

PART III

**RECOMMENDATIONS TO FACILITATE EFFECTIVE
COMPETITION IN THE COMMONWEALTH**

PART III

Recommendations to Facilitate Effective Competition in the Commonwealth

Part III of this report includes discussions of comments advanced by various stakeholders as means of facilitating effective competition in the Commonwealth along with the SCC's continued actions to implement the elements of the Restructuring Act as soon as practicable. Also included is the SCC's analysis of key industry events occurring since the issuance of last year's report.

To assist development of a comprehensive list of recommendations to foster effective competition, on April 7, 2006, the Staff sent a letter electronically to over 90 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 the following initial and reply comments, included as Appendix III-A to this Report:

- Comments of Mr. Urchie B. Ellis (Dated 05/01/06)
- Comments of Dominion Virginia Power (Dated 05/17/06)
- Comments of Constellation New Energy (Dated 05/22/06)
- Comments of VCFUR/ODCFUR (Dated 05/22/06)
- Comments of Dr. Irene E. Leech (Dated 05/23/06), on behalf of the Virginia Citizens Consumer Council.
- Comments of Old Dominion Electric Cooperative (Dated 05/25/06)
- VA, MD, & DE Association of Electric Cooperatives Reply Comments (Dated 06/12/06)
- VCFUR/ODCFUR Reply Comments (Dated 06/12/06)

In similar surveys conducted in 2005, 2004 and 2003, the SCC received six, 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 responses, we did receive input from 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. While respondents' recommendations do not provide new ideas as to ways to better facilitate retail competition in Virginia, some respondents have reiterated or called anew for a fundamental reconsideration of Virginia's overall approach to electric industry restructuring. Behind these second thoughts and calls for policy reassessment is the realization that while the expiration of price caps may facilitate electric service competition at retail, resulting prices paid by Virginia's families and businesses may be substantially higher than what would have prevailed in the absence of restructuring. A related question could probe potential changes in federal policy direction impacting wholesale electric markets that could reduce retail prices paid by consumers in restructured electric markets. In fact, much of the Commission's participation in policy debates over the past several years as well as this past year has been directed at attempting to influence electric industry policy at the federal level to allow for the best possible market outcomes for retail customers in this Commonwealth.

An example of a call for fundamental policy re-examination comes from the comments and reply comments of the Virginia, Maryland & Delaware Association of

Electric Cooperatives. In their reply comments dated June 12, 2006, the Association asks:

1. Without regard to whether Virginia should ever have made the choice to go down the path of deregulation of retail electric service, is it the right path now for Virginia's future?
2. If not, is it possible to return to cost of service regulation, and what challenges would we have to overcome to do so?
3. Are there other, more important objectives than economically efficient competition, such as transmission system development, that would be a better focus for industry stakeholder efforts?

The Commission and its staff have spent considerable effort on a variant of the first question. As alluded to above, that variant involves studying and advocating for potential federal policy changes relating to FERC regulated wholesale markets and RTOs believed to be in Virginia's best interests. The third question posed by the Association continues to receive much Commission and industry attention. Regarding electric industry restructuring, should the policy goal be competition for electric service for competition's sake or should the policy goal be the provision of safe, reliable service at the lowest possible cost to Virginia's consumers?

Our last report noted that most perspectives submitted for inclusion in the 2005 report indicated that a major milestone was reached in the spring of 2005 when DVP integrated its transmission and generation facilities into PJM. That action completed the transfer of operational control of transmission lines to an RTO for the investor-owned utilities as required by the Restructuring Act. It was also stated in the 2005 report that "... after only a few months of RTO operation, it is premature to determine if the

anticipated benefits to customers will be realized.” To follow up, we note that it is still premature to determine if anticipated benefits will ever materialize. What has materialized is a new proposed PJM capacity market along with other federal policy changes that may substantially alter anticipated cash flows from those that would otherwise prevail without these FERC determined market “enhancements.” We also note that based on the difficulty of obtaining much of the data and information requested from PJM, this Commission remains unable to independently warrant that PJM’s competitive wholesale electricity markets are effectively competitive. Our Staff continues to work with PJM to obtain the data and information necessary to answer this important and complex question.

Other major issues mentioned in the comments, both presently as well as over the past several years, include the now largely non-existent issue of wires charges and the degree to which the low capped rates of incumbent utilities providing default service at rates presumably below market prices inhibit or prevent the development of robust retail competition in the Commonwealth. These low capped rates of incumbent utilities currently thwart the development of effective retail competition in Virginia. However, overcoming this barrier could well have Virginians paying more for electricity with the ability to choose a supplier than they would pay in the absence of choice. For example, it may turn out that the 25% increase recently granted to Delmarva Power Company serving approximately 22,000 Virginia customers may lead to greater choice. Moreover, customer ability to choose to take service from a competitive service provider might even allow some customers to mitigate the recent rate hike to some degree. However, it seems generally clear from the many comments received during the Delmarva rate proceeding

that customers would forgo the right to choose in order to obtain greater rate stability, even if that stability means taking electric service from a single provider.

In their comments this year, both DVP and Constellation note that relatively low capped rates do not allow for the development of retail competition. DVP states its comfort with Virginia's restructuring legislation, noting that the Commission on Electric Utility Restructuring will soon begin a two year review on the provision of default service after the scheduled expiration of price caps in 2011. Virginia Power further contends that restructuring in Virginia has and will continue to produce benefits for electricity consumers in the Commonwealth. DVP's and Constellation's overall message can be interpreted as one of "stay the course" on electric industry restructuring in Virginia. In contrast, responses representing consumer interests remain skeptical about the ability of industry restructuring to produce benefits for Virginia consumers. Mr. Ellis urges this Commission "to make a strong report calling on the General Assembly to cancel electric deregulation..." Dr. Leech, as well as large industrial customers representative Virginia/Old Dominion Committee for Fair Utility Rates, urges that the General Assembly undertake a comprehensive policy reassessment.

As they did last year, the large consumer group cites examples of competitive wholesale markets resulting in significantly higher retail prices in other jurisdictions. 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 well articulated, and they believe a better balance of risks and benefits among all stakeholders is needed, the VA/ODCFUR stop short of suggesting a stop or reversal to electric restructuring. Instead these large customer representatives urge comprehensive policy

changes at the Virginia General Assembly to remedy what they claim to be fundamentally unfair provisions of the Virginia Electric Utility Restructuring Act. Dr. Leech and Mr. Ellis contend that deregulation is not working, will not work in the future, and urge 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 to materialize.

The above discussion illustrates what likely may be the only consensus feature of the current debate surrounding the appropriate policy direction for this industry in Virginia as well as the rest of the country: the only thing stakeholders could likely agree on is that the debate has become more polarized over the past year with vast differences among parties as to the appropriate policy path for this industry. That said, and since the Commission does not have any new policy recommendations to facilitate effective competition in the Commonwealth, the Commission will not offer policy advice to the General Assembly or Governor regarding broader policy issues raised by stakeholder comments and reply comments. In the next section we strive to deliver the facts and assess the current situation in Virginia as well as regionally. Of course, should the legislative or executive branch seek policy recommendations regarding the appropriate policy path for Virginia's electric utility industry from the Commission, we would provide such recommendations in a timely manner.

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 our 2004 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 two years since the issuance of the 2004 report, the SCC continues to perform its charge to provide regulatory certainty and put in place the necessary infrastructure to implement restructuring.

As noted in last year's report, 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. As we stated last year and repeat again here, while delay in PJM integration was thought by some stakeholders to be a major impediment to the spread of retail competition in the Commonwealth, after almost two years for APCo and 16 months for DVP, 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 2006 and are not expected to apply in 2007. 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, it remains true the PJM integrations are still relatively recent events and future wires charges expectations are just that; expectations that may turn out differently. The possibility of a return to wires charges in the first half of 2007 does indeed add some degree of risk 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 proved highly controversial and time consuming. By the time of our report last year, these changes had yet to be implemented. Market conditions that continue to have electricity market prices exceeding capped generation rates (including fuel costs) by a substantial amount render these changes moot; 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.

In our report last year we noted that the State Corporation Commission had been monitoring the transition to competitive electricity markets, both wholesale and retail,

within and without Virginia. Last year's report discussed what were described as "some ominous new industry features and trends." Over the past year, those ominous industry features and trends continued. Below, we use this report to update the General Assembly and Governor on how those trends have progressed this past year and how industry restructuring in Virginia has been affected by those trends. Many of these trends are discussed in more detail in the body of this Report. The trends as stated in last year's report immediately follow. Updates and analysis are then set forth below for each identified feature or trend.

- Single Price Auction. 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.
- Historical Wholesale Prices. 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.
- Actual Impacts on Customers. Some Virginia electric utilities (Craig Botetourt Electric Cooperative, City of Danville Municipal, and 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.

- Industry Consolidation. 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.
- FERC Actions. 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.
- Market Monitoring. 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.

Single Price Auction

The single price auction is the energy market model employed by PJM. This market model attracted considerable controversy as wholesale market prices have increased over the past few years. The model's basic premise is that in order to send an accurate price signal about what and where generation, transmission or demand response

is needed, all generators receive the price paid to the last, highest priced generator selected to operate during that time period at that location. There is currently much debate about the theoretical underpinnings of this market structure as well as how it operates in practice. What is clear is that, for better or worse, the single price auction requires that customers purchase all energy for the applicable time period at the energy cost of the most expensive unit selected to serve load for that time period. This means that if the last unit needed to serve load has a very high marginal cost due to high natural gas prices, market manipulation or some other reason, all generation --- including units with much lower short-run operating costs --- will receive that higher price. Customers paying that higher price will pay considerably more for electric energy during that time period than had they paid an amount equaling the sum of the costs of each generating unit --- some higher but some lower cost --- required to serve load during the period under consideration.

The overall, long-run impact of imposing this market structure on consumers depends on many complex, debatable and controversial factors including the price spread between various generating units, the inventory of generating units in a particular market at a particular time, the ability of customers, distribution utilities, suppliers and generators to react to price signals and the timing and strength of any such reaction. Also vital are fuel prices, the degree of market competition, market rules and the effectiveness of market power mitigation when generators could potentially impact market results.

One of the goals of this discussion is to provide relevant analysis of the substantial and highly contentious default price increases recently proposed and currently effective in Maryland and Delaware. Very importantly and unlike the situation in most

of Virginia, restructuring in those states led to a legal and financial separation of generating units from the customers that formerly relied upon those generating units for electric service. This means that the distribution utility providing default service (the provider of last resort) must purchase full requirements service in PJM's wholesale electric market or from entities that trade power in that market. In effect, the market results in PJM's single price auction market greatly influence the cost that default service providers, narrowly defined, must incur to provide default service to retail customers. The prior sentence's "narrowly defined" qualification is to highlight that very often the default service providing utility resides in the same corporate family as a wholesale trading entity or generation entity that reaps the benefits of higher prices resulting from PJM's single price auction model. Finally, note that both the single price auction as well as any wholesale power sale to default service providers is under the exclusive jurisdiction of FERC.

As a result of the expiration of capped rates as required under Maryland and Delaware restructuring programs, default service providing utilities in these two states proposed historically large rate increases for retail default service. The factors described in the above paragraph --- legal separation of generation from load, transfer of jurisdiction to FERC, and business structures that have default service providers intending to compensate generation in the same corporate family at relatively high marginal cost for electricity produced by generating units paid for through time by the very same ratepayers now facing the large rate increases --- have made the proposed default service rate increases very controversial.

A debate currently rages as to the cause of these price increases. One side of the debate maintains that rates, frozen for several years as a result of state restructuring proceedings, necessarily must rise as they “thaw” in an era of much higher fuel costs. The other side of the debate condemns the move to a default pricing regime greatly influenced by the results of the single price auction as practiced in PJM as the cause of the proposed price increases. A more polarized restatement of the central issue in dispute is: “The proposed Maryland and Delaware price increases are appropriate and result from an artificially low starting point combined with higher fuel costs reflected in well functioning wholesale electric markets” versus “the proposed increases are inappropriate and result from industry restructuring gone awry.” The short answer is that both sides of the debate are jointly correct and neither is exclusively correct.

The issue is important to Virginia. At some point this Commonwealth may face this question for the bulk of the state’s electricity consumers. As explained below, for the 22,000 customers of Delmarva Power Company on Virginia’s Eastern Shore this question is currently relevant. For DVP and APCo, at some point rate caps will expire and predictions of the impact of that expiration will likely be controversial. The actual impact will crucially depend on the legal and financial structural location of AEP and DVP generation that, supported by Virginia ratepayers, has served Virginia load for many years. In other words, the legal and financial relationship between customers and the generation that has historically served them and that those customers have supported in rates for years will be crucial.

In Maryland and Delaware defenders of the rate increase note that rates in Maryland, for example, had been frozen for quite some time and it is to be expected that

a thawing of those rates should lead to large increases. It is implied that the frozen level of rates was somehow set artificially low and that, other things being equal, one should expect that electric rates should rise over time much like the general level of prices in the economy. Moreover, defenders of the rate increase maintain that the new rate level is the result of an effectively competitive PJM LMP market employing the single price auction structure and that the default service auctions --- where the default service providing distribution utility solicits offers from suppliers to supply all-requirements service for a year's time --- are also effectively competitive.

The Virginia SCC and its staff is --- to the extent procedurally allowed --- closely monitoring the debate surrounding the appropriateness of default service rates in Maryland, Delaware and other states. Any proposed percentage increase is an arithmetic function of the existing rate and the new, proposed rate. In Maryland, it is posited by defenders of the proposed increase that the existing frozen rates were set artificially low and the new proposed rates are appropriate. The adequacy and appropriateness of frozen rates through time is an empirical issue that can be studied. Likewise, the appropriateness of the new proposed rates depends on the structure and functioning of PJM's wholesale markets and the default suppliers' power procurement processes. These factors can be studied to inform claims that Maryland and Delaware percentage rate increases are or are not too high.

In Virginia, the Commission's Annual Information Filing reporting requirements allow for an empirical assessment of the adequacy and appropriateness of frozen rates as they change through time. Also, the new level of rates required to collect default service costs are dependent on both the structure and the functioning of the PJM single price

auction energy market as well as the power procurement techniques of the default service provider. The Commission has and will continue to study, assess and participate in FERC, OPSI and PJM stakeholder processes that will in large part determine the level of rates required to fund default service when rate caps expire in Virginia under the Restructuring Act.

Finally, one could view the recent Delmarva Power Company-Virginia fuel factor proceeding before the SCC as an empirical test of the above discussed proposition. In that matter, the company proposed to collect from its 22,000 Virginia customers costs required to recover power costs set by a default service procurement process presumably based on PJM administered markets for energy, capacity and ancillary services. That rate level, if granted by the Commission, would have increased Delmarva's rates by 49.5% and could be considered to result from changing to a regime where prices are based on the single price auction as administered by PJM as well as other factors including the increase in fuel costs.

An alternative method of calculating an appropriate rate increase for Delmarva's Virginia customers in this circumstance arose from a settlement agreed to by the company and the Commission in the year 2000. The settlement allowed the company to divest generating units that had served its Virginia load. That settlement method calculates required revenues based on the average cost of electricity across a portfolio of generating sources that once served Delmarva-Virginia customers and is more akin to the way costs and rates were determined before industry restructuring. That method, while still sensitive to increases in fuel costs, does not directly or indirectly re-price all power consumed at the cost of the most expensive generating unit. This latter cost-based

method produced a rate increase for Delmarva-Virginia customers of roughly 25%. The difference between the 49.5% requested rate increased based on the single price auction and secondary default service solicitation administered by Delmarva and the lower 25% increase that results from a calculation based on average costs could be considered at least the short-term impact of implementing a single price auction market structure. Thus, both fuel price increases as well as the implementation of a changing market structure would have significantly impacted Delmarva-Virginia's rates if the cost-based settlement method was not available. Even with the cost-based alternative, prices still increased by 25% indicating that increased fuel prices significantly impact rates throughout the region.

The key point of this somewhat lengthy discussion is that regardless of whether fuel prices or PJM's single price auction are driving rates higher, the ability of state policy makers to mitigate financially adverse impacts on consumers crucially depends on the corporate structural relationship between generation and consumers. Had generation legally resided in the same entity charged with providing default service to retail customers, Maryland and Delaware policymakers would have had more options to deal with the pressures serving to increase default rates --- whether those pressures come from increased fuel prices, the transfer of jurisdiction to FERC, or the implementation of the single price auction, with or without the inappropriate exercise of market power. On the Eastern Shore, even though customers and the generation historically serving them were separated six years ago, the settlement in that separation proceeding provided this Commission an option to employ to mitigate the impact of Delmarva's requested 49.5% rate hike. For the vast bulk of retail customers in Virginia, as long as AEP and DVP

generation legally reside in the distribution utility, policymakers in Virginia still have those options should they be needed.

Historical Wholesale Prices.

Wholesale prices, as set forth in the body of this year's report continue their upward trend. PJM load-weighted energy prices increased 43.1% from full-year 2004 (\$44.34 per MWh) to \$63.46 per MWh for full-year 2005. Energy prices for the first six-months of 2006 appear about 5% higher than for the comparable period last year.

Last year we noted that "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." This statement is still true as has been demonstrated by sizable rate increases facing many customers as they transition from rate caps, are served by municipal utilities or cooperatives with expiring long-term contracts or otherwise must take service at prices influenced by the market.

Actual Impacts on Customers.

Virginia transmission dependent utilities – municipals and cooperatives – continue to deal with high wholesale prices. For example, as reported by the VA, MD, & DE Association of Electric Cooperatives in their reply comments, the Town of Front Royal reports a 76% increase in its wholesale power rates. Also, Craig-Botetourt Electric Cooperative's wholesale rates recently increased an average of 18%. We also note that the Eastalco aluminum smelter near Frederick, Maryland did indeed cease major operations. All but about 60 of its 600 workers have been let go. Local and state

officials continue to work to try to find an electric power provision plan that would allow the plant to resume regular operations.

Industry Consolidation.

Last year's report anticipated that PUHCA repeal may allow further industry consolidation. The Energy Act of 2005 did indeed become law and PUHCA has been repealed.

Two big pending mergers in the PJM region have yet to close. The proposed deal between Constellation (parent of Baltimore Gas & Electric) and Florida Power & Light appears to have been slowed down by the turmoil in Maryland. The proposed merger of Exelon and Public Service Electric & Gas (New Jersey) has yet to receive final approval from the New Jersey Board of Public Utilities. Adjacent to the region, Cinergy (OH, IN, KY) and Duke Energy (NC, SC) did complete their merger earlier this year.

FERC Actions.

The Federal Energy Regulatory Commission continues to 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. During the past year, FERC relaxed market mitigation rules by allowing for higher prices during periods when demand and supply conditions suggest that "scarcity" price signals are appropriate. In addition, FERC continues to move towards a new capacity market construct for PJM. This process is now in settlement conference before a FERC settlement judge. As such,

as of this writing, it is not clear how such a market will eventually function or what changes in cash flows will result from any outcome that may be reached.

The FERC apparently continues to believe that raising the generation sector's financial returns will lead to a more robust, competitive generation sector that will benefit consumers in the longer run. The logic may be that higher prices now will lead to lower prices later. This theory has been embraced by other supporters of restructuring as they urge policymakers to "stay the course" because, in the long run, restructuring will produce benefits for consumers. While restructuring may or may not produce long-run benefits that outweigh short-run costs for consumers, we note that this proposition too can be subject to rigorous, quantitative thinking if not analysis. The way to compare potential short-run costs with expected long-run benefits is through the use of present value analysis using appropriate risk adjusted discount rates.

From the consumers' perspective, if the potential short run-costs of restructuring are relatively large and certain while the expected benefits are small, far off in time and less certain, restructuring looks like a bad deal. If these conditions are reversed, then restructuring would look like a good deal for consumers. One thing is clear, however. Economic behavior indicates that consumers appear to have relatively high discount rates, meaning their tolerance for short-run costs is low even if those costs buy considerable and certain long-run benefits.

Market Monitoring.

The SCC continues to be troubled by both the enormity of the market monitoring task, the inability to get timely responses to data requests, the placement of the PJM

Market Monitoring Unit internal to PJM's organizational structure, and FERC's oversight of PJM market monitoring. We will continue to direct our staff to work with PJM, OPSI, PJM stakeholders and FERC to remedy this serious flaw in Virginia's participation in PJM. Based on PJM's current practices and policies, the SCC cannot represent to the General Assembly or Governor that PJM's wholesale market is transparent, competitive or in the public interest of Virginia ratepayers.

Based on activities observed during the past year since we issued our last report we reiterate here our closing paragraph from the 2005 report:

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 solely as a result of 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 17, 2006)
- Comments of Old Dominion Electric Cooperative (May 25, 2006)
- Reply Comments of VA/MD/DE Association of Electric Cooperatives (June 12, 2006)

Competitive Service Providers/Aggregators:

- Comments of Constellation New Energy (May 22, 2006)

Consumer Representatives:

- Comments of Mr. Urchie B. Ellis (May 1, 2006)
- Comments of Dr. Irene E. Leech (May 23, 2006)
- Comments of Virginia Committee for Fair Utility Rates and
Old Dominion Committee for Fair Utility Rates (May 22, 2006)
- Reply Comments of Virginia Committee for Fair Utility Rates and
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STATE CORPORATION COMMISSION
DIVISION OF ECONOMICS AND FINANCE

April 7, 2006

Dear Market Participant:

As directed by §56-596 B of the Virginia Electric Utility Restructuring Act, the State Corporation Commission is preparing its sixth annual report to the Commission on Electric Utility Restructuring ("CEUR") and the Governor, to be filed by September 1, 2006. 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.

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. Because of the current status of high market prices, recent auction results within neighboring states, some experience with PJM, and the continued lack of competitive activity in and around Virginia, consider the Commonwealth's statute and offer any thoughts or recommendations, whether positive or negative.

Please provide your comments to me by May 12, 2006. 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, 2006. 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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DominionSM
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May 17, 2006

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

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 develop your annual report.

As we have stated in past years, Dominion believes the Virginia restructuring program has produced significant benefits for consumers and promoted efficiency in the electric industry. The Commonwealth’s restructuring effort has shown it can successfully adapt to changing circumstances. This flexibility, based on close regulatory and legislative oversight, has helped Virginia avoid the problems that have occurred in some other states undertaking restructuring. Virginia’s program has laid a strong foundation for retail competition. Interest in customer choice remains high among competitive suppliers and aggregators, and the restructuring movement took a major step forward this spring when the Commission licensed the City of Fairfax as Virginia’s first municipal aggregator. A higher level of retail competition should not be expected to develop until market conditions improve (i.e., wholesale market prices fall below capped rates). This would provide competitive suppliers with increased opportunity to make favorable offers. This situation could occur at some time during the period from July 1, 2007 through December 31, 2010. During this period Dominion’s capped rates will be adjusted annually to reflect actual fuel costs.

Restructuring Already Producing Significant Consumer Benefits

While the restructuring process has not been perfect in Virginia, it has produced significant benefits for the Commonwealth’s consumers. This is due in large measure to the close regulatory and legislative oversight built into the process. This oversight mechanism, apparently lacking in some other restructured states, has allowed Virginia to make necessary midcourse corrections to protect customers and keep the process on track.

The freeze imposed on Dominion's fuel factor by the 2004 General Assembly has produced hundreds of millions of dollars in savings for the Company's customers. The freeze, extending through mid-2007, was implemented just as fuel prices began surging toward record levels. The Company recently estimated the freeze will produce savings of about \$260 for the typical residential customer using 1,000 kWh per month during the two year period of 2005-2006.

The General Assembly in April took additional steps to ensure the accuracy of the reset of Dominion's fuel factor beginning in 2007 and protect customers from a dramatic price increase. The legislature approved Gov. Tim Kaine's amendment requiring that Dominion's fuel factor be adjusted annually from July 1, 2007 through July 1, 2010. The amendment eliminated the need for a long-term, 42-month projection of fuel expenses through the end of 2010. This would have presented the Commission with an extremely difficult, if not impossible, job. The amendment ensures that Dominion customers will pay no more for fuel than Dominion's actual costs and provides annual opportunities for correction. The amendment also allows the Commission to defer up to 40 percent of Dominion's 2007 fuel factor adjustment to subsequent years, blunting its impact on consumers and offering further price stability.

As we have noted in past comments, the capped rate provisions of the Virginia Electric Utility Restructuring Act have also produced substantial savings for customers. The 2004 Dominion-commissioned study by Chmura Economics & Analytics projected that capped base rates will save residential consumers served by the Company as much as \$1.8 billion through 2010. Residential customers will see annual savings of up to \$74 during the Restructuring Act's transition period due to capped rates, according to the study.

Restructuring savings are not confined to Virginia. An October 2005 report by Cambridge Energy Research Associates found restructuring, through 2003, had produced \$34 billion in consumer savings nationwide. Another consultant, Global Energy Decisions, reported last year that customers enjoyed \$15.1 billion in benefits through increased wholesale competition from 1999 through 2003. Both the Public Utility Commission of Texas and the New York Public Service Commission have found restructuring has generated significant savings for consumers in their states. In New York, the PSC estimated inflation-adjusted power prices for utilities' residential customers dropped an average of 16 percent between 1996 and 2004.

Rates Increasing in Non-Restructured States

Controversy over increases in states such as Maryland and Delaware with expiring rate caps has tended to obscure steady, and in some cases dramatic, rate increases in many non-restructured states. For example, Wisconsin Public Service rates for customers in the eastern part of the state have risen approximately 60 percent since 2001. If the company's latest petition is approved, the rate of increase would rise to approximately 81 percent. Florida Power and Light's monthly residential bill for 1,000 kWh has risen from \$69.73 in 2000 to \$108.61 this year, an increase of approximately 56 percent, largely resulting from increasing fuel expenses. Residential customers of Public

Service Company of Oklahoma, an AEP affiliate, experienced a 32 percent increase in December 2005 due to higher fuel prices.

As these examples indicate, escalating fuel costs have been the primary reason for the higher electric rates many consumers have experienced in recent years in states maintaining traditional cost-of-service regulation, as well as in restructured states. In addition, higher costs for equipment, materials (such as steel, copper and aluminum), labor and other factors in the production and delivery of electricity are exerting significant upward pressure on base electric rates.

Virginia Restructuring: Default Service

Virginia consumers can take comfort in the Commonwealth's careful steps to prepare for the expiration of capped rates and the beginning of market-based default service on January 1, 2011. As the Staff noted in their April 28 default service report, the Commission on Electric Utility Restructuring will soon begin a two-year review of the provision of default electric supply service after the capped rates expire. The study will allow Virginia to evaluate the experiences of other states and develop workable plans for the future. The CEUR review will also furnish this Commission with much of the information it will need to implement post-rate-cap default service.

Virginia Restructuring: Retail Competition

Interest by competitive power suppliers (CSPs) and aggregators in Virginia's restructuring program remains strong. As of May 4, six competitive suppliers and six commercial aggregators were licensed by the SCC. Of these, all except one aggregator were registered with Dominion. Market conditions, however, have made it virtually impossible for CSPs and aggregators to make customer offers more favorable than capped rate service. Wholesale market prices for electricity have risen sharply in recent years, in large part due to the rapid increase in fuel prices. The freeze imposed on Dominion's fuel factor by action of the 2004 General Assembly has protected consumers from rising fuel costs. However, this has made it even harder for CSPs to make attractive offers. We expect retail competition to begin developing in the Commonwealth as market conditions improve and the Dominion fuel factor is adjusted to recover increased fuel costs later in the decade.

We also continue to believe that aggregation provides the most effective means for bringing the benefits of retail competition to smaller customers, including residential customers and small businesses. One of the best ways to form customer buying groups is through municipal aggregation, with the city or county government acting as the buying agent for customers within the locality's boundaries. Municipal aggregation allows the locality's residents to achieve the critical mass needed to attract competitive providers. This method of procurement has had some notable successes elsewhere, including northeastern Ohio and the Cape Cod area of Massachusetts.

Municipal aggregation took a significant step forward this spring with the SCC's April 18 issuance of an aggregation license for the City of Fairfax. The license allows the city government to provide competitive aggregation service to residential, commercial and industrial customers within the city limits. Fairfax became the first locality in the state to apply for an aggregation license on February 21. This application followed Fairfax City Council's October 11, 2005 vote to create a municipal aggregation program with opt-out participation. (Customers will automatically be included in the aggregation unless they notify the city that they do not wish to participate.) With its license, Fairfax is now ready to enter the electricity market when conditions improve.

Dominion will continue to support Fairfax's efforts to conduct a successful aggregation program. Additionally, we will continue to assist other municipalities as they explore aggregation programs.

Retail Competition: Trends Elsewhere

Low shopping rates among smaller customers, coupled with continued rate caps and freezes, have tended to obscure the fact that fairly vigorous retail competition is developing in some states. This is especially true among larger users, such as industries and large commercial establishments. Data from several states emphasize this fact.

The New York Public Service Commission recently reported that competitive suppliers served 72 percent of the large commercial and industrial-class load in February; almost 55 percent of the accounts in the rate class were buying from competitive providers. Competition was also strong among small and medium-sized commercial customers, according to the Public Service Commission. Competitive providers furnished more than 44 percent of the rate class's load; almost 19 percent of the accounts within the rate class were shopping.

In Massachusetts, the Department of Telecommunications and Energy reported that competitive marketers in February were serving more than 56 percent of the state's large commercial and industrial users and 17 percent of its medium-sized commercial and industrial customers.

The attention centered on the pending standard offer service increases for residential customers in Maryland has also largely hidden the growth of electric competition in the state. Earlier this month the Maryland Public Service Commission said competitive providers served more than 80 percent of the large commercial and industrial accounts during March. Marketers also provided electricity to more than 15 percent of medium-sized commercial and industrial accounts. And in Maine, Public Utilities Commission shopping statistics indicate marketers served 38 percent of the state's total demand for electricity as of April 1. The Public Utilities Commission reported that competitive providers were serving 91 percent of the large industrial load in Maine Public Service's territory and 87 percent of the large industrial load in Central Maine Power's territory.

Consumer interest in retail competition also remains strong. A recent survey of registered voters in Connecticut found 87 percent want the ability to shop for power. Sixty-eight percent said competition was the best way to lower prices for energy, according to the survey sponsored by the Retail Electric Supply Association.

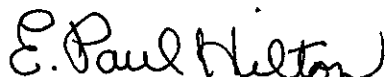
Virginia's Restructuring Effort: A Sound Plan for the Future

Virginia's restructuring effort has produced real savings for consumers and introduced greater efficiency in the electric utility industry. The initiative has shifted the risk for billions of dollars in new costs and investments from utility customers to the companies themselves and their shareholders. The Commonwealth's program has greatly benefited from the ongoing regulatory and legislative oversight prescribed by the Restructuring Act. Virginia's ability to monitor and correct its restructuring program sets it apart from the initiatives underway in several other restructured states. The oversight has allowed Virginia to deal with changing circumstances and make the midcourse corrections needed to keep the restructuring program on track. The examination of the post-rate-cap situation by the Commission on Electric Utility Restructuring is another example of this close oversight. The study should greatly assist all parties in developing the terms for the default service that will be offered after the capped rates expire.

Although market forces have worked against retail competition in Virginia in recent years, the Commonwealth's restructuring program has laid a solid foundation for customer choice. Interest by suppliers and aggregators remains high. The SCC's recent approval of a municipal aggregation license for the city of Fairfax marks a first step toward cities and counties acting as buying agents for their citizens. Additionally, significant numbers of customers are shopping for power in other restructured states, including Maryland, following the expiration of rate caps. Electric customers in Virginia are well positioned to realize continued benefits from capped rates during the rest of the transition period and to take advantage of the competitive market for electricity after the capped rates expire.

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

Sincerely,



E. Paul Hilton

May 25, 2006



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

Dear Mr. Eichenlaub:

This is in response to your letter dated April 7, 2006, soliciting informal written comments regarding Staff's review of methods to facilitate effective competition in Virginia. This is the first year Old Dominion Electric Cooperative ("Old Dominion") has offered comments for your annual report. Now that the entire Commonwealth is within the PJM footprint, we believe our experience in that wholesale arena could be helpful to you, especially with regard to the status of regional competitive markets. Old Dominion appreciates the opportunity to provide input, and looks forward to participating actively in any further discussions with Commission staff and with the Commission on Electric Utility Restructuring (CEUR).

Old Dominion is a not-for-profit power supply electric cooperative, organized and operating under the laws of Virginia and subject to the Federal Energy Regulatory Commission jurisdiction. Old Dominion supplies capacity and energy to its twelve electric distribution cooperative members, ten of which are regulated by the Virginia State Corporation Commission. Old Dominion is a network transmission customer of PJM, as well as a PJM Transmission Owner. As a generation-owning utility, Old Dominion is dependent upon use of the transmission facilities of PJM under its Open Access Transmission Tariff ("OATT") to deliver the output of Old Dominion's generation facilities located within PJM and to deliver periodic power purchases from third party sellers to the load of its member systems in PJM's footprint. Old Dominion has been an active participant in PJM's stakeholder process since 1997.

The April 7 letter encourages the submission of comments regarding "national, regional, or Virginia restructuring efforts, policies, activities, or events." Specifically, the Commission is interested in ideas to facilitate effective retail competition in Virginia. As will be discussed below, Old Dominion is of the opinion that a viable and competitive wholesale market is a necessary prerequisite to retail choice and that more must be done to achieve such a wholesale market. Pursuant to §56-596 B of the Virginia Electric Utility Restructuring Act, Old Dominion offers these comments so that the Commission can make its report to the CEUR and the Governor to include recommendations that are in the public interest.

1. Status of Development of Regional Competitive Markets

Old Dominion has relied upon three general forums to shape its thinking on this topic: individual industry assessments, proceedings before the Federal Energy Regulatory Commission (FERC) regarding PJM, and the comments of others relative to retail choice. The industry assessments and retail comments speak for themselves. The PJM FERC proceedings have given us first hand experience in the current debates on market efficacy within an RTO that has been generally accepted through the industry as having the most viable competitive wholesale market.

A. The Industry Assessment of Competitive Markets

A number of competing studies have been widely circulated that, depending on who commissioned them, attempt to either portray competitive markets as a resounding success or refute the pro-competitive studies by pointing out significant omissions or errors in approach. A summary of some of the more prominent studies and their counterpoints is presented below.

Although the study results differ, there is still tremendous value that can be derived from these conflicting views. First, it is useful to consider the many different metrics that can be used to assess performance and the drawbacks of each. Second, it is instructive to understand the positions of the study sponsors as one reviews a particular study's conclusions. Consistently, studies declaring victory are sponsored by independent generation and investor-owned utility groups while the counter studies are commissioned by load interests. It is of particular note that all studies purport to represent the view of consumers!

Most importantly, however, these competing studies remind us that we must do our own due diligence and seek to objectively assess success or failure. They point out the danger of relying on sound bites prepared by special interest groups that support pre-determined perspectives on an issue. Recent retail rate issues in Maryland and Delaware are also instructive as we evaluate success. As Dr. Roy Shanker pointed out in Richmond during PJM's April 26, 2006, meeting, economists are seeking economic efficiency and not lower prices. We must bear this caution in mind as the Virginia General Assembly assesses the next move to facilitate competitive markets in the Commonwealth.

These studies are also useful in that they affirm that, at this point, it is too soon to tell if competitive wholesale markets have been successful or not. The infrastructure of our current electric grid evolved from the PUCHA rules established in the 1930's. The current transmission grid was built by vertically integrated monopolists in a regulated cost-of-service environment where generation and transmission planning was harmonized and coordinated for the least cost result. Unbundling generation and transmission under FERC Orders 888 and 2000 represented a significant change in approach. Generation and transmission construction are no longer coordinated, and market participants are still

working to develop wholesale market and planning rules to accommodate this huge paradigm shift. In PJM, the industry has been “experiencing” a uniform clearing price LMP market since 1998. The electric utility industry is still evolving and many additional changes will be required to achieve the anticipated benefits of a truly competitive wholesale market.

For all but the Cambridge Energy Research Associates (“CERA”) “Crossroads” study¹, Old Dominion has attached the actual reports for those who wish to explore these in more detail. Study summaries follow²:

Studies

(i) CAEM Study -- Dr. Ron Sutherland, from the Center for the Advancement of Energy Markets (“CAEM”), prepared a study entitled “Estimating the Benefits of Restructuring Electricity Markets: An Application to the PJM Region” in 2003. The study found that the present discounted value of future savings to consumers in the PJM region as a result of then current restructuring efforts would be about \$28.7 billion. The study broke down the savings into two components. The first \$20.1 billion was derived using a comparison of retail electricity price changes in PJM between 1997 and 2002 to retail price changes in neighboring states and the United States average. The second \$8.6 billion was attributed as a “post stranded cost recovery” benefit representing the savings that customers would enjoy when the stranded cost recovery period ends resulting in a decline in PJM prices in the year 2009. (See Attachment 1.)

(ii) Kirsch, Morey Response to CAEM Study -- On the other hand, in a report entitled “Erecting Sandcastles from Numbers: The CAEM Study of Restructuring Electricity Markets Or a Critique of Estimating the Benefits of Restructuring Electricity Market: An Application to the PJM Region,” by Mathew Morey, Laurence D. Kirsch, Steven Braithwait, and Kelly Eakin, all of whom are associated with Laurits R. Christensen and Associates, the authors refute the CAEM report stating that the study represents a seriously flawed analysis of the economic effects of restructuring in the wholesale and retail electricity markets in the PJM region. Morey *et al* add that the CERA study cannot be relied on to identify the elements of restructuring in the wholesale and retail markets or to infer what, if anything, is good or bad. The study fails to conduct a proper benefit-cost analysis of restructuring, and has not provided any evidence that the reductions in retail prices in the PJM states from 1997 to 2002 were the effect of any efficiency gains resulting from restructuring either the wholesale or retail markets. They conclude their analysis by stating that while restructuring wholesale electricity markets may provide long-term benefits (and have achieved a certain level of success in some parts of the country), there are some key restructuring problems which have not been solved, partly because “policymakers

¹ The CERA study resulted from a solicitation by CERA among competitive market advocates and is available only to non-participants for a fee.

² The bibliography for each of the studies referenced here is included in Appendix A.

underestimated the nature and magnitude of the technical and institutional challenges associated with successfully introducing competitive markets.” (Christensen report, p. 21) (See Attachment 2.)

(iii) Cambridge Energy Research Associates (“CERA”) Study -- The CERA study, entitled “Beyond the Crossroads: The Future Direction of Power Industry Restructuring,” (2005) estimates that the average U.S. residential electric consumer paid about \$34 billion less for electricity over the past seven years than they would have paid if traditional regulation had continued. They claim that the savings from deregulation reflect many of the expected gains from introducing more competitive pressures into the power business, introducing greater efficiency, more innovation, and cost discipline. The report also concludes that under a deregulated regime, the costs of new supply are shifted to investors who hold the market risk as opposed to going into ratebase, implying that deregulation reallocated the risk in the power industry.

(iv) Kirsch and Morey Response to the CERA Study -- Kirsch and Morey refute the CERA study in a report entitled, “Beyond Belief: A Critique of the Cambridge Energy research Associates’ Special Report – ‘Beyond the Crossroads: The Future Direction of Power Industry Restructuring.’” (See Attachment 3.) Kirsch and Morey argue that CERA’s net benefit findings rely on the assumptions that (1) markets in all four regions were “regulated” through 1997 and were “deregulated” after 1997, and (2) that CERA’s statistical model provides reasonable estimates of what retail electricity prices would have been if deregulation had not occurred. These assumptions are erroneous and render the study “beyond belief” for the following reasons:

- The study is careless in its distinction between regulated and deregulated market periods;
- There is an ascription of the lion’s share of deregulation benefits to the southern region to the tune of \$24 billion dollars although this region has experienced little deregulation;
- There is a large share of the benefits attributed to the Midwest region even though that region had no functioning RTO until 2002;
- The study counted losses of generators during the recent “bust” portion of the business cycle as part of the deregulation benefits for residential consumers and these losses are not sustainable over the course of the business cycle;
- The study ignored the huge administrative costs of implementing restructuring which would offset any efficiencies that might be passed on to residential consumers;
- The empirical analysis focused solely on retail electricity prices when the direct effects of deregulation are primarily on wholesale prices, and additionally the continuing regulation at the state level of rates prevents a direct link between retail and wholesale prices; and

- The prediction equation miscalculates what “regulated” prices would have been after 1997.

(v) Global Energy Decision Study -- Global Energy Decision (“GED”) prepared a study entitled “Putting Competitive Power Markets to the Test,” Sacramento, July 2005, which concluded that over the 1999-2003 period, consumers in the “Eastern Interconnection have realized a \$15.1 billion benefit due to wholesale competition over what they would have realized under the traditional regulated utility environment.” (Report, p. 1-1) They also have determined that the industry as a whole has improved its operations and efficiencies largely due to competitive forces. (See Attachment 4.)

(vi) Kirsch and Morey Response to the GED Study³ -- The GED report was reviewed and critiqued by Kirsch and Morey in their report titled “Putting Competitive Power Markets to the Test: An Alternative View of the Evidence.” (See Attachment 5.) Kirsch and Morey conclude that the GED results are based on false assumptions that lead to grossly overestimated benefits. Their arguments against the report’s assumptions are as follows:

- GED wrongly assumed that losses sustained by competitive suppliers during the 1999-2003 study period, which account for over half of the estimated benefits of competition in their report, can continue in perpetuity; such a sustained level of benefits is impossible. Kirsch and Morey argued that the losses are actually part of the business cycle. In order to accurately anticipate the benefits of competition, GED should have incorporated the “bust-boom” phenomenon of the electric utility industry’s natural business cycle.
- The study wrongly assumed that traditional utilities will make generation investments that are inferior (less efficient) to those made by competing firms both during the study period and on into the future. This assumption accounts for 1/3 of the calculated benefits. The assumption was wrong because the per MW capital cost for investments in new generation only counts for part of the overall cost of generation that consumers pay for power.
- Fuel cost was another component that is not addressed. As has been dramatically demonstrated since 2003, the cost of natural gas has sufficiently changed the price of delivered power. Furthermore, industry investment before 2003 in gas-fired technologies is currently greatly impacting the market. Neither of these parameters was addressed in the study report, thus skewing the conclusions.

³ This study was also commissioned by the NRECA as a critique of the results of the GED Study.

- The report ignored the costs of RTO operations. The authors should have taken into account the estimated \$1.6 billion on RTO operational costs for the 1999-2003 study period. If this cost were incorporated into the analysis, the benefits would have greatly decreased. In fact, Kirsch and Morey conclude that, after correcting for GED's most problematic assumptions, the consumer has actually experienced a net loss as a result of electric utilities competitive markets.

(vii) Spinner Response to CERA and GED Studies -- Virginia's very own Howard Spinner, Director, Division of Economics and Finance, of the Virginia State Corporation Commission, has provided his own views on two of the studies discussed above (the CERA and the GED Studies) in his paper titled "A Response To Two Recent Studies That Purport To Calculate Electric Utility Restructuring Benefits Captured by Consumers," (November 2005). (See Attachment 6.) Spinner outlined his thoughts of what he believed to be "conceptual flaws" in each of the studies in question. Spinner questioned the fundamental philosophy of both studies that conclude that "savings" to consumers resulted from losses realized by the competitive generator arena. The problem Spinner highlighted is that the methodologies used in these two studies to prove benefits of competition did not address "long-term impacts on capital formation, capital cost and operating expenses" which, if properly addressed, would lead the study's conclusions to different outcomes.

(viii) ESAI Study -- In October 2005, PJM released a commissioned study by Energy Security Analysis, Inc. ("ESAI"). The purpose of this study, written by Edward N. Krapels and Paul Fleming, was to review the impact of the expansion of PJM on the classic PJM area as well as the new service areas (Ohio, Kentucky, Virginia, West Virginia, Illinois, Indiana and Michigan). The study assessed the benefits of the increase in dispatch efficiency, improvements to market liquidity, changes in the transmission flows and the proposed Reliability Pricing Model. It concluded that over the past several years, wholesale electricity customers have saved more than \$500 million a year as a result of the expansion of PJM into the Midwest and Southeast, resulting in a full RTO as one system, as compared with separate dispatch of disaggregated areas.

The study also found that PJM market integration has resulted in innovations that benefit the industry. Examples of such benefits included price transparency, rules for asset interconnection and open rights to use the transmission system. The study supported the Day 2 market mode, stating that this model allows buyers and sellers to hedge their risks effectively. The bid-ask spread is decreasing, which increases liquidity and helps reduce transaction costs for buyers and sellers. It also supported PJM's new capacity-market plan, the Reliability Pricing Model (RPM), which the authors concluded would stimulate investment in resources. It stated that market integrations have stimulated substantial growth

in electricity trading. Increased diversity of supply has led to increases in import-export trading.

