issuance of last year's report, the SCC continues to perform its charge to provide regulatory certainty and put in place the necessary infrastructure to implement restructuring.

The integration of APCo and DVP into PJM on October 1, 2004, and May 1, 2005, respectively, were watershed events in Virginia's transition to a restructured electricity market. At present, virtually all Virginia load is served under the terms and conditions of a FERC approved RTO (PJM) and the wholesale electric market rules that go hand-in-hand with those integrations. While delay in PJM integration was thought by some stakeholders to be a major impediment to the spread of retail competition in the Commonwealth, thus far the integration of Virginia's two largest incumbent electric utilities has not led to greater levels of retail competition.

Virginia traditionally enjoyed relatively low regulated electricity prices. The existence of capped rates along with steep increases in fuel and wholesale electric power costs continue to provide little margin in which alternative suppliers can compete. As past versions of this Report have noted for some time, there is tension between the belief

that price caps are a fundamental flaw of the Restructuring Act and the belief that consumers should not be exposed to market-based prices until effective competition has developed and can be depended upon to regulate prices.

The 2004 General Assembly agreed that rate caps are an essential consumer protection built into the Act and chose to continue such protection by extending the capped non-fuel rates for incumbent utilities until December 31, 2010. It also determined that wires charges would expire on July 1, 2007, as originally intended. Since current and expected electricity market prices generally exceed capped generation rates (including fuel costs), wires charges were generally not applicable in 2005 and are not expected to apply in 2006. The current and likely future absence of wires charges combined with the integration of APCo and DVP into PJM have yet to induce any increase in retail competition in Virginia even though these two “barriers” were long stated to be major impediments, at least by certain stakeholders. On the other hand, note that the PJM integrations were relatively recent and future wires charges expectations are just that; expectations that may turn out differently. Though unlikely, the possibility of a return to wires charges in 2006 and the first half of 2007 does indeed add risk, and thus costs, to the provision or consumption of competitive retail services.

In 2004 the General Assembly amended the Restructuring Act to allow a large customer that chooses to take service from a competitive service provider to be exempt from minimum stay provisions or the payment of wires charges. In exchange, any such shopping customer will face market-based costs upon any subsequent return to supply service provided by the incumbent utility. The SCC was charged with implementing these statutory changes. Unfortunately, the SCC proceeding related to these changes has

proved highly controversial and time consuming. As such, these changes have yet to be implemented. However, given the amount by which electricity market prices exceed capped generation rates (including fuel costs), it is unlikely that any delays in implementing these provisions have retarded the development of competitive retail electricity markets in Virginia.

Many believe the underlying premise of the Restructuring Act is that a competitive market will result in lower retail electricity prices for all Virginia consumers. Unfortunately, retail competitive activity continues to develop slowly throughout the nation, not just in Virginia or in the Mid-Atlantic region. This is especially true for smaller, mass market consumers. Consequently, a market has not yet fully developed that can be depended upon to govern prices. Many have said that the development of well-functioning competitive retail markets must be preceded by the development of well-functioning competitive wholesale markets. While this may be true, it may also turn out that well-functioning wholesale and retail markets may still result in prices to consumers that are higher than historical prices or higher than what “just and reasonable” prices would have been under continued regulation, either as had been practiced in the past or some close variation thereof. Poorly functioning markets may aggravate the situation, increasing prices to Virginia’s homes and business even further.

As the State Corporation Commission continues to monitor the transition to competitive electricity markets, both wholesale and retail, within and without Virginia, it notes some ominous new industry features and trends. Many of these trends are discussed in more detail in the body of this Report. They are as follows:

- The nature of the single price auction as practiced in PJM means that retail prices based on wholesale market results may reflect higher marginal costs (actually, the offer price of the last unit required to meet load) for any period under consideration, as compared to the actual average cost of power charged or potentially charged under regulatory regimes where customers are served from a diverse fleet of generating resources.
- The wholesale price histories as described in the body of this Report indicate large retail cost increases for Virginians should those wholesale prices become the basis for retail rates or prices.
- Some Virginia electric utilities (Craig Botetourt Electric Cooperative, City of Danville Municipal, City of Bristol Municipal) have already had to deal with large price increases necessitated by exposure to current and expected future wholesale market conditions. In addition, the Staff of the SCC has been monitoring the plight of the Eastalco aluminum smelter near Frederick, Maryland. Here, the viability of a major manufacturer is in jeopardy due to an impending shift to market-based electricity costs.
- As Dr. Rose points out in Part I, there is an increasing tendency towards oligopoly in the electric power generation sector. PUHCA repeal may allow further industry consolidation. Basic economic theory indicates that, other things equal, increasing industry concentration will diminish competition and raise prices.
- The Federal Energy Regulatory Commission may soon allow more net cash flow to the generation sector, with such cash flow to be obtained from

consumers via new capacity pricing constructs or relaxed market mitigation rules. The FERC apparently seems to believe that raising the sector's financial returns will lead to a more robust, competitive generation sector that will benefit consumers in the longer run.

- The SCC has long been troubled by the monumental challenge that market monitoring imposes on the PJM MMU, the placement of the PJM MMU inside PJM, the lack of an external market monitor and the difficulty of and delays in getting information from the PJM MMU.

These factors lead us to believe that, after the end of capped rates in 2010, should Virginia's homes and businesses face electricity prices based on, set by or primarily influenced by wholesale electric prices in PJM, prices for electric service could rise precipitously in the Commonwealth. While post-2010 market conditions cannot be known with certainty, based on the best available information at the time of this writing, we believe that post rate cap prices could be significantly higher than today's capped rate levels. At the same time, such higher electricity prices will likely yield extraordinarily high returns to certain base load coal and nuclear fired generating resources that currently serve APCo and DVP customers. To the extent that such base load generating units remain inside the incumbent utility as opposed to being spun off to an affiliate or sold outright to a third party, such generating units will remain subject to Virginia state jurisdiction. As such, it would be possible for Virginia policymakers to mitigate, in a non-confiscatory manner, potentially high retail rate levels. Alternatively, Virginia may face dilemmas similar to that currently faced by Maryland where state policymakers have

no good alternatives to deal with the threatened shutdown of the Eastalco plant and the loss of close to 700 well-paying manufacturing jobs, which has been attributed to increasing electricity prices.

APPENDIX III-A

RESPONSES FROM STAKEHOLDERS

**APPENDIX III-A
RESPONSES FROM STAKEHOLDERS
CONTENTS**

LETTER FROM STAFF SOLICITING COMMENTS

E-MAIL DISTRIBUTION LIST

RESPONSES:

Utilities:

- Comments of Dominion Virginia Power (May 5, 2005)

Competitive Service Providers/Aggregators:

- Comments of WPS Energy Services, Inc. (April 29, 2005)
- Comments of Certain Competitive Stakeholders (May 6, 2005)

Consumer Representatives:

- Comments of Mr. Urchie B. Ellis (June 18, 2005)
- Comments of Virginia Committee for Fair Utility Rates and
Old Dominion Committee for Fair Utility Rates (May 2, 2005)
- Reply Comments of Virginia Committee for Fair Utility Rates and
Old Dominion Committee for Fair Utility Rates (June 3, 2005)

COMMONWEALTH OF VIRGINIA

Howard M. Spinner
Director
Lawrence T. Oliver
Assistant Director, Finance
David R. Eichenlaub
Assistant Director, Economics

1300 E. Main St.
P.O. Box 1197
Richmond, VA 23218
Telephone: (804) 371-9050
Fax: (804) 371-9935
deichenlaub@scc.state.va.us



STATE CORPORATION COMMISSION
DIVISION OF ECONOMICS AND FINANCE

March 17, 2005

Dear Market Participant:

As directed by §56-596 B of the Virginia Electric Utility Restructuring Act, the State Corporation Commission is preparing its fifth annual report to the Commission on Electric Utility Restructuring ("EURC") and the Governor, to be filed by September 1, 2005. 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 the current status of utility membership with PJM, pending dockets before the Commission, and the continued lack of competitive activity in Virginia, 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 comments 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 2, 2005. Such response may be sent as a hardcopy via mail or preferably, electronically as an attached WORD Document at david.eichenlaub@scc.virginia.gov. Such comments will be posted to our website at <http://www.scc.virginia.gov/division/eaf/comments.htm>. Following such posting, any party may submit additional comments in reaction to those posted, if they so desire, by June 1, 2005. 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

E-Mail Distribution List

CSPs

Eric Matheson	eric.matheson@constellation.com
Fran Francis	ffrancis@aoba-metro.org
G. Harris Warner, Jr.	ghw@ghwplc.com
Gil Jaramillo	gjarami@novec.com
Gordon Pozza	gpozza@mmenergy.com
Jack Greenhalgh	jack@neweraenergy.com
Jack Mason	Jack_Mason@energywindow.com
James S. Kozlowski	jkozurs@aol.com
Jay Kooper	jkooper@hess.com
Jeff Middleton	jm@jpcomgroup.com
Jonathan Gewirtz	gewirtzj@econenergy.com
John Dosker	jdosker@stand-energy.com
Kathleen Gaston	elecderereg@flash.net
Kevin Nason	knason@vivex.net
Laura Shaw	lshaw@wges.com
Linda Jablonski	lindaj@americanpower.net
Marc Hanks	Hanksma@selectenergy.com
Mark Burns	mburns@naturalgas-electric.com
Mark Kumm	mkumm@pepcoenergy.com
Matthew Dutzman	mdutzman@gasmark.com
Meg Brunson	meg@bollingerenergy.com
Mitch Kine	mitchkine@oldmillpower.com
Ransome Owan	ransomeowan@wges.com
Rebecca Schlanert	Rschlanert@electric.com
Teresa Ringenbach	TRingen@wpsenergy.com
Teresa Walker	twalker@tigernaturalgas.com
Thomas Bellish	tmbellish@hotmail.com
Tom Butler	thomas_j._butler@dom.com
Tony Cusati	Tony.Cusati@acnenergy.com

Industry

Alan Petersen	apetersen@ingenco.com
August Wallmeyer	augie@wallmeyercommunications.com
Bill Axselle	baxselle@williamsmullen.com
Brian Greene	bgreene@cblaw.com
Chris King	chris.king@americanenergyinstitutes.org
Craig Goodman	cgoodman@energymarketers.com
Ed Petrini	epetrini@cblaw.com
Ellen Davenport	edavenport@vaco.org
Irene Leech	ileech@vt.edu
Jim Dunn	jim.dunn@grcc.com
Jim Minneman	jmminneman@pplweb.com
John Anderson	janderson@elcon.org
Ken Hurwitz	ken.hurwitz@haynesboone.com
Laurie Peterson	vrma@virginiaretail.com
Louis Monacell	lmonacell@cblaw.com
Mat Roussy	droussy@oag.state.va.us
Meade Browder	mbrowder@oag.state.va.us
Michael Edwards	medwards@vml.org
Mike Swider	mswider@sel.com
Preston Perrin	pperrin@retailmerchants.com
Richard Gary	rgary@hunton.com
Ron Sewell	rsewell@viterrausa.com
Scott Brown	scott.brown@exeloncorp.com
Steven Myers	steve@vplc.org

Tom Dick
Tom Nicholson
Tripp Pollard
Urchie Ellis

TAD_govern@msn.com
tnicholson@macbur.com
TPollard@selcva.org
UBEllis@worldnet.att.net

LDCs - Electric Cooperatives

Bruce King
Charles Rice
Dale Bradshaw
Douglas Wine
Gerald Groseclose
Howard Scarboro
James Reynolds
John Bowman
John Pirko
Kent Farmer
Larry Longshore
Rob Omberg
Stanley Feuerberg
Vernon Brinkley

co-op@barcelectric.com
crice@nec.com
dbradshaw@odec.com
cdwine@svec.coop
craigbot@swva.net
hscarboro@forcvec.com
jreynolds@comelec.coop
jbow@meckelec.org
jpirko@leclairryan.com
kfarmer@rappelec.com
larry.longshore@ssecoop.com
romberg@odec.com
sfeuerb@novec.com
vbrinkley@anec.com

LDCs - Electric

Barry Thomas
Cindy Menhorn
David Koogler
Gary Cohen
Howard Bush
Phillip Golden

blthomas@aep.com
cmenhor@allegHENYenergy.com
david_koogler@dom.com
gary.cohen@conectiv.com
Howard.Bush@lgeenergy.com
goldep@pjm.com

LDCs - Natural Gas

Allan McClain
Don Hayes
Henry Linginfelter
Jim Copenhaver
John Williamson
Tom Petersen

jmccclain@swvagases.com
dhayes@washgas.com
hlinginf@aglresources.com
jcopenhaver@nisource.com
john_williamson@rgcresources.com
tom.petersen@atmosenergy.com



May 5, 2005

Dear Mr. Eichenlaub,

Dominion Virginia Power ("Dominion" or "the Company") is pleased to submit our annual comments on the status of electric industry restructuring and competition in the Commonwealth. We hope these comments will be useful to the Staff and to the Commission as you compile your annual report.

While increased market prices during a period of capped rates work against the development of retail competition in Virginia, we strongly believe that the Commonwealth's effort to restructure the electric utility industry is making significant long-term progress. In the short term, the effort is producing substantial savings for Virginia consumers and is contributing to the economic growth in the Commonwealth.

Dominion Integration into PJM

One of the clearest hallmarks of this development was Dominion's May 1 integration into the PJM Interconnection, LLC. At midnight on that date Dominion turned over operational control of its 6,000 miles of transmission lines to PJM, the largest regional transmission organization (RTO) in the United States. PJM will operate Dominion's transmission assets as the PJM South region. PJM manages more than 50,000 miles of transmission lines stretching from Illinois to North Carolina with the integration of Dominion. The PJM service area contains about 168,000 megawatts of installed generating capacity.

The development of RTOs, called regional transmission entities (RTE) in the Virginia Electric Utility Restructuring Act (Restructuring Act), was viewed as a foundation of the Commonwealth's restructuring process by the framers of the law. Section 56-579 of the Act directs all Virginia utilities "owning, operating, controlling or having entitlement to transmission" to "join or establish" a RTO. The commitment to regional transmission was affirmed by the 2003 General Assembly through the passage of House Bill 2453 amending the Act. Dominion's PJM membership was approved by the State Corporation Commission on November 10, 2004, by the Federal Energy Regulatory Commission on October 5, 2004, and by the North Carolina Public Utilities Commission on April 19, 2005.

Integration into PJM will produce significant benefits for the Commonwealth and its consumers. PJM's ability to monitor and control transmission assets across a broad region of the country will enhance system reliability. PJM's ability to respond quickly and effectively to changing grid conditions has been hailed as a key factor in stemming the cascading blackout that affected much of the northeastern United States and Canada in August 2003. PJM's regional planning expertise will enhance reliability by directing improvements across a wide area. Dominion's integration into PJM will also give the

Commonwealth's consumers improved access to a diverse supply of generation, another important step in ensuring reliability.

Additionally, Dominion's participation in PJM will promote the development of wholesale and retail competition for the supply of electricity. PJM promotes wholesale competition by eliminating market barriers posed by multiple transmission rates – so-called rate “pancaking.” PJM will also give competitive service providers (CSPs) in Virginia increased access to competitively priced generation.

In fact, stakeholders have almost universally viewed the lack of a functioning RTO in Virginia as a prime impediment to competition. The Commission took note of this view in its 2003 report on the status of competition in Virginia:

“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.”

With Dominion's integration, all utilities covered by the RTE membership requirements of Section 56-579 of the Restructuring Act are now included in PJM, operator of the world's largest competitive wholesale electricity market. The integration into PJM will make the extensive and diverse generating capacity within this market more available to meet the needs of Virginia customers, including those receiving default service after capped rates end on December 31, 2010. Access to this successful and highly competitive market will help fulfill the Restructuring Act's mandate, expressed in Section 56-585.C.1, that “after the expiration or termination of such capped rates, the rates for default services shall be based upon competitive market prices for electric generation services.”

Restructuring Already Producing Significant Consumer Benefits

The Commonwealth's restructuring process is already producing substantial savings for Virginia consumers. These savings are even more striking against a backdrop of sharply rising prices for almost all other forms of energy, as well as steep electricity price increases in many other states.

The Restructuring Act has produced these savings through curbs on both base and fuel rates for electricity. Senate Bill 651 (SB 651), passed by the 2004 General Assembly, amended the Restructuring Act and froze the provisions of Dominion's fuel factor through July 1, 2007. At that point, the Commission will adjust the fuel rate, based on estimated fuel costs, to run through the end of the capped rate period on December 31, 2010. SB 651 extended the capped rates, originally scheduled to terminate on July 1, 2007, by three and one-half years.

Savings from the fuel factor freeze have been striking. In 2004, the Company reported a fuel under-recovery in Virginia of approximately \$201 million. The Company has publicly stated that it expects a similar under-recovery in 2005. It is difficult to

quantify exactly how much the fuel factor would have risen in the absence of the freeze. However, the Company earlier this year estimated the adjusted fuel rate would have increased the typical 1,000 kWh residential bill by approximately 8 percent.

The fuel factor freeze was implemented as energy sector market prices rose to record levels. From September 2003 to December 2004, market commodity prices for coal rose by 83 percent, oil by 54 percent, and natural gas by 36 percent, according to the U.S. Department of Energy's Energy Information Administration (EIA). In addition, during the past year, retail gasoline prices in the mid-Atlantic region have increased by more than 42 percent, according to the EIA.

Savings from Capped Base Rates

Potential savings from capped base rates are expected to be even more dramatic. The Restructuring Act capped Dominion's base electric rates at early-1990s levels. Capped rates represented a significant shift of risk from utility customers to shareholders and brought to a halt the base rate cases that frequently occurred on an almost-annual basis. Adjusted for inflation, Dominion's base rates are expected to be about 40 percent lower in 2010, the end of the capped rate period, than in 1994.

In January 2004, a Dominion-commissioned study by Chmura Economics & Analytics found that capped base rates would save the Company's Virginia residential customers as much as \$1.8 billion through 2010. This translates into per-customer savings of up to \$966 during the extended transition period, according to the study. It also forecast that capped base rates would generate about \$307 million in additional economic activity in the Commonwealth.

The Restructuring Act has imposed base rate stability during a period of rising costs for utilities. According to the U.S. Department of Labor's Producer Price Index, the price of copper rose by almost 129 percent from December 2001 to March 2005. During the same period, iron and steel increased by about 63 percent; electric wire and cable by more than 16 percent; and transformers and power regulators by about 12 percent.

Virginia's Rate Stability: A Sharp Contrast with Other States

Virginia's rate stability also stands in sharp contrast to the behavior of electric rates in states that have not embarked on restructuring. Since January 1, 2003, utilities in more than two dozen states maintaining traditional cost-of-service regulation have petitioned for or implemented rate increases, often of double-digit magnitude.

The rising rates have been most pronounced in Florida. Florida Power and Light's typical monthly bill for a 1,000 kWh residential customer has risen by 32 percent, from \$69.73 in 2000 to \$92.01 this year, according to information on the company's web site. Factors specific to Florida have driven many of the increases in the state, such as heavy dependence on natural gas-fired generation and hurricane recovery costs. However, rates have risen sharply in states that do not face these problems.

Georgia Power, for example, in February asked the state's Public Service Commission for a \$550 million increase in the company's fuel cost recovery. If approved, the increase would raise the average residential customer's monthly bill by approximately 10 percent, according to the February 17 edition of the *Atlanta Journal-Constitution*. The petition for the higher fuel rate follows a \$134 million base rate increase, approved by the Public Service Commission in December 2004. This increase raised the average monthly residential bill by approximately 4 percent. Also in Georgia, Savannah Electric and Power Company has requested a base rate increase that would raise the typical monthly residential bill by about 8.8 percent, according to a company news release. The petition is now before the Public Service Commission.

In Kentucky, the Public Service Commission in June 2004 approved base rate increases for both Louisville Gas & Electric Co. (LG&E) and Kentucky Utilities Co. (KU). The increases raised LG&E's average monthly residential bill by 8.9 percent and KU's by 6.4 percent, according to a Public Service Commission news release.

Wisconsin has also seen an upward spiral of electric rates, affecting virtually every part of the state. Some utilities have applied for – and been granted – multiple rate increases. The adjustments have raised both base and fuel rates, occasionally by double-digit figures. As an example in Wisconsin, Wisconsin Public Service Co. (WPS) just this month applied for an 11.4 percent base rate increase and We Energies recently applied for a \$115 million fuel rate increase. If approved, this would raise the average monthly residential bill by about 4.8 percent, according to the company. Further the company warned customers to expect rate increases averaging 3 to 4 percent annually during the next few years.

These increases, and those in many other states maintaining traditional regulation, bear out the warning made by the respected trade publication *Public Utilities Fortnightly* in April 2004. *Public Utilities Fortnightly* 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. (Richard Stavros, "Sticker Shock," *Public Utilities Fortnightly*, April 2004, pages 4-5)

Since that article appeared, soaring fuel prices have exacerbated pressure to raise rates. But the Restructuring Act continues to protect Dominion's retail customers in Virginia from these factors.

Promotion of Energy Reliability for the Commonwealth

The Restructuring Act, particularly the 2004 amendments incorporated in SB651, is also working to promote a high level of continued energy reliability in the Commonwealth. Section 56-585.G of the Restructuring Act, added in 2004, encourages development of a coal-fired generating station to serve Virginia utilities' native load and default service customers. The station would utilize Virginia coal and promote the economic development of the Commonwealth's coal-producing regions. On February 24,

Virginia's leading electric utilities announced formation of a consortium to explore the development of the facility in Southwest Virginia. Consortium participants include Dominion, Appalachian Power, Old Dominion Electric Cooperative, the Virginia Municipal Electric Association, and the Blue Ridge Power Agency. The non-binding agreement is an expression of the utilities' interest in exploring the development of the project and does not commit them to participating in construction or operation. Dominion will undertake, on behalf of the consortium, the initial development activities for the station, which is expected to cost approximately \$1 billion. The possible timeline announced in February included a construction start in 2008 and commercial operation in 2012.

Retail Competition Development in Virginia

The sharp upward movement in energy market prices, including wholesale prices for electricity, has slowed the development of retail competition in Virginia. Market prices were so high, in fact, that Dominion determined most of its customer classes would incur no wires charges during 2005. After making this determination, Dominion waived its right to collect wires charges from any customer classes this year, while reserving the right to impose them in the future.

Even in the absence of wires charges, CSPs have found it virtually impossible to make competitive offers that undercut the capped rates. This situation has also worked against Dominion's retail pilots, despite the Company's efforts to revise them. However, if market prices should decline, the Company believes the changes made in the pilot programs during the past year will make it easier for CSPs to make attractive offers to customers.

For example, the Company has dropped the monthly bidding cycle from its Competitive Bid Supply (CBS) pilot. Instead, CSPs may now submit bids on any business day; this change enables them to move quickly when market prices become favorable. If a CSP submits an offer, other CSPs would have the opportunity to submit competing bids the next business day and the original CSP would have a chance to refresh its offer. The Company also modified the bidding period for the CBS pilot. Under the revisions, there will be one bidding period, extending through October 2007, instead of the two initially proposed. The Commission approved these revisions to the CBS pilot in March 2005.

Interestingly, up until early 2004, only three CSPs had completed licensing to do business in the Commonwealth and had registered with Dominion Virginia Power. Currently, there are six suppliers that are licensed in Virginia and registered with Dominion Virginia Power, with an additional five that are licensed to do business in the Commonwealth but have not completed registration with the Company. Three other suppliers have shown significant interest in restructuring in the Commonwealth and have filed comments in several applicable regulatory proceedings before the Virginia State Corporation Commission. In terms of aggregators interested in opportunities in Virginia, currently there are five entities that have completed both the licensing and registration

processes. An additional seven companies are licensed to do business but have not completed the registration process. Clearly, suppliers and aggregators are monitoring progress in the Commonwealth, and are getting ready to move when market conditions are more favorable.

The Company has actively pursued its municipal aggregation and commercial and industrial pilots. Here again, high market prices have proved a barrier to any competitive activity. Dominion, however, has worked with several cities and counties considering participation in the municipal aggregation pilot. During 2004, the Company commissioned a study of the feasibility of six interested municipalities participating in the program. The local governments selected Buckeye Energy Brokers, Inc., an Ohio firm with wide experience in municipal aggregation, to conduct the study. In its report, Buckeye Energy Brokers found it was "very likely" participating municipalities could reach agreements with competitive suppliers that would save money for consumers. The report also termed the pilot "an excellent program...that appears feasible to implement." (Page 1 of the Executive Summary)

Dominion has actively supported the Commission's efforts to implement the wires charge and minimum stay exemption programs authorized by SB 651. We submitted our compliance filing for the two programs on January 10, 2005. The Company's proposed wires charge exemption program included a provision allowing participants who enrolled with a CSP during 2005 to return to capped rate service after their October 2007 meter reading date. This provision was designed to address customer and supplier concerns that the risk of waiving the right to capped rates forever outweighed the benefits of participating. We urge the Commission to complete action on the implementation of the SB 651 programs as soon as possible, as the Restructuring Act calls for the expiration of all wires charges in little more than two years – on July 1, 2007. Without such implementation in the near term, the opportunity for success of the wires charge exemption program will quickly disappear.

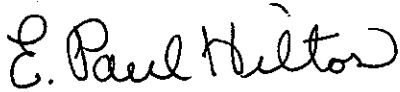
A decline in market prices would make successful offers from CSPs much more likely, especially since competitors now have improved access to generation supplies through Dominion's PJM membership.

In conclusion, the implementation of restructuring continues to make substantial progress in the Commonwealth. All incumbent utilities, subject to the RTE provision of the Restructuring Act have now joined PJM. This fulfills a core requirement of the Act and enhances reliability while providing access to a robust wholesale market. Consumers are seeing significant benefits through the capped rates and the frozen fuel factor in a period when prevailing costs that would have driven rates upward under traditional ratemaking are rising significantly. Another consequence of the stability provided by these capped base rates and frozen fuel factor, however, is that it will be very difficult for CSPs to make attractive offers of savings to customers if prevailing wholesale market prices remain elevated. As a result, the number of customers that switch to a CSP can be reasonably expected to remain at relatively low levels during the capped rate period. The number of customers that have switched to a CSP should not be used to measure the

success of electric restructuring in Virginia or elsewhere. This expected state of affairs also should not be misconstrued as a failure of restructuring in Virginia, but given the constructs of the Restructuring Act, viewed positively as a reasonable and acceptable position at this stage of the transition toward a fully restructured electric industry in the Commonwealth.

If we can be of further assistance as you develop your annual report, please let us know.

Sincerely,

A handwritten signature in cursive script that reads "E. Paul Hilton". The signature is written in dark ink and is positioned above the printed name.

E. Paul Hilton



April 29, 2005

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

Dear Mr. Eichenlaub:

Thank you for the opportunity to offer comments for input to the annual report to the Governor. WPS Energy Services' comments are listed below.

Cure for Market Power

Deregulated states need a structure that limits abuse of market power by utilities and their affiliates. This includes divestment of generation by statute (state law), a requirement for full corporate separation by affiliates, a strong code of conduct that is strictly enforced, and true rate unbundling. We have seen in other states that when full divestment is not enforced a dampening of competition results. Also, a code of conduct is worthless if it is full of loopholes and/or is not enforced.

True Rate Unbundling

Incomplete rate unbundling allows utilities to collect on charges that a customer would also pay to their supplier. This leads to a customer paying twice for the same service. A true unbundled rate would eliminate duplicate charges. States need to provide regulations that allow shopping customers to avoid all generation and transmission related utility charges that are already included in supplier rates.

Standard Service Auction

An auction for standard offer service or provider of last resort service encourages a true market. Auctioning off standard offer service provides a market-based rate for suppliers to compete against. Customers no longer subsidize utility rates that are below the market. Utility tariff rates are difficult for suppliers to compete against while customers in the end pay the market price through riders and stranded costs to the utilities. A true market based rate for suppliers to compete against provides real savings to customers.

Municipal Aggregation

Opt-out municipal aggregation has been a success in Ohio. Aggregation allows municipalities to negotiate electric and natural gas rates on behalf of their residents and

small businesses. This offers individual consumers an opportunity to receive a lower price than they typically would be able to negotiate on their own. In addition, municipal aggregation attracts suppliers by allowing them to purchase electricity on a greater scale. This ensures a supplier more customers and greater supply certainty for the purchase than individual sign-ups. Thus making it possible to offer lower prices to residential customers and small business customers.

In Ohio, opt-out municipal aggregation accounts for the majority of consumer shopping on the electric side.

Measurable Market Development Periods and Goals

Market development periods need solid end dates and goals that don't change mid-stream. This allows suppliers to plan and offer the greatest savings. It reduces customer and supplier risk when shopping or purchasing supplies. If a supplier knows the rules of the game aren't going to change mid-way through the market development period the market becomes more attractive and higher savings are possible.

In addition continuing market development periods beyond their initial end dates with different rules and requirements becomes costly for both suppliers and customers. **In Michigan for example, there was a drastic drop in customer shopping due to changes in the rules mid-stream.** There needs to be certainty for deregulation to be successful.

Pilot Programs can help jump start the competitive market and increase consumer education. When properly implemented these programs can be beneficial. Voluntary enrollment programs and shopping credits have been helpful in other states for attracting competition and educating customers on their options.

Purchase of Receivables Requirements and/or Disconnect for Supplier Charges

In Ohio early, the payment priority rules created large arrearages for customers and suppliers. Initially, the payment priority in Ohio was utility past due, utility current, supplier past due, supplier current, and then other charges. When a customer paid their bill even a day late their full payment for that bill would go to the utility charges on that bill plus the utility charges for the current (following month's) bill. This left the supplier without payment and thus the charges would accrue and continue to accrue as long as the customer continued to pay late. This created customer confusion and frustration. Customers were paying their bills yet the supplier received none of the money. As a result, many customers were sent to collections for non-payment. A simple solution to this problem is to require utilities to purchase supplier receivables. This provides one point for collection dollars and less confusion for customers on how their money reaches the supplier. In Ohio, the problem led to expensive litigation and an eventual stipulation that changed the payment priority to utility past due, supplier past due, supplier current, utility current, and then other charges.

New generation should not be built on the back of ratepayers

Utilities should be required to completely divest their generation assets. Also ratepayers should not pay for any new generation. In particular, those customers who shop and are receiving their generation from an alternate supplier should not have to pay for utility

generation they never use. Utilities receive full payment for the cost of the generation and then receive returns by selling it on the market. This creates a situation where ratepayers receive no benefit from something they paid for.

Excessive Utility Charges

Utilities in many states have implemented excessive customer switching, customer list, and billing fees in order to limit or avoid competition in their territories. The SCC should monitor utility charges to ensure these charges are in line with actual utility costs. In addition, for many of these items (once the initial set up costs are recovered) the costs to provide the service should be reduced. There needs to be a process to monitor these charges to avoid excessive utility charges, which hamper competition.

Thank you again for the opportunity to comment. Please contact me if you have any questions or would like clarification on any of these items.

Sincerely,
Teresa Ringenbach
Account Manager
WPS Energy Services, Inc.

May 6, 2005

By E-Mail

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

**Re: State Corporation Commission 2005 Report To Governor Warner And The Commission
On Electric Utility Restructuring On The Status Of The Development Of Regional
Competitive Markets And Recommendations To Facilitate Effective Competition In The
Commonwealth As Soon As Practical**

**Competitive Stakeholders' Comments on the Status of Regional Competitive Markets and
Recommendations of to Facilitate Effective Competition in Virginia**

Dear Mr. Eichenlaub:

In conjunction with the preparation of the State Corporation Commission's ("Commission" or "SCC") 2004 report ("2004 EURC Report") to Governor Warner and the legislative Commission on Electric Utility Restructuring ("EURC"), an *ad hoc* coalition of retail companies submitted comments on the status of the developments of regional competitive markets, and recommendations to facilitate effective competition in Virginia as soon as practical.

Last year's comments reflected the commitments of many stakeholders to viable competitive wholesale and retail electricity markets in the Commonwealth of Virginia, and urged the Commission to facilitate the process towards fully competitive retail and wholesale electricity markets by completing its review of the applications then pending for the integration of incumbent electric utilities with a Regional Transmission Organization ("RTO").¹ The comments also called for a re-commitment from stakeholders to strive for the successful development of competitive markets in Virginia, based upon the firm belief that continued restructuring is in the best interests of the consumers in the Commonwealth.

¹ The Code of Virginia, §§ 56-577, and 56-579, refers to RTOs as "regional transmission entities". These terms may be used interchangeably.

The retail companies identified herein appreciate this additional opportunity to elaborate on those principles from their unique perspectives as potential retail competitors of Virginia's incumbent electric utilities.

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

- Constellation NewEnergy, Inc.,
- Direct Energy Services, LLC
- Strategic Energy, LLC

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.

Pursuant to Va. Code § 56-596 B of the Virginia Electric Utility Restructuring Act, Va. Code Title 56, Chapter 23 (as amended, the "Restructuring Act" or "Act"), the SCC is charged with reporting to the 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 your March 17, 2005 letter to stakeholders ("March 17 Letter"), you state (p.2)

Because of the current status of utility membership with PJM, pending dockets before the Commission, and the continued lack of competitive activity in Virginia, 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.

Consistent with your invitation and applicable law, 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.

I. COMMENTS ON THE STATUS OF THE DEVELOPMENT OF REGIONAL COMPETITIVE MARKETS.

A key concern expressed by many stakeholders last year was the lack of progress towards fully competitive retail and wholesale electricity markets as a result of the delayed integration of incumbent electric utilities into an RTO. The comments also called for a re-commitment from stakeholders to strive for the successful development of competitive markets in Virginia, based upon the firm belief that continued restructuring is in the best interests of the consumers in the Commonwealth.

With the May 1, 2005 integration of Virginia Electric and Power Company d/b/a Dominion Virginia Power (“DVP”) into PJM, a key milestone was reached in the development of effectively competitive wholesale and retail electricity markets in Virginia. Along with DVP, Appalachian Power Company, Potomac Edison Company, and Delmarva Electric & Power Company are now part of PJM’s larger competitive regional energy markets.

While there has not been enough time to gauge the impact on retail competition in Virginia resulting from the participation of these Virginia investor-owned utilities in PJM’s competitive markets, experience is showing that regional competitive retail energy markets are developing in the larger PJM region, especially in those areas that have emerged from the transition period to competition. The degree of success in developing competitive retail electricity markets is largely dependent upon the degree to which the retail markets have addressed the following four areas:

1. Access to competitive, transparent regional wholesale markets, such as those administered by PJM;
2. Costs are properly allocated, so that monopoly services (distribution and transmission services) reflect costs, and do not provide a hidden subsidy to the incumbent’s competitive generation service;
3. Default rates reasonably reflect market prices, so that boom/bust cycles in retail markets are avoided; and
4. Minimum stay requirements and exit fees are avoided, and are replaced by market-responsive pricing mechanisms.

As examples, Maryland has addressed all these critical elements for large customers, and competition is taking hold. According to the latest information from the Maryland Public Service Commission, almost 65% of large Commercial and Industrial (“C&I”) customers are taking service from competitive suppliers, along with 22.5% of Mid C&I, 3.4% of Small C&I, and 2% of residential customers.² This competitive activity represents over 2.1 million distribution service accounts, 51, 257 customers, 3250 MW of Demand (peak load obligation), 12,602 MW of total MW Peak Load, and 25.8% of peak load obligation served by competitive suppliers.³

The District of Columbia is making progress on all of these elements. Figures for March 2005 show that 11,462 retail customers (5.6%) and 5523 non-residential customers (20.8%) have switched to

² Source: MD PSC website, Month Ending March 2005: <http://www.psc.state.md.us/psc/electric/enrollmentrpt.htm>.

³ *Id.*

competitive suppliers,⁴ representing in the aggregate 1,381 MW of customer demand (60.5%)⁵ and 484,619 MWH (57%) of customer energy usage.⁶ However, competition is frozen due to an unexpected order from the District of Columbia Public Service Commission that locked in customers for 12 months to Standard Offer Service. Market participants, however, are united in removing this last barrier, and hope changes will be made in the near future.

In Pennsylvania, Duquesne Light Company has moved into the post-transition period. As of April 1, 2005, 134,609 (22.9%) of its customers are being served by alternative suppliers, representing 1,742.9 MW (42.4 %) of customer load.⁷ Other Pennsylvania utilities will be transitioning to market rates through 2011.

In all of these instances, the regulators have moved forward with addressing the need to properly establish default rates that are truly reflective of market pricing.

II. IDENTIFICATION AND FURTHER DISCUSSION OF KEY PRINCIPLES AND RECOMMENDATIONS FOR THE DEVELOPMENT OF EFFECTIVE COMPETITION IN THE COMMONWEALTH OF VIRGINIA.

Notwithstanding the progress in other states, it is unreasonable to expect any significant retail competition to develop in Virginia until several important transition period policies are changed that have erected real barriers to competition. The remaining barriers include items 2, 3, and 4 above:

2. Costs are properly allocated at the end of the stranded cost recovery period (July 1, 2007), so that monopoly services (distribution and transmission services) reflect current costs and load growth, and do not provide a hidden subsidy to the incumbent's competitive generation service;
3. Default rates reasonably reflect market prices, so that boom/bust cycles in retail markets are avoided; and
4. Minimum stay requirements and exit fees are avoided, and are replaced by market-responsive pricing mechanisms.

In addition, the Commission needs to be in a position to re-examine and adjust the allocation of retail supply costs to the supply rates (billing & collection, customer service, account management and other administrative, regulatory and legal costs), so that when the wires charge transition period ends, a more level playing field is created. The present policy is akin to a retail gasoline station (Competitive Service Providers) attempting to compete against a wholesale gasoline terminal (the incumbent electric utility). In addition, it is critical that for retail competition to take hold, the monopoly distribution company not receive a subsidy from competitors by having rates that do not properly reflect costs.

⁴ Source: DC PSC website, Month ending March 2005:
http://www.dcpsc.org/pdf_files/customerchoice/electric/electric_sumstats_no_cons.pdf

⁵ *Id.*, http://www.dcpsc.org/pdf_files/customerchoice/electric/electric_sumstats_cons_dmnd.pdf

⁶ *Id.*, http://www.dcpsc.org/pdf_files/customerchoice/electric/electric_sumstats_cust_energyuse.pdf

⁷ *Id.*

The new exemption programs mandated by Chapter 827 of the 2004 Acts of Assembly (“Senate Bill 651”) placed an initial limit on the amount of load [1,000 megawatts (“MW”) or eight percent (8%) of a utility’s prior year Virginia adjusted peak-load] that could participate in the wires charge exemption program. *See* Va. Code §56-283 E 4.

The original version of Senate Bill 651 as endorsed by the EURC would have allowed all customers the opportunity to purchase electric energy from Competitive Service Providers without paying the wires charge, as long as they were willing to accept market-based pricing if they returned to their utility for generation service. 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, thus placing increased pressure on default service programs.

To date, the exemption programs have yet to be implemented, so they have produced nothing in the way of customer switching or savings. Every passing day reduces the value of these programs. As a means of stimulating the market, the Commission’s next consideration of wires charges should encompass the remaining 18 months of the original capped rate/ wires charge period (i.e., from January 1, 2006 through July 1, 2007), so that customers and suppliers may reasonably evaluate whether to participate in Virginia’s retail electricity markets.

Because a wires charge may be applicable for some or all of the period from January 1, 2006 through July 1, 2007, the General Assembly’s consideration of potential modifications to the Act in the next legislative session should include an expansion of the exemption programs to all customers that wish to participate. Delaying any potential review of expanding the participation beyond 1,000 MW to 18 months after implementation, and periodically thereafter, perpetuates barriers to CSP entry and consumer participation.

The 1,000 MW limit is insufficient to attract widespread and meaningful retail competition to Virginia, notwithstanding RTO developments in Virginia, given current market conditions and the remaining period during which Virginia’s public utilities are permitted to impose wires charges.

DVP and Virginia’s other investor owned electric utilities are not imposing a wires charge for 2005. Accordingly, current retail electric rates in Virginia represent the current “price to beat” for CSPs and consumers alike. For CSPs that wish to serve residential customers, 40,000 residential customers (approximately 150 MW of load) represents a minimum critical mass, while a group of 100,000 residential customers (approximately 370 MW of load) represents a preferable tranche size for marketers interested in the residential market. Current market conditions suggest that these levels of customer participation may not produce sufficient economies of scale to encourage meaningful CSP entry and savings for consumers. Increasing the amount of load above 1,000 MW will place less pressure on default service, and may allow the economy of scale to encourage multiple marketers to enter the market and provide service to customers, notwithstanding razor-thin margins.

While the Competitive Stakeholders support all efforts to encourage customer participation in competitive retail electricity markets, Virginia’s consumers should be assured of being able to return to capped rates rather than market-based rates at any time capped rates are in place.

Many residential customers and businesses will be reluctant to participate if they give up the right to return to capped rates through 2010 in exchange for a limited opportunity (at most, the period January 1, 2006 to July 1, 2007) to avoid a wires charge. Accordingly, the Competitive Stakeholders recommend that all customers have equal access to the same default service applicable to the customer's class, independent of whether or not customers choose to avail themselves of competitive market opportunities.

III. CONCLUSION.

The Competitive Stakeholders appreciate the opportunity to comment upon these issues related to the development of effective competition in Virginia as soon as practical. The Commission should be encouraged to draw on the experiences in other states in developing competitive options for all customers, including those receiving default service.

The Competitive Stakeholders offer their assistance to help design and promote well-developed, effectively competitive retail electric markets in Virginia, which have been envisioned by the General Assembly since 1999. The Competitive Stakeholders encourage the Commission and the General Assembly to use these recommendations to concentrate stakeholder attention and comments on the goal of facilitating effective competition in the Commonwealth as soon as practical.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Thomas B. Nicholson', written in a cursive style.

