

**REPORT OF THE  
JOINT SUBCOMMITTEE STUDYING**

**RESTRUCTURING OF THE  
ELECTRIC UTILITY INDUSTRY**

**TO THE GOVERNOR AND  
THE GENERAL ASSEMBLY OF VIRGINIA**



**SENATE DOCUMENT NO. 28**

**COMMONWEALTH OF VIRGINIA  
RICHMOND  
1997**



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**Report of the  
Joint Subcommittee Studying  
Restructuring of the Electric Utility Industry  
To  
The Governor and the  
General Assembly of Virginia  
Richmond, Virginia  
1997**

TO: The Honorable George F. Allen, Governor  
and  
The General Assembly of Virginia

**I. INTRODUCTION**

Senate Joint Resolution 118 of 1996 (*Appendix A*) established a joint subcommittee to study the potential for electric utility industry restructuring within the Commonwealth. Virginia thus joined more than 40 other states and the District of Columbia in asking whether deregulating the retail electricity market is appropriate and in the public interest. Responding to intense nationwide interest in this issue, legislators and public utility regulators are addressing an important question: whether electricity customers should be permitted to choose electric companies with the same ease telephone customers select their long distance carriers.

Those favoring a deregulated retail market believe that electricity customers are best served by an open market that includes the traditional players (such as investor-owned utilities and electric cooperatives) plus a cadre of new entrants that include independent power producers and power marketers. Competition proponents assert that conventional delivery through franchised service territories is expensive and inefficient. However, others contend that in Virginia, electric service is reliable and moderately priced. What is not broken, they say, does not require repair.

A handful of states, including New Hampshire, Pennsylvania and California, have enacted retail competition legislation establishing pilot and other experimental programs permitting retail customer choice. The key question before this joint subcommittee was whether Virginia should join these states in laying the statutory groundwork for business, residential and industrial customer choice in a deregulated retail electricity market.

The following General Assembly members served on the joint subcommittee: Senators Reasor of Bluefield, Holland of Windsor, and Norment of Williamsburg, appointed by the Senate Committee on Privileges and Elections; and Delegates Woodrum of Roanoke, Plum of Reston, J.C. Jones of Norfolk and Watkins of Midlothian appointed by the Speaker of the House. Senator Reasor chaired the joint subcommittee, and Delegate Woodrum served as its vice-chairman.

The joint subcommittee convened four meetings between the 1996 and 1997 Sessions of the General Assembly, three at the Capitol in Richmond and one in Charlottesville. It devoted its meetings to learning about restructuring by providing a forum for electricity market stakeholders. To that end, representatives of investor-owned utilities, electrical cooperatives, independent power producers, and municipal power system operators, together with representatives of business, industrial, and residential electric power customers; natural gas distribution companies; and environmental and consumer groups all appeared before the joint subcommittee to share their views on retail competition and other facets of electric industry restructuring.

Members of the Virginia State Corporation Commission's (SCC) staff also appeared before the joint subcommittee to summarize their conclusions and recommendations to the SCC's commissioners concerning electric utility restructuring. The report followed an extensive study of restructuring by the staff of the Energy Regulation and Economics & Finance sections within the SCC's Public Utilities division. The report observed that retail competition has gained the most momentum in California and in Northeastern states where electric rates are highest. Virginia's electricity market is stable, reliable and moderately priced, the report further noted and then concluded that Virginia's electricity customers would benefit most from a go-slow approach to restructuring with the SCC monitoring and analyzing retail competition programs in other states.

One meeting was held in Charlottesville in conjunction with an SCC-sponsored forum on restructuring. In addition to learning about recent SCC orders related to restructuring, the joint subcommittee also received testimony about the entry of regulated electric utilities into unregulated business activities. Owners and operators of heating, air conditioning and ventilation (HVAC) companies appeared before the joint subcommittee to protest the anticipated entry of a Virginia electric utility (through an affiliated company) into the heating and cooling equipment service contract and warranty repair market. The Air Conditioning Contractors of America (ACCA) and other HVAC industry representatives believe the utility's market power, coupled with direct access to a sizable customer base (generated by its regulated activities), poses an anti-competitive threat to HVAC companies, most of which are small businesses.

The SJR 118 joint subcommittee held its final meeting immediately prior to the 1997 Session to discuss draft legislation continuing the study in 1997. The joint



subcommittee approved and the 1997 Session enacted Senate Joint Resolution 259 (*Appendix B*), which (i) continues the joint subcommittee's examination of retail competition and (ii) requests the Virginia State Corporation Commission staff to provide to the joint subcommittee by November 7, 1997, its draft of a working restructuring model, which may include experiments and pilot programs. The resolution also directs the joint subcommittee to consider the effects of electric utility restructuring on small business and residential consumers, and on the environment.

The joint subcommittee also met during the 1997 Session to (i) review proposed amendments to Senate Joint Resolution 259 and (ii) anticipating SJR 259's passage, to establish a special task force to examine restructuring's potential impact on state and local tax revenues.

## II. OVERVIEW

The principal issue before the joint subcommittee was whether conventional methods of delivering electricity to residential and business customers in the Commonwealth through franchised public utilities should be shelved in favor of a deregulated, competitive market. The intense debate over electric industry restructuring on state and federal levels originated in federal energy initiatives, with the current round prompted largely by the federal Energy Policy Act of 1992 (EPACT).

Building on the Public Utilities Regulatory Policy Act of 1978 (PURPA), EPACT authorized nonutility generators (producers of electricity having no transmission facilities or distribution systems) to sell electrical power in the wholesale market at unregulated market rates. PURPA had required utilities to purchase power from nonutility generators, but at rates that reflected costs utilities would avoid by purchasing power rather than generating it. PURPA and EPACT together mandate nonutility generator access to public utilities' transmission networks to facilitate wholesale power sales. Moreover, utility charges for such access must be reasonable and nondiscriminatory.

In 1996 and 1997, congressional public utility activity shifted from wholesale to retail electrical power sales. Several bills were introduced that would preempt state law on this issue, mandating customer choice nationwide. The federal bills also address numerous ancillary issues such as generation facility emissions, utility use of renewable energy sources, and utility recovery of stranded investments and nuclear plant decommissioning costs. The "Electric Consumers Protection Act of 1997" (S. 237) is typical of such federal legislation. No consensus on restructuring has yet developed, however, in the House Commerce or Senate Energy and Natural Resources committees considering these bills.

Retail competition is also under legislative consideration by many of Virginia's sister states. Nearly all states are studying the issue, and several states, including New Hampshire, California and Pennsylvania, have enacted legislation authorizing retail competition on some level. In New Hampshire, for example, a 1995 retail choice pilot program will give way to full implementation for all customer classes in 1998. California's retail competition initiative is also scheduled for full implementation in 1998.

The joint subcommittee noted that retail deregulation raises practical and policy considerations in three distinct categories: (i) the opportunities and challenges presented by "unbundling" electrical generation from transmission and distribution; (ii) the potential for "stranded" utility assets; and (iii) competitive and regulatory parity between utilities and nonutility generators in the emerging deregulated market. An overarching issue is whether regulatory responses to these issues should be enacted state by state, or in comprehensive federal legislation.

### **III. PERSPECTIVES: POWER PRODUCERS AND SUPPLIERS**

#### **A. INVESTOR-OWNED UTILITIES**

Investor-owned utilities represent the current model for electric power delivery throughout the U.S., exclusive of public power sources such as the Tennessee Valley Authority (TVA). Electricity is delivered through franchised service territories in which utilities are obligated to furnish retail electric service to all consumers and businesses in those territories at regulated rates. In exchange for the obligation to serve, utilities obtain the sole right to provide electric service in these areas, to the exclusion of any other potential provider. Representatives of investor-owned utilities, including the Edison Electric Institute (EEI), a trade association representing such utilities, appeared before the joint subcommittee to present their views on restructuring. Virginia's EEI members include Virginia Power; American Electric Power; Virginia (AEP Virginia); and Potomac Edison (an Allegheny Power operating unit).

Virginia Power (with retail electricity sales centered in the Commonwealth) favors a state-based approach to the restructuring process, preferring the Virginia State Corporation Commission to Congress as the principal forum for Virginia's restructuring debate (*Appendix C*). According to Virginia Power, the current pressure for retail deregulation exerted by large industrial customers is premature and unnecessary because electric service in Virginia is reliable and reasonably priced.

Virginia Power urged the joint subcommittee to consider carefully the potential impact of retail competition, including system reliability, parity among

competing suppliers, the possibility of cross-subsidization and cost-shifting among consumer classes, and the potential for stranded investments. The company expressed considerable concern about retail competition's potential to leave electric utilities with stranded investments, i.e., service and facility investment costs incurred and likely recoverable in a regulated structure that may not be recouped in a fully competitive market.

Allegheny Power, on the other hand, expressed support for 50-state uniformity and a preference for regional or national guidelines. Allegheny, with an interstate service territory, advocates a deregulated, market-priced environment for electrical generation in which electrical transmission and distribution would continue to be regulated (*Appendix D*). AEP Virginia, a subsidiary of American Electric Power, however, supports state-originated retail competition initiatives, but emphasized the need for assured equal access to interstate markets, or some form of state market reciprocity (*Appendix E*).

AEP Virginia favors retail customer choice for generation services. It believes that fair and efficient competition, with customer access to a large body of generating companies and resources, can best be accomplished by the creation of independent system operators (ISOs). ISOs would assume independent operating control, but not ownership, of the transmission systems of utilities within large regions of the country. Transmission pricing would be simplified and cost based. In effect, an ISO would define the boundaries of a regional market for generation services.

## **B. INDEPENDENT POWER PRODUCERS**

Nonutility generating companies, also known as independent power producers (IPPs), with more than \$3.7 billion in generating facilities in Virginia advocate the swiftest possible route to retail competition. The Virginia Independent Power Producers, an IPP trade association, reported that approximately 60 percent of Virginia's new generating capacity within the past 10 years has been provided by IPPs. IPPs view federal support and endorsement of full, nationwide retail competition as inevitable, and assert that a competitive market will be more financially beneficial to Virginians than the current regulated system (*Appendix F*).

## **C. ELECTRICAL COOPERATIVES**

Virginia's electric cooperatives favor a go-slow approach to electric market restructuring. The co-ops were represented before the joint subcommittee by the Virginia, Maryland and Delaware Association of Electric Cooperatives. With distribution facilities in Virginia's less densely populated areas, the co-ops expressed concern about the fate of their residential customers if co-op industrial customers (representing less than two percent of their customer base, but over 22

percent of their electrical sales) leave the co-op system. Furthermore, they contend that stranded costs resulting from retail competition should be borne by those who choose to leave their current supplier, and not by the remaining customers such as the small business and residential customers who comprise 98 percent of their customer base (*Appendix G*).

#### **D. MUNICIPAL POWER SUPPLIERS**

A number of Virginia's municipalities purchase electrical power from public utilities for resale to municipal residents. The cities of Harrisonburg and Blackstone are typical of localities with municipal power supply systems. Their power system managers appeared before the joint subcommittee to express concern about the potential impact of retail competition on municipal power suppliers who rely on electric utilities' reserve generation capacity--a capacity that could easily be eliminated in a highly competitive retail environment.

Without utility generating reserves, municipal power systems could find it increasingly difficult to purchase affordable power for their customers. The Harrisonburg and Blackstone power system managers also expressed concern that their larger business customers could potentially abandon them for better deals from remote generators, leaving municipalities with the problem of recovering the cost of distribution system improvements made for the benefit of business customers. Thus, stranded costs were seen as a potential problem for municipal power suppliers as well.

#### **IV. SCC STAFF REPORT ON RETAIL COMPETITION**

The Virginia State Corporation Commission's public utility staff prepared a report in 1996 on utility restructuring for the SCC commissioners, and summarized their findings about retail competition for the joint subcommittee (*Appendices H, I and J*). The reasons for national interest in retail competition, the staff said, include the development of low-cost, natural gas-fired units, an excess of base-load capacity resulting in low cost power availability in the spot market, and sharp regional price differences. Federal energy regulatory policies have contributed as well, they said, citing Federal Energy Regulatory Commission (FERC) Order 888, which requires electric utilities to offer transmission services for the transport of electricity. Members of Congress have also added momentum by introducing retail competition bills, including a measure calling for retail customer choice by the year 2000.

SCC staff recommended a measured, incremental approach to retail competition in Virginia since residential electric rates in the Commonwealth are, on average, the 27th lowest in the U.S., while industrial customers are currently paying the 15th lowest rates. Consequently, Virginia is unlike states such as

California and New York where utility rates are high, and thus the SCC staff sees no immediate need to begin retail competition--on an experimental basis or otherwise. However, the staff has recommended that the SCC monitor retail competition experiments in other states to help answer some of the following questions: (i) Will all customers benefit from retail competition? (ii) Will price volatility be acceptable to all customers? (iii) What will become of the excess capacity currently driving the market toward retail competition? (iv) How should retail competition be structured to minimize stranded costs and benefits?

SCC staff concluded that Virginia's electric utilities are furnishing reliable service at moderate prices, and that there is little to gain by rushing into retail restructuring. The staff did, however, recommend to the Commission several steps Virginia could take in the meantime, including the following: (i) prices for all utility services should be "unbundled" (separated into their component parts of generation, transmission and distribution) for informational purposes, and "real time" pricing should be explored; (ii) reserve margins for utilities should be scrutinized and studied; (iii) utilities should seek to renegotiate high-cost contracts with nonutility generators; (iv) an updated and thorough cost of services study should be completed for each public utility; and (v) conservation and load management programs should be reviewed. An SCC order dated November 12, 1996, incorporated these recommendations in directives to Virginia's electric companies and electric cooperatives (*Appendix K*).

## V. ELECTRICITY CUSTOMERS' VIEW OF RETAIL COMPETITION

Energy customers appeared before the joint subcommittee to express their views about electrical market restructuring and retail competition. The Alliance for Lower Electricity Rates Today (ALERT), a coalition of industrial, business and residential customers, favors moving forward expeditiously to retail competition. ALERT representatives advocated doing more in Virginia than merely monitoring retail competition activities in other states, and asserted that retail competition will result in significant electric customer savings (*Appendix L*).

The Committee for Fair Utility Rates, an association of Virginia Power's 20 largest industrial customers, told the joint subcommittee that the paramount issue is whether the Commonwealth will embrace retail competition or wait passively for Congress to enact federal legislation providing such choice. The Committee favors a structured transition to customer choice, including (i) "hands on" experience with a retail competition, (ii) study and development of rules for customer choice, and (iii) the implementation of customer choice when feasible (*Appendix M*). Hoechst Celanese, a large AEP Virginia industrial customer also expressed its desire for customer choice by the year 2000 (*Appendix N*).

The Virginia Citizens Consumer Council (VCCC) advocates residential rates that are as low as possible and that assure the reliable, safe delivery of electricity. However, a VCCC representative cautioned, residential customers are at great risk if electric utility restructuring is done poorly without safeguards and protections. The VCCC suggested that goals for a restructured electric industry should include (i) restructuring and not cost shifting among customer classes, (ii) real price benefits for consumers, including affordable electricity bills for low-income customers, (iii) retaining price regulation of transmission and distribution to avoid anticompetitive behavior, and (iv) maximum public participation (*Appendix O*).

## VI. NATURAL GAS INDUSTRY PERSPECTIVES

A representative of Washington Gas, a large natural gas distributor, told the subcommittee that competition will bring the benefits of greater choice and lower rates to electricity consumers in Virginia (*Appendix P*). However, he said, if electric utilities are permitted to sell natural gas to retail customers--as they are doing now--gas companies should be given a reciprocal right to sell electricity. Washington Gas believes that the SCC staff's go-slow recommendations do not go far enough; that it is not enough to merely develop unbundled prices for generation, transmission and distribution for informational purposes. It proposes that the General Assembly enable the opening of the retail electricity market, at least on a pilot basis.

## VII. ENVIRONMENTAL IMPACT OF RESTRUCTURING

According to the Southern Environmental Law Center, the potential environmental impacts of restructuring are significant. If the electric utility industry is deregulated improperly, a Center representative told the joint subcommittee, deregulation will increase the environmental damage caused by power production. Retail competition could, for example, create additional markets for older power plants which enjoy an economic advantage because of depreciation and relaxed environmental standards for such plants.

Exemptions in the federal Clean Air Act for older plants allow plants built prior to 1977 to emit two to ten times the level of key pollutants as similar new plants. If plants of this age are kept in service longer and run more frequently, there could be dramatic increases in air pollution, a Center representative said. The Center also advocates continued emphasis on utility investment in energy conservation and load management and expressed concern that retail competition will result in utilities focusing exclusively on short-term prices with less emphasis on energy efficiency (*Appendix Q*).

## VIII. ANCILLARY ISSUES: ELECTRIC UTILITY COMPETITION WITH HEATING AND AIR CONDITIONING CONTRACTORS

Representatives of the Air Conditioning Contractors of America (ACCA) appeared before the joint subcommittee to express the organization's concerns about competition from regulated electric utilities. The focal point of ACCA's concern was Virginia Power's acquisition of a subsidiary for the purpose of entering the electric appliance and equipment warranty repairs market. ACCA had formally opposed the utility's application for SCC approval of this affiliated relationship (*Appendix R*).

In 1996 the SCC approved Virginia Power's use of this subsidiary for commercial and industrial warranty service, but the application for residential service was withdrawn by Virginia Power before the SCC formally acted on it. ACCA expressed concern that the residential market entry issue was far from resolved, and that Virginia Power could take advantage of its size and a current customer base of nearly two million to compete unfairly with small HVAC companies for warranty and repair work. ACCA representatives cited Baltimore Gas & Electric's sale of nearly 40 percent of all appliances sold at retail in the Baltimore area as an example of utilities' potential market power in nonregulated areas.

## IX. CONTINUING THE RESTRUCTURING STUDY IN 1997

At its final meeting before the 1997 General Assembly Session, the joint subcommittee recommended continuing this legislative study on restructuring. Noting the Virginia State Corporation Commission's orders designed to develop data needed for the SCC's internal study of restructuring, the joint subcommittee concluded that continued legislative monitoring of these and other developments--including those occurring at the federal level and in other states--was warranted.

Accordingly, the joint subcommittee approved and the 1997 Session enacted Senate Joint Resolution 259 (*Appendix B*) which (i) continues the joint subcommittee's examination of retail competition and (ii) requests the Virginia State Corporation Commission staff to provide to the joint subcommittee by November 7, 1997, its draft of a working restructuring model, which may include experiments and pilot programs. The resolution also directs the joint subcommittee to consider the effects of electric utility restructuring on small business and residential consumers, and on the environment.

Respectfully submitted,

Jackson E. Reasor, Jr., Chairman  
Clifton A. Woodrum, Vice Chairman  
Richard J. Holland  
Thomas K. Norment, Jr.  
Jerrauld C. Jones  
Kenneth R. Plum  
John Watkins



## SENATE JOINT RESOLUTION NO. 118

*Establishing a joint subcommittee to study restructuring and potential changes in the electric utility industry in the Commonwealth.*

Agreed to by the Senate, March 4, 1996

Agreed to by the House of Delegates, February 29, 1996

WHEREAS, electricity is a necessity for all individuals, industries, businesses, and municipalities in the Commonwealth; and

WHEREAS, the generation and transmission of electric power and the sale and distribution of electricity to consumers within the Commonwealth are affected by the public interest; and

WHEREAS, it is the policy of the General Assembly and this Commonwealth to support a regulatory climate that ensures reliable electric services at reasonable prices for all consumers considering the public interest; and

WHEREAS, markets for electricity are changing nationally and appear to be moving toward increased competition; and

WHEREAS, changes in the electric utility industry could enhance the competitive position of Virginia's businesses and industries, including Virginia's ability to compete more effectively in business development; and

WHEREAS, there is a need for careful consideration of all issues involving customer choice and the potential restructuring of, and competition in, the electric utility industry and the system of electric utility regulation; and

WHEREAS, electric utilities have expressed the desire to have certain of their services deregulated, to be able to negotiate special rates with individual customers, to enter competitive and unregulated lines of business, and to offer a full package of energy services; and

WHEREAS, the Federal Energy Regulatory Commission, and the legislatures and regulatory commissions of more than thirty-five states, either have implemented or are studying initiatives to restructure and to increase competition in the electric utility industry; and

WHEREAS, the State Corporation Commission of Virginia (SCC) is currently studying electric utility industry restructuring and consumer choice issues in its pending investigation in Case No. PUE950089; and

WHEREAS, the SCC's investigation will encompass an examination which includes, among other matters, the following issues:

1. What services and other aspects of the electric utility industry can best achieve their goals by being subject to competition, taking into account factors such as reliability, price, profit, and rates.

2. What services and other aspects of the electric utility industry can best achieve their goals through regulation or a combination of regulation and competition.

3. With respect to those services and elements that should be subjected to competition, how those services and elements may be monitored to ensure that there is, in fact, competition and that competition is achieving its goals.

4. With respect to those services and elements that should be regulated, what form the regulation should take and how it will be determined whether or not such regulation is achieving its goals; and

WHEREAS, the interest of Virginia's citizens in a competitive electric utility industry warrants the immediate attention of the General Assembly; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That a joint subcommittee be established to study restructuring and potential changes in the electric utility industry in the Commonwealth and determine the need for legislative changes in order to promote the public interest as determined by the work of the joint subcommittee.

As part of the study, the joint subcommittee shall consider the SCC's investigation in case number PUE950089 and consult with the SCC regarding issues under consideration by the subcommittee.

The joint subcommittee shall be composed of seven members representing the various geographic areas of the Commonwealth as follows: three members of the Senate Committee on Labor and Commerce, to be appointed by the Senate Committee on Privileges and Elections, and four members of the House of Delegates with expertise in corporations, insurance and banking, to be appointed by the Speaker of the House.

- 1 The direct costs of this study shall not exceed \$5,250.
- 2 The Division of Legislative Services shall provide staff support for the study. Technical assistance  
3 shall be provided by the public utilities staff of the Virginia State Corporation Commission. All  
4 agencies of the Commonwealth shall provide assistance to the joint subcommittee, upon request.
- 5 The joint subcommittee shall complete its work in time to submit its findings and  
6 recommendations to the Governor and the 1997 Session of the General Assembly as provided in the  
7 procedures of the Division of Legislative Automated Systems for the processing of legislative  
8 documents.
- 9 Implementation of this resolution is subject to subsequent approval and certification by the Joint  
10 Rules Committee. The Committee may withhold expenditures or delay the period for the conduct of  
11 the study.

## SENATE JOINT RESOLUTION NO. 259

*Continuing the joint subcommittee examining the restructuring of the electric utility industry.*

Agreed to by the Senate, February 20, 1997

Agreed to by the House of Delegates, February 20, 1997

WHEREAS, more than 40 states now have under consideration restructuring in the electric utility industry; and

WHEREAS, significant efforts involving retail competition are in various stages of study, planning and implementation in the various states; and

WHEREAS, there are legislative proposals pending in the United States Congress directing the implementation of retail competition for electricity by dates certain in the near future; and

WHEREAS, the General Assembly in 1996 approved Senate Joint Resolution No. 118 (1996), establishing a joint legislative subcommittee that has commenced its study of such restructuring and retail competition; and

WHEREAS, the joint subcommittee conducted public hearings to hear from the providers and consumers of electricity; and

WHEREAS, the staff of the State Corporation Commission (SCC) has just completed its initial overview of such restructuring of the electric utility industry and retail competition; and

WHEREAS, it is in the best interest of the residential, industrial, commercial and governmental electricity consumers in Virginia to have reliable electricity at the most competitive cost while protecting environmental quality; and

WHEREAS, the Commonwealth should be prepared for the potential of retail competition for electricity in Virginia and have the necessary information to make decisions regarding such potential competition; and

WHEREAS, the SCC and its staff possess the expertise to develop a model plan for the restructuring of the electric utility industry in Virginia that will provide for reliable, competitive electricity; and

WHEREAS, restructuring of the electric utility industry may have a significant impact on small businesses and residential consumers within the Commonwealth; and

WHEREAS, the joint subcommittee study and the SCC staff examination should be continued and coordinated both with each other and with the various impacted parties such as electricity suppliers and electricity consumers in the Commonwealth; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That the joint subcommittee studying restructuring in the electric utility industry be continued. The joint subcommittee shall also study the impact that restructuring in the electric utility industry may have on small businesses and residential consumers in the Commonwealth.

The members appointed pursuant to Senate Joint Resolution No. 118 (1996) shall continue to serve, and any vacancies shall be filled as provided in the resolution. Staffing shall continue to be provided by the Division of Legislative Services.

The SCC staff is requested to provide to the joint subcommittee by November 7, 1997, its draft of (i) a working model, which may also include experiments and pilot programs, most appropriate for the Commonwealth of Virginia for the future structure of the electric utility industry to provide reliable, competitive electricity and meet the demands of a changing industry while protecting environmental quality, (ii) any statutory or regulatory changes considered appropriate under such model, and (iii) the appropriate timetable and transition for the model to be implemented. In conducting its analysis and preparing its recommendations, the SCC staff shall work in a collaborative fashion with representatives of electricity suppliers, consumers of electricity in the Commonwealth, and other parties of interest in this issue.

All agencies of the Commonwealth shall provide assistance to the joint subcommittee, upon request.

The direct costs of this study shall not exceed \$4,200.

The joint subcommittee shall complete its work in time to submit its findings and recommendations to the Governor and the 1998 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for the processing of legislative

documents.

Implementation of this resolution is subject to subsequent approval and certification by the Joint Rules Committee. The Committee may withhold expenditures or delay the period for the conduct of the study.

Remarks of R. E. Rigsby  
Executive Vice President -- Virginia Power  
Before the  
Joint Legislative Subcommittee on Competition  
July 2, 1996

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Good morning, Mr. Chairman and members of the subcommittee.

My name is Robert Rigsby, and I am the executive vice president of Virginia Power. I am here on behalf of our president and CEO, Jim Rhodes, who is currently out of the country.

Virginia Power first wishes to applaud this subcommittee for its interest in the important issues surrounding the debate on electric utility restructuring. We especially want to express our appreciation for legislation passed during the recent session of the General Assembly which gives the State Corporation Commission the additional authority it needs to uphold the interests of Virginia's consumers... and the flexibility to respond to the rapidly changing conditions in the electric business.

We are privileged in this country to enjoy the world's most dependable and lowest-cost electric system -- a system that has evolved over the course of the last six or seven decades under a mix of federal and state regulation. This system has the virtue of attracting private investment to provide a valuable public service.

Virginia's citizens, unlike those in some other areas of the country, enjoy reliable and reasonably-priced electric service that makes the Commonwealth an attractive place to live and do business. That attractiveness is demonstrated by the recent string of announcements from several major corporations choosing to locate new facilities in Virginia. Current efforts to restructure the electric industry are most prevalent in states and regions with the highest electricity costs -- California and the Northeast, in particular.

Virginia Power believes that competitive energy markets could ultimately provide some consumer benefits. However, we also believe that reliable and reasonably-priced electric service is too vital to the citizens of Virginia and its economy... to be fundamentally altered by federal or state legislation before critical and complex transitional issues are identified and addressed by policymakers. These issues include the following:

- ◆ First, implementing the Federal Energy Regulatory Commission's order on transmission access, which Dave Owens has already discussed:
- ◆ Second, the issue of fairness and equity among different customer classes.

The introduction of competition should be structured so that large industrial customers with market clout are not allowed to benefit at the expense of residential and small business customers. Otherwise, the result will be cross-subsidization and a shifting of costs among customer groups.

- ❖ Third, the issue of maintaining the reliability of the power system. With all the changes occurring in the industry, it's vital that the electric grid remain dependable under all circumstances;
- ❖ Fourth is the issue of stranded investment, or costs that were prudently incurred by utilities to serve their customers under the historic regulatory compact. To be credible and fair, regulators and legislators must honor prior commitments to electric utilities and their customers. The establishment of a fair and workable mechanism for the recovery of stranded costs is thus essential to the development of efficient competition.
- ❖ The fifth issue is the creation of a level playing field, or parity among competing suppliers. If competition is to be fair and efficient, all competitors should play by the same rules. That includes investor-owned utilities, public and cooperative utilities, independent power producers, power marketers and energy services companies.
- ❖ Sixth, clarification of state and federal jurisdiction on matters related to utility regulation;
- ❖ Seventh and last, resolution of the utility's obligation to serve in a more competitive environment. The question becomes, will the marketplace be truly competitive in the sense that the customer can choose among various suppliers and the supplier can also choose among customers, based on profitability or some other criteria? *And if so, how will that marketplace ensure that the corner grocer, the single mother and the elderly couple on a fixed income -- not just the big industrial users -- always receive the electric service they need?*

Those are just some of many complex issues that must be addressed and resolved as we move toward competition and deregulation in the electric industry.

Virginia Power believes the current pressure for comprehensive federal deregulation legislation coming from large industrial companies and others with market power -- while understandable from their perspective -- is premature and unnecessary at this time. Federal legislative proposals would effectively preempt longstanding state authority over public utilities, which would be wrong.

In addition, Virginia Power remains somewhat skeptical about the enormous consumer benefits being claimed by those advocating immediate open access. In the cases we have examined, the projected dollar savings are greatly inflated because they assume significant changes in electricity usage patterns that would require highly unrealistic consumer lifestyle changes. They also overlook transmission costs and the impact of stranded investment.

The better approach, in our opinion, is for the General Assembly and the State Corporation Commission to manage the transition process in an orderly manner that benefits the interests of all of Virginia's citizens.

As you know, the SCC is currently in the midst of a detailed investigation into the pros and cons of increased competition. Virginia Power supports that effort. We look forward to the completed study, and from there, to proceeding with open and honest discussion, careful deliberation, and a measured, long-term plan of action that best serves the interests of the Commonwealth.

Activities of this nature are currently underway in more than 40 states, the real "laboratories of democracy," as Chief Justice Brandeis once said. Virginia Power believes that state-level retail wheeling pilot programs and experiments that address local goals and concerns should be allowed to go forward in instances where state utility commissions deem it appropriate -- without the interference of an inflexible, federally-prescribed approach. Pilot customer choice programs and experiments at the state level are already revealing implementation problems and issues that were not foreseen.

We believe the proper forum for the restructuring debate in Virginia is the State Corporation Commission. After all, it is the SCC that is charged with protecting the public interest of the Commonwealth's citizens. It is the SCC, therefore, that is most likely to craft solutions that make sense for all Virginians -- including residential and small business consumers -- those who are most likely to suffer from a single, federally-imposed solution.

In short, we do not think a good case exists for Congress to override Virginia's prerogative to manage retail utility service within its borders. In the rush to achieve lower electric rates, innovative, state-level experiments with customer choice should not be short-circuited by Washington.

And here in Virginia, the General Assembly should proceed to work in close cooperation with the State Corporation Commission as you have in the past to achieve an outcome that makes sense for the Commonwealth.

As Elizabeth Moler, Chairman of the Federal Energy Regulatory Commission

has said, "States have jurisdiction over the service of delivering electric service to end users."

The road to deregulation may indeed be before us, but we need to proceed at a reasonable pace and with caution. Reliable, reasonably-priced electric service is too important to Virginia's citizens and its economy to act without fully understanding what we're doing or where we're going.

In closing, I'd like to summarize the three key points of my testimony:

- ◆ First, electric service in Virginia is reliable and reasonably priced, unlike some other areas of the country. Therefore, we don't need to fix what isn't broken with legislative mandates and timetables for restructuring the electric power industry;
- ◆ Second, the proper forum for the restructuring debate is the State Corporation Commission, which you have already empowered to uphold the public interest through forward-thinking legislation. The SCC and the General Assembly should continue to work together to address complex policy issues related to emerging competition and to craft solutions that meet the energy needs of Virginia's citizens;
- ◆ And third, comprehensive federal legislation is unnecessary and could derail ongoing, innovative state-level customer choice experiments and violate time-honored state prerogatives regarding the retail sale of electricity. *After all, states are like people. They come in all shapes and sizes and don't conform readily to a one-size-fits-all federal solution.*

On behalf of Virginia Power, I want to thank this subcommittee for the opportunity to share my company's views on competition and restructuring in the electric industry. The issues we are grappling with are highly complex, and they defy quick resolution. They also could have an enormous impact on people's livelihoods and overall quality of life.

Again, we commend your efforts, Mr. Chairman and members of the subcommittee, to be informed about these important matters. We think it's vital for members of the General Assembly to be knowledgeable about the issues shaping today's -- and tomorrow's -- electric utility industry. Virginia Power stands ready, willing and able to provide you with any additional information you may need and to participate in any further discussions you may wish to have.

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STATEMENT OF  
THOMAS K. HENDERSON

VICE PRESIDENT,  
ALLEGHENY POWER

Before the Virginia Joint  
Subcommittee Studying Re-Structuring  
the Electric Utility Industry in the Commonwealth  
Senate Joint Resolution No. 118

Dated: July 2, 1996

Good morning Chairman Reesor and members of the Joint Subcommittee. My name is Thomas K. Henderson. I am Vice President, Legal of Allegheny Power. The Potomac Edison Company is one of the Allegheny Power Operating Units. While Potomac Edison will continue to be a legal entity, it will be doing business using the name Allegheny Power, as will the other Allegheny Power units.

I appreciate the opportunity to present our comments on Senate Joint Resolution No. 118.

I believe it is fair to say that the United States' electric utility industry is the envy of the world. Allegheny Power is proud of our history and of our role within that industry. We have provided very reliable, low-cost electric service to our customers and have earned a sustained return for our shareholders.

However, now the electric utility industry is unmistakably going through the greatest period of change since the 1930's. The driving force behind this change is the idea of competition---moving from a regime of monopoly service providers to a regime of customer choice of supplier.

Allegheny Power operates in five states, including Virginia, and has experienced various levels of state activity concerning competition. We applaud the Virginia legislature and the State Corporation Commission for beginning their inquiries into competition. We believe that the question is not whether

competition will come, but when and how. Unless the states address these issues, they will abdicate their proper roles to the federal government.

Where does Allegheny Power stand? This is a very complex subject with many details to be worked out. In the short time allotted, I can only give you a very brief overview. In short, Allegheny Power believes that, to properly address the issues, you must separate the electric utility industry into two basic components: first, the electric delivery business, the "wires" business, which entails the wires themselves and the other services and facilities necessary for the safe and reliable delivery of electric service; and second, the electric energy business, or what is delivered over the wires, together with any other services that may enhance the value of the service or provide additional benefits, but which are not essential for the delivery of the service itself.

Keeping the above separate and distinct businesses in mind, several fundamental principles must be observed.

(1) SERVICE RELIABILITY MUST NOT BE COMPROMISED. Customers expect and deserve the present high level of service reliability to continue in a more competitive environment. The transition to competition must insure that proper funding exists for spinning reserves, voltage support, fuel supplies, and vegetation control,

just to mention a few. Funding for these services would best be addressed in the wires charges.

(2) All customers should have a choice of their electric supplier as soon as possible. The transition period to full competition should be as short as possible, consistent with ensuring that necessary system changes are accommodated.

(3) Uniform rules among the states are required. We are an advocate of states' rights. But 50 or 51 sets of different rules will only ensure that the system will not work for everyone's benefit. Some regional or national guidelines are needed. This is especially important to Allegheny Power because our retail service territory stretches into five states.

(4) All generation, and we mean all utility and non-utility generation, including PURPA purchases, should be deregulated and priced by the market as quickly as possible.

(5) We agree that the transmission and distribution portion of the business, the "wires" business, should continue to be regulated, but the regulation should maximize and not impede competition. And what should be regulated is the delivery system, the wires, and not the energy delivered. New approaches are needed that reward productivity and efficiency, and cost of service regulation must be abandoned. Owners of distribution facilities are entitled to fair compensation for the use of their facilities and should be rewarded for efficiencies.

(6) Social costs must be recognized and provided for. Obviously, there must always be a safety net for persons who cannot afford electric service. The fairest method of funding low income and universal-access programs is through a broad-based tax that includes all competing energy markets, gas, electric and oil.

In order to achieve the above, utilities should functionally unbundle their generation, transmission and distribution functions. Allegheny Power is already well along the road to completing this task. This functional unbundling is all that is necessary to separate the two basic businesses. The government should not mandate any particular form of corporate organization to accomplish this.

Once this unbundling is accomplished and after an appropriate but brief transition period, the existing utilities, co-operatives and municipals should continue to provide the regulated "wires" business in their existing service territories. However, energy and energy services should be available to all customers from all suppliers in a competitive market. In order to allay fears that price increases would result, it may be necessary to provide customers with the option of receiving bundled service, as at present, for some finite period of time at prices that would not increase by more than some fraction of inflation.

There is a major concern in the generation market, which I will briefly address. All subsidies to all segments of the generation market must be ended in order to have effective and fair competition. Some subsidies may have to be dealt with by the federal government, such as the mitigation of existing PURPA contracts. But others, such as so called stranded utility assets, should be addressed by the states.

Simply put, stranded costs are above market costs which are created in a regulatory environment, but unrecoverable in a competitive market. Potomac Edison has, or will have, stranded costs. However, our stranded costs will be significantly less than others, primarily because we have no nuclear units. There are three major categories of stranded costs:

- (1) Nuclear generation assets reflecting the high capital cost of nuclear units. These were incurred because of management decisions to use nuclear rather than other types of generation;
- (2) Costs for PURPA power plants imposed by PURPA, which I've already mentioned; and
- (3) Deferred taxes not yet collected from customers.

We believe that a true competitive solution would preclude recovery of stranded costs, or at least those stranded costs that were not the result of governmental requirements.

Further, recovery of stranded costs could subsidize the operations of high-cost suppliers and delay the benefit of competition and opportunities for lower costs to their customers. High-cost utilities could also receive an unfair competitive advantage by selling their high-cost power to new customers at less than its total cost (capital and operating) while requiring their existing customers to pay the unrecovered costs. This is not unlike high tariffs and dumping in international trade, where the home market is protected by high tariffs while exports are dumped on the foreign market at whatever minimal price the market will bear.

How is this so? It must be remembered that nuclear units have very high fixed costs (capital costs) and very low fuel costs. Coal plants tend to have much lower capital costs but, relative to nuclear, higher fuel costs. Therefore, if the fixed costs of nuclear units are protected as "stranded costs," they will be able to undersell coal-fired generation. To allow such a possibility is uneconomic and certainly contrary to fair competition. As I said before, it is not unlike high tariffs and dumping in international trade. It must not be allowed to occur.

Should it be thought necessary to provide at least some recovery for utility stranded generating assets, the above should be kept in mind and appropriate limitations be maintained to prevent the potential abuses and adverse impacts upon the establishment of a truly competitive marketplace.

### Conclusion

I believe the above briefly and generally answers the questions posed in Senate Joint Resolution No. 118. We believe competition in energy and energy services will be beneficial, and the challenge is to create a system which benefits customers as a whole and in which winners and losers are determined by the market rather than by governmental action such as requirements applicable to only some market participants but not others, and subsidies for some market participants.

We would be happy to assist the subcommittee in any way possible.

That completes my statement. I appreciate the opportunity to present these comments and am available to answer any questions.



**SJR 118 Joint Subcommittee Studying Restructuring And Potential  
Changes In The Electric Utility Industry**

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**Meeting of July 2, 1996**

**Comments of R. Daniel Carson, Jr., American Electric Power Co.**

Good morning, and thank you for the opportunity to participate in the subcommittee's meeting today and explain American Electric Power Company's position on retail competition.

I will first explain that AEP is an investor-owned, multi-state holding company, which owns seven electric utility subsidiaries, one of which is Appalachian Power Company. In Virginia, Appalachian serves customers in the area which can be generally described as Lynchburg and Pittsylvania County, west.

Given the changes which have already occurred -- and are expected -- within the industry, AEP and its subsidiaries were realigned organizationally to produce a single company organization effective January 1 of this year. Legally and financially, the operating subsidiaries continue to exist, but the organization which you and our customers will see from this point forward is AEP, which maintains its state office for

Virginia and Tennessee in Roanoke. We believe very strongly that our new single company identity and organizational structure will serve us well in terms of efficiency of operation and comparatively low rates for our customers.

AEP has taken a position in support of retail competition and customer choice, and is working deliberately in pursuit of an industry structure which would meet certain parameters and goals which we believe are necessary and which I will describe. We don't have all the answers yet, but we believe that retail competition is inevitable and that we have learned a great deal from the revolutionary changes of 1992 which introduced competition and its benefits to wholesale suppliers and customers (including the cooperatives and municipal utilities you will hear from later this morning). The changes which this subcommittee is studying are complex and have significant economic implications for utilities and their customers. We would submit, however, that competition is feasible technically – it is in fact here for the wholesale sector of our business – and is a goal which should be pursued carefully, yet aggressively.

When we speak today of competition in the electric utility industry, we're speaking about the generation function, or the production of energy. The transmission and distribution of that energy should, as we see it today, continue to be regulated, monopoly functions. A competitive market for generation has been evolving for a number of years, and in fact for quite a few years prior to enactment of the Energy Policy Act of 1992.

The Energy Policy Act effectuated a competitive market for wholesale customers and suppliers ... a wholesale customer being one who buys power for resale. The Act empowered the Federal Energy Regulatory Commission to require utilities to open their transmission systems for use by these buyers and sellers at regulated, cost-based rates.

Our experience with wholesale competition has been enlightening for purposes of considering a workable structure for competition at the retail level, yet has not been altogether positive here in Virginia. I, for one, did not imagine that we would lose sales to our wholesale customers by being undercut on price by another utility, but it happened. We have since gained sales as well in this market – which accounts for probably 10% of our business – and we have learned some valuable lessons: on the high importance of price to the customer, and on the need to be very active in ensuring that the public policy results for retail competition are as fair and equitable as possible for both customers and suppliers.

While the Energy Policy Act created a structure for competition at the wholesale level, it left the question of retail competition to the States, and by our count initiatives of one form or another, including studies, are underway in 46 states.

Though a hands-off approach by Congress was implicit in its actions in 1992, some of its leaders are today in the early stages of formally considering legislation which would provide for retail customer choice. AEP is an advocate of allowing the individual state initiatives to move forward independent of any federal action at this time. An exception requiring federal attention in connection with retail customer choice will be the issue of assuring equal interstate access to markets, or reciprocity by the states.

AEP supports retail customer choice – in generation services – in a structure which provides that (1) the benefits of competition, and choice, are available to all customers at the same time, and (2) the playing field among suppliers of such services is a level one. The commitment to a level playing field is necessary because of the tax and financing differences and preferences which exist among investor-owned, government-owned, and government-subsidized providers of generation today.

AEP believes that a goal of fair and efficient competition, with customer access to a large body of generating companies and resources, and with the substantial coordination and planning that will be required for maintaining reliable operations, can best be accomplished by the creation of Independent System Operators (or ISOs). Conceptually, ISOs would assume independent operating control, but not ownership, of the transmission systems of utilities within very large regions of the country – encompassing multiple states and multiple systems. Pricing for the transmission of energy within the region from generators to customers would be simplified and cost-based. An ISO could thereby, to a large degree, define the boundaries of a regional market for generation services.

AEP is today working with several other utilities which have joined together on a strictly voluntary basis in attempting to form an IS, establishing objectives and negotiating to resolve the many issues and questions which surround it.

To complement the IS, we further envision the establishment of a Regional Power Exchange (or RPX) which would be independent of all buyers and sellers of energy, and into which generators would offer their supplies and buyers would commit their purchase needs on an hourly basis. The RPX would facilitate a spot market for generation with price determined by supply and demand. It would also facilitate bilateral transactions -- or transactions between individual buyers and sellers -- which could be expected to be numerous. Small retail customers -- commercial and residential -- could be served by local distribution companies or marketers which would purchase generation potentially from a mix of sources including the spot market and individual generators.

AEP believes that the ISO, and RPX solutions are both technically feasible and desirable for achieving the goals of a fair and workable competitive market and the opportunity for participation in such a market by customers of all sizes. Consensus and much work would serve to make these solutions realities.

Understandably, there are concerns about the price and quality of service in a competitive regime, and in this regard it is worthwhile to examine the experiences of other industries where similar transitions have been made. I am making available to the subcommittee a paper by Dr. Jerry Ellig of George Mason University which speaks to the price benefits derived by customers in connection with the introduction of competition and regulatory reform in the natural gas, telecommunications, airline, railroad, and trucking industries. Among other things, Dr. Ellig notes that price decreases were generally accompanied by improvements in service reliability and the expansion of services available to customers.

As with other industries regulated since their origin, cross-subsidization of some classes of customers by others exists in the pricing of electric utility services. In our case, the Virginia Commission has taken an enlightened position on cost allocation, attempting to correct major cross-subsidies, though they continue to exist



with smaller customers as the beneficiaries. I mention this because cross-subsidization affects prices and the mechanism for subsidies of this sort can be expected to disappear with the advent of a competitive market. We advocate that as much progress as possible toward the elimination of such subsidies be made as the transition to competition takes place.

The final issue that I will touch on is that of stranded investment (or stranded costs), which among other things may include investments in generating facilities whose book value exceeds market value in a competitive regime, or in generating facilities which were built for the sole purpose of serving the now-departing customer. Stranded investment is one of the most difficult issues to be involved with the deregulation of the generation function, and we believe that it is an issue best dealt with by the state public service commissions. A number of mechanisms,

including charges for access to a competitive market, for recovery of stranded investment or costs, have been suggested. The difficulty lies, however, in the determination and application of stranded cost remedies, because what is considered stranded today may be a short term condition (market price and market value are difficult to predict), and significant differentials in the costs being recovered by individual utilities could create competitive advantages, and disadvantages, in gaining or retaining customers.

That concludes my remarks. Thank you for this opportunity to address the subcommittee. AEP looks forward to working with you in any way that you would consider helpful.

Remarks of  
August Wallmeyer  
Executive Director, Virginia Independent Power Producers, Inc.  
Before the Joint Legislative Subcommittee Studying Industry  
Restructuring

July 2, 1996  
Richmond, VA

### Introduction of VIPP

Independent power generators have invested more than \$3.7 billion in generating facilities in Virginia. Independents have added about 60 percent of new generating capacity in Virginia in the last ten years. Independents generate at wholesale and sell electricity to public utilities such as Virginia Power.

Independent generators produce about 14 percent of the electricity sold by Virginia Power to its customers—about 10 billion kilowatt-hours yearly.

VIPP's members and other independents are precluded by existing Virginia law from selling electricity at retail.

VIPP members do sell steam and other thermal products to Virginia industries such as Hoechst Celanese, DuPont, Sonoco, Burlington Industries, Hercules, Allied Signal, Aqualon and the Lane Company, among others. We have very good relationships with Virginia industries, who have used inexpensive steam to become and remain more competitive in world markets. Many of our thermal customers have expanded their manufacturing operations in Virginia.

### Movement Toward Deregulation

There appears to be an unstoppable movement at the federal level to deregulate the electricity industry and to provide all electricity

customers with competitive choices. Two weeks ago, I was in Washington and spoke with Congressman Tom Bliley, Chairman of the House Commerce Committee. According to Congressman Bliley, Washington has now moved beyond the question of whether to deregulate the industry. That question has been answered 'yes.' Now, the questions are 'when' and 'how.' Congressman Bliley said, "As Republicans, how can we justify continuing the [electricity] monopoly? We say we're for the free market."

While in Washington, I was also fortunate to speak with US Energy Secretary Hazel O'Leary, who said "Orderly transition [to a freely competitive market] does not mean [a] slow [transition]."

Thus, two national figures at the vortex of the deregulation debate, one a ranking Republican chairman, the other a Democratic Cabinet Member, agreed that deregulation will happen, sooner rather than later.

### Virginia Movement Toward Deregulation

As you well know, Virginia, too, is grappling with the many complex issues involved.

A host of utility legislation was passed by the 1996 Virginia legislature, most of it sought by the public utilities and most of it opposed by virtually all utility customers.

The Virginia State Corporation Commission is engaged in a comprehensive investigation of the issues. The Staff report is due out in about two weeks. Afterwards, expectation is the SCC will convene a formal hearing and investigation later this Summer or Fall.

### Complexities

Deregulation is a very complex undertaking. This likely will be the largest, most comprehensive deregulation ever undertaken in history. Billions of dollars, hundreds of millions of customers' bills, and many thousands of jobs are involved.

The effects are already being felt. Here in Virginia, one utility's workforce has been reduced nearly 25 percent, largely, I believe, as a direct response to the threat of emerging competition.

Electric utilities everywhere are struggling to cope with the coming changes, as are independent energy producers.

In light of all this, it is reasonable to ask "why bother? Why make such a fundamental, unsettling change?"

The answer, I believe, is that an unregulated market will provide more tangible, financial benefits-- more pocketbook savings--for the citizens of Virginia and the US than has the existing system of utility regulation.

I think we must believe and now admit that the system of utility regulation has proven to be an inadequate substitute for free market forces. I say this with no ill will whatsoever for the utility regulators here in Virginia. The SCC here is composed of extremely bright, extremely capable, extremely well-intentioned persons. The failing is not theirs, the people at the SCC--the failing is the system of regulation itself.

For proof, I suggest you ask the customers what they think.

### Customers Want Competition

Customers are clamoring for competition, precisely because they believe that being able to deal and negotiate with multiple, competing suppliers will reduce their prices.

Contrary to popular belief here--at least during the legislative session--the customers who are demanding the system be changed are not only the largest, most sophisticated customers. Medium-sized customers, and very small customers, residential users, are in favor of change. And suppliers are very interested in selling to both medium and smaller residential customers.

I'd like to cite you just a few examples.

First, recently I received a very interesting, unsolicited telephone call from the Council of Independent Colleges in Virginia.

The Council wanted to know the current status of the deregulation debate. And the Council wanted to know if the independent generators would come to speak to the Chief Financial Officers of the colleges, along with several utility companies. The Council wants to start thinking about shopping for the power needs of its members, because they realize there is a potential to save significant sums of money, perhaps in the millions of dollars per year.

This group of customers has a history of similar experiences, as they have used competition in the telephone industry to lower their costs significantly, and as they have used competition in the insurance industry to lower their costs significantly.

Residential customers, likewise, are demonstrating a healthy appetite for competition, and contrary to some popular beliefs, suppliers are very interested in serving residential customers.

The City of Peterboro, New Hampshire, recently tested the marketplace, by freeing a group of 17,000 customers to competition. Of the 17,000, 15,000 are residential customers. Thirty companies competed head-to-head for the residential business, offering lower prices, consumer rebates and other sales incentives. The winning bid, 2.29 cents per kilowatt-hour, plus distribution and transmission charges, will save residential consumers between 25 and 30 percent. There are other, similar examples around the Nation.

So, I'd like to put to rest the incorrect notion that the deregulation debate is all about the largest industrial customers trying to save money, and that no one cares about the residential customers.

That notion is incorrect, as demonstrated by the numbers: In Virginia Power's service territory, there are 1.9 million electricity customers. 1.7 million of them are residential customers. True, residential accounts are typically smaller than industrial accounts. But there are so very many more residential accounts, a tremendous volume of potential business.

Power marketers and brokers are eager to aggregate and accumulate residential accounts, and to serve them.

## Conclusion

Customers, large and small, are demanding competition, and it appears to be coming--sooner rather than later.

Much is at stake--restructuring has to be done carefully, and it has to be done right. The legislature's job should be to help shape a market that operates fairly and freely, without artificial constraints, without any preferences.

Doing it wrong, stopping short of full, actual, viable competition, will have tremendously negative consequences for economic development in Virginia. If large customers don't get true choice and competition in Virginia, they will go somewhere else to get it. If smaller customers don't get true competition, they will be financially penalized.

I'll be happy to respond to your questions.

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**Testimony of**

**Greg White  
Vice President**

**Virginia, Maryland and Delaware Association of Electric Cooperatives**

**before the**

**Joint Legislative Study Committee on Competition and Restructuring  
within the  
Electric Utility Industry**

**July 2, 1996**

**General Assembly Building  
Richmond, Virginia**



fr. Chairman, members of the joint committee, I am Greg White, Vice President of the Virginia, Maryland and Delaware Association of Electric Cooperatives representing 12 cooperatives located throughout Virginia. Virginia's electric cooperatives appreciate the opportunity to share our views with you on competition and the possible deregulation of the electric utility industry. Collectively, Virginia's electric cooperatives are owned by over 300,000 primary member-consumers, and provide over 750,000 Virginians with reliable, affordable electricity. We serve all classes of consumers--industrial, commercial and residential--in 64 of the state's 95 counties. Approximately 98% of those meters are for residential and small business (under 1000 KVA) consumers, located in the less densely populated areas of the Commonwealth.

Rural electric distribution cooperatives are consumer-owned, not-for-profit, state-chartered electric utilities regulated by the State Corporation Commission. Old Dominion Electric Cooperative is a generation and transmission cooperative which provides power to 10 distribution cooperatives in Virginia, as well as one in Maryland and one in Delaware. Old Dominion owns 11.6% of the North Anna Nuclear Power Station in Louisa County, Virginia and 50% of the Clover Power Plant in Halifax County, Virginia. Old Dominion is regulated by the Federal Energy Regulatory Commission.

These two generating stations in which it has an ownership interest provide about 55 percent of the energy needs of Old Dominion's 12 member cooperatives. Old Dominion purchases the balance of its members' needs from other utilities, including Virginia Power and AEP-Virginia.

The electric utility industry in the United States increasingly is being motivated and influenced by a new force -- competition, either real or assumed to be imminent. Federal legislation, most notably the Energy Policy Act of 1992, created competition at a wholesale level several years ago. In fact, Old Dominion was one of the first utilities in the nation to take advantage of wholesale competition when it began purchasing 150 megawatts of electricity in 1995 from Public Service Electric & Gas of New Jersey, displacing this purchase for reasons of economics from traditional supplier Delmarva Power. Yet let's remember that wholesale competition is decidedly NOT the same as retail competition would be, especially as it could relate to the residential consumer. Wholesale competition has very little "down side" for anyone, save the utility that isn't able to produce competitively priced power. Retail competition, on the other hand, could have a MAJOR down side to thousands, perhaps millions, of residential consumers and small businesses. We must be certain that structural changes we make protect the small consumer - and remember over 98% of our electricity consumers are small businesses and residences. The cooperatives, however, do serve industrial consumers (> 1000 KVA) as well. Although, they represent only 2 % of our consumer base, these members represent 22% of our energy sales. Any drastic departure by industrial consumer-members from our system (without substantial compensation for stranded costs, including future revenue loss) would have a significant adverse effect on our remaining residential and small business consumers. Therefore, we need to be deliberate in studying the issue, allow members of the public ample opportunity to voice their views, and not assume that the priorities of other states should necessarily be our priorities. Surely, not even large electricity users want to benefit at the expense of small users.

Very recently, the Federal Energy Regulatory Commission's Orders 888 and 889 have called for virtually unrestricted wholesale wheeling. The Energy Policy Act of 1992 and the resulting FERC order, however, do not address retail access. Jurisdiction of retail consumers have traditionally been under the purview of state commissions. Now there additionally are calls by large users of electricity for government to take swift action to promote more competition within the electric utility industry and allow retail consumers to choose their power supplier. Obviously, their goal is to lower their purchase price for electricity. While that is a logical and laudable aim, the means to achieve that result must be very carefully weighed to review the consequences for ALL stakeholders -- not just large power consumers. Questions and debate on this involve several issues, including: options available for industry deregulation, "retail wheeling," stranded investment, impact on small business or residential consumers, a utility's obligation to serve its consumers, territorial integrity, and timing. What is in the "public interest" and what changes, if any, are needed for us to fulfill our ultimate goal of providing safe, reliable and reasonably priced power to our consumers? These fundamental issues and questions are what bring us all here today.

The cooperatives believe that these issues are important and worthy of study. We urge, however, that the subject at hand be viewed in perspective and on a regional basis. What is good or immediately necessary in California or New England may--or may not--be in the best interest of the citizens of the Commonwealth at this time, or perhaps at all. Our primary agenda--indeed our ONLY agenda--should be to improve electric service overall to the citizens of Virginia. Period.

We believe that it is particularly important to listen to the views of the residential consumer as restructuring moves forward. The cooperatives conducted focus groups with our members last year to learn how they felt about the cooperatives' service and the possibility of competition in the electric utility industry. The results of these sessions indicated that individual consumers are casting a wary eye to electricity deregulation, based on their experience with telephone deregulation and with airline deregulation. It is our recommendation that this joint committee include as a part of its process a method to hear from these individual consumers. We would be pleased to share the results of our 15 focus groups, along with the methodology we followed, as a possible blueprint for this committee to follow in seeking out and ascertaining the views of Virginia's citizens on this important issue.

Let's not forget that, currently and for the foreseeable future, Virginia enjoys power prices that are competitive both on a regional and indeed on a national basis. We thankfully do not need to take any sudden or drastic actions at this time. It is the cooperatives' position that Virginia should take a measured, methodical approach to integrating the benefits of competition into the electric utility business, to ensure that all consumers in the Commonwealth enjoy these benefits. Virginia should allow the competitive wholesale market to continue to develop, while providing for innovative rate structures which will enable electric utilities in the state to be more competitive where there are alternative choices such as self-generation.

Once the wholesale market has fully matured and all parties have had the opportunity to assess the benefits of FERC Orders 888 and 889, the commission, the General Assembly, the utilities,

and consumer representatives should work—deliberately, determinedly, and above all together—to determine if there are any additional steps which need to be taken in Virginia. If there are changes needed at the retail level, then those changes should be done in a way that provides a smooth transition, protecting the interest of all stakeholders. We must also continuously evaluate any additional actions which may be needed to promote competition in the industry and ensure the continued flow of safe, reliable and reasonably priced power to Virginia's businesses and citizens.

The cooperative's mission, regardless of the business environment, has always been to deliver safe, reliable and reasonably priced power to our consumers, all our consumers. In fact, the ultimate barometer of whether we're doing our job right has always been in answering this question: how well are we serving the person at the end of the line? This has been our core mission from the inception of electric cooperatives 60 years ago, when the cooperatives responded to rural Virginia's need for electric service. We still believe our core mission is appropriate, not only in today's changing times, but also that it's appropriate for all utilities. For in serving all our consumers well, electric utilities of all types can meet their underlying goal: for investor-owned utilities, to earn a profit for their stockholders; for electric cooperatives, to provide the lowest priced power to our consumer-members, who of course are also our owners.

From our perspective, it's never taken competition or the threat of it to spur us to control costs wherever possible; after all, that's part of fulfilling our goal for our member-owners. In addition, many of Virginia's cooperatives are restructuring their already-lean workforce and creating new

and more efficient ways to deliver electric and other services. The cooperatives; however, do not believe that the goal of this committee, the commission or our industry should be competition and deregulation for the sake of change or ideology. We believe our mission applies to all parties present here today. If, after analysis of hard data and careful study of consequences, expanding competition or reducing regulation are eventually seen as the best means to improve electric service to Virginians, then cooperatives will warmly embrace such measures.

The cooperatives believe that several core principles should be kept in mind when examining options promoting competition and deregulation of the electric industry. These principles have been adopted by the nation's 1,000 electric cooperatives, and apply to your task as outlined in Senate Joint Resolution 118 and by the investigative order issued by the State Corporation Commission last Fall. These principles are:

- Any changes must be thoughtfully considered and in the public interest of all stakeholders after careful consideration of reliable data - not simply changing for change's sake or for reasons of ideology.
- All electric consumers should have access to safe, reliable electric service at a reasonable cost.
- All classes of electric consumers should be treated equally, not just those with special interests or influence.
- All energy providers should be subject to the same standards.
- Safety and reliability of electric service must be protected.
- Exclusive delivery service areas should be maintained to avoid expensive duplication of facilities and equipment.

- The financial security of all-requirement contracts must be protected to avoid catastrophic repercussions in the financial markets.
- Stranded costs should be borne by those who choose to leave their current supplier, not by the remaining consumers (probably small business and residential).
- We oppose any form of "retail wheeling" which is detrimental to the best interests of electric cooperative consumers.

The cooperatives further believe that the federal government should allow the state commissions the flexibility to take actions regarding retail consumers. This has historically been in the purview of state regulators, as recognized in the Energy Policy Act of 1992. Many of the issues being discussed here today have different regional components which should be considered accordingly.

In closing, let's remember that everyone needs and relies on electricity. Many say—not inappropriately—that access to reliable, reasonably priced power is a moral obligation, a human need as basic as food, clothing and shelter. We cannot and should not forget that many Virginians rely on our industry not just for life's luxuries, but for life itself. Let's not forget those on fixed incomes, or those who depend on electrically powered medical equipment, or those who live in areas which have traditionally been viewed as not profitable to serve. In short, let's not forget the guy at the end of the line. Many of these men and women are cooperative consumers and will be adversely impacted if the federal government, this committee or the commission act in haste, or without full knowledge of the consequences of their decisions.

Unlike our counterparts in California or the Northeast, Virginia has the luxury of time, to study all our options, gather and analyze data, learn from others and take the "go slow" approach. To this luxury of time, let us be sure to add the gift of wisdom for all involved in this process: to take great pains to carefully consider the needs of ALL classes of customers, to make certain that the results of our efforts is better service or lower prices for the electricity so vital to Virginia's present and future. We've got a good situation currently. Let's make sure that we only make it better for all, and not simply bow to the narrow desires of a powerful few.

Virginia's electric cooperatives appreciate the invitation to speak to you today and welcome the opportunity to work with the committee as you study these very important issues. I would be happy to answer any questions you have at this time.



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Good morning, my name is Bill Stephens and I represent the Commission's Division of Energy Regulation. We are here today to provide an overview and summary of the July 31, 1996, staff report on restructuring of the electric utility industry. Mr. Richard Williams, Director of our Division of Economics and Finance Division, will provide that summary. I will offer some brief introductory remarks.

Let me begin by noting that the 400-page document and Appendices filed on July 31 of this year cover a wide array of topics and were the work of a number of our Senior Staff members. As a result, some of those Staff members are here today to assist in responding to specific questions you may have relative to the report. I would like to take a moment to introduce those folks. First, as I have already mentioned Richard Williams is the Director of our Division

of Economics and Finance, James C. Dimitri is Senior Counsel in our Office of General Counsel, Cody Walker is the Deputy Director of the Division of Energy Regulation, and Tom Lamm is an Assistant Director also in the Division of Energy Regulation. The package that I have provided you contains the names, titles and phone numbers of these individuals; and I can assure you they stand ready and willing to provide you with any assistance we can offer.

As I mentioned, the staff report was filed on July 31, 1996. Throughout last week comments on that report were filed by a number of individuals and organizations. As can be expected, there is some agreement with the Staff's analysis and some disagreement, with the most notable disagreement being the speed at which Virginia should embrace restructuring. As you may recall, the Staff

recommended a cautious approach. While the Staff has reviewed most of those comments, we have not yet had an opportunity to conduct a detailed analysis since they have been in hand for about a week. Even so, as can be expected, we already have concerns, some serious, with statements of fact and conclusions reached in several of those documents. I can tell you we do not know with certainty what the impact of competition would be in Virginia. We have stated in our report and Mr. Williams will reiterate we are concerned that a rate levelization may occur and in some instances Virginia consumers could suffer. Some of the comments to the staff report indicate that this is unlikely while others acknowledge that it is a distinct possibility. We have reviewed the rationale and presentation of facts by those that believe that rates will only come down and we are

uncomfortable with some of the opinions and facts used to support those conclusions. In any event, we will continue our analysis and will offer any input you might require relative to the staff report or to the comments filed on the staff report.

Now, let me next take a moment to remind you of our upcoming Electricity Forum sponsored by the SCC at the Boar's Head Inn in Charlottesville. That conference will be held on November 13-15 and will cover an array of topics including.

- Advantages/Disadvantages of Competition
- Transmission Issues
- Models for Retail Competition
- Alternatives for Retail Competition, and
- A session on the Best Approach for Virginia.

We expect this to be a lively and informative dialogue and we encourage you to join us in Charlottesville next month.

Finally, I thought it might be helpful to give you an update of what other states, particularly our neighbors, are up to. I will refer you to the color handouts that have been provided. These are essentially status reports; they were extracted from a September 18, 1996, issue of Regulatory Focus put together by Regulator Research Associates of New Jersey. We have super-imposed these status reports onto a rate comparison document. If you will bear with me for a moment, I think you will find this information useful.

First, 49 states are listed in order of increasing average electricity rates. For example, the first page shows that

Idaho has the cheapest overall average rates with New Hampshire having the most expensive; Virginia ranks 20th.

Likewise, the second page shows that for residentials Tennessee has the lowest rates with New York having the highest. Virginia ranks 27th. Turning to the next page, for commercial customers Idaho is again the cheapest and New York maintains the highest honors. Virginia ranks 12th. Finally, for the industrials Idaho is again the cheapest with Hawaii being the most expensive. Here Virginia ranks 15th.

Now if you will turn back to page 1, let us look at the color coding key at the bottom of the first page. Tier 1 or the red states have adopted restructuring plans. They include California (No. 43) and Rhode Island (No. 44). The Tier 2 states have ordered their utilities to file restructuring plans or legislation has been enacted. Those include No.

36-Michigan; No. 40-Vermont; No. 42-Massachusetts; No. 47-New York; and No. 49-New Hampshire. The green code represents states where a legislative investigation is underway that is likely to lead to a restructuring plan. The light blue states including Virginia have studies underway or have legislation pending. These states are still addressing the many issues associated with restructuring prior to leaping forward. Finally the dark blue states have no substantial activities underway. This information is also presented on the map at the end of your handout. As you can tell by the key, the orange states (again Rhode Island and California) have adopted restructuring plans. The rose states in the northeast have substantial restructuring activities underway. The green states have Commission or legislative actions underway, the yellow states (including



Virginia) have a fact finding workshop or study underway and the blue states primarily in the southeast have no substantial activity underway. So in summary, the rose, orange and green states are the most proactive and with few exceptions they represent the 13 most expensive states depicted on the earlier charts.

This is to be expected since those states are facing in some cases enormous pressure because of their very high cost of electricity. Since we want to provide our consumers with the lowest cost of electricity with acceptable levels of reliability, we are certainly interested in the actions taken by these states and we are currently reviewing their initiatives, including their retail wheeling experiments to determine what future activities may be appropriate for Virginia.

With those comments, I will respond to any questions or comments you might have and I would like to reintroduce Richard Williams who will proceed with a summary of our staff report.

## Average Rates All Customers

1 Idaho	\$ 0.0395	26 Nevada	\$ 0.0632
2 Wyoming	\$ 0.0400	27 Kansas	\$ 0.0635
3 Tennessee	\$ 0.0433	28 Mississippi	\$ 0.0636
4 Kentucky	\$ 0.0446	29 Arkansas	\$ 0.0660
5 Montana	\$ 0.0491	30 Delaware	\$ 0.0662
6 Oregon	\$ 0.0497	31 New Mexico	\$ 0.0663
7 Oklahoma	\$ 0.0510	32 Ohio	\$ 0.0675
8 Utah	\$ 0.0512	33 Florida	\$ 0.0689
9 Indiana	\$ 0.0526	34 Maryland	\$ 0.0700
10 West Virginia	\$ 0.0529	35 District of Columbia	\$ 0.0712
11 Minnesota	\$ 0.0532	36 Michigan	\$ 0.0740
12 Wisconsin	\$ 0.0544	37 Pennsylvania	\$ 0.0769
13 South Carolina	\$ 0.0547	38 Illinois	\$ 0.0782
14 Washington	\$ 0.0549	39 Arizona	\$ 0.0824
15 Louisiana	\$ 0.0554	40 Vermont	\$ 0.0939
16 Alabama	\$ 0.0559	41 Maine	\$ 0.0957
17 North Dakota	\$ 0.0560	42 Massachusetts	\$ 0.1033
18 Colorado	\$ 0.0568	43 California	\$ 0.1044
19 Iowa	\$ 0.0593	44 Rhode Island	\$ 0.1051
20 Virginia	\$ 0.0606	45 New Jersey	\$ 0.1062
21 North Carolina	\$ 0.0608	46 Connecticut	\$ 0.1071
22 Texas	\$ 0.0617	47 New York	\$ 0.1082
23 South Dakota	\$ 0.0624	48 Hawaii	\$ 0.1106
24 Georgia	\$ 0.0629	49 New Hampshire	\$ 0.1170
25 Missouri	\$ 0.0632		

**Tier I** Statewide restructuring plans have been adopted.

**Tier II** Companies have been ordered to file restructuring plans or general legislation requiring restructuring has been enacted.

**Tier III A** Commission or legislative investigation is underway that is likely to lead directly to the adoption of a restructuring plan.

**Tier IV** An informational or fact-finding workshop or study is underway, or legislation is pending.

**Tier V** No substantial activity.

**Note:** September 18, 1996, Regulatory Focus, Regulatory Research Associates, Inc. used as source for restructuring information.

## Average Rates Residentials

1 Tennessee	\$ 0.0495	26 Kansas	\$ 0.0770
2 Kentucky	\$ 0.0513	27 Virginia	\$ 0.0730
3 Idaho	\$ 0.0526	28 Florida	\$ 0.0782
4 Oregon	\$ 0.0561	29 Texas	\$ 0.0789
5 Washington	\$ 0.0568	30 Maryland	\$ 0.0843
6 Montana	\$ 0.0535	31 Arkansas	\$ 0.0856
7 Wyoming	\$ 0.0592	32 New Mexico	\$ 0.0857
8 North Dakota	\$ 0.0607	33 Iowa	\$ 0.0862
9 West Virginia	\$ 0.0646	34 Michigan	\$ 0.0878
10 Oklahoma	\$ 0.0658	35 Ohio	\$ 0.0882
11 Indiana	\$ 0.0670	36 Delaware	\$ 0.0905
12 Alabama	\$ 0.0693	37 Pennsylvania	\$ 0.0969
13 Wisconsin	\$ 0.0697	38 Arizona	\$ 0.0981
14 Nevada	\$ 0.0699	39 Illinois	\$ 0.1058
15 Utah	\$ 0.0700	40 Vermont	\$ 0.1061
16 Louisiana	\$ 0.0715	41 Rhode Island	\$ 0.1161
17 Missouri	\$ 0.0744	42 Massachusetts	\$ 0.1169
18 Minnesota	\$ 0.0745	43 New Jersey	\$ 0.1200
19 South Carolina	\$ 0.0747	44 Connecticut	\$ 0.1203
20 Mississippi	\$ 0.0750	45 California	\$ 0.1224
21 South Dakota	\$ 0.0752	46 Maine	\$ 0.1261
22 District of Columbia	\$ 0.0752	47 Hawaii	\$ 0.1311
23 Colorado	\$ 0.0752	48 New Hampshire	\$ 0.1349
24 North Carolina	\$ 0.0765	49 New York	\$ 0.1433
25 Georgia	\$ 0.0756		

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## Average Rates Commercials

1 Idaho	\$ 0.0430	26 Arkansas	\$ 0.0685
2 Wyoming	\$ 0.0480	27 Iowa	\$ 0.0687
3 Kentucky	\$ 0.0484	28 Delaware	\$ 0.0687
4 Tennessee	\$ 0.0499	29 Maryland	\$ 0.0690
5 Oregon	\$ 0.0516	30 Mississippi	\$ 0.0703
6 Montana	\$ 0.0519	31 District of Columbi	\$ 0.0715
7 Oklahoma	\$ 0.0535	32 Georgia	\$ 0.0728
8 Wisconsin	\$ 0.0580	33 Ohio	\$ 0.0775
9 Utah	\$ 0.0590	34 Illinois	\$ 0.0789
10 West Virginia	\$ 0.0584	35 New Mexico	\$ 0.0789
11 Indiana	\$ 0.0536	36 Michigan	\$ 0.0824
12 Virginia	\$ 0.0599	37 Colorado	\$ 0.0836
13 North Carolina	\$ 0.0610	38 Pennsylvania	\$ 0.0841
14 South Carolina	\$ 0.0621	39 Arizona	\$ 0.0881
15 Florida	\$ 0.0623	40 Vermont	\$ 0.0977
16 Missouri	\$ 0.0627	41 Massachusetts	\$ 0.0998
17 North Dakota	\$ 0.0627	42 Rhode Island	\$ 0.1022
18 Minnesota	\$ 0.0632	43 New Jersey	\$ 0.1022
19 Kansas	\$ 0.0643	44 Maine	\$ 0.1031
20 South Dakota	\$ 0.0655	45 Connecticut	\$ 0.1039
21 Washington	\$ 0.0655	46 California	\$ 0.1092
22 Texas	\$ 0.0662	47 New Hampshire	\$ 0.1131
23 Alabama	\$ 0.0668	48 Hawaii	\$ 0.1195
24 Nevada	\$ 0.0676	49 New York	\$ 0.1221
25 Louisiana	\$ 0.0680		

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Tier V No substantial activity.

**Note:** September 18, 1996, Regulatory Focus, Regulatory Research Associates, Inc. used as source for restructuring information.

## Average Rates Industrials

1 Idaho	\$ 0.0277	26 Colorado	\$ 0.0458
2 Wyoming	\$ 0.0328	27 South Dakota	\$ 0.0461
3 Kentucky	\$ 0.0345	28 Mississippi	\$ 0.0466
4 Tennessee	\$ 0.0348	29 North Carolina	\$ 0.0468
5 Utah	\$ 0.0365	30 Missouri	\$ 0.0469
6 Oklahoma	\$ 0.0369	31 Kansas	\$ 0.0474
7 Oregon	\$ 0.0380	32 Florida	\$ 0.0481
8 Iowa	\$ 0.0390	33 Ohio	\$ 0.0488
9 Wisconsin	\$ 0.0391	34 Arkansas	\$ 0.0510
10 Louisiana	\$ 0.0391	35 Michigan	\$ 0.0522
11 Texas	\$ 0.0393	36 Illinois	\$ 0.0546
12 Montana	\$ 0.0400	37 Nevada	\$ 0.0579
13 West Virginia	\$ 0.0403	38 Pennsylvania	\$ 0.0590
14 Alabama	\$ 0.0406	39 Arizona	\$ 0.0603
15 Virginia	\$ 0.0408	40 Maine	\$ 0.0651
16 Indiana	\$ 0.0409	41 Vermont	\$ 0.0670
17 Maryland	\$ 0.0412	42 California	\$ 0.0732
18 South Carolina	\$ 0.0417	43 New York	\$ 0.0773
19 New Mexico	\$ 0.0422	44 New Jersey	\$ 0.0819
20 Minnesota	\$ 0.0425	45 Connecticut	\$ 0.0829
21 District of Columbi	\$ 0.0436	46 Massachusetts	\$ 0.0848
22 Washington	\$ 0.0436	47 New Hampshire	\$ 0.0879
23 Delaware	\$ 0.0441	48 Rhode Island	\$ 0.0898
24 North Dakota	\$ 0.0443	49 Hawaii	\$ 0.0902
25 Georgia	\$ 0.0450		

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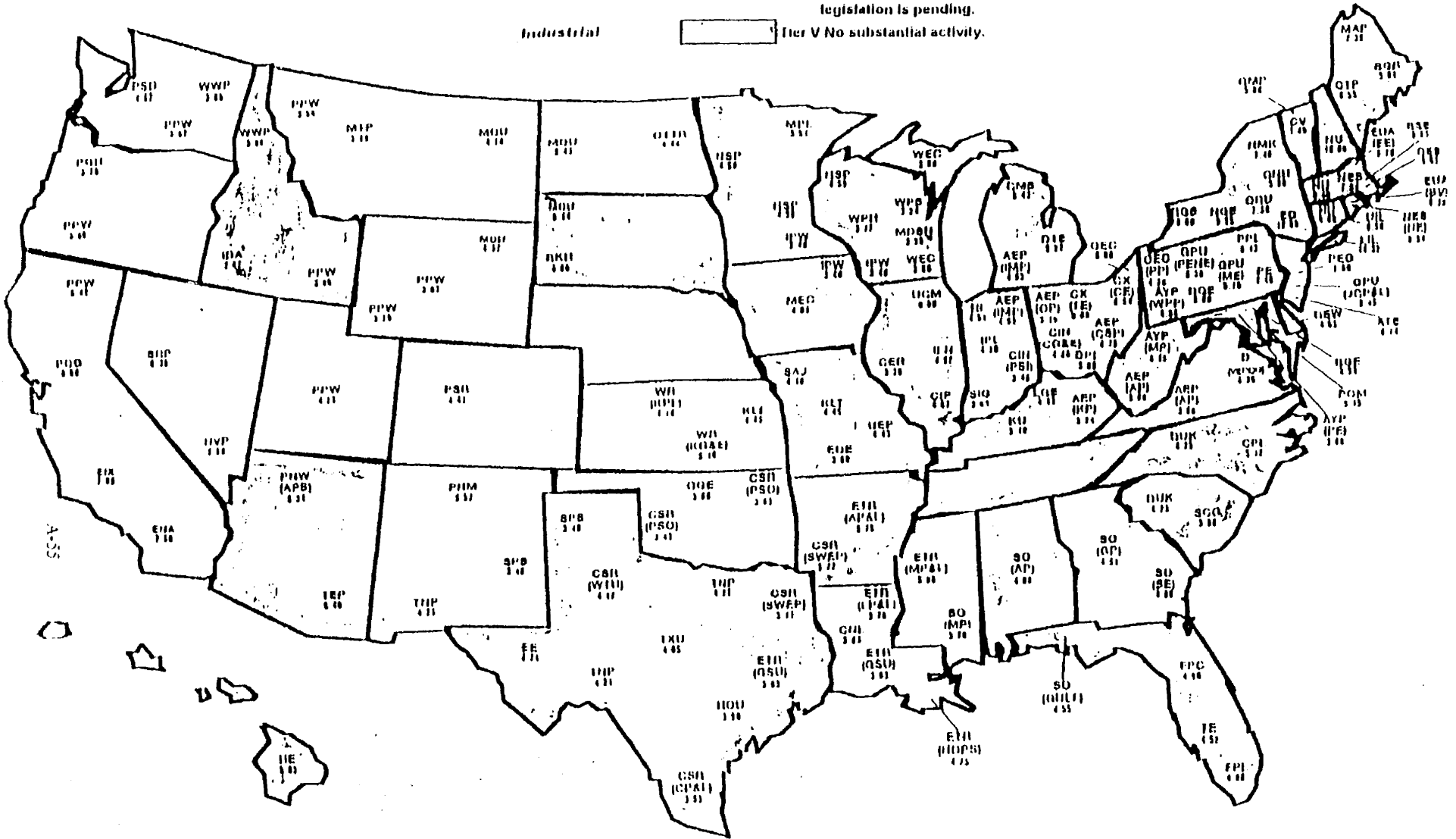
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*Industrial*



**SUMMARY OF STAFF RESTRUCTURING REPORT****GENERAL ASSEMBLY JOINT SUBCOMMITTEE****OCTOBER 2, 1996**

In preparing its report on the restructuring of the electric industry the Commission Staff had a goal of providing an objective view of the possibilities and challenges inherent in a competitive electricity market. We believe that, when feasible, competition governs markets more effectively than regulation.

For instance, our Commission and the General Assembly have allowed Virginia to be a leader among states in introducing competition in the telecommunications industry. But the electric utility business is quite different from the telephone utility business. The focus of the electric restructuring debate should not be conceptual arguments about free markets versus regulation, but practical discussions of whether and how competition will benefit our electric system.

During the Staff analysis of restructuring issues, the protection of the public interest was our foremost thought. We are concerned about the effect of a restructured electric market upon all customers, large and small, upon investor-owned electric companies and electric cooperatives, upon economic development and other social objectives. Maintaining a wide perspective added levels of complexity to our study. Parties with a more narrowly defined focus are often more certain about the benefits or dangers of restructuring to their particular interest. There are only two entities in Virginia that must view the perplexing issues of restructuring from the broad perspective of the public's interest, the Commission and the General Assembly.

As a first step in our study, we examined why the electric industry has been regulated in the first place. One reason has been the belief that the electric industry is a natural monopoly, whereby a single firm can produce a desired level of output at a lower total cost than two or more firms. In addition, allowing one firm to serve a franchised area prevented the cumbersome and inefficient duplication of facilities, such as several power lines serving a neighborhood. The generation of electricity is no longer considered a monopoly, although most believe that the transmission and distribution of electricity maintain their monopoly characteristics.

The electric industry has unique operational complexities. Electricity cannot be stored effectively, it must be generated at the time it is needed. Customers' usage patterns vary during the day and by season, but the utility must be prepared to meet its customers demand even on the hottest or coldest day of the year. This causes the need for generating capacity that may sit idle for many hours of the year.



Perhaps the main reason the electric industry has been regulated is that electric service is essential for our economic and social well-being. There is a long history of economic regulation, and many activities have been regulated not because they were monopolies but because of their importance to the public.

There is a public need for reliable and efficient electric service that is incomparable to other services and products.

There are social benefits and social costs which must be considered that do not figure into conventional economic analyses.

The public interest is best served by an efficient, reliable, cost-effective and reasonably priced electric system that is environmentally sound. For decades, traditional regulation has been able to provide reliable electric service at stable and reasonable rates. Recently the efficiency and cost-effectiveness of our regulated electric industry have justifiably been questioned.

There are several factors that have added strength to the call for a restructured electric industry. In particular, the basic economic argument that market forces can control an industry more effectively than regulation is hard to debate. Often cited by restructuring proponents are the successes in deregulating other industries in our country and the electric industry in other countries.

In examining other industries that have been deregulated, our belief is that due to the unique characteristics of the electric industry there is no existing blueprint for successful restructuring.

Perhaps the most frequently mentioned comparable industry is natural gas. However, the structure of the natural gas industry was more conducive to deregulation since it was not vertically integrated like the electric industry. In addition, the natural gas industry is not as capital intensive and the product can be stored. The flow of gas in a pipeline can be controlled, unlike electricity flowing through transmission lines according to the laws of physics. In general, the restructuring of the natural gas industry was not as complex or controversial as the electric industry will be.

We also examined the experiences of some foreign countries that have deregulated their electric industries to varying degrees, in particular Britain, Norway, Chile and Argentina. Each of these countries has privatized what was formerly a government-owned electric system. This is a major distinction from the United States' electric system which is already predominately privately owned. In addition, except for Britain, these countries have a great amount of hydroelectric power. Norway, in fact, gets 99% of its energy from hydropower.

Our study of Britain's restructuring experience indicated that British electric prices have fallen at a slightly faster rate than U.S. prices in recent years. Upon further review, however, it appeared that the decline in British electric prices is at least partially attributable to reduced fuel prices that may not be associated with increased competition. There are indications that reforms have increased productivity in the British electric system. However, it is hard to determine if this productivity increase is related to the change from a government-owned system. A common criticism of the British model is that it established only two private sector generators and did not allow significant competition in the power supply market.

The British model provides limited support for electric industry reform in the U.S. Perhaps the most important lesson to be learned from Britain is that rushed or poorly managed attempts at restructuring may have undesirable consequences.

We also analyzed how the average United States electric prices compared with other countries. Our research showed U.S. electric prices to be competitive and stable compared to other countries. In particular, our average industrial prices in 1994 were the fourth lowest of 20 countries studied.

Events here have precipitated increased competition in the wholesale electric market and the current push for retail competition.

Technological innovations in the electric industry have not approached the advances seen in telecommunications. However, improvements in generating equipment have enhanced the opportunity for competition to develop in the electric industry. Economies of scale used to prevail in the generation of electricity making "bigger and better" the approach to building new capacity. Now small, efficient gas-fired units with low-installed costs have reduced the capital requirements for constructing new generation and, as a result, have reduced the barriers to entry in the generation market.

Because of an excess supply of base-load capacity, low-cost power became available in the spot and wholesale markets creating a desire in customers, particularly industrial users, for access to cheaper electricity. Sharp differences in electric prices can be found between regions and within regions of the country. Customers in high-cost areas have been at the forefront of the restructuring debate.

In April of this year the Federal Energy Regulatory Commission (FERC) issued its Order 888 which requires electric utilities to offer transmission services for the transport of wholesale power. Historically FERC's authority has been over the wholesale segment of the electric market, about 10% of the total market. Aspects of Order 888 have increased FERC's influence to a larger portion of the market. There are several state commissions, including ours, that have requested a rehearing of Order 888 in the belief that FERC has exceeded the scope of its statutory authority. Nevertheless, the Order is one more in a series of events that have fueled the restructuring debate.

There is now considerable activity at the state level regarding restructuring and the introduction of competition. The greatest movement has come in those states that have the highest retail rates – particularly California, New York and some New England states. The activities in these states range from experimental retail wheeling programs to plans to begin open access within a definite time frame.

Bills have been introduced in Congress aimed at deregulating the electric industry. Perhaps the most visible proposal has been that of Representative Dan Schaefer named the Electric Consumers' Power to Choose Act of 1996, which calls for retail customer choice by 2000. How this would be accomplished and the potential impacts are not addressed in the proposal.

All of this activity has certainly gained the attention of the electric utilities. They have responded to increased competition by cutting costs, discounting rates, merging, reorganizing and entering new businesses. The increased competition at the wholesale level and threat of competition at the retail level have caused moves toward efficiency in the electric industry that decades of regulation was never able to muster.

In the midst of all of this activity, the Staff issued its report at the end of July and recommended that the Commission and General Assembly be cautious in their decisions concerning the electric industry. We advised that a massive restructuring of the industry was inadvisable at this time. We stated that Virginia appears to have little to gain and much to lose by being a leader in the restructuring movement.

Why do we offer such a seemingly unpopular opinion?

It's not because we think regulation is or has been perfect. Regulation must continue to change.

If retail competition in this industry can truly work, can maintain or improve reliability, can lower prices and offer all customers choices, of course we will be in favor of it.

The reason we advise caution is that there are too many unanswered questions as to how the currently discussed restructuring proposals can achieve those ends. Our concerns go directly to the issue of public interest I discussed earlier. We need a high level of assurance that our vital electric industry can operate effectively under any new plan.

One basic question that is yet unanswered is what model will be used to try to develop competitive power markets? There are a number of possible models including regional power pools, bilateral contracts, independent transmission operators, retail wheeling or a combination of these alternatives. Even the advocates of competition disagree about the appropriate model for the future. Furthermore, many of the details about the operation of those models have not yet been well defined. The ultimate success or failure of a competitive power market will depend heavily on its structure.

Can restructuring be accomplished without providing existing utilities market power arising from their control over transmission access and large blocks of generation? In other words, will a deregulated market necessarily be a competitive market? This concern is heightened with the recent merger activity in the electric industry.

Will all customers benefit from retail competition? The large industrial and commercial customers have the know-how and clout to fend for themselves. Our fear is that the best deals will be taken before residential users get a choice, leaving small customers with options that are more expensive than what they have today. Can this be prevented?

Will the volatility of prices that may arise from a competitive market be acceptable to most customers? We expect that electric prices will be highest during peak periods when the heating or air-conditioning requirements are greatest on residential consumers. This may lead to a twofold impact on customer bills – the highest rate applied to the highest usage period.

Traditionally utilities have had an obligation to serve all customers in their retail franchise territory. It seems unfair to require utilities to make the financial commitments to provide power supplies to customers who have the option to receive their power from another provider. Who will be responsible for serving customers that may not have alternatives offered?

In a competitive environment, utilities will no longer plan to meet future generating capacity needs. Supposedly the market prices will send signals that let developers know when and what type of capacity is needed. Can we be assured that the price signals will be adequate and timely? If they are not, the result will be inadequate supply to meet demand and corresponding shortages and price increases.

Considering the high capital costs and long lead-times involved with constructing base-load capacity, who will ever build a coal plant in the future? Will we become dependent upon natural gas-fired facilities? If our electric market becomes too dependent upon the price of natural gas there could be a great deal of price volatility.

From an operating standpoint, generation and transmission are interdependent. The operation of the electric system requires a delicate coordination of these two functions. If generation is to be separated from transmission, we wonder how the electric system will be efficiently operated and planned. For example, transmission congestions can be relieved by installing new generation or an altered dispatch of existing units. In an environment where generating decisions are made based on market prices and transmission decisions are made by an independent system operator, how can these be coordinated?

The reliability of our electric system has been the envy of the world. We are concerned that reliability may decline with restructuring. Our transmission system was not built to handle massive transfers of power from region to region. In August there was a blackout that affected several Western states that was caused by a transmission line problem. As a contributor to the incident, the manager of PacifiCorp's transmission grid said, "We are running the system a lot harder than we have in past years."

With a restructured electric system it is not clear who will be responsible for the planning, siting and construction of transmission facilities. There may be an independent system operator planning a transmission system on the basis of bulk power requirements, not on the basis of local needs. The siting of transmission facilities can have a tremendous impact on a large number of people and their property. Transmission siting should be a local matter. What will be the role of state commissions in this process and how will local versus regional interests be balanced?

We are concerned that the low-cost offers of electricity available today that have helped create the clamor for competition will not be available on a sustained basis. Over the long-term, the excess capacity that contributes to the current cheap price of power should disappear as supply and demand reach equilibrium. In the short-term, if the industry is restructured so that generation assets are divested, there may be an immediate increase in the offered price. There are two components to the price of power, energy and capacity. Current excess utility owned capacity is in that utility's ratebase. Therefore, ratepayers are paying the capacity component of the price of those units' power. The utility can offer power on the wholesale market that just covers the price of energy. If that generation is removed from ratebase by divestiture, both the energy and capacity portions of cost need to be recovered from the wholesale market.

Some existing generating capacity has been largely depreciated. Customers that have supported this depreciation through years of rate payments may, with restructuring, have to pay a higher, market-based rate for that same capacity.

A transition from the embedded-cost pricing of traditional regulation to market-based pricing may cause significant reductions in the value of assets. This is the stranded cost issue. On the other hand, some assets may increase in value resulting in stranded benefits. In effect, the stranded cost/stranded benefit issue involves determining the appropriate transfer of wealth which should result from changing the rules of the game.

This is a huge policy issue with no clear answer. A regulatory compact has been in existence for decades under which utilities have been provided exclusive retail service franchises. The utility charges regulated rates which allow for the recovery of prudently incurred costs. In exchange, the utility has an obligation to provide reliable service at a reasonable rate to all customers in its service territory.

If the rules change now, should stockholders be forced to bear the cost of devalued assets that were prudently developed to serve their franchise? Opponents of stranded cost recovery argue that equity investors assume the risk of losses in exchange for equity returns. How should stranded costs and benefits be calculated and allocated? We conclude that it is too early to address this issue and flexibility should be maintained. Current estimates of stranded costs are speculative and will be until a comprehensive market structure has been defined.

In Virginia, the most significant threat to stranded cost exposure is the presence of high-cost contracts with non-utility generators. We recommend that every effort be made to renegotiate these contracts to reduce their effect upon current rates and minimize the potential for stranded costs.

This has been a partial list of the unanswered questions and concerns raised in our report. We do not claim that all uncertainties must be resolved before restructuring is possible. An endless study would not remove all doubt. But basic questions relating to the operation of a complex electric system should be worked out first. Otherwise we are taking a leap of faith.

We have recommended in our report certain actions that may be taken to position the Commonwealth for retail competition if further review proves it to be acceptable. We recognize that traditional rate of return regulation is not suited for competition. There may be alternative regulatory plans that provide a better transition to competition. Current methodologies for the allocation of costs should be reviewed. Prices for the generation, transmission and distribution of electricity should be separated. Improved price signals should be sent to customers. Deferred accounting mechanisms, such as fuel factors, should be reconsidered. We recommend that regulatory flexibility be sought for the approval of merchant power plants and the ability of non-utility generators to construct energy facilities for large users.

I mentioned that some states have implemented retail wheeling experiments. We feel it is premature to begin such a program in Virginia simply for the sake of having a similar experiment. Instead, we propose to monitor the programs in other states to determine how they are being conducted and what lessons they learn.

In fact, we have already begun an information gathering process on other states' experiments and thus far we have been disappointed with the design of some of these programs. In particular, current experiments may provide customers with flawed knowledge of both the cost and reliability implications of retail wheeling. There are few residential customers that have real-time meters to determine their hourly consumption, a critical determinant of cost. Also, experiments are structured so that the distribution company will be responsible for service interruptions during constraints, so the reliability a customer experiences will not reflect the reliability of the power supplier.

We recognize that federal legislation may transfer the decisions of the appropriate future of the Commonwealth's electric system from the Commission and General Assembly to a federally-controlled industry framework. I mentioned the Schaefer bill that is now receiving wide attention. Advocates of that bill cite as support a study commissioned by the Citizens for a Sound Economy Foundation. That study concludes that retail wheeling will increase our Gross Domestic Product by \$191 billion, lower prices and increase employment. We have reviewed the study and discussed it with its authors. In our report we describe several very dubious assumptions contained in the study that, in our minds, makes its dependability worthless. Unfortunately it may be used to propel federal policy regarding a drastic overhaul of our electric system.

We encourage the Commission and the General Assembly to seek to preserve state jurisdiction over retail electric service.

You will hear that retail wheeling is inevitable and restructuring will benefit everyone. We beg you to ask for details, not concepts. If the answer you receive is "Don't worry, the free market will take care of it", beware. As wonderful as our free market system is, remember that competition creates winners and losers. Competitive prices may not be stable, they are dependent upon supply and demand.

With the lack of detail regarding the form of a restructured electric system and how it would operate, are you ready to allow the reliability and pricing of our electric service to be governed by competitive markets? That is the fundamental issue facing you and our Commissioners.

COMMONWEALTH OF VIRGINIA  
STATE CORPORATION COMMISSION

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COMMONWEALTH OF VIRGINIA, ex rel.

At the relation of the

STATE CORPORATION COMMISSION

CASE NO. PUE950089

Ex Parte: In the matter of reviewing and considering Commission policy regarding restructuring of and competition in the electric utility industry

ORDER

By Order entered September 18, 1995, in this proceeding, the Commission directed the Staff to continue and expand its investigation of current issues related to potential restructuring in the electric industry and to file a report on its observations and recommendations. All investor-owned electric utilities and electric cooperatives were made parties to the proceeding and directed to respond to the Staff's requests for information. Interested parties were invited to file written comments and requests for oral argument in response to the Staff Report.

The Staff filed its report on July 31, 1996. Comments have been received from a number of parties, filed both before and after filing of the Staff Report, and several parties requested



oral argument. However, as the Staff Report constitutes only the initial stage of what will be an extended evolutionary process, and the scope of the issues addressed herein is limited, oral argument is premature at this time.

We believe that significantly more evaluation is necessary to determine what, if any, restructuring may best serve the public interest in Virginia. To facilitate such evaluation, Staff made various recommendations that will require consideration of utility-specific data relevant to potential changes in the electric industry.

Accordingly, we are establishing by separate orders new dockets directing certain investor-owned electric utilities to provide information relevant to Recommendations Nos. 1, 2, 3, 4, 6 and 13 of the Staff Report. The requested information and analyses address: cost-of-service studies; illustrative tariffs reflecting unbundled rates for generation, transmission and distribution functions; means of improving price signals to customers; determining reserve margins, future incremental capacity needs and capacity solicitation processes; and conservation and load management programs. In addition, all investor-owned utilities were directed to file with the Commission copies of any filings made with federal or other state

regulatory bodies that relate to any of the recommendations in the Staff Report or to alternative forms of regulation.

Although we are not instituting separate proceedings for electric cooperatives at this time, similar proceedings may be required of cooperatives in the future. Moreover, any cooperative proposing an alternative form of regulation should be prepared to address the Staff recommendations outlined above.

In addition to the data to be filed by certain companies in the above-referenced proceedings, all investor-owned electric utilities and cooperatives that have non-utility generation that impacts their Virginia jurisdictional rates are directed to file, by June 1, 1997, a report detailing their efforts to restructure contracts with non-utility generators ("NUGs") to mitigate their potentially negative effect on current and future rates. Each utility shall also subsequently file quarterly reports detailing its continuing efforts in this area.

Staff recommendations also stated the need for monitoring certain aspects of the electric industry to better assess particular restructuring and competition issues. Areas identified by Staff warranting closer inspection include developments in the wholesale power market, retail wheeling experiments of other states and electric utility service quality.

We believe that the information derived from monitoring such activities will be valuable in considering possible restructuring alternatives. Staff, therefore, is directed to monitor developments in the wholesale power market and evaluate wholesale competition and its impact and potential impact on Virginia's utilities. Staff shall file a report of its findings by June 1, 1997, and shall file reports thereafter as necessary.

Staff is further directed to prepare a report by September 1, 1997, on the results of retail wheeling experiments and activities in other states. Staff shall make appropriate recommendations based upon its study.

Also, Staff shall report by July 1, 1997, on whether, and if so, how to increase monitoring of electric utility service quality. Staff's recommendations should address whether the Commission should establish service quality standards.

Accordingly, IT IS ORDERED THAT:

(1) On or before June 1, 1997, each investor-owned electric utility and electric cooperative that has non-utility generation that impacts its Virginia jurisdictional rates shall file a report on its efforts to renegotiate its NUG contracts as appropriate and shall thereafter file similar reports quarterly;

(2) The Commission Staff shall continue to monitor developments in the wholesale power market and file a report as outlined above on or before June 1, 1997. Staff shall file reports thereafter as necessary;

(3) On or before September 1, 1997, Staff shall file a report on the retail wheeling experiments of other states and make appropriate recommendations;

(4) On or before July 1, 1997, Staff shall file a report recommending whether, and if so, how to increase monitoring of electric utility service quality; and

(5) This matter shall be continued generally until further order of the Commission.

AN ATTESTED COPY of this Order shall be sent by the Clerk of the Commission to: all Virginia Electric Cooperatives and Electric Utilities as set out in Appendix A to this Order; the additional service list attached as Appendix B to this Order; Philip F. Abraham, Esquire, Hazel & Thomas, P.C., P.O. Box 788, Richmond, Virginia 23206; John A. Pirko, Esquire, LeClair Ryan, 4201 Dominion Boulevard, #200, Glen Allen, Virginia 23060; Donald R. Hayes, Esquire, Washington Gas Light Company, 1100 H. Street, N.W., Washington, D.C. 20080; James L. Dobson, CFA, Donaldson, Lufkin & Jenrette, 140 Broadway, New York, New York 10005; James E. Franklin, Cogentrix Energy, Inc., 9405 Arrowpoint

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Michael J. Quinan, Esquire, Woods, Rogers & Hazlegrove, P.O.  
Box 14125, Roanoke, Virginia 24011; and to the Commission's  
Divisions of Energy Regulation, Economics and Finance, and Public  
Utility Accounting.

A True Copy  
Taken: *William J. Bridge*  
Clerk of the  
State Corporation Commission



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Remarks of Reginald N. Jones  
On Behalf Of  
ALLIANCE FOR LOWER ELECTRICITY RATES TODAY  
to the Joint Subcommittee Studying the Restructuring  
in the Electric Utilities in Virginia  
October 2, 1996

Chairman Reasor, members of the Joint Subcommittee, thank you for this opportunity to appear before you. On behalf of Bill Axselle and myself, I am pleased to advise you of a new coalition being formed known as ALERT, which is the acronym for Alliance for Lower Electricity Rates Today in Virginia. ALERT is an alliance of electricity consumers who are uniting to pursue competitive electric rates for all residential and business consumers of electricity; and I emphasize all. The Alliance is open to membership by all residential, commercial and industrial customers.

Alert is in its formative stage and will be signing up members throughout the fall and winter. We are pleased with the base of members who have come together to initiate this effort and welcome all who support its stated principals.

Bill Axselle and I look forward to working with this committee, the General Assembly, the Administration and the State Corporation Commission as we move towards retail competition for electricity in Virginia.

In 1776, Adam Smith wrote in his Wealth of Nations:

"A monopoly granted either to an individual or to a trading company has the same effect as a secret in trade or manufactures. The monopolists, by keeping the market constantly understocked, by never fully supplying the effectual demand, sell the commodities much above the natural price, and raise their involvements, whether they consist in wages or profit, greatly above their natural rate."

This is the foundation on which our competitive markets for the past 220 years has been built, i.e. costs of goods and services based upon supply and demand pricing - perhaps the most



important principle of our free enterprise system.

ALERT believes that consumers, all consumers, of electricity will benefit by competition i.e. paying the "natural price". The Virginia General Assembly and the State Corporation Commission have implemented, or are in the process of implementing very successful transitions in demonopolizing other regulated services that we thought would always remain under monopoly control. The cost of long distance telephone service has reduced by as much as 55%, according to some reports, since 1984 when competition in the inter-LATA market was codified in Virginia. Additionally many new telecommunications services and products have been developed and offered to the consumers in response to competition.

In the 1994 Session of the General Assembly you passed legislation authorizing local .change telephone competition with certain guidelines for the SCC to consider in implementing the law. Virginia was a leader in local exchange deregulation. We didn't wait for Congress to act. Now is the time to turn our attention to retail competition for electricity.

Bill Axelle and I, on behalf of ALERT, look forward to working with you to insure that Virginia remains a leader in deregulation. We are confident that the Virginia General Assembly will provide the leadership for passage of retail competition not a day before we have a plan that will be in the best interest of all consumers of electricity, but not a day later than necessary, since each day we delay means Virginia consumers are most certainly paying more for electricity than they would in a competitive market.

I have given each of you a copy of the "Statement of Principles" of ALERT. I believe you will find that these principles are consistent with what you believe Virginia consumers should expect in reforming the electric utility industry in Virginia.

I would like to turn the podium over to Bill Axelle for some remarks on behalf of ALERT.

# ALERT

Alliance for Lower Electricity Rates Today in Virginia

## STATEMENT OF PRINCIPLES

ALERT is an alliance of electricity consumers who are working to achieve competitive electric rates for all residential and business customers. ALERT members believe that restructuring the electric utility industry and bringing consumer choice and competition into play will result in lower electricity prices and improved service. Competitive sources of electricity are essential to the continued economic development of Virginia and the well being of its citizens. Individual consumers will benefit through lower prices, and so will Virginia's economy.

Free enterprise and customer choice are the foundation of a dynamic, responsible energy policy for Virginia. ALERT advocates the following principles for reforming the electric utility industry in Virginia:

1. *All consumers should be able to freely choose their electricity suppliers.*
2. *All classes of customers should have the opportunity to benefit from competition during the same time frame.*
3. *Generation, transmission and distribution services should be available on a separate basis to all customers. Customers should also be free to receive "bundled" (i.e., distribution, transmission and generation) service from utilities based on established cost-of-service principles.*
4. *To the fullest extent possible, electricity prices should be determined by buyers and sellers, that is, by the market.*
5. *Competitive market forces will achieve fair pricing for all customers, and will send true economic signals.*
6. *Transmission and distribution services should be available and provided to all buyers and sellers of electricity on a non-discriminatory basis.*
7. *As long as transmission and distribution facilities are operated by monopoly providers, prices for these services should remain under regulation based on embedded cost-of-service principles.*
8. *Utilities should be required to provide transmission and distribution services to all other parties that are comparable in quality, scope and price to the services they provide themselves.*
9. *Service reliability should be maintained.*
10. *Issues concerning the transition to full competition should be identified and expeditiously resolved by the State Corporation Commission in a manner that is equitable to all stakeholders and promotes the public good.*

WILLIAMS, MULLEN,  
CHRISTIAN & DOBBINS  

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ATTORNEYS & COUNSELORS AT LAW

REMARKS OF RALPH L. "BILL" AXSELLE, JR.

ON BEHALF OF

ALLIANCE FOR LOWER ELECTRICITY RATES  
TODAY IN VIRGINIA (ALERT)

TO THE JOINT SUBCOMMITTEE STUDYING  
RESTRUCTURING IN THE ELECTRIC UTILITY INDUSTRY

OCTOBER 2, 1996

Let me follow up on the remarks regarding the Alliance for Lower Electricity Rates Today by Reggie Jones.

Our message on behalf of electricity customers in the Commonwealth is fairly simple: (1) Virginia residential and business consumers want lower electricity rates. (2) While Virginia may not be a high electricity cost state, it is not truly a low cost state either. (3) There are considerable disparities in electric rates for customers within different parts of Virginia today. (4) Virginia electricity consumers should have a choice of electricity generation. (5) Such competition will result in lower electric rates and less disparities in rates around the state. (6) These benefits must be available to all Virginia citizens and businesses, and in the same time frame.

It might be helpful at the onset to see how our preference for retail competition compares with the positions of a number of Virginia utility companies based on their comments at your July 2 meeting. On behalf of American Electric Power Company whose Appalachian Power serves much of the western part of the state, Dan Carson stated "AEP has taken a position in support of retail competition and customer choice", "retail competition is inevitable" and finally that competition "is a goal which should be pursued carefully, yet aggressively." We agree.

On behalf of Alleghany Power whose Potomac Edison Company serves parts of the northern portion of the Commonwealth, Tom Henderson stated that "We believe that the question is not whether competition will come, but when and how." He stated unequivocally that "All customers should have a choice of their electric supplier as soon as possible. The transition period to full competition should be as short as possible, consistent with ensuring that necessary system changes are accommodated." We agree.

Even Virginia Power, while expressing several reservations, stated through Robert Rigsby that "Virginia Power believes that competitive energy markets could ultimately provide some consumer benefits" and spoke of a "transition process in an orderly manner that benefits the interest of all of Virginia's citizens." We agree.

While Greg White for the Virginia, Maryland and Delaware Association of Electric Cooperatives expressed opposition to retail competition, August Walmeyer for the Virginia Independent Power Producers called for immediate implementation of competition and customer choice. In so doing, he quoted Republican Congressman Tom Bliley about the decision in Washington being no longer whether to deregulate, but "when" and "how", stating his party's difficulty in justifying continuing the electricity monopoly as they are "for the free market", and also Democrat U.S. Energy Secretary O'Leary who said "Orderly transition [to a freely competitive market] does not mean [a] slow [transition]."

It is thus clear that most of the industry recognizes that allowing competition in the procurement of electricity generation will benefit Virginia consumers. The issue then is not whether we should go to a competitive, market-based structure, but "when" and "how".

From the perspective of Virginia electricity consumers, the answer to "when" is also simple: as soon as the Commonwealth can put in place a system that assures that all classes of electricity consumers benefit from retail competition. No sooner ... but definitely no later ... than such a comprehensive system can be implemented. And, we need to start in an orderly fashion to that goal now. While we do not want the Commonwealth to be so on the leading edge that it undertakes a risky restructuring, we

also do not want it to be so cautious it takes no action because of a too measured a response.

Over 40 states now have underway some examination of or implementation of restructuring of the electric industry, with most of those involving some form of retail competition. For Virginia to delay beyond what is reasonable is to postpone the benefits of consumer choice for our residents and to ultimately put our Virginia businesses at a competitive disadvantage.

Regulatory reform in other business areas has led to enhanced competition that has resulted in lower prices, expanded output and either improved or unchanged quality of service. Significant lessons can be learned from the experiences of competition in the gas and telecommunications industries. In each instance, there has been a significant reduction in cost to consumers when retail competition is allowed.

While we understandably focus on cost reduction to consumers, there are other benefits. As noted by the SCC staff in their recent report, Virginians today pay widely differing electric rates dependent simply on where they live. Recent comments by a consultant Jeffry Pollock filed with the SCC indicate the residential customers in eastern Virginia are paying about 60-77% more than similar residential customers in the western part of our state. Likewise, there are variances of 50-80% on rates paid by Virginia industrial and commercial users among those same regions. Why should any electric customer in

Virginia pay that much difference simply because of the area in which they reside?

Competition and consumer choice will reduce what are, relative to other parts of the state, excessive rates in certain areas.

Competition will also likely improve service to customers. I note the article last Friday (September 27) regarding Virginia Power's commendable announcement of a \$100 million customer service improvement program e.g., answering phones faster, reading meters automatically, upgrading their network of lines, etc. The newspaper article stated "The aim is to cut cost and improve service so that the utility will be able to compete better if the electricity market opens up." (Richmond Times Dispatch, September 27, 1996) This is evidence of how competition ... even the potential of competition ... may bring better customer service.

Parenthetically, I should note that a number of utilities serving Virginia, such as Alleghany Power and Virginia Power, are already preparing for that competition, and properly so. They and several other utilities are already working together in managing high-voltage transmission lines "to make it easier for outsiders to ship across the grid" of different companies. (Virginia Power Planning Manager Glenn Ross, Richmond Times Dispatch, June 20, 1996)

Perhaps even more interestingly, a number of utilities in Virginia are already vigorously competing where permitted. They should be doing likewise here in Virginia.

I have always found it ironic that the utilities, when procuring their electricity, do so in a competitive fashion ... and yet, when they sell that same electricity to their customers, those customers do not have a competitive choice.

In a nutshell, the industry knows retail competition is coming as a market force. What we collectively need to do now is put in place a regulatory system that allows such competition in an appropriate fashion.

While there may be disagreements among different utilities about how we reach that desired result and even different perspectives among some customers, there should not be any hesitancy by the Commonwealth to provide its citizens with the benefits of retail competition as soon as possible. Whether it be a residential customer in your district or whether it be a manufacturing plant, a local retailer or a government facility in your district, they all should have the ability to choose their electric generation in a competitive free market as soon as possible.

The estimated savings from retail competition vary by prognosticator, area of the country and class of customer: 20-30-40% savings ... \$80-100 billion or even higher in savings nationwide. Those details can be debated at another time. What



s clear is that almost everyone recognizes that there will be a reduction in cost to the end users of electricity if a comprehensive system of competition is put in place.

Lower rates obviously help Virginia residents. They also help Virginia businesses by allowing them to be more competitive, leading to enhanced economic development, business expansion and job creation benefiting all Virginians.

It is frequently stated that the large industrial users are those who will primarily benefit from retail competition and thus are its major advocates. While it is true that they seek abandonment of our current monopolistic system and the benefits of competition, those benefits are not and cannot be limited to manufacturers. They must be equally applicable to all classes of customers ... residential, commercial, governmental and industrial ... and all within the same time frame.

It should be noted that, in fact, delay in implementing consumer choice may actually hurt the residential customers more. Some observers perceive the start of a trend somewhat like what took place with natural gas before its deregulation. Because of the cost of electricity being higher than they feel appropriate, some large industrials across the country are beginning to bypass the current system by self-generation, joint ventures and construction of privately-owned transmission lines to more competitive generation sources. Some are also negotiating special rates because of their large electricity consumption. A

few large retailers are also seeking to by-pass by procuring from a single energy supplier and negotiating for energy through their trade organizations. Likewise, there are local governments across the country exploring the formation of member-owned, non-private purchasing cooperatives to realize savings through competition.

The point is that it is the industrials, commercial and governmental consumers who may, at least, have some options through size and structure to interject some competition ... but not the residential customers. ALERT favors all customers having options of competition. If large users leave the system, negotiate special rates or build plants in states that are moving to retail competition, it is the remaining residential customers who will get hurt if we do not have true comprehensive customer retail competition for all consumers.

Regrettably, there will be entities that will try to delay this process to protect their market share as long as they can; they fear competition will decrease the profits for their companies and their shareholders. While that is understandable, it is not right. There will be entities that will try to shape the restructuring in the electric industry in a fashion that replaces their monopoly with other government protections that again are designed simply to preserve market share and their bottom line. Again, understandable, but not right. Yes, there may even be segments of the consumer community that would want

the restructuring to conclude in a format that benefits them to the detriment of other consumers. Likewise, understandable, but not right.

This is not an unusual situation in which you will find yourself: listening to the impacted, "special interests" properly looking out for themselves, while evaluating the issues based ... not on what any utility or business may tell you ... but on what is in the best interest of all our citizens.

None of this is to say that some utilities will not be impacted. Those that have operational costs too high or operational efficiencies too few will be impacted ... as they should. Those failing to respond to customer choices will be impacted ... as they should. These impacts may be reflected in reduced profits and stock prices, but is that not what business is all about? Most respectfully, it should be noted that the investor-owned utilities in Virginia are for-profit businesses designed to make a profit for their shareholders ... just like other Virginia companies. They should not have immunity from competition.

As your deliberations continue, we will share in the future our thoughts on "how" retail competition should take place in Virginia. Without going into those details at this time, let me make a couple general comments.

Simply put, the "how" of implementing consumer choice will involve both considerable analysis and a good, comprehensive

plan. The "what to do" --- move towards providing lower electric rates for Virginians through retail competition --- and the "when" to do it --- as soon as practical --- are clear. The "how" admittedly involves some very important decisions so that the restructuring put in place in Virginia is consistent with providing for all Virginians reliable safe electric service at reasonable rates.

There are, in fact, numerous serious issues that will need our collective attention. There is public policy duty for the Commonwealth to assure both reliable electric service and the lowest cost practical. Neither can be sacrificed during restructuring.

All this will not be an easy undertaking. Fortunately, we have a good State Corporation Commission and General Assembly that recognize both their duties to provide reliable electric service and the lowest practical costs, and which have the abilities to have such a system in place in the near future.

What we cannot do is accept these legitimate issues as excuses. They are opportunities, not obstacles. While there is a degree of difficulty to this assignment, it is commensurate with the rewards that await all Virginians. The staff at the SCC has outlined some of those issues. Now working together, we need to move aggressively through those opportunities in a fashion that concludes with a restructured electric industry in the

Commonwealth that provides, in a comprehensive fashion, all of our citizens retail competition and consumer choice.

We need to do more than monitor. We may not want to "lead the way", but we do need to "move forward" expeditiously. In this instance "standing still" will result in Virginia "losing ground" competitively.

ALERT, Reggie and I look forward to working with you and the SCC in putting in place that system as soon as possible. Thank you.

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REMARKS OF LOUIS R. MONACELL

ON BEHALF OF

THE VIRGINIA COMMITTEE FOR FAIR UTILITY RATES

TO THE JOINT SUBCOMMITTEE STUDYING  
RESTRUCTURING IN THE ELECTRIC UTILITY INDUSTRY

OCTOBER 2, 1996

The Virginia Committee for Fair Utility Rates is an association of twenty large industrial customers of Virginia Power. It has existed since the early 1970s and regularly participates in proceedings before the State Corporation Commission on matters pertaining to regulation of Virginia Power.

I appreciate the opportunity to address the overriding issue that the Commonwealth faces regarding restructuring and competition in the electric utility industry. The issue is not the steps that are needed to prepare for the restructuring and competition that is already occurring, and that will continue to develop. The Commission Staff, customer representatives, and the regulated utilities are in significant agreement that certain steps are needed to adapt and to get ready. The State Corporation Commission -- the expert regulators - should, and,

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October 2, 1996

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under existing authority, for the most part can, determine and implement these steps.

Instead, the paramount issue is whether, on the one hand, the Commonwealth is to embrace customer choice of electricity suppliers and be proactive, or, on the other hand, fearful of competition, it will passively observe experience in other states and wait until the United States Congress enacts federal legislation giving customers the ability to choose their electricity suppliers.

On this overriding issue, although some are still learning and not yet decided, nonetheless the battle line already has been drawn. Arrayed on one side of the battle line are those embracing customer choice and encouraging proactive steps. These interests include three of Virginia's investor-owned utilities -- AEP/Appalachian Power, Allegheny Power, and Delmarva Power -- as well as independent power producers, marketers that want to sell electricity in Virginia, and customer representatives such as ALERT and the Virginia Committee for Fair Utility Rates. On the other side of the battle line, we find those who fear the possible consequences of granting of choice to customers in the Commonwealth. These include the Commonwealth's largest investor-owned utility -- Virginia Power -- as well as representatives of the electric cooperatives in Virginia and of electric municipal distributors in Virginia.

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No one in Virginia, to our knowledge, advocates a flash cut to customer choice, as opposed to a planned and measured transition. The modest proposal we present to you today is for the Commonwealth to try "hands on" experience with customer choice in the Commonwealth.

What are the "pros" for adopting this proposal? There are at least four.

First, Virginia's citizens are paying widely disparate rates depending upon where they happen to reside in the Commonwealth. I draw your attention to Attachment I to my prepared remarks.

Second, there is significant room for improvement in Virginia's rates.

Third, if Virginia stands still, it inevitably will lose vis-à-vis other states that improve the structure and competitiveness of their respective electric industries.

Fourth, Virginia loses if it waits until it is compelled to act by federal fiat or industry developments in other states. If the Commonwealth must act under compulsion, it will do so with less flexibility than the states that are already gaining experience with retail competition initiatives. Virginia also will be lower on the learning curve than these sister states.



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What are the "cons"? Two are cited most often: a fear that Virginia's rates may increase, and a fear that reliability will suffer. There is, however, no proof that either fear would materialize.

Included in the Committee's comments submitted to the State Corporation Commission (which previously have been distributed to members of this Subcommittee) are the comments of Jeffry Pollock, an expert on electric regulatory matters. He concludes, based on his economic analysis of the cost of operating current generation and the cost of new generation, that Virginia's rates are likely to decrease and are not likely to increase.

Furthermore, in the natural gas industry, reliability did not suffer when the interstate pipelines were completely unbundled and gas transportation customers were given a choice of suppliers.

More importantly, concerns of reliability and price -- which can lead to endless theoretical discussions -- should not keep Virginia from starting to obtain pragmatic, hands on experience with customer choice. This is because the State Corporation Commission can manage pricing and reliability concerns as the Commonwealth is gaining hands on experience with customer choice. The Commission can manage these concerns, for example, by determining the size and speed of the transition, and

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through continued regulation of price and reliability factors for so long as necessary.

What should the General Assembly do? We submit that it should determine, as a matter of state policy, that customer choice for all electricity consumers -- residential, commercial, governmental, and industrial -- is in the best interest of the Commonwealth, its citizens, and its economy. Therefore, the General Assembly should direct the Commission to try hands on experience with customer choice, study and develop the rules, and implement choice when feasible.

The Virginia Committee and its members look forward to working with you in addressing these issues. Thank you.

#358527

## HOW VIRGINIA'S RATES COMPARE

### Average 1995 Electric Bills (cents/kWh)<sup>1</sup>

#### National and Regional Averages

United States	7.16¢
South Atlantic (DE, MD, DC, VA, WV, NC, SC, GA, FL)	6.35
Middle Atlantic (NY, NJ, PA)	9.53
East So. Central (KY, TN, AL, MS)	5.36
East No. Central (OH, IN, IL, MI, WI)	6.82

#### Virginia's Utilities

Virginia Power (67.8% of VA)	6.37
APCO/AEP (16.5%)	4.65
Cooperatives/ODEC (10.6%)	8.1
Potomac Edison/APS (2.7%)	6.08
Kentucky Utilities (1%)	4.99
Delmarva Power (.5%)	8.22
Cooperatives/Other (.9%)	7.5

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<sup>1</sup> Data is from Staff Report on the Restructuring of the Electric Industry. State Corporation Commission Case No. PUE950089, Vol. I, Table IV-A2 (July 1996). The percentages shown are the percentages of Virginia's retail customers served by each supplier as reported in the Staff Report, page 161.

**Hoechst Celanese**

Hoechst Celanese Corporation  
PO Box 32414  
Charlotte, NC 28232-9973  
704 554 2000

October 2, 1996

**Testimony before the Virginia General Assembly Subcommittee on Electricity Restructuring**

Thank you for the opportunity to present information on the issue of Electricity Restructuring.

My name is James W. York, and I represent Hoechst Celanese. My title is Purchasing Manager for the Fibers Group in Charlotte, North Carolina, with responsibilities for energy procurement.

Our division of Hoechst has seven plants in North and South Carolina, and one facility in Narrows, Virginia. I am here to present the position on the issue of electricity restructuring on behalf of the Narrows plant, which directly employs 1900 people at this site. The Narrows facility is a customer of American Electric Power of Virginia.

American Electric Power has provided a reliable supply of power at a price lower than other Virginia utilities. However, our company is most supportive of the movement towards restructuring of the electricity market, which will provide for customer choice.

Electricity is the only commodity that our company purchases for which there are no competitive options. However, customer choice connotes issues of importance other than just the right to purchase electricity at the retail level. Current regulations do not provide an opportunity to seek other providers for electricity, but they also severely restrict the ability of the Narrows facility to maximize its total energy balance. This situation for Narrows and other energy intensive companies can lead to increased fuel usage, environmental issues, and impacts total costs and competitiveness.

The "Report on the Restructuring of the Electric Industry" issued by the Staff of the State Corporation Commission, summarized many of the key points that should be considered. While recognizing the complexity of the issues, and the need to proceed cautiously, it is our request that the General Assembly Subcommittee initiate the efforts to begin the process. While the issues are complex, there are solutions to the obstacles that will allow the benefits of Customer Choice to be achieved by all customer classes in Virginia. The potential economic benefit to all electricity customers is too great to delay starting the process.

It is the recommendation of Hoechst Celanese that the General Assembly pass legislation that would ensure the enactment of Customer Choice for all customer classes not later than January 1, 2000.

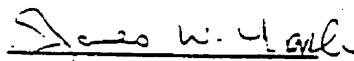
The period until this date would allow for identified concerns to be addressed. Concerns relating to electricity restructuring that have been presented include:

1. Ensuring that all customer classes can benefit
2. No cost shifting to other customer classes
3. Recovery of stranded costs
4. Ensure system reliability
5. Reciprocity within and between states
6. Social concerns
7. Environmental concerns

These points and others have been mentioned as barriers to implementation. Hoechst Celanese does not have the answer to all of the issues, but strongly believes that the General Assembly can bring together resources from all concerned parties to develop a plan that will allow for restructuring.

In conclusion, Hoechst Celanese is fully supportive of the efforts to restructure the electricity industry to remove its monopolistic position. The real issue is one of fairness to provide electricity customers with the same opportunity for choice that exists in all other markets. The General Assembly must address the issues expressed, but conversely should not allow the fear of change to preclude the opportunity for all citizens and industries of Virginia to pursue the benefits of choice.

Respectfully submitted,

  
James W. York



**Joint Subcommittee Studying  
Restructuring in the Electric Utility Industry**

October 2, 1996

Remarks  
Jean Ann Fox, President  
Virginia Citizens Consumer Council

Mr. Chairman, members of the committee, thank you for inviting me to discuss restructuring of the electric utility industry from the perspective of residential electric customers. Earlier this year, VCCC members and representatives from low income, housing, and senior citizen organizations met with the SCC staff during the preparation of their report to outline principles important to protecting residential customers in a transition to a more competitive electric industry. This morning, I will expand on those principles with you.

Competition or "customer choice" in the electric market is not an end in itself. A change in the structure of the electric utility industry should only be done if and when benefits to society are improved. All classes of customers must see a direct benefit for change to be acceptable. In a transition, we should not lose ground on the fairness of electric rates, the quality and reliability of service, protection of the environment, or public health and safety.

Powerful interests are pushing for their economic gains:

Large industrial customers are seeking lower rates.

Independent power producers want access to new markets.

Incumbent utilities want deregulation of their profits while maintaining their market power.

What do residential customers want? Rates that are as low as possible. Reliable, safe delivery of electricity. Access to customer service staff who us fairly and with dignity. Prompt restoration of power after storms. Air that is breathable. If a change in the structure of the industry makes it more likely that those goals will be met, customers will favor that change. If change leads to higher rates for residential customers, unreliable service, confusion, rip-offs and market abuses, and groups of customers that nobody wants to serve, change will be a disaster.

As elected representatives, you can make sure that any change in the electric industry delivers benefits to the less powerful members of our society, notably residential customers. Residential electric customers are at great risk if electric utility restructuring is done poorly without safeguards and protections. We concur with the staff recommendation that changes be made in a thoughtful and measured fashion.

**Goals for a restructured electric industry:**

1. **Restructuring, Not Cost Shifting.** Any restructuring of the electric utility industry must provide for rate fairness. All classes of customers must benefit equitably. Large utility customers must not benefit at the expense of smaller business and residential customers. When utilities talk about "pricing flexibility," they mean the ability to offer discount rates to favored users. The key question is who pays for those discounts: The utility or non-favored customers?
2. **The Residential Consumer Should Come First...but definitely not last.** Competition for residential customers must occur no later than for other customers. They must have equivalent access to all the benefits of competition, if there are any.

**3. Price Benefits and Affordability.** Any restructuring of the electric utility industry should result in real price benefits to consumers, including affordable bills for low-income customers. Utilities want performance-based ratemaking plans. Price caps and other alternate regulatory plans should not be adopted until there is effective competition for all customers. When it is appropriate to change from traditional regulation, "going-in" rates must be fair and reasonable. Getting the right level of regulation at the right time is going to be tricky. The hardest task will be to balance between letting new competition in and withdrawing controls on prices. If the controls are removed before competition is effective, the utility has a bonanza: it holds monopoly power but is constrained neither by competition nor by regulation. The opposite error is to let competition in but keep rigid controls on the original firm. Getting the timing right is essential.

**4. Fair Allocation of the Costs of Past and Current Decision.** The costs resulting from past and current decisions on plant investments must be fairly borne by the stakeholders after the Commission has carefully determined if there are any legitimate transition costs. Stranded cost recovery will be a very contentious issue in the transition. Some thoughts to bear in mind: Utilities are not entitled to full recovery of all prudently incurred costs. Utilities are only entitled to an opportunity to earn a fair rate of return on investment. Utilities are not entitled to recover misreported costs, misallocated costs, excess profits, inefficiently incurred costs, strategic investments or outmoded costs. In Virginia, plants must be "used and useful" to be included in charges to customers.

You and I did not sign a "regulatory compact" with our electric utility. Even if costs were prudently incurred, but not yet recovered, utilities are not entitled to indemnification against technological or market change. Utilities earn a risk premium in their allowed rate of return. Investors have already been compensated for all risks, as the Attorney General's comments to the Commission reflect.



If incumbent utilities are allowed to recover broadly defined "stranded investments," they will have an anti-competitive advantage over any new entrant which does not have access to captive ratepayers' pockets. If recovery of justified "stranded investment" is handled incorrectly, the result could very well delay implementation of effective competition.

**5. Fair Competition.** Self-dealing on generation of electricity should be prohibited. Transmission and distribution should remain monopolies with prices regulated by the SCC. The National Association of Regulatory Utility Commissioners Principles to Guide the Restructuring of the Electric Industry state that consumers should be protected from anti-competitive behavior and undue discrimination, with regulatory processes continuing where effective competition is absent and where monopolies and other forms of market power remain. Market power concerns are particularly relevant, NARUC says, when considering electric utility mergers and acquisitions.

**6. Universal Service.** Universal service is the availability to all Virginians of a reasonable level of electricity service at prices that do not strain household budgets or result in excess profits for electricity suppliers. The concept of universal service has traditionally rested upon a commitment by a single provider to ensure that service will be available. This obligation to serve commitment in the franchise monopoly environment must be transformed into an effective and equitable carrier of last resort arrangement in a competitive environment. No consumer should be left in the dark.

Electricity service is vital for health, safety and economic opportunity. NARUC lists universal service as a cornerstone of the public interest. Virginia does not now have a universal service policy or program for electric customers. We have no lifeline rates or equivalent to the program that makes modest telephone service affordable to low-income consumers. We know

of no study that quantifies the number of Virginia households who do not have electric service or the proportion of households who sacrifice necessities of life just to keep the power on. As we move ahead, we must not leave our poorest citizens behind.

**7. Customer Service and Consumer Protection.** Relaxed regulation and greater competitive pressure will give electric utilities a disincentive to provide customer service to a class of customer without real choices. The SCC should revisit its 20-year old customer service rules that apply to billing and collection, adverse weather disconnects, complaint handling, payment plans, deposits and pay-by periods.

Since utility companies are exempt from the Virginia Consumer Protection Act, the Commission must include prohibitions against unfair and deceptive acts and practices along with a dispute resolution system. In a competitive market, consumer abuses are more likely, such as unauthorized switching of providers. In long distance service, this is called "slamming." When it happens with electric companies, I guess we'll call it "shocking."

Consumers will have to learn how to comparison shop for electricity in a more competitive market. How will we compare prices, service quality and reliability, special offers. I understand that the retail wheeling experiment in New Hampshire is very confusing for customers who are being bombarded with offers. Many of us lived through the break-up of AT&T when consumers had to learn how to shop for long distance service. That was a picnic compared to the amount of education and assistance that consumers will need to fare well in a new electric market.

**8. Public participation.** The Commission staff report is just the opening curtain in the restructuring of Virginia's electric utility industry. It will be challenging to involve all segments of the community in addressing the issues and participating in public policy decisions, but the

public must be informed and involved for changes to be politically acceptable and beneficial to all customer classes. Residential customers are not as well organized as the industrial group. And, we are not a homogeneous lot. Extra effort will be required to bring all interests to the table.

We look forward to participating in the public discussion of how all of Virginia's consumers can benefit from an improved electric industry. Thank you for permitting us to share our concerns at the outset with this committee.

elecdoc.wps

**OUTLINE OF COMMENTS OF JOSEPH M. SCHEPIS  
SENIOR VICE PRESIDENT  
WASHINGTON GAS LIGHT COMPANY, INC.**

**INTRODUCTION**

- Washington Gas believes that competition will bring the benefits of greater choice and lower rates to electricity consumers in Virginia.
- If electric utilities will sell gas, gas companies must be permitted to sell electricity.
- Unbundled prices for generation, transmission, and distribution should be developed and implemented on a controlled, pilot program basis.

**WHOLESALE COMPETITIVE DEVELOPMENTS**

- Developments at the Federal level have given the utilities greater and more economic choices in securing energy supplies to serve their local customers.
- For gas utilities, the developments include:
  - Wellhead natural gas markets are fully deregulated, and as a result of FERC Order No. 636, wellhead sales are made to upstream interstate pipeline delivery points in a highly competitive market.
  - Interstate pipeline transportation and storage services are fully unbundled and have been for almost three years.
  - Unregulated city gate service providers have emerged which are providing competitive alternatives to pipeline transportation services.
- For electric utilities, the developments include:
  - Wholesale power is being sold in competition with investor-owned wholesale power transactions.
  - FERC has mandated open access and is seeking to establish a competitive wholesale power market.

**RETAIL COMPETITIVE DEVELOPMENTS**

- Pilot programs are in operation in other states that reflect pervasive retail unbundling of natural gas markets and limited electric retail wheeling programs.
- Gas and electric end use markets are now merging with oil markets into energy service markets.

- Merger activity is picking up once again, and taking a turn toward combined energy companies.
- Utilities are beginning to offer different types of services to customers.

#### RELEVANCE TO VIRGINIA

- In Virginia, only on the gas side have these competitive developments been cascaded to provide some retail gas customers equally significant choices, and Washington Gas expects shortly to expand customer choice to more customers.
- An electric utility already supplies the natural gas for certain retail customers within the Washington Gas franchise area.
- Only the electric utilities are in a position to offer (indeed, are already offering) total energy services to energy consumers, while their markets remain closed and protected from competition.
- This head start will have a significant bearing on the outcome of the competition.

#### RESPONSE TO THE STAFF REPORT

- Washington Gas is concerned that Staff's "go slow" recommendations do not go far enough.
- The market is changing rapidly. Much like the Staff report, Maryland concluded, only one year ago, that the state benefited from low cost electricity providers and that no action was appropriate. Since the Virginia Staff report was issued, Maryland announced that it would revisit these findings.
- Unbundled prices for generation, transmission, and distribution should be developed and implemented on a pilot program basis.
- Staff's "go slow" approach continues to place gas companies at a significant disadvantage in the emerging competitive market and confers a significant advantage upon the electric utilities.

#### REQUESTED REMEDIES

- Washington Gas proposes that the legislature encourage the opening of the electricity market, at least on a controlled, pilot program basis.
- Customers will benefit from the increased competition when gas companies can sell electricity in the same way electric companies can sell gas.

COMMENTS OF  
JOSEPH M. SCHEPIS  
SENIOR VICE PRESIDENT  
WASHINGTON GAS LIGHT COMPANY, INC.

BEFORE THE  
JOINT SUBCOMMITTEE STUDYING  
POTENTIAL CHANGES IN  
RESTRUCTURING THE ELECTRICAL UTILITY INDUSTRY

OCTOBER 2, 1996

**COMMENTS OF JOSEPH M. SCHEPIS  
SENIOR VICE PRESIDENT  
WASHINGTON GAS LIGHT COMPANY, INC.**

**INTRODUCTION**

My name is Joseph M. Schepis. I am a Senior Vice President of Washington Gas Light Company (Washington Gas or Company), the natural gas local distribution company that provides natural gas service to approximately 300,000 customers in northern Virginia. I commend the Joint Subcommittee Studying Potential Changes in Restructuring the Electrical Utility Industry. I am pleased to be before you to express Washington Gas' viewpoint.

Washington Gas believes that unbundled prices for generation, transmission, and distribution should be developed and implemented on a pilot program basis. By doing so, you will help to bring the benefits of competition to the residents and businesses in Virginia and ensure a level playing field for participants in the energy markets in Virginia. But you must also ensure that resulting competition is fair: If electric utilities are allowed to sell natural gas (as they are now doing), gas utilities should be allowed to sell electricity.

My comments focus on why Washington Gas believes this to be so. They are structured into six sections. I'll discuss recent activity in the wholesale energy markets. Retail competition activities are described next. This is followed by a discussion of the relevance of these activities to Virginia energy consumers. My comments next briefly address the Virginia State Corporation Commission Staff Report on the Restructuring of the Electric Industry. Washington Gas has already filed comments on this report with the Virginia State Corporation Commission, which I am making available to Subcommittee members today. I believe that this report will likely serve as a major input to any industry restructuring in the Commonwealth, and therefore warrants a careful review and evaluation. A section on requested remedies and a conclusion end my remarks.

**WHOLESALE COMPETITIVE DEVELOPMENTS**

The delivery of natural gas by natural gas utilities and the delivery of electricity by the electric utilities to end use customers in Virginia are both regulated, and the nature of both have been profoundly affected by developments at the Federal level relating to electric generation, electric transmission, natural gas production, and interstate pipeline transportation and storage markets. These interstate developments have given gas and electric utilities greater and more economic choices in securing energy supplies to serve their local customers.

Upstream natural gas markets are fully deregulated, and as a result of FERC Order No.

636, wellhead sales are made to upstream interstate pipeline delivery points in a highly competitive market. Interstate pipeline transportation and storage services have been fully unbundled for almost three years. With capacity release, unregulated city gate service providers have emerged which are providing competitive alternatives to pipeline transportation services. Independent market based storage providers and market based LNG peaking service providers are emerging. In addition, market based pipeline capacity options have emerged as have market based secondary capacity options.

In interstate electric markets, market based wholesale power sales are being made in competition with investor-owned wholesale power transactions. In addition, the Federal Energy Regulatory Commission (FERC) has mandated open access, unbundled wholesale and ancillary service tariffs in Order No. 888 and is seeking to establish a competitive wholesale power market. Market based transmission pricing in secondary markets is also being explored and electronic information system standards for both gas and electric markets are in place.

## RETAIL COMPETITIVE DEVELOPMENTS

Intrastate energy markets are also becoming increasingly competitive as evidenced by pilot programs in other states reflecting pervasive retail unbundling of interruptible and firm natural gas markets and limited electric retail wheeling programs. Gas and electric end use markets are now merging with oil markets into energy service markets. Future competitors in these markets will include current natural gas utilities, electric utilities and combination utilities as well as natural gas and power marketers, both independent and affiliated with interstate pipelines, and other utilities.

These activities are also evident in the recent merger activity among energy utilities, as has been recently confirmed in Electric Intelligence, the on-line service of Power & Analytic Resources, Inc. There, it is reported that, "The pace of electric utility restructuring activity is picking up once again, and taking a noteworthy turn toward combined energy companies." This report cites the recently announced or rumored mergers of Enron and Portland General Electric, Houston Industries (parent of Houston Lighting & Power, HL&P), and CInergy and either Williams Cos. or PanEnergy. Evidence that the recent wave of merger activities is headed toward the creation of combined gas and electric suppliers can also be found in EnergyOnline, September 26, 1995, "Electrics eventually are expected to seek merger opportunities that will create national companies with ties in both electricity and gas markets."

Utilities are also beginning to offer different services to customers. Some of the more likely services that will be offered include: (1) design/build services, (2) engineering assistance, (3) energy information, and (4) provision of multiple fuels. Washington Gas believes that utilities will continue to focus on the provision of these types of services, and probably others that have not yet been fully developed.



Regardless of the evolution of these other services, however, the primary economic activity of utilities will continue to be the provision of different forms of energy. It has been and, in all likelihood, will continue to be a core competency of utilities. The provision of energy has historically accounted for about 90% of the business activity of utilities, and this is not likely to change in any significant way in the future. A recent announcement by New Jersey Resources Corp., indicating their long term business focus to involve a greater emphasis on gas sales and fuel management, rather than making long-term investments in gas-fired generating facilities underscores this point.<sup>1</sup>

## RELEVANCE TO VIRGINIA

In Virginia, only on the gas side have these competitive developments been cascaded to provide some retail gas customers equally significant choices. And only on the gas side, are initiatives being undertaken to increase such choices. These developments have even progressed to the point where electric companies are currently providing natural gas to major customers within the franchise areas of natural gas local distribution utilities. For example, an electric company already supplies the natural gas for certain retail customers within the Washington Gas franchise area. While Washington Gas cautions that it is important that this business not be subsidized by utility operations, Washington Gas welcomes fair and honest competition because it provides choice to our customers.

These developments are significant and germane to issues of electricity restructuring in Virginia because development of energy service markets is now skewed in favor of single, combination utility providers and electric utilities with natural gas marketing affiliates. This implies that only the electric utilities are in a position to offer total energy services to energy consumers. Absent an open access retail electric wheeling tariff that is available to both the electric utility and to other electric energy providers, including Washington Gas, the energy service market will remain stunted and closed. This is not in the public interest.

Furthermore, while their markets remain closed and protected from competition, electric utilities can learn the gas business while their basic market (electricity) is protected. These "virtual" combination utilities are already exploiting the advantage of their position. Common sense dictates that this head start will have a significant bearing on the outcome of the competition. Further consequences of this tilted playing field include larger players in a protected market competing against smaller players in bitterly competitive markets. The difficulty of monitoring and regulating these markets so that benefits are captured for citizens of the Commonwealth are exacerbated because some of the markets will be regulated and some will be competitive.

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<sup>1</sup> [EnergyOnline](#), September 26, 1995.

## RESPONSE TO THE STAFF REPORT

By all accounts, Staff's position relative to the introduction of competition to the electricity industry is a cautious one, and it urges a "go slow" approach.<sup>2</sup> Washington Gas believes that the problem with such an approach is that it presents a serious impediment to entities (such as Washington Gas) who have a business interest in bringing the benefits of choice and competition to customers.

Washington Gas is concerned that Staff's recommendations do not go far enough. Specifically, Washington Gas believes that it is not enough merely to develop unbundled prices for generation, transmission, and distribution, for informational purposes. Rather, such prices should be developed and implemented on a controllable, pilot program basis. Washington Gas believes that Staff's "go slow" approach continues to place it at a significant disadvantage in the emerging competitive market and confers a significant advantage upon the electric utilities.

## REQUESTED REMEDIES

Washington Gas proposes a workable remedy to the problems outlined in the above discussion. The Company proposes that the legislature encourage the opening of the electricity market, at least on a pilot program basis. Such a proposal may even be philosophically more in line with Staff's go slow approach, which provides significant protections for the electric industry.

In proposing this remedy, Washington Gas is mindful of the need to avoid making chaotic changes that could have significant consequences on the citizens of Virginia. However, the pilot program structure will allow all interested participants the opportunity to explore ways of bringing the benefits of competition to the Commonwealth, while at the same time guarding against the justifiable concerns raised by the Staff report, and other informed parties in the debate:

- The ability of a competitive market to send accurate price signals to spur new construction. Washington Gas is mindful of the need to ensure an adequate and reliable supply of electricity, and would regard any effort at retail competition that did not provide such assurances as an abysmal failure. However, the pilot program approach is designed precisely to address these types of concerns.

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<sup>2</sup> "SCC report urges caution, Says state should move slowly in effort to restructure electric power business." The Richmond Times-Dispatch, 8/2/96. "Virginia Regulators Want to Go Slow on Electric Deregulation." EnergyOnline, August 8, 1996.

- The ability of all customers to participate in the competitive market. Having developed and implemented pilot programs to introduce retail competition in Maryland, Washington Gas has structured its programs to encourage and ensure broad participation. This concern, however, relates to the design of the pilot program rather than any philosophical deficiency of retail competition.
- Customer's rights to universal service and the utilities' obligation to serve. Again, Washington Gas is mindful of the need to ensure universal service, and would regard any effort at retail competition that did not provide such assurances as a failure. The pilot program approach can be designed to address these types of concerns.
- The rates, rules, and conditions governing a competitive market. It seems obvious that the rates, rules, and conditions governing a competitive market will evolve as experience is gained. This evolution cannot occur in a vacuum and if it is to occur in any meaningful way, the participants in the electricity market in Virginia must get experience. The least disruptive way for the participants to gain this experience is through a pilot program of retail competition.
- The treatment of stranded costs. Retail access does not have to occur at the price of stranded costs. Under all models of increased retail competition, the Virginia State Corporation Commission will still regulate the distribution system, which serves as the final interface between the competitive generation market and the end-user. Stranded cost recovery can therefore be assured through delivery service rate designs, regardless of the mechanism used to recover the costs.
- Virginia has little to gain and much to lose from retail competition. This appears to Washington Gas to be speculative. What is clear however, is that inaction will ensure that the potential benefits of competition are never realized. It is also painfully clear to Washington Gas that the gas utilities in Virginia have little to gain and much to lose from closed electricity markets and open natural gas markets.

## CONCLUSION

In conclusion, Washington Gas strongly urges the legislature to encourage retail competition in the Commonwealth. The Company favors a go slow approach in the

form of a pilot program, in contrast to Staff's approach under which little meaningful experience would be gained. It acknowledges Staff's concerns if retail competition were encouraged, but Washington Gas believes that these issues can be adequately addressed through appropriate pilot program design. It also attempts to redress the balance: electric utilities are already selling natural gas to end users; natural gas utilities should be afforded the same opportunity.

Joint Subcommittee Studying  
Restructuring in the Electric Utility Industry

October 2, 1996

Remarks of  
Trip Pollard  
Southern Environmental Law Center

Mr. Chairman, members of the committee, I thank you for the opportunity to present these remarks.

As the initial meeting of this committee and the remarks you've heard so far today indicate, one of the few things clear about electric utility restructuring is that it's an extremely complicated issue with very high stakes. I'd like to say a few words this morning about another significant area of complexity surrounding this issue -- the environmental impacts of restructuring.

Often, restructuring is depicted as a struggle between industrial users seeking cheaper electric rates and utilities seeking to protect monopoly profits. This is too simplistic.

The General Assembly needs to be aware that electric utility restructuring is a serious environmental issue, and that the potential environmental -- and accompanying economic -- impacts of restructuring are tremendous.

As the State Corporation Commission noted in its order establishing its restructuring investigation, the possibility of fundamental change in this industry carries profound implications for consumers, including impacts on the environment.

Electric utility restructuring presents both an opportunity and a threat to environmental quality. Although the Southern Environmental Law Center supports increased competition in the electric utility industry, and believes it can lead to both economic and environmental benefits, these benefits will only be realized if competition is implemented properly. If done improperly, deregulation will increase the environmental damage caused by power production.

In order to promote a cleaner, more sustainable energy future, electric utility restructuring must provide net environmental benefits and include specific elements such as funding for energy efficiency and renewable energy.

#### **Pollution Impacts**

I'd like to focus first on pollution impacts.

EPA has found that fossil fuel-burning power plants account for most air pollution in the United States, releasing approximately 70% of the sulfur dioxide (SO<sub>2</sub>), 33% of the nitrogen oxides (NO<sub>x</sub>), and 35% of the carbon dioxide (CO<sub>2</sub>) emitted.

Byproducts of these emissions include acid rain, reduced visibility from smog, ground-level ozone, and global climate change, which harm natural areas in Virginia. For example, air quality in Shenandoah National Park is among the worst in the country -- summertime visibility is less than one-quarter the

natural range, aquatic life has disappeared from streams due to acid rain, and ozone pollution damages native plants.

In addition to fossil fuel plant impacts, nuclear power plants produce a substantial amount of both high and low level radioactive wastes.

Given these impacts of the electric industry, it is readily apparent that any changes in the structure or incentives governing this industry could have significant environmental impacts.

As SCC staff's restructuring report recognizes, ensuring that the electric system is operated in a manner that protects the environment is a central issue which must be examined to ensure that any restructuring is in the public interest.

Of particular importance, restructuring will influence the type of power plants built and operated, and thus may have a major impact on air emissions.

Exemptions in the Clean Air Act for older plants allow plants built prior to 1977 to emit two to ten times the level of key pollutants as similar new plants. Substantial emissions reductions will result if competition leads to cleaning up or retiring older plants. However, competition may create additional markets for older plants, which enjoy an economic advantage because of depreciation and laxer environmental standards. If so, these plants may be kept in service longer and run more frequently, dramatically increasing air pollution.

Parts of this battle may be fought out at the federal level, but this subcommittee should be aware of, and look more closely at, the significant financial impacts for Virginia.

In addition to direct environmental costs, these impacts can increase health costs -- for example, ozone pollution has been known for some time to decrease respiratory function and cause acute respiratory distress, particularly for children, elderly, and those suffer from chronic lung disorders such as asthma. Fine particulate matter poses an even more serious health threat, linked to reduction in lung function and premature death.

There are also a number of economic impacts of power production. For one thing, the health impacts noted above result in direct costs to employers and consumers.

Also, pollution can hurt some of Virginia's largest industries, such as agriculture and forestry. For example, ozone pollution impacts plant growth in rural areas. Studies have shown that ozone decreases yields of crops such as peanuts, soybeans and tobacco, and it also retards growth of loblolly pine, all valuable products in the state.

Pollution also may hurt tourism -- another major industry in Virginia. For example, it can spoil the scenic beauty that is a major Virginia attraction.

Power plant pollution can also put increased financial burdens on businesses and hinder the ability to attract new business to non-attainment areas under Clean Air Act or areas



close to being classified as non-attainment areas.

A further area of impact restructuring could cause is the environmental degradation, economic impact, and intense political controversy it will spur if it leads to the need for increased construction of power lines and power plants.

The National Association of Regulatory Utility Commissioners (NARUC) has recognized the need to consider the environmental impacts of restructuring. In July 1996, they adopted a resolution on industry restructuring principles which calls for environmental quality to be maintained or improved as a result of any changes to the electric industry.

The General Assembly similarly should carefully consider the pollution impacts of restructuring proposals and ensure that industry restructuring is guided with an eye toward environmental protection.

#### **Impacts on Energy Efficiency and Renewable Energy**

The second primary area in which restructuring may affect the environment is investment in energy efficiency and renewable energy.

One of the best, most cost effective ways to address adverse impacts of power plant pollution is energy efficiency. This doesn't mean freezing in the dark. New technologies offer the same level of comfort and services -- such as heating, cooling and lighting -- as conventional measures, but use far less

energy. For example, high efficiency industrial motors use 50% of the energy of standard equipment.

Experience and studies show that one-quarter to one-third of our energy use can be eliminated by installing cost-effective, high-efficiency technologies and improving building design and construction practices.

Let me be clear -- these technologies are all available today. Why aren't they used? Because market barriers hinder purchase and use of these technologies, such as higher up-front cost and limited availability of such equipment.

For years, SCC has strongly encouraged utility investment in conservation and load management -- as the Commission has stated "cost effective CLM programs are essential components of the balanced resource portfolio that utilities must achieve to provide energy to Virginia consumers at fair and reasonable rates." (*Commonwealth of Virginia, At the relation of the State Corporation Commission, Ex Parte: In re, Investigation of Conservation and Load Management Programs, Case No. PUE900070, Final Order, March 27, 1992*).

Here are a few of the reasons why this is true -- for one thing, efficiency could significantly reduce the pollutants which harm our environment and our health, and it could also reduce utilities' present and future environmental compliance costs, thus cutting our utility rates.

Energy efficiency improvements can also reduce our utility bills by cutting individual consumption and by lowering the total cost of the electric system we must pay for, since improving the efficiency of consumption is often cheaper than building or buying power to meet consumers' electric demand.

What will be the impact of restructuring on utility investments in energy efficiency?

As the SCC staff report observes, a potential impact of industry restructuring is that utilities will abandon programs promoting conservation and energy efficiency. (Report, p. 345).

Quite simply, utility investments in energy efficiency are in jeopardy as competition increases in the electric industry.

Utilities have begun to focus exclusively on short-term sales, slashing energy efficiency and renewable energy investments and focusing on promoting increased electric use.

A prime example of this trend is Virginia Power. Virginia Power has reduced its planned energy savings by more than 90%.

Even worse, utilities increasingly are focusing on programs to promote customer electricity use. These promotional efforts harken back to the 1960's, when utilities pushed all-electric homes which lacked any efficiency measures, regardless of the impact of these sales on the environment or on customer bills.

Although these actions may result in short-term cost savings, the long term costs of abandoning energy efficiency efforts -- in terms of increased pollution, risk of further

environmental regulation, and increased costs to consumers -- are staggering. These actions are clearly contrary to the public interest.

The National Association of Regulatory Utility Commissioners' restructuring principles call for the maintenance of investment in energy efficiency and renewable energy.

The General Assembly, like the Commission and NARUC, should recognize the importance of these investments and ensure that they are not lost during restructuring.

#### Conclusion

Restructuring is a complex issue which may come before the general assembly in various forms for years to come. I commend you on establishing this subcommittee to carefully study and develop a knowledge base on this critical issue.

I urge you to keep the environmental impacts of restructuring in mind as you build this knowledge base and as you evaluate restructuring proposals. I also urge you to ensure that the public interest is protected by considering the impact of restructuring proposals on pollution levels and on funding of energy efficiency and renewable energy. Promoting environmental protection and maintaining or improving environmental quality should be ensured in any form of restructuring in Virginia.

I thank you for the opportunity to present these remarks.

## ENVIRONMENTAL IMPACTS OF ELECTRIC UTILITY INDUSTRY RESTRUCTURING

- \* Electric utilities are the most polluting industries in the United States. Thus, proposed changes in the regulatory standards and incentives guiding this industry are likely to have significant environmental impacts.

### Current Environmental Impacts of Utilities

- \* Electric power plants release approximately 70% of the sulfur dioxide (SO<sub>2</sub>), 33% of the nitrogen oxides (NO<sub>x</sub>), 35% of the carbon dioxide (CO<sub>2</sub>), 32% of the particulate matter (PM), and 23% of the mercury emitted in the country.
  - \* Power plant emissions are a primary contributor to acid rain, reduced visibility from smog, ground-level ozone, global climate change, and other serious problems. These pollutants harm air and water quality, forests, and wildlife -- as well as our quality of life.
  - \* For example, in Shenandoah and Great Smoky Mountains national parks, summertime visibility is less than one-quarter of natural visage, aquatic life has disappeared from streams due to acid rain, and native plants show signs of foliar damage due to ozone pollution.
- \* Other adverse environmental impacts of electric utilities include harm to ecosystems caused by building and operating power plants and transmission lines, as well as production of high-level radioactive wastes by nuclear plants.

### Potential Environmental Impacts of Restructuring

- \* Whether electric utility restructuring will help or harm our environment remains to be seen. Numerous alternative models of restructuring have been proposed, and the environmental impacts of these models differ significantly.
- \* One possibility is that an open and competitive industry will hasten the replacement of older, dirtier fossil fuel plants with cleaner generation sources which must meet more rigorous environmental standards.

- \* Restructuring also may allow customers to choose from whom they buy their power. Public opinion surveys consistently show that, given the choice, consumers want to purchase power from clean, "green" sources. Should this occur, restructuring would produce significant environmental benefits.
- \* On the other hand, our environment could suffer if restructuring evolves so that existing utilities continue to be the dominant electric power generators and disparities in emission standards for new and old plants are not addressed.
- \* Older plants would have a cost advantage over new plants if they continue to be held to a laxer pollution standard and if their capital costs have already been paid for by ratepayers over the years. As a result, companies could have new incentives to keep older, dirtier plants running and to increase the output of these plants, dramatically increasing air pollution.
  - \* For example, a study of the American Electric Power Company found that restructuring could result in additional emissions of up to 35 million tons of CO<sub>2</sub> and 85,000 tons of NO<sub>x</sub> per year above what was otherwise projected.
- \* Further, if utilities are allowed to ignore the long term costs of power production, environmentally-sound alternatives such as energy efficiency and renewable energy may not be developed. Although these clean sources are cheaper in the long run, they have higher up-front costs.
  - \* Many Southeastern utilities have already slashed their energy efficiency programs as they position themselves for competition.

#### Addressing the Environmental Impacts of Restructuring

- \* The following principles must be part of any plan to restructure the electric utility industry:
  - \* Restructuring should provide environmental benefits and must not result in increased pollution.
  - \* Markets must not favor dirtier power plants. Options to prevent this include requiring that all sources of electric generation meet the same environmental standards, offering incentives for cleaner resources, and requiring companies to offset increased emissions.
  - \* Investments in energy efficiency and renewable energy resources must be increased.

FOR MORE INFORMATION, CONTACT JEFF GLEASON OR TRIP POLLARD  
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**Remarks of Mark Rubin  
on behalf of the Air Conditioning Contractors of America  
The Virginia Chapters  
Before the Subcommittee Studying Electricity Deregulation Issues  
October 2, 1996**

Thank you, Mr. Chairman. I am Mark Rubin on behalf of the three Virginia Chapters of the Air Conditioning Contractors of America.

The Air Conditioning Contractors of America, or ACCA, would like to bring to the attention of the Subcommittee several issues related to the possible deregulation of the electricity industry in Virginia.

The three ACCA chapters in Virginia have more than 150 member companies and represent more than 4,000 employees working in the heating, ventilation, and air conditioning trades. The ACCA chapters are concerned about the entry of regulated utility companies into private business lines.

As the electricity industry prepares for deregulation, one reaction by monopoly utility companies is to consider broadening their base of business into fields which are somewhat related to their core business of supplying electricity or natural gas. Specifically, Virginia Power has announced its intention to enter into the energy services business in a way which would directly compete with private contractors such as the ACCA chapters. We are also aware that at least three other regulated utilities in Virginia have similar plans to enter into energy services businesses, and are nearing announcement dates.

At the outset, the ACCA chapters would like to make it clear that they are not concerned with the entry of additional competitors into their businesses. The observation that more than 4,000 individual heating and cooling companies currently compete for customers' business in Virginia indicates that the ACCA members are used to a competitive environment and capable of surviving and thriving in a competitive environment.

The crux of the ACCA members' concern, however, is that the entry of regulated monopoly utility companies represents not just the entry of another competitor, but rather the entry of a competitor who has unique advantages that confer an unfair competitive edge and whose actions may also threaten the interests of ratepayers .

For example, the ACCA members have been aware for some months that Virginia Power plans to enter the energy services business and has in fact purchased another company, A&C Enercom, to achieve its business purposes. One of the business activities that Virginia Power plans to engage in is to offer homeowners in Virginia the opportunity

to purchase appliance warranties from the utility. Virginia Power and its subsidiary, A&C, late last year filed an application for approval of certain affiliate transactions with the State Corporation Commission. The ACCA members became aware of that application and filed a Protest, specifying their concerns about Virginia Power's ability to compete unfairly by using its monopoly status and assets gained from monopoly operations for more than 60 years. In response to that Protest, Virginia Power subsequently withdrew the home appliance warranty portion of its application from active consideration at the Commission, while the remainder of its application remains active. When it withdrew the home appliance warranty program, however, Virginia Power clearly indicated that it did still intend to enter this line of business and that it would re-file that portion of its application at a future time.

Again, I would like to emphasize that the ACCA members do not object to the entry of another competitor. Rather, it is the entry of a competitor with monopoly advantages that give it an unfair edge that is of concern to the ACCA dealers.

In particular, the ACCA members are concerned that, for example, Virginia Power--and only Virginia Power--has information about its customers which would be extremely useful in marketing an appliance warranty program. The information includes customers' rate of electricity usage, trends in electricity usage, the make and model of heating and air conditioning equipment customers own, customers' payment history and credit history and so forth.

Armed with this information, Virginia Power has indicated that it will use other monopoly advantages to promote its business, by mailing advertisements offering its warranty service to its 1.9 million electricity consumers in the same envelope with the monthly electric bill. These are significant advantages available only to Virginia Power and the basis for ACCA's assertion that Virginia Power would be an unfair competitor. These advantages exist for Virginia Power only because it has enjoyed monopoly protection for 60-plus years. Use of monopoly utility assets also poses the potential risk of inappropriate cross-subsidization between a utility's core business and its other business activities, to the detriment of utility ratepayers.

The ACCA members are concerned that operation of such a warranty program by a regulated utility may be anti-competitive. Some members indicate they have been told by Virginia Power that to participate as qualified contractors in the Virginia Power warranty program they would be prohibited from participating in any other warranty program offered by any other company or utility.

These are just some of the important issues raised by the potential entry of regulated monopolies into new business lines. And it is important to note that under virtually all the deregulation models currently being discussed, these issues will not go away once deregulation and competition occur in Virginia. After deregulation, there will still be a local electricity distribution company operating as a monopoly to provide retail



electric service to home owners. Therefore, the concerns of the ACCA members will not be addressed by simply waiting for deregulation and competition to occur.

The State Corporation Commission's Staff, in its Report on Industry Restructuring, recognized many of these problems when it wrote, on Page 394,

"Competition in unregulated activities must be fair, however. Utilities still have monopoly power that can be abused. At the present time, the utilities' competitors cannot sell electricity to end users, a significant disadvantage because only the utility can offer a full "energy package." The allowance of participation by an electric utility in the energy services business must, therefore, be tempered with regulatory oversight to prevent abuses."

And, on page 395:

"When utilities undertake energy service activities through affiliates, the powers and responsibilities in the Affiliates Act will need to be maintained and perhaps strengthened to allow effective and fair competition. It is possible that a great deal of regulatory oversight in the future will shift from cost of service, rate case reviews to the monitoring of affiliate transactions and the separation of monopoly and competitive activities to help maintain a level playing field."

The ACCA groups are hopeful of continuing discussions with Virginia Power to resolve the many problems inherent in that utility's venture into the energy services business. However, we welcome the chance to make the Subcommittee aware of these problems today, so that should it become necessary to seek legislation in 1997 you will be aware of this problem affecting thousands of small businesses across Virginia.

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