To that end, the study found that there is great value in a market where risks can be effectively hedged, bid-ask spreads are small, and where there is high diversity in the portfolio of power generating facilities. It concluded that the liquidity and diversity of the expanded PJM would yield savings to electricity consumers of \$700 million to \$1.4 billion per year. (See Attachment 7.)

Old Dominion is in the process of carefully reviewing the ESAI study. At this point, it appears ESAI's reliance on a heat rate analysis based on natural gas as the marginal unit to assess dispatch efficiency may not provide the most accurate assessment of efficiency as the marginal unit is often coal. Additionally, assuming that suppliers bid to recover their variable cost (as did ESAI) as opposed to maximizing profits will affect the results. The conclusions on efficiency based on FTR pricing and congestion revenue appear to be circular and the relationship between bid-ask spreads appears to be more relevant to assessing a lack of arbitrage opportunities rather than a lack of market inefficiencies.

(ix) Synapse Studies -- Addressing another very contentious market component, Synapse Energy Economics Inc. has prepared several reports after studying PJM's capacity market design. The market design has been called the Reliability Pricing Model (RPM). (See Section B for more details.) In the first report, which was prepared for the Pennsylvania Office of Consumer Advocate, the authors, Paul Peterson, David White, and Bruce Biewald, analyzed the revenues that existing, large base load generation units are receiving from the capacity market structure and what these same units would receive in the future under both the capacity market structure and the then proposed PJM RPM ("Capacity Revenues for Existing, Base Load Generation in the PJM Interconnection, A Pennsylvania Case Study," Synapse Energy Economics, June 10, 2005, Synapse.) (See Attachment 8.) The authors concluded that setting capacity prices under RPM significantly increased annual capacity revenues for these large generation units. They stated that these revenues are hard to justify, as they do not relate to financial hardship or enhanced services. They concluded by questioning how the RPM-type compensation mechanism can produce wholesale power rates that meet the "just and reasonable" standard under the Federal Power Act.

In the second report titled "An RPM Case Study: Higher Costs for Consumers, Windfall Profits for Exelon," Synapse Energy Economics, October 18, 2005, prepared for the Illinois Citizens Utility Board, these same authors looked specifically at the capacity revenues of nuclear generating facilities operated by Exelon Generation in northern Illinois. (See Attachment 9.) The authors highlighted that the RPM utilizes an administrative process to determine the market price of capacity resulting in higher prices than the current market would sustain. As a result of these higher prices, generators gain windfall

benefits at the expense of ratepayers, with no guarantee that new capacity will be built. The authors conclude by questioning the efficiency of the RPM-type compensation mechanism.

The third study by these same authors (Ezra Hausman, Paul Peterson, David White, and Bruce Biewald, “RPM 2006: Windfall Profits for Existing Base Load Units in PJM. An Update of Two Case Studies,” Synapse Energy Economics, February 2, 2006), also prepared for the Pennsylvania Office of Consumer Advocate, took a close look at the Reliability Pricing Model (RPM), filed at the Federal Energy Regulatory Commission in August 2005. (Ironically, a number of deficiencies PJM seeks to address reflect competitive market “successes” in some of the above reports.) The authors of this study continue to express concern that capacity prices as well as capacity revenues will rise significantly with the implementation of RPM. They concluded that RPM represents a major windfall for owners of base load generation at the expense of consumers, and find that “RPM is an inefficient and arbitrary price-setting scheme that will lead to windfall profits for generators, much higher costs for consumers, and no guarantee of increased reliability.” (See Attachment 10.)

(x) Department of Energy Study -- The U.S. Department of Energy’s Office of Electricity Delivery and Reliability sponsored a report prepared by Joseph H. Eto and Bernard C. Lesieutre of the Lawrence Berkley National Laboratory and Douglas R. Hale of the Energy Information Administration entitled “A Review of Recent RTO Benefit-Cost Studies: Toward More Comprehensive Assessments of FERC Electricity Restructuring Policies,” December 2005. (See Attachment 11.) This study evaluated 11 RTO benefit-cost analyses conducted between 2002 and 2004 and made recommendations to improve future studies. The document provides an excellent primer for some of the underlying economic theory behind proposed efficiency improvements. Of particular interest is the conclusion that “[t]aken as a whole, it is difficult to draw definitive conclusions from these studies because they have not examined potentially much larger benefits (and costs) resulting from the impacts of RTOs on reliability management, generation and transmission investment and operation, and wholesale electricity market operation.” Among the studies evaluated are those in support of AEP and DVP’s integration into PJM.

B. Proceedings Before the Federal Energy Regulatory Commission

A quick review of the number of proceedings currently before the Federal Energy Regulatory Commission (“FERC”) addressing significant components of wholesale market design demonstrates we have not yet attained a workably competitive wholesale arena. Of the numerous proceedings currently before FERC that could significantly affect the viability of competitive wholesale markets of particular concern are:

- Reliability Pricing Model (E105-148 and ER05-1410)

- Identification of beneficiaries, allocation of costs for transmission and long term regional rate design (EL02-111, ER05-6, ER05-6, ER06-456, EL06-50, EL06-54, ER06-954, ER06-880)
- Marginal losses (EL06-55)
- Market monitoring (ER06-826, AD06-7)
- NERC and ERO reliability Standards (RM06-1, RM06-16)
- Long term transmission rights (RM05-17)
- Revisions to the Open Access Transmission Tariff rules (RM05-25, RM05-17)

While all of the above have the potential to greatly influence the long-term viability of a competitive wholesale market, of particular concern is PJM's proposed Reliability Pricing Model (see Section A (ix) above). On August 31, 2005, PJM filed with FERC to modify its existing capacity rules to address "serious inadequacies." PJM notes in its filing that the current capacity adequacy rules have proven to be unjust and unreasonable because they (1) do not look far enough into the future to secure capacity in a timely fashion relative to reliability needs; (2) lack an important locational element; (3) are not providing sufficient financial incentives for supply additions, and (4) unchanged, will not ensure the future reliability of the region. In reality, PJM transmission infrastructure has not kept pace with load growth. Steps need to be taken to address those problems, including modifications to the Regional Transmission Expansion Plan ("RTEP"), and incorporating a methodology to evaluate a declining generation profile. Transmission planning needs to evolve to reflect the current competitive, non-integrated resource planning environment. The Commission issued an initial order on April 20, 2006, ruling on several issues and leaving others to a technical conference and paper hearing.

Old Dominion and a number of other entities representing load interests take serious issue with this proposal and the subsequent Commission order. As proposed, RPM has the potential to increase costs between \$5 to \$12 billion annually with no assurance that new generation will be attracted to build in constrained areas such as Washington, D.C. The order ignores significant information that contradict PJM assertions in support of this construct, as well as concurrent initiatives on local market power, transmission planning and rate design. As an example, based on PJM's December 2005, Regional Transmission Expansion Plan (RTEP), less than \$300 million had been invested in transmission upgrades not associated with new generation interconnections since the RTEP process began. Assessing available Energy Information Administration ("EIA") data for new generation construction over that same time period indicates over \$9.5 billion had been invested in new generation. The order ignores the severe locational aspect of PJM's perceived deficiencies as well as less onerous and broad alternatives to address legitimate local concerns. Additionally, as articulated in the October 19, 2005, comments of the Virginia Office of the Attorney General's Division of Consumer Counsel, implementation of such a construct will effectively negate anticipated benefits to Virginia of Dominion Virginia Power's ("DVP") integration into PJM by between \$298 to \$314 million, dependent on the low or high-end benefit case as submitted on June 25, 2004 by DVP. (See Comments of the Virginia Office of the Attorney General's Division of Consumer Counsel under ER05-148, dated October 19, 2005, pg. 4.)

Old Dominion adamantly opposes RPM as currently proposed and is actively involved in all available forums to achieve a more favorable resolution to this initial order.

C. Effect of Regulatory Changes in Other States

Recent rate increases in retail choice states to the north should be of interest to the Commission. As pointed out in an editorial printed in the Washington Post on April 16, 2006, by former SCC Chairman Hullahen W. Moore, residential customers of Baltimore Gas & Electric in Maryland have experienced an increase of 72%, and in Delaware residential customers will be hit with a 59% increase and industrial customers will see rates doubled. Additionally, Delmarva Power recently filed for an increase in rates to their customers on the Eastern Shore of Virginia to the tune of as much as 65% due to purchased power contracts from an affiliate in the PJM market.

In an editorial opinion published on May 14, 2006, in the Richmond Times Dispatch, the author cited a report on deregulation in The Christian Science Monitor stating that in addition to the increases in Delaware, Pennsylvania consumers are paying rates that are fifty percent higher than before deregulation, New York's retail rates have increased 16%, and other New England customers are paying around 15% more than before deregulation. The Christian Science Monitor report also noted that "thirty-four states have repealed, delayed, suspended, or are no longer considering deregulated electricity for retail customers." The utility-pricing consumer advocate in Pennsylvania, Irwin Popowsky, who at one time was a proponent of deregulation, is quoted to say that "[t]his isn't the way it was supposed to be," and added that competition has not transpired as promised and rates have skyrocketed.

It will be vital that the Commission and the legislators in Virginia be fully cognizant of not just the status of the energy industry in surrounding states, but also to stay in tune with the root causes of why or why not the effort by other states to develop an electric retail market has materialized in the fashion as originally intended.

2. Status of Competition in the Commonwealth

In its Fifth Annual Summary on the Status of Retail Electric Competition in the Commonwealth (dated September 1, 2005), the Commission reported its observation that, thus far, the integration of Virginia's two largest investor-owned electric utilities into PJM had not led to greater levels of retail competition. This is still true today. Even with the Competitive Transition Charge (CTC) set at zero for the majority of all rate classes of all the utilities, competitive service providers ("CSPs") still find little economic incentive to enter Virginia's retail market. There are 3.2 million electricity consumers in Virginia who have the right to choose an alternative supplier. There are twelve competitive service providers licensed in the Commonwealth, only six of which are registered with an incumbent utility; however, none is offering to sell energy that would allow those consumers to save money. Approximately 1,400 customers are purchasing electricity

from one supplier offering a more environmentally-friendly source of electricity; however, that electricity is priced at a higher rate than the capped rate of the customers' incumbent utility.

This is by no means a reflection on the efforts exerted by the Commission. In the six years since the Restructuring Act was adopted and implemented, the Commission has endeavored to provide regulatory certainty and erect the infrastructure to enable restructuring. However, despite all its efforts, the competitive retail market is floundering due to constraints surrounding the wholesale market.

In the same status report referenced above, the Commission concluded that robust retail competition has yet to develop. Old Dominion agrees with the Commission's conclusion. It is clear that, at least at present, retail competition has not arrived in Virginia as witnessed by the simple fact that the incumbent utilities are still providing nearly all of the electric energy supply to customers throughout Virginia. Additionally, the problems that have impeded the development of retail competition in Virginia and other regional markets continue unabated.

Price is not the only component of a competitive retail market; choice is important as well. Perhaps one approach that should be revisited is an incremental rather than universal evolution of choice similar to the experience of the natural gas industry. The gas industry largely began offering choice incrementally – only to those customers that could easily handle choice and wanted it – transportation customers first and then gradually moved into other market areas as demand for the new “choice” offering increased. The natural gas industry within Virginia and across the country has created some level of “choice” for customers within its marketplace. Clearly, there are some areas within the gas industry model that can be readily improved upon, but there may also be some lessons to be learned.

Retail “choice” or “competitive retail markets,” however they are constructed, need to be made available equitably so that no consumer and/or member is harmed by the election of another. This premise needs to be adhered to no matter the final policy, program or activity.

3. Recommendations to facilitate effective competition in the Commonwealth

The fate of retail competition in Virginia is tied not only to that which occurs in the Commonwealth, but what occurs regionally and nationally. As discussed above, the wholesale market needs more work. Additionally, we must assure that we have availed ourselves of all useful information and analyses. We then need to talk among ourselves.

Toward this end, Old Dominion recommends the Commonwealth strive for more local and regional transmission, become an active and vocal participant in the PJM and federal debate and initiate dialogue within the Commonwealth relative to retail markets.

A. Need for Local and Regional Transmission

With the integration of Virginia's two largest investor-owned utilities into the PJM footprint, there are many issues to be resolved to attain the robust wholesale market that is necessary to facilitate effective competition in the Commonwealth. Of primary concern is the general inadequacy of the transmission system to support a competitive market and the lack of recent expansion of the grid. PJM has even admitted that it has "the transmission system on life support as opposed to that robust system" that it wants. Additionally, PJM recognizes the failure of its planning process thus far to go beyond the shortsightedness of upgrades that incrementally address the next reliability violation, and to focus on the long-term needs of the transmission system for reliability and economics to support FERC's open-access and competitive goals. [Transcript of AD05-5 Technical Conference, April 22, 2005, Audrey Zibelman, at pp. 66, 71-73.]

In order to continue down the path toward competition, the transmission grid must be enhanced. To date, load serving entities have struggled with the dual problem of increased congestion costs experienced by load with the implementation of Locational Marginal Pricing ("LMP") within PJM and the inadequacy and insufficiency of Financial Transmission Rights ("FTRs") to hedge against increased and sometimes excessive congestion costs. Notwithstanding price signals arguably sent by LMP, there still remains insufficient transmission infrastructure to relieve congestion in many areas within PJM.

The evolution of the electric utility industry from a vertically-integrated monopoly into unbundled competing enterprises requires further progress toward "openness" of the process and the methodological approach to transmission planning in this new environment. The current PJM planning process must be improved in order to facilitate this progress. The process of selecting transmission projects to address reliability violations and congestion must be broadened to include meaningful input from affected stakeholders. These inputs fall across the broad spectrum to cover issues such as reliability, economics, operational performance, generation retirement scenarios, and regional planning. Following are recommendations Old Dominion believes would greatly improve grid expansion and reliability:

Reliability: PJM evaluates reliability of the transmission system based on Reliability Council, Transmission Owner ("TO"), and limited PJM criteria for the subset of transmission facilities turned over to PJM control (PJM Monitored Facilities). For all other facilities, each TO uses only its own set of criteria. There is a fine balance as to what is appropriately standardized among all TOs, as far as what may be turned over to an RTO, versus what may need to be different among TOs. Nonetheless, additional consistency would be valuable. Old

Dominion recommends developing additional planning criteria for local facilities included in PJM's security-constrained economic dispatch (PJM Monitored Facilities) and that such facilities be excluded from that dispatch until such criteria is met and maintained. Old Dominion further recommends that TO planning criteria, which happens to be utilized for PJM monitored facilities, be more standardized and subject to modification from affected loads and PJM itself through PJM stakeholder processes. Each TO has determined what it will turn over to PJM. Although PJM has high-level criteria for facilities under its control, this "turn over" process could be greatly improved by adding consistency.

Economics: The current PJM economic transmission planning process has resulted in no discernable new transmission construction, predominantly due to the evaluation of only "unhedgeable" congestion. PJM staff is working hard to address the concerns of its various stakeholder groups as it develops its enhanced planning process. Old Dominion is highly supportive of their efforts. There are, however, a number of stakeholders who benefit from a continued dearth of transmission. As such, PJM needs the strong support of the Federal Energy Regulatory Commission, as well as the support of the Organization of PJM States, INC. (OPSI), to accomplish its mission.

Operational Issues: Operational issues need to be addressed in the process so projects that relieve the PJM operators' concerns can be constructed. These are projects that don't necessarily relieve a specific reliability problem but provide significant operational and economic benefit. Projects could be proposed by PJM's operations group and evaluated by the PJM Planning Committee on a case-by-case basis.

Generation Retirement: In most jurisdictions in PJM, generation is no longer a regulated asset. Therefore, there must be recognition of a higher level of uncertainty for specific generation assets in our transmission planning. PJM's transmission planning process has not evolved beyond that which was appropriate for vertically integrated monopolies, controlling both transmission and generation and trading them against each other. With generation as a competitive asset with no obligations to load, transmission planning must assume that certain generators may no longer be available. PJM has experienced transmission reliability problems caused by unforeseen generation retirements. Scenario analysis to address such a possibility needs to be included in PJM's planning process now, rather than later. To illustrate, suppose that a generator announces it will retire in 90 days. This near immediate retirement may require transmission upgrades that take years to get into place. In the meantime, the system would be operated unreliably and/or Reliability Must Run contracts may be used.

Regional Planning: PJM has exerted an admirable effort in developing a regional transmission plan. Old Dominion would propose that there are improvements and enhancements that would benefit all users. Projects planned via a modified PJM stakeholder process (more open and inclusive of all

stakeholders), accounting for longer-term cost benefits based on gross congestion and accounting for generation retirements, should be part of the regional plan. Establishment of clear criteria, in conjunction with not only the traditional stakeholders but also OPSI, will be critical. The criteria should be broader than simply identifying beneficiaries of one peak hour of load flow and should assess the benefits of economic development as well as national energy independence. For example, load in the east of PJM will benefit from economic coal from the west. Load in the west will in turn benefit from increased production from existing and new capacity.

Additionally, evaluation of projects should also strongly consider enhancements and upgrades to existing infrastructure. Such a requirement will optimize solutions as well as provide guidance to siting new facilities based on upgrade opportunities. For long lead-time projects, PJM should develop an approach to relieve congestion until such time as that project goes into service.

Long Term Regional Rate Design: A key aspect to new transmission construction is resolving how it will be paid for. Old Dominion believes application of a highway-byway regional transmission rate represents a reasonable solution in harmony with the physical uses and flows of the grid. Some facilities are clearly local and resolve local issues; others provide inter-regional benefit.

PJM is beginning to make good progress moving toward a longer planning horizon and evaluating economic as well as reliability-based projects. PJM needs strong support, however, to complete this process as well as integrate generation retirement scenarios into its transmission planning function.

B. Active Participation In PJM and other Regional and National Forums

With the Commonwealth's integration into PJM, it is imperative to be a frequent and vocal participant in the PJM stakeholder process. Old Dominion, DVP, AEP and APS have been active participants. The Commonwealth's Office of the Attorney General's Division of Consumer Counsel has also been participating since 2005. As the representative of Virginia consumers, the AG's office needs adequate funding and staff to continue to be an effective participant in this forum. Additionally, the Virginia State Corporation Commission now has a forum via OPSI to make its views known to PJM. Active participation via this pathway will be required to protect the Commonwealth's interests. Finally, FERC is particularly receptive at this time to the views of the various states as it continues down the path to competitive markets and wrestles with federal and state jurisdictional issues. One-on-one dialogue with FERC provides another avenue to effectuate change. This type of interaction and frank exchange of views will be particularly important as the FERC resolves capacity market and market monitoring rules as well as revisions to its pro forma open access tariff.

C. Renew the Debate on the Type of Retail Energy Markets Needed Within the Commonwealth

Virginia and all of its stakeholders need to debate and decide the type of energy marketplace (whether it be a competitive “de-regulated” or a regulated market) best suited for the Commonwealth. This discussion would then shape a plan and timeframe to achieve that marketplace. A clear definition and understanding of the type of market desired by the citizenry is a necessary prerequisite. As a member-owned not-for-profit cooperative, Old Dominion believes that input from consumers of the Commonwealth is important and should be solicited. Discussion, debate, and most importantly, an answer to these questions will help guide Virginia, its energy industry, and its consumers into the future on this very important topic.

4. Conclusion

As shown in the discussion above regarding the competing studies, it is imperative that consumers and policy makers have an opportunity to get all the facts and the full story on issues of this vital import. And an effective way to achieve this awareness is to participate in the regional and federal processes and insist on logical and understandable answers. Significant points of awareness are:

- Economists are going for economic efficiency and not lower prices. We must bear this caution in mind as we assess our next moves to facilitate competitive markets in the Commonwealth.
- The electric utility industry, particularly the wholesale market, is still evolving, and many additional changes will be required in order to achieve the anticipated benefits of a truly competitive wholesale market.
- PJM’s proposed RPM capacity construct has the potential to take an additional \$5 to \$12 billion annually from customers in PJM with no guarantee of improved reliability or economic efficiency.
- Transmission planning needs to evolve to reflect the current unbundled, non-integrated resource planning environment.

The journey to competitive markets is not complete. Throughout this process, Old Dominion is dedicated to working toward a broadly beneficial outcome for all Virginians. We caution that the environment must be developed appropriately for competitive markets to truly exist. A competitive retail market cannot develop if the wholesale market is not mature.

To date, from a retail standpoint, there has been no competition in Virginia, with the small exception of those consumers taking advantage of environmentally-friendly energy at higher rates. Old Dominion’s member owner distribution cooperatives are generally and increasingly concerned with increasing power costs throughout the industry. They are also concerned of the possibility of achieving a “competitive” retail market that has consistently higher prices.

Renewed, healthy debate over the need for and type of retail energy markets required by the Commonwealth today and in the future is something we should commit ourselves to as an on-going demonstration of all stakeholders to the long-term best interests of the citizens of the Commonwealth.

It is imperative that the legislators and other stakeholders in the Commonwealth of Virginia dig beneath the headlines to fully comprehend the impact of competition at the wholesale level in order to assess the status of retail competition within Virginia. As such, it is prudent for the Commonwealth to continue assessing the successes, or lack thereof, of restructuring initiatives nationally, regionally, and at the state level; and to be prepared to make changes should they be necessary.

The Commonwealth must also take an active role in the regional and national debate on wholesale market development to assure that actions in that arena do not preclude our vision of the future.

Old Dominion appreciates the opportunity to participate in your assessment and stand ready to help you in any way we can.

Sincerely,

Edward D. Tatum, Jr.

Edward D. Tatum, Jr.
AVP Rates & Regulations
Old Dominion Electric Cooperative

Attachments

APPENDIX A - Bibliography

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June 12, 2006

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

Dear Mr. Eichenlaub:

The Virginia, Maryland & Delaware Association of Electric Cooperatives (the “Association”) has reviewed with interest the comments filed in this proceeding by Dominion Virginia Power, Constellation New Energy, the Virginia Citizens Consumer Council, the Virginia Committee for Fair Utility Rates, Old Dominion Electric Cooperative (which serves many of our members and with which we are federated) and Mr. Urchie Ellis. We appreciate this opportunity to provide these comments in reply to those referenced above.

I. Introduction

Interest in the status of electric competition in Virginia, which has been so well articulated by all of the commentators, raises unquestionable concern that the stakes are enormously high for all Virginians, and also raises a number of questions. The first question these proceedings and the comments already filed herein bring to light is whether industry restructuring is still, or ever was, the right choice for Virginia.

There can be no serious doubt that our electric energy infrastructure is fundamental to every facet of our economy, and every sector of our society. The interests of consumers (both large and small), utilities (both for-profit and not-for-profit), investors, citizens and our legislators are important, as are the effects on the future of our commonwealth.

Virginia’s electric cooperatives have a perspective that is unique among the stakeholders in this industry. As utilities, on the one hand, they have, along with investor-owned and municipal systems, the heavy responsibility and duty of a public utility. Their experience has taught them that the highest level of vigilance and care is continually required in order to reliably and safely deliver that most vital commodity – electricity – to every meter on their systems. They have undertaken the enormous capital commitments necessary to build, maintain and grow an electric utility system.

As cooperatives, on the other hand, they are unlike investor-owned utilities in that they serve a single interest – the consumer. Even municipal utilities, as government-owned enterprises, are subject to pressures and considerations that may sometimes differ from the cooperatives’ sole cause and object – the safe, reliable delivery of electric energy at the lowest, possible cost. The members of a cooperative may struggle over what is the best way to achieve their mission, but the mission itself is never in doubt. It is vital for the cooperatives to put at the highest level of priority the best interest of the consumers who, as ratepayers and voters, bear the ultimate risk or enjoy the full benefits of a competitive environment.

The Association has long believed that the cooperatives’ unique perspective, incorporating the experience of a utility with the undiluted motivation of consumer ownership and direction, aligns it, more closely than is possible for other stakeholders, with the ideal perspective for utility policy analysis. The cooperatives stand fully in both camps. They are fully utilities. They are fully electric consumer associations.

II. Reply to Comments

A. Deregulation has not brought significant benefits to consumers.

The proponents of deregulation sidestep the central issue of the status of competition by reciting a long list of purported benefits of deregulation to the consumers. In its comments to this proceeding, Dominion Virginia Power states that Virginia’s restructuring program has “produced significant benefits for consumers,” as well as promoted efficiency in the industry. They state that retail competition will come inevitably once wholesale prices dip below capped rates. Many of the purported benefits, however, are benefits, not of competition, but of the artificial shields, such as capped rates, that have been implemented to protect consumers during the intended transition to deregulation. Capped rates are not a function of competition; they are a function of legislation. And while competition could thrive if wholesale prices drop, it is not hard to see that in jurisdictions where it has “succeeded” so far, it is not because of low wholesale prices, but because of very high retail prices.

Indeed, recent developments in Virginia demonstrate unequivocally that wholesale prices, far from dropping, are increasing dramatically. The Town of Front Royal reports a 76% increase in its wholesale power rates.¹ Craig-Botetourt Electric Cooperative’s wholesale rates recently increased an average of 18%. Conectiv is currently seeking a 49.5% increase for its ratepayers on Virginia’s Eastern Shore. The experience in neighboring states appears to be even more severe. As such, what we are experiencing is an increase in Virginia’s electric utility bills as the price gravitates towards market based rates. While Virginia once had lower than average electric utility rates under a regulated cost-based environment, deregulation will inevitably increase our electric rates to meet market based prices.

Dominion Virginia Power also states that interests in retail competition is still strong, citing that there are currently six competitive service providers and six aggregators licensed by the SCC. However, none of those have approached the cooperatives for certification to provide offers to their consumers. With the exception of the one supplier providing “environmentally-friendly” energy, it is our understanding that no offers are even available to consumers of the

¹ “Town Ironing Out New Budget,” *Northern Virginia Daily*, June 5, 2006.

investor-owned utilities. As has been pointed out in a number of the comments, the wholesale market is not ripe to produce an effective retail market.

Dominion Virginia Power concludes their comments by stating that Virginia's restructuring initiative has shifted the risk for "billions of dollars in new cost and investments from utility customers to the companies and their shareholders." While that may present itself as a benefit to their consumers, the cooperative's customers are its shareholders, and thus the ultimate risk bearer.

It is important to note that from the outset, there has never been a political outcry from the mass market (ratepayers/voters) for deregulation. Restructuring developed based on an expectation of lower cost to consumers as a result of competition and the associated opportunity for choice. In fact, competition never materialized. Industry groups that once supported deregulation based on the expectation of competition and the associated lower electric utility bills are now facing much higher electric rates once the restructuring transition period expires on December 31, 2010. In fact, in their comments to this proceeding, the Virginia Committee for Fair Utility Rates (CFUR) urges the State Corporation Commission to consider the fact that "[e]lectric restructuring has not worked so far in Virginia, and recent developments do not bode well for its future success" as it develops recommendations for their report to the Commission on Electric Restructuring.

B. The Retail Market Cannot be Effective without a Successful Wholesale Market.

The comments submitted by Old Dominion Electric Cooperative provided a series of studies demonstrating that the jury is still out on whether or not wholesale competition is successful. It is difficult to make any argument with this sizable body of evidence that competition at the retail level can be implemented in any effective manner until such time that there is an effective wholesale market. The transmission and generation constraints, the price models used to determine market rates, along with a host of other issues (e.g., fuel costs volatility,) that arise in the wholesale arena provide no assurance that there will be true wholesale competition at any point in time in the near future. Without an effective wholesale market, competition in the retail sector cannot develop.

III. Conclusion:

In examining the status of competition in Virginia, it is best to separate competition from deregulation. We need to be perfectly clear that the cooperatives are not opposed to competition. We recognize that the prospect of an effective competitive market that produces maximum value from capital investment and offers customers a wide variety of choices (including lower prices) is enticing. The objective of restructuring electricity markets is to achieve more efficient allocation of resources with lower prices as a desired result. However, the model implemented in the Commonwealth is not working and the facts do not refute that. As stated above, deregulation was embraced with the expectation of lower cost as a result of competition. In reality, it meant a shift to a market based reality, and in a market such as this prices gravitate towards the average. Those with prices below the average will see an increase. Since consumers in Virginia had long enjoyed a cost of electricity below the national average prior to the restructuring, it seems to reason that a promise of lower prices will go unrealized. And this brings the discussion back to the question posed early on in this response to comments, "Is industry restructuring still, or was it ever, the right choice for Virginia?"

Despite enormous cost and effort, there is no meaningful, effective retail electric competition in Virginia. As a consequence, the Association wishes now to pose these additional questions:

1. Without regard to whether Virginia should ever have made the choice to go down the path of deregulation of retail electric service, is it the right path now for Virginia's future?
2. If not, is it possible to return to cost of service regulation, and what challenges would we have to overcome to do so?
3. Are there other, more important objectives than economically efficient competition, such as transmission system development, that would be a better focus for industry stakeholder efforts?

The Association asks that these questions be included in the Commission's report to the General Assembly on the status of competition in Virginia.

As a final note, I would cite the comments on Wholesale and Retail Electricity Competition, submitted by The Alliance of State Leaders Protecting Electricity Consumers to the United States of America electric Energy; Market Competition Interagency Task Force and the Federal Energy Regulatory Commission (Docket No. AD05-17-000). While these comments are specific to national policy, I would argue their relevance to Virginia:

“The ultimate test for evaluating any approach to the delivery of electric service should be its effect on consumers. [National] policy should seek to ensure that electric power is delivered to end users at a reasonable cost and with adequate reliability. If that result is best achieved through competition, then electricity policy should favor competition. If that result is best achieved through reliance on regulated monopoly, then electricity policy should focus on regulation. If that result is best achieved through a hybrid policy that mixes competition and regulation, then a hybrid approach should be taken. The determination of which approach is most appropriate should be based on an analysis of relevant facts rather than on economic theory.”

Again, we appreciate the opportunity to respond to comments to these proceedings. Please contact me at (804) 968-4084 should you have any questions.

Sincerely,

Susan Rubin
Assistant Vice President – Governmental Affairs

cc: CEOs, Virginia Member Systems



May 22, 2006

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

***Re: The Commission's Sixth Annual Report to the
Commission on Electric Utility Restructuring and the Governor***

Dear Mr. Eichenlaub:

Constellation NewEnergy, Inc. ("Constellation NewEnergy") appreciates the opportunity to offer ideas to assist the Commission in developing effective competition in the Commonwealth. As you are aware Constellation NewEnergy is a licensed Competitive Service Provider in the Commonwealth.

In addition, Constellation NewEnergy is licensed or certified to act as an alternative retail electric supplier to serve customers located in more than 20 states and provinces throughout the United States and Canada. Constellation NewEnergy has over 15,500 MW of load under contract with over 10,000 retail customers. In the PJM region, Constellation NewEnergy serves approximately 1,200 MW of industrial and commercial load. Our customers include universities, manufacturers, schools, hospitals, hotels, retail stores, and office buildings.

The Status of Competition in the Commonwealth

Retail competition continues to evade the Commonwealth, and will likely continue to do so during the period when utility rates are capped below market prices.

While the promise of competition is in the development of products and services that

meet customer needs, markets develop first based on price competition. Given the persistence of rate caps in the Commonwealth, it is not surprising to find a lack of interested competitive suppliers providing customers with competitive offerings. Until such time as those rate caps expire, this situation is unlikely to change. In the meantime, we urge the Commonwealth to begin an examination of the utilities' rate designs to ensure that distribution and transmission service costs are properly allocated and do not in any way subsidize generation service. Transparency of costs and ability to compare rates with prices will be a critical element in the development of competitive markets.

As we noted in our comments in the Commission's Default Service investigation, the Commission and the Commonwealth would be well served by the initiation of a Working Group to explore the design of default service after the expiration of rate caps in the Commonwealth.¹ Lessons learned in the PJM retail markets, as well as other U.S. markets, could prove very useful in shaping the future of Virginia's retail electric market. The Commission Staff has a long and successful history of effectively facilitating Working Groups and we urge the Commission to initiate a Default Service Working Group that would report to this Commission, the Commission on Electric Utility Restructuring ("EURC") and the Governor.

1. The Status of the Development of Regional Competitive Markets

a. Wholesale

An important step in Virginia's transition to competitive markets occurred on May 1, 2005 when Dominion Virginia Power became a member of PJM. The integration

¹ See Comments of Constellation NewEnergy, Inc., Case No. PUE-2006-00001, March 24, 2006.

was by all accounts successful. While membership in PJM in and of itself is not sufficient to develop retail choice, we note that success in retail markets is more immediate and comprehensive where there is an organized and vibrant wholesale market. PJM is by no means perfect but in our experience is among the best of the organized markets. Members of PJM benefit from the improved system reliability, increase in available resources during peak periods and access to economic power supplies. In addition, PJM continues to address issues of importance to the market participants via the stakeholder process. We are encouraged by the development and growth of the Organization of PJM States (“OPSI”) as a mechanism for the Commission (and other Commissions) to voice their views to PJM and the stakeholders. OPSI provides the Commission a means to work with other Commissions within PJM on issues of mutual interest. This involves the Commission early on in the stakeholder process allowing for valuable input and comment as the stakeholders work toward consensus.

b. Retail

Within the PJM footprint, retail markets continue to develop and PJM continues to develop new products, such as PJM’s integration of load response into their ancillary service markets. While the expiration of residential rate caps that froze rates to their 1993 level in the BGE territory has recently generated significant political interest, commercial and industrial customers have displayed a willingness to participate in the competitive market and that desire has led to the development of a competitive market for those rate classes.

Within the classic PJM region, the number of commercial and industrial customers choosing alternate energy suppliers continues to demonstrate a high degree of

switching activity. In Maryland, the switching statistics for commercial and industrial customers show that 58.8% of the commercial and industrial customers have switched to competitive suppliers.² The March 2006 switching rates for commercial and industrial customers in other classic PJM regions were as follows also demonstrate a high degree of switching among commercial and industrial customers. In the Duquesne Light Company service territory in Pennsylvania, 59.2% of industrial and commercial customers have switched to a competitive electric supplier.³ In the Pepco service territory in the District of Columbia, 44.6% of industrial and commercial customers have switched to a competitive electric supplier.⁴ While switching statistics are not the only metric on which to judge the success or development of retail markets, they are one important factor.

Another indicator of retail market development in the commercial and industrial sector is the number of retail competitors vying for the commercial and industrial business, putting downward pressure on prices and creating new products and services. In Maryland, there are nineteen (19) electric suppliers serving large commercial and industrial customers.⁵ There are also a significant number of retail competitors participating in the DC and Delaware markets as well as in the market behind the one utility in Pennsylvania whose rate caps have expired.⁶

Clearly, the high degree of switching activity demonstrates that customers have shown the willingness to participate in the marketplace and take electric service from

² See <http://www.psc.state.md.us/psc/Electric/electricRestructuring.htm>.

³ See <http://www.oca.state.pa.us/cinfo/instat.htm>.

⁴ See <http://www.dcpssc.org/customerchoice/whatis/electric/electric.shtm>.

⁵ See *infra* Footnote 2.

⁶ See *infra* Footnotes 2, 3, and 4. See also <http://www.state.de.us/delpsc/electric/elecsupplierinfo.com>.

companies that provide products and services that best meet their needs. In turn, the participation by a large number of suppliers in the marketplace demonstrates that if the market rules are fairly and properly constructed, competitive retail electric suppliers will invest in the market and vie for the opportunity to provide service to customers.

Thank you for the opportunity to submit comments to the Commission as it prepares its report to the EURC and the Governor. Please do not hesitate to contact me should you have any questions or concerns.

Very truly yours,

A handwritten signature in black ink, appearing to read "Martha Duggan", written in a cursive style.

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May 1, 2006

Re: 6th Annual Report to the CEUR

To the Staff of the State Corporation Commission:

Current developments in connection with electric deregulation make it even clearer that the general public is at great risk and has all to lose if deregulation is allowed to continue. I renew the comments in my letter printed in the SCC Report of Sept. 5, 2005 (correct the typo in para. 4 where it should read "August 2002"). Virginia has had over 100 years of good electric service, at comparatively low rates, pursuant to SCC regulation, and it should not be lost.

We now see very serious problems close to home in Maryland, on the Eastern Shore, and in Western Virginia, and we do not see any prospect of any competition providing lower rates than we have long had from Dominion Virginia Power and other suppliers in Virginia. Recent news items from other parts of the U.S. also reflect the failure of electric deregulation.

Factors making it even more unlikely that we will ever get the lower rates that CEUR, and Dominion, and others, have predicted, are the natural gas and petroleum price increases and shortages. Nearly all of the predicted lower rates were to come from generating plants using those fuels.

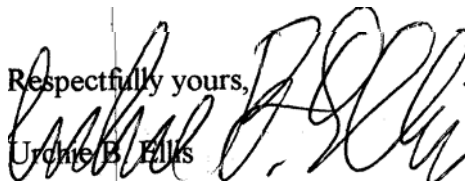
The joining of PJM by several major Virginia power companies does not appear to offer any benefit to Virginia general public homeowner electricity users.

It is of concern to me that meetings are being held to discuss important aspects of this subject, and decisions on statutory changes are made, such as the recent change of fuel rate increase procedures, and the recent meeting involving PJM, with little or no input or participation from the few voices of the general public. I also remain concerned about the large political contributions being made by the vested interests, which adversely affect the general public voices and interests.

I again urge the Commission to make a strong report calling on the General Assembly to cancel electric deregulation and restore regulation to the SCC as fully as can be done in the present circumstances. The General Assembly and the Governor should call upon Congress to modify the Federal Energy laws as necessary to permit complete restoration of SCC authority. This is a complicated subject and needs the expertise of the SCC Staff. The SCC has a Constitutional and statutory duty to protect the public.

Respectfully yours,

Urchie B. Ellis



Status of Electric Restructuring in Virginia 2006 Assessment of the Virginia Citizens Consumer Council

Seven years after the passage of Virginia's Electric Restructuring legislation, it is the view of the Virginia Citizens Consumer Council (VCCC) that neither Virginia nor the nation is anywhere close to having an effective, fair, competitive retail market. For consumers, electricity is a basic necessity of daily life. Depending on where we live, the season of the year, and our specific needs, we depend on it to operate the heating or cooling systems that protect us from the weather, to pump our water, to cool and cook our food, and to run our life-sustaining medical equipment. Our communities depend on our traditionally low cost electricity for economic development and to help keep our tax payer provided school operation costs low. Electricity is not, for us, an investment. We want stability and guarantees for our electric supply, not a risk-reward relationship, especially when the system makes consumers responsible for most of the risk and guarantees us none of the reward.

Since the beginning of this venture, there have been pervasive structural problems that remain unresolved, so it is not surprising that the competitive market has not developed. All of the actions that have been undertaken to change the legislation to promote competition have, like the original legislation, been largely designed around the needs and desires of the industry, primarily, the investor owned sector.

1. Consumers are still not receiving competitive offers for electricity and there is no sign of impending choice. Until Virginia's average price for electricity increases sufficiently above the average in PJM, no competitor will find it economically possible to enter our market, especially since significant marketing and customer care dollars will have to be spent to gain notice above the incumbent utilities. It is not in the consumer interest for our prices to rise to this high level. When this occurs, consumers, businesses, and government will experience substantial problems paying the bill and the ramifications will be negative for all but the utility industry.

Craig-Botetourt Electric Cooperative, and Radford and Salem's public power systems just signed a new long-term contract with AEP that they hope will help contain their costs. Last year those entities faced increases of 40-80%. After a one year contract (with AEP), this contract replaces one between Craig-Botetourt and AEP that had lasted 20 years. Since the market now drives costs, Craig-Botetourt customers are now paying more at the wholesale level than is an AEP customer located about a mile away pays at the retail level. Salem has informed it's customers that the new contract will help hold costs down in the long run, but that they still face increased rates after July 1.

The fact that even in a "competitive" environment AEP has the market power to be able to win the contracts back, shows that Virginia consumers are not benefiting from the competitive market. AEP is benefiting from a situation that

allows it to increase its revenue from these entities while still keeping the business.

Last year Craig-Botetourt, Salem, and Radford did not pass the entire cost increase to their customers, but in the future customers will have to pay the entire cost. These entities have no choice. Their only source of income is their customers and to continue to provide power, they must charge consumers the real cost. Anyone curious about what the future holds for AEP and Dominion customers when the rate caps come off should study the current experiences of these entities.

2. Investor owned utilities are still not prepared to accept the risk – lows as well as highs – of a truly competitive market. Every action that has been taken in Virginia's electric restructuring has provided protection for the incumbents, especially actions that have been touted as being consumer benefits.

Dominion repeatedly points to its calculated savings per consumer of \$61-\$74 per year during the capped rate period. However, because Dominion refused to allow a leveling rate case before rates were capped, at a time that energy rates were low and to address the fact that it was widely known that within several years of its last rate case it would be over-collecting costs, it is unfair for Dominion to claim such large savings. Further, few segments of the economy increase at a rate equal to or above the inflation rate every year, so it is unfair to assume that electric prices would absolutely have done so. Virginia's generation costs are still documented as being lower than those in most other states. It is more prudent to assume that they would have continued to be lower had rate-of-return regulation been kept in place.

Virginia's legislation allows our utilities to be protected from large fuel price increases and increases in several other areas. However, from the outset, there was no parallel guarantee of prices dropping if utility costs dropped. Consumers have seen customer service decline as the primary cuts by utilities have occurred on the consumer's side of the ledger sheet.

Consumers, even those not directly served by Dominion, have complained in recent years about waiting too long to have disrupted service restored. Craig Botetourt Electric Cooperative members found service disruptions to last longer and be more frequent since experienced Dominion staff retired and were replaced by workers based over an hour farther away from the substation that serves the Cooperative. Often disruptions that were once typically handled during the night wait until morning or for days, for example, and it generally takes the less experienced workers longer to complete repairs. The cooperative has been forced to take the extremely expensive option of buying back-up power from AEP, essentially buying power twice, to protect affected customers.

The commonwealth's electricity restructuring legislation also protected the incumbent utilities from taking any risk from stranded costs, even though the restructuring was something they requested. Our incumbent utilities refused to actually calculate stranded costs, instead convincing the Attorney General to use a current market price value to get the issue off the table. While stranded costs were expected to be recouped, Dominion earned enough that it made several significant investments to increase its ability to serve the market outside of Virginia and their executive compensation and stock returns remained comparatively outstanding. On the other hand, unlike Maryland consumers, Virginia consumers got no compensation for stranded benefits.

While Dominion tells customers and everyone else how much money customers have saved from capped rates, it is the company that has benefited the most. When the capped rates were extended, Wall Street approved, giving Dominion advantages due to the benefit of having guaranteed minimum income for longer than before.

Dominion asked the legislature to extend the capped rates as a means of defeating consumer legislation that would have stopped the restructuring process. It even volunteered to forgo annual fuel increases and to limit its requests for a fuel increase to one during the remainder of the capped rate period. It had just received what may have been the largest fuel rate increase in history when it took this action. The agreement did not hold since it recently convinced the Governor to send the General Assembly a provision to the Veto Session for it to revert to annual increases. This strategy meant that it did not have to go through full public consideration of the change that broke the agreement that kept restructuring in place.

In 2004, Dominion broke apart the broad coalition working for the legislation to stop restructuring, finding ways to resolve concerns of large electric users through contracts and adding opportunities to increase rates for AEP. In 2004, the State Corporation Commission Staff projected that Dominion's customers were paying \$400 million per year more than they would have under rate-of-return regulation. This is equivalent to a 9-cent increase in the gasoline tax. While legislators are rejecting such an increase to improve transportation, a public good, they approved it when the money went to Dominion, an investor owned private business.

At the same time, Dominion asked the Federal Energy Regulatory Commission (FERC) to allow it to retroactively recoup the fuel costs accumulated under the capped rates from Virginia consumers after the capped rate period ends. This is not action that shows that the company is ready to accept the bad along with the good in a competitive market.

AEP's extraordinary earnings last year were attributed in the media to "favorable regulatory decisions." While AEP is no longer based in Virginia and its territory in Virginia is not significant enough to drive the earnings of the entire company,

the increased rates approved for Virginia customers last year certainly contributed to that outstanding outcome for the company and its investors. Again, this shows that the company is dependent upon traditional regulation, not that it is adjusting to the inherent risk of a truly competitive market.

3. There remains no competitive solution for the need to entice building of new infrastructure, especially generation. The coal-fired plant that the legislature approved is not a competitive solution. The electric consumers of Virginia are on the hook to pay whatever the cost of that electricity for the life of the plant. That isn't competition! The default service customers who will have to pay for that electricity are likely to predominantly be the ones in difficult economic situations who can least afford to pay a premium for this basic life necessity. If these consumers cannot pay the entire cost, we can be assured that others will be forced to do it.

If by some miracle the plant produces electricity at lower than market prices, consumers have no means of being guaranteed to benefit. In that case, the utilities will be free to sell the power to the highest bidder – not forced to sell it at its true cost, plus a reasonable investment return, to the citizens who are actually taking the risk for this project.