Thomas B. Nicholson

TBN/tn

Urchie B. Ellis
ATTORNEY AT LAW
7900 Marilea Road
Richmond, Virginia 23225
Home Phone 804-272-5923

June 18, 2005

To the Members of the State Corportation Commission:
Messers Morrison, Miller, and Christie:

Re: Electric Deregulation

The SCC is due to make its annual report to the Legislative Committee about Sept. 1, and I wish to make the following comments and suggestions:

1. On May 25, Dominion Virginia Power filed its annual report in Case No. PUE-2003-00118 Retail Access Pilot Programs, which showed that much time has now elapsed, and in spite of various manipulations and concessions, no entity has come to Virginia to offer the public or industry any competitive service. All indications are that there will be no such offers in the future.
2. The adverse experience in the Craig-Botetourt Elect. Coop. area illustrates the serious risk to the public. When the rate caps expire the public in Virginia is going to be hurt badly. No benefit from the PJM arrangements is foreseen for Virginia. We are currently faced with big costs if Dominion Virginia Power is allowed to to defer the accounting for the PJM costs until after the rate caps expire.
3. Recent articles in various publications indicate that Virginia has lower electric rates than most areas, and much lower than some in the PJM involved territory. Recent articles have pointed to problems in Texas, which has been cited by some as a pathfinder in deregulation.
4. In August 1992 the SCC issued a 2 volume report pointing out problems, and in Nov. 2002 the SCC issued a lengthy report in connection with 2002 SB 684 which on pages 13-16 documented reasons for concern. Then on Jan 3, 2003, the Commission spontaneously issued a 48 page report entitled "Potential Risks to Electric Service in Viginia" which on pages 31-33 stated there were serious risks and recommended delay and other action to stop deregulation. See also the August 2003 SCC report.
5. The undersigned has been much involved in this legislative and SCC case procedure for several years, and has been on record many times: e.g. see my letter of Jan. 13, 2004, to the Commission on Electric Utility Restructuring, and see my involvement in several major cases before the SCC.
6. The Commission is urged to make a strong report urging the Legislature to review electric deregulation and to take steps to stop and reverse the direction. The subject is complicated by the Federal law, and expertise is required. The SCC has a Constitutional and statutory duty to protect the public.

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



CHRISTIAN | BARTON, LLP
Attorneys At Law

Phone: 804-697-4120
Fax: 804-697-6120
E-mail: imonacell@cblaw.com

Phone: 804.697.4135
Fax: 804.697.6395
E-mail: epetrini@cblaw.com

May 2, 2005

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 March 17, 2005, 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 Dominion Virginia Power ("DVP") and Appalachian Power Company ("APCo"), respectively.

In response to prior years' requests of the Commission Staff for comments on the status of competition, the Committees have observed that retail competition for generation services has 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, little, if anything, has changed; 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 attached Report Card on Electric Utility Restructuring, which evaluates progress on key issues related to competition and restructuring. (See Attachment I.) 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

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.

David M. Eichenlaub

May 2, 2005

Page 2

plants are worth more or less than book value), and entry of independent power producers. The only "A" grade is utility earnings. Functioning of a regional transmission entity earned a "C" grade after DVP and APCo finally joined the PJM Interconnection LLC, four years after the original statutory deadline. While "capped rates" may provide incentives for reduced distribution and transmission reliability, that category receives no grade because it is still being assessed.

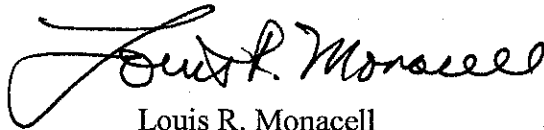
Virginia electricity customers in communities in the western part of the Commonwealth are feeling the impact of going to market-based rates. With the expiration of wholesale power contracts that supplied their local, municipally owned utilities for years, retail customers in such communities face significant rate increases.

The Federal Energy Regulatory Commission now has ruled in the case involving DVP's request to defer \$280 million in estimated RTO-related costs until after 2010, when its "capped rates" are scheduled to expire. Attachment II discusses the case. DVP sought the deferral in order to allow such costs to be passed through to its customers. DVP represented to the General Assembly, however, that the 2004 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.

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 these 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

ATTACHMENT I

**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 a few "green" power sales at prices higher than the utility's capped rates, no supplier has offered to serve retail customers.
Prospects for future savings from retail choice	D	Present market prices and trends suggest that Appalachian Power Company's ("APCo's") customers have no prospect for future savings. Dominion Virginia Power's ("DVP's") customers' prospects for such savings are dim in view of the fact that market prices now exceed capped generation rates.
Customers rates during the transition to competition	D	In October 2003, the State Corporation Commission ("SCC") Staff issued its most recent report on DVP's earnings and, in that report, the Staff indicated 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 of DVP's customers have soared since the Act 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, and customers are paying a lower fuel factor than otherwise would have been the case. Fuel factor savings, however, fall well below the excess found by Staff in DVP's non-fuel rates. APCo customers' rates appear to be only moderately excessive. In April 2005, the SCC Staff issued its most recent report on APCo's earnings. The report indicated a "revenue surplus" of \$9.6 million, or about 1%. Further, 2004 amendments to the Act encourage unfair single issue rate increases for APCo without the ability to review the total cost of service to determine whether there are any cost reduction offsets.

Utility earnings	A	DVP's annual report to the SCC for 2003 states that DVP earned a jurisdictional return of 13.26% on common equity. The SCC Staff has not completed its review of DVP's report; however, the 13.26% rate of return exceeds the 9.10% to 10.10% rate of return found reasonable in its review of DVP's prior annual report. DVP has not filed its 2004 annual financial report with the SCC. APCo's Virginia electric business appears to have produced modest over-earnings during 2003, as indicated in the recent SCC Staff report discussed above. The Staff has not reviewed APCo's 2004 earnings.
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)	C	The Act initially required utilities to join an RTE by January 1, 2001. Neither DVP nor APCo met the statutory deadline. In 2003, two years after the deadline, the General Assembly eliminated the original deadline and enacted a <i>new</i> deadline that requires utilities to join an RTE by January 1, 2005, subject to approval by the SCC. Both utilities have now joined the PJM Interconnection, LLC ("PJM").
Entry of independent power producers	D	Generation owned or controlled by DVP and APCo 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, in reviewing utilities' responses to Hurricane Isabel, stated that it appeared that DVP had decreased the number of linemen it employs but that "the Staff has not observed a deterioration in day-to-day operations based on standard measures of performance." Nevertheless, the Staff determined that it was appropriate to conduct an "in-depth audit" of DVP's resources beginning in the fourth quarter of 2004 as a result of "(i) anecdotal feedback from customers and anonymous employees relative to a decline in resources, (ii) the natural incentive to reduce resources within a rate cap environment, and (iii) the belief that any deleterious effects of a reduction in resources might not materialize until years later ..." The SCC staff's audit has not been completed.
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ATTACHMENT II

**Dominion Virginia Power's
Deferral of \$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 asked FERC to permit it to defer approximately \$280 million in costs, plus carrying charges, that DVP estimates it will incur from seeking to join and joining a regional transmission organization ("RTO"). DVP argued 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 stated 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

In FERC's order of October 5, 2004, approving DVP's entry into PJM, FERC stated that it could not determine whether such costs are, in fact, unrecoverable in DVP's current rates or whether they ultimately would be found in a FERC rate case to be recoverable in future rates.³ Nevertheless, FERC stated that DVP itself must assess all available evidence bearing on the likelihood of rate recovery of such costs in periods other than the period in which they would otherwise be charged to expense under the general accounting requirements for such costs. If DVP determines that it is probable that these costs will be recovered in rates in future periods, then it should record a regulatory asset for such costs.⁴

On March 4, 2005, the FERC denied rehearing of its October 5 order regarding the RTO-related costs.⁵ FERC stated that it had made no finding in its October 5 order concerning the "ultimate justness and reasonableness" of the RTO-related costs and that such a finding could be made only in a DVP rate case at FERC. FERC characterized its October 5 order regarding such costs as providing "guidance" on "the proper accounting and recordation of a regulatory asset"

¹ *PJM Interconnection, L.L.C.*, FERC Dkt. No. ER04-829-000, Joint Application at 20.

² *Id.*, Joint Application at 21, fn. 45.

³ *Id.*, Order Establishing PJM-South Subject to Conditions, dated October 5, 2004 (slip op. at 21).

⁴ *Id.*

⁵ *Id.*, Order Denying Rehearing, dated March 4, 2005 (slip op. at 13).

and as “procedural in nature without prejudice to any party seeking to challenge the subsequent recoverability of these costs in a future rate case.”⁶

FERC states that DVP itself, not FERC, must determine the recoverability of such costs in rates in periods other than the period in which they are incurred, and FERC states that DVP must support its determination with “relevant, reliable evidence demonstrating that it indeed meets the criteria for recognition of a regulatory asset ... at the time it makes the initial determination, each accounting period thereafter, and when it makes its [rate] filing.”⁷

Despite the FERC’s assurances in its order on rehearing that it intends only to address the accounting, not the ratemaking, treatment of the RTO-related costs, and that parties may challenge the “regulatory asset” treatment of such costs in a later rate case, FERC’s order provides little comfort to DVP’s customers. While not a model of clarity, FERC’s order on rehearing still permits DVP, not FERC, to determine whether DVP may book the RTO-related costs periodically as a “regulatory asset.” By permitting DVP to make such periodic determinations on its own, until its rates are re-set by FERC, the order thus appears to permit DVP to record on its books what may turn out to be an enormous “regulatory asset.” When FERC decides the ratemaking treatment of that “regulatory asset” in a rate case, FERC may find it difficult to refuse to recognize such RTO-related cost deferrals in setting rates due to the impact such refusal on DVP’s annual earnings.

In any case, 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.”

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⁶ Id.

⁷ Id.



CHRISTIAN | BARTON, LLP
Attorneys At Law

Phone: 804-697-4120
Fax: 804-697-6120
E-mail: lmonacell@cblaw.com

Phone: 804.697.4135
Fax: 804.697.6395
E-mail: epetrini@cblaw.com

June 3, 2005

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

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

Dear Mr. Eichenlaub:

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 Dominion Virginia Power ("DVP") and Appalachian Power Company ("APCo"), respectively, we wish to respond to comments regarding market-based rates for default service.

In particular, Competitive Stakeholders suggest that the degree of success of retail electricity markets is largely dependent, among other things, upon the degree to which retail markets have addressed "default rates [that] reasonably reflect market prices, so that boom/bust cycles in retail markets are avoided."¹ Competitive Stakeholders recommend that the Commission "draw on experiences in other states in developing competitive options for all customers, including those receiving default service," and Competitive Stakeholders mention in particular customers now paying market rates in Maryland, the District of Columbia, and Pennsylvania.

In addition, WPS Energy Services, Inc. ("WPS") states that an auction for "standard offer service or provider of last resort service encourages a true market" and that "[a]uctioning off standard offer service provides a market-based rate for suppliers to compete against." According to WPS, a "true market based rate for suppliers to compete against *provides real savings to customers.*" (Emphasis added.)

In assessing these suggestions regarding market-based rates for default service, the Commission should take into account the experience of a number of communities in the western

¹ Competitive Stakeholders' comments were submitted on behalf of Constellation New Energy, Inc.; Direct Energy Services, LLC; and Strategic Energy, LLC.

David M. Eichenlaub

June 3, 2005

Page 2

part of Virginia in which electricity customers are paying, or will be paying shortly, market-based rates. Retail customers served by municipally owned utilities that are members of the Blue Ridge Power Agency ("BRPA") face significant rate increases.² Such utilities have been served at wholesale under seven-year supply contracts with Cinergy; however, with expiration of the Cinergy contracts in 2005, almost all signed new, one-year contracts, based on current market prices, with American Electric Power ("AEP"). The AEP contracts are the result of BRPA's seeking wholesale bids through an RFP process. AEP was the low bidder. Nonetheless, the resulting rate increases for customers served by such utilities are enormous. For example, the largest of the communities, the City of Danville, reports a 78% increase in power supply costs, resulting in the following average percentage increases in rates to its retail customers:

Class	Average Percent Increase
Residential	35.3
Churches	20.4
Small general	25.9
Medium general	40.3
Large general	40.2
Lighting	28.0
Average	36.2

Other communities reportedly face similar increases.³ The City of Danville, moreover, expects its base rates to rise still further in 2006, by an average of 4.4%, in order to accommodate cost deferrals and other effects of the increase in purchased power costs resulting from the new contract.⁴ In addition, based on proposals recently requested by the City from utilities, prices are ranging 15% to 30% higher than those in the new AEP contract, according to the City, so electric rates may jump again to accommodate higher purchased power costs when the AEP contract expires.⁵

Section 56-585.C.1 of the Restructuring Act provides that, until the expiration or termination of capped rates, rates for default service will be the capped rates. After the expiration of capped rates, the rates for default services shall be the based upon competitive market prices for electric generation services. The capped rates currently are scheduled to expire on December 31, 2010, so customers must pay market-based rates for default service after that

² Municipally owned utilities that are members of the Blue Ridge Power Agency include Danville, Bedford, Bristol, Martinsville, Radford, Salem, and Richland.

³ Local newspapers report the following increases, for example: Radford (26-30%); Bristol (40-42%); Salem (approximately 40%); Bedford (41%).

⁴ Next year's expected base rate increases are as follows: residential, 3.6%; churches, 3.3%; small general, 2.7%; medium general, 4.2%; large general, 8.1%; lighting, 2.1%. These expected base rate increases do not include the effect of predicted increases in purchased power costs after July 1, 2006.

⁵ "More Utility Rate Hikes Expected Next Year," Danville Register & Bee, May 24, 2005.

David M. Eichenlaub

June 3, 2005

Page 3

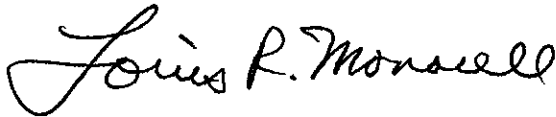
date. The gap between current market prices and Virginia utilities' capped rates does not bode well for customers, many of whom, depending upon the utility that serves them, could face adverse consequences similar to those being experienced by customers of BRPA members. APCo's "price to beat" for generation and transmission service for jurisdictional industrial customers, according to the Commission's calculation released on December 21, 2004, is 2.9 cents/kWh; current generation market prices, however, are running around 5 cents/kWh, more than 60% higher.

Admittedly, the rate shock experience of retail customers served by BRPA members result from a tremendous increase in wholesale prices as shown by the competitive bidding results in 1997 compared to now. Nonetheless, their experience illustrates that, although wholesale procurement may be done through a competitive bidding process, customers may be forced to pay significantly higher prices. In other words, just as competitive wholesale procurement has resulted in significant rate shock for retail customers of BRPA members, such procurement also could result in rate shock for retail customers of investor-owned utilities when their capped rates end.

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 these developments. Electric restructuring has not worked so far in Virginia, and such 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