REPORT OF THE
JOINT SUBCOMMITTEE STUDYING

THE REGULATORY RESPONSIBILITIES, POLICIES AND ACTIVITIES OF THE STATE CORPORATION COMMISSION

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

SENATE DOCUMENT NO. 20

COMMONWEALTH OF VIRGINIA
RICHMOND
2003

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Mr. William E. Fitzgerald
Mr. Robert P. Hardie
Mr. B. Rod Rodriguez
Mr. Robert W. Woltz, Jr.

STAFF

DIVISION OF LEGISLATIVE SERVICES
Amigo R. Wade, *Senior Attorney*
David A. Rosenberg, *Senior Attorney*
Rhonda J. Dyer, *Senior Operations Staff Assistant*

SENATE COMMITTEE OPERATIONS
John M. Garrett, *Coordinator*

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EXECUTIVE SUMMARY

The 1902 Constitution of Virginia created the State Corporation Commission (the SCC) vesting it with legislative, judicial, and executive powers. When it began operations in 1903, the SCC had two primary functions, the regulation of rates and services of railroads and the issuance of corporate charters. Since 1903, the SCC's jurisdiction has expanded significantly as a result of legislative amendments and constitutional amendments to include the regulation of energy, insurance, securities, corporate filings, communications, financial institutions, and railroads. Despite the growth of the regulatory responsibility of the SCC over the years and the ever-increasing impact of its policies, there is no external assessment routinely made showing the impact that the policies have had or will have on the economy and the lives of citizens of the Commonwealth, or whether alternative approaches would allow the SCC to better fulfill its constitutional and legislative responsibilities. Senate Joint Resolution 173 and House Joint Resolution 187, passed during the 2000 General Assembly Session, created the joint subcommittee to review the regulatory responsibilities, policies and activities of the SCC and examine the short- and long-term impact of its policies and activities. Though initially created for a two-year period, Senate Joint Resolution 45 (2002) continued the study for an additional year.

The broad scope of the study required the joint subcommittee to spend a significant portion of the first year of the study developing a comprehensive list of issues appropriate for its consideration. A final list of issues for consideration, which included input from interested parties and stakeholders, became the joint subcommittee's base reference for the parameters of its inquiry. At the close of the first year of the study the joint subcommittee hired the George Mason University School of Public Policy (GMU consultant) as an independent consultant to conduct a study of the SCC and provide recommendations for the consideration of the joint subcommittee in carrying out its charge.

The second year of the study initially focused on the joint subcommittee's review of successive drafts of the GMU consultant's report culminating with the final report that was submitted on August 1, 2002. Recognizing the need to obtain effective input from the business sectors regulated by the SCC as well as groups representing consumers and citizens, the joint subcommittee encouraged interested parties to submit their comments directly to the consultant. After the submission of the second draft report, a public comment process was instituted to further facilitate participation from these interested parties. In addition, the joint subcommittee provided the SCC with the opportunity to respond or provide comment at every critical juncture of its review.

Prior to the hiring of the GMU consultant, the joint subcommittee learned that in January 2000 the SCC had hired David Wirick of the National Regulatory Research Institute to perform a comprehensive review of its operations. His findings were submitted to the SCC in March 2001 and made available to the joint subcommittee. After the submission of the GMU consultant's final report, the joint subcommittee decided to include the recommendations of Mr. Wirick in its deliberations. A matrix consisting of the 76 recommendations submitted by both consultants was developed including a comparative analysis of the findings. The joint subcommittee focused on

developing its final recommendations using the matrix of consultants' recommendations as a reference guide. Throughout the study, the SCC had taken actions based on the findings of the consultants' reports. In light of these actions, the joint subcommittee determined that it would be appropriate to allow the SCC more time to complete its implementation efforts before further deliberating possible final recommendations. To provide this opportunity, the joint subcommittee requested and received an additional year of study.

The final year of the study began with a review of the status of the SCC's implementation of the consultants' recommendations and additional opportunities for public comment. The joint subcommittee noted the success that been achieved in providing a forum for groups with diversified interests to express their views on the operations of the SCC and how those operations might improved in light of the rapidly changing environment of the business sectors it regulated. It also was noted that the SCC had taken several actions in response to the consultants' reports and other concerns raised by interested groups over the course of the joint subcommittee's study.

Many of these actions served to promote more efficient operations at the SCC and alleviate specific concerns, both actual and perceived, regarding the agency's regulatory and policy-making process. After some deliberation, the joint subcommittee determined that many of the major issues and concerns raised not only by the consultants' reports, but also by the inquiries of the joint subcommittee, had been addressed or were in the process of being addressed. It was the consensus of the joint subcommittee that, given the on-going nature of the SCC's efforts in this regard, additional final recommendations were not necessary. Rather, the joint subcommittee determined that it would be appropriate to review the SCC's efforts at some point in the near future.

Accordingly, the membership unanimously agreed to recommend that the SCC provide the Governor and the General Assembly an update on the status of actions taken in response to the consultants' reports by November 30, 2003.

**REPORT OF THE
JOINT SUBCOMMITTEE STUDYING THE REGULATORY RESPONSIBILITIES,
POLICIES AND ACTIVITIES OF THE STATE CORPORATION COMMISSION**

To: The Honorable Mark Warner, Governor of Virginia
and
The General Assembly of Virginia

Richmond, Virginia
June 2003

I. STUDY AUTHORITY

Senate Joint Resolution No. 173 and House Joint Resolution No. 187 (Appendix B), agreed to during the 2000 Session of the General Assembly, established a joint subcommittee to study the regulatory responsibilities, policies and activities of the State Corporation Commission (SCC). The joint subcommittee was required by the resolution to complete its work and submit its findings and recommendations to the Governor and the 2002 Session of the General Assembly. However, legislation passed during the 2002 Session of the General Assembly extended the study for an additional year (Appendix A).

The joint subcommittee is composed of 16 members: four members of the Senate, appointed by the Senate Committee on Privileges and Elections; six members of the House of Delegates, appointed by the Speaker of the House; and four citizens, appointed by the Governor. In addition, the Attorney General and the Secretary of Commerce and Trade or their designees serve ex officio.

II. OVERVIEW OF FIRST YEAR

At the outset of its deliberations, the joint subcommittee determined that the scope of the SCC's regulatory authority necessitated the need to develop a focus on issues that would be most appropriate to include in the study. The joint subcommittee adopted a comprehensive document titled "Issues for Consideration," encompassing the issues for inclusion in the study. This document was developed with input from several stakeholders and interested parties. In addition, the joint subcommittee adopted a work plan to provide a detailed yet flexible method for achieving the study objectives.

The joint subcommittee determined that securing an independent consultant would greatly assist in achieving the objectives of the study by providing more focused expertise in the various business sectors and industries regulated by the SCC. The joint subcommittee secured a total of $100,000 to fund the consulting services that would be needed. At the direction of the joint subcommittee, staff developed a request for proposal (RFP) requiring respondents to

provide (i) qualifications and experience of the individuals who would be providing consulting services, (ii) a proposed consulting work plan addressing the items included in the "Issues for Consideration" document and the methodology to be utilized, and (iii) the proposed consulting fee and schedule of payments.

The joint subcommittee determined that the RFP for the consulting services would be sent to the Commonwealth's 14 public institutions of higher education. The George Mason University (GMU) School of Public Policy was the only institution that submitted a proposal meeting all criteria established by the joint subcommittee. While several members were concerned with having only one proposal, the joint subcommittee proceeded with the review of the GMU proposal. In the process of reviewing the proposal, it was determined that the initial scope included in the RFP was too broad. The joint subcommittee decided to limit the scope of the consultant's work to those issues under the heading of "Appropriate Regulation of New and Future Industries," "Developing Regulatory Policy," "Compliance with General Assembly Policy and Intent," "Mission and Structure," and "Operations." The GMU proposal, as amended to incorporate changes requested by the joint subcommittee, was ultimately accepted. The GMU consultant's work was intended by the joint subcommittee to be an important component of its deliberations in the second year of the study.

In addition, the joint subcommittee learned that in January 2000 the SCC hired David Wirick of the National Regulatory Research Institute to perform a comprehensive review of its operations. During the first year of its study, Mr. Wirick provided the joint subcommittee with an interim report on his findings. The joint subcommittee determined that Mr. Wirick's final report, which was to be available in early 2001, would be helpful in its review of the SCC.

At the close of the first year of the study, the joint subcommittee submitted an interim report reviewing its activities (Appendix C).

III. ACTIVITY OF JOINT SUBCOMMITTEE IN SECOND AND THIRD YEAR

A. 2001 Meetings

April 17, 2001

The meeting began with a brief overview of the final report of David Wirick, the consultant hired by the SCC, and by Kenneth Schrad, Director of the Division of Information Resources for the SCC. The SCC had previously provided copies of the report to members of the joint subcommittee. The report included 25 recommendations focusing on a variety of areas but mainly concentrating on the internal operations of the SCC (Appendix E). Mr. Schrad noted that while there was disagreement regarding some passages that were believed to be factually inaccurate, the SCC intended to proceed with reviewing the recommendations and determining how they may be implemented. The joint subcommittee paid special note to the consultant's recommendations concerning the SCC's policy-making process, including the recommendations

that the SCC establish a dialogue with legislative leaders on its role and that the SCC actively seek legislative guidance on important matters. Some members of the joint subcommittee were interested in determining how the SCC would implement the recommendations or whether an official response to the report would be provided. Mr. Schrad indicated that the SCC was still in the process of reviewing the report and had not determined its response or plan of action regarding all of the recommendations. He offered, on behalf of the SCC, to provide a presentation from the consultant at a future meeting of the joint subcommittee. The joint subcommittee resolved to continue monitoring the implementation of the report by the SCC.

Joint Subcommittee Consultant

Dr. Kenneth Button, one of the principal investigators working on the consulting project for GMU, presented the interim report that had been submitted to the joint subcommittee in March 2001. According to Dr. Button, the interim report constituted the first stage of the basis for the final report. Dr. Button explained that the primary objective of the report was to explore trends in the industries regulated by the SCC and the associated regulation of those industries from a more general standpoint. Dr. Button also reviewed the work plan developed by the consultant contract that provided for the submission of at least two drafts prior to the submission of the final report by August 31, 2001. The joint subcommittee developed a work plan revolving around its review of each draft and the final report.

The first draft of the final report from the GMU consultant would be due on May 28, 2001. The joint subcommittee resolved that it would be appropriate to allow the SCC to comment on the draft and further to have those comments available to the public simultaneously with the report. The joint subcommittee set its next meeting for June 15, 2001, to review the draft report. In addition, staff was directed to ensure that any comments of the SCC on the draft report be made available to the public via the joint subcommittee's website.

June 15, 2001

Dr. Button presented the first draft report to the joint subcommittee. The report contained a total of 29 recommendations organized under six subject headings (Appendix D, p. A-153). The first 13 recommendations were organized under the heading "Assessment of the SCC." The remaining 16 recommendations were placed under headings that were specific to industries regulated by different divisions of the SCC including insurance, finance, securities and retail franchising, telecommunications and energy.

Generally, the GMU consultant's first draft recommended that the SCC retain its role as the body responsible for the economic regulation of the sectors currently under its oversight. The GMU consultant recommended, however, that the number of judges should be increased from three to five, with one judge being replaced each year. The rationale for the recommendation was that it would serve to speed up decision-making and allow for more "fresh blood" to flow through the bench. Other recommendations of the assessment portion of the report included suggestions for the establishment of (i) an administrative committee to act as a formal link between the divisions and the commissioners to provide a degree of ex parte separation between staff and (ii) separate directors for energy and communications.

Among the recommendations made for the specific business sectors, the findings and recommendations with regard to the telecommunications and energy sectors generated the most discussion among the members. Regarding the telecommunications area, there was a concern that there was an over-reliance in the report on market share numbers and that perhaps other market factors should be considered. It was the consensus of the joint subcommittee that additional work should be undertaken by the GMU consultant to get a better view of where the Commonwealth stood relative to other states undergoing the same regulatory changes and that some additional effort should be taken to examine the experience of these states. It was further noted that the report's assertion, that the telecommunications and energy sectors needed more competition at a faster pace, failed to adequately discuss factors outside of the SCC's control, affecting the pace of deregulation efforts in those sectors (e.g., relevant federal laws and the issue of sovereign immunity).

Dr. Button informed the joint subcommittee that the second draft of the final report would be submitted to the joint subcommittee on July 13, 2001. The joint subcommittee felt it would be important to allow interested parties to provide written comments directly to the GMU consultant for consideration and possible inclusion in the second draft. Interested parties were directed to provide their written comments on the first draft directly to Dr. Button by June 29, 2001.

July 20, 2001

The joint subcommittee focused on reviewing the second draft of the GMU consultant's report (Appendix D, p. A-157). Dr. Button noted that several written comments had been received from interested parties and considered for incorporation into the second draft. He also highlighted the major changes that had been made from the first draft including:

- Including information on the revenue generated by the SCC.
- Including the results from an insurance industry telephone sample.
- Additional tables included in the appendix to support findings related to telecommunications.
- A softening of the recommendation to increase the number of commissioners (though the basic recommendation to increase the membership to five remained).
- More discussion on the need to respond to broader issues such as the promotion of competition as a rationale for increasing the number of commissioners.
- Including discussion on the need to address issues concerning ex parte communications to avoid the appearance of impropriety.

Mr. Schrad reviewed the SCC's written response to the first draft of the GMU Consultant (Appendix G). The response consisted generally of (i) identification of factual errors and corrections to the draft report, (ii) suggested clarifications and additions to the report, and (iii) specific responses to each of the recommendations made by the GMU consultant.

After Mr. Schrad's presentation, the joint subcommittee reviewed the progress of the GMU consultant and made suggestions for the final draft. Mr. Woltz requested that the consultant pay particular regard to the comments of Dominion Power regarding the issue of establishing a separate Director of Energy and Director of Telecommunications. Senator Norment further requested that the consultant develop additional detail regarding that issue as well as performance assessment. Mr. Woltz also requested that the final report should include discussion of the appropriate role of the SCC in developing regulations and whether the activities of the SCC were in compliance with the policy of the General Assembly. Chairman Norment noted that the next meeting of the joint subcommittee would include preferential placement on the agenda for public comment.

September 19, 2001

Review of the GMU consultant's final report

The meeting began with a review of the GMU consultant's final report (Appendix D). The report had been revised to a total of 26 recommendations, though the headings remained unchanged from the previous two drafts. Dr. Button provided the members with a brief overview of the final recommendations after which a public comment period was held. The recommendations and page references are as follows:

Recommendation 1
The structure of regulation in Virginia has stood the test of time and change should only be undertaken in light of serious long-term problems. Many sectors overseen by the SCC have undergone major technical and structural changes. In itself, this is not justification for change unless lack of change impairs the long-term efficiency with which Virginian's can access these services. The SCC should retain its role as the body responsible for economic regulation of the sectors currently under its oversight (p. 22).

Recommendation 2
The SCC should remain as independent as possible from short-term political pressures (p. 23).

Recommendation 3
The basic principle of regulation should be to allow the market to function and only to intervene when there are demonstrable market failures that appropriate regulatory control can be demonstrated to reduce (p. 23).

Recommendation 4
The Commonwealth's structure of regulation was initially designed to deal with fundamental market flaws as perceived at the time. Our understanding of how markets function has subsequently changed, as has technology. It is important to ensure that the workings and decisions of the SCC continue to take full account of this (p. 23).

Recommendation 5
It is important that the SCC collect salient data and that this data adequately reflect the implications of its actions on consumers as well as on the industrial sectors under its jurisdiction. One of the most effective forms of consumer protection is good information (p. 23).

Recommendation 6
The SCC should continually review the data that industry is required to provide and limit that data to which is necessary for the agency to fulfill its regulatory requirements. In doing this, it should seek to minimize the burden on the regulated industries of providing data and other information (p. 23).

Recommendation 7
The activities of the SCC should continue to be self-funded to avoid problems that many states have in achieving efficiency and effectiveness because of a dependence on annual state budgetary decisions (p. 24).

Recommendation 8
The suggestion that the number of judges should be increased to five, with one being replaced each year, should be seriously considered. This would require constitutional change (p. 26).

Recommendation 9
Adequate resources should be provided to reduce the turnover of staff in the Office of General Counsel. This turnover at a minimum impedes the speed at which cases can be brought (p. 26).

Recommendation 10
The State Corporation Commission should continue to explore ways of improving the public understanding of how it internally handles potential ex parte conflicts. It should continually seek ways to mitigate potential conflict (p. 27).

Recommendation 11
The current process of dispute resolution, with its informal and formal elements, seems to work well if slowly at times. There is no recommendation of further informal 'alternative dispute resolution' procedures being required. More formality generally leads to even slower decision-making (p. 27).

Recommendation 12
The similarities and interconnections between the regulatory demands in the fields of gas, electricity and water regulation justify the creation of a Directorate of Energy (p. 28).

Recommendation 13
The various divisions should develop a system of performance-assessment procedures suitable to their own activities. These should be quantifiable where possible but should also contain qualitative indicators. Performance measured against criteria should be part of annual division reports (p. 29).

Recommendation 14
All divisions of the SCC should engage in more public information dissemination and information gathering. The banking division holds a number of courses for the industry as well as periodic seminars – this type of model may be usefully replicated elsewhere (p. 29).

Recommendation 15 (Insurance)
To ensure that emerging issues related to deregulation are built into future agreements, and that industry agents and agencies can give opinions confidently in the jurisdiction, the Bureau of Insurance should identify other states or countries with which Virginia currently has no reciprocity agreements, but with which it is most likely to establish such in the near future (p. 40).

Recommendation 16 (Insurance)
The Bureau of Insurance should continue to identify specific areas where threats to consumers' privacy may be at risk from increased reliance on electronic commerce and develop effective measures to counter those threats (p. 40).

Recommendation 17 (Insurance)
The Bureau of Insurance should continue to work with the National Association of Insurance Commissioners to develop uniform 'treatment of companies' and 'market conduct' standards or regulations (p. 40).

Recommendation 18 (Finance)
There have been a number of changes to the Virginian Banking Code over the years. A full review of the Code should now be conducted. This should not be taken to imply that radical change is needed; rather, it is a matter of 'good housekeeping' (p. 51).

Recommendation 19 (Finance)
The Bureau of Financial Institutions has developed successful ad hoc ties with other bureaus and divisions within the SCC. These should be continued although there would seem to be no good reason for any formalization of the process (p. 52).

Recommendation 20 (Securities and Retail)
The Securities Division would benefit from having more attorneys working with it. At present, there is only one attorney in the Office of General Counsel who works with the Division, even though that division deals with a growing market. The implications of the 1999 Financial Modernization Act and some internal adjustment of SCC rules and operation commands are likely to increase pressure on attorneys (p. 65).

Recommendation 21 (Telecommunications)
A variety of methods exist for measuring the effects of competition that go beyond price. With competition as the broad goal, it is essential to determine how to measure the attainment of that goal. Therefore, a system needs to be designed to establish the baseline (current state of competition) and then to monitor it over time (p. 81).

Recommendation 22 (Telecommunications)
The activities of the collaborative committee are critical to competition in the Commonwealth. Therefore, it is important to continue to take steps to move the process along as quickly as possible (p. 81).

Recommendation 23 (Telecommunications)
The citizens of the Commonwealth are primarily restricted to local telephone service by one firm. Considering that the telecommunications industry is evolving rapidly, it is recommended that the Commission take periodic snapshots of available services across major telecommunications markets to determine if those services are available in the Commonwealth. If it is found that the Commonwealth is lagging, then the Commission can enter into discussions with local telecommunications providers to determine why (p. 81).

Recommendation 24 (Telecommunications)
In order to enhance competition in the Commonwealth, the SCC should continue to find additional ways to allow competitors into the marketplace as rapidly as possible. The current financial difficulties of the smaller Competitive Local Exchange Carriers combined with the inherent economies of scale indicate that the most immediate source of competition will come from the larger and more established firms. The current arbitration impasse is blocking the largest potential competitors. Methods of circumventing this problem should be sought expeditiously (p. 82).

Recommendation 25 (Energy)
The SCC should continue to foster more pilot programs in natural gas supply and accelerate the development of competitive markets in energy provision wherever possible (p. 101).

Recommendation 26 (Energy)
There are several remits under which the SCC is required to consider matters pertaining to the environment, economic development, and consumer protection. To allow these broader matters to be dealt with adequately, the SCC should seek ways of allowing the widest sets of evidence to be brought to bear in cases (p. 101).

Public Comment

Eleven individuals, some representing interested organizations, provided public comment at the meeting (Appendix K). The highlights of the comments, including a reference to relevant final recommendations of the Wirick and GMU consultant reports, are as follows:

American Electric Power (Dan Carson, Virginia President)

- Consider establishing a Director of Utilities position *(GMU #11/ Wirick #2).*
- Separation of the administrative and judicial processes merit further study and perhaps formal change *(GMU #10/Wirick #5).*

Mr. Tom Branen

- The SCC is fair, cooperative, and easy to work with.

Cavalier Telephone

- The current process designed for competitive interconnection is inadequate and discriminatory.. The SCC should effectively govern relationships between carriers *(GMU #23, #24).*

- The SCC should have a fixed timetable for handling disputes and complaints and rendering decisions in such disputes.

The Virginia Citizens Consumer Council (Irene E. Leech, President)

- The joint subcommittee should increase its efforts to ensure that all interested parties, in particular those representing the interests of "citizen consumers," be allowed the opportunity to participate in the review of the SCC.

- A regulatory policy providing that regulation is appropriate only when there is market failure and the regulation can be proven to correct the problem does not meet the needs of the citizen consumer *(GMU #3, #4).*

- The current structure of the SCC works and should not be changed to make the Commission more political *(GMU #8).*

- The use of alternative dispute processes would be supported if the process would not disadvantage citizen consumers by reducing opportunities for involvement *(GMU # 11/Wirick #11, #12).*

- Any change in the relationship between staff and the judges to prevent perceived problems concerning ex parte contacts should only be made if the current arrangement has caused problems *(GMU #10).*

- Funding should be increased for the Consumer Division of the Attorney General's Office and for SCC staff. Creating a consumer advocate within the SCC should be considered *(Wirick #6, #7 and #15).*

Cox Virginia Telcom, Inc. (E. Ford Stephens, Esq.)

- The SCC should seek methods of circumventing the arbitration impasse regarding the interconnection agreements *(GMU #24).*

Virginia Committee for Fair Utility Rates and the Old Dominion Committee for Fair Utility Rates (Edward L. Petrini, Esq.)

- The GMU report does not reveal serious long-term problems warranting its recommendations to increase the number of judges from three to five and establishing an Energy Directorate *(GMU #8, #12).*

Mr. Edward L. Flippen, Esq.

- Increasing the number of judges from three to five and changing the duration of their terms should not be considered *(GMU #8)*.

Dominion Power

- ·Establishing Directors of Energy and Telecommunications and evaluating the organization of the staff overseeing these sectors warrants careful consideration *(GMU #12)*.

- Providing an enhanced role for the executive branch in providing information and analysis to the SCC should be considered.

MCI WORLDCOM

- The General Assembly should provide stronger long-term policy guidance and provide regular oversight of the SCC and its implementation of public policy *(GMU #2)*.

- The General Assembly should consider legislation to specifically allow the SCC to waive sovereign immunity on issues relating to the Federal Telecommunications Act *(GMU #24)*.

- The basic principle of regulation should be to allow the market to function and only to intervene when there are demonstrable market failures *(GMU #3)*.

Mr. James C. Roberts, Esq.

- The current number of SCC Commissioners and method of replacing them should not be changed *(GMU #8)*.

- Creation of a Director of Energy Regulation position should be considered *(GMU #12)*.

The New Power Company(Martha Dugan, Director of Governmental Affairs)

- The joint subcommittee should address how the SCC will relate to new electricity sector participants in a manner that will ensure that the benefits of competition are widespread throughout the Commonwealth.

Mr. George Poffenberger, Jr.

- The SCC should streamline the application requirements for licensing insurance agents.

Mr. Earl Ward

- The conduct and activities of the Bureau of Insurance in handling disciplinary cases involving regulants of the insurance industry requires further review by the joint subcommittee.

After the public comment period, Clinton Miller, Chairman of the SCC, spoke briefly, highlighting the written response provided to the joint subcommittee on September 17, 2001 (Appendix H).

The joint subcommittee then reviewed options for proceeding with the final phase of the study. It was determined that the SCC would be provided with copies of the public comments given at the meeting in order to respond at the next meeting. In addition, the SCC would be given an opportunity to respond to the final report of the GMU consultant. The joint subcommittee directed staff to develop a matrix comparing the final reports of Mr. Wirick and the GMU consultant as well as recommendations or issues that have been brought before the joint subcommittee through public comment. The aim of the matrix would be to develop a method for determining and prioritizing the major policy issues that need to be decided relative to the study. Upon determination of these major issues, the joint subcommittee would be able to determine action on specific issues raised by the studies and public comment and also decide whether an additional year would be needed to complete the study.

November 19, 2001

Public Comment

The meeting began with a public comment period that included written and oral comments (Appendix L). Irene Leech, President of the Virginia Citizens Consumer Council, stated that the final report failed to adequately address the very critical role that the SCC plays in representing consumers. She also asserted that the study has appeared to focus primarily on the interests of business, favoring business over the consumer, and that consumers are very concerned about the potential damage that could occur from such an unbalanced approach. Ms. Leech further noted that the Office of the Attorney General, which is charged with representing consumers before the SCC, does not have sufficient resources to participate in every case that affects consumers. As possible alternatives for ensuring more consumer participation, Ms. Leech suggested providing funding for established consumer groups to participate in more SCC proceedings or the establishment of a separate consumer advocate entity.

Mr. Urchie B. Ellis stated that the political pressure involved with energy deregulation was being adequately resisted at the SCC but that there was a need for a stronger consumer voice outside of the Office of the Attorney General. A written statement submitted by the Virginia Association of Family and Consumer Sciences commended the SCC for being a very reliable source of resources providing critical information that impacts the economic welfare of Virginia families and professionals working closely with consumers; the agency has proven to be a beneficial agency for the association's membership and a vital and useful part of state government.

John F. Dudley, Senior Assistant Attorney General, Insurance and Utilities Regulatory Section, provided comment on behalf of the Division of Consumer Counsel of the Office of the Attorney General. Mr. Dudley agreed with the findings of the GMU consultant relative to (i) the SCC's continued responsibility over the business sectors it currently regulates, (ii) development of a structure providing for one person to serve as a primary point of contact and coordinator of policy in the areas of electricity, natural gas, and water, and (iii) the continued review of data collection requirements. However, Mr. Dudley expressed concern with the apparent suggestion of the report that regulation was only needed after there was a demonstrable market failure. This approach, stated Mr. Dudley, would invariably result in harm to consumers and what was needed was a more balanced approach that would protect consumers as competition evolved.

Summary of Matrix review

The joint subcommittee also reviewed a matrix containing the recommendations provided by the Wirick and GMU consultant reports (Appendix N). The matrix organizes the recommendations under six broad categories and provides the number of each recommendation as it appears in each consultant's report.[1]

The Wirick and GMU reports take somewhat different approaches, which makes comparison of the recommendations more difficult. The Wirick report contains several recommendations that relate to internal staff issues not addressed in the GMU report. Conversely, unlike the Wirick report, the GMU report contains "general" recommendations relating to the SCC, and also makes several recommendations that are specific to five regulatory divisions within the SCC. Even with these different approaches, the consultants' reports generally agree on the following recommendations:

1. Continue the SCC's responsibility for economic regulation of the sectors currently under its oversight;
2. Improve the coordination of operations governing utilities;[2]
3. Provide additional resources for the Office of General Counsel;
4. Develop a mission regarding the regulation of competitive markets;
5. Develop better performance measurements; and
6. Engage in more public information and information gathering.

Other issues discussed by one or both of the consultants that generated substantial discussion among joint subcommittee members include (i) whether to increase the number of

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[1] The matrix headings are *Mission, Structure, Funding, Performance Assessment, Consumer/Public Relations,* and *Division Specific.*

[2] The previous study of the SCC performed by the Joint Legislative Audit and Review Committee (Organization and Management Review of the State Corporation Commission, House Document No. 15, (1987)) also identified a problem in coordination of utility cases.

SCC Commissioners and (ii) whether additional measures should be taken to restrict ex parte communications between the SCC Commissioners and SCC staff.[3]

Staff proceeded to provide the joint subcommittee with an overview of the matrix document on a category by category basis.

Mission. The consultants' reports agree that the SCC should continue in its role as the body responsible for regulating the economic sectors that it is currently assigned. The remaining issue regarding the mission appears to be in determining how that role is to be carried out -- that is, whether the mission should emphasize fostering competitive markets or the regulation of competitive markets.

Structure. Both consultants discussed the perception among some that there was inadequate separation between SCC staff and the Commissioners. The GMU consultant recommends that the SCC explore ways of better communicating how it internally handles potential ex parte conflicts. The Wirick report recommends adoption of a stronger model of separation. Regarding the organization of the public utilities sector, the GMU report recommends the establishment of an Energy Directorate that would oversee gas, electricity and water regulation. The Wirick report takes the position that a Director of Public Utilities is not needed. From a more general standpoint, the Wirick report recommends the establishment of a Director of Administration as a structural change to the SCC to assist in the coordination of administrative services to its operating divisions.

Funding. The reports agree that an effort should be made to make more resources available for legal staff at the SCC as well as for consumer representation at the Office of the Attorney General.

Performance Assessment. The general areas of concern identified involve the need to develop tasks or factors that are measurable that may be used in an ongoing basis for determining whether and how well the SCC is carrying out legislative mandates.

Consumer/Public Relations. The consensus of the reports indicate there are some perceptions of the problem that may be the result of a lack of good communication between SCC and (i) consumers, (ii) the General Assembly, and (iii) the regulated industries. In addition, there is a need for the SCC to make more efforts to reach out and cooperate with these three groups.

Division Specific. While there were recommendations that applied to all divisions of the SCC, the major areas of contention centered on energy and telecommunications. Regarding energy, a need to accelerate development of more competitive markets and to broaden evidence considered when dealing with energy issues was cited. For telecommunications, the recommendations coalesced around the need to increase efforts to bring in more competition and to address the arbitration impasse.

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[3] The most comprehensive previous study of the SCC's fundamental structure (the Commission on State Governmental Management (the Hopkins Commission)) found this issue to be a substantial problem, resulting in its central recommendation to transfer most of the SCC's executive/administrative responsibilities to executive branch agencies.

SCC Comments on GMU Consultant Final Report

In response to the final report of the GMU consultant, the SCC provided the joint subcommittee with a document dividing the report into the following categories: (i) recommendations for continuing current practices, (ii) internal staffing, (iii) improved information and understanding, and (iv) public policy/legislative consideration (Appendix I).

The SCC expressed particular concern with recommendations for increasing the number of judges, ex parte separation, and the establishment of a Directorate of Energy. The SCC asserted that the recommendation for increasing the number of judges to five left the impression that there remained something to be implemented as a result of the 1971 amendments to the Virginia Constitution. There is no specific constitutional mandate for such an increase. In addition, according to the SCC, the estimate of the first-year costs for the additional commissioners would be slightly more than $1 million in the first year and approximately $780,000 in the second year.

Regarding ex parte separation, the SCC maintained that the issue is addressed adequately in its Rules of Practice and Procedure, which include provisions that go well beyond the ex parte rules of the Administrative Process Act, applying to most administrative branch agencies. The SCC pointed out that the rules were revised in January of 2001 with significant involvement and participation by interested parties.

The SCC also maintained that the proposed Director of Energy would insert an additional layer of bureaucracy and that the present organization that allows the industry and the public with more direct access to the individuals with the proper expertise was preferable.

Deliberation of the joint subcommittee

After the SCC's report, the joint subcommittee proceeded to review the status of the study and to determine possible final recommendations. Chairman Norment expressed concern about the ex parte separation issue as well as the need to more clearly develop performance measures to gauge compliance with implementation of legislative mandates.

Chairman Norment also raised the issue of whether the joint subcommittee, in view of the complexity of the issues that had been raised by both consultant reports and the need to carefully study the recommendations, could adequately complete an effective review of the important issues within the time frame provided by the original study resolution. He cited the critical nature of these issues to consumers and the regulated community as well as the need to achieve a favorable resolution.

At least two members of the joint subcommittee expressed the opinion that continuation of the study for an additional year was not necessary. Delegate Morgan stated that he did not believe a continuation of the study was necessary but rather that the issues could be revisited in six months to determine whether any progress had been made toward resolution of the issues contained in the consultants' reports. Senator Colgan agreed, stating that perhaps a meeting in

the Fall of 2002 could serve as an avenue for such review. After additional discussion among the joint subcommittee, it became the consensus of the membership that legislation be introduced requesting an additional year to complete the study. This would give the joint subcommittee additional time to review the recommendations of the consultant reports as well as provide the SCC with further opportunity for implementation of the recommendations.

Mr. Woltz stated that one of the most critical issues that should be taken up in the final deliberations of the study was the gap that appeared to exist between the General Assembly and the SCC in establishing policy. He asserted that there needed to be greater involvement by the General Assembly in the development of policy and in ensuring that policy established by the legislature was being carried out properly. Mr. Woltz also asserted that the problems currently experienced in the telecommunications industry related to interconnectivity agreements could be resolved by perhaps waiving the state's sovereign immunity for the limited purpose of allowing the SCC to arbitrate such agreements. It was agreed that these issues would be taken up in the next year of the study.

Citing the public comments and statements of joint subcommittee members, Mr. Woltz also stated that the recommendation made by the GMU consultant to increase the number of judges from three to five not be pursued by the joint subcommittee since it appeared that no one was in favor of doing so. Mr. Flippen agreed with this suggestion stating that it would be appropriate to resolve the issue even though the joint subcommittee had already agreed to request an additional year for the study. It was the general consent of the membership, without a vote being taken, that increasing the number of judges from three to five as recommended by the GMU consultant would not be included as a recommendation of the joint subcommittee.

B. 2002 Meetings

September 17, 2002

The joint subcommittee focused on the review of the status of the SCC's implementation of the recommendations contained in reports of the consultant hired by the joint subcommittee (the GMU report) and the consultant hired by the State Corporation Commission (the Wirick report). Chairman Norment opened the meeting with the introduction of Robert D. Hardie and B. Rod Rodgriguez as the new citizen members appointed to the joint subcommittee by the Governor, and Robert Schewel, the newly appointed Secretary of Commerce and Trade.

Kenneth Schrad, Director of the Division of Information Resources, presented the joint subcommittee with an overview of the actions taken by the SCC to implement some of the recommendations contained in the two consultant reports (Appendix O).

The highlights of Mr. Schrad's remarks on the status of the SCC's implementation actions include:

- Instituting a "strong chairman" structure giving the chairman of the SCC a dominant role in administrative matters affecting all SCC divisions. Under this structure, all divisions of the SCC report to the chairman, who now serves as the primary point of contact for all division-related administrative matters (i.e., including operations, budget, and personnel). Mr. Schrad noted that, though the chairman will continue to be elected annually, the traditional annual rotation of the chairmanship is expected to continue.

- Creating two new positions, Counsel to the Commission-Utilities and Counsel to the Commission-Business and Financial to provide a buffer between the Commission and Commission staff. This action was taken in response to concerns raised in both the GMU and Wirick reports regarding what appeared to be a lack of adequate separation between the Commissioners and SCC staff. Commissioners will now rely on these counsel positions in non-administrative matters whenever legal issues or facts of technical nature are such that direct involvement by SCC staff in formulating a Commission decision must be avoided.

- Designating high ranking agency staff as "single points of contact" for each of the primary industry sectors. Each of these individuals are directed by the Commission to coordinate all regulatory matters and assume the lead in communicating and encouraging the development of competitive markets involving their respective sectors. The single points of contact would specifically cover the industry sectors areas grouped as (i) telecommunications, (ii) electric, natural gas, and water, (iii) insurance, (iv) financial, (v) investment, and (vi) business entity filings.

- Identifying all formal cases under categories that match the six primary industry sectors.

- Implementing a computer-based case management system tracking all documents filed in each formal case. It was anticipated that by late November 2002 the SCC's web site would allow the general public to access every public document filed in a case.

- Adding one attorney position in the Office of General Counsel who will focus on the securities area bringing the total to two attorneys with primary responsibility in this area.

- Involving stakeholders earlier in the process through stakeholder sessions convened by SCC staff during the development of proposed rules or regulations. Mr. Schrad emphasized that the use of such stakeholder sessions have been successful in the development of retail access rules for electricity and natural gas, competitive metering, and consolidated billing. Stakeholder sessions are also currently being used in the development of default service guidelines.

- Establishing through a collaborative effort new performance standards and a remedy plan for Verizon when providing service to Verizon's competitors through a collaborative effort involving all stakeholders.

At the conclusion of his remarks, Mr. Schrad fielded questions from several members of the joint subcommittee. Chairman Norment asked if the SCC had gotten any feedback on whether the new Commission counsel positions were having any impact on the perception of the ex parte separation issue. Mr. Schrad responded that while he had not personally been made aware of any concerns, there initially seems to be a desire to see if the arrangement works. John F. Dudley, the current counsel to Commission-Utilities, indicated that though things were still in transition, while serving in his role he has not received information from any stakeholders or participants that the arrangement was not working. Chairman Norment then asked what was done proactively to dispel the perceived ex parte separation problem. Mr. Dudley responded that his initial contacts with industry and consumer stakeholders have been to explain his role and to express his openness to contact from these parties. Mr. Schrad added that the affect of the new positions could be measured by inviting comments from practitioners, which under the newly adopted "strong chairman" model, could be done both formally and informally.

Delegate Rollison stated that there remained some question concerning whether a Commission comprised of three individuals where each commissioner is responsible for issues and cases in a given subject matter area to the exclusion of the other two commissioners was adequate in terms of the workload and power exercised by the individual commission member. He asked if individual Commissioners were still assigned subject matter areas exclusive of other members. Mr. Schrad responded that under the "strong chairman" model the chairman would now make the decision regarding which of the commissioners would handle a given issue or case. It was resolved through further discussion, however, that there was nothing to prohibit the chairman from assigning the issues and cases involving a given subject matter to the same commissioner who handled the subject matter prior to the change in structure.