The project now involves a broad coalition of electric utilities, but for the consumer, it remains a likely white elephant, whose price is still unknown. More than two years after passage of the legislation approving this facility, it is extremely disturbing to consumers that the cost and price estimates that our legislature and administration should have demanded before approval are still unknown. While the desperately needed employment that the project will provide to far southwest Virginia is important, it appears that the cost to all Virginians will not be worth the expenditure.

All work on the project should cease until a reasonably based cost-benefit estimate, conducted by a reputable unbiased entity completely unconnected with and not directed or influenced in any way by our utilities, **proves** that it is worth pursuing. Unless the risk level of this project is proven to be such that typical investors would put their money forward for it, Virginia consumers' legislatively approved commitment to pay for it should be rescinded. Legislators outside of the far southwestern area should realize that the voters they represent are going to be very unhappy when they are forced to pay significantly higher electricity bills to pay for this plant.

4. Since incumbent utilities have purchased most of the merchant power built in the state in recent years, there is again very little diversity in the ownership of generation. Again, this is not a condition conducive to a competitive market.
5. For the competitive market to operate as anticipated, more transmission will be needed. While the new AEP line in southwest Virginia is operational, clearly,

- across the state and the region significantly more transmission is needed for competition to work. The PJM system of rewarding those who own transmission by keeping competition for its use tight, means that there is no incentive for anyone to build more than the bare minimum transmission. This means that operation costs will always be higher than optimal for consumers and that construction will never take a forward looking approach to keep long-term costs down.
6. PJM's system of making the largest bid the price paid by all buyers at a given time rather than adding up the cost of all bids as was done in the past, automatically makes our market prices high. This is a systemic design that hurts consumers. It should be changed.
 7. To counter concerns about Virginia's lack of influence over the operation of transmission once our utilities transferred control to PJM, PJM pointed out that the state had an ex-officio position on the Reliability, Electric Markets, and Member's Committees. (December 10, 2004 presentation to the CEUR Consumer Advisory Board). So far, Virginia has declined to place an individual in a position of regularly following and participating in proceedings at PJM, preferring to pay for consultants if there are major issues. This means that Virginia depends upon PJM and our utility members of PJM to notify us if there are issues. It means that there is no party with the public interest, as well as no party with a consumer interest, regularly following and participating in PJM decisions. Virginia should have at least a public interest, if not a funded consumer interest, individual regularly participating in PJM every available way. To date, we have essentially totally given up any influence there to balance the industry interest.
 8. Currently, Virginia's investor owned utilities have extremely strong influence over our elected officials at all levels and over the Commission. We have found that decision makers are extremely hesitant to take action that would displease Dominion, in particular. It means that they are unable to impartially represent the public interest. Consumer voices are few and are habitually allowed extremely limited opportunities to participate in the discussion or the decision making process whether in the legislative realm or in other meetings. For example, none of the typical consumer participants were even invited to the recent PJM Virginia Summit. Some view the situation as being not unlike that of the railroads a century ago. The Commission may not be in a position to fully evaluate the situation, but the commonwealth is in an extremely unbalanced posture.
 9. There has been no public or widespread discussion of how this restructuring affects the security of Virginia's electric power in our post 9-11 world. It seems that the more highly interconnected system will be more vulnerable to damage by terrorists. This is an issue that should be addressed.

10. There should be a cost-benefit study of the restructured system with the traditional rate-of-return system. Today the restructured electric market has new or higher costs for a Regional Transmission Organization (PJM), trading power, tools like hedging, and growing transmission costs. Instead of spending money on lawyers and experts for proceedings before the State Corporation Commission, utilities spend increasing sums donating to and lobbying legislators and others. It appears that there are more new and increased costs than savings in the restructured system.
11. The legislature should investigate further restructuring of the electric market so that a more reasonable balance exists between the industry and consumers. The public interest is not being served by the current situation. Only utilities are benefiting. Consumers and communities are being harmed.

Since Virginia is now one of only three states with electric rates traditionally below the national average still involved in “deregulation” of the electric market, and since we have only given away control of our transmission system, it is time to actively investigate other alternatives for restructuring. Of our geographic neighbors, only DC and Maryland have restructured their electric markets. Under rate-of-return regulation, our neighboring states provide businesses and consumers that locate in their states better options than those currently available in Virginia. The future economic stability and sustainability of our families and our communities depends upon a more balanced solution than the current one. VCCC would welcome the opportunity to participate in a process to design and implement such a solution.

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May 22, 2006

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1300 East Main Street
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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 7, 2006, 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 (“Virginia Power”) and Appalachian Power Company (“Appalachian Power”), respectively.

I. Report Card

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

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 22, 2006
Page 2

Utility Restructuring, which evaluates progress on key issues related to competition and restructuring. It reveals low or failing grades on the degree of retail competition and 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), and the entry of independent power producers. We are unaware of reliability problems, so we have given transmission and distribution reliability our only "A" grade. The only "B" grade is utility earnings. Functioning of a regional transmission entity earned a "C" grade after Virginia Power and Appalachian Power finally joined the PJM Interconnection LLC, four years after the original statutory deadline.

II. Committees' Concerns with Electric Restructuring

Electric restructuring in Virginia, raises serious concerns, which can be summarized as follows:

- Customers of both Virginia Power and Appalachian Power will soon face significant, unwarranted rate increases based on an unfair, lopsided process.
- Commencing after 2010, when so-called "capped rates" end, customers of both utilities may face *extraordinary* rate increases, of perhaps 100% or more, that would unfairly enrich both utilities with no corresponding benefit to consumers. After 2010, customers of both utilities are scheduled to pay "market prices" for electricity supply. States north of Virginia, and, indeed, portions of Virginia itself now are grappling with crushing rate burdens resulting from going to "market" prices for electric supplies.

We discuss these concerns in greater detail below. In connection with the near term increases, we first discuss those related to Virginia Power and then those related to Appalachian Power. The concerns regarding near-term increases arise primarily from fundamentally unfair provisions in the Restructuring Act that (i) prohibit the Commission from initiating base rate decreases even if utilities' costs and revenues would warrant such decreases, and (ii) require the Commission to grant rate increases but ignore utilities' costs and revenues that would mitigate or eliminate the need for such increases. We discuss these concerns below in connection with both Virginia Power's and Appalachian's near term rate increases. We also discuss below the exorbitant future rate increases that may result from imposition of market prices on customers of both utilities upon the expiration of "capped rates."

David M. Eichenlaub
May 22, 2006
Page 3

A. Virginia Power's Near Term Rate Increase

Virginia Power's current "base" (or non-fuel) rates were established in a rate case decided by the Commission in 1998. The Restructuring Act, enacted on July 1, 1999, essentially "froze" those base rates.

The Restructuring Act permits utilities to recover certain "stranded costs" through their rates. With customers given the opportunity to choose a supplier other than their local utility, it was claimed at the time of enactment that utilities might be unable to recover costs incurred under the pre-existing regulatory regime.

The Commission Staff's most recent review of Virginia Power's level of profits and rates shows that Virginia Power accumulated more than \$1.2 billion "available for stranded cost" recovery from 1998 through 2003.² Only a miniscule number of Virginia Power's customers, however, have elected to obtain service from a supplier other than Virginia Power. Thus, while it has not experienced its first dollar of "stranded cost," Virginia Power accumulated more than a billion dollars toward "stranded cost" recovery as of the time of completion of the most recent Commission Staff review of its finances. Further, the same Commission Staff report shows that Virginia Power's base, or non-fuel, rates are excessive by about \$400 million per year, or about 10% of total rates.³

While Virginia Power accumulated such significant amounts for what turned out to be non-existent "stranded costs," its fuel factor rose steadily. From 1998 through 2003, Virginia Power's fuel factor increased from 1.152 cents/kWh to 1.613 cents/kWh.⁴ Because charges imposed by Virginia Power through its fuel factor account for a disproportionately large portion of the total bill of its large industrial customers, significant increases in the fuel factor adversely affected large industrial customers. (Virginia Power's current fuel factor accounts for approximately 40% of the total bills of its large industrial customers.)

In December 2003, the Commission issued an order establishing a new fuel factor of 1.891 cents/kWh for Virginia Power to take effect on January 1, 2004. A few months later, in the 2004 Session, the General Assembly amended the fuel factor provisions of the Virginia Code, among other things, by freezing that fuel factor through June 30, 2007. The General

² The Commission Staff reviews annual financial data filed by Virginia Power and other electric utilities. The Staff completed its most recent report concerning Virginia Power's financial data on October 15, 2005. That report covers data for the year 2003.

³ Virginia Power has filed its Annual Informational Filings for 2004 and 2005; however, the Commission Staff has not yet completed its review of those filings.

⁴ Virginia Power's fuel factor was 1.050 cents/kWh from May 1998 to December 1998; 1.152 cents/kWh from December 1998 through January 2000; 1.339 cents/kWh from February 2000 through December 2000; and 1.613 cents/kWh from January 1, 2001 through December 31, 2003.

David M. Eichenlaub

May 22, 2006

Page 4

Assembly's amendment further required that, prior to that date, the Commission would establish another fuel factor tariff to take effect on July 1, 2007 and remain in effect through December 31, 2010. (The 2004 amendment to the fuel factor provisions of the Code prohibited the Commission from increasing Virginia Power's fuel factor to permit collection of fuel costs not recovered through the current fuel factor or decreasing the fuel factor to credit customers for any over-recovery of fuel costs through the current fuel factor. In the 2006 Session, the General Assembly adopted an amendment to the fuel factor provisions of the Virginia Code that requires the Commission to set annual fuel factors, commencing July 1, 2007, and requires such fuel factors to be 'trued up' for under- or over- recoveries incurred by Virginia Power subsequent to that date. Thus, the fuel factor that takes effect on July 1, 2007, will remain in effect for one year and be subject to adjustment, starting July 1, 2008, for under- or over-recovery of fuel costs from July 1, 2007.)

Since 2004, Virginia Power's fuel costs have risen substantially, and its current fuel factor has not produced sufficient revenues to recover such costs. However, the over-recovery of its non-fuel costs in its base rates, discussed above, will likely offset the under-recovery of its fuel costs.

Virginia Power's customers now face a potentially *significant* fuel rate increase on July 1, 2007. Because projected fuel costs are higher than the level of such costs included in the calculation of its current fuel factor, Virginia Power may request an increase in its fuel factor of as much as 50% or more, which could increase customers' bills by as much as 20% or more. While the 2006 amendment to the fuel factor provisions of the Code, § 56-249.6, permit the Commission to defer for later recovery up to 40% of such increase, thereby smoothing the effect of any rate "shock" that otherwise might occur on that date, deferral of the recovery of such costs in the fuel factor merely means paying them later.

Any such increase in fuel costs, moreover, cannot, under current law, be offset by a corresponding decrease in Virginia Power's non-fuel, or base, rates because the Restructuring Act essentially freezes its base rates. Thus, even though its base rates remain essentially frozen by law at an excessive level (according to the Commission Staff's most recent analysis), Virginia Power may be able to increase its fuel factor significantly and continue to collect deferred amounts through 2010. It can continue to enjoy the benefit of the excess revenues collected through its base rates while also increasing its fuel factor to collect increases in its fuel costs. Large industrial customers, whose bills are significantly affected by changes in the fuel factor, will be especially disadvantaged. Their fuel factor may increase significantly with no offsetting decrease in base rates.

In sum, Virginia Power's customers, including its large industrial customers, face a potentially significant, unnecessary, and unwarranted rate increase on July 1, 2007.

David M. Eichenlaub
May 22, 2006
Page 5

B. Appalachian Power's Near Term Rate Increases

Appalachian Power's current base rates were established in a rate case decided in 1999. Since that time, Appalachian's base rates have not produced excess revenues to the extent of those produced by Virginia Power's base rates. In fact, the Commission Staff's most recent report on Appalachian Power's level of profits and rates, dated April 27, 2005, shows that, based on 2004 data, Appalachian's current rates under-collect its costs by more than \$49 million per year. (This contrasts with the Commission Staff's report for the prior year, 2003, which found a revenue excess of \$9.7 million per year.)

The Restructuring Act prohibits the Commission, whether on its own initiative or in response to a complaint by customers or any customer representatives, such as the Division of Consumer Counsel of the Attorney General's Office, from reducing Appalachian's base rates, so the Commission was not able, as a result of the findings in the Staff's report for 2003, to initiate a proceeding to determine whether Appalachian's rates should be reduced. This prohibition contrasts with the provision in the Restructuring Act permitting the Commission to "adjust" Appalachian's "capped rates" to reflect changes in the cost of fuel. Pursuant to that provision, the Commission recently increased Appalachian's fuel factor by 3.65 mills/kWh, effective January 1, 2006. This increase in the fuel factor resulted in an increase in the bills of Appalachian's large industrial customers of more than 10%; however, due to the prohibition in the Act against Commission-initiated base rate changes, the Commission could not even consider changes in Appalachian's base rates that might have been warranted and that might have had the effect of offsetting the fuel factor increase.

The prohibition against Commission-initiated base rate changes also contrasts with the requirement for the Commission to "adjust" Appalachian's base rates for certain specified categories of costs *known to be increasing*, regardless of whether all of its other costs and revenues warrant any change in rates. One of the 2004 amendments to the Restructuring Act *requires* the Commission to "adjust" Appalachian's so-called "capped rates" not more frequently than once every 12 months for incremental environmental compliance and transmission and distribution reliability costs ("E&R" costs) prudently incurred on and after July 1, 2004. Thus, pursuant to the Restructuring Act, the Commission must "adjust" Appalachian's "base," or non-fuel, rates, for E&R costs, which are known to be increasing, but the Commission is prohibited from considering all of Appalachian's non-fuel costs and revenues and modifying Appalachian's rates accordingly. On July 1, 2005, Appalachian Power filed an application with the Commission to increase its "capped rates" for E&R costs. As modified by Appalachian during the case, the application seeks an average annual increase of 3.06%. The request is currently pending before the Commission.

Moreover, unlike the provisions in the Restructuring Act applicable to Virginia Power, the Act's provisions relating to Appalachian permit it to seek, prior to July 1, 2007, a change in its base rates based on a traditional rate case in which all of its costs and revenues are considered.

David M. Eichenlaub

May 22, 2006

Page 6

Appalachian recently has filed with the Commission an application for an average annual increase of about 25%. Thus, due to the prohibition against Commission-initiated rate changes, the Commission has not been able to order any rate reduction that otherwise might have resulted from excess base rates, but now Appalachian's customers may face a significant base rate *increase*, instituted by Appalachian, and any such increase may be over and above both the recent (and any future) fuel rate increases and any annual E&R base rate increases resulting from currently pending, and subsequent, E&R rate cases.

In sum, the Restructuring Act causes unfair and unreasonable rates that disadvantage Appalachian's customers. The Act prohibits the Commission from initiating a case to reduce Appalachian's rates when they produce excess revenues, but it has permitted rate increases. Appalachian has increased its fuel factor, and now it is poised to increase its base rates, both in its recently filed general rate case and in its pending and future "E&R" cases.

C. Future Exorbitant Rate Increases from Market Prices for Customers of Virginia Power and Appalachian Power

Beyond the Committees' concerns about the unfair and lopsided law that permits selective rate increases (but not rate decreases) for Virginia Power and Appalachian Power, the Committees are deeply concerned about the prospect of extraordinarily large rate increases resulting from market-based pricing after expiration of the current, "capped rates."

Pursuant to the Restructuring Act, "capped rates" are scheduled to expire on December 31, 2010. Rates for generation and related services will be based on the Commission's determination of market prices after that date. While no one can predict with certainty prevailing market prices for such services at that time, the current difference between market prices and the "capped rates" of Virginia Power and Appalachian Power suggests that going to market-based prices could be devastating for consumers, including large industrial consumers. Presently, large industrial customers of Virginia Power pay about 4.5 cents/kWh, on average, while large industrial customers of Appalachian pay about 3.5 cents/kWh. In contrast, market prices in the PJM region have caused utilities' retail rates to customers in Maryland and Delaware, where capped rates have ended, or are about to end, to exceed 10¢/kWh. This would represent an increase of 100% to almost 200% in bills to some industrial customers of Virginia's two largest utilities.

Moreover, as the Commission's most recent annual report to the Commission on Electric Utility Restructuring ("Restructuring Commission") has emphasized, the poorly functioning wholesale market -- which, after December 31, 2010, would drive prices for Virginia Power's and Appalachian's retail customers -- does not bode well for customers of those utilities. Trends and features in the wholesale market, as stated in that report, include the following:

- the so-called "single price auction" (where the price in wholesale spot market is set by the offer price of the last unit required to meet load, not by the average cost of power

David M. Eichenlaub

May 22, 2006

Page 7

from a diverse fleet of generating resources, as is the case under cost of service regulation by the Commission);

- an increasing tendency toward oligopoly as a result of mergers in the power generation sector;
- new capacity pricing constructs, or relaxed market mitigation, which may result in additional cash flow to the generation sector; and
- challenges related to market monitoring and related concerns about the exercise of market power.

In sum, the expiration of so-called "capped rates" in 2011 could result in massive rate increases for customers of Virginia Power and Appalachian Power, and in related adverse impacts on Virginia's homes, businesses and economic development, as compared to other states, such as North Carolina, which have not restructured their electric industry.

The Restructuring Commission is, of course, launching a two-year study of the impact of the expiration of the "capped rates," but it need look no farther than to states north of Virginia to glimpse the future. Here are only a couple examples:

- In Maryland, in the face of the ending of capped rates and being forced to market prices, Alcoa shut down an aluminum smelter with 600 jobs lost. That state's largest utility, Baltimore Gas and Electric ("BG&E"), will go to market rates in July. The Maryland Public Service Commission, which has estimated that a typical residential customer would be hit with rate increases of 72%, has proposed to "phase in" the rate increase, thus reducing the impact of the increase in July. Participants in the "phase-in" plan, however, still would be required to pay BG&E the entire amount of the increase that is deferred for later payment. Merely "phasing in" massive rate increases mitigates their immediate impact but, because customers ultimately must pay the massive, deferred costs, obviously does not represent a solution to the increase itself.
- In Delaware, Delmarva Power announced in February that it would raise its residential rates by approximately 59% on May 1, when rate caps expired in that state. Delmarva Power's rates for large commercial and industrial customers were to increase even more. The General Assembly enacted a "phase-in" plan to help customers defer, but not avoid, the rate increases unless customers elected to "opt-out" of the plan, in which case they would pay the entire increase commencing May 1.

Beyond such current experiences in nearby states, the Restructuring Commission need not look beyond Virginia's own borders to appreciate the impact of going to market prices. Delmarva has filed an application with the Commission seeking an average rate increase of 50% in its Virginia territory (as much as 65.3% for certain large commercial and industrial customers)

David M. Eichenlaub

May 22, 2006

Page 8

as a result of going to market-based rates, and the Commission's annual report to the Restructuring Commission, cited above, describes the "rate shock" of customers of some Virginia electric utilities (Craig Botetourt Electric Cooperative, City of Danville Municipal, City of Bristol Municipal) resulting from large price increases necessitated by exposure to current and expected future wholesale market conditions.

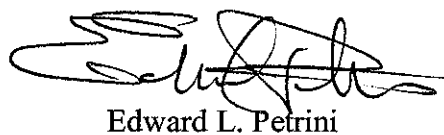
Conclusion

We hope you will take the Committees' concerns into account as you continue to study and assess public policy in this area, and we appreciate the opportunity to share those concerns with you. 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 recent developments do not bode well for its future success.

Sincerely,



Louis R. Monacell



Edward L. Petrini

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	F	Present market prices and trends suggest that retail customers of Appalachian Power Company ("APCo") and Dominion Virginia Power ("DVP") have few or no prospects for savings from retail competition in view of the fact that market prices now greatly exceed the regulated generation costs of APCo and DVP.
Customers rates during the transition to competition	D	<p>The State Corporation Commission ("SCC") Staff's most recent report on DVP's earnings and indicates that its rates are excessive by 10% and would be reduced by approximately \$400 million per year if reset based on cost of service. DVP's rates have soared since the Act passed in 1999 due to rate "adjustments" to reflect increased fuel costs. Legislation enacted in 2004 froze DVP's 2004 fuel factor through June 2007. As a result, customers now are paying a lower fuel factor than otherwise would have been the case. DVP's fuel factor is likely to rise again significantly on July 1, 2007, when the SCC re-sets it. The SCC, however, still cannot offset the increase by considering DVP's base (non-fuel) rates.</p> <p>The SCC most recent report on APCo's earnings indicates an annual "revenue deficiency" of about 5.2%. This month, APCo applied to the SCC for a general base rate increase. It stated that the increase, if granted, would increase rates approximately \$198 million, or about 25% on average. Based on SCC Staff's most recent financial review and the rate application, it appears that APCo's rates are collecting revenues below its costs. The 2004 amendments to the Act, on the other hand, encourage unfair, single-issue rate increases for APCo without permitting the SCC to review the total cost of service to determine whether cost reductions or revenue increases would offset such increases.</p>

Utility earnings	B	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 2004 or 2005 annual informational filings ("AIFs"); however, the 13.26% rate of return exceeds the 9.10% to 10.10% rate of return found reasonable in the SCC Staff's review of DVP's 2003 annual report, the most recent AIF reviewed by the SCC Staff. While APCo's Virginia electric business appears to have produced modest over-earnings during 2003, APCo's earnings -- as indicated in the recent SCC Staff report on its 2004 AIF and in APCo's most recent general base rate increase application, discussed above -- appear to be falling below a reasonable range.
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>i.e.</i> , costs rendered unrecoverable as a result of restructuring and competition). Despite the likelihood that no stranded costs exist, no such determination has been made.
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.
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.

<p>Reliability of distribution and transmission system</p>	<p>A</p>	<p>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 was completed and no serious deficiencies were shown. We are not aware of an independent, in-depth review of transmission and distribution reliability. In the absence of such a review, we must assume that normal measures of performance are being met. We remain cautious, nevertheless, about the effect of restructuring on transmission and distribution reliability in view of the factors cited by the SCC Staff as well as the significant reductions in employees reported by DVP to the SCC Staff during its post-Isabel audit. Employees in the "transmission" category declined by 61%, for example, during the period 2000 through 2004, while employees in the "distribution" category declined 23.34%.</p>
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June 12, 2006

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 the opportunity to offer the following comments in response to those of other interested persons. 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 ("Virginia Power") and Appalachian Power Company ("Appalachian Power"), respectively.

The Committees' initial comments expressed serious concerns about electric restructuring in Virginia. Such concerns include the fact that customers of both Virginia Power and Appalachian Power will soon face significant, unwarranted rate increases based on an unfair, lopsided process; and, commencing after 2010, when so-called "capped rates" end, customers of both utilities may face extraordinary rate increases, of perhaps 100% or more, that would unfairly enrich both utilities with no corresponding benefit to consumers. The Committees' comments emphasized that states north of Virginia, and, indeed, portions of Virginia itself now are grappling with crushing rate burdens resulting from going to "market" prices for electric supplies. Virginia Power filed comments that largely ignored these concerns, but they address other matters that warrant this brief response.

Claimed Customer Benefits

Virginia Power asserts that restructuring "has produced significant benefits for the Commonwealth's customers." Virginia Power cites "hundreds of millions of dollars" in customer savings resulting from the fuel factor freeze enacted by the General Assembly in 2004. Virginia Power's comments, however, ignore the "hundreds of millions of dollars" in excess revenues that the base, or non-fuel, portion of its "capped rates" has generated and may continue to generate through 2010. As indicated in the Committees' initial comments, Virginia Power had

David M. Eichenlaub

June 12, 2006

Page 2

accumulated, according to the Commission Staff's most recent report concerning Virginia Power's earnings (for the year 2003), more than \$1.2 billion in earnings available for stranded cost recovery during the 1998 – 2003 period. Virginia Power, however, has yet to incur its first dollar of "stranded costs." The excessive base rates that have produced such excess earnings – rates estimated to be excessive by about \$400 million per year for the most recent periods (2002 and 2003) analyzed by the Staff -- are scheduled to remain in effect through 2010. Thus, while the fuel factor freeze, considered alone, has produced since 2004 some customer savings, the Restructuring Act's non-fuel (base) rate provisions have produced significantly excessive non-fuel rates. The adverse impact of the excess base rates on customers may exceed, by a substantial margin, the savings from the fuel rate freeze. Moreover, as Virginia Power's comments acknowledge, the fuel factor freeze is scheduled to end on July 1, 2007, when its fuel factor will be re-set, so any customer savings resulting from the freeze will terminate as of that date. Virginia Power's base rates, however, will not change on that date. Customers, therefore, are scheduled to continue to pay the same base rates that have produced such excessive earnings through 2010.

Virginia Power also claims that consumers have benefited from the "capped rates" on the basis of a study performed in 2002, and later updated in 2004, by Chmura Economics & Analytics ("Chmura"), a Richmond economic consulting firm. Virginia Power hired Chmura to study the impact of "capped rates" on residential utility consumers during the period in which "capped rates" will be in effect. Virginia Power states in its comments that the 2004 study projects residential customer savings of "as much as \$1.8 billion through 2010" and "annual savings" for a typical residential customer of "up to \$74" during the "capped rate" period.

The Chmura study, however, is based on a macro-economic forecasting model, not Virginia Power's costs. Thus, it ignores the most basic fact of ratemaking: that the Commission sets rates to cover operating costs plus a reasonable return on the utility's investment in assets that provide customers with service. While Virginia Power's cost data during the "capped rate" period, both actual and projected, presumably could have been made available to its own consultant, its consultant proceeded without it. Instead of analyzing Virginia Power's costs in order to determine what its rates would have been if the General Assembly had not enacted the "capped rates," the study estimates what Virginia Power's rates would have been on the basis of factors, such as national employment rates and short-term national interest rates, that have never been the basis for setting Virginia Power's regulated revenue requirement.

The Chmura study's findings, moreover, have been contradicted by detailed annual analyses of Virginia Power's costs and revenues conducted by the Commission Staff. As indicated above, the most recent of those analyses available, which follow the approach used by the Commission in setting rates, show that Virginia Power's "capped rates" have produced revenues significantly in excess of its costs – that is, significantly in excess of the costs that would have been used for ratemaking purposes if its "capped rates" had not been in effect.

David M. Eichenlaub

June 12, 2006

Page 3

Finally, Virginia Power asserts that restructuring “savings” have not been confined to Virginia, and it cites, in particular, studies by two consulting firms, Cambridge Energy Research Associates (“CERA”) and Global Energy Decisions, which purport to show significant customers savings nationwide and in the Eastern Interconnect, respectively. As the comments of the Old Dominion Electric Cooperative detail, however, *both* studies contain significant flaws. For example, most of the claimed \$34 billion in consumer savings found by the CERA study are ascribed to the southern states, which have experienced little restructuring.

Rate Increases in Non-Restructured States

Virginia Power also contends that rates have increased in non-restructured states, and it cites as examples significant rate increases for utilities in Wisconsin, Oklahoma, and Florida. The Commission and the General Assembly, however, should not be misled by such cases. No one suggests that traditional, cost-based regulation “immune[izes]” customers from legitimate, cost-based rate increases related to a utility’s specific circumstances. Thus, customers served by a utility that is heavily dependent upon natural gas, like Public Service Company of Oklahoma (Generation owned by that utility is 74% gas-fired.), will doubtless experience significant rate increases if natural gas prices triple; customers of a utility like Florida Power and Light, which also is heavily dependent upon natural gas-fired generation and which just experienced significant damage due to several massive hurricanes, can expect significant, cost-based rate increases; and customers of utilities in the midst of constructing base load generation (and experiencing increases in fuel and other costs), such as the customers of Wisconsin Public Service Corporation, can expect significant rate increases. Virginia Power’s generation fleet, however, is not heavily dependent upon natural gas; its service territory has not experienced anything approaching the level of hurricane-inflicted damage visited upon Florida’s utilities; and it is not constructing any new base load generation.

While Virginia Power refers to utilities different from it in important respects as examples of utilities experiencing significant rate increases under traditional regulation, it might have elected to cite an example of such regulation closer to home. North Carolina has not restructured. Virginia Power’s North Carolina operations, therefore, are subject to traditional rate regulation in that state. Thus, under North Carolina law, the North Carolina Utilities Commission (“NCUC”) may initiate a rate case and, if it finds that a utility’s rates are excessive, order a rate reduction. Last year, following such an NCUC-initiated investigation, Virginia Power agreed to a base rate *reduction* of \$12 million per year for its North Carolina operations. In contrast, as the Committees’ initial comments point out, Virginia’s Restructuring Act prohibits the Commission from reducing Virginia Power’s base rates.

Increased “Shopping” Elsewhere

Virginia Power cites “fairly vigorous” shopping in several other jurisdictions, especially among larger industrial and commercial users. For example, Virginia Power cites March 2006 data from the Maryland Public Service Commission indicating that competitive providers served

David M. Eichenlaub

June 12, 2006

Page 4

80% of large commercial and industrial accounts. The comments of Constellation Energy make a similar point about high shopping rates among such customers in Maryland.

No one doubts that the expiration of "price caps" in other jurisdictions, and the implementation of market-based rates for large customers, has resulted in increased shopping by large commercial and industrial customers. Obviously, where large users are forced to face significant rate increases (ranging up to 118% in Delaware, for example), as a result of going to market-based default service rates, many large users can be expected to shop to take service from alternative suppliers.

The Committees are concerned, however, about the potentially *extraordinary* rate increases that may result from going to market rates in Virginia and the resulting *windfalls* for Appalachian Power and Virginia Power at their customers' expense. Such "shopping" does not deliver customer benefits if market-based rates are greatly in excess of cost-based, regulated rates for Appalachian Power and Virginia Power. On the contrary, it merely produces unfair and unnecessarily negative economic consequences for millions of customers, including large industrial and commercial customers. The potential for such consequences does not bode well for Virginia's economic future, including the future of jobs in Virginia's manufacturing sector.

Conclusion

We appreciate the opportunity to comment on restructuring issues, and, again, we hope you will take the Committees' concerns into account as you continue to study and assess public policy in this area

Sincerely,



Louis R. Monacell



Edward L. Petrini