Delegate Morgan asked why the SCC had discontinued its practice five or six years ago of rotating subject matter and issues among the commissioners. Mr. Schrad responded that the objective of the "strong chairman" model is to provide for issue rotation among the commissioners.

Chairman Norment asked if the SCC had revisited the issue of increasing the number of commissioners to help the state through changes that the industries under the SCC's charge are undergoing. Mr. Schrad stated that such a change was a policy issue that had to be determined by the General Assembly. Delegate Rollison asked how many members did similar commissions in other states have. Mr. Schrad stated that most commissions consisted of three or five members. Mr. Woltz stated he could not recall anyone, other than the GMU consultant, who thought increasing the number of commissioners was a good idea. He further stated that he was not aware of any benefit in having five commissioners rather than three. Delegate Rollison stated that his concern was to avoid the situation where, without effective issue and case rotation, there would be a de facto one-member commission.

Chairman Norment also noted that a recommendation of the GMU report contained in the energy section urged the SCC to develop a method to allow more information to be considered when it had to make determinations involving the environment. He further noted that the recent legislation passed by the General Assembly required the SCC and the Department of

Environmental Quality to enter into a memorandum of agreement to govern their coordination of reviews of the environmental impacts of electric generating facilities. Chairman Norment asked for an update on the status of the memorandum of agreement. In response, Mr. Schrad stated that a final memorandum of agreement to coordinate the review on air and water permits for the plants had been completed in late July and that in August that document was released.

Citing an issue raised in the Wirick report, Chairman Norment asked if the SCC had taken any specific steps to improve its dialogue with the General Assembly. Mr. Schrad indicated that SCC staff and members are always available to the members of the General Assembly and legislative staff. Delegate Morgan applauded the SCC for what he described was the increase in the number of comments from the SCC that he had seen as Chairman of the House Committee on Commerce and Labor.

Chairman Norment noted that the Wirick report specifically recommended that the SCC should create rules and procedures for the application or alternative dispute resolution and asked what the SCC had done in response to the recommendation. Mr. Schrad responded that rules had been developed for the use of alternative dispute resolution involving some telecommunication issues. Mr. William Irby, Director of the Division of Communications of the SCC, stated that the process would attempt to resolve issues that fell between informal and formal processes. He further indicated that the dispute resolution process had not been used yet.

Delegate Drake noted that both the Wirick and the GMU reports discussed consumer and public relations. Citing a recent public comment period conducted by the SCC concerning banks owning real estate companies, Delegate Drake expressed concern that comments would only be accepted by letter. Mr. Schrad stated that there were issues associated with receiving comments by fax including the quality and the lack of original signatures. Senator Saslaw stated that the SCC should not have such a requirement and that comments should be accepted even by e-mail. Delegate Drake suggested that a form could be devised on the web site to ensure that the correct information is given. Mr. Schrad indicated that he would take the suggestions back to the commissioners.

Chairman Norment concluded that it would be appropriate for the joint subcommittee to receive additional public comment from consumers, the regulated industry and litigants who appear before the SCC regarding how the changes made by the SCC have been perceived and how the SCC might be improved. Delegate Morgan expressed concern regarding the reluctance of some to come forward for fear of reprisals. He suggested that perhaps they could contact the members individually without having to go on public record. It was resolved that a portion of the next meeting will be set aside to receive public comment and recommendations regarding the actions taken by the SCC in response to the consultant reports and how the SCC might be improved.

October 22, 2002

The meeting began with the public comment period. Four individuals provided written comments prior to the meeting: (i) Mr. David G. Hutchinson, Sr., (ii) Mr. Urchie B. Ellis, (iii)

Mr. Claude E. Kinder, and (iv) Ms. Grace B. Layfield (Appendix M). Mr. Kinder and Ms. Layfield also appeared at the meeting to provide oral presentations.

After the public comment period, the joint subcommittee reviewed the status of the study and discussed possible recommendations. Chairman Norment noted that the joint subcommittee had been successful in providing a forum for groups with diversified interests to express their views on the operations of the SCC and how those operations might be improved in light of the rapidly changing environment of the business sectors it regulated. It also was noted that the SCC had taken several actions in response to the consultants' reports and other concerns raised by interested groups over the course of the joint subcommittee's study.

Many of these actions served to promote more efficient operations at the SCC and alleviate specific concerns, both actual and perceived, regarding the agency's regulatory and policy-making process. After some deliberation, the joint subcommittee determined that many of the major issues and concerns raised not only by the consultants' reports, but also by the inquiries of the joint subcommittee, had been addressed or were in the process of being addressed. It was the consensus of the joint subcommittee that, given the on-going nature of the SCC's efforts in this regard, additional final recommendations were not necessary. Rather, the joint subcommittee determined that it would be appropriate to review the SCC's efforts at some point in the near future.

Accordingly, the membership unanimously agreed to recommend that the SCC provide the Governor and the General Assembly an update on the status of actions taken in response to the consultants' reports by November 30, 2003.

2002 SESSION

ENROLLED

SENATE JOINT RESOLUTION NO. 45

Continuing the Joint Subcommittee to Study the Regulatory Responsibilities, Policies, and Activities of the State Corporation Commission.

Agreed to by the Senate, January 25, 2002
Agreed to by the House of Delegates, March 6, 2002

WHEREAS, in 2000 Senate Joint Resolution No. 173 and House Joint Resolution No. 187 established a joint subcommittee to study the regulatory responsibilities, policies, and activities of the State Corporation Commission (SCC); and

WHEREAS, the most recent comprehensive study of the SCC mandated by the General Assembly was performed by the Joint Legislative Audit and Review Commission in 1987; and

WHEREAS, since 1903, the SCC has operated under unique constitutional and statutory responsibilities involving the regulation of many key sectors of the Commonwealth's economy including financial services, insurance, energy, and telecommunications; and

WHEREAS, these industries are undergoing sweeping change as a result of new technology and federal and state deregulatory initiatives; and

WHEREAS, during the first year of its work, the joint subcommittee contracted with George Mason School of Public Policy (GMU-SPP) to provide assistance and services; and

WHEREAS, in March 2001, the joint subcommittee received the final report from a consultant hired by the SCC containing 25 recommendations regarding SCC operations; and

WHEREAS, GMU-SPP submitted its final report to the joint subcommittee on August 1, 2001, containing 26 recommendations regarding the general operations of the SCC and its various regulatory divisions; and

WHEREAS, combining the consultants' reports, the joint subcommittee has received a total of 51 recommendations regarding SCC operations, many of which raised issues that proved to be controversial; and

WHEREAS, although the joint subcommittee held 10 well-attended and informative meetings during the course of the two years of the study, the complexity of the issues raised by the consultants' reports and the joint subcommittee's review, the number and variety of industries affected, and the importance of the favorable resolution of these issues to the people of the Commonwealth have made it impossible for the joint subcommittee to complete its study within the time contemplated by Senate Joint Resolution No. 173 and House Joint Resolution No. 187; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That the Joint Subcommittee to Study the Regulatory Responsibilities, Policies, and Activities of the State Corporation Commission be continued. The joint subcommittee shall consist of 16 members, which shall include 10 legislative members, four nonlegislative and two ex officio members as follows: four members of the Senate, to be appointed by the Senate Committee on Privileges and Elections; six members of the House of Delegates, to be appointed by the Speaker of the House, in accordance with the principles of proportional representation contained in the Rules of the House of Delegates; four citizens to be appointed by the Governor; and the Attorney General or his designee and the Secretary of Commerce and Trade or his designee to serve ex officio with full voting privileges.

The Division of Legislative Services shall continue to provide staff support for the study. All agencies of the Commonwealth shall provide assistance, upon request.

The joint subcommittee shall hold no more than two meetings during the 2002 legislative interim.

The direct costs of this study shall not exceed $5,800.

The joint subcommittee shall complete its work by November 30, 2002, and shall submit its written findings and recommendations to the Governor and the 2003 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.

2000 SESSION

ENROLLED

SENATE JOINT RESOLUTION NO. 173

Establishing a joint subcommittee to study the regulatory responsibilities, policies, and activities of the State Corporation Commission.

Agreed to by the Senate, March 9, 2000
Agreed to by the House of Delegates, March 8, 2000

WHEREAS, the 1902 Constitution of Virginia created the State Corporation Commission (the Commission), enumerating in detail its duties and procedures and vesting the Commission with legislative, judicial, and executive powers; and

WHEREAS, the Commission exercises legislative authority when it makes rules or sets rates, judicial authority when it acts as a court of record and holds formal hearings, and executive authority in its day-to-day administration; and

WHEREAS, despite the exercise of these powers, the Commission is not part of the legislative, judicial, and executive branches of government; however, it is a separate department of Virginia state government; and

WHEREAS, when it began its operations in 1903, the Commission had two primary functions, the regulation of rates and services of railroads and the issuance of corporate charters with a budget of $24,000 and five employees; and

WHEREAS, since that time the Commission's jurisdiction has expanded significantly as a result of legislative amendments and constitutional amendments to include the regulation of energy, insurance, securities, corporate filings, communications, financial institutions, and railroads; and

WHEREAS, the Commission has a current staff of 560 and an annual operating budget of approximately $51 million; and

WHEREAS, despite the growth of the Commission over the years and the ever-increasing impact its policies have on the economy and lives of the citizens of the Commonwealth, there is no external assessment routinely made showing the impact its actions have had or will have on the economy and the lives of citizens of the Commonwealth, or whether alternative approaches would allow the Commission to fulfill its Constitutional and legislative responsibilities; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That a joint subcommittee be established to study the regulatory responsibilities, policies, and activities of the State Corporation Commission. The joint subcommittee shall also study the impact of such policies and activities on the lives of the citizens of the Commonwealth.

The joint subcommittee shall consist of 16 members, which shall include 10 legislative members, 4 nonlegislative citizen members, and 2 ex officio members as follows: four members of the Senate to be appointed by the Senate Committee on Privileges and Elections; six members of the House of Delegates to be appointed by the Speaker of the House, in accordance with the principles of Rule 16 of the Rules of the House of Delegates; four citizens to be appointed by the Governor; and the Attorney General or his designee and the Secretary of Commerce and Trade or his designee to serve ex officio.

The direct costs of this study shall not exceed $14,500.

The Division of Legislative Services shall provide staff support for the study. The State Corporation Commission shall provide technical assistance to the joint subcommittee, upon request. All agencies of the Commonwealth shall provide assistance to the joint subcommittee, upon request.

The joint subcommittee shall submit an interim report to the Governor and the 2001 Session of the General Assembly. The joint subcommittee shall complete its work in time to submit its written findings and recommendations to the Governor and the 2002 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.

GENERAL ASSEMBLY OF VIRGINIA -- 2000 SESSION

HOUSE JOINT RESOLUTION NO. 187

Establishing a joint subcommittee to study the regulatory responsibilities, policies, and activities of the State Corporation Commission.

Agreed to by the House of Delegates, March 10, 2000
Agreed to by the Senate, March 10, 2000

WHEREAS, the 1902 Constitution of Virginia created the State Corporation Commission (the Commission), enumerating in detail its duties and procedures and vesting the Commission with legislative, judicial, and executive powers; and

WHEREAS, the Commission exercises legislative authority when it makes rules or sets rates, judicial authority when it acts as a court of record and holds formal hearings, and executive authority in its day-to-day administration; and

WHEREAS, despite the exercise of these powers, the Commission is not part of the legislative, judicial, and executive branches of government; however, it is a separate department of state government; and

WHEREAS, when it began its operations in 1903, the Commission had two primary functions, the regulation of rates and services of railroads and the issuance of corporate charters with a budget of $24,000 and five employees; and

WHEREAS, since that time the Commission's jurisdiction has expanded significantly as a result of legislative amendments and constitutional amendments to include the regulation of energy, insurance, securities, corporate filings, communications, financial institutions, and railroads; and

WHEREAS, the Commission has a current staff of 560 and an annual operating budget of approximately $51 million; and

WHEREAS, despite the growth of the Commission over the years and the ever-increasing impact its policies have on the economy and lives of the citizens of the Commonwealth, there is no external assessment routinely made showing the impact its actions have had or will have on the economy and the lives of citizens of the Commonwealth, or whether alternative approaches would allow the Commission to fulfill its Constitutional and legislative responsibilities; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That a joint subcommittee be established to study the regulatory responsibilities, policies, and activities of the State Corporation Commission. The joint subcommittee shall also study the impact of such policies and activities on the lives of the citizens of the Commonwealth.

The joint subcommittee shall consist of 16 members, which shall include 10 legislative members, 4 nonlegislative citizen members, and 2 ex officio members as follows: six members of the House of Delegates to be appointed by the Speaker of the House, in accordance with the principles of Rule 16 of the Rules of the House of Delegates; four members of the Senate to be appointed by the Senate Committee on Privileges and Elections; four citizens to be appointed by the Governor; and the Attorney General or his designee and the Secretary of Commerce and Trade or his designee to serve ex officio.

The direct costs of this study shall not exceed $14,500.

The Division of Legislative Services shall provide staff support for the study. The State Corporation Commission shall provide technical assistance to the joint subcommittee, upon request. All agencies of the Commonwealth shall provide assistance to the joint subcommittee, upon request.

The joint subcommittee shall submit an interim report to the Governor and the 2001 Session of the General Assembly. The joint subcommittee shall complete its work in time to submit its written findings and recommendations to the Governor and the 2002 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.

Appendix C

(A-4 through A-36)

INTERIM REPORT OF THE
JOINT SUBCOMMITTEE STUDYING

The Regulatory Responsibilities, Policies and Activities of the State Corporation Commission

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

SENATE DOCUMENT NO. 33

COMMONWEALTH OF VIRGINIA
RICHMOND
2001

MEMBERS OF THE JOINT SUBCOMMITTEE

The Honorable Thomas K. Norment, Jr., *Chair*
The Honorable Eric I. Cantor, *Vice-Chair*
The Honorable Kathy J. Byron
The Honorable Charles J. Colgan
The Honorable L. Karen Darner
The Honorable Barry E. DuVal
Mr. William E. Fitzgerald
Mr. Edward L. Flippen, Esq
Mr. Andrew B. Fogarty
Ms. Judith Williams Jagdmann, Esq.
The Honorable Joseph P. Johnson, Jr.
The Honorable Harvey B. Morgan
The Honorable Richard L. Saslaw
The Honorable Kenneth W. Stolle
The Honorable Frank W. Wagner
Mr. Robert W. Woltz, Jr.

STAFF

DIVISION OF LEGISLATIVE SERVICES
Amigo R. Wade, *Senior Attorney*
David Rosenberg, *Staff Attorney*
Rhonda J. Dyer, *Senior Operations Staff Assistant*

SENATE COMMITTEE OPERATIONS
John M. Garrett, *Coordinator*

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EXECUTIVE SUMMARY

Adopted by the 2000 Session of the General Assembly, Senate Joint Resolution No. 173 and House Joint Resolution No. 187 established a joint subcommittee to study the regulatory responsibilities, policies and activities of the State Corporation Commission. The joint subcommittee is required by the resolution to complete its work and submit its findings and recommendations to the Governor and the 2002 Session of the General Assembly.

The 1902 *Constitution of Virginia* created the State Corporation Commission (SCC) as a separate department of state government vested with legislative, executive and judicial functions. Pursuant to its constitutional mandate, the SCC exercises executive, legislative and judicial powers, a departure from the separation of powers doctrine that serves as the basis for the role and organization of state government in most other instances. Though initially established with three basic powers (granting charters of incorporation in Virginia and administering corporate laws, regulating rates and services of railroads and telephone and telegraph companies, and regulating certain other transportation companies), within a few years the General Assembly began to add several statutory duties and responsibilities to the SCC. This statutory expansion of the original constitutional mandate served to give the SCC authority to exercise executive, legislative and judicial powers over public utilities, banks, insurance companies, securities, motor carriers, pipelines and railroads. It is this growth in the SCC's regulatory responsibility and the concurrent increase in the impact of the SCC's regulatory policies on the state's economy and its citizens that are the basis of the joint subcommittee's charge.

At the outset of its deliberations, the joint subcommittee determined that the enormous scope of SCC's regulatory authority necessitated the need to develop a focus on issues that would be most appropriate to include in the study. The joint subcommittee adopted a comprehensive document titled "Issues for Consideration," encompassing the issues for inclusion in the study. The joint subcommittee adopted a study work plan that provides a detailed yet flexible method for achieving the study objectives.

The joint subcommittee also determined that securing an independent consultant would greatly assist in achieving the objectives of the study. At its last meeting, the joint subcommittee hired the School of Public Policy at George Mason University as a consultant. The report of the consultant will be due on August 31, 2001, and is anticipated to be an important component of the joint subcommittee's deliberations in the second year of the study.

INTERIM REPORT OF THE
JOINT SUBCOMMITTEE STUDYING
THE REGULATORY RESPONSIBILITIES, POLICIES, AND ACTIVITIES OF THE STAE
CORPORATION COMMISSION

To: The Honorable James C. Gilmore, III, Governor of Virginia
and
The General Assembly of Virginia

Richmond, Virginia
January 2001

I. STUDY AUTHORITY

Senate Joint Resolution No. 173 (Appendix A) and House Joint Resolution No. 187 (Appendix B), agreed to during the 2000 Session of the General Assembly, established a joint subcommittee to study the regulatory responsibilities, policies and activities of the State Corporation Commission. The joint subcommittee is required by the resolution to complete its work and submit its findings and recommendations to the Governor and the 2002 Session of the General Assembly.

The joint subcommittee is comprised of 16 members: four members of the Senate, appointed by the Senate Committee on Privileges and Elections; six members of the House of Delegates, appointed by the Speaker of the House; and four citizens, appointed by the Governor. In addition, the Attorney General and the Secretary of Commerce and Trade or their designees serve ex officio.

II. BACKGROUND

A. Historical Overview

The 1902 *Constitution of Virginia* created the State Corporation Commission (SCC) as a separate department of state government vested with legislative, executive and judicial functions. Pursuant to its constitutional mandate, the SCC exercises executive, legislative and judicial powers, a departure from the separation of powers doctrine that serves as the basis for the role and organization of State government in most other instances. This unique grant of power is directly the product of the circumstances that existed in the years preceding the creation of the SCC.

The years preceding the 1902 constitutional revision saw a great rise in the size and power of railroad companies in the country. As railroads became the predominant means of transportation across the nation, state legislators became increasingly concerned about the industry's economic power and the potential harmful effects of that power on the public interest. The need for some form of regulation became evident as a means to protect the public interest. In Virginia during the 1800s, the General Assembly frequently attempted to regulate railroads and provide for a state entity to promulgate and enforce railroad regulations. Beginning in 1816, with the creation of the Board of Public Works and continuing through the establishment of the Railroad Commissioner in 1876, most of these efforts to control the power of the railroads through regulatory action were ineffective. (Appendix D)

The dominance of railroad companies in the commercial and political arenas and the abuses of such concentrated power have been cited by many observers as the single most important contributing factor in the Commonwealth's failure to achieve effective railroad regulation during this time period. The widely held belief of the time was that the regular legislative process, with its exposure to the powerful pressures of the railroad industry, was not operating effectively in the area of this form of economic regulation and was failing to adequately protect the public interest.

The combined experience of these past regulatory failures led to the feeling among the state's legislators that the need to meet the challenge of effective economic regulation in the public interest overshadowed the problems inherent in granting any one governmental body judicial, legislative and executive powers. As a result, the 1902 *Constitution of Virginia* created the SCC as a separate department of state government empowered to perform legislative functions and to issue and enforce its own orders as a court of record. In effect, it formed an independent regulatory agency administering an independent regulatory mechanism. Legislative authority is exercised by the SCC when it makes rules or sets rates. The executive authority of the SCC is exercised in its day-to-day administration of the various regulatory programs within its jurisdiction. When the SCC acts as a court of record and holds formal hearings, it is exercising judicial authority.

B. Constitutional powers and duties of the State Corporation Commission

The 1902 *Constitution of Virginia* established the SCC with three basic powers: (1) to grant charters of incorporation in Virginia and administer corporate laws, (2) to regulate the rates and services of railroads and telephone and telegraph companies, and (3) to regulate certain other transportation companies. The 1902 Constitution also provided for the General Assembly to grant additional responsibilities to the SCC. Within a few years the General Assembly began to add several statutory duties and responsibilities to the SCC. This statutory expansion of the original constitutional mandate served to give the SCC authority to exercise executive, legislative and judicial

powers over public utilities, banks, insurance companies, securities, motor carriers, pipelines and railroads by the time of the constitutional revision of 1971. (Appendix E)

The 1971 *Constitution of Virginia* left the core structure of the SCC intact; however, the General Assembly was provided with broader authority to shape the role and responsibilities of the SCC than provided for in the 1902 *Constitution of Virginia.* Article IX of the 1971 *Constitution of Virginia*, comprised of seven sections, contains the constitutional provisions pertaining to the SCC. (Appendix C) Section 1 of the article confers upon the SCC its constitutional status and provides for the number, qualifications and manner of election of the commissioners. This section also authorizes the General Assembly to increase the number of commissioners from three to no more than five.[1] Other provisions pertaining to the SCC commissioners are also contained in this section including (i) the method of removal and for filling vacancies, (ii) retirement, (iii) election of a chairman, and (iv) the extent of the SCC's power over its subordinates and employees.

The powers and duties of the SCC are detailed in Section 2 of Article IX:

Subject to the provisions of this Constitution and to such requirements as may be prescribed by law, the Commission shall be the department of government through which shall be issued all charters, and amendments or extensions thereof, of domestic corporations and all licenses of foreign corporations to do business in this Commonwealth.

Except as may be otherwise prescribed by this Constitution or by law, the Commission shall be charged with the duty of administering the laws made in pursuance of this Constitution for the regulation and control of corporations doing business in this Commonwealth. Subject to such criteria and other requirements as may be prescribed by law, the Commission shall have the power and be charged with the duty of regulating the rates, charges, and services and, except as may be otherwise authorized by this Constitution or by general law, the facilities of railroad, telephone, gas, and electric companies.

The Commission shall in proceedings before it ensure that the interests of the consumers of the Commonwealth are represented, unless the General Assembly otherwise provides for representation of such interests.

The Commission shall have such other powers and duties not inconsistent with this Constitution as may be prescribed by law.

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[1] Between 1919 and 1926, Commissioners were elected through public election. The 1928 *Constitution of Virginia* implemented the present form of selection providing for election of Commissioners by the General Assembly.

Three provisions of this section provide the parameters of SCC jurisdiction and the ability of the General Assembly to affect that jurisdiction: regulation of railroads and utilities, chartering and regulation of corporations, and conferring of additional duties.

The Constitution gives the SCC the power and duty to regulate the rates, charges and services of railroad, telephone, gas and electric companies. This authority, however, is "[s]ubject to such criteria and other requirements as may be prescribed by law." Accordingly, the SCC's authority in this regard "is subordinate to the power of the General Assembly to command otherwise."[2] Similarly, the Constitution gives the SCC the power and duty to regulate the facilities of such companies (e.g. the placement of electric and telephone transmission lines), except as otherwise authorized by the General Assembly.

In terms of the regulation of corporations in general, the Constitution creates the SCC as the department of government to issue all charters, amendments and extensions thereof of domestic corporations and to issue all licenses of foreign companies to do business in the state. This authority is subject to such requirements as may be prescribed by the General Assembly. Similarly, except as may be otherwise prescribed by the General Assembly, the SCC is constitutionally charged with the duty of administering the laws for the regulation and control of corporations doing business in Virginia.

Regarding additional duties, the last sentence of Section 2 of Article IX authorizes the General Assembly to confer powers and duties on the SCC beyond those specifically conferred in the Constitution, confirming the practice of the legislature since the SCC's inception in 1903.

Section 3 of Article IX provides the SCC its judicial power by conferring upon it the power of a court of record, including the ability to administer oaths, compel the attendance of witnesses and production of documents, and to enforce compliance with its orders. This section also authorizes the SCC to develop its own rules of practice and procedure. The General Assembly, however, has the power to adopt, amend, modify or set aside SCC rules or substitute SCC rules with rules of its own.

The rights of parties to appeal final decisions of the SCC are set out in Section 4. The Commonwealth, parties in interest and parties aggrieved by the action of the SCC may appeal only to the Virginia Supreme Court. The section further provides that no other court of the Commonwealth has jurisdiction to review, reverse, correct or annul any action of the SCC. Section 5 prohibits foreign corporations from exercising public service functions in the Commonwealth. Foreign corporations must reincorporate in Virginia in order to act as public service companies.

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[2] See Commonwealth v. Virginia Electric and Power Company, et al, 214 Va. 457, 465 (1974).

Section 6 requires that corporations be chartered and that charters be amended or extended only through the passage of general laws thereby prohibiting the use of special acts to achieve such purposes. The section also limits the discretion that may be exercised by the SCC in granting, amending or extending corporate charters by restricting its purview to making sure the applicant has fully complied with all requirements of the law. Finally, Section 7 defines the term "corporation" as used in the article by excluding municipal corporations, other political subdivisions and public institutions owned or controlled by the Commonwealth.

In carrying out its broad regulatory responsibilities, the SCC exercises some degree of fiscal independence. The SCC is a non—general fund agency that receives all funding for its operations from revenues derived from specified regulatory assessments or fees paid by regulated industries or other earmarked revenue sources. Revenues are received into four special funds: corporate operations, financial institutions, insurance and valuation. These revenues are collected by the SCC in the form of (i) taxes, (ii) interest and penalties on delinquent taxes, (iii) regulatory assessments, (iv) fees for special items or activities such as licenses, corporate charters, and special audits, and (v) copy certification and publication charges. Funds for the operation of the SCC are budgeted under the normal state appropriation process and are maintained in the four special funds.

III. OVERVIEW OF SCC OPERATIONS

From its initial 1903 budget of $24,000 and staff of five employees, the SCC has grown to have an annual operating budget of approximately $51 million and a staff of 560. This growth was in response to the additional duties conferred by the General Assembly, duties that have the common thread of economic regulation. The SCC's regulatory functions are divided among seven divisions, each overseeing a specific industry or group of industries. The SCC exercises economic regulation over a wide range of businesses and operations that daily affect the lives of citizens; no other state regulatory commission in the country has the jurisdiction over as many areas as does the SCC. A brief description of the core regulatory functions of the SCC follows.

Office of the Clerk of the Commission

The Clerk's office performs functions similar to those of a clerk of court in a court of record except that it deals only with matters within the Commission's jurisdiction. The office is responsible for maintaining the Commission's judicial records and the docket of cases and preparing and transmitting records to the Supreme Court in cases on appeal from Commission judgments. In addition, the office is responsible for the

issuance of corporate charters and the collection of registration and franchise fees[3] and serves as the depository for all documents required to be filed by corporations, both foreign and domestic. The office also serves as the statutory agent for service of process on certain corporations and acts as the filing officer under the Uniform Federal Tax Lien Regulatory Act[4] and for Uniform Commercial Code financing statements, amendments, termination statements, and assignments by secured parties.

Bureau of Insurance

The Bureau of Insurance is divided into several divisions dealing with different aspects of insurance regulation. The financial regulation division (i) licenses insurance companies;[5] (ii) approves holding companies;[6] (iii) regulates/monitors premium finance companies, auto clubs, multiple employer welfare arrangements, HMOs, and continuing care retirement communities;[7] (iv) monitors financial solvency of insurance companies;[8] (v) audits finances of insurance companies and publishes the data.[9] Other divisions of the Bureau deal specifically with different types of insurance offerings (i.e. Life and Health, Property and Casualty, etc.). Each of these divisions licenses agents and agencies, investigates consumer complaints and the affairs of agents, examines market conduct, and monitors forms and rates. In total, the Bureau licenses approximately 82,903 insurance agents[10] and agencies in the state.

In addition, the Bureau performs financial examinations of Virginia insurance companies. Other functions include reviewing insurance forms, performing market conduct examinations, and assisting consumers with the review of insurance forms. Through the Office of the Managed Care Ombudsman, the Bureau assists consumers in understanding the managed care process. Adverse treatment decisions by managed care entities are subject to review by outside medical peer review organizations through the external appeals process accessed through the Office.

Bureau of Financial Institutions

The Bureau of Financial Institutions regulates several aspects of the financial industry in Virginia. It investigates and makes recommendations on charter applications for new state financial institutions and new branches of existing institutions. The Bureau also analyzes and monitors the financial soundness of state banks, savings institutions and credit unions. Banks are required to get certification of

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[3] VA. CODE ANN. §12.1-20 (1999)
[4] VA. CODE ANN. §55-142.1 et seq.
[5] VA. CODE ANN. §38.2-200 (1999)
[6] VA. CODE ANN. §38.2-326 (1999)
[7] **VA. CODE ANN. §38.2 (1999)**
[8] VA. CODE ANN. §38.2-1300 (1999)
[9] VA. CODE ANN. §§38.2-1317, 38.2-1320.4 (1999)
[10] This figure includes property & casualty, life & health and title insurance agents and agencies.

authority from the SCC before doing business in Virginia.[11] Also, the SCC reviews applications filed by financial institutions in Virginia before they merge with other institutions and administers interstate bank acquisitions.[12] The Bureau also licenses and examines mortgage lenders and brokers.[13]

In addition, the Bureau licenses money order sellers, money transmitters, consumer finance (small loan) companies, debt counseling services, and industrial loan associations and registers check cashers.

Division of Securities and Retail Franchising

The Division of Securities and Retail Franchising oversees the registration of publicly offered securities as well as the regulation of broker-dealers, securities salesmen, and investment advisors. The Division registers franchises and registers, audits and investigates securities transactions as well as the people who sell securities and the people who provide investment advice with respect to them. It also investigates complaints under the "Blue Sky Laws," registers franchises and accompanying disclosure documents under the Retail Franchising Act and registers intrastate trademarks and service marks.

Division of Railroad Regulation

The Division of Railroad Regulation conducts inspections and surveillance of railroad tracks and inspects motive power and equipment in Virginia according to Federal Railroad Administration Track Safety Standards. The Division investigates citizen complaints regarding blocking of rail crossings and conducts accident investigations in cooperation with the Federal Railroad Administration. The Division also investigates various complaints involving service and any other matters pertaining to railroad problems in the State.

Division of Communications

This division monitors, enforces and makes recommendations on certain rates, tariffs and operating procedures of investor-owned telecommunications companies including local exchange telephone companies, intrastate long distance companies, and cellular/wireless telephone and radio common carriers (including the maintenance of territorial maps). In carrying out these responsibilities, the division (i) enforces service standards, (ii) assures compliance with tariff regulations, (iii) coordinates extended area

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[11] VA. CODE ANN. §6.1-13 (1999)

[12] *See* VA CODE ANN. §§§ 6.1-194.39, 6.1-194.97, 6.1-399 (1999)

[13] *But see* VA. CODE ANN. §6.1-194.62 (1999) (providing that when a loan is "insured, guaranteed or made under a firm commitment to be sold, assigned or otherwise transferred to an agency or instrumentality of the federal government or to a corporation organized under federal law, it is subject to these (i.e. federal) laws").

service studies, (iv) enforces pay telephone regulations, (v) assists in carrying out provisions of the 1996 Telecommunications Act, and (vi) prescribes depreciation rates. The Division also prepares testimony for rate and service proceedings, develops special studies, monitors construction programs, and investigates and resolves consumer complaints. The Division has a major role in overseeing the implementation of competition in the telecommunications market[14] and developing and implementing alternatives to traditional forms of regulation as competitive markets develop.[15]

Division of Energy Regulation

The Division reviews rate applications filed by investor-owned utilities and member-owned cooperatives and prepares testimony for rate cases before the Commission. The Division is responsible for monitoring utility construction projects and reviewing applications for the construction of transmission lines exceeding 150 kilovolts, electric generating units exceeding 100 megawatts, and natural gas pipelines. Other responsibilities of this division include (i) review of generating unit performance of investor-owned electric utilities, (ii) administration of the gas pipeline safety program including approximately 240 master-metered systems, (iii) enforcement of the "Underground Utility Damage Prevention Act,"[16] and (iv) investigation of gas accidents. The Division responds to consumer complaints and inquiries regarding electric, gas, water and sewer utilities and serves a major role in assisting the Commission in the performance of its implementation responsibilities regarding the restructuring of the electric and natural gas industries.

Division of Public Utility Taxation

This division is responsible for assessing the property of public service companies for local taxation, annual certification of those assessments and assessing and collecting gross receipts and special regulatory taxes from certain public service companies.

Miscellaneous Operations

Several other divisions, grouped as either administrative or law divisions, provide support for the SCC's activities. The administrative divisions include: Division of Information Resources, Division of Human Resources, Office of Comptroller/Administrative Services, and Information Technology Division. The law

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[14] *See* 47 U.S.C. §§§ 252(a)(2), 252(b)(1), 252(d) (1999) (requiring state regulatory commissions to mediate disputes between entering carriers and the existing carrier and after negotiations have run their course to arbitrate and "open issues").

[15] *See* VA. CODE ANN. §56-235.5 (1999) (including price regulation, ranges of authorized rates of return, categories of service and price indexing).

[16] *See* VA. CODE ANN. § 56-265.14 (1999)

divisions consist of: Office of General Counsel, Office of Hearing Examiners, and the Office of Solicitor General.

IV. PAST STUDIES

Since the creation of the SCC, numerous studies have been commissioned by the General Assembly reviewing various operational components of the SCC and the industries it regulates. Only a few of these have had the objective, however, of independently examining the SCC's core functions in their entirety.

One such study was performed in the mid-1970s by the Commission on State Governmental Management (Hopkins Commission). The Hopkins Commission was created by the 1973 General Assembly to examine state government in its entirety, primarily in response to concerns about the growth of the state's government. The Commission's priority recommendations for 1977 and 1978 included numerous proposed changes to the SCC.

Based mainly on perceived advantages inherent in the separation of governmental powers, the Hopkins Commission recommended that most of the executive functions of the SCC be transferred to various executive branch agencies headed by individuals appointed by and directly responsible to the Governor.[17] Under these proposals the SCC would have continued its rate-making, rule-making and adjudicative activities. The Commission thought that this separation of responsibilities was necessary both to ensure the independence of the judicial and legislative activities of the State Corporation Commission and to subject the executive decisions to policy-making input by elected officials directly responsible to the people.

The specific recommendations of the Hopkins Commission included:

1. Transferring executive responsibilities for public utility regulation to a Department of Public Utilities;

2. Transferring executive responsibilities for insurance regulation to a Department of Insurance;

3. Transferring executive responsibilities for banking regulation to a Department of Banking;

4. Transferring executive responsibilities for securities regulation to a Department of Securities and Retail Franchising;

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[17] Seven members of the 15-member commission dissented regarding most of the recommendations affecting the SCC.

5. Transferring the taxation of public service corporations to the Department of Taxation;

6. Transferring executive responsibilities over motor carrier activities to the Division of Motor Vehicles;

7. Transferring the Division of Aeronautics to the proposed Office of Transportation; and

8. Transferring the Fire Marshal Division to the proposed Office of Public Safety.

Soon after the Hopkins Commission report, the General Assembly enacted only two of the recommendations regarding the SCC; transferring the Division of Aeronautics and the Fire Marshal Division from the SCC to the executive branch.[18]

Another broad, independent study of the SCC was performed by the Joint Legislative Audit and Review Commission (JLARC) in 1985. Item 11 of the 1985 Appropriations Act directed JLARC to perform a comprehensive audit and review of the operations of the independent agencies of the Commonwealth. Its subsequent report regarding the SCC, House Document No. 15 (1987), titled "Organization and Management Review of the State Corporation Commission," focused primarily on the efficiency, effectiveness and degree of compliance with legislative intent of the internal structure and management of the SCC. In this regard the report found that, for the most part, the overall organization and management of the SCC was sound.

Some areas where JLARC found problems existed included:

1. Maintenance of excessive balances in certain special funds maintained by the SCC;

2. Assessment of regulatory fees upon certain industries at rates not in line with the actual costs of regulating the particular industry, thereby improperly having some industries "subsidize" the costs of regulating other industries;

3. Underutilization of the Executive Director, whose responsibilities are not clearly defined; and

[18] The Motor Carrier Division was transferred to the Department of Motor Vehicles by legislation enacted during the 1995 Session of the General Assembly.

4. General weakness in all areas of the organization and management of the Bureau of Insurance.

JLARC's report alluded to, but did not address, the issue concerning separation of powers raised by the Hopkins Commission. However, based on concerns with duplication of efforts regarding the regulation of motor carriers, the report recommended more coordination of efforts between the SCC and the executive branch agencies having responsibilities in this regard. The report also recommended that the SCC postpone a proposed expansion of its regulation of financial institutions until an appropriate needs analysis had been performed.

Previously, in 1978, in a more narrow vein, the General Assembly passed HJR 56 that created a joint subcommittee to study the feasibility of granting the State Corporation Commission certain management overview responsibilities and powers to facilitate the regulation of public utilities. In its report, House Document No. 40 (1980), the joint subcommittee made several specific, narrow recommendations, but on the broader issue merely stated that "since the SCC should be carrying out important overview and inspection functions [over utility companies], . . . the Legislature should not hesitate to give the Commission the proper powers to carry out such functions."

In a study of even narrower scope, JLARC reported in 1985 that the SCC should have permitted more competition in its award of certain contracts for automated services ("ADP Contracting at the State Corporation Commission," House Document No. 4, (1985)).

In 1994, the General Assembly passed HJR 212 that requested the Motor Carrier Division of the State Corporation Commission to provide a comprehensive report on the service to the motor carrier industry and recommend ways to simplify regulation to achieve "one-stop" shopping. In its report, House Document No. 12 (1995), the SCC concluded that the Commonwealth should move toward a concept of one-stop shopping, and, "because the Motor Carrier Division deals with the motor carrier industry exclusively, it naturally follows that the SCC should be the focus of the 'one-stop shopping' concept." Despite this recommendation, however, the General Assembly enacted legislation during the 1995 Session transferring motor carrier activities from the SCC to the Division of Motor Vehicles.

In 1996, the General Assembly passed SJR 118 that formed a joint subcommittee to study the potential for restructuring the electric utility industry. This study was continued for two additional years and resulted in three reports, Senate Document No. 28 (1997), Senate Document No. 40 (1998) and Senate Document No. 34 (1999). The final report recommended restructuring Virginia's electric utility industry through a phase-in of customer choice for electricity generation in combination with a seven-year rate cap.

It was recommended that the SCC have regulatory oversight of this process, working collaboratively with a legislative oversight committee.

In 1999, the General Assembly enacted legislation restructuring the electric utility industry to provide for a phase-in of market competition for the generation of electric power. Similar legislation restructuring the gas utility industry was enacted by the General Assembly in 1999 and 2000.

As part of the electric utility restructuring, the General Assembly statutorily created the Legislative Transition Task Force to work collaboratively with the SCC in conjunction with the phase-in of electric energy retail competition, until July 1, 2005. The task force is to report annually to the Governor and the General Assembly concerning the progress of each stage of the phase-in of retail competition.

V. MEETINGS OF THE JOINT SUBCOMMITTEE

June 24, 2000, Meeting

The joint subcommittee met four times in its first year of the study. The first meeting was on June 24, 2000, and began with a historical overview of the creation and regulatory responsibilities of the State Corporation Commission. In addition, Judge Hullihen Williams Moore, one of three Commissioners, provided the joint subcommittee with an overview of the SCC's operations.

Judge Moore discussed the growth in the regulatory responsibility of the SCC since its creation. He also stated that the primary businesses regulated by the SCC, especially insurance, banking, communications, and energy, shared three basic characteristics: (i) each is a critical industry that affects the lives of the state's citizens every day, (ii) each industry has been subject to comprehensive economic regulation, and (iii) each industry is moving to an increased reliance on the market and competition as principal regulators.

Judge Moore informed the joint subcommittee that the SCC had hired an independent consultant to undertake a comprehensive study of the SCC's organization, structure and process as well as its rules of practice and procedure to determine how best to meet its regulatory responsibilities. It was emphasized that the scope of the consultant's review would be confined to the effectiveness and efficiency of SCC operations and was not intended to extend to the powers and duties of the SCC. Judge Moore offered the independent consultant as a resource to the joint subcommittee.

Discussion among the members of the joint subcommittee centered on developing a work plan for the first year of the study. Based on the breadth and importance of the study, the joint subcommittee determined that before a work plan

could be developed there was a need to clarify the focus and direction of the study. Suggestions among the joint subcommittee members regarding the focus and direction included:

- defining the relevance of the SCC's structure in light of the changes to the regulatory scheme of many of the industries within the SCC's purview;

- determining whether the Commonwealth is best served under the SCC's current authority and organizational structure;

- determining the economic development role of the SCC;

- examining the impact of federal regulation and the direction of such regulation over time; and

- reviewing how regulation of the various industries is shared by the state and federal governments.

The joint subcommittee also discussed the possibility of hiring an independent consultant to assist the joint subcommittee in its work, especially in consideration of the enormity of the legislative charge. While some members voiced support for such a consultant, others expressed concern about funding for the services and the amount of time necessary for the work to be completed. It was agreed that Chairman Norment, Secretary DuVal and staff would review the issue and provide the joint subcommittee with a recommendation regarding the feasibility of securing an independent consultant and further, what issues would be appropriate for such a consultant to examine.

It was also resolved that a portion of the next meeting of the joint subcommittee be devoted to clarifying the greater issue of the direction of the study and finalizing a work plan and timeline for the remainder of the study. In this regard, Chairman Norment suggested that members provide staff with their comments regarding the overall direction of the study as well as the on the issue of securing an independent consultant and the possible areas of examination for such consultant by July 17, 2000. These suggestions would be incorporated into the discussion of the joint subcommittee's charge at the its next meeting.

Several members believed that the report of the consultant hired by the SCC would be extremely helpful to the work of the joint subcommittee. After it was indicated that a preliminary report would be available by August of 2000, it was decided that the report be reviewed at the next meeting.

August 24, 2000, Meeting

The second meeting of the joint subcommittee began with a presentation by David Wirick from the National Regulatory Research Institute, the consultant hired by the SCC to study its operations, presented an interim report on his study.

Mr. Wirick stated that the scope of his engagement included examination of SCC structure, organization, and procedures focusing on a broad array of areas and issues, including (i) communications and leadership, both internal and external; (ii) commission structure; (iii) staffing, management and coordination among divisions; (iv) commission process; (v) external relations; and (vi) consumer protection. Regarding the intended timing of the engagement, Mr. Wirick detailed the following time line:

- Extensive interviews with Judges, managers, staff, legislators, utility representatives, and consumer representatives (June-December 2000).
- Interim report (August 2000).
- Identification of the scope of the final report (September 2000).
- Final report (end of year 2000) to include options and recommendations.

Mr. Wirick also informed the joint subcommittee of several issues and recommendations that his research uncovered including i) the establishment of a Director of Administration for the SCC, ii) consideration of options for coordination of public utility functions with no recommendation to establish a Director of Utilities, and iii) continuation of SCC authority for regulation of insurance, financial institutions and securities and examination of those models for application to public utilities. Potential issues for additional consideration by his examination included:

1. Strategic planning and identification of the future mission of the SCC;

2. SCC staffing and the role of the staff, particularly in public utility regulation;

3. Consumer relations;

4. Organization for accomplishment of the SCC mission;

5. Commission processes, including alternative dispute resolution;

6. Information systems;

7. Legislative and public relations;

8. Internal communications; and

9. Regulatory convergence and new regulatory methods.

After Mr. Wirick's presentation, the joint subcommittee discussed whether it would hire a consultant to assist in its study. The joint subcommittee ultimately determined that securing a consultant would be beneficial in helping achieve the goals of the study. It was agreed that at the next meeting the subcommittee would consider the process for hiring the consultant and issues for the consultant to examine.

Staff presented a list of possible issues, divided between general considerations and internal operational considerations, for the joint subcommittee's review to assist in developing the study's scope. Chairman Norment stated that the public would have an opportunity through September 5, 2000, to comment on the list of issues and to suggest additional issues. At that time, Chairman Norment stated that staff, using the list of issues presented, public comments, and issues raised by Mr. Wirick's interim report, will develop a draft of a proposed work plan for the subcommittee, and will distribute the proposal to all subcommittee members. Subcommittee members will then respond to the proposal, and staff will prepare a new draft in light of the responses, for consideration by the subcommittee at its next meeting on October 4, 2000, at 10:00 a.m.

October 4, 2000, Meeting

The joint subcommittee held its third meeting on October 4, 2000. The purpose of the meeting was to review and adopt a final list of considerations compiled by staff and developed from public and subcommittee member comment and to adopt a study work plan for accomplishment of the study objectives. An additional purpose of the meeting was for the joint subcommittee to determine a process for securing an independent consultant.

The joint subcommittee adopted a comprehensive document titled "Issues for Consideration,' which encompassed the scope of the study objectives that the joint subcommittee intended to reach over the course of the study. (Appendix D) The issues are set out in two broad categories--general considerations and internal operational considerations. Subjects under general consideration include i) appropriate regulation of new and future industries, ii) developing regulatory policy, iii) compliance with General Assembly policy and intent, iv) separation functions, v) the relationship among the SCC, the General Assembly, and the Executive Branch, and vi) funding and financial oversight. Internal operational considerations involved examination of the mission and structure of the SCC as well as the operation of its regulatory programs.

Procedure for selecting the independent consultant

Staff presented information to the joint subcommittee regarding options for the process to be used in securing an independent consultant, funding for the consultant and the scope of the issues to be examined by the consultant. Discussion among the

joint subcommittee members centered on the need to secure a consultant by December of 2000 and how to structure the request for proposals. The joint subcommittee decided that it would look to the state's public institutions of higher education to provide the consultant services and instructed staff to send requests for proposals to the state's 14 public four-year institutions of higher education. It was further decided that the "Issues for Consideration' previously approved by the joint subcommittee provided the appropriate scope of issues for determination by the consultant. The joint subcommittee decided it would seek funding for the consultant from the Legislative Reversion Account through the Joint Rules Committee.

In order to facilitate the selection of the consultant, the joint subcommittee directed staff to develop a request for proposals and to perform the initial review of any submitted proposals. After reviewing the proposals, staff would then provide a recommendation regarding the finalist(s) who best satisfies the needs of the joint subcommittee. The finalist(s) then would present the proposal at the December 2000 meeting of the joint subcommittee.

The joint subcommittee also adopted a work plan that would carry its work through the completion of the study. There was also agreement that the work plan should remain flexible to ensure maximum participation and input from all interested parties. As a part of the work plan discussion, some members expressed a desire to provide an opportunity for public comment, formal or informal, at the next meeting of the joint subcommittee. Several members noted that the consultant hired by the joint subcommittee would be required to obtain comment from the regulated community, consumer groups, and other interested parties. It was ultimately resolved that it would be more appropriate to provide for a public hearing or public comment period after the consultant had been engaged, in the second year of the study.

The joint subcommittee scheduled its next meeting for December 5, 2000, at 1:00 p.m. Several subcommittee members indicated an interest in the SCC's revision of its procedural rules. SCC representatives indicated that an executive summary of the proposed changes would be provided prior to the subcommittee's next meeting. An update on the status of the report from the SCC's consultant was also requested for the next meeting.

December 5, 2000, Meeting

The fourth meeting of the joint subcommittee focused on the review of the staff recommendation regarding proposals received in response to the joint subcommittee's request for proposals to provide consultant services. In addition, the joint subcommittee briefly reviewed the status of the work of the consultant hired by the State Corporation Commission and the agency's revision of its rules and procedures.

Joint Subcommittee Chair, Senator Norment, also introduced William E. Fitzgerald to the joint subcommittee as the new member appointed by the Governor.

Selection of the independent consultant

The joint subcommittee obtained a total of $100,000 to fund a contract for consultant services. Half of the amount was provided from the Legislative Reversion Account with the other half provided by the Secretary of Commerce and Trade. On October 11, 2000, staff sent request for proposals to each of the state's 14 public institutions of higher education. As directed by the joint subcommittee, entities responding to the request for proposals were required to address the items included in the "Issues for Consideration" document. In addition, the request for proposals also stated that each proposal submitted should contain, at a minimum, (1) the qualifications and experience of the individuals who will provide the consulting services, (2) a proposed consulting work plan and methodology to be utilized, and (3) the proposed consulting fee and schedule of payments.

The School of Public Policy at George Mason University (SPP) was the only institution submitting a complete proposal.[19] Staff reviewed the proposal using the following criteria:

1. Degree of understanding of the work to be shown by the thoroughness and quality of proposal;
2. Number, qualifications, role, and related experience of professions providing the consulting services;
3. Amount of compensation required, and schedule of payments; and
4. Proposed scheduling of tasks to ensure completion of work according to the established deadlines.

The initial proposal included a total budget substantially over the funding available for the study. After meeting with staff to discuss the proposal, SPP submitted a revised proposal including a budget of $142,999, with the University providing an in-kind contribution of $43,000. Staff proceeded to review the revised proposal using the agreed-upon criteria included in the request for proposals and subsequently concluded that the SPP proposal should be recommended to the joint subcommittee.

At the December 5, 2000, meeting, the joint subcommittee received a presentation from SPP representatives regarding the proposal including the methodology and

[19] Three other institutions, the University of Virginia, Mary Washington University and Virginia State University, made inquiries or responded that they were unable to provide the consulting services.

intended work plan. Several members were concerned that only one complete proposal was submitted. It was suggested that perhaps additional proposals should be solicited. The joint subcommittee resolved, however, that soliciting additional proposals would prevent the consultant from commencing work in January. The joint subcommittee ultimately determined that additional proposals would not be solicited.

Some subcommittee members expressed concern that the scope of the study, as provided by the request for proposals, was too broad to allow a useful report to be produced within the time frame allowed. There was discussion among the members regarding how to best limit the scope to achieve the maximum benefit from the consultant's work. Some members felt there was a need to determine whether the SCC was carrying out its mission and objectives in compliance with the policy and intent of the General Assembly. Other members believed that a more prospective approach was required that involved analyzing the prevailing trends of the industries regulated by the SCC and the impact of those trends. The joint subcommittee ultimately determined that the appropriate scope of issues for the consultant to study were encompassed in Item I A, B and C and Item II A and B of the "Issues for Consideration" document. The joint subcommittee requested SPP to submit a revised proposal indicating the more narrow scope.

Some members also expressed a strong desire for the consultant to include other entities of the University in the proposal. The joint subcommittee requested that an attempt be made by SPP to include other divisions and entities of the University in the study. SPP representatives at the meeting indicated a willingness to include other entities and stated that an attempt would be made to do so in the revised proposal.

Status of SCC consultant's work

Regarding status of the consultant hired by the SCC, the joint subcommittee was informed that the report would be submitted in January of 2001 rather than December of 2000. Kenneth Schrad reiterated that the SCC would make the report and the consultant available to the joint subcommittee. Mr. Schrad also updated the joint subcommittee on the status of the proposed revisions to the SCC's Rules of Practice and Procedure. Prior to the meeting, each joint subcommittee member was provided with a summary of comments received from interested parties. Oral argument on the proposed rule revisions were held on Tuesday, January 9, 2001, at 10:00 a.m. As requested by the joint subcommittee, the SCC provided members of the General Assembly with notice of the oral argument.

Respectfully Submitted,

The Honorable Thomas K. Norment, Jr., *Chair*
The Honorable Eric I. Cantor, *Vice-Chair*
The Honorable Kathy J. Byron
The Honorable Charles J. Colgan
The Honorable L. Karen Darner
The Honorable Barry E. DuVal
Mr. William E. Fitzgerald
Mr. Edward L. Flippen, Esq
Mr. Andrew B. Fogarty
Ms. Judith Williams Jagdmann, Esq.
The Honorable Joseph P. Johnson, Jr.
The Honorable Harvey B. Morgan
The Honorable Richard L. Saslaw
The Honorable Kenneth W. Stolle
The Honorable Frank W. Wagner
Mr. Robert W. Woltz, Jr.

2000 SESSION

ENROLLED

SENATE JOINT RESOLUTION NO. 173

Establishing a joint subcommittee to study the regulatory responsibilities, policies, and activities of the State Corporation Commission.

Agreed to by the Senate, March 9, 2000
Agreed to by the House of Delegates, March 8, 2000

WHEREAS, the 1902 Constitution of Virginia created the State Corporation Commission (the Commission), enumerating in detail its duties and procedures and vesting the Commission with legislative, judicial, and executive powers; and

WHEREAS, the Commission exercises legislative authority when it makes rules or sets rates, judicial authority when it acts as a court of record and holds formal hearings, and executive authority in its day-to-day administration; and

WHEREAS, despite the exercise of these powers, the Commission is not part of the legislative, judicial, and executive branches of government; however, it is a separate department of Virginia state government; and

WHEREAS, when it began its operations in 1903, the Commission had two primary functions, the regulation of rates and services of railroads and the issuance of corporate charters with a budget of $24,000 and five employees; and

WHEREAS, since that time the Commission's jurisdiction has expanded significantly as a result of legislative amendments and constitutional amendments to include the regulation of energy, insurance, securities, corporate filings, communications, financial institutions, and railroads; and

WHEREAS, the Commission has a current staff of 560 and an annual operating budget of approximately $51 million; and

WHEREAS, despite the growth of the Commission over the years and the ever-increasing impact its policies have on the economy and lives of the citizens of the Commonwealth, there is no external assessment routinely made showing the impact its actions have had or will have on the economy and the lives of citizens of the Commonwealth, or whether alternative approaches would allow the Commission to fulfill its Constitutional and legislative responsibilities; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That a joint subcommittee be established to study the regulatory responsibilities, policies, and activities of the State Corporation Commission. The joint subcommittee shall also study the impact of such policies and activities on the lives of the citizens of the Commonwealth.

The joint subcommittee shall consist of 16 members, which shall include 10 legislative members, 4 nonlegislative citizen members, and 2 ex officio members as follows: four members of the Senate to be appointed by the Senate Committee on Privileges and Elections; six members of the House of Delegates to be appointed by the Speaker of the House, in accordance with the principles of Rule 16 of the Rules of the House of Delegates; four citizens to be appointed by the Governor; and the Attorney General or his designee and the Secretary of Commerce and Trade or his designee to serve ex officio.

The direct costs of this study shall not exceed $14,500.

The Division of Legislative Services shall provide staff support for the study. The State Corporation Commission shall provide technical assistance to the joint subcommittee, upon request. All agencies of the Commonwealth shall provide assistance to the joint subcommittee, upon request.

The joint subcommittee shall submit an interim report to the Governor and the 2001 Session of the General Assembly. The joint subcommittee shall complete its work in time to submit its written findings and recommendations to the Governor and the 2002 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.

GENERAL ASSEMBLY OF VIRGINIA -- 2000 SESSION

HOUSE JOINT RESOLUTION NO. 187

Establishing a joint subcommittee to study the regulatory responsibilities, policies, and activities of the State Corporation Commission.

Agreed to by the House of Delegates, March 10, 2000
Agreed to by the Senate, March 10, 2000

WHEREAS, the 1902 Constitution of Virginia created the State Corporation Commission (the Commission), enumerating in detail its duties and procedures and vesting the Commission with legislative, judicial, and executive powers; and

WHEREAS, the Commission exercises legislative authority when it makes rules or sets rates, judicial authority when it acts as a court of record and holds formal hearings, and executive authority in its day-to-day administration; and

WHEREAS, despite the exercise of these powers, the Commission is not part of the legislative, judicial, and executive branches of government; however, it is a separate department of state government; and

WHEREAS, when it began its operations in 1903, the Commission had two primary functions, the regulation of rates and services of railroads and the issuance of corporate charters with a budget of $24,000 and five employees; and

WHEREAS, since that time the Commission's jurisdiction has expanded significantly as a result of legislative amendments and constitutional amendments to include the regulation of energy, insurance, securities, corporate filings, communications, financial institutions, and railroads; and

WHEREAS, the Commission has a current staff of 560 and an annual operating budget of approximately $51 million; and

WHEREAS, despite the growth of the Commission over the years and the ever-increasing impact its policies have on the economy and lives of the citizens of the Commonwealth, there is no external assessment routinely made showing the impact its actions have had or will have on the economy and the lives of citizens of the Commonwealth, or whether alternative approaches would allow the Commission to fulfill its Constitutional and legislative responsibilities; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That a joint subcommittee be established to study the regulatory responsibilities, policies, and activities of the State Corporation Commission. The joint subcommittee shall also study the impact of such policies and activities on the lives of the citizens of the Commonwealth.

The joint subcommittee shall consist of 16 members, which shall include 10 legislative members, 4 nonlegislative citizen members, and 2 ex officio members as follows: six members of the House of Delegates to be appointed by the Speaker of the House, in accordance with the principles of Rule 16 of the Rules of the House of Delegates; four members of the Senate to be appointed by the Senate Committee on Privileges and Elections; four citizens to be appointed by the Governor; and the Attorney General or his designee and the Secretary of Commerce and Trade or his designee to serve ex officio.

The direct costs of this study shall not exceed $14,500.

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The joint subcommittee shall submit an interim report to the Governor and the 2001 Session of the General Assembly. The joint subcommittee shall complete its work in time to submit its written findings and recommendations to the Governor and the 2002 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.

EXPANSION OF SCC REGULATORY RESPONSIBILITY (1902 through1971)

Year	Additional Regulatory Responsibility
1906	Regulation of insurance.
1906	Investigate cases of suspected arson.
1910	Valuation of the property of public utilities for local taxation, and assessment of state taxes on them.
1910	Regulation of banking.
1914	Fixing the rates of public utilities, and regulating their services.
1915	Taxation of the rolling stock of car line companies.
1918	Administration of the Blue Sky Law.
1923	Regulation of transportation by motor vehicle.
1924	Fixing rates of pilotage.
1928	Regulation of aeronautics.
1928	Licensing of dams.
1930	Transferring to the Commission from the office of the Secretary of the Commonwealth the recording of corporate charters.
1932	Collection of the gross receipts tax on common carriers by motor vehicle.
1934	Regulation of the issuance of securities by public utilities.
1934	Regulation of contracts between public utilities and affiliates.
1938	Transferring from the Department of Highways to the Commission functions relating to the construction and maintenance of airports.
1940	Assessment and collection of the motor fuel road tax.
1940	Supervision of Blue Cross and Blue Shield contracts.
1946	Fixing the maximum charges of small loan companies.
1948	Registration of trade-marks.
1948	Adoption and enforcement of regulations for the prevention of fire hazards in public buildings. Appointment of Chief Fire Marshal for the state.

Source: Data from Preston C. Shannon, "The Evolution of Virginia's State Corporation Commission," William & Mary Law Review Vol. 14 #1, 1972.

1948	Regulation of household goods carriers.
1950	Adoption of safety regulations for liquefied petroleum gas.
1950	Issuance of certificates of public convenience and necessity to public utilities.
1952	Regulation of petroleum tank truck carriers.
1954	Transferring from the Division of Motor Vehicles the issuance of identification tags for commercial vehicles.
1956	Issuance of certificates of convenience and advantage to small loan companies.
1956	Transferring from the Secretary of the Commonwealth to the Clerk of the Commission all functions relating to service of process on corporations.
1956	Collection of surtax on motor fuel used in the state by heavy vehicles.
1956	Regulation of transportation of explosives.
1956	Regulation of sight-seeing carriers.
1956	Licensing of automobile clubs.
1958	Administration of uninsured motorists' funds.
1958	Registration of service marks.
1958	Registration of laundry marks.
1960	Regulations for installation of boilers.
1964	Regulation of insurance premium finance companies.
1964	Regulation of the leasing of motor vehicles.
1964	Central filing office, Uniform Commercial Code.
1964	Publish motor vehicle reciprocity agreements and decide whether a motor vehicle carrier is entitled to reciprocity.
1964	Register Interstate Commerce Commission authority of motor carriers.
1964	Assessment for local taxation of petroleum pipe line companies.
1966	Regulation of parachute jumping.
1968	Administration of Take-Over-Bid Disclosure Act.
1968	Administration of Consumer Credit Code.
1968	Regulation of sight-seeing and charter party boats.

1968	Regulation of Basic Property Insurance Inspection and Placement Plan.
1970	Regulation of Radio Common Carriers.
1970	Regulation of Virginia Insurance Guaranty Association.
1970	Administration of Virginia Industrialized Building Unit and Mobile Home Safety Law.
1971	Mediate controversies between public service companies and their employees and patrons.

JOINT SUBCOMMITTEE STUDYING THE REGULATORY RESPONSIBILITIES, POLICIES AND ACTIVITIES OF THE STATE CORPORATION COMMISSION
(SJR 173/HJR 187)
ISSUES FOR CONSIDERATION

I. General Considerations

A. Appropriate Regulation of New and Future Industries

1. Is the overall direction of the SCC in terms of its policy and rule making authority well suited to the new market dynamics of the business activities it regulates?

2. Is the SCC's current direction and approach towards the new economic conditions affecting the business activities it regulates appropriate? If not, what new direction and approaches are required?

3. How can the SCC be changed to ensure that in the future government will continue to achieve the proper balance between public protection and encouraging and rewarding entrepreneurial initiative, competitive innovation and economic development?

B. Developing Regulatory Policy

1. What is the appropriate role of the SCC in the development of regulatory policy for the Commonwealth?

2. How effectively has the SCC participated in the development of regulatory policy for the Commonwealth?

C. Compliance with General Assembly Policy and Intent

1. Is the SCC, in exercising the authority delegated to it by the General Assembly, achieving the results that the General Assembly intended?

2. Is the SCC staff effective and faithful in carrying out the legislative intent of the General Assembly in those cases where policy has been set by legislation?

D. Separation of Functions

1. Are the interests of the Commonwealth best served by having policy determinations and rule making authority for the various business activities regulated by the SCC housed in one agency?

2. Should policy making decisions and rule making be conducted by other state agencies or the General Assembly?

3. In light of technological advances and more universal access to information, does there remain a need to have a single regulatory agency in order to achieve the goals of regulatory consistency, expertise and specific institutional knowledge, and to prevent undue influence on the regulatory process?

4. Should the same SCC staff lobby and then regulate? Does this relationship represent a conflict?

5. Should the adjudicatory and management roles of the SCC be separated?

E. Relationship Among SCC, General Assembly, and Executive Branch

1. Should more collaboration be established among the SCC, the Executive branch and the General Assembly to promote common goals and create more job opportunities while protecting consumers?

F. Funding and Financial Oversight

1. What is the proper level of funding for the SCC in light of its responsibilities in the changing regulatory environment?

2. What are the financial operations of the SCC and how does the General Assembly provide oversight over those operations?

G. Miscellaneous

1. Should the process for selecting judges be changed?

2. Should the SCC be authorized to waive its immunity from suit in federal court in order to permit it to address issues brought for its consideration pursuant to the federal Telecommunications Act of 1996? (Federal courts have concluded that state commissions like the SCC are deemed to have waived their immunity from suit in federal court if they arbitrate unsettled issues between new entry telephone companies and incumbent telephone companies, because either party may then appeal to federal court. Accordingly, the SCC recently concluded that it could not longer arbitrate such issues because it was not empowered to waive such immunity.)

II. Internal Operational Considerations

A. Mission and Structure

1. Does the SCC's mission accurately describe its activities?

2. Does the SCC's organizational structure advance its ability to achieve the stated mission?

3. Could the SCC be restructured to better accomplish its mission?

B. Operations

1. Is there excessive fragmentation of the SCC staff such that responsibilities are unclear and/or duplicative, contributing to cumbersome and protracted regulatory proceedings?

2. How are the functions (executive/legislative/judicial) carried out by the SCC are different from those carried out by other executive or legislative branch agencies?

3. Do the SCC's Rules of Practice provide for adequate due process?

4. Do the Commissioners provide adequate oversight over the activities of its divisions including addressing complaints regarding the actions of SCC employees?

5. What are the different proceedings held or conducted by the SCC and how can they be streamlined?

6. Should the SCC's processes and structure be modified to better accommodate a collaborative model for rulemaking?

JOINT SUBCOMMITTEE STUDYING THE STATE CORPORATION COMMISSION (SJR 173/HJR 187) PROPOSED WORK PLAN

First Meeting- June 29, 2000

- ✓ Reviewed subcommittee charge
- ✓ Reviewed past studies of the powers, structure, and policies of the SCC
- ✓ Received background information on the SCC (constitutional and statutory framework, history, and areas of regulatory responsibility)
- ✓ Received overview of SCC Operations

Second Meeting- August 24, 2000

- ✓ Received presentation on preliminary report of SCC consultant
- ✓ Continued discussion regarding use of consultant by the joint subcommittee
- ✓ Continued identification and prioritization of issues related to the study

Third Meeting- October 4, 2000

- ➔ Determine options regarding hiring a consultant:
  - *Who*- restricted pool (i.e. public universities), unrestricted pool
  - *What*- issues to be studied by the consultant
  - *When*- time frame for i) hiring the consultant and ii) final completion of the study
  - *Funding*- i) estimated consultant fee and ii) source of funding
- ➔ Identify issues for consideration by the joint subcommittee (<u>See</u> **Revised Issues for Consideration**)
- ➔ Approval of workplan

Fourth Meeting- December, 2000

- ➔ Receive presentation by consultant finalist
- ➔ Select consultant (subject to resolution of funding issue)
- ➔ Opportunity for public comment
- ➔ Review content of joint subcommittee's interim report to the Governor and General Assembly

Fifth Meeting- April, 2001

- ➔ Receive presentation by consultant on work progress
- ➔ Assess and refine goals and objectives relative to the work of the consultant and the joint subcommittee
- ➔ Establish remaining workplan

Meetings- May, June and July, 2001

Meetings as needed may be scheduled during this period as the study evolves and the workplan is refined

Meeting- August, 2001

- ➔ Receive final report and recommendations from consultant
- ➔ Opportunity for public comment (Note: final report of consultant will be made available prior to the meeting)
- ➔ Determine action on consultant recommendations

Meetings- September, October and November, 2001

Meetings as needed may be scheduled during this period to allow the joint subcommittee to develop its final recommendations and receive additional information and public comment

Meeting- November/December, 2001

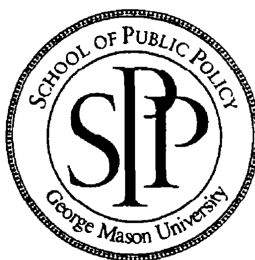
- ➔ Opportunity for public comment
- ➔ Approve final report and recommendations of the joint subcommittee to the Governor and the General Assembly

Study of Regulatory Responsibilities, Policies and Activities of the State Corporation Commission Reference: SJR 173/HJR 187 (2000)

School of Public Policy
George Mason University

Prepared by:
Kenneth Button
Roger Stough

with the assistance of
Jerry Ellig
Jim Riggles
Marc Thibault
Emily Wang
Aleta Wilson



August 2001

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SUMMARY

The Commonwealth of Virginia's State Corporation Commission (SCC) is nearly a hundred years old. It is a unique institution that has the responsibility for the regulation of many key sectors of the Commonwealth's economy. Its charges and responsibilities have been modified periodically in the light of changes in industrial structure, the needs of the citizens of the Commonwealth, and in the light of better understanding of regulatory methods. This review looks at the position of the SCC as it stands at the beginning of the twenty-first century and considers whether and where there are justifications for any reforms.

There have been important changes in the way that regulation is now treated as opposed to the ideas pertaining when the Commission was first set up. Some of the changes are technological, others institutional or due to changes in the economic structure of the State's economy, while others reflect changes in the way in which regulation is now perceived. Some of these changes have generic effects across the entire range of responsibilities of the SCC whilst others are more focused on particular sectors.

The SCC was set up at a time when there were fears over the potential monopoly power that railways and transmission companies might exercise. The Commission was given a remit to curtail such powers by controlling rates and service characteristics. Since that time technological shifts and changes in market structures have widened the range of sectors within the ambit of SCC regulation. The recent changes have coincided with more fundamental developments in the way economic regulation is viewed. There is now a much clearer distinction between social regulation aimed at such things as environmental protection and social justice, and economic regulation of monopoly power and cartels. In general, while economic regulation has tended to become less stringent, social regulation has grown in importance.

The State Assembly and the SCC have in the past adapted to the changes in technology and market structures by modifying the ways that regulations have been exercised. This is relevant in a state that has seen significant economic growth and structural change, particularly over the past twenty years. The growth of high technology industry in Northern Virginia has resulted in demands for new approaches to regulatory control while the need to ensure adequate provision of many services in the remainder of the State has not diminished.

The features of the operations of the SCC, the changing technologies of the sectors under regulation, and the emerging demands of the citizens of the Commonwealth lead to a number of policy recommendations regarding the way the SCC will need to change to meet current and future challenges. The broader recommendations are:

1. **The structure of regulation in Virginia has stood the test of time well and change should only be undertaken in the light of serious long-term problems. Many sectors overseen by the SCC have been going through major technical and**

structural changes. In itself this is not justification for change unless lack of change impairs the long-term efficiency with which Virginian's can access these services. The SCC should retain its role as the body responsible for economic regulation of the sectors currently under its oversight.

2. **The SCC should remain as independent as possible from short term political pressures.**

3. **The basic principle of regulation should be to allow the market to function and only to intervene when there are demonstrable market failures that appropriate regulatory control can be demonstrated to reduce.**

4. **The Commonwealth's structure of regulation was initially designed to deal with fundamental market flaws as perceived at the time. Our understanding of how markets function has subsequently changed as has technology. It is important to ensure that the workings and decisions of the SCC continue to take full account of this.**

5. **It is important that the SCC collects salient data and that this data adequately reflects the implications of its actions on consumers as well as on the industrial sectors under its jurisdiction. One of the most effective forms of consumer protection is good information.**

6. **The SCC should continually review the data that industry is required to provide and limit them to those that are necessary to fulfil its regulatory requirements. In doing this it should seek to minimize the burden on the regulated industries of providing data and other information.**

7. **The activities of the SCC should continue to be self-funded to avoid problems that many states have in achieving efficiency and effectiveness because of a dependence on annual state budgetary decisions.**

8. **The notion that the number of Judges should in fact be increased to five, with one being replaced each year, should be seriously considered. This would require Constitutional change.**

9. **Adequate resources should be provided to reduce the turnover of staff in the Office of the Council General. This turnover at a minimum impedes the speed at which cases can be brought.**

10. **The State Corporation Commission should continue to explore ways of improving the public understanding of how it internally handles potential ex parte conflicts. It should continually seek ways to mitigate potential conflicts.**

11. **The current process of dispute resolution, with its informal and formal elements seems to work well if a little slowly at times. There is no recommendation of**

further informal 'alternative dispute resolution' procedures being required. More formality generally leads to even slower decision-making

12. **The similarities and interconnections between the regulatory demands in the fields of gas, electricity and water regulation justify the creation of a Directorate of Energy.**

13. **The various divisions should develop a system of performance assessment procedures suitable to their own activities. These should be quantifiable where possible but also contain qualitative indicators. Performance measured against criteria should be part of annual division reports.**

14. **All divisions of the SCC should engage in more public information dissemination and information gathering. The banking division runs a number of courses for the industry as well as periodic seminars – this type of model may usefully be replicated elsewhere.**

Recommendations regarding the individual Divisions of the State Corporation Commission are contained within their respective sections of the report.

1. INTRODUCTION

At the request of the Joint Sub-Committee Studying the Regulatory Responsibilities Policies and Activities of the State Corporation Commission (hereinafter referred to as the Joint Subcommittee), the Division of Legislative Services (DLS) contracted with George Mason University, School of Public Policy, to study the regulatory responsibilities, policies, and activities of the State Corporation Commission. The Joint Subcommittee articulated specific issues that they desired to be investigated, and after some modification it was decided that the issues laid out in Appendix A of the Request for Proposal would be covered in this report.[1]

The impetus for the study is related to the following trends in industry and governance:

- Industries that have traditionally been regulated by the Commission – especially utilities, telecommunications, and financial services – are undergoing sweeping change as a result of new technology and federal deregulatory initiatives.
- Across the nation, regulators and regulatory scholars have developed and implemented a new generation of regulatory approaches believed to be more consistent with enhanced competition in many regulated industries. The nature of "best regulatory practices" has changed considerably over the past decade.
- At all levels of government, a new approach to public administration seeks to promote accountability by having government agencies articulate the public benefits they provide, identify performance measures that indicate whether they are producing the intended benefits, and reform organizational and incentive structures to improve performance.

George Mason University enlisted the Mercatus Center, an affiliate of the University, to assist in its assessment of the Virginia State Commission. They were brought onboard due to their expertise in state regulations in general and the energy industry, in particular.

Mission, Structure and Management of the SCC

The SCC came into existence as a result of provisions included in the Constitution of Virginia adopted in 1902. Unlike other agencies created by that Constitution, the SCC was given formal independence from all three traditional branches of government. It was empowered to set rates that could not be altered by the executive or legislative branches, and to issue and enforce its own orders as a court of record. This extraordinary approach from the doctrine of separation of powers was prompted by a feeling at the turn of the 19th century that:

- the powerful railroads and transmission companies exercised inordinate influence, actually controlling the legislative process including rate-making and economic regulation to such an extent that a regulatory agency with legislative power independent of the General Assembly and the Governor was warranted, and

[1] *Proposal Submitted in Response to Commonwealth of Virginia Division of Legislative Services Request for Proposal Dated 10/11/2000: Study of Regulatory responsibilities, Policies and Activities of the State Corporation Commission,* Reference: SJR 173/HJR 187 (2000).

- such a regulatory agency should not be encumbered with the requirement that it apply to another branch of government to have its orders enforced.[2]

In addition to its Constitutional authority, the Commission is subject to such requirements as may be prescribed by law. It is the department of government charged with issuing charters, and amendments or extensions thereof, of domestic corporations and all licenses of foreign corporations to do business in the Commonwealth. The Commission administers laws to regulate and control corporations doing business in the Commonwealth. It has the power to regulate rates, charges, services, and facilities of all public service companies (§ 56-1.)(Article IX of Virginia Constitution)

No other state has charged one agency with such a broad array of regulatory responsibility. The SCC is organized as a fourth branch of government with its own legislative, administrative, and judicial powers. SCC decisions can only be appealed to the Virginia Supreme Court.[3]

The current mission of the Commission is derived from the Virginia state constitution as follows "[t]he Commission shall be the department of government through which shall be issued all charters, and amendments or extensions thereof, of domestic corporations and all licenses of foreign corporations to do business in this Commonwealth.

Except as may be otherwise prescribed by the Constitution or by law, the Commission shall be charged with the duty of administering the laws made in pursuance of the Constitution for the regulation and control of corporations doing business in this Commonwealth. Subject to such criteria and other requirements as may be prescribed by law, the Commission shall have the power and be charged the duty of regulating the rates, charges, and services and, except as may be otherwise authorized by the Constitution or by general law, the facilities of railroad, telephone, gas, and electric companies.

The Commission shall in proceedings before it ensure that the interests of the consumers of the Commonwealth are represented, unless the General Assembly otherwise provides for representation of such interests.

The Commission shall have such other powers and duties not inconsistent with the Constitution as may be prescribed by law"[4]

Organizational Structure

The State Corporation Commission is divided into specialized units that work together to carry out the Commission's responsibilities. The bureaus and the divisions are shown in Exhibit 1.1. The Commission consists of three members elected by the joint vote of the

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2 Commission on State Governmental Management (1975) *Staff Documents, Volume 1, Executive Management Responsibilities, Part Seven: Executive Functions of the State Corporation Commission of Virginia* ,Staff, Commission on State Governmental Management.

3 Ibid.

4 Virginia Constitution, Article IX, Section 1. http://legis.state.va.us/vaonline/li1i.htm

two houses of the General Assembly for regular staggered terms of six years. At the regular session of the General Assembly convened in each even-numbered year, one Commissioner (Judge) is elected for a regular six-year term to begin on February 1 of such year.[5] A listing of all key staff including Judges is shown in Exhibit 1.2.

The Judges are charged with a number of substantive constitutional duties (i.e., the issuance of charters of domestic corporations; the licensing of foreign corporations; and the regulation of rates, charges, services and facilities of railroad, telephone, gas, and electric companies) and other discrete statutory responsibilities listed in Exhibit 1.3. The SCC currently has 647 authorized positions of which 572 are filled. Details are shown in Exhibit 1.4.

Historically the SCC has had responsibility for regulating a number of public service industries ranging from railroads, pilotage, aeronautics, dams, motor carriers and airports. Today it is responsible for the following industries:

- Financial Services
  - Insurance
  - Banks
  - Securities
- Communications
  - Telephone companies
    - Local Exchange Carriers
    - Competitive Local Exchange Carriers
    - Long Distance Telephone Companies
    - Private pay Telephone Providers
- Railroads
- Energy
  - Electric
  - Gas
  - Water

The Review Approach

The review initially involved the preparation of a 'deliverable' at the end of March 2001 that was a 'Report containing results of literature review and practices of other jurisdictions'.[6] This document contains the findings of the final phase.

In the process of completing this, and the earlier drafts, a considerable number of people were interviewed and a significant number of documents collected. Many of these were personal interviews although some were also numerous telephone interviews. No postal

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5 (§ 12.1-6. Election or appointment of members; terms.) One of its members is elected chairman by the Commission for a one-year term beginning on the first day of February of each year (5VAC5-10-60. Chairman). The term Judge is used throughout for these Commissioners to distinguish them from others (such as the Commissioner of Financial Institutions). The term judge sometimes thought of as a 'nickname' for the Commissions but according to ""Judge" means a justice of the Supreme Court, judge of the Court of Appeal, judge of a circuit or district court, member of the State Corporation Commission....' (1971, Ex Sess, c 154, §2.1-37.1; 1984, c2001, cc 113, 844)

6 *Proposal Submitted in Response to Commonwealth of Virginia Division of......* op cit.

questionnaires were conducted. In total well over 100 people were spoken to.[7] The written nmaterial includes numerous responses to the Initial Draft Reports as well as actions to clarify issues raised by the Joint Sub-committee. Those consulted have included all SCC Judges, bureau commissioners and divisional directors, other SCC staff, those engaged in the regulated sectors, chamber of commerce, and representatives of various user groups. Additionally, a number of academics working directly in the field of regulation and industrial analysis were consulted. Two draft reports were prepared for the Joint Committee and for public debate. The written responses to these are embodied in this Report.

During the early preparation of this document an internal report commissioned by the SCC (hereafter the 'Wirick Report') was completed. Like the Wirick Report, the aim here is to look at the current situation of the SCC and to look for ways of ensuring that it is in a position to meet future challenges. This report is largely in agreement with very many findings of the Wirick Report (e.g., in terms of actions to ensure consumer representation in the SCC processes), although this report looks at things more in terms of public policy and economics than in public administration. Where there is substantive disagreement with the internal report this is noted in the text and in recommendations. To avoid replication, the focus here is somewhat wider than that of the Wirick Report' which concentrated largely on the internal structure of the SCC.[8]

Those involved in preparing this report have been cognizant of the need to take account of the particular features of the Commonwealth's economy and historic approach to regulation. They have not, however, ignored the possibility of radical change and reform. Equally, they appreciate that regulation is actually conducted by people and that, while it may be possible to offer recommendations for institutional reform, the de facto implementation of policy lay in the hands of the individuals involved.

The number of recommendations is not large compared to many reports. Little purpose is served in making recommendations for the sake of it. In addition, some issues raised by the Wirick Report have already been partly addressed by the SCC. There also seems little point in being repetitive of material already covered in the earlier study. Many of the recommendations here are also not for change but rather seek to reinforce actions that are already being taken and to provide support for them.

The overall aim has been to see if changes could be made that, in their view, would be of benefit to the citizens of Virginia.

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[7] Care was taken to ensure that particular issues or incidents were not magnified. For example, a number of Chambers of Commerce were contacted but since they tend to pass on members with complaints about the SCC to the relevant association there is a danger of at least double counting if the views of the party concerned, the Chambers, and the associations are taken independently.

[8] In terms of style, the Wirick Report essentially took a blue print developed at the National Regulatory Research Institute and sought to look at ways in which the SCC may more closely match it. The approach here has no notion of a blue print but rather looks at ways in which the SCC can better serve the public interest of Virginia.

Exhibit 1.1: The Structute of the Virginia State Corporation Commision

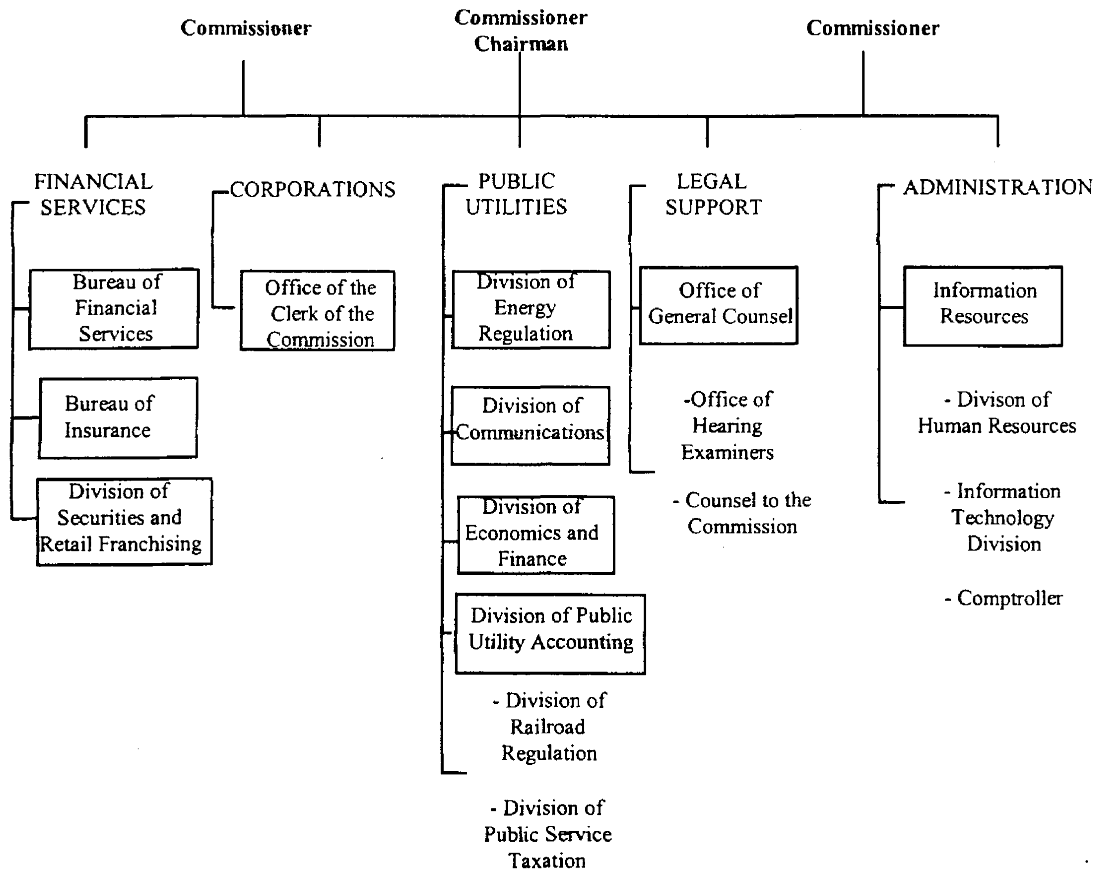

Exhibit 1.2: State Corporation Commission Key Staff

Commission	Title
Hullihen Williams Moore	Judge (Commissioner)
Clinton Miller	Judge (Commissioner) - current chairman
Theodore V. Morrison, Jr.	Judge (Commissioner)
Division Directors	**Title**
Joel H. Peck	Clerk of the Commission
E. Joseph Face, Jr.	Commissioner of Financial Institutions
Alfred W. Gross	Commissioner of Insurance
Ronald A. Gibson	Director, Division of Public Utility Accounting
William Irby	Director, Division of Communications
Richard J. Williams	Director, Division of Economics and Finance
William F. Stephens	Director, Division of Energy Regulation
Robert S. Tucker	Director, Public Service Taxation
Donald L. McPherson	Manager, Railroad Regulation
Ronald W. Thomas	Director, Division of Securities & Retail Franchising
William H. Chambliss	General Counsel
Deborah V. Ellenberg	Chief Hearing Examiner
Philip R. DeHaas	Counsel to the Commission
Kenneth J. Schrad	Director, Division of Information Resources
Welton H. Jones, Jr.	Comptroller
Chester A. Roberts	Director, Division of Human Resources
Gerald S. Pacyna	Director, Information Technology Division

Exhibit 1.3: Constitutional Duties of Commissions

Division/Bureau	Virginia State Code
SCC – General	Title 12.1, Chapters 1 to 5
Bureau of Insurance	Title 38.2
Bureau of Financial Institutions	Title 6.1
Division of Securities & Retail Franchising	Title 13.1, Chapter 5 and 8; Title 59.1, Chapter 6
Office of the Clerk of the Commission	Titles 12.1, 13.1 and 50
Division of Railroad Regulation	Title 56
Division of Communications	Title 56
Division of Energy Regulation	Title 56
Division of Public Service Taxation	Title 58.1, Chapters 26 and 29

Exhibit 1.4: Staffing of the State Corporation Commission

Division	FTEs authorized	FTEs actual
Bureau of Insurance	209	191
Bureau of Financial Institutions	102	82
Securities & Retail Franchising	34	31
Clerk's Office	68	64
Communications	29	23
Economics & Finance	14	13
Energy Regulation	27	28
Public Utility Accounting	27	19
Public Service Taxation	15	13
Railroad Regulation	5	5
Office of General Counsel	28	28
Office of Hearing Examiners	7	6
Office of Commission Counsel	2	2
Commissioners	11	10
Comptroller/Adm. Services	15	13
Human Resources	7	6
Information Resources	10	9
Information Technology	37	29
TOTAL	647	572

2. Rationale for Regulation

Background

The Virginian SCC has been in existence since the Constitution of 1902.[9] Initially it was seen as a mechanism to regulate the powerful railroads and transmission companies of the day. The monopoly power exerted by the large companies in these industries was seen as damaging to the economy of the State. The concern with the market power exercised by these businesses had earlier seen efforts at control through mechanisms such as court actions at common law, *ad hoc* state legislation, and the granting of licenses by cities and charters by the state. These were often slow and inflexible and, with regard to court actions were reactive in nature.

At the federal level, there had been some actions to regulate the market power of railroads – e.g., the establishment of the Interstate Commerce Commission in 1887. The creation of the SCC can be seen as an adoption of this type of approach at the state level. It followed earlier, unsuccessful efforts at creating a strong state railroad commission in 1890 and 1892. The SCC was given power of rate and service regulation over railroads and transmission companies and ability to issue corporate charters. Although all US states have commissions, the Commonwealth is the only one of nine states that has given its public service commission constitutional status.

The General Assembly was given the power grant additional powers to the SCC. The domain of the SCC has consequently expanded since the early days in response to developments in technology, new ideas of regulation should function, and the changes in the perception of the needs of the citizens of the Commonwealth. The statutory expansion of the original constitutional mandate has served to give the SCC authority to exercise executive, legislative, and judicial powers over public utilities, banks, insurance companies, securities, telecommunications, motor carriers (licensing transferred to the Department of Motor Vehicles and enforcement to the Virginia State Police in 1995), pipelines and railroads.

From its initial 1903 budget and staff of $24,000 and five employees, the SCC has grown to an annual operating budget of over $51 million and a staff of some 570.[10] This growth

[9] The State Corporation Commission was created as a separate department of state government empowered to perform legislative functions and to issue and enforce its own orders as a court of record. It was an independent regulatory agency administrating an independent regulatory mechanism. The SCC exercises legislative authority when making rules or setting rates. It exercises executive authority through its administration of regulation. It exercises judicial authority when acting as a court of record and holding formal hearings.

[10] The SCC is funded through the fees and other charges that are levied on the sectors over which it has oversight. This provides a high degree of insulation from day-to-day political interference in the operations of the SCC (a situation not found in all states). It does leave the Commission open to the need to raise revenue and this imparts a degree of uncertainty in its revenue flows (e.g., witness the loss of examination fees from banking as Crestar has removed from the state.) There are also debates in the theoretic literature about the potential for capture when the regulated finance the regulators.

was in response to the additional duties conferred by the General Assembly, duties that have the common thread of economic regulation. The SCC exercises economic regulation over a wide range of businesses and operations that daily affect the lives of citizens. No other state regulatory commission in the country has the jurisdiction over as many areas as does the SCC.

The Constitutional Powers and Duties of the SCC

The 1971 Constitution of Virginia left the core structure of the SCC intact but the General Assembly was provided with broader authority to shape the role and responsibilites of the SCC than in the 1902 Constituion of Virginia. Article IX of the 1971 Constitution of Virginia, comprised the provisions pertaining to the SCC. The article confers upon the SCC its constitutional status and provides for the number, qualifications and manner of election of the Judges.[11] This section also authoizes the General Assembly to increase the number of Judges from three to no more than five.[12]

Three provisions within the constitutional powers and duties of SCC provide the parameters of its jurisdiction and the ability of the General Assembly to affect that jurisdiction: regulation of the railroads and utilities, chartering and regulation of corporations and conferring of additional duties.[13]

Regarding railroads and utilites, the Constitution gives the SCC the power and duty to regulate the rates, charges and services of railroad, telephone, gas and eletric companies. This authority, however, is '[s]ubject to such criteria and other requirements as may be prescribed by law.' Accordingly, the SCC's authority in this regard 'is subordinate to the power of the General Assembly to command otherwise.'[14] Similarly, the Constituion gives the SCC the power and duty to regulate the facilities of such companies (e.g. the

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[11] Appendix of Section 1.

[12] Other provisions pertaining to the SCC commissioners including the method of removal and for filling vacancies, retirement, election of a chairman, and the extent of the SCC's power over its subordinates and employees.

[13] The powers and duties of the SCC are detailed in Section 2 of Article IX.

1. Subject to the provisions of this Constitution and to such requirements as may be prescribed by law, the Commission shall be the department of government through which shall be issued all charters, and amendments or extensions thereof, of domestic corporations and all licenses of foreign corporations to do business in this Commonwealth.
2. Except as may be otherwise prescribed by this Constitution or by law, the Commission shall be charged with the duty of administering the laws made in pursuance of this Constitution for the regulation and control of corporations doing business in this Commonwealth. Subject of such criteria and other requirements as may be prescribed by law, the Commission shall have the power and be charged with the duty of regulating the rates, charges and services and, except as may be otherwise authorized by this Constitution or by general law, the facilities of railroad, telephone, gas, and electric companies.
3. The Commission shall in proceedings before it secure that the intersects of the consumers of the Commonwealth are represented, unless the General Assembly otherwise provides for representation of such interests.
4. The Commission shall have such other powers and duties not inconsistent with this Constitution as may be prescribed by law.

[14] See *Commonwealth v. Virginia Electric and Power Company et al*, 214 Va. 457.465 (1974)

placement of electric and telephone transmission lilnes) except as otherwise authorized by the General Assembly.

Regarding corporations in general, the Constitution creates the State Corporation Commission as the department of government to issue all charters, amendments and extensions thereof of domestic corporations and to issue all licenses of foreign companies to do business in the state. This authority is subject to such requirements as may be prescribed by the General Assembly. Similarly, except as may be otherwise prescribed by the General Assembly, the SCC is constitutionally charged with the duty of administering the laws for the regulation and control of corporations doing business in the Commonwealth.

Regarding additional duties, the Constitution authorizes the General Assembly to confer powers and duties on the SCC beyond those specifically conferred in the Constitution, confirming the practice of the legislature since the SCC's inception in 1903.

The Constitution provides the SCC its judicial power by conferring upon it the power of a court of record, including the ability to administer oaths, compel the attendace of witnesses and production of documents, and to enforce compliance with its orders. This section also authorizes the SCC to develop its own rules of practice and procedure. The General Assembly has the power to adopt, amend, modify or set aside SCC rules or substitute SCC rules with rules of its own.

The Commonwealth, parties with interest and parties aggrieved by the action of the SCC may appeal only to the Virginia Supreme Court. The Constitution further provides that no further court of the Commonwealth has jurisidiction to review, reverse, correct or annul any action of the SCC. The Constitution prohibits foreign corporations from exercising public service functions in the Commonwealth. Foreign corporations must reincorporate in Virginia in order to act as public service companies.

The Constitution requires that corporations be chartered and that charters be amended or extended only through the passage of general laws thereby prohibiting the use of special acts to achieve such purposes. It also limits the discretion that may be exercised by the SCC in granting, amending or extending corporate charters by restricting its purview to making sure the applicant has fully complied with all requirements of the law. It defines the term 'corporation' by excluding municiple corporations, other political subdivisions and public institutions owned or controlled by the Commonwealth.

Several aspects of the Commission's management and structure have the potential to impact substantive policy. They include the selection method for Judges and the manner in which industry oversight is divided among Judges. The Virginia Corporation Commission is unusual in that its Judges are elected by the General Assembly. In most other states, commissioners are either appointed by the governor (often subject to legislative confirmation) or elected by the voters.

A sizeable scholarly literature examines the relationship between the method of selecting utility commissioners and regulatory outcomes, such as prices, allowed rates of return, and regulatory lag. The evidence is mixed, depending on the time period and the design of the study. Some studies find that states with commissioners elected by the voters, for example, tend to have lower utility prices and allowed rates of return than states with appointed commissioners. Many studies, however, find that the selection method has no effect on outcomes. Unfortunately, the existing literature offers little guidance in assessing the impact of the commissioner selection method on a commission's openness to replacing regulated monopoly with more open competition.

Another unusual organizational feature of the Virginia Corporation Commission is that each Judge specializes in overseeing the Commission's activities in a particular set of industries. Staff working on each industry report directly to the individual Judges responsible for that industry, rather than reporting to the chairman or the Commission as a whole. In contrast, most federal and many state regulatory agencies employ a 'strong chairman' mode, in which the chairman takes the lead in setting the agenda in all regulated industries and virtually all permanent professional staff report to the chairman. However, we have encountered no research that assesses the pros and cons of the Virginia model versus alternative models.

The SCC has been the subject of periodic studies and reviews that have generally focused on its internal efficiency.[15] These have produced a number of recommendations that have resulted in some changes in how the SCC functions. Perhaps of more importance in terms of modifications in the fundamental, longer-term approach of the SCC to regulation have been the changes that have occurred at the federal level of policy governing each sector overseen by the SCC. There have also been major changes in intellectual and practical thinking regarding the role and application of regulation, and changes in the 'client base' for regulation, most especially in the nature of the economy of the Commonwealth.

The Need for Regulation in the 21st Century

For a variety of reasons the nature of regulation has changed in recent years. Since the mid-1970s, state and federal legislators and regulators have undertaken significant regulatory reforms. There has been regulatory reform in all of the industries regulated by the Virginia State Corporation Commission. Some of these changes represent recognition of technological shifts that made the traditional regulatory structures and instruments obsolete. The implications of the very rapid advances in telecommunication technologies are the most marked of these but there have also been developments across the broad range of regulated industries. Combined with this, there have been societal changes that have affected the expectations of citizens. Rising incomes, new demographic patterns,

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15 In recent years these include:- *Second Staff Report on the State Corporation Commission: Recommendations on the Reallocation and Reorganization of Responsibilities, for the Executive Management Subcommittee Commission on state Governmental Management*, 1977; *Report from the Commission of State Government Management on Priority Recommendations for 1978 to the Governor and the General Assembly*, Commonwealth of Virginia, Senate Document No.21, 1978.; *Report of the Joint Legislative Audit and Review Commission on Organization and Management Review of the State Corporation Commission*, House Document No.15, Commonwealth of Virginia, 1987.

changes in the industrial structure of the US, and Virginia more specifically, and new management techniques are among these developments.

These reforms have also been aided by some significant changes in academic understanding of the causes and consequences of regulation. The SCC and other states regulatory commissions came into existence primarily to combat what was seen as the economic inefficiencies and social injustices associated with monopoly power and inter-firm collusion in a number of key sectors. In economic jargon, there was particular concern about allocative inefficiency in cases where market power was highly concentrated.

At the same time, it was realized that many of these industries, or large suppliers within them, because of the potential to exploit economies of large-scale production, should remain intact. In some countries, a solution was sought in state ownership of such enterprises and in the US the federal government decided to constrain the monopoly problem in some industries, in spite of any loss of scale economies, by splitting the supplying companies up, e.g., Standard Oil. The ICC has been created at the federal level to pursue a different strategy, namely the substitution for competition by a government regulation through a regulatory agency. The creation of state commissions was the parallel to this approach at the state level. Such regulation would be in the 'Public Interest'.

Since the creation of the SCC there have been important developments in the ways in which regulation is viewed. The principal strands of scholarly research with concrete implications for regulatory policy include literature on contestable markets, efficient rate design, dynamic efficiency, public choice, and information economics.

- *Contestable Markets*. Traditionally, policymakers and many economists assumed that significant economies of scale led to 'natural monopoly,' which then required regulation to protect the public from excessive prices or under supply.[16] But in 1968, a landmark study argued that economies of scale alone do not imply that regulation is necessary. Even if an industry is a natural monopoly, firms can still compete for the right to be the monopolist, and long-term contracting can lock in competitive prices for customers.[17] It is not economies of scale, but irretrievable investments in assets with few or no alternative uses – 'sunk costs' – that discourage new competitors from challenging an incumbent monopolist. To achieve the beneficial results of competition, we do not need numerous actual competitors in the marketplace; we need only very easy entry and exit.[18]

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16 Strictly the problem was only seen to exist if the monopolist only charges a single price. If it can perfectly price discriminate between consumers then the output of a profit maximizing monopolist will be optimal although all the excess benefits will accrue in the form of monopoly rent.

17 H. Demsetz (1968) 'Why regulate utilities?' *Journal of Law & Economics,* Vol.11, pp.55-65.

18 W. Baumol, J. Panzar, and R. Willig (1982) *Contestable Markets and the Theory of Industry Structure* (New York: Harcourt Brace Jovanovich).

This contestable market theory undermined the case for regulating entire industries as integrated monopolies. Instead, scholars and policymakers sought to confine regulation to the parts of the industry where competition is unlikely to emerge due to a combination of heavy sunk costs and large economies of scale. As long as competitors have nondiscriminatory access to 'essential facilities' like electric wires and local gas pipes, competition could develop in the rest of the industry.[19] Contestability theory thus provided the intellectual framework underlying 'unbundling' in energy, telecommunications and many other industries.

- *Efficient Rate Design*. For much of the 20th century, regulators focused largely on distribution issues in rate design, inquiring what set of rates would prevent regulated firms from earning 'excessive' profits and distribute the burden of fixed costs 'fairly' among different customer classes. It was known as rate-of-return regulation. The latter half of the century, however, saw a resurgence of research on efficient rate design. The purpose of this research was to identify pricing plans that would most closely reflect the actual costs created by customers' consumption decisions.

  One result of this focus on allocative efficiency is the redesign of rates to more closely match prices with costs. During the 1970s, for example, states began reversing 'declining block' electric rates, which gave customers lower prices as they used more electricity. Such rates created perverse economic and environmental effects, because the cost of incremental generation capacity was rising, not falling.[20] Competition in energy supply and telecommunications has also led to new retail price offerings that reward customers for shifting their usage to off-peak periods.[21]

  Another principal effect of the new focus on allocative efficiency is the replacement of poorly targeted cross-subsidies hidden in rates with explicit subsidies targeted to more carefully defined customer groups, such as poor and rural customers.[22] This change is most obvious in telecommunications, but it has also occurred in the energy industry as competitive energy supply is separated from monopolized transmission and distribution networks and, at the federal level with domestic air transportation.

- *Dynamic Efficiency* Textbook economic models of competition and monopoly usually assume that resources, production techniques, and customer desires are known and given. Real-world markets, however, are a trial-and-error process by which businesses discover new products, new technologies, new sources of supply, and new

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19 E.E. Bailey (1981) 'Contestability and the design of regulatory and antitrust policy,' *American Economic Review* , Vol. 71, pp. 178-83.

20 A. Kahn enunciated many efficient pricing principles in his classic *Economics of Regulation*, first published in 1971, and then went on to implement many of them as chairman of the New York Public Service Commission. See T. McCraw (1990)*Prophets of Regulation* (Boston: Harvard University Press).

21 S. Littlechild (2000) *Why we Need Electricity Retailers: A Reply to Joskow on Wholesale Spot Price Pass-through*, Department of Applied Economics, Working Paper 0008, University of Cambridge.

22 Empirical research has demonstrated that cross-subsidies embedded in rate structures generate large costs that are much higher than the cost of providing more direct assistance to the customer groups that policymakers seek to help. See, e.g., R.W. Crandall and L. Waverman (2000)*Who Pays for Universal Service?* (Washington: Brookings Institution Pres).

customer demands. Regulatory researchers have increasingly sought to analyze how regulation affects these elements of 'dynamic efficiency.' A large body of literature has found that traditional, cost-of-service regulation can inflate costs and stifle incentives for innovation. The resulting rates might be 'just and reasonable' from a legal perspective, but they are rates for an artificially restricted set of services produced at inflated costs.[23]

Aside from providing another rationale for deregulating where competition is possible, research on dynamic efficiency has prompted interest in 'performance-based' rate making that allows regulated firms to earn greater profits if they find ways to lower costs and improve service. Such rate making innovations have been widely adopted by both federal and state utility regulators.[24]

- *Public Choice.* Public choice research views politics and regulatory proceedings as a marketplace in which various groups compete to shape laws and regulations in ways that will benefit their own, private interests. The influence of private interests on public decisions means that there is no guarantee that government decisions will actually reflect the public interest. Regulatory commission can be 'captured' either by the regulated firms or by a subset of customers who use regulation to obtain subsidies at the expense of other customers.[25]

  Historical public choice research has contributed to increased skepticism of natural monopoly claims, because it reveals that regulation in practice often originated in the desire of a particular industry to achieve protection from competition and/or avoid government ownership.[26] As a result, scholars and policymakers alike are more likely to seek competitive solutions to perceived problems.

  Additional impetus for deregulation has come from research on political influence costs. When regulation constrains prices, the regulated firm and its customers both

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[23] L. Courville, 'Regulation and efficiency in the electric utility industry,' *Bell Journal of Economics* Vol. 5, pp. 53-74; P.M. Hayashi and J.M. Trapani, 'Rate of return regulation and the regulated firm's choice of capital-labor ratio: further empirical evidence on the Averch-Johnson effect,' *Southern Economic Journal,* Vol. 42, pp.384-97; H.C. Petersen, 'An empirical test of regulatory effects,' *Bell Journal of Economics,* Vol. 6, pp.111-26 R.M. Spann, 'Rate of return regulation and efficiency in production: an empirical test of the Averch-Johnson thesis,' *Bell Journal of Economics* Vol. 5, pp. 8-52; E. Canterbery, B. Johnson, and D. Reading (1996) 'Cost savings from nuclear regulatory reform: an econometric model,' *Southern Economic Journal,* January, 554-66. I. Kirzner (1985) 'The perils of regulation: A market process approach,' in *Discovery and the Capitalist Process* (University of Chicago Press).

[24] See, e.g., M. Crew (Ed.) (1992) *Economic Innovations in Public Utility Regulation* (Boston: Kluwer Academic Publishers).

[25] G. Stigler (1961) 'The theory of economic regulation,' *Journal of Political Economy* Vol. 69, pp. 213-225; M. Crew and C. Rowley (1988) 'Toward a public choice theory of monopoly regulation,' *Public Choice* Vol. 57, 49-67; R.K. Huitt (1952)'Federal Regulation of the Uses of Natural Gas,' *American Political Science Review,* June, 455-69; Jerry Ellig (1995)'Why do regulators regulate? the case of the Southern California gas market,' *Journal of Regulatory Economics* March; J. Ellig and J. High, 'Social contracts and pipe dreams,' *Contemporary Policy Issues* Vol. 10, 46-48; J.C. High (1991) *Regulation: Economic Theory and History* (Ann Arbor: University of Michigan Press).

[26] R. Poole Jr. (1982)*Unnatural Monopolies* (Lexington: DC Heath).

have incentives to capture wealth transfers by influencing regulators and legislators. Such battles are commonplace in regulated industries.[27] Although the firms fighting over the wealth transfers benefit, the resources they expend are pure waste from a broader social perspective.[28] The existence of political influence costs does not mean that regulation cannot improve on market outcomes, but it does mean that regulation has an additional cost that must be considered.

- *Information Economics*. Because models of perfect markets assume that consumers have perfect information, it is tempting to assume that incomplete information automatically implies that there is a 'market failure' that regulation can correct. A great deal of regulation in the securities and banking industries is based on this assumption.

  Research on information economics offers a different perspective. Information is a good thing, but its production and dissemination requires scarce resources that have alternative uses.[29] As Nobel Laureate George Stigler, an early pioneer in the economics of information, noted 'Ignorance is like subzero weather: by sufficient expenditure its effects on people can be kept within tolerable bounds, but it would be wholly uneconomic entirely to eliminate all of its effects.'[30]

  A market failure in regard to information occurs only when some market participants lack information whose value exceeds its costs of production and dissemination. The principal policy implication is that regulation is justified when it provides the lowest-cost way of alleviating such a market failure. In many cases, regulators have determined that disclosure requirements accomplish the public policy goal at lower cost than more onerous measures, such as prohibitions.

The developments in economic thinking, combined with an increasing body of empirical analysis that began to emerge in the mid-1960s,[31] brought about important changes in the way regulation was viewed and applied. At the federal level in the US, airfreight transportation was deregulated in 1977 and air passenger transportation from 1978. These reforms, and many others that were adopted in other industries, removed controls over such matters as pricing, market entry, and scale of operations. In most cases, however, the term deregulation was something of a misnomer. Regulations were often made less

[27] See, e.g., R.K. Huitt (1952) 'Federal regulation of the uses of natural gas,' *American Political Science Review*, June, 455-69; J. Ellig (1995) 'Why do regulators regulate? the Case of the Southern California gas market,' *Journal of Regulatory Economics*, March; J. Ellig and J. High, 'Social contracts and Pipe Dreams,' *Contemporary Policy Issues* Vol.10, 46-48.

[28] J. Buchanan, R. Tollison, and G. Tullock (1980) *Toward a Theory of the Rent-Seeking Society* (College Station: Texas A&M University Press).

[29] H. Demsetz (1969) 'Information and efficiency: another viewpoint,' *Journal of Law and Economics* Vol.12, pp.1-22.

[30] G.J. Stigler (1961) 'The economics of information,' *Journal of Political Economy* Vol. 69, pp.213-225.

[31] In particular, the availability of computers allowed for the easier handling of data and the application of more sophisticated econometric techniques (notably stochastic frontier analysis) and programming methods (notably data envelopment analysis) that allowed the efficiency of different regulatory regimes to be compared.

stringent or changed in form but regulations did not entirely disappear. In many cases there was an appreciation that while the traditional methods of regulation had defects, problems of market failure remained and were often significant. What did emerge, however, was an increase in the portfolio of policy instruments that could be deployed. For example, the traditional rate-of-return regulation over prices was now often replaced by various forms of price capping that had the incentive effect of allowing providers to retain any profits that could be made at the stipulated price. In this way, it was hoped that dynamic efficiency would be stimulated.

What has been less well researched and operationalized have been the transition mechanisms and paths that can most effectively move regulation to a less intrusive position. Economists and analysts have tended to be more focused on the outcomes than the means moving to new regulatory environments. Inappropriate paths of change can, however, result in such problems as large stranded costs if equipment and plant have to be abandoned under a new regulatory regime. It can lead to considerable inefficiencies in the short term in the supply of goods and services. There are issues of the speed of transition[32] and the degree to which regulators should micromanage the process.[33]

Trends in Virginia Affecting the Regulatory Approach

Regulation is largely contextual. There are general theories of regulation, but their application depends very much on circumstance. It depends on the intrinsic natures of the markets that are to be regulated, the perception of the nature of any market failures, the form of intervention instruments that are available, and the objectives to be served. At the state level, many of these factors are determined by the way that the state is developing over time. The needs and priorities of the citizens of a largely agrarian state, for example, are likely to be somewhat different to a state with a major high-technology service sector. The obvious difficulty is that most states, including Virginia, are not homogeneous entities but contain a mixture of activities.

What is clear about Virginia is that has enjoyed a significant population growth over the past twenty years and that in many regions of the state there have been important structural changes in the nature of the economy and the resident population. In the period 1995 to 1999, Virginia was in the nation's top ten states for attracting venture capital. Overall the Commonwealth's economy has performed well with non-agricultural employment in 1999 reaching 3.38 million with an unemployment rate of 2.8%.

The Commonwealth has witnessed some of the fastest growth in high technology activity in the country, most notably the metropolitan areas of Northern Virginia[34], Richmond, Hampton Roads and Roanoke.

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[32] K.J. Button and K. Johnson (1998) 'Incremental versus trend-break change in airline regulation', *Transportation Journal*, Vol.37, pp.25-34.

[33] A.E. Kahn (2001) *Whom the Gods Would Destroy, or How Not to Deregulate*, (AEI–Brookings Joint Center for Regulatory Studies, Washington).

[34] Which embodies the counties of Arlington, Clark, Culpeper, Fairfax, Fauquier, King George, Loudoun, Prince William, Spotsylvania Stafford and Warren, and the independent cities of Alexandria, Fairfax City, Falls Church, Fredericksburg, Manassas City and Manassas Park.

In particular, Northern Virginia has seen major expansions in its high-technology activities and significant increases in the incomes of residents in the area – e.g., Fairfax County had the highest medium household income ($90,000) in the US at the end of 2000. It has seen a major growth in its employment base over the past twenty years and the region now constitutes over 30% of the jobs in the Commonwealth. Forecasts indicate that the relative importance of Northern Virginia in the Commonwealth's economy, both in terms of employment and income, is likely to continue to grow into the foreseeable future (see Exhibits 2-1 and 2-2).[35] Northern Virginia is anticipated to account for about 50% of the State's population growth between 1998 and 2010. Its share of employment growth within the Commonwealth is projected to be just under 50% and its share of total income growth to be over 60% of the State's rise in total wages and salaries.

The major reason for growth has been a structural shift in the economy of Northern Virginia and a rapid rise in the productivity of its labor force.[36] This has expanded and deepened the tax base of the region.[37] The change has implications for the relative tax load in Virginia. In terms of its contribution to the state's fiscal purse, Northern Virginian contribute on a per capita basis about one-third more in state income tax than residents in the remainder of the state.[38] The public expenditure patterns in the Commonwealth have resulted in transfers from Northern Virginia to areas in the rest of the state that may pose problems of economic sustainability for Northern Virginia in the longer-term.

Not all parts of the State have performed equally well.[39] The far Southwest Virginia coal-fields have seen employment decline as automation of the mines has taken place. The area of Southern Virginia bordering North Carolina have seen textile and apparel unemployment losses as the result of the local industry having to compete in highly competitive global markets. Apparel manufacturing employment has been in secular decline with 2,200 jobs going in 1999 alone. A slightly smaller decline has been witnessed in recent years in tobacco manufacturing and a somewhat larger one in the manufacture of transportation equipment.

These and other economic and social changes within the Commonwealth pose continual challenges to regulating agencies such as the SCC. The rapid growth in regions such as Northern Virginia pose not only problems in ensuring that the underlying financial

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35 S.S. Fuller (1999) *The Importance of Northern Virginia's Economy in the Commonwealth of Virginia, A Comparison of the Economic Growth Patterns Between Northern Virginia and the remainder of the State: 1980 to 1998 and 1998 to 2010,* Commonwealth of Virginia House of Delegates Appropriations Committee.

36 'High technology fuels employment and wages growth in Virgina, *Virginia Economic Trends,* Chmura economics and Associates, Richmond, 1999

37 In terms of high-technology industry, the driving force behind the economic expansion at the end of the last century, Virginia ranked 8th amongst US states in terms of high-technology employment creation between 1990 and 1998. In 1999 there were nearly 320 thousand high-technology employees in the state, the majority, over 180 thousand in Northern Virginia. Other centers of high-technology employment are Hamppton Roads and Richmond-Petersburg.

38 Ibid.

39 Indeed, the evidence would seem to indicate an increase in income inequality across Virginia, see J.L. Knapp and S.C. Kulp (2001)'Virginia adjusted gross income, 1998', *Spotlight on Virginia*, Vol. 5 No. 1.

structure of the region's economy is based on a sound foundation but also that the supply of essential infrastructure, such as water supply, is maintained at a satisfactory quality. But the SCC also has concerns of basic supply and the requirement to ensure that the slower growing parts of the Commonwealth are not deprived of essential services such as telecommunications. This is taking place at a time of significant technological change and during a period of important social metamorphosis as the shift into the information age occurs. The definition of the public interest, for example, would not be the same now, as it was when the SCC was established even if there had been no advances in economic thinking on regulatory policy. What the public now wants and hopes for is simply different from a century ago.

Exhibit 2-1: Employment Growth in Virginia 1980-98 and 1998-2010 (employment numbers in thousands)

Year	Northern Virginia	Rest of State
1980		
Number	694.57	2,022,01
% of State	25.6	74.4
1998		
Number	1,344.66	2,776.83
% of State	32.6	67.4
2010 (forecast)		
Number	1,860.16	3,302.80
% of State	36,0	64.0

Source: George Mason University Mason Center, NPA Data services, Inc.

Exhibit 2-2: Salary, Per Capita Income and Gross Regional Product: 1980, 1998, and 2010 (in 1992 dollars, GRP in billions)

State portion	1980	1998	2010 (forecast)
Mean salary			
Northern Virginia	$26,938	$34,484	$39,195
Rest of State	$22,491	$27,349	$28,457
Per capita income			
Northern Virginia	$22,978	$32,099	$39,500
Rest of State	$15,106	$20,764	$26,348
Gross regional product			
Northern Virginia	$30.70	$72.69	$112.75
Rest of State	$74.54	$117,30	$161.80
NVA as % of the State total	29.2%	38.2%	41.1%

Source: George Mason University Mason Center, NPA Data services, Inc.

3. ASSESMENT OF THE STATE CORPORATION COMMISSION

The SCC has been in existence for a century and has weathered many storms in terms of changing economic conditions, fluctuating ideas on the role of regulation, changing political moods, and a wide variety of external shocks. It has served the Commonwealth well. It has proved to be a robust institution that has largely managed to separate the development of broad regulatory policy from the implementation of regulatory policy. It has been both conservative in its approach to regulation but at times innovative as with the initiation of long-distance competition in telecommunications. This has allowed for success in handling such serious matters as the financial crisis of the late 1980s.

Circumstances do, however, change and with change may come the need for a new or at least modified approach to regulation. The fundamental issues the Commonwealth faces as it moves into the new century is whether the structure of the SCC and its ethos is appropriate to meet the conditions that exist at present, but perhaps more importantly, the conditions that are likely to develop over the next decade or more. In particular, new thinking on regulatory philosophy places more emphasis on the workings of markets and this requires a lighter regulatory touch where regulation is retained. The problem of deciding exactly when and how to intervene in markets has been compounded by a variety of technological changes that have taken place over recent years in sectors that have traditionally been regulated. These changes are likely to continue to take place.

The best practices stem from the view that there is only a need for regulation when there are demonstrable market failures and when it can be shown that regulatory intervention will produce a preferred social outcome to the imperfect market.

The result of these developments is that traditional regulatory approaches that take it as almost axiomatic that a regulatory system can correct market distortions have been undergoing a process of reform. The issue for the Commonwealth is effectively whether its regulatory structure has the capability of incorporating these developments.

There is also another side to the regulatory equation. There is an inevitable tendency to try and look at institutional structures in the light of specific current challenges and those of the immediate past. This can result in tinkering with existing structure to handle immediate, but possibly transitory and in the long term, relatively minor problems. Frequent changes in regulatory institutional structure can lead to uncertainty and inevitably prove harmful to all parties concerned unless there is demonstrable evidence to the contrary. Four recommendations flow directly from these observations.

1. **The structure of regulation in Virginia has stood the test of time well and change should only be undertaken in the light of serious long-term problems. Many sectors overseen by the SCC have been going through major technical and structural changes. In itself this is not justification for change unless lack of change impairs the long-term efficiency with which Virginian's can access these**

services. The SCC should retain its role as the body responsible for economic regulation of the sectors currently under its oversight.

2. **The SCC should remain as independent as possible from short term political pressures.**

3. **The basic principle of regulation should be to allow the market to function and only to intervene when there are demonstrable market failures that appropriate regulatory control can be demonstrated to reduce.**

4. **The Commonwealth's structure of regulation was initially designed to deal with fundamental market flaws as perceived at the time. Our understanding of how markets function has subsequently changed as has technology. It is important to ensure that the workings and decisions of the SCC continue to take full account of this.**

Modern regulatory practices involve much less day-to-day involvement with the sectors being controlled than in the past. Regulation is seen as an aid to developing and maintaining a competitive environment to the ultimate benefit of consumers. To ensure that that this goal is being achieved, however, appropriate statistics are required. At present the SCC collects a variety of data. It is unclear that all of this is necessary, that it is always the most salient data, and that a clear strategy exists for reviewing data collection processes. It is also important that the data reflects where ever possible the outcomes of the actions of the SCC on the industries concerned and on consumers. This is not simply a matter of internal efficiency within the SCC. Without adequate data it is difficult for both industry and consumers to assess the impacts of SCC actions.

5. **It is important that the SCC collects salient data and that this data adequately reflects the implications of its actions on consumers as well as on the industrial sectors under its jurisdiction. One of the most effective forms of consumer protection is good information.**

Data collection imposes costs on those in the sectors that are required to provide it, and in many cases sample information is sufficient. There is the need for continual vigilance to ensure that data collection is not unnecessarily burdensome. Hence:

6. **The SCC should continually review the data that industry is required to provide and limit them to those that are necessary to fulfil its regulatory requirements. In doing this it should seek to minimize the burden on the regulated industries of providing data and other information.**

The unique nature of the SCC means that it has been largely able to isolate itself from excessive day-to-day political pressures. It is also clear from the many interviews conducted in the course of this work that its staff are perceived to be highly professional in their approach. These are not features found in all US states. Part of this independence comes from the ability of the SCC to finance its activities through fees, licensing, and

similar charges.[40] There are potential problems in this. The sources of revenue may shrink, e.g., if more major banks leave the State. It is also theoretically possible that those regulated may, through their financial inputs, exercise some control over SCC actions, although there are no indications of this happening in practice. On the other side, there is potential for the SCC to raise excessive fees to cover expenditures that may not be incurred under other regimes. There may also theoretically be managerial slack under such a system.

However, these possibilities seem far outweighed by the benefits of financial independence from the legislature. It frees the SCC from political pressures in its day-to-day operations and affords it the ability plan with some control over its finances. Thus:

7. **The activities of the SCC should continue to be self-funded to avoid problems that many states have in achieving efficiency and effectiveness because of a dependence on annual state budgetary decisions.**

A number of critical comments have been made regarding the operations of the SCC. Some of these relate to the nature of judgements but per se these are not the concerns of interest here. Concern has also been expressed about the perceived slow speed at which some decisions are arrived at. It is difficult to assess the validity of this. In most of its roles, the SCC provides de facto implementation of the de jure regulatory structure set in statutes. This inevitable involves a degree of interpretation and judgement. How the judges are selected and the way that they operate is thus of importance. The Virginia Constitution allows for a maximum of five Judges but this has never been implemented and only three are in position. These have taken a special interest in particular sectors under the SCC jurisdiction that they administer. Little criticism was made in our interviews our submitted documentation of the current Judges who are seen as knowledgeable and hard working.

There have also been concerns about the links between the policy-making body in Virginia and the SCC. In particular, that in some spheres the SCC has been slow to implement more competitive oriented approaches to regulation. This appears to be a particular issue in the more technologically dynamic sectors such as telecommunications where consumers lose many of the gains of new systems if their adoption is constrained.[41] The SCC offers a somewhat different perspective. Individuals within it and

[40] The SCC collects and deposits into the General Fund fees and charges that amounted to $362,807,732 in the financial year ending June 2001. In addition, the SCC has traditionally made an annual surplus that is transferred from the Clerk and Securities special fund per code into the General Fund of the Commonwealth. In recent years the transfers have been:

1997	$14,261,144	2000	$14,298,140
1998	$8,670,194	2001	$15,679,454
1999	$16,064,871		

[41] Indeed, tracing out complaints filed with the SCC sees a marked increase from the mid-1990s when deregulation began. Data is obtainable from the SCC complaints tracking system.

its various directorates point to the development of rules covering competitive practices, the efforts to educate those involved of what is happening, and the movements that have emerged on the ground. In some cases, such as in the energy sector, continued statutory controls, such as price-capping, are seen as making it difficult to foster competitive markets. The argument is very much in terms of the need to protect the public during time of change. The counter argument could well be that there is the need to protect the public from excessive conservatism at such times. It is inevitably a matter of balance.

There have been changes in the way that regulation is viewed and in ideals and practices of implementation. As discussed in the previous chapter, regulation has become less 'heavy handed' and somewhat more top-heavy in the ways in which it functions.[42] In many ways it has become more judgmental. The costs of delay in decision-making have also tended to increase.

Some of the perceived difficulties here may be reduced if the number of Judges were increased to the maximum of five. This would share the burden more widely and potentially allow for a greater breath of expertise to be brought to each case. The range of industries covered has increased significantly since the inception of the SCC. One way to meet this issue is to have five Judges each with five year terms so that one new member is appointed to the SCC each year. This would also allow for the introduction of individuals by the Assembly that reflect a bias towards the more pressing shorter term issues without impeding longer term stability. Of course, this would ultimately be dependent on who the Assembly appoints to the positions.

The increased number of Judges would also remove the 'Sword of Damocles' that potential exists. Having only three judges when five are permitted poses the possibility of politically loading the Commission by the appointment of two additional judges at one time. Indeed, history has shown at least one instance when this was attempted. Whilst the thread holding the sword may be thick, the situation is at best untidy and, at worst, has the potential for removing the generally well received idea of a largely politically independent SCC.

We recognize that this is unlikely to be a measure that could be introduced rapidly and that it would require modifications to the Virginia Constitution because it would require a change to the length of term each Judge served. There is no Constitutional issue concerning increasing the number of judges per se.

We also note a number of objections to this idea. These include those voiced the SCC itself.[43] Overall these concerns include practical considerations of costs[44], the loss of experience to the Assembly by Judges only serving fives years, although renewal would

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[42] For example, see A.E. Kahn (2001) *Whom the Gods Would Destroy, or How Not to Deregulate*, (AEI–Brookings Joint Center for Regulatory Studies, Washington)

[43] Virginia State Corporation Commission (2001) *Response of the State Corporation Commission to the 1st Draft Report of SCC Study*, June 29.

[44] These would only involve staff and operating costs, the SCC building is designed to facilitate five Judges.

be possible and the cumulative experiences of five exceed those of three. There may be difficulties involved in changing the existing system within the SCC, that the SCC would become more political in its nature, and the possible greater complexity of decision-making. Nevertheless, given changes in the way regulation is now viewed there is a case for considering putting more resources at the higher end of the regulatory structure. Hence:

8. **The notion that the number of Judges should in fact be increased to five, with one being replaced each year, should be seriously considered. This would require Constitutional change.**

At a more micro level, one of the concerns expressed both within the SCC and by some parties is that the relatively high turn over of staff within the Office of the General Counsel's can a pose problem of continuity when dealing with issues and cases. This can slow down due processes as new individuals are brought up-to-date. While the Office had a full compliment of staff at the time this report was prepared, there may also be a longer-term need to look at wider issues of staffing and allocation. Experience is often acquired on a case-by-case basis when regulating rapidly changing industrial structures and, as new technologies need to be brought into consideration. Quality of life factors do influence career choices but financial considerations are also inevitable important in market based economies.

9. **Adequate resources should be provided to reduce the turnover of staff in the Office of the Council General. This turnover at a minimum impedes the speed at which cases can be brought.**

There has been expressed some concern about the closeness of the administrative processes within the SCC and the judicial processes. As seen in both the public discussions within the Sub-Committee itself and in interviews there is often confusion as to where the judicial role ends and the administrative role begins.

As pointed out by the SCC, this is not a problem unique to its structure and is found, often in much more acute forms in many other bodies in the Commonwealth.[45] This we accept as fact but not a reason for not addressing the SCC situation. Other states use a variety of mechanisms for dealing with the issue. In some cases it is simply ignored while in other resource intensive measures of completely separating functions are deployed. This ex parte question was also addressed in the recent internal review of the SCC.[46] The response of this review can be summarized as the initiation of a more transparent structure with the identification of advocacy staff ' by memorandum' in each Commission case. This approach has merit and is now largely being pursued by the SCC.

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[45] The Judges also point out that in the case of the SCC there is a final appeals procedure available through the Commonwealth's Supreme Court that is not available in the context of many other bodies where similar issues exist.

[46] D. Wirick and J. Wilhelm (2001) *Final Report on the Virginia State Corporation Commission* (The National Regulatory Institute, Columbus).

This study finds the rather unstructured nature of this development may not be sufficient in the eyes of the public. Justice needs to be seen to be done as well as being done. In consequence a number of alternatives were proposed in earlier drafts of this Report with the objective of seeking out a structure with a more formal buffer between the advisory role of the administration and the advocacy role. Efforts to device such a committee structure encountered severe difficulties in terms of such things as its composition, its powers, and its detailed functions. The conclusion is that, while the current situation is not idea, the alternatives appear either too costly or to pose equally problematic issues. We do feel, however, that the SCC would help by making it more widely know how it deals with the ex parte problem within its own working practices. It should also be continually aware of the issue and vigilant for any possible changes that might in the future further reduce the problem.

10. The State Corporation Commission should continue to explore ways of improving the public understanding of how it internally handles potential ex parte conflicts. It should continually seek ways to mitigate potential conflicts.

There are also proposals in the internal SCC report for the creation of more formalized alternative dispute resolution (ADR) structures within the SCC.[47] The SCC has responded to criticisms regarding the lack of non-judicial processes within its 'operating style'. In addition some new structures are being put into place. The SCC points to the very large number of disputes that are settled before they come to court and to the fact that judicial review is only needed for part of 'cases' that are settled by other means.[48] The issue of developing ADRs is one attracting a lot of attention in the public administration field and with some justification. But there are problems in introducing more formalized procedures into an otherwise partially informal structure. Not the least of these are that they may act to slow down agreements and judgements. There are inevitably more issues to be resolved, and the potential for a more adversarial approach in a period of relative rapid industrial change, and when ideas of appropriate regulatory policy are in flux, but another layer of formal procedures would seem unlikely to instill the dynamism such conditions require.

11. The current process of dispute resolution, with its informal and formal elements seems to work well if a little slowly at times. There is no recommendation of further informal 'alternative dispute resolution' procedures being required. More formality generally leads to even slower decision-making

The SCC is effectively divided into a number of divisions, with Commissioners for financial institutions and insurance and Directors for public utility accounting, communications, securities, economics and finance, energy regulation, and public service taxation. Proposals have been voiced for the establishment of a Director of Public Utilities whose responsibilities would embrace energy and water regulation. Some have indicated that telecommunications would also be included. In part, this suggestion would seem to be based on administrative considerations of the size of divisions that would be

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47 Ibid.

48 Joint letter from C. Miller, T.V Morrison and H.W Moore dated April 9, 2001.

involved and with the introduction of a unit on a par in size with the Bureaus of Insurance and Financial Institutions.

Administrative divisions should not be based simply on consideration on the number of workers involved. The notion of an overall 'Public Utilities Directorate' that would include energy, water and telecommunications is also a somewhat dated one. There are significant differences in the issues confronting telecommunications and energy. While periodic reviews of any regulatory agency may result in changes in structure, there is a much stronger case at present for creating a Director for Energy embracing gas and electricity and water. These are areas that for the foreseeable future will interact and require considerable skill and expertise.

We note that there have been efforts to develop such a structure in the past but these have met with administrative difficulties. Not the least of these being the horizontal operational nature of the SCC structure making it difficult to isolate the role of an overall Director for energy from the roles of those separately responsible for gas and electricity. This would seem to be the primary reason for the Wirick Report feeling the proposal not to be timely. We note that there may be differences between the bureaucratic structure within an energy directorate and the two existing bureaus that also cover a number of areas of responsibility. Notably, that the former may involve responsibilities that extend across a number of divisions outside of its direct control. The internal structure of an energy directorate would, therefore, inevitably be different. Nevertheless, a carefully structure energy directorate would seem to offer synergies in thought, approach and application across closely related sectors.

12. The similarities and interconnections between the regulatory demands in the fields of gas, electricity and water regulation justify the creation of a Directorate of Energy.

The internal review of the SCC made strong recommendations that more stringent performance review procedures should be established within the Commission.[49] This review strongly concurs with this recommendation.

It is important that the various bureaus and directorates know what they are trying to achieve and to what extent they are meeting their goals. This is not only vital for the internal efficiency of the units but is also important in terms of the accountability of the SCC to the citizens of the Commonwealth and their elected representatives.[50] It is not proposed that these necessarily be accounting type indicators but should provide at a minimum clear written statements of how each directorate sees its role within the overall strategy of the Commission and how it is going about achieving it.

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49 D. Wirick and J. Wilhelm (2001) op cit.

50 The SCC does have a number of objectives and internal mechanisms for assessment (SCC, 2001 op cit) and does score well on these. They often, however, tend to be resource based rather than performance related. This is very much a reiteration of the view of the internal review.

Various components are often assessed by outside agencies in terms of their capacities to perform their functions. In economic terms, however, these may be seen as 'stock' indicators that reflect the pool and quality of resources available. Ideally, however, performance indicators should not be seen as static but continually reviewed in the light of experience as well as the changing world in which regulation is conducted. It is much more an issue of how resources are used, and activities conducted rather than the availablity of resources *per se.*

13. **The various divisions should develop a system of performance assessment procedures suitable to their own activities. These should be quantifiable where possible but also contain qualitative indicators. Performance measured against criteria should be part of annual division reports.**

This notion of public accountability is important in another context; information and interaction. If those affected by the regulatory process are ill informed about the mechanisms involved, and not convinced of the merits of the system per se, this can lead to higher costs of operations and a resistance to the processes. In addition, regulators themselves can benefit from feed-back from those they are regulating and the public more generally.

It is particularly important from a consumer protection perspective that there is the maximum dissemination of information and that is done in such a way that it is readily understood by all interested parties. Outreach is important and an oft neglected aspect regulatory activities in most states. Like most others, the SCC is very patchy in terms of the extent that it successfully interacts with those over which it has regulatory control and those who are affected less directly by its decisions.

14. **All divisions of the SCC should engage in more public information dissemination and information gathering. The banking division runs a number of courses for the industry as well as periodic seminars – this type of model may usefully be replicated elsewhere.**

4. AREAS OF RESPONSIBILITY

4. A The Insurance Industry

The pace of change in the insurance industry is rapid, and thus the scope of this section has been narrowed to include the effects of technology – mainly the Internet and applied information technologies – and the Financial Services Modernization Act of 1999 (also know as the Gramm-Leach-Bliley Act, or GLBA).

The effects of technology have driven rapid change for several years in the insurance industry, and in state government regulation of the industry. However, the industry has long been an early adopter or user of emerging technologies, thereby helping to define the effects of technology when they are applied by business and industry in general.[51] The pace of change has become even more rapid and the changes themselves more complex as the deregulatory effects of GLBA on all financial services coincide with the ongoing effects of applied technology.

SCC Bureau of Insurance Divisions:[52]

Life and Health Division

The Life and Health Market Regulation Division of the SCC monitors the activities of companies within the Life and Health classes of insurance and monitors agents in all classes of insurance. The functional sections have the following responsibilities:

- *Agents Licensing:* This section gives licenses for all lines of insurance and performs tracking functions for the Bureau of Insurance. It screens applications, issue agents and agency licenses, track appointments, process appointment renewals, and monitors regulatory requirements for licensing. It responds to requests for information about agents. There are approximately 80,000 insurance agents, 1,500 insurance companies, and 8,400 insurance agencies in Virginia and the section handles an average of 4,525 telephone calls per month.
- *Automated Systems*: This section is responsible for oversight of all the computer-based systems utilized within the Bureau.
- *Consumer Services:* This section logs, investigates and works toward resolution of complaints about agents, agencies and companies. It makes recommendations for disciplinary action where necessary. Consumer Services representatives provide consumers with information and answer insurance-related questions.
- *Market Conduct*: This section performs field examinations of insurance companies to ensure their business practices comply with Virginia's laws and regulations.
- *Forms and Rates*: This section reviews policies and contracts to ensure they are in compliance with statutory and regulatory requirements. It also reviews and, for certain lines, may approve premium rates.

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[51] J. Yates (1993) *From Tabulators to Early Computers in the US Life Insurance Industry: Co-evolution and Continuities*, Sloan School White Paper No. 3618-93.

[52] Information on functional divisions and activities within the Bureau of Insurance are taken from the SCC's website, which can be found at: http://www.state.va.us/scc/division/boi/webpages/bureaudivisionsadministrativeservices.htm

- *Agent Investigations:* This section conducts field examinations of agent activities and reviews their financial transactions and business practices to ensure they comply with the Commonwealth's insurance laws and regulations.
- *Research:* This section assesses the impact of major issues affecting the insurance industry, develops regulations and proposes legislation relative to the issues. It participates in legislative studies, undertakes consumer research projects, and develops guidebooks to promote awareness of insurance issues and standards.
- *Office of the Managed Care Ombudsman:* This section helps consumers who have Managed Care Health Insurance Plan (MCHIPs) products understand their rights of appeal of adverse decisions by MCHIPs.
- *Outreach Coordinator:* This section coordinates all life and health consumer outreach, including special programs for senior citizens.

Property and Casualty Division

The Property and Casualty Market Regulation Division monitors the activities of companies and agents within the Property and Casualty classes of insurance. The functional sections have responsibilities for:

- *Consumer Services*: This section logs, investigates and works toward resolution of complaints about agents, agencies and companies. Consumer Services representatives also provide consumers with information and answer insurance-related questions.
- *Market Conduct*: This section performs field examinations of suppliers to ensure their business practices are in compliance with Virginia's laws and regulations.
- *Personal and Commercial Lines Rules, Rates and Forms*: This section reviews policies and contracts to ensure they are in compliance with statutory and regulatory requirements. It also reviews and, for certain lines, may approve premium rates.
- *Agent Investigations*: This section conducts field examinations of agent activities and reviews their financial transactions and business practices to ensure they are in compliance with Virginia laws and regulations. It conducts examinations of title settlement agents for compliance with the Consumer Real Estate Settlement Protection Act.
- *Research*: This section assesses the impact of major issues affecting the insurance industry, develops regulations, and proposes relevant legislation. It participates in legislative studies, undertakes consumer research projects, and develops guidebooks to promote awareness of insurance issues and standards.

Financial Regulation Division

The Financial Regulation Division of the Bureau is divided into three sections.

- *Company Licensing and Regulatory Compliance*: This section is responsible for administering the initial license, approval, and registration process for insurers and insurance related entities desiring to do the business of insurance in Virginia. It monitors health maintenance organizations, premium finance companies, automobile clubs, multiple employer welfare arrangements, and continuing care retirement communities. It is responsible for ensuring compliance with licensing requirements for companies transacting business in Virginia.

- *Financial Analysis*: This section is charged with the on-going monitoring and solvency assessment of insurance companies. It approves purchasing groups, risk retention groups, surplus lines carriers, and qualified reinsurers. It is responsible for notification of any insolvency to the Insurance Guaranty Fund Associations.
- *The Financial Condition Examination*: This section is responsible for conducting periodic on-site examinations of domestic insurers' accounts, records, books, and operations. It publishes Examination Reports on the financial condition of insurance companies and any material findings.

The Virginia Bureau of Insurance also includes an Administrative Services Division that is responsible for the Bureau's internal management functions, including human services, budgeting, and internal financial management.

How Other States Regulate the Insurance Industry

The form of insurance industry regulation is essentially the same across states. There is a basic view that there is a need for consumer protection because of the difficulties of individuals efficiently and economically obtaining sufficient accurate information to make good judgments about insurance coverage and other financial instruments. Moreover, since the 1930s, states have been bound by the same set of federal regulations. There are, however, differences between states' political cultures and the ways some functions are organized.

Reorganization of state governments has occurred regularly. The general trend has been for increasing the powers and the tenure of the states' chief executives – their governors. Any reorganization initiative by a state, however, is inevitably partly political and influenced by partisanship.[53] The larger trend has been for governments to become more corporate in their structure and in their workings. It is not surprising that the great majority of state insurance regulatory agencies are executive departments or subdivisions of executive departments.[54] In most of these cases, the respective governors appoint the insurance commissioners. Agency titles and functions show significant variety, including departments of: Insurance, Banking and Finance, Commerce and Regulation, Commerce and Economic Development, and Consumer Regulation and Insurance.

Many Southern states still reflect a traditional distaste for strong government executives. For example, insurance regulation in North Carolina and Georgia is housed in departments of insurance, but the agency heads are elected. In Florida, the state treasurer is elected and serves also as Florida's insurance commissioner and as the state fire marshal. West Virginia's insurance commission is similar to the Commonwealth's SCC in the way it is constituted and in its operation. However, the West Virginia agency's authority and responsibility are limited to insurance. New Mexico approved a new Public Regulation Commission similar to the SCC in 1996 to regulate telecommunications,

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[53] J.L. Garnett (1980) *Reorganizing State Government: The Executive Branch* (Westview Press, Boulder, CO).

[54] See http://www.patientrights.com/links/links7.htm for links to most state insurance regulatory agencies.

utilities, and insurance. However, voters elect New Mexico's five insurance commissioners from five separate districts.[55]

The nation's state insurance commissioners all belong to a public interest group, the National Association of Insurance Commissioners (NAIC). NAIC is currently playing a highly visible role in assisting the states in understanding new deregulated policies, and to implement them in ways that promote increased cooperation and collaboration among the states.

Trends Affecting the Insurance Industry

The Effects of Emerging Technology

The insurance industry's move 'from tabulating to computing technology illustrates two forces evident at many points of technological change: co-evolution and continuity. The technology and its use in life insurance co-evolved, shaping each other in their interactions over' time.[56] The use of computer technology in the insurance industry, particularly the 'life insurance industry...was not a wholly new phenomenon, emerging suddenly and without precedent, but a generational transition in information or data processing.'[57] The insurance industry adopted punch card tabulators, the most direct commercial predecessor of computers, around 1890 because processing data was not simply 'ancillary to the production of goods: information was its only product and information processing was the production line of the firm.'[58]

The ability of all sectors of the insurance industry to assess and manage risk accurately is based on information and firms' ability to compile, process and use that information. Thus, competitive advantages accrue to those firms that can most quickly adopt emerging information technologies. This historical trend continues today, and affects all types of financial services. In a 1997 speech, Federal Reserve Board Chairman Alan Greenspan emphasized the continuation of the effects of advances in information technology, telecommunications, and theory:[59] His remarks were aimed at the financial services industry including insurance companies. He separates applied technology from political and regulatory barriers. Indeed, he argues that technology actually drove deregulation as well as reshaping the industries' products and services.

To answer questions about the effects of technology on Virginia's insurance industry, a more specific focus is needed. There are two principal areas appearing to be exerting the

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55 See http://www.nmprc.state.nm.us/.

56 Yates op cit

57 Ibid.

58 Ibid.

59 'Today, the marketplace for financial services is intensely competitive, innovative, and global. Banks and nonbanks, domestic and foreign, now compete aggressively across a broad range of on- and off-balance-sheet financial activities. It is noteworthy that, for the most part, sweeping legislative reforms has not propelled this transformation. Rather, the primary driving forces have been advances in computing, telecommunications, and theoretical finance that, taken together, have eroded economic and regulatory barriers to competition, de facto. Technology has fundamentally reshaped how financial products are created and how these products are delivered, received, and employed by end-users.' Remarks by Alan Greenspan, Conference on Bank Structure and Competition of the Federal bank of Chicago, Chicago, May 1, 1997.

greatest forces of change. These are advances in computing technology, particularly software, and computer-based telecommunications, primarily the Internet.

The ability to manipulate large data sets at high speed and accuracy has increased efficiency and competition among firms in the insurance industry. In an interview about the adoption of electronic procurement by the Commonwealth, its local governments and the small business vendors who supply them, one Fairfax County official offered insights that apply to insurance companies as well. The discussion focused on concerns that small business owners in Virginia who supply the state and local governments might not have the computer skills to compete through an Internet-based e-procurement portal. On the contrary, the respondent argued that most small businesses in Virginia use personal computers, and that most new small businesses start up using personal computers and off-the-shelf (OTS) software, including products like Quicken and Excel.[60] Assuming these observations are correct, even the smallest insurance agencies and independent agents should become increasingly efficient in operating their businesses, and more effective in meeting customers' individual needs. On an industry-wide basis the efficiencies gained from advances in computing technology are even more widespread and significant.

Whether firms rely on OTS products or custom designed software, the efficiencies gained from computing technology affect business operations and insurance products. The ability to analyze data from thousands of insurance claims enables firms and their underwriters to assess risk more accurately, and thereby price their products more competitively. The ability to keep and manipulate more detailed customer records allows insurance policies and products to be refined in ways that more closely meet customers' individual circumstances and needs. These trends were cited in separate telephone interviews by top Virginia government and industry officials.[61] The Internet and telecommunications technologies have also increased efficiency within the insurance industry for firms and for government regulatory agencies.

Interviews also identified the emergence of techniques such as 'data mining' as having the potential to impose even greater technological effects on the insurance industry. Data mining methods are already being used to 'target consumers.' Such highly specialized applications will drive even further product specialization and competition among firms.[62]

Research conducted during the mid-1990s by GMU's School of Public Policy for a City of Alexandria Task Force on Telecommunications and Information Technology found that computers could as accurately be called 'communicators' due to their rapidly increasing use for e-mail and the World Wide Web (Internet or web browsers were still in their infancy during the mid-1990s). Another IIAV representative emphasized the use of computers as communications devices by insurance agencies and firms. The Internet is

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60 Telephone interview, January 2001.

61 Telephone interviews for this study conducted with Alfred W. Gross, Virginia's Commissioner of Insurance, and Ted Smith, (immediate past) president and chief lobbyist of the Independent Insurance Agents of Virginia (IIAV), March 2001.

62 Telephone interview .

principally a means of communicating, marketing, and providing customer service for insurance agents and firms at the present time. The Internet functions in ways similar to more traditional broadcast and print media, but it increases the industry's efficiency and customer service in important ways, allowing marketing and advertising messages to be 'narrowcast' and responses to requests to be customized individually. [63]

The Internet can be accessed from virtually anywhere, thereby freeing agents from their desks and offices. Increasingly agents and firms to quote rates to potential customers 'instantly' instead of taking days or weeks are using the Internet. Agencies are offering 'opinions' about insurance coverage and claims to customers over the Internet, although disclaimers limiting the opinion to Virginia and states with reciprocity agreements with Virginia usually accompany these. The combined effect of computing power and the Internet is that agents and agencies are more focused on customers and not the agency (i.e., the agency's practices and business processes) in writing insurance policies. That is, there is less reliance on standardized products and more emphasis on personal service. Moreover, the insurance industry is not a technology leader, but its agents and firms are learning to use the technology to improve business processes and practices.[64] These comments from within the industry support the findings of Yates' research cited above. There are also drawbacks in using the Internet more extensively.

Government and industry representatives hear more frequent concerns about protecting current and potential customers' privacy with respect to electronic communication and business. Recent state and federal deregulation of insurance and financial services also increases the need for disclaimers on insurance web sites to limit expressly the accuracy and validity of electronic information and opinions. Interview findings identified government and industry concerns that Internet-based quotes on insurance coverage, rates and policies may not be given by licensed agents or agencies, or that the responding agents and agencies are licensed in another state subject to different rules and regulations.

There is general agreement among insurance agents, regulators, trade associations and industry lobbyists that technology has led to increased competitiveness among firms and within the industry, more diverse and specialized insurance products, and enhanced customer service. Interview findings affirm the remarks made by Fed Chairman Greenspan in his 1997 speech cited above. The interviews also suggest the Internet as the likely medium for increasing reciprocity agreements among the states or at least as the medium for implementing and enforcing those agreements as the industry continues to nationalize and globalize. The effects of the Internet on the insurance industry are also viewed as somewhat unpredictable[65] and uncertain,[66] comments that fit with the notion that technology and the insurance industry co-evolve. Thus regulatory and public policy concerns exist with respect to privacy, interstate commerce within the industry, and the implementation of ongoing federal and state deregulation of the insurance industry.

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63 Telephone interview with Diane Mattis, Director of Education for the IIAV, March 2001.

64 Ibid.

65 Telephone interview.

66 Telephone interview.

The issue of deregulation also has significant effects on the insurance industry. Moreover, the current deregulatory environment in public policy at all levels of government in the US coincides with the effects of new technology. In some cases technology may be the means of implementing and carrying through deregulation, e.g., because of improved information flows. At the same time new technology can increase the complexity and uncertainty about short-run industry trends and the regulatory requirements they may necessitate.

The Effects of Deregulation

The Financial Services Modernization Act of 1999 (also known as the Gramm-Leach-Bliley Act or GLUBA) removes many of the regulatory constraints imposed on financial services, including insurance, during and after the Great Depression. The summary provisions of Articles the first four Titles of the law are cited in Exhibit A.1. The provisions that address the insurance industry directly are included in Title III. However, the summary of other Titles is included because it blurs many longstanding regulations and legal distinctions among various sectors of the financial services industry as a whole, including insurance.

For example, in January 2001 State Farm Insurance mailed its preferred automobile and homeowners insurance policy holders an invitation to transfer their investment, including, cash, cash equivalents, and equities, to State Farm. Thus, notwithstanding the legal and regulatory changes affecting banks, savings and loans, credit unions, and other depository institutions, insurance companies apparently may now operate as retail investment brokerages – and potentially investment banks. Moreover, while Greenspan's 1997 remarks about the effects of technology and finance theory on financial services and insurance remain true, it is also clear that deregulation is now a major factor affecting trends within the industry.

While Title III of the act 'ensures state *functional* regulation of insurance,' the following response by the National Association of Insurance Commissioners (NAIC), the association of state insurance officials, indicates the degree to which the law itself and its implementation leave numerous questions unanswered—or create new questions and uncertainties.

'With the establishment of the following working groups, the NAIC has designed a blueprint to achieve the goals of the Gramm-Leach-Bliley Financial Services Modernization Act (GLBA).'

- *Definition of Insurance Working Group*. This working group will work on a definition of insurance needed to implement functional regulation in accordance with Title III of GLBA.
- *Consumer Protections Working Group*. This working group will work on standards for consumer protections that states can adopt to provide greater uniformity among states.
- *Privacy Working Group*. The working group will explore the uniform approach that the states should take with respect to the consumer privacy provisions under GLBA.

- Coordinating with Federal Regulators Working Group. This working group will explore all aspects of coordinating with federal regulators to make functional regulation a reality.
- *NARAB Working Group.* This working group will track the implementation of the NAIC Producer Licensing Model Act and explore using all the technology resources available to the NAIC, including its affiliates.
- *Market Conduct Issues Working Group.* This working group will examine market conduct programs in the states to identify the issues and concerns that exist because of a lack of uniformity among the states and evaluate the merits of establishing voluntary uniform national standards.
- *'Speed to Market' Working Group.* This working group will develop state-based, uniform standards for policy form-and-rate filings for appropriate product lines. They will consider development of a system for domiciliary deference using one-stop filing based on minimum standards for products issued on a multi-state basis. The will also consider the feasibility of developing an electronic repository for filings and tracking data and a voluntary certification process.
- *National Treatment of Companies Working Group.* This working group will explore all options that could offer greater uniformity within a state-based system. This, includes development of a proposal for national treatment of insurance companies through a single, uniform regulatory process or development of a proposal for a state-based system that could provide the same efficiencies as a federal charter for insurance companies.
- *Financial Services Holding Company* Analysis/Examination/Review Working Group. This working Group will make recommendations regarding the implications of GLBA on the regulatory authority, focus, and procedures provided by the NAIC Insurance Holding Company System Model Act and accompanying Model Regulation and recommend changes for consistency with the functional regulatory scheme set forth in the GLBA and related federal regulations.[67]

A principal Virginia insurance official suggests that potential effects of GLBA on the insurance industry will include:

- There will be increased pressure for standardization, coordination, and reciprocity among states with respect to the licensing of insurance carriers, the licensing of insurance agencies, and the regulation of insurance products and rates.
- There will be increased communication among the states over insurance-related issues. The Internet is likely to be the medium for more efficient communication. For example, when an insurance agent who is licensed in California applies to do business in Virginia the Internet will likely be used to assess that agent's credentials and performance in California. Likewise, the solvency of firms seeking to do business in multiple states may be examined over the Internet.
- Increased vigilance and security will be necessary to prevent Internet-based fraud, and to protect the privacy of consumers, insurance agents, and insurance companies from Internet 'hacking.'

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[67] http://www.naic.org/GLBA/index.htm

- There will be increased pressure on individual states to coordinate with the Federal Reserve Board over Fed regulation of the risk exposure of insurance industry holding companies and depositories.[68]

State regulators also view NAIC's role as the forum that is most likely to be used by the states as they increase their overall coordination and reciprocity agreements.[69] This pattern of an increased and more important role of state and local public interest groups is likely to occur as part of another trend. Similar groups, including the Conference of Mayors, the League of Cities, the National Association of Counties, and the National Governors' Association were given major credit for the adoption of the Unfunded Mandates Reform Act of 1995. As federal deregulation continues, and the policy initiatives of states and local governments increase, the public interest groups function more and more like private interest groups and trade associations in debates over policy development and implementation. The effect is to build stronger networks among states and localities as government and policy continue to decentralize, or devolve, in the US

There is likely to be a significant split within the insurance industry over the nature of financial services regulation as a result of GLBA. That is, large global life insurance companies, large commercial property and casualty insurance companies, and especially marine insurers will favor national or even international regulations and standards. On the other hand, independent agents and agencies, and small firms will resist national, international, or global regulations. The small and independent firms are likely to support continued state-level industry regulation because they believe they can have greater influence over it, or that they will be unable to compete in truly national or global environments.[70]

There are some concerns that deregulation is occurring too fast, or simply as part of a growing libertarian political ideology. An IIVA representative voiced concern that in Virginia and at the national level deregulation of financial services is occurring principally for political reasons. Deregulation is occurring arguably for the sake of limiting government and that the reasons behind initial (mainly the financial crises of the Great Depression) government regulations have been forgotten or are being ignored. Moreover, Virginia's SCC itself may be overly influenced by political winds, endorsing certain deregulatory proposals made by the Republican majority in the General Assembly in order to avoid political repercussions on itself.[71] These views about early (1930s) federal regulation of financial services are subject to debate.

There is some agreement among experts that the regulations imposed by the Depression-era Glass-Steagall Act were wrong in the first place, and that the events that governed congressional action during the Depression were far 'from today's market conditions.'[72]

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68 Telephone interview with Gross.

69 Ibid.

70 Telephone interview with Gross.

71 Telephone interview with Smith.

72 K. England, 'Banking on free markets,' *Regulation: Cato Review of Business and Government*, http://www.cato.org/pubs/regulation/reg18n2b.html.

Technology also plays a large role in the evaluation of financial services industries regulations. In a recent speech, one financial industry executive took care to avoid saying that the Internet was 'responsible' for all the effects of technology in his industry, but that the Internet is an 'analogue for the sheer neck-snapping speed with which telecommunications, data processing and personal computers' have improved productivity and access to information in the last decade. The speaker argues that technology has made possible the 'the Napsterization of finance...Napster is a so-called peer-to-peer distribution service, meaning that it allows me to download onto my computer a digital recording from someone else who already has it...a fascinating example of what economists call disintermediation: the elimination of the middle man.'[73]

The debate over the correctness of the Glass-Steagall Act regulations is principally a discussion of politics and history. It is reasonable to argue that regulations enacted during an economic and political crisis almost 70 years earlier should be evaluated in comparison with the realities of today's markets. Moreover, it may be that technology is the principal driver of financial theory and practice – and political theory and practice, albeit to a lesser degree. If the notion of co-evolution among technology and institutions is valid in this context then mid-20th century public policy may be an unnecessary burden – notwithstanding whether it was right or wrong. However, the worries of business executives and government bureaucrats who have learned to live and work within the confines of historical regulation are no less legitimate.

Industry Attitudes Towards the SCC

To gain additional insight into the way those regulated by the Bureau of Insurance felt about its performs a small random telephone sample of 25 companies was conducted. This asked a number of specific questions as well giving the respondents the opportunity to offer opinions. This was conducted in addition to the interviews and separate from any written or unsolicited information that was received. The vast majority of respondents felt the SCC to be fair, consumer friendly and pro-business, that regulation is a necessary evil, that the system had not gotten worse in recent years (a minority saying it had improved), and licensing and continuing education requirements are good but need to be improved. A number of concerns were, however, expressed. 20% felt that rate changes and product reviews were slow. A number, while liking the principle of 'continuing education' felt that it was often not rigorous, too frequent, were often available only at inconvenient times, and sometimes did not provide the up-to-date material that is seen as part of the process.[74] Ten percent of the sample felt that State mandates for rare

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[73] 'A Decade of Difference: The Newly Improved US Economy', Remarks by J. Guynn, President and Chief Executive Officer, Federal Reserve Bank of Atlanta to the Gwinnett County Chamber of Commerce, Duluth, September 18, 2000.

[74] The need for continuing education was enacted in 1992 at the initiative of the Virginia insurance agents association. The Virginia Insurance Continuing Education Board was created as a separate entity by the SCC Bureau of Insurance to address concerns that administration of the system was independent of the Bureau. The number of appeals has declined over the years and there have been annual modifications of the continuing education law as experience has been gained. In 1999-2001 some 88% of agents were in compliance.

conditions was driving up rates. There was some concern expressed by one respondent that SCC punishments are too severe for small infractions.[75]

Overall one may conclude from this exercise that while there were no major concerns there were a number of areas that the Bureau may wish to consider from an internal management perspective. The issue of continuing education was raised in one form or another, and on their own accord, by many of the sample. There inevitable always seem to be problem regarding this aspect of regulation.[76] In principle virtually all agree that up-dating is good but the problem is often one of delivery of service. In particular, changes in best practices, regulations, technology and so on do not occur evenly through time but educational requirements are stipulated as being needed every two years. The problem of linearity in requirement but infrequent steps in change poses generic difficulties for up-dating practices. They may be no simple solution to this situation although concerns about it may be contained through closer interaction with those in the insurance industry.

15. **To ensure that emerging issues related to deregulation are built into future agreements, and that industry agents and agencies can give opinions confidently in such jurisdiction, the Bureau of Insurance should identify other states or countries with which Virginia currently has no reciprocity agreements, but which are most likely to establish them in the near future,**

16. **To continue to identify specific areas where threats to consumers' privacy may be at risk from increased reliance on electronic commerce, and develop effective measures to counter those threats.**

17. **The Bureau of Insurance should continue to work with the National Association of Insurance Commissioners to develop uniform 'treatment of companies' and 'market conduct' standards or regulations.**

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[75] A similar concern was raised in a separate telephone interview.

[76] It is certainly not an issue unique either to the insurance sector or to the US. See for example, K.J. Button and S. Taylor (2000) 'Mandatory education for the bus and coach industry', *Journal of Public Transportation* Vol.3, pp.19–36 and K.J. Button and M. Fleming (1991) *Architectural Education and Training Needs: A Study in the Context of Regulatory Reform and the Single European Market* (RIBA, London)

Exhibit 4A1. Summary of the Financial Services Act of 1999

The 'Financial Services Act of 1999' creates a framework that will permit the banking, securities, and insurance industries to compete more efficiently and effectively while improving consumer access to financial services, protecting investors, and ensuring a safe and sound banking system.

Title I - Facilitating Affiliation Among Securities Firms, Insurance Companies, and Depository Institutions

1. Repeals the Glass-Steagall Act prohibitions on banks affiliating with securities firms, permitting holding companies to engage in securities underwriting and dealing, without limitation, as well as sponsoring and distributing mutual funds.
2. Repeals Bank Holding Company Act prohibitions on insurance underwriting, allowing holding companies to underwrite and broker any type of insurance product.
3. Expands permissible nonbanking activities for holding companies from those 'closely related to banking' to those that are 'financial in nature.'
4. Contains list of authorized financial activities which includes merchant banking, insurance company
5. Portfolio activities, and activities authorized for US bank overseas under Federal Reserve Regulation .
6. Permits the Federal Reserve Board ('FRB') to authorize additional financial activities after
7. Consultation with the Treasury which can veto a FRB determination.
8. Permits holding companies to offer developing financial services and products (with certain limitations) that the holding company reasonably believes are financial and that the FRB has not found to be not financial.
9. Grandfathers nonfinancial activities for companies that are predominantly financial (85% of revenues) for a 10-year period subject to certain conditions. The FRB can extend the period for an additional 5 years.
10. Preempts State anti-affiliation laws which prevent banks from affiliating with financial companies as provided for under this Act or in Federal law. Preserves ability of the States to request information regarding acquisition of insurance companies. Also protects States' ability to require capital compliance for insurance companies, to take actions relating to receivership/conservatorship of insurance companies, and to restrict for a 3-year period the change of ownership of an insurance company that has converted from a mutual to stock form. State corporations laws and antitrust laws are also protected.
11. Requires that holding companies that want to engage in financial activities have their subsidiary depository institutions well capitalized and well managed. Also requires that subsidiary depository institutions have a satisfactory CRA rating as of the time the holding company elects to qualify as a financial holding company. The FRB can only limit or restrict the activities of a financial holding company if its subsidiary depository institutions do not meet capital and management requirements. If the holding company fails to correct the capital and management deficiencies of a subsidiary institution, the FRB can require, at the election of the company, either divestiture of the institution or cessation of financial activities.
12. Eliminates application process for companies to engage in financial activities that are listed in the statute or that have been approved by the FRB. Requires notice to the FRB within 30 days of engaging in the activity or consummating the acquisition. Ten-day after the fact notice required for developing basket activity.
13. Requires that a company file a notice with the FRB electing to be a financial holding company. Requires an application for mega-mergers involving companies with total assets in excess of $40 billion.
14. Streamlines holding company supervision and regulation by directing the FRB to rely to the fullest extent possible on reports prepared for functional regulators and by limiting examinations of functionally-regulated subsidiaries to situations where the FRB has 'reasonable cause to believe' that there is a 'material risk' to an affiliated depository institution or that a subsidiary is not in compliance with the Act.
15. Prohibits direct or indirect imposition of capital requirements on functionally regulated subsidiaries that are in compliance with applicable Federal/State capital requirements and prohibits the FRB from

enforcing a requirement that a functionally regulated affiliate transfer funds to an insured depository institution if the functional regulator objects.

16. Authorizes the FRB to impose prudential safeguards on transactions/relationships between a depository institution and an affiliate to avoid safety and soundness risks, avoid conflicts of interest, and protect the privacy of customers. The FRB's authority to adopt restrictions that relate to a functionally-regulated nonbanking affiliate is limited to that necessary to prevent or redress an unsafe or unsound practice that poses a material risk to the safety and soundness or stability of a depository institution or to the payment system.
17. Authorizes the FRB to transfer certain holding company supervision to the appropriate Federal banking agency for holding companies that are not engaged in significant nonbanking activities.
18. Incorporates functional regulation into holding company supervision by requiring the FRB to defer to the SEC and state securities regulators on interpretations of federal and state securities law and to state insurance regulators on interpretations of state insurance law. Provision is also made for the FRB and state insurance regulators to share information on a confidential basis. Provides that the SEC is the sole regulator of registered investment companies.
19. Limits the FDIC's authority to examine nonbanking affiliates of insured depository institutions in connection with its deposit insurance responsibilities.
20. Authorizes national banks to underwrite municipal revenue bonds.
21. Authorizes national bank operating subsidiaries to engage as agent in financial activities. Such activities include acting as a travel agent and insurance agent (without the place of 5,000 restrictions). Operating subsidiaries may also engage in any activity permissible for a national bank including underwriting municipal revenue bonds.
22. Creates a new type of uninsured bank charter known as a wholesale financial institution ('WFIs') which can be either a national or state bank. WFIs may not receive initial deposits of $100,000 or less (except on an incidental basis). WFIs will be subject to CRA. WFIs can be owned by a holding company that has an insured depository institution affiliate. Holding companies that own only WFIs may retain the commercial activities that they were engaged in as of the date of enactment. The FRB may adopt only risk-based capital requirements for WFI holding companies and not a leverage ratio. Capital requirements for WFI holding companies must focus on the use of debt and other liabilities to fund capital investments in subsidiaries.
23. Provides relief to nonbank banks and their holding companies by allowing the companies to invest in credit card receivables, lifting the activity restrictions on well- capitalized and well managed nonbank banks (nonbank banks would not be able to both take demand deposits and make commercial loans), exempting business credit cards from the restriction on making commercial loans, eliminating the cross-marketing prohibition, and providing an 180-day cure period if a company or nonbank bank falls out of compliance.
24. Reforms the Federal Home Loan Bank System (FHLBS) in the following four ways. First, Federal thrift membership in the FHLBS is made voluntary, instead of mandatory. Second, thrifts and banks with less than $500 million in assets are provided greater access to the FHLBS by expanding the types of assets that they may pledge as collateral to include small business, agriculture, rural development or low-income community development loans. Third, the Resolution Funding Corporation obligation is changed from a fixed dollar figure to a percentage of the FHLBS's current net earnings. Lastly, many of the day-to-day management functions of the individual banks are taken away from the Federal Housing Finance Board (FHFB), the system's safety and soundness regulator, and given to the twelve Federal Home Loan Banks.
25. Eliminates the SAIF 'special reserve' fund which the FDIC established on January 1, 1999 as required by law.

Title II - Functional Regulation (Securities Activities)

1. Incorporates the securities compromise worked out during consideration of financial modernization in the Senate.
2. Replaces the broad bank exemption from regulation as a broker-dealer under the Securities Exchange Act with more limited exemptions for the following: third party brokerage; transactions for trust and fiduciary accounts; transactions in exempted securities; transactions for stock purchase and employee benefit plans; sweep accounts transactions; affiliate transactions; transactions for safekeeping and custody accounts; de minimis number of transactions; underwriting and dealing in certain types of

asset-backed securities; transactions involving certain derivatives; and transactions involving banking products. Also contains an exemption for private placements if the bank does not have a securities affiliate engaged in dealing, market making, or underwriting securities (other than exempted securities).

3. Contains a list of banking products that banks can continue to offer even if the SEC determines that such products are securities.
4. Adopts a new procedure for determining whether a product is a banking product or a security that must be forced out of the bank. The SEC, after consultation with the FRB, may determine by regulation that a new product a bank offers is a security and as a result should be pushed out of the bank. The FRB or an aggrieved party would then be able to initiate an expedited judicial appeals process to challenge the SEC's rulemaking. During the proceeding, the SEC would be prohibited from bringing an enforcement action.
5. Amends the Investment Company Act of 1940 and the Investment Advisers Act of 1940 to incorporate functional regulation.
6. Requires each Federal banking agency to adopt regulations regarding retail sales of securities by banks (other than sales conducted by regulated securities firms or personnel). The Federal banking agencies are also required to jointly establish procedures for processing complaints against banks arising in connection with sales of securities.
7. Provides for a voluntary system of SEC supervised broker-dealer holding companies that do not control depository institutions.

Title III - Insurance

1. Incorporates (along with section 104) the insurance compromise worked out in the Senate on bank insurance activities.
2. Ensures state functional regulation of insurance.
3. Clarifies that national banks cannot underwrite insurance within the bank, except for those products which national banks were authorized to engage in as of January 1, 1997. (Insurance is defined as those products regulated as insurance as of January 1, 1997 with new products after that date being treated as insurance if regulated as insurance, unless the product has a banking component and is not treated as insurance under the tax code.)
4. Prohibits national banks from underwriting title insurance unless the national bank or its subsidiary was actively and lawfully engaged in doing so before the date of enactment of this Act.
5. Provides for an expedited and equalized court proceeding ('without unequal deference') for disputes between state insurance and Federal regulators on whether a product is insurance for purposes of the ban on insurance underwriting within a national bank and whether state laws regulating bank insurance agency activities should be preempted under section 104.
6. Subjects state laws governing regulation of insurance sales and enacted prior to September 3, 1998, but which are not covered by the 13 statutorily prescribed safe harbors, to the Barnett preemption standard with no restriction on deference being provided to the interpretation of Federal laws. State laws on insurance sales enacted on or after September 3, 1998 and that are not covered by the 13 safe harbors are subject to the Barnett preemption standard, an anti-discrimination test, and the 'without unequal deference' standard.
7. Requires the Federal banking agencies to adopt jointly consumer protection regulations regarding retail sales of insurance products by depository institutions. These regulations do not apply in states that have regulations that are inconsistent or contrary unless the Federal banking agencies decide that the federal regulations afford consumers better protection. The Federal banking agencies are also required to establish a consumer grievance process.
8. Creates the National Association of Registered Agents and Brokers for the purpose of establishing uniform standards for qualification, training, and education of insurance agents. Meeting these standards would permit an agent to sell in any state.
9. Incorporates a redomestication provision allowing mutual insurance companies to move their state of incorporation for the purpose of facilitating a reorganization to a stock company.
10. Requires the OTS to publish in the Federal Register notices of intent when preempting state laws regarding consumer protection to provide interested parties at least 30 days to submit written comments. Current law requires this notification and publication for the OCC.

Title IV - Unitary Savings and Loan Holding Companies

15. Provides that no company which becomes a unitary holding company after 10/7/98 may engage in commercial activities.
16. Grandfathers existing unitary holding companies and those companies that had filed an application to become a unitary holding company as of 10/7/98.[77]

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[77] http://www.house.gov/financialservices

4B. FINANCE

Dual Banking System

The US has a 'dual' system of banking. This stems from the two parallel systems of bank chartering, regulation and supervision that have evolved. The Federal government and the individual state issue bank charters and examine financial institutions for the benefit of their citizens. In some cases the financial institutions may be the subject of unitary authority whilst others are subject to both federal and state regulation.

States have been regulating banks since before the creation of the independent US. State legislatures issued bank charters, until the Michigan ''free banking' statute of 1837 gave this authority to the executive branch. When Congress created the national bank charter in 1863, it created the Office of the Comptroller of the Currency (OCC) within the Treasury Department to issue these charters and regulate the new national banks. The relative openness of this chartering system allows a unique level of access and entrepreneurship within banking.

The existence of separate regulatory systems also provides a creative tension. The choice of charters encourages innovation in bank powers and in regulatory techniques and acts as a check and balance on bank regulators. It allows, for example, for the threat of conversion from a state-chartered to a federal charter or vice versa. The advantages of the state charter are often couched in terms of; easier access to the primary regulator, greater response to requests, parity of banking statutes, efficiency of regulatory operations, significantly lower assessments, and consistent regulatory policies.

State bank supervisors are the primary regulators of state-chartered banks. These banks also receive oversight from the Federal Deposit Insurance Corporation (FDIC) or the Federal Reserve System. Federal Reserve System membership is automatic for national banks, whose primary regulator is the Comptroller of the Currency. Federal Reserve System membership is optional for state-chartered banks; at the end of 1998, 994 state member banks belonged to the Federal Reserve System, an increase from 993 in 1997. The FDIC act as 'primary federal regulator' of the 5,322 nonmember commercial banks and of 522 state-chartered savings banks. The FDIC acts as insurer for all retail commercial and savings banks, regardless of whether they hold a state or national charter.

Recent years have seen efforts to reform regulations more generally across the US and to introduce a lighter hand to the regulatory process in a large number of sectors. This move towards less stringent market regulation was initiated in the 1970s in the transportation sector and has become a feature of financial regulation subsequently.[78] It is also part of a global trend to allow markets to work more effectively.

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[78] See R. Dale (1989) 'International financial Regulation: the separation issue', in K.J. Button and D> Swan (eds) *The Age of Regulatory Reform*, (Oxford University Press, Oxford)

The regulatory ethos has moved from one of containing potential monopoly exploitation by service providers to an interest in developing regimes that maximize the internal efficiency of enterprises, protects consumers, and allows for technological and managerial development. In particular, the regulatory structure now seeks to introduce as much flexibility into the system as is consistent with protecting consumer rights. The regulatory changes that have taken place also reflected the increased international nature of many activities, including those involving financial institutions. These factors have led to changes in the ways the dual banking system now operates.

States, the FDIC and the Federal Reserve now try to work closely together to supervise and regulate state-chartered banks efficiently, with a minimum of regulatory burden.[79] The coordinated effort dates back to the creation of the Federal Reserve and the FDIC. It became more formal with information-sharing agreements in 1992, and expanded further with the approval of the Nationwide State-Federal Agreement for multi-state bank supervision in 1996. In 1998, the state banking departments, FDIC and the Federal Reserve signed new agreements to streamline the supervision of foreign banking organizations (FBOs) across state lines. The Riegle-Neale Interstate Banking and Branching Efficiency Act altered the International Banking Act to allow foreign banks registered in any state to set up branches out side of that state on the same terms as other banks registered in that state.

In 1999 the Gramm-Leach-Bliley Financial Modernization Act (PL 106-102) was signed. This is designed to up-date financial service laws and break down the barriers between commercial banks, securities firms, and insurance companies. The previous federal laws governing what companies could affiliate with banks – notably the Glass-Steagall Act and the Bank Holding Company Act – only permitted limited affiliations between banks and other financial service firms. The new legislation reflects a reality that has been emerging at the state level where in many instances regulations have allowed bank sales of securities, insurance, and real estate with the states developing their own coordinated 'functional' regulation to supervise such activities.[80] The law makes changes to federal laws that govern the activities of national banks and bank holding companies, and respects the authority of states to govern the activities of state-chartered banks. As such it does not require changes in state banking law but it does interact with state law in ways that have competitive implications for state-chartered banks.

Trends

The reforms that have occurred in banking law combined with important market shifts and technical developments have led to changes in the nature of banking in the US. In particular, there has been a consolidation of banks as mergers have taken place. This is true at the national and state levels, and mergers are increasingly becoming an international phenomenon.

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[79] Although there has been a longer tradition of coordination especially regarding examinations and shared reports.

[80] See The Conference of State Bank Supervisors, *The Gramm-Leach-Bliley Financial Modernization Act of 1999: A Guide for the State System*, 1999.

The period from 1980 saw a rapid acceleration in bank mergers in the US. In the period 1960 to 1982 there was average of 190 bank mergers per year (see Exhibit 4B-1). But within this timeframe, there was also an increase from typically less than 150 mergers per annum in the 1960s to higher rates due to the passing of the 1970 Bank Holding Company Act.[81] This pattern accelerated considerably in the 1980s. The number of mergers, some 6,347, that took place between 1980 and 1994, represented 43% of all banks in existence in 1980. The annual rate over the period was 423 mergers.[82] Many of these mergers represented larger banks acquiring smaller entities. The proportion of US banks with a single office declined from 58% in 1975 to 40% in 1995. At the same time, the proportion of banks with a network of more than fifty offices rose from 0.5% to about 2% giving them 41% of all offices operated, up from 17%.

The driving forces behind this trend in the 1970s can largely be explained in state and federal legislation that multiplied opportunities and incentives for geographical expansion, particularly for bank holding companies, and thus offered and impetus for mergers.[83] The merger growth in the 1980s was largely due to state initiatives in reducing branching restrictions or permitting multi-bank holding companies to form.[84] During the 1980s twenty-two states, including Virginia, reduced branching restrictions, for example, compared with six states in the 1970s. Eleven states allowed multi-bank holding companies in the 1980s. The period also saw most states allowing acquisition of home-state banks by out-of-state banking organizations.[85]

Over the longer period to 1998 the implications of the Riegle-Neal Interstate Banking and Branching Act of 1994 have become important. By effectively repealing the Douglas Amendment of 1956, it allows bank holding companies to consolidate their interstate banks into an office network and ' independent' banks (i.e. those not owned by a bank holding company) to branch interstate by merging with another bank across state lines. It gave impetus to the continuation of the merger trend and between 1995 and 1998 a further 1,639 mergers occurred.[86] Some of this reflected high levels of mergers in states such as Texas and Illinois that did not permit branching and thus acquisition was the best

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81 S. Rhoades (1985)*Mergers and Acquisitions by Commercial Banks, 1960-83*, Federal Reserve Staff Paper 142 (Board of Governors of the Federal Reserve). In this and subsequent analysis by Rhoades drawn upon below, the definition of a merger consolidated under common ownership of operating banks formerly independent of one another. It thus does not included what might be termed corporate restructuring exercises.

82 S. Rhoades (1996)*Bank Mergers and Industrywide structure, 1980-94*, Federal Reserve Staff Paper 169 (Board of Governors of the Federal Reserve). The situation in Virginia was not out of line with the rest of the US. There were 101 acquisitions over the period 1980 to 1994 involving $34,238 million in bank assets.

83 D. Amel and N. Liang, 'The relationship between entry into banking markets and changes in legal restrictions on entry', *Antitrust Bulletin*, Vol. 37, pp. 631-49.

84 Although some branching may have occurred interstate by mergers between de novo banks as some states allowed.

85 D. Savage (1993) 'Interstate banking: a status report', *Federal Reserve Bulletin*, December pp. 1075-89.

86 S. Rhoades (2000)*Bank Mergers and Banking Structure in the United States, 1980-94*, Federal Reserve Staff Paper 174 (Board of Governors of the Federal Reserve). The figures for Virginia between 1995 and 1998 were 32 acquisitions amounting to $52,449million.

way of accomplishing expansion. In other cases (notably New York, California and Illinois) there were very large mergers involving acquisitions large mounts of assets. These states had large money center banks.

In addition to mergers, consolidation has come about because high numbers of bank failures, especially in the early 1990s. Between 1984 and 1994 nearly 1,300 commercial banks and 1,100 savings associations failed. Some of these failed banks and saving institutions were acquired by healthier organizations and restructured within them. In some cases the offices of failed banks and savings institutions were taken up by new investors (e.g., between 1984 and 1994 nearly 2,100 new commercial banks were chartered in the US.)

The issue of whether this continual change in the number of banks is desirable for bank users depends upon a number of factors. The regulatory reform process is largely posited upon the idea that competition is an effective means of containing the market power of banks and for stimulating technical innovation and the introduction of new financial products. But there are also potential scale benefits emanating from larger banks, especially if they can offer customers a larger portfolio of products and more access points to services. Modern technology generates economies of scale and multi-product output can produce economies of scope.[87] A wider geographical market coverage offers users the benefits of market presence and the concomitant service attributes that this may bring. The challenge of effective public policy is to define and then develop institutional structures that balance losses from reduced competition with the advantage of larger size and seamless service.

One mechanism for limiting the exploitation of power by enterprises, including financial institutions, is through the dissemination of information to customers. To some extent, this is done in the banking sector with banks having to make clear the terms of their transactions. The Gramm-Leach-Bliley Financial Modernization Act, for example, acts on this by making financial institutions provide notice to customers about its privacy policy and practices. What is more difficult for customers of banks and other financial institutions is to gain and assimilate information about the financial security of banks and savings institutions. Individuals are seldom trained or capable of assessing the financial security of a bank or similar institution that is handling their transactions, They do not normally have the expertise to make an informed judgement even if all relevant information is before them. Much regulation in the financial sector is, therefore, inevitably concerned with licensing and examining the accounts and practices of the financial institutions.

The System within the Commonwealth

The Bureau of Financial Institutions

State banks in Virginia, as with state-chartered banks in many other states, can engage in permissible activities beyond the powers of national banks in; securities brokerage

[87] See D. Humphrey (1991) 'Why do estimates of bank scale economies differ?' *Federal Reserve Bank of Richmond, Economic Review*, September/October, pp.38-50.

(discount or full), real estate development, real estate equity participation, and insurance brokerage (see Exhibit 4B-2).

The Bureau of Financial Institutions is the agency within the State Corporate Commission that oversees state-chartered banks, savings banks, mortgage brokers, and dealers and other financial entities in Virginia.[88] It regulated or supervised in July 2001 about 108 banks with over 1,027 branches and $47.0 billion in total assets, 59 bank holding companies, 3 savings institutions, 4 independent trust companies, 924 mortgage lenders and brokers, 292 consumer finance licensees, 73 credit unions, 37 money order sellers, 38 check cashers, 14 nonprofit debt counseling agencies and 8 industrial loan associations.[89]

The responsibilities of the Bureau of Financial Institutions embrace, among others:

- Investigating and recommending action on applications to the Commission for new state finance institution charters and branches of existing institutions.
- Analyzing and monitoring the financial conditions of state-chartered banks, savings institutions, and credit unions to ascertain their soundness. This includes examining these institutions (examinations being determined by the size and the financial condition of the bank).
- Reviewing applications filed with the State Corporation Commission to merge financial institutions in Virginia and administering interstate bank acquisitions,
- Licensing and examining mortgage lenders and brokers.
- Licensing and regulating money order sellers, money transmitters, consumer finance (small loan) companies, and debt Counseling services; registering check cashers and industrial loan associations.
- Conducting studies and providing reports on industry and consumer issues.

To carry out its various functions the Bureau is divided into five sections – Corporate Structure and Research Section, Consumer Finance Section, Banks and Savings Institutions Section, Credit Union Section, and Administration and Finance Section (see Exhibit 4B-3).

Virginia's chartered banking

New banks in the Commonwealth have emerged in waves with three pronounced clusterings since 1970 (in the 1970s, the late 1980s and the late 1990s).[90] The most recent wave has been less pronounced than in the 1980s or 1970s. On average some five new banks have opened each year from 1970 with between zero and eight each year in the 1990s. The recent increase in opening has been paralleled by a large number of bank acquisitions and consolidations, and in particular 1997-98 saw a significant number of

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[88] The majority of the staff of the Bureau of Financial Institutions are professional examiners. Its budget for the fiscal year ending 06/30/00 was $8.4 million that was funded through assessments on regulated institutions, and application and licenses fees. The loss of the State's largest state chartered bank, Crestar Bank, in 2000 brought about a 20% decline in revenue despite some off-set through an examination agreement with state banking authorities in Georgia.

[89] Point data for 2000.

[90] N.C. Kyrus (1999) 'Prospects for new banks', *Virginia State Banker*, Issue 5, Winter, pp.3-5

Virginian banks being acquired and consolidated with out-of-state banks. This latter feature of the sector was stimulated by State and federal legislative changes that permitted out-of-state banks to merge their Commonwealth subsidiaries into their home offices and to operate them as branches. In the years1997-98 about 45% of Commonwealth bank deposits came under the control of out-of-state banks and holding companies, resulting in out-of-state banks and holding companies holding about 60% of total Virginia deposits. At the same time there was a significant consolidation of intra-state banking.

At the same time there has been a steady inflow of out-of-state banking continuing from an amendment of the Virginia Banking Act in 1985. This for the first time allowed acquisition of banks across borders.

The pattern of new bank entry over the past thirty years has been on of a high survival rate with profitability within two to three years. About 65% of the new banks have subsequently merged, generally with larger banks. The total number of bank failures among the new banks has been 5 out of the 160 or so that have formed. This is a rate well below that of the US as a whole and also below that for east coast states.

Much of the recent bank formation has been in the more densely populated metropolitan areas of Virginia, notably the Northern Virginia Metropolitan, Norfolk-Newport, and Richmond Statistical Areas. The level of capitalization of these banks has been high (from $6.9 to $37.0 million). Of the 23 bank organizing groups seeking charters in 1998-99, 17 sought State-charters rather than federal charters. This was despite the fact that State-chartered banks in the Commonwealth are required to obtain subscriptions for their stock prior to applying for a certificate of authority to commence business.

One of the objectives of any regulatory agency is to minimize the transactions costs, most notably on those being regulated, of carrying out its regulatory functions. Lengthy, financial costly and uncertain regulation is almost inevitably damaging to the long term economic interests of those it is meant to be serving. Protection of consumer interest, because it instills necessary confidence in the financial infrastructure of an economy, is important to the overall wellbeing of the Commonwealth. Uncertainty of outcome is also a feature of the market when institutional reforms take place. The outcome of the change in policy regarding Savings and Loans ('thrifts') in the early 1980s (e.g., the Depository Institutions Deregulation and Monetary Control Act of 1980) to cope with their increased uncompetitiveness, which led to sales of high risk Savings and Loans is a vivid example. Financial regulation has a role in reducing the chances of such market failure through licensing and examination but this should be done at minimum cost.

In the case of the Bureau of Financial Institutions, there is the especial need to minimize potential excessive costs of examination of institutions, particularly those that are both nationally and state regulated. These examinations, depending on the size of the bank or savings institution may take from days to several weeks. Previous reports on the State Corporation Commission have found that the financial institutions are in favor of such

examinations as they serve to provide an external view on their lending, investment practices and other activities.[91]

The number of examinations is currently a minimum of one every three years by the SCC, through the Bureau of Financial Institutions, but with newer, smaller banks the examinations may be more frequently, generally once every six months until 'satisfactory' examinations are recorded. The Federal Reserve Board also carries out examinations based on the size and condition of the institution. These frequently fit between the SCC examinations (i.e., the banks are effectively examined every 18 months or so). Depository institutions are examined for adequacy of capital, quality of assets, capability of management, earnings and liquidity. The nature and degree of various credit and market risks are evaluated and compliance with law and regulations is reviewed. Non-depository financial institutions are examined primarily for compliance with laws and regulations.

Virginia was one of the first tranche of states to allow statewide branching (Exhibit 4B.4). The current policy is that providing a bank is sound it is largely a commercial decision on where its branches should be. The procedure for establishing new branches has traditionally been a relatively lengthy one. Recently, in line with an established practice of streamlining when law changes permit it, the Bureau of Financial Institutions initiated further streamline procedures. The successful implementation of this faster mechanism is important given the rapid population growth in the northern part of the state and the development that is occurring away from more traditional core, urban areas.

Financial markets are ever evolving in the face of institutional reform, more sophisticated banking practices and as the demands of customers change. Virginia has a law designed to maintain state-chartered banks' parity with national banks (the 'wild card' statute 6.1-5.1 of the Code of Virginia). This allows for the expansion of state-chartered banks as the power and activities of national banks expands. The SCC, through the Bureau of Financial Institutions, can examine the Virginia wild card statute. The Commission considers new activities that are 'financial in nature or incidental to such financial activity' or 'complementary to a financial activity' so that the Virginia state-chartered banks remain operating in an environment on a parity with national banks. In this way, the enactment of the Gramm-Leach-Bliley Act does not require changes in state banking laws. In effect the Bureau of Financial Institutions may by regulation amend the powers of state banks so as to allow them to engage in any activity that national banks may be allowed to conduct. If seen as appropriate, the Bureau of Financial Institutions will then recommend equivalent legislation at the next General Assembly Session.

18. There have been a number of changes to the Virginian Banking Code over the years. A full review of the code should now be conducted. This should not be taken to imply radical change is needed but is a matter of 'good housekeeping'.

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[91] Joint Legislative Audit and Review Commission, (1986) *Report of the Joint Legislative Audit and Review Commission on Organization and Management Review of the State Corporation Commission to the Governor and the General Assembly* (Commonwealth of Virginia, House Document No. 15, Richmond)

19. The Bureau of Financial Institutions has developed successful ad hoc ties with other Bureaus and Divisions within the SCC. These should be continued although there would seem no good reason for any formalization of the process.

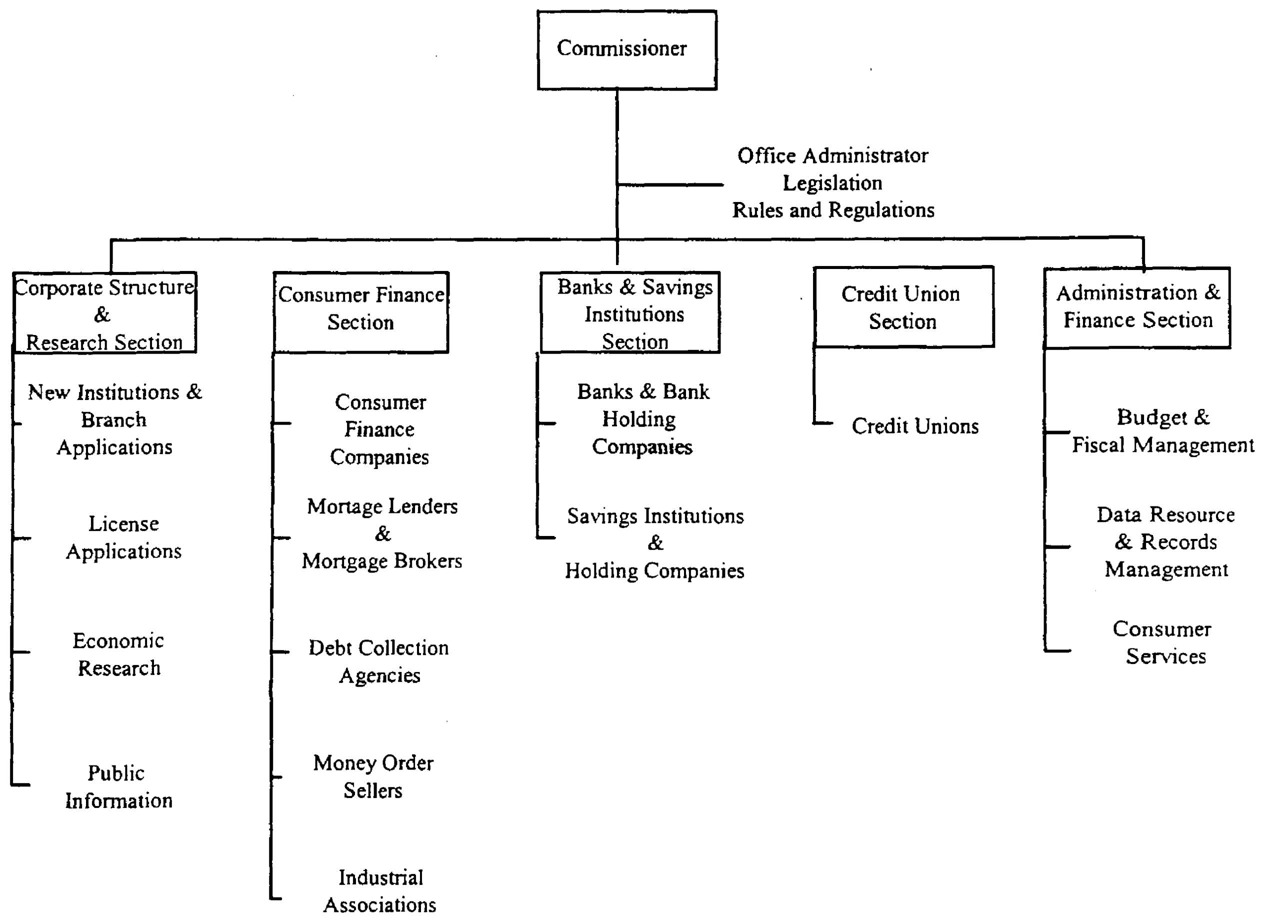
Exhibit 4B-1: Bank Acquisitions in the US and within Virginia

Year	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1995
National	190	359	420	428	441	475	573	649	468	365	566	345	401	436	446	345	392
Virginia	8	9	18	9	5	10	11	5	0	5	4	2	2	6	7	1	8

Exhibit 4B-2: Permissible Activities Beyond Powers of National Banks (1999)

	Security brokerage	Municipal revenue bond underwriting	Real estate brokerage	Real estate development	Real estate equity participation	Insurance brokerage
Alabama PSC	✓	✓	✓		✓	✓
Alaska PUC	✓	✓	✓	✓	✓	
Arizona CC	✓			✓	✓	✓
Arkansas PSC	✓		✓	✓	✓	
California PUC			✓	✓	✓	✓
Colorado PUC	✓			✓	✓	
Connecticut DPUC		✓				✓
Delaware PSC	✓	✓				✓
DC PSC	✓				✓	
Florida PSC	✓	✓	✓	✓	✓	✓
Georgia PSC	✓	✓	✓	✓	✓	
Hawaii PUC	✓				✓	✓
Idaho PUC	✓	✓	✓	✓	✓	✓
Illinois CC	✓		✓	✓		✓
Indiana URC	✓	✓				✓
Iowa UB	✓		✓	✓		✓
Kansas SCC	✓	✓				
Kentucky PSC	✓			✓	✓	
Louisiana PSC	✓	✓				✓
Maine PUC	✓	✓	✓	✓	✓	✓
Maryland PSC	✓					✓
Massachusetts DPU	✓	✓	✓	✓	✓	✓
Michigan PSC	✓			✓	✓	✓
Minnesota PUC			✓	✓		
Mississippi PSC	✓			✓		✓
Missouri PSC	✓	✓		✓		
Montana PSC		✓				✓
Nebraska PSC	✓	✓				✓
Nevada PSC	✓			✓	✓	✓
New Hampshire PUC	✓			✓	✓	
New Jersey BPU	✓	✓	✓	✓	✓	✓
New Mexico SCC	✓		✓		✓	✓
New York PSC	✓					
North Carolina UC	✓	✓	✓	✓	✓	✓
North Dakota PSC	✓					✓
Ohio PUC	✓				✓	✓
Oklahoma CC						
Oregon PUC	✓					✓
Pennsylvania PUC	✓	✓		✓		✓
Rhode Island PUC				✓	✓	✓
South Carolina PSC						✓
South Dakota PUC	✓					✓
Tennessee PSC	✓	✓		✓	✓	✓
Texas PUC	✓		✓			
Utah	✓	✓		✓	✓	✓
Vermont PSB	✓	✓				✓
Virginia SCC	✓			✓	✓	
Washington UTC				✓		
West Virginia PSC	✓	✓	✓	✓	✓	
Wisconsin PSC	✓		✓		✓	✓
Wyoming PSC	✓		✓	✓		

Exhibit 4B-3: Organizational Chart of the Bureau of Financial Institutions



Source: From, Bureau of Financial Institutions (2000) *1999 Annual Report of the Bureau of Financial Institutions* (State Corporation Commission, Richmond)

Exhibit 4B.4: Categorization of States by Changes in Intrastate Branching Laws

Categorization by changes in state branching restrictions	States
Full state branching 1975-1992	Alaska, Arizona, California, Delaware, District of Columbia Hawaii, Idaho, Maine, Maryland, Nevada, North Carolina, Rhode Island, South Carolina, South Dakota, Vermont, Virginia, Washington
Severe restrictions 1975-1992	Iowa
Severe restrictions in 1975; eliminated by 1992	Florida, Indiana, Kansas, Louisiana, NewHampshire, Texas, West Virginia, Wisconsin
Severe restrictions in 1975; significantly relaxation by 1992	Colorado, Illinois, Kentucky, Minnesota, Montana, Nebraska, North Dakota, Oklahoma, Wyoming
Moderate restriction in 1975; elimination or significantly relaxation by 1992	Alabama, Arkansas, Connecticut, Georgia, Massachusetts, Michigan, Mississippi, Missouri, New Jersey, New Mexico, New York, Ohio, Oregon, Pennsylvania, Tennessee, Utah

4C. Securities and Retail Franchising

The Industry and Trends

American securities market started in 1792 and in 1911, the first "blue sky" law was passed in Kansas, marking the inception of state regulation of securities.[92] After the 1929 stock market crash, a series of federal securities statutes was enacted and an independent federal regulatory agency, the Securities and Exchange Commission (SEC), was established. Since then, securities markets have gone through rounds of booms and busts, each cycle leading to a round of scrutiny of existing markets and regulation.

In 1975 Congress established the national market system to link the isolated securities markets. The national market consists of the New York, American, Boston, Philadelphia, Cincinnati, Midwest, and Pacific stock exchanges, and the National Association of Securities Dealers (NASD), representing the over-the-counter (OTC) market[93]. The National Association of Securities Dealers' Automated Quotation (NASDAQ) later became the key market for start-ups and a forerunner of cyber securities markets.

The 1990s the proliferation of the Internet and other information technologies spurred a boom in securities markets, marked by high trading volumes and new practices. The average daily trading volume in the New York Stock Exchange (NYSE) has grew from 157 to 809 million shares during the decade; that in the NASDAQ increased from 132 to 1082 million shares.[94]

Primary Market

Information technology changed the structure of the primary market by lowering transactions costs, giving more effective access to investors, and by speeding up processing. In 1995, the Spring Street Brewing Company launched the first online direct initial public offering (DPO) without the help of professional underwriters. In less than 2 years, at least 35 online DPOs were completed.[95] There are 20 million small businesses in the US, comprising almost half the Gross National Product[96]. Online DPO offers an affordable way for them to generate capital. Meanwhile, underwriters introduce the Internet into initial public offerings (IPOs) to distribute stocks through the Internet. Internet-based service providers accommodate a pool of small IPOs on specialized web sites, forming virtual IPO super-markets where investors can shop among a bunch of new issues. A third channel to funds through the Internet is online private placement. Online

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[92] Securities industries are classified into the primary market for the new offerings by public companies, and the secondary market is for the trading of the securities after they have been offered to the public with stock exchanges unifying the two.

[93] A.M. Khademian (1992) *The SEC and Capital Market Regulation. Pittsburgh and London:* (University of Pittsburgh Press, Pitsburgh).

[94] Based on data from SIA (http://www.sia.com)

[95] D.E. Giddings(1998) 'An innovative link between the internet, the capital markets, and the SEC: how the internet direct public offering helps small companies looking to raise capital', *Pepperdine Law Review*.25.785

[96] J.E. Fisch (1998) 'Can internet offerings bridge the small business capital barrier?' *Journal of Small and Emerging Business Law.* Vol.2.57

private securities offerings have the advantages of speed of access to capital, savings in legal fees, and lower administrative costs.

There are also an increasing number of IT issuing companies. Most issuing companies make their filings online through the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system provide by the SEC. Companies provide information by publicizing business and financial information on the Internet. New practices also include electronic road-shows, electronic sales literature, electronic delivery of proxy materials, electronic voting, and electronic access to shareholder meetings.[97]

As IT has transformed the primary markets so new regulatory issues arise. These include issues surrounding the use of electronic media to satisfy delivery obligations of disclosure documents, and reexamining basic securities law principles based-on traditional communication media to make them applicable to electronic media. Online offering frauds have attracted particular attention. The Internet, while facilitating legal transactions, also provides for the convenient dissemination of false information. Many frauds involve aggressive and sometimes fraudulent sales of 'micro cap' stocks[98]. For example, in the "Interactive Products" case, 160 investors were sold a non-existing stock online and lost an aggregate of $190,000.[99]

Secondary Market

IT has, primarily through online trading and online brokers-dealers decentralized and diversified market the secondary market. Broker-dealers have offered investors direct dial-up connections to submit orders since the 1980s but a dramatic increase of online trading began after the introduction of Internet-based trading systems in 1995. Bancorp Piper Jaffray estimated that there were 3.7 million online accounts in 1997, 7.3 million in 1998, and 9.7 million by the end of the second quarter of 1999.[100] CS First Boston reported that the online trading accounted for about 6.5% of total traded equity in 1997 and 18% in 1999, almost a tripling in two years. The number of online brokers grew from 1 in 1995 to 173 in 1999.[101]

The growth of alternative trading systems (ATS)[102] is another trend. The Electronic Communication Networks (ECNs) are the most notable ATSs. These are any electronic

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97 SEC. 1997.*Report to the Congress: The Impact of Recent Technological Advances on the Securities Markets* (http://www.sec.gov/news/studies/techrp97.htm)

98 For simplicity, "micro capital" stock is called "macro cap" stock in this paper. "Micro cap" stock refers to the stock of any company with comparatively low capitalization, regardless of its price or where it is traded. "Micro cap" stock includes penny stock. A penny stock is a security that is priced at less than $5 per share.

99 105 Senate Hearings, S. Hrg. 105-266.

100 Forrester Research's figures for the three years are 3, 4, and 6 million respectively. (http://www.sia.com/publications/html/key_trends_5.html).

101 The number is subject to change frequently due to the rapid development. SEC.1997.*Report to the Congress: The Impact of Recent Technological Advances on the Securities Markets* (http://www.sec.gov/news/studies/techrp97.htm)

102 ATSs are off-exchange, Internet-based systems that centralize, display, match, cross or otherwise execute trading interest, including Internet-based crossing systems and Internet-based bulletin boards. ATSs put investors into contact with one another or execute a trade themselves.

system that widely disseminates orders entered into it by an exchange or OTC market maker, and permits execution of these orders in whole or in part.[103] The nine ECNs, account for approximately 30% of the total share volume and 40% of the dollar volume traded on NASDAQ, and almost 3% of the share volume of exchange-listed securities.[104]

To strengthen their competitive advantage, exchanges and NASDAQ have made continuous efforts to assimilate IT. They have adopted electronic systems for order delivery, automatic execution, automatic dissemination of transaction and quotation information, specialists' limit order books, and the comparison of trades prior to settlement. Moreover, they are seeking to cooperate with established ECNs or develop their own ECNs[105].

Investment companies and advisors have also adapted IT into their operations and communications. Investment companies (including mutual funds) have taken the advantage of the Internet and other electronic media to deliver disclosure materials and sales literature, provide online tools to assist investors with their portfolio management, respond to shareholder inquiries, and develop new types of fund services. They also permit shareholders to purchase and exchange shares online. Investment advisors are using IT to provide investment advisory services, obtain investment research, facilitate portfolio management, and administer client accounts.

The widespread of IT has given rise to several key benefits. First, commissions have dropped dramatically. The average commission charged by top online trading firms dropped from $52.89 in 1996 to $15.75 in 1999[106], a 70% discount in three years. Second, investors have more access to market information than ever before, resulting from both the interconnection between different market and the competition between intermediaries. The "playing field" between individual and institutional investors has been greatly leveled. Third, the overall market efficiency has augmented, demonstrated in communication, order execution and price discovery. Investors have access to more markets and have more chance to get best execution of orders.

The transformation of the secondary market has also placed new challenges before regulators. With the multiplication of trading volumes, online securities frauds have increased, although this does not necessarily mean the degradation of industry service and enforcement quality. The number of e-mail complaints to the SEC alleging the potential Internet securities frauds grew from about 10 to 15 a day in 1996 to between 200 and 300 in early 1999. Frauds relating to day trading, micro cap stocks, and pump and dump have proved a serious problem. New issues, such as the regulation of ECN and after-hours trading, also command more regulatory efforts.

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[103] SEC. 2000. "Electronic Communication Networks and After-Hours Trading" (http://www.sec.gov/news/studies/ecnafter.htm).

[104] Supra.

[105] I. Greg (2000) 'Deals and deal makers: Archipelago to Set up New Stock Market'. *The Wall Street Journal*. March 15.

[106] T.W. Carey (2000) 'Better, not just bigger'.*Barron's*.March. 13.39.

Regulatory Framework of Securities Industry

Prior 1929, securities markets were governed by an assortment of state laws, the blue sky laws, and the industry's self-regulation. State laws covered primary and secondary markets embracing securities offerings, information disclosure, and the trading of securities. This patchwork of state laws provided inadequate protection for investors with the quality of protection and the level of enforcement varying between states, and with no statute regulating interstate trafficking in securities. Exchanges conducted internal regulation by regulating their members' qualification, transactions on their floors, and stipulations for listing stocks. But these systems were designed to protect exchanges and their members, not necessarily investors[107].

The 1929 stock market crash raised broad concerns about the regulatory systems. In the following seventy years, eight federal statutes[108] were enacted and constantly amended, laying the legal foundation for federal regulation and modern securities market. Meanwhile, federal securities laws preserve the right of the states to regulate securities transactions. States have concurrent jurisdiction with the federal Securities and Exchange Commission and the states are free, within certain imposed limits, to regulate the securities industry. Federal laws, state laws, court cases, SEC rules, and SRO rules form the legal body of securities regulation.[109]

Federal securities laws apply to the SEC, public companies, exchanges and other self-regulated oorganizations (SRO)s, broker-dealers, investment companies, and investment advisors and their representatives to ensure fairness, transparency, and efficiency in securities markets. Provisions of federal laws fall into eight categories:

- registration of broker-dealers and their agents, investment companies and advisers, and exchanges and other SROs;
- registration of public offerings of equity securities, debt securities, mutual funds, and other securities;
- information disclosure and periodic reports by regulated parties; (4) establishment and empowerment of the SEC;
- creation of the Securities Investor Protection Corporation (SIPC) to insure investors' accounts;
- exemptions;
- prohibition of deceit, misrepresentations, insider trading[110], and other frauds;
- sanctions.

In addition to federal laws, any transaction in securities may be subject to one or more state securities laws. State laws vary among states, but generally contain four types of

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[107] D.L.Ratner (1978) *Securities Regulation in A Nutshell*. St. Paul, Minn: West Publishing Co.

[108] The eight statutes are the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, Corporate Reorganization (Chapter 11 of the Bankruptcy Reform Act of 1978), and the Securities Investor Protection Act of 1970.

[109] Ibid

[110] Insider trading refers to that in which an officer, director, or other person who has a fiduciary relationship with a corporation buys or sells the company's securities when in the possession of material, non-public information.

provisions; registration of broker-dealers and their agents investment, advisors and their representatives with a state agency, registration of securities offerings, antifraud provisions, and sanctions for violation.

The federal-state-SRO framework provides a high level of regulation for the securities industry. The federal-SRO regulatory partnership is clearly defined with the SEC responsible for overall administration and enforcement of federal securities laws and SROs delegated with most of the day-to-day surveillance of securities markets. However, the federal-state dual regulation is more controversial and a number of efforts have been made to coordinate federal and state regulation.

- The Uniform Securities Act of 1956 was promulgated for adoption by states to harmonize variations among state laws while reflecting the pre-existing pattern of laws and the differences in regulatory philosophy across the states.
- The Securities Act of 1933 required the SEC to hold an annual meeting with state regulators and the NASAA to maximize uniformity exchange in federal and state securities regulation, maximize effectiveness of regulation, reduce costs and paperwork for issuers, and minimize interference with capital formation[111]. The SEC and some state regulators reached consensus to share information in enforcement acts.
- The North American Securities Administrators Association (NASAA) developed 14 policy statements and 5 model rules for states regulators to adopt in an effort to promote uniformity of securities regulation[112].
- The National Securities Markets Improvement Act of 1996 realigned the regulatory responsibilities among the federal and state regulators. The SEC acquired exclusive jurisdiction over federal covered securities[113] and national investment advisers, and exclusive regulation of investment companies with an exemption for private investment companies. The states retained jurisdiction over smaller investment advisers and issuers of stock. The states were preempted from imposing on broker-dealers financial responsibility and reporting requirements different from or in addition to federal requirements.[114]
- In 1981, as a joint effort by the SEC, NASD, and the NASAA, the Central Registration Depository (CRD) was launched to centrally process broker-dealers and broker-dealer agents applications.
- From 2001, the Investment Adviser Registration Depository (IARD), a joint effort by the SEC and the NASAA, will provide investment advisers and investment advisers representatives with a one-stop filing system.
- Coordinated Equity Review (CER), a uniform nationwide program, was established for multi-state registration of public offerings of corporate equity securities where a

[111] SEC. 9/2000. '2000 conference on federal-state securities regulation: final report', (http://www.sec.gov/smbus/ffedst00.htm).

[112] Information from the NASAA (http://www.nasaa.org). The NASAA is a voluntary association whose membership consists of 66 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, Canada, and Mexico. In the US, the NASAA is the voice of the 50 state securities agencies responsible for investor protection and efficient capital formation.

[113] Federal covered securities refer to the securities preempted from state registration by the Securities Act of 1933.

[114] G.B. Maserit, *New Legislation Reduces Role of States in Securities Regulation*, (http://www.bizmonthly.com/news1997/february/maseritz.html).

registration statement has been filed with the US Securities and Exchange Commission.

- The Mid-Atlantic Regional Review Program (MARR) was established to offer a coordinated review to an entrepreneur who simultaneously files to register securities under the Small Company Offering Registration (SCOR) program in at least two of; Pennsylvania, Delaware, Maryland, New Jersey, Virginia, and West Virginia.

These achievements greatly enhanced the effectiveness and efficiency of federal-state-SRO regulation. As IT has been reshaping securities industry, further federal-state-SRO regulatory cooperation is required. IT, while raising regulatory challenges, also facilitates potential solutions.

Another regulatory issue arises with the enactment of the 1999 Financial Modernization Act, which repealed the isolation of banking, securities and insurance industry. An enforcement database is proposed to link the three industries at federal and state levels. Some states are thinking about merging different regulatory agencies for the three industries. The consolidation of the three industries and their regulation requires the enhancement of functional regulation, e.g., securities products should be regulated by those with expertise in securities, and efficient and seamless communication and cooperation between the regulators of the three industries.

SCC's Regulation of the Securities Industry

The SCC was delegated with securities regulation in 1918 to administer the Virginia Securities Act. In 1934, the SCC began to regulate securities offerings by public utilities and,in 1968 began to administer the Take-Over-Bid Disclosure Act.[115] The Division of Securities and Retail Franchising (SRF) is the SCC's functional unit and enjoys a high level of independence within the Commission. Internally, the SRF has a formal cooperative relationship with the Office of General Counsel (OGC). The OGC is responsible for prosecuting before the SCC any violations forwarded by the SRF, working with the SRF on new legislative initiatives, and providing interpretations of law. The OGC has appointed one attorney to work with the SRF. Externally, the SRF cooperates with the SEC Philadelphia Regional Office, the NASD, and the NASAA in securities laws enforcement and new legislative initiatives. The SRF maintains working relations with the Virginia State Police, the FBI, the Postal Inspection Service, the US Attorney's Office and Commonwealth Attorneys.

"[T]he overall mission of the Division (the SRF) is to protect the Virginia public from fraudulent practices in connection with the offer, sale and purchase of securities and franchises while encouraging the financing and formation of legitimate business and industry in the Commonwealth."[116] The mission is carried out within five sections: Registration, Audits and Complaints, Examination, Investigation, and Administration (Exhibit 4C.1). The SRF's regulatory responsibilities fall into several categories.

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[115] Commission on State Governmental Management (1976). *Staff Documents Volume 1: Executive Management Responsibilities*, (SCC, Richmond).

[116] Virginia State Corporation Commission Division of Securities & Retail Franchising *Operations Guide*, (SCC, Richmond).

Registration
The SRF administers the registration of industry providers, e.g., Virginia-registered broker-dealers, investment advisors and their representatives, and securities. It has franchise, trademark and service mark registration responsibilities. Notification registration provides for 'blue-chip' Virginia companies meeting specified asset, net worth or earnings requirements for non-Virginia issues. Coordination registration applies for securities offerings that need to be registered with the SEC and the SCC. Virginia's participation in the CER program has facilitated the coordination registration processes. Qualification registration is available to any securities offering in Virginia and is used by most small businesses. For offerings up to $1million, Virginia accepts SCOR documentation with a fill-in-the-blank prospectus that simplifies the registration process. Virginia's participation in the MARR program also assists the capital formation by small businesses. Some offerings may qualify for exemption from registration in Virginia and are effected by the SCC's exemption orders.

Audits and Investigation
The SRF conducts unannounced routine and for cause compliance audits of operating in-state offices of registered broker-dealers and state covered investment advisors located in the Commonwealth. It also is responsible for franchise investigations. Broker-dealer audits cover book- and record-keeping requirements, registration compliance, sales practices, supervision practices, suitability of customer investments, disciplinary problems and complaints. Investment adviser audits cover book- and record-keeping requirements, registration compliance, performance claims, supervision practices, disclosure compliance and brochures. In case of routine deficiencies found in audits, the SRF will request that the firms and applicable agents become compliant in a reasonably short time or face stiffer actions. In cases of significant violations or repeat violations, the SRF will likely undertake official action. The SRF is authorized investigate suspected violations of the Virginia Securities Act. Investigation files are confidential. Investigations are initiated based on consumer complaints, referrals from outside agencies, and investigative surveillance Investigations, which uncover deficiencies and violations, can be resolved by settlement orders, tried by the SCC for civil violations, or referred to outside state or federal agencies for criminal prosecution.

Legislative Responsibilities
The SRF monitors the appropriateness of state securities laws and regulations. It executes a legislative monitoring process by recommending and/or drafting additions, deletions, and modifications to regulatory provisions.[117] The SRF makes efforts to bring Virginia's securities laws and regulations into conformity and uniform with other regulators in the

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[117] Examples include the *Report of the State Corporation Commission on the Effectiveness of the Commonwealth's Securities Laws* and the *Report of the Division of Securities and Retail Franchising of the Virginia State Corporation Commission on the Statutory and Regulatory Requirements Concerning Broker-Dealers Who Provide Discount Brokerage Services* in 2000.

industry so as to facilitate capital formation, reduce regulatory costs, and maintain regulatory quality.[118].

Education
The SRF provides training and education concerning securities regulation to consumers and industry providers and makes efforts to educate investors about investment practice, risk awareness, and existing frauds. On its website, the SRF provides precautionary information about online investment frauds, a referral to "Investing Online Resource Center", links to other securities regulators, SROs or resources that provide investor education information, and regulatory reports. The SRF also joins in the NASAA's effort in the program of Financial Literacy 2001[119], specifically by distributing free copies of a Virginia-specific personal finance teaching guide to select high school instructors across the state and offering videos to public libraries in the state. The SRF periodically revises its consumer guide to keep consumers abreast of the market and regulatory environment.

The SRF tries to achieve the goals of protecting investors and encouraging capital formation simultaneously. The SRF maintains that registration of industry providers and securities is an effective approach to protect investors from inferior transaction agents and investments of limited value. It performs pre-registration review for the completeness, relevance, and clarity of applications and to ensure that the disclosed information is substantive and easily understood, whereas the SEC typically performs only disclosure pre-registration review[120]. Exhibit 4C.2 gives a snapshot of the SRF's efforts to protect investors.

The SRF claims to promote capital raising by small businesses by fighting against stringent regulation and providing a variety of conveniences. The SRF has looked at problems facing small securities issuers, including the lack of uniformity among blue sky laws, the expense required to comply with the current law, gaps in financing available for small businesses, and the lack of liquidity in secondary markets for small securities. Some of the problems are intrinsic in the small securities market, but some can be alleviated by legislative modification. The SRF recommended amendments to Virginia's laws to facilitate small securities offerings.[121]

The SRF works closely with the SEC, NASAA, NASD, and other securities regulators to meet new regulatory challenges. Among many of its efforts, the SRF took a special initiative to study complaints for the time periods of 10/1998-3/1999 and 1/2000-4/2000

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118 For instance, Virginia has participated in CER and MARR and has adopted several NASAA policy statements, specifically Unsound Financial Condition, Options and Warrants and Underwriting Expenses, Underwriter's Warrants, Selling Expenses, and Selling Security Holders.

119 Pursuant to H.R. 61, the Youth Financial Education Act, Financial Literacy 2001 aims at educating students with the skills, knowledge and experience to manage their personal finances.

120 Ibid.

121 State Corporation Commission Division of Securities and Retail Franchising (1999) *Report of the State Corporation Commission on the Effectiveness of the Commonwealth's Securities Laws* (HD 16), (SCC, Richmond).

in Virginia.[122] The SRF also participates in the SEC and the NASAA's rulemaking, enforcement sweeps, and workshops concerning online trading and regulation.

In the context of the Gramm-Leach-Bliley Act, the SRF is working with the SCCC insurance and banking divisions for better inter-division communication. The unique structure of the SCC with the regulation of the three industries incorporated in one agency will facilitate the adaptation of its regulation to the new environment.

20. The Securities Division would benefit from having more attorneys working with it. At present there is only one attorney in the OGC who works with the Division that deals with a growing market. The implications of the 1999 Financial Modernization Act and some internal adjustment of SCC rules and operation commands are likely increase pressure on attorneys.

[122] State Corporation Commission Division of Securities and Retail Franchising (2000) *Report of the Division of Securities and Retail Franchising of the Virginia State Corporation Commission on the Statutory and Regulatory Requirements Concerning Broker-Dealers Who Provide Discount Brokerage Services*. (SCC, Richmond).

Exhibit 4C-1: State Corporation Commission Securities Division Organization Chart

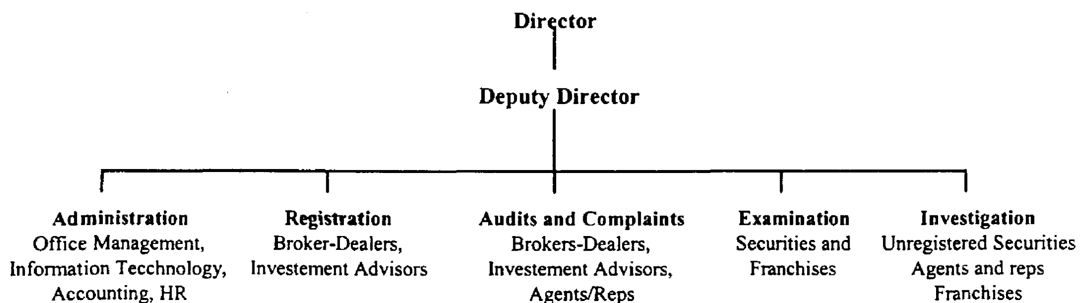

Exhibit 4C-2: SRF's Role in Protecting Investors

Broker-dealers registered as of 3/5/01	2,223
Agents registered as of 3/5/01	135,935
Investment advisors/Notice filers registered as of 3/5/01	1,480
Investment advisor representatives registered as of 3/5/01	6,479
Total investigations opened	108
Total orders entered	21
Remedies:	
Monetary penalties	$88,200
Investigation costs	$8,630
Rescission/Restitution	14
Permanent injunction	12
Criminal cases underway	5
Other cases	3
Audits of registered broker-dealers	102
Audits of registered investment advisors	93

Source: Data from State Corporation Commission Division of Securities and Retail Franchising

4D Telecommunications

Description of Industry and Trends

Historically, technical constraints severely limited the capability of telecommunication networks.[123] Telephone networks provided consumers with two-way communications and no broadcast services. Radio, television, cable, and satellite networks provided consumers with broadcast services and extremely limited two-way communication capabilities. As a result, consumers had to rely on different networks for different types of telecommunication service. Today, advances in digital technology have greatly expanded the capability of most telecommunication networks. Digital technology now allows telephone, radio, television, and satellite networks to provide both broadcast and communications services.

Congress recognized the significance of digital technology trends on the US economy, by passing the Telecommunications Act of 1996. The Act was based on the premise that the basic assumptions of the 1934 Communications Act were defunct. Monopoly market structures are no longer presumptively efficient and best accommodated through common carrier rules and rate regulation. The primary goal of the 1996 Act was, therefore, and still is, to promote competition and technological innovation in all US telecommunication markets by removing barriers to telecommunication competition.[124]

Regulation in the US has always involved something of a struggle between the states, the Federal Communications Commission (FCC) and the courts. Until 1996 all liberalization of markets was either done by the FCC or to a more limited extent by the states. Some *de facto* liberalization of long-distance services began in the mid-1970s when the FCC allowed MCI to offer switched interstate services. The states, with authority to regulate intrastate wireline services under the 1934 Communications Act, tended to limit market access and by 1996 no states had moved to required equal access for intrastate long-distance calls and only 6 allowed even limited competition for local-service dispersed small-business and residential customers. The states did, however, allow the construction of high-capacity fiber-optic in business districts – the competitive access providers – but low, regulated residential rates typically kept them out of residential areas.

The 1934 Act aimed to 'provide for a pro-competitive, deregulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition…'.[125] The Act was designed to open existing networks built by incumbent local exchange companies so that entrants can

[123] C. Blackman, 'Convergence between telecommunications and other media: How should regulation adapt?', *Telecommunications Policy*, Vol 22, p163

[124] Competition in the telecommunications industry was never envisaged to meet the economist's idea of perfect competition, largely because localized constant returns do not exist around the equilibrium. For a discussion of alternative see, W.J. Baumol and J.G. Sidak (1994) *Towards Competition in Local Telephony* (MIT Press Washington)

[125] *Telecommunications Act of 1996 Conference Report*, 104th Congress 2nd Session Report 104-458 (Jan 31, 1996)

interconnect with them in any variety of ways. The incumbents are required to unbundle their networks into a set of components and to offer them to their perspective rivals at a cost-based rate. Entrants also have the opportunity to resell incumbents' retail services by obtaining them at retail rates from the incumbents less the avoided costs of retailing the service. Incumbents must exchange local traffic with entrants on equal terms. All of these 'interconnection' terms are to be negotiated or, failing negotiation, are to be determined in arbitration conducted under the auspices of state regulators.

Unfortunately, the Act has not entirely lived up to expectations. In part there has been demonstrable inefficiencies in the way that the transition to deregulation has been conducted.[126] But there are also problems at the local level that it takes time to construct capacity, and this has meant there has been little change in local rates. The FCC policy of determining that the wholesale prices of network elements should be set below the true economic cost has reduced the incentive for suppliers to invest in their own networks.[127]

The Act's elimination of ownership restrictions has also resulted in industry consolidation. amongst the larger companies. The seven Regional Bell Operating Companies (RBOCs) existing in 1996 consolidated into four corporations – BellSouth, Pacific Bell, Southwest Bell, and Verizon. Long distance companies have merged with each other (e.g. MCI/WorldCom, and AT&T/Media One), and cable giants have joined forces in monopolistic alliances (e.g. Time Warner/Turner, partly owned by Telecommunications Inc., now united with Cablevision and Rupert Murdoch's News Corp.). [128] In addition, a new type of competitor formed with the merger of AOL and Time-Warner. Each of these mergers provides the resulting companies with the resources to deliver a broad array of telecommunication services.

One hoped for outcome of the Act has occurred – the entry of new firms into the industry.[129] By 2000, over 350 Competitive Local Exchange Carriers (CLECS) had entered the US telecommunications industry[130]. In the first six months of 2000, CLECS increased their market share of local phone service from 8.3 million customers at the end of 1999 to 12.7 million customers in June 2000[131]. This is some 8.5% of the local

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[126] For example see A.E. Kahn (2001) *Whom the Gods Would Destroy, or How Not to Deregulate*, (AEI–Brookings Joint Center for Regulatory Studies, Washington) and R.W. Crandall and J.A. Haausman (2000) 'Competition in US telecommunications services: effects of the 1996 legislation', in S. Peltzman and C. Winston (eds) *Deregulation of Network Industries: What Next?* (Brookings Institution, Washington). For a contrast with the Canadian approach see, R.W. Crandall and T.W. Hazlett (2000) *Telecommunications Policy Reform in the United States and Canada*, Working Paper 00-9, AEI–Brookings Joint Center for Regulatory Studies, Washington.

[127] Crandall and Hausman (2000) op cit.

[128] G. Kimmelman (1998) 'Consolidation in the Telephone Industry: Good or Bad for Consumers' Testimony before the Subcommittee on Antitrust Business rights and Competition committee on Judiciary, US Senate, May 19.

[129] R.W. Crandall (2001) *An Assessment of the Competitive Local Exchange Carriers Five Years After the Passage of the Telecommunications Act*, (Criterion Economics, LLC).

[130] Association for Local Telecommunications Services, *The State of Competition in the US Local Telecommunications Marketplace* February 2000.

[131] FCC Common Carrier Bureau, *Trends in Telephone Service*, December 2000

telephone lines in the US. CLECS provide 60% of local dial up ISP traffic.[132] In addition, CLECS have been extremely aggressive in providing advanced telecommunications services to consumers. For example, in 2000, CLECS had 8,200 DSL-equipped central offices while ILECS had 4,979, and long distance companies had 2,050.[133] Unfortunately, the majority of CLECS are facing financial trouble. The Bear Stearns CLEC index shows that as of December 22, 2000 the stock prices of public CLECS were down 71% since the beginning of 2000[134]. In addition, industry analysts forecast that 50% of all CLECS might go bankrupt if an economic slow down occurs. Indeed, a number have sought Chapter 11 bankruptcy protection.

This pattern of significant market entry together with restructuring of companies within an industry after regulatory reform, followed by financial difficulties for some and market exit or take-over by others is not peculiar to the telecommunications sector. It, for example, mirrors very closely the events following the 1978 Airline Deregulation Act.[135] The underlying issue is why this is happens. The question is whether the pattern is due to natural market forces, whereby because of ignorance of true market conditions following an extended period of regulation suppliers have poor information about the underlying market structure[136], or due to imperfections in the post-reform market that impedes the long term success of all but a few, normally incumbent, suppliers.[137]

In reality, the situation is probably a combination of the two forces. Changing regulatory regimes after an extensive period of institutional stability inevitably introduces uncertainty into the market.[138] This means entry by companies with different views of how the market will evolve as well as different stances by incumbents. Short-term over capacity occurs.[139] Inevitably this will ultimately lead to some shake out, although this may take time if the regulatory change initially takes place during an up-turn in the national business cycle. Even after the shakeout there is no anticipation of homogeneity amongst suppliers. At the same time, the incumbents inevitably have an incentive to protect their position – they are commercial undertakings. Separating these two on-going effects is not easy, especially when the economy moves through stages in the trade-cycle. It is possibly only after the market has stabilized that their relative importance can be determined and whether the Act is working.

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[132] Wolcott (2001) *Local Competition and The New Economy, Association for Local Telecommunications.*

[133] Telechoice (2000) *TeleChoice DSL Deployment Summary*

[134] Wolcott, op cit

[135] K.J. Button (1989) 'The deregulation of US interstate aviation: an assessment of causes and effects: Part 2', *Transport Reviews*, Vol.9, pp.189-215.

[136] This is essentially the argument of Crandall (2001) who looks at the business strategy of companies in the local exchange carrier market.

[137] 'The Bell monopolies are killing DSL, broadband and competition, and America is paying the price- Part 1', *Broadwatch Magazine*, Vol 15.

[138] This is one reason why consumers are often as apprehensive about change as are the supplying companies as seen in written evidence from the Virginian Citizens Consumer Council.

[139] This can also be seen in the over investment in fibre-optic cables. See, R. Blumenstein (2001) 'How the fibre barons plunged the US into a telcom glut', *Wall Street Journal*, June 18.

Technology Trends

Due to technological changes, telecommunication firms are now competing with each other to provide audio, video, and data services over several different networks. The "last mile", the distance from the consumer to the telecommunication network, is the focal point of this competition. The last mile is a constraint to telecommunications competition because analog telephone lines, which connect most consumers to the telecommunications networks, do not have the capacity to quickly deliver audio, video, and data services. Digital technology has allowed telecommunications firms to overcome last mile technical challenges. There are seven "last mile technologies": dial-up, fiber optics, digital subscriber lines (DSL), cable modems, terrestrial wireless, satellite wireless, and power lines. Each technology has different, capabilities, limitations and associated trends[140].

- Dial-Up connects users to telecommunications networks using a modem and traditional copper phone lines. Ninety percent of Americans can use Dial-UP technology to connect to the telecommunications network[141]. However, Dial-UP technology has limited capacity and cannot provide audio, video, and data in a prompt manner. Consumers will switch to faster last mile technologies as prices decrease.
- Fiber Optics transmits data by transmitting light down a glass cable. Fiber optics technology can cheaply transmit large amounts of data over long distances. It is currently the fastest connection to the telecommunications network. Cable and telephone companies are currently in the process of installing fiber optic connections to their telecommunication network. The cost to install fiber optics is currently 15% more than for copper phone lines, which will slow its deployment to consumers.
- Digital Subscriber Lines transmit digital data over existing copper phone lines at higher frequencies than those used for voice. The advantage of this technology is the use of existing copper telephone lines. Its disadvantage is that its speed is limited by distance from the switching node. It is not available to all phone customers. The number of DSL subscribers in the US increased from 370,000 lines in 1999 to almost one million lines in 2000, a 157% increase[142]
- Cable Modem transmits data over the cable infrastructure. The advantage of this technology is that it can use existing coaxial cable. The disadvantage of this technology is that speed decreases as the number of users increases. Some cable systems cannot handle this type of technology. The number of high-speed lines over cable systems increased from 1.4 million in 1999 to 2.2 million lines in 2000, a 59% increase.
- Terrestrial Wireless uses microwaves to broadcast data. This technology requires very little infrastructure. Its disadvantage is that its signals are limited by line of sight and other microwaves can cause interference[143]. Terrestrial wireless is being used primarily for phone service. However, it is also being used to provide internet access to consumers who do not have access to DSL.

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140 J.B. Morris Jr (2000)*Broadband Backgrounder: Public Policy Issues Raised by Broadband Technology*, Broad Band Access Project of the Center for Democracy and Public Policy.

141 W. Lee, 'Open access, private interests, and the emerging broadband market', *Policy Analysis* No. 379, CATO Institute, Washington.

142 FCC Common Carrier Bureau, High Speed Services for Internet Access, October 2000

143 The FCC could not develop this statistic due to data inconsistencies

- Satellite Wireless broadcasts audio, video, and data from space to consumers' receivers. This technology can cover a large broadcast area but it has limited two-way communication capabilities. Satellite technology is being used to provide consumers with television services. The US home satellite industry serves approximately 11.86 million homes[144]
- Power lines may have the capability to carry telecommunication services. Several companies have already attempted to develop technology that will allow power lines to be used for telecommunication. They were unable to develop a marketable product. However, two companies, Online AG (European company) and Media Fusion (US company) have announced they are testing or developing power line telecommunication products.

Fiber optics, digital subscriber lines, cable modems, terrestrial wireless, satellite wireless, and power lines are also considered "advanced service" technologies because they offer two-way communications at a rate equal or greater then 200 kilo bits per second. These technologies are important from a consumer and regulatory standpoint. Consumers will want advance services that can quickly provide them with audio, video, and data services. In addition, the Telecommunication Act of 1996 requires that consumers have universal service for advanced telecommunication technologies.

Convergence and New Uses of Technology

In the near future, the aforementioned technology trends will gradually combine, which will bring about another major shift in the telecommunications industry. The firm or firms that are able to capitalize on the converged technologies will gain the ability to offer all types of telecommunication service. Other issues affecting the telecommunications industry include the ways in which technology is currently being used which include:

- PBS-base networks,
- Intra-company voice and data networks,
- Inter-exchange carrier (IXC) networks,
- Wireless networks,
- Competitive access provider (CAP) networks, and
- Local area networks.

The future structure of the US telecommunication industry is undecided. Many CLECS have not generated a profit and the US economy is entering an economic slowdown. There is a strong possibility that once the telecommunication industry has restructured there may be a telecommunication oligopoly. The regulatory challenge will be to not only allow CLECs access to the market, but to ensure that they have the necessary support of the regulators to be successful.[145]

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[144] Satellite Broadcasting and Communications Association, Competition, *Report: Satellite Industry Making Advances, Remains Hindered by Outmode Regulations,* www.sbca.com/press/aug08-99.htm.

[145] Virginia Code sec. 56-481.2 provides that when the SCC approves new forms of regulation for telecommunication companies, it is to 'do so in a manner that is equitable to the new entrant and to the incumbent local exchange telephone company…'

How the SCC Regulates Telecommunications

The 1993 Virginia Assembly adopted legislation giving the SCC the authority to consider alternative forms of regulation to address the increasingly competitive nature of the communications industry. The Commission has the responsibility for protecting the affordability of telephone service and assuring continuation of service quality. Two years later the General Assembly adopted legislation giving the SCC authority to allow other companies to compete in local Virginia telephone markets. The enactment of the 1996 Telecommunications Act in 1996 promotes competition in all telephone markets. The Division of Communications is responsible for carrying out the mandate of this legislation by ensuring that competition evolves in a timely manner and is fair for consumers and well as suppliers. It supervises some 200 firms (Exhibit 4D-1).

The SCC Division of Communications is specifically charged with monitoring, enforcing and making recommendations for the following entities:

- Investor-owned telecommunications utilities
- Cooperative Local Exchange Telephone Companies[146]
- Competitive Local Exchange Telephone Companies
- Long Distance Telephone Companies
- Private Pay Telephone Providers.

The primary role of the Division is to enforce service standards, assure compliance with tariff regulations, coordinate extended area service studies, enforce pay telephone regulations, assist in carrying out provisions of the 1996 Telecommunications Act, and prescribe depreciation rates. Their goal is to, 'Insure that the rates, tariffs, service performance, interconnection arrangements, and network reliability of telecommunications carriers, provide Virginia consumers with reasonable, adequate utility service at fair rates within a regulated and competitive environment, with minimum use of outside assistance.'[147]

Duties of the staff include testifying in rate, service, and generic hearings, and meeting with the general public on communications issues and problems. The Division also maintains territorial maps, performs special studies, monitors construction programs, and investigates and resolves consumer inquiries and complaints. The staff is also responsible for monitoring developments at the federal level, and preparing Commission responses where appropriate.[148]

Division activities are fairly routine and standard from one year to the next with the high volume activities shown in Exhibit 4D-2. The activities requiring the majority of the Divisions resources are responsibilities related to implementing the Telecommunications Act of 1996; receiving, investigating and resolving complaints and inquiries from

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[146] Cooperative Local Exchange Telephone Companies are no longer regulated by the SCC.

[147] State Corporation Commission (2000) *Commonwealth of Virginia, State Corporation Commission, Divisions*, www.state.va.us/scc/division.htm.

[148] State Corporation Commission (2001) *Virginia State Corporation Commission: Division of Communications, Annual Report*, http://www.state.va.us/scc/division/puc/00annual.htm.

consumers; monitoring and enforcing service quality and standards; Processing tariff filings; area code and numbering issues; and, EAS, local calling, and boundary issues.

How SCC Regulates Telecommunications versus Other States

There are 78 state agencies with jurisdiction over utilities and carriers. Eighteen of those agencies are primarily involved with overseeing motor vehicles and transport. All fifty states have an agency that has responsibility for some aspect of the telecommunications industry. Virginia's Division of Communication, like forty-four other states, does not regulate the cable industry, or the telegraph business.[149] (See Exhibit 4D-3 for state agency jurisdiction of the telecommunications industry.) Telecommunications related organizations operating in the Commonwealth are regulated by the Division of Communications within a specialized unit and referred to as Public Utilities.

When other states were questioned regarding how they were able to approve ILECS entry into the long distance market, they stressed two things – commitment to competition and rapid response to problems with associated timetables. Example of phrases heard during the interviews were 'commitment to competition', 'competition is an attitude', and 'Commissioners embraced competition instead of regulation'. If Virginia's published material is an indication of their 'attitude' regarding regulation of the telecommunications industry, then it appears that the focus is still on regulation first and competition second. As stated the goal of the Division is to, 'Insure that the rates, tariffs, service performance, interconnection arrangements, and network reliability of telecommunications carriers, provide Virginia consumers with reasonable, adequate utility service at fair rates within a regulated and competitive environment, with minimum use of outside assistance.'[150]

Customers and Other Stakeholders Think Views on Regulation

Consumers are concerned with a portfolio of attributes provided from their telecommunications services. The attributes and the weights attached to them vary according to their particular situations (e.g., business views may differ from residents). Major concerns often involve access charges and rates. Exhibit 4D-4 making use of data from the FCC provides some historical data on these for a sample of 95 US cities[151]. Caveats must be attached because the period of data ends in 1999 and there is a lack of any weighting by factors such as city size but some insights are gained from the position of Richmond and Smithfield *vis-a-vis* the average of all the cities. The data also covers the full costs of bills and not just the cost of local service. The full service may include various federal and local taxes, wire maintenance, telephone sets, etc. as well as the local service rates.[152]

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[149] NARUC (1996) *Profiles of Regulatory Agencies of the United States and Canada, Yearbook 1995-1996*, National Association of Regulatory Utility Commissioners.

[150] State Coporation Commission (2000) *Commonwealth of Virginia, State Corporation Commission, Divisions*, www.state.va.us/scc/division.htm.

[151] P. Chelilik (1999) *Reference Book of Rates, Price Indices and Expenditures for Telephone Service*, Federal Communications Commission, Washington.

[152] The local service rates for Richmond were $10.10 (1980), $15.22 (1984), $13.87 (1989), $13.59 (1994), $13.59 (1997), and $13.59 (1999).

The residential service rates in the Virginian cities have in practice been lower than the larger average, but this may be a function of different demographic, geographical factors, etc. The important point is that rates in the Virginian cities have remained fixed over the period whilst falling for the overall average.[153]. Since there has been deregulation of other markets, albeit at different rates, in the states where the other cities are located then this downward movement may be seen as reflective of this reformed institutional structure. In all cases the connection charges for business are higher than for residents which may be seen either as a form of cross subsidy or reflective of price discrimination dependent on the underlying cost structure.

To gain more detailed insight several groups of stakeholders were interviewed regarding telecommunication regulation in the Commonwealth including long distance companies; payphone companies; incumbent local exchange companies; and, competitive local exchange companies. Additionally, industry associations have provided input.

Consumer groups[154] expressed some concern about the problems of coordination in a competitive market, for example the difficulties of making payments when there are changes in supplier. This is often linked to poor information flows and to the desire of companies to contain competitive pressures.

There was general consensus among the business community that the Commission structure as an independent body removes it from the political fray and works well. The judges and staff are professional and well informed. The lack of turnover indicates a generally good work environment and contributes to the long-term knowledge base.

The new collaborative committee and its focus on performance standards (metrics) are good ideas. Although OSS testing metrics has been in place since August 2000[155], it was slow to get started and the atmosphere was somewhat adversarial. It is felt that the leaders of the committee need to provide more guidance and to establish specific goals along with timelines. Further delays in the collaborative process could benefit the incumbents and delay competition.

When asked to compare Virginia to other states, the Commonwealth was consistently rated higher than others in most areas. Some indicated that the judges are open to informal discussion of issues that can preclude formal actions, save time, and that they are generally pro-business. The SCC was also praised for the fact that there have been relatively few changes in judges in over 100 years, which lends to the stability of the environment.

The Commonwealth was rated lower than other states in the area of interconnection agreements. These include, dispute resolution, timeliness, drive for competition, and best

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153 Since there has been a gradual deregulation in many states this may tentatively be a reflection of freer markets elsewhere.

154 For example, the Virginian Citizens Consumer Council.

155 OSS is seem as important, for example, for Verizon Virginia's goal of entering the long distance market, although the Verizon chose to test in its largest states first.

practices. When attempting to resolve disputes, it is felt that the Commission needs to recognize frivolous and unreasonable behavior and push harder for resolution. Regarding issues of timeliness where the SCC was consistently given low marks for taking too long to respond to critical business issues. It is felt that the Commission espouses a belief in competition, but does not do all that it can to ensure competition in the Commonwealth. There is a belief that the SCC has not transitioned from a regulatory mindset to that of competition. The last category of questions posed to interviewees concerned the list of best practices in Exhibit 4D-5. CLECs agreed that implementation of the practices in that Exhibit would in general be beneficial to the Commonwealth and its resident constituency.

There are some 20 incumbents incumbent telephone companies in the Commonwealth. The largest are – Verizon, Sprint, Shentel and nTelos, with Verizon the largest by far with about 85% of the market. The community of competitors outweighs the ILECs in number. Consequently, comments on dispute resolution, timeliness, and drive for competition, must be considered in that light. In general, companies on both sides gave the Commission high marks for professionalism, knowledge, experience and a genuine desire to provide the best service possible.

Effects of Communications Regulation on the Commonwealth

Communications regulation is primarily about competition. The more any of the parties involved in a communication system is capable of independently determining accessibility to it, the more it is liable to restrict the freedom of communication. Thus, free and equal access implies that no party dominates control in communications, that is, a balance of power exists between the parties involved in the communication process. Since control over access to communications is control over deciding who gets access to what information and communication resources, when, where, how, and on what conditions, any imbalance in this relation may require monitoring by some authority, in order to prevent abuse of power.[156]

Competition in local exchange service is different from that faced by long distance carriers following the Modification of Final Judgment. Potential entrants into local exchange services today include corporate giants like AT&T, MCI and other established communications providers such as cable companies. In the language of competitive strategy – entry into telephone equipment and long distance was largely denovo, while entry into local exchange services product line extensions was by existing communications companies.[157] Potential competitors in the local exchange markets include self-suppliers, private branch exchanges, shared tenant services, competitive access providers (or facilities-based competitive local exchange carriers), long-distance companies, wireless carriers, local service resellers, cable companies and other utilities.[24] All of which have either entered the Commonwealth or are vying to enter.

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[156] J. van Cuilenburg and P. Verhoest (1998) 'Free and Equal Access: In search of policy models for converging communication systems', *Telecommunications Policy*, Vol, 22, pp. 171-181.

[157] S. Oster (1990) *Modern Competitive Analysis*, New York: London: Oxford University Press.

As shown in Exhibit 4D-6 the numbers of CLECS has been increasing, because the SCC has made it relatively easy to obtain 'certificates', but the growing number of certificates in the residential dial tone market is a false measure of competition. In fact, although there has been a gradual change towards more CLERCS participating, market in the Commonwealth continues to be dominated by large companies. Major companies have been, at varying pace, entering the residential market over the past three to five years – AT&T and MCI. GTE was an ILEC with an existing presence if Virginia and has since merged with Bell Atlantic to form Verizon South. AT&T and MCI have made a more limited effort with attention mainly on business customers prior to the acquisition of Media One by AT&T.

AT&T and MCI's access to the residential market has been slowed by the Commonwealth's decision to stop arbitration of interconnection agreements as called for by the Telecommunications Act.[158] The result of the arbitration impasse is that two of the largest firms, AT&T and MCI, have been impeded in their entry to the Commonwealth.[159] The effect of this is impossible to measure, but economic theory and evidence from many other industries is that those two firms are large enough to provide competition that could potentially lead to innovation, lower prices for residential dial tone markets, and new services.

According to industry representatives, the increase in numbers of CLECS applying to do business in the Commonwealth is due to the growing residential and business market in the Commonwealth, especially Northern Virginia. The Commonwealth is one of the top 15 to 20 most desirable markets for telecommunications firms in the US Another attraction is the large number of Internet and other technology related firms that require the latest communications technology.

Back in 1997, MCI announced that they could lose as much as $800 million on their local telephone business due to higher than anticipated costs of entering the market.[160] In that same year, MCI and AT&T claimed the reason for their delay in entry has been that incumbent local exchange carriers have been employing anti-competitive tactics to forestall their entry.[161] Four years later, they make the same claim. Whether these claims

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158 In detail, the SCC had begun arbitrating interconnection agreements pursuant to the 1996 telecommunications Act soon after it was enacted. However, certain parties to federal court some agreements that the Commission has arbitrated. The SCC argued to the federal court that the 11th Amendment to the US Constitution barred that court from asserting jurisdiction over the SCC. The federal court held that the SCC, by undertaking review of interconnection agreements pursuant to the 1996 Act had waived the states 11th Amendment sovereign immunity. Since the SCC cannot waive the Commonwealth's sovereign immunity it has been compelled to cease arbitrating these agreements. The issue awaits a Supreme Court decision.

159 An alternative company view is that AT&T and MCI have used this problem as an excuse to oppose Verizon's entry into long distance markets. The support for this view being Verizon's agreement to waive its right to appeal to federal court while AT&T and MCI did not. Without access to companies' papers it is not possible to assess these positions.

160 MCI Press Release, July 1997.

161 R.G. Harris and J.C. Kraft (1997). 'Meddling through: Regulating local telephone competition in the United States', *Journal of Economic Perspectives*, Vol. 11, pp. 93-112.

are legitimate or part of a market/judicial strategy is impossible to say without detailed consideration of each and that is outside of the scope of this Report.

Measuring Effects of Competition

Whether regulating a monopoly or transitioning to a competitive environment, measuring the effects usually includes price; costs and productivity; service quality; profitability; and, infrastructure investment. Additionally, there are other ways to measure including; financial strength of Virginian companies, penetration of competitors, customer complaints, numbers and variety of services, and opportunity for citizen input.

- *Price.* Due to the historic view that there are inherent monopolies in telecommunications, pricing or rates have been the primary element that regulators and analysts have traditionally measured. By law, CLECs cannot charge more than the incumbent for products not yet found by SCC to be competitive (basic and discretionary). There are no limits on pricing for competitive products. Therefore, by definition, when a CLEC enters the market, the consumer normally benefits from lower prices.
- *Costs and Productivity.* Study results in this area are mixed. When a link is found between cost, investment levels and productivity, it is difficult to attribute it to a particular regulatory effort.
- *Service Quality.* The evidence here is largely for the pre-1996 reforms period, but in Virginia the SCC has found that service quality has deteriorated.
- *Profits.* There is strong evidence that rate of return regulation provides a company with lower profits than price caps.
- *Infrastructure.* Studies show that incentive regulation speed deployment of switches and ISDN.
- *Financial Strength of Virginian Companies.* This is one of the elements scrutinized by the SCC in granting a firm's access to Virginia.
- *Penetration of competitors.* In 1998, the number of Competitive Local Exchange Telephone Companies (CLECs) stood at 65 and currently stands at 182 (205 certificates have been granted and 23 cancelled). This represents a near 300% increase in three years. During that same time period, the number of long distance companies has doubled. There have also been more than 450 interconnection agreements approved.
- *Customer complaints.* The SCC has indicated that the number of complaints has risen as more companies have entered the market. This seems, amongst other things, to be due to the number of charges displayed on a customer's phone bills and the difficulty in understanding. There have also been complaints regarding out of services conditions and billing errors. Consequently, the SCC has provided extensive answers in writing and on their website.
- *Number and variety of services.* The SCC captures information on services provided by telecommunication firms, but there is no tracking method for determining changes in number and variety of services over time.
- *Opportunity for citizen input.* Citizens can provide input to the SCC in a variety of ways including telephone and through the Attorney Generals' Virginia Citizens

Consumer Counsel. Additionally, several times a year, representatives of the division speak before community groups.

There is currently no systematic way of measuring the effects of regulation or competition in the Commonwealth.

The Economics of Local Exchange Competition

The nature and features of telecommunications networks must be considered in assessing the anti-competitive potential of local exchange carriers. Local exchange carrier service can be characterized as an essential facility since these carriers provide access to all customers. Some analysts have suggested that the services provided by local exchange carriers be unbundled, but unbundling may not be efficient and may harm the competitiveness of the local exchange carriers.

With present technology, entry in the local exchange is inherently more difficult than entry in long distance. Two of the factors that contribute to this are:

- *High capital requirements*. Building the local loop that connects the customer to the network requires much more capital per customer than creating a long distance network.
- *Cooperation*. Need for significant cooperation with the local telephone company that the entrant plans to compete against.
- *Location-specific constraints*. While many elements/components of the long distance network are moveable, much of the investment in the local exchange has to be made at specific locations.[162]

The requirement that networks be interconnected to the LEC's network for competition to occur raises two classic competitive concerns, that essential facilities required for interconnection be made available on reasonable terms, and that these interconnection facilities be priced in a way that prevents anti-competitive price squeezes.

Because LECs are required to provide ubiquitous coverage to all customers in their service territories, interconnection is currently an input required for competition. Therefore, in the name of economic efficiency, certain features of telecommunications networks should be accommodated in establishing the availability and prices for essential network interconnection. This translates into rules that prevent anti-competitive outcomes or judging whether anti-competitive behavior has occurred after the fact. The key question for the regulators is whether the industry is using the least amount of resources to produce the greatest output of goods or services for the consumer. Otherwise, resources that could be productively employed in other sectors of the economy are wasted.[163]

The traditional distinction between local and long-distance telephone service, and the demarcation between voice, record, data, and video services, is fast disappearing. 'Many

[162] N. Economides (2000) *The Telecommunications Act of 1996 and its Impact*, http://raven stern.nyu.edu/networks/telco96.html

[163] Hausman, and Tardiff, op cit.

academics and practitioners hold that technology-induced proliferation of new suppliers at all stages of domestic and international communications suggests that privately owned telephone systems in the US and Canada should be deregulated...'[164] Rules under deregulation would include:

- mandate full access or interconnection so that as many suppliers as possible would be able to reach the ultimate retail customer
- government would retain antimonopoly surveillance to prevent collusive behavior some limited type of regulation, such as price caps or price freezes
- if there is a social value judgment that universal service (not universal access) is a desirable goal, then some form of tax to subsidize low-income subscribers in high-cost/thin markets.

Several factors need consider when considering deregulation. The first is the persistence of significant network economies, i.e. economies of scale, scope, joint production and pooled reserves. As a result, networks will tend to be large relative to the size of the market and this can lead to high market concentration. Market concentration results in oligopoly and, typically, a much greater degree of freedom in setting prices, defining markets, and investing in services.

Another factor is the potential for exploitative behavior when tight oligopolies supply markets that are readily differentiated on the basis of price and service. A third factor is the comparative advantage enjoyed by individual participants. Each participant will have particular areas of strength as well as particular areas of vulnerability. The player will enjoy the greatest net advantage will be in the strongest position to control markets and exploit net technology.

Best Operational and Management Practices

Passage of the Telecommunications Act of 1996 was not only a change in law, but also a major change in the intent of the law. Previously, the intent had been price regulation in a monopolistic environment. The new intent can be summed up as competition. The Act represents a vision of the telecommunications marketplace where the flexibility and innovation of competition replaces the heavy hand of regulation.[165] The new intent is propelling state regulatory agencies to respond by revising existing telecommunications regulations. That revision process continues to evolve today, and regulators face many challenges.

Best practices can be established through an ongoing process of benchmarking, even after 6 years since the passage of the Telecommunications Act, it is difficult to say what is the absolute best practice. What has been accomplished is the identification of best practice candidates. The National Association of Regulatory Utility Commissions (NARUC) and

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[164] H.M, Trebring and M. Estabrooks (1995) 'The globalization of telecommunications: a study in the struggle to control markets and technology." *Journal of Economic Issues*, Vol.29 pp.535-45.

[165] M. Meyerson, (1996). *Ideas of the Marketplace: A Guide to the 1996 Telecommunications Ac*t, University of Baltimore School of Law. www.law.indiana.edu/fclj/pubs/v49/no2/meyerson .html.

the Commonwealth is lagging, then the Commission can enter into discussions with local telecommunications providers to determine why.

24. **In order to enhance competitor in the Commonwealth, the SCC should continue to find additional ways to allow competitors into the marketplace as rapidly as possible. The current financial difficulties of the smaller CLECs combined with the inherent economies of scale indicate that the most immediate source of competition will come from the larger and more established firms. The current arbitration impasse is blocking the largest potential competitors. Methods of circumventing this problem should be sought expeditiously.**

Exhibit 4D-1: Communications Firms under the Supervision of the Division

Communications Firms Under the Supervision of the SCC			
	1998	1999	2000
ILEC	14	14	14
Cooperative LEC	--	6	6
Competitive LEC	65	109	154
Long Distance Companies (IXCs)	50	72	104
Private Payphone Providers	569	542	521
Total	698	743	799

Exhibit 4D-2: High Volume Activities Carried Out by the Communications Division

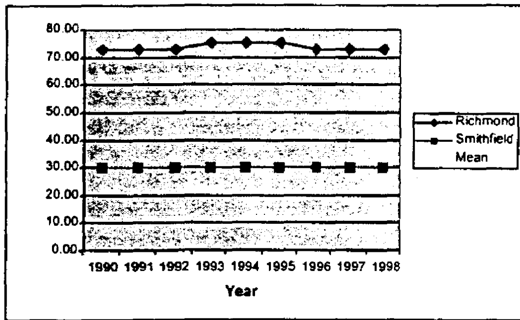
Activities	1998	1999	2000
Consumer complaints and protests investigated	4,584	4,004	4,642
Telephone inquiries received	7,968	13,750	13,392
Tariff Revisions	320	392	397
Tariff Sheets Filed	7,494	5,678	11,102
Pay Telephone Registration and Enforcement	52,671	55,100	52,380

Source: Virginia State Corporation Commission Annual Report, 1998, 1999, 2000

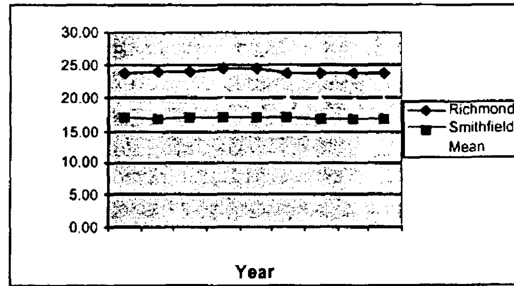
Exhibit 4D-3: Summary of Agency Jurisdiction Over Telecommunications

State	Telephone	Telegraph	Radio	Cable	Cellular
Alabama PSC	✓	✓			
Alaska PUC	✓	✓	✓	✓	✓
Arizona CC	✓	✓			
Arkansas PSC	✓				
California PUC	✓	✓	✓		
Colorado PUC	✓	✓			
Connecticut DPUC	✓			✓	
Delaware PSC	✓			✓	
DC PSC	✓	✓			
Florida PSC	✓				
Georgia PSC	✓	✓	✓		
Hawaii PUC	✓		✓		
Idaho PUC	✓				
Illinois CC	✓				
Indiana URC	✓	✓			
Iowa UB	✓	✓			
Kansas SCC	✓	✓	✓		
Kentucky PSC	✓	✓	✓		
Louisiana PSC	✓	✓	✓		
Maine PUC	✓	✓	✓		
Maryland PSC	✓				
Massachusetts DPU		✓	✓		
Michigan PSC	✓				
Minnesota PUC	✓	✓			
Mississippi PSC	✓	✓	✓		
Missouri PSC	✓				
Montana PSC	✓	✓	✓		
Nebraska PSC	✓				
Nevada PSC	✓				
New Hampshire PUC	✓	✓			
New Jersey BPU	✓	✓		✓	
New Mexico SCC	✓	✓	✓		
New York PSC	✓				✓
North Carolina UC	✓		✓		
North Dakota PSC	✓				
Ohio PUC	✓				
Oklahoma CC	✓	✓			
Oregon PUC	✓				
Pennsylvania PUC	✓	✓	✓		
Rhode Island PUC	✓	✓		✓	
South Carolina PSC	✓		✓		
South Dakota PUC	✓		✓		
Tennessee PSC	✓				
Texas PUC	✓				
Utah	✓				
Vermont PSB	✓			✓	
Virginia SCC	✓				
Washington UTC	✓				
West Virginia PSC	✓	✓	✓		
Wisconsin PSC	✓				
Wyoming PSC	✓	✓			

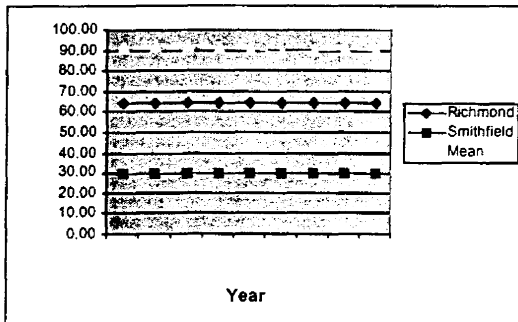
Source NARUC, 1996



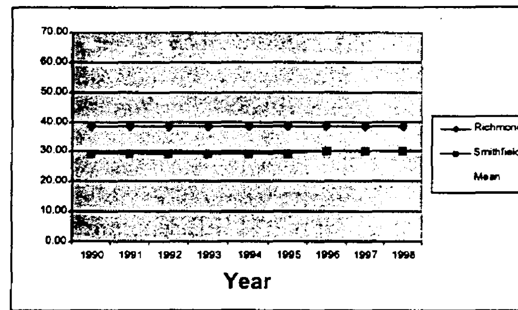
Monthly telephone rates in sample of cities for a business with a single line



Connection charges for a residential telephone line in the sample cities



Connection charge for a single business line in the sample cities



Monthly residential telephone rates in the sample cities

Source: Calculated from data in, P. Chelilik (1999) *Reference Book of Rates, Price Indices and Expenditures for Telephone Service,* Federal Communications Commission, Washington..

Exhibit 4D-4 Comparative Data on Telephone Costs in a Variety of US Cities

Exhibit 4D-5 : Studies on Effects of Telecommunications Incentive Regulations

Study	Period Covered	Subject of study	Results
		Prices	
Ai and Sappington (1998)	1990-1996	Local residential rates	Lower by $1.60/month (7.6%) under price cap regulation than under rate-of-return regulation
Armstrong, Crown & Vickers (1994)	1984 – 1993	British Telecom rates under price cap regulation	Residential line rental rates rose 4.6 %, peak local calling rates fell 17.8%, peak national calling rates fell 44.6%
Braeutigam et. Al (1997)	1987 – 1993	Local residential and business rates	Lower under price caps, but not if accompanied by mandated infrastructure investment
Crandall & Waverman (1995)	1987 – 1993	Local residential and business rates	Lower under price caps, but not under other forms of incentive regulation
		Costs and Productivity	
Sappington (1998)	1990 - 1996 1988 – 1993	Cost and investment levels.	Earnings increases productivity in the short term but decreases it by almost as much after 2 years.
Christensen & Meitzen (1994)	1984 – 1992	Productivity of local telcos subject to price caps	Annual productivity growth averaged 3.5%, but not all of this is attributable to price caps
Tardiff (1993)	1980 – 1991	Productivity of large US telcos	Incentive regulation increases productivity by 2.8% annually
		Service Quality	
Study	Period Covered	Subject of study	Results
Sappington (1998)	1990-1996	Service quality measures under incentive regulation	Phones are installed more quickly, customers file fewer complaints with state PUCs, time to resolve service problems rise by 4-21 hours.
Tardiff & Taylor (get cite from law library)	1980 – 1991	Service quality of Bell Operating Companies under incentive regulation	No evidence incentive regulation has reduced quality of service
		Profits	
Study	Period Covered	Subject of study	Results
Armstrong, Cowan and Vickers (1994)	1987 – 1992 1984 – 1990 1989 – 1991	British Telecom's rate of return	Rose from 16.7% in 1984 to above 21 % in 1987 – 92
Armstrong, Cowan and Vickers (1994)	1987 – 1992 1984 – 1990 1989 – 1991	British Telecom's rate of return	Rose from 16.7% in 1984 to above 21 % in 1987 – 92
Sapington (1998)	1990-1996	Effect of incentive regulation on profits	Weak evidence that price caps raise profits by 16%
		Infrastructure	
Study	Period Covered	Subject of study	Results
Hausman & Tardiff (1995)	1984 – 92	Incentive regulation and technology deployment	Incentive regulation speeds deployment of digital switches
Sapington (1998)	1990-1996	Local telco technology deployment	Incentive regulation increases deployment of ISDN switches

Exhibit 4D-6: Best Practice Procedures from NARUC and NRRI Poll with Advantages

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Alternative Dispute Resolution and Administrative Flexibility

Range of dispute resolution services including mediation, arbitration and facilitation teams including judges and staff

Advantage: Collaboration can be useful in defining and narrowing issues, and eliminating peripheral issues and greater illumination of complex disagreements.

Informal mediation of carrier disputes. Ask parties to meet and work out problem rather than immediately opening a docket.

Convene CLEC/RBOC working groups to address, on a semi-monthly basis, common issues.

Advantage: Brings issues and problems to the table rapidly and creates forum for discussion and consensual resolution.

Allow either party to an interconnection agreement to request a settlement conference with Commission staff within 10 business days of request.

Advantage: Enable CLECS to quickly inform Commission of attempted resolutions. May also improve efficiency of Commission staff by reducing the number of formal proceedings.

Expedite resolution of formal, interconnection-related complaints to 30 days after filing of formal complaint.

Advantage: Quickly resolve interconnection-related disputes that affect CLEC's ability to provide service.

Expedite Carrier-to-carrier complaints by 1) a 'quick-look' process in which complainant and respondent are advised of likely outcome of case 2) sharply expedited procedures to arrive at decision 3) mandatory mediation and voluntary arbitration for complaints or 4) ability of commission to award litigation costs to a prevailing party and 5) ability of commission to sanction a party if it determines frivolous activity, harassment or tactical delays.

Advantage: Unburden commission dockets, speed up resolution reduce legal costs and sharpen incentives of regulated companies to comply. Provide competing companies with timely outcome that will in turn enhance competition.

Allow non-dominant carriers to file tariffs that are effective and presumed lawful on one day's notice.

Advantage: Improves ability of CLECS to respond quickly to marketplace and enables carriers who operate on a regional and national basis to have uniform rates and service offerings at the same time.

Customer Service and Education

Publish and distribute comparisons of retail rates, along with related consumer education pieces

Advantage: Customers less likely to complain about high prices if given tools to make optimal choice.

Prohibit slamming of all services

Advantage: Reduces incidences of slamming and associated resources to regulate

Institute equivalent of 'small claims court' where consumer can get rapid resolution of complaint

Advantage: Reduces resources required for handling formal complaints

Mandate independent third party verification for all changes in residential and business preferred carriers or services.

Advantage: Fair, pro-consumer way to address slamming, Protects consumer from frustration, hassle, time and money associated with slamming.

Require industry to remove disputed 'cramming' charges from consumers' bills immediately

Advantage: Removes burden of contacting crammers first to try to resolve the problem.

Advanced Telecommunications Services

Carriers engage in discussion to resolve contested issues.

Advantage: Carriers reduce the number of contested issues for regulators to resolve

Resolve xDSL spectrum interference issues in industry standards committees.

Advantage: Prevents firms from setting xDSL standards that limit their competitors DSL options.

Firms provide unbundled xDSL loops to their competitors.

Advantage: Unbundled xDSL loops are required in order for consumers to receive DSL service.

Establish Pro-Competitive loop provisions. Currently there is no standard for the provisioning of loop services to a competitor.

Advantage: Allows firms to access loops in a timely manner.

Require ILECS to impute loop costs.
Advantage: Reduces the ability of ILECS to set high loop charges. Increases DSL competition.

Universal Service

Target universal service support to smallest geographical area that is feasible.
Establish no support zones for areas with low costs.
Advantage: Provides support funding to those who need it most. Allows per-customer cost to be closer to the cost of serving the high-cost customer.
Identify high-cost universal service areas for analysis by determining if the average wire center cost exceeds the funding benchmark.
Advantage: Reduces the number of areas for analysis. Reduces the size of the universal service support fund.
Establish state or local level competitive grant programs that provide non-profit organizations with matching funds for projects that improve quality and public-access to education, health care, public safety, and other community based services.
Advantage: Allows the non-profit sector to develop the critical mass and infrastructure to utilize advanced communication services for the provision of public services.
Develop policies that encourage the development of public broadband networks in locations (bus stops, rail stations, shopping centers, neighborhoods) that consumers easily access.
Advantage: Reduces the number of trips required by consumers. Encourages telemobility. Can be used to provide public services such as health care.
Establish a 711 service standard for all local service providers. 711 service simplifies the process of reaching Telecommunications Relay Service centers and makes it easier to communicate using text telephone devices.
Advantages: Would make it easier for the deaf and hard of hearing community to use the telecommunication network. Would reduce the need of operator assistance.

Market Entry and Other Issues Related to Competition

Consider IXC and CLEC plans for entry into the local exchange market when evaluating RBOC Section 271 applications.
Advantage: Facilitates the process of evaluating Section 271 applications by ensuring that the record contains a complete and accurate assessment of the state of local competition.
Develop "Red light/green light" section 271 checklist status chart.
Advantage: Helps keep 271 meeting focused. Allows quick assessment of 271 status.
Implement statutes that require that building owners must allow their tenants to determine their telecommunications carrier of choice.
Advantages: Promotes competition for telecommunications service by preventing building owners from signing exclusive service contracts. Facilitates negotiations between telecommunication carriers and building owners by establishing reasonable parameters within which access negotiations must occur.
Relocate the demarcation point for all multi-units buildings to the minimum point of entry as defined in Section 68.3(b)(2) of the FCC rules.
Advantage: Permits all telecommunication carriers to connect with facilities of a building at the same location. Equalizes the cost of access for all carriers and avoids giving one carrier control over facilities that must be used by other carriers in order to reach consumers in a multi-unit building.
Require all certified IXCs permit the ILEC to originate and terminate their long distance traffic must also permit a CLEC operating in the area to originate and terminate their traffic through authorizing the CLEC to input the IXC's carrier identification code into the CLEC switch.
Advantage: Allows consumer to chose CLEC without having to consider whether that CLEC can provide the customer with access to the IXC of their choice.

Numbering Issues

In an area code split scenario, the carrier holding the original number should maintain intercept on all numbers assigned to customers that are affected by the split until the carrier awarded those numbers can activate the numbers into its switch or activate an intercept message itself.
Advantage: Improve customer satisfaction and reduce consumer confusion when an area code split occurs. During this situation a consumer could go without phone service because the telephone switch with their number has not been activated.

In jeopardy or number exhaust situations all remaining NXXs in the existing area code should be reserved for new entrants.
Advantage: Reduce potential anti-competitive effects of new area codes overlays because it will not single out new entrants by their assigned overlay codes.
ILECs should contact CLECS on the day of scheduled disconnect to ensure all parties are prepared and that a subsequent cancellation of the disconnect has not been overlooked.
Advantage: Improve efficiency and reduce customer dissatisfaction by ensuring all parties are prepared for the disconnect and that a subsequent cancellation of the disconnect order had not been overlooked.

Collocation

Implement cageless collocation rules.
Advantage: Uncaged collocation can accommodate far more collocation customers than a caged environment.
Adopt reforms that improve traditional collocation: improve available space, create smaller physical collocation arrangements, improve intervals and throughput, remove unnecessary restrictions of equipment type and use, remove restrictions that prevent shared collocation of space, reduce the price of providing collocation.
Advantage: Improve CLECs' ability to obtain traditional collocation arrangements in a more efficient manner.
Establish third party testing of ILEC's Operation Support Services
Advantage: Allows CLECS to determine which equipment they will use to provide their service. Currently, ILECS limit the type of equipment that can be used.
Implement general collocation areas in which a firm's equipment is located in a locked box/area.
Advantages: Reduces the amount of collocation space needed. Encourage more collocation in central offices thus expanding the footprint for loop and DSL-based applications.
Develop virtual collocation requirements in which ILEC and CLEC equipment is intermixed.
Advantage: Allows CLECs and ILECS to install and maintain their own equipment.
Decrease wholesale collocation costs and require ILECS to impute to their own services the collocation charges they collect from CLECS
Advantage: Increased competition by lowering costs for CLECS
Ensure prompt collocation ordering rights by requiring ILECS to file collocation tariffs.
Advantage: Allows CLECS to enter broadband market faster.
Require ILECS to submit detailed floor plans to State Commissions whenever they contend space for physical collocation is unavailable.
Advantage: Third party scrutiny can make ILECS more conscientious in identifying available space.
Specify that Remote Access Management and Equipment and Retail Services can be placed in collocation cages
Advantage: Allows CLECS to remotely monitor the performance of their equipment.
Require ILECS adopt space neutral polices and make publicly available the status of space availability in the larger end offices.
Advantage: Encourages ILECS to look more closely at space availability.

Operation Support Services and Other Interconnection Issues

Implement third party testing of a Bell Operating Company's (BOC) Operation Support service
Advantage: Helps BOC make necessary changes to meet conditions of the Telecommunications Act of 1996. Provides CLECS with a roadmap for interconnection with the BOC.
Interconnection collocation agreements in one jurisdiction should be considered justification for similar interconnections in other jurisdictions.
Advantage: Reduces the ability for CLECS to claim an interconnection is not feasible.
ILECS should provide Loop Qualification Databases.
Advantage: Informs CLEC of the technical capability of different service loops.
Early interconnection meetings should be held between ILECS and CLECS. ILECS should provide documentation on how to do business with them, emphasizing all of the elements necessary for establishing connectivity with their networks.
Advantage: Make it easier for CLECS to interconnect with ILECS.
ILECS should ensure all necessary underlying facilities are available before issuing firm order commitment dates.
Advantage: Allows CLECS to better plan their market roll-outs.

As a CLEC enters a market it should exchange contact information with other ILEC and CLECS in that market.
Advantage: Reduces problems associated with interconnection among different networks.
Adopt laws that allow CLECs to seek damages from an ILEC for violation of an interconnection agreement provision.
Advantage: Provide monetary relief for CLECS who lose customers due to ILEC performance.

E. Energy (Electricity and Gas)

Industry and Trends

Utilities and other 'network' industries have traditionally been regulated as monopolies at both the federal and state levels.[168] During the late 1970s and 1980s, however, a variety of network industries underwent deregulation or restructuring. The parts of those industries that could clearly be competitive were opened to competition and deregulated. Cost-based regulation of monopoly elements (wires and pipes) has been increasingly replaced with performance-based regulation, for example price –capping, that allows the regulated firm to earn higher profits if it finds ways of cutting costs or improving service quality.

These restructuring efforts produced a strikingly similar pattern of results in industries as diverse as interstate natural gas transportation, telecommunications, airlines, trucking, and railroads. After controlling for other factors, restructuring was usually responsible for price reductions of between 10% and 20%. Restructuring and competition have also unleashed waves of entrepreneurial creativity that cut costs, improved service quality, and led to the introduction of new products and services.[169]

The 1990s saw a continuation of this regulatory reform trend to encompass electricity and gas at the retail level. Three factors have driven state-level reforms: new technologies that facilitate competition, successful federal initiatives, and (in some cases) regulatory failure.

Electricity

Traditionally electricity involved vertically integrated firms involved in generation, transmission, distribution and retailing that held de facto exclusive rights to serve retail consumers within defined geographical areas. These firms were normally subjected to 'cost of service' or 'rate of return' regulation by state public utility commissions. The US differed from most other countries in that the suppliers were private companies and that they were fairly large in number (i.e., there was little horizontal integration). There are three large, synchronized AC networks (the Eastern Interconnection, the Western Interconnection and the Texas Interconnection) which have superimposed on them over 140 control areas and individual vertically integrated utilities operating through pooling arrangements provide generation dispatch, network operations and reliability on specific sections of the network.[170]

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168 The primary focus here is on economic regulation (e.g., rates and market entry). The Division of Energy Regulation also has responsibility for overseeing damage prevention and safety. The evidence here from comparative analysis is that the SCC performs extremely well in these areas, see for example *Common Ground: Best Practices for Damage Prevention,* http://ops.dot.gov/comgrnd.htm

169 See literature summarized in R. Crandall and J. Ellig (1996) *Economic Deregulation and Customer Choice: Lessons for the Electric Industry* (Center for Market Processes, Fairfax).

170 P.L. Joskow (2000) 'Deregulation and regulatory reform in the US electric power sector', in S. Peltzman and C. Winston (eds) *Deregulation of Network Industries: What Next?* (Brookings Institution, Washington).

The nature of the market has led to a long tradition of wholesale markets whereby utilities buy and sell electricity amongst them. Differential short-term costs of generation according to the fuel and technology deployed fostered such transactions. Most retail customers received a 'bundled' product (generation, distribution and retailing services in a single package) from the local monopoly distributor.

Some researchers have doubted whether monopoly in electricity was ever really required by technology.[171] Nevertheless, it became clear in the 1980s that new generation technologies had rendered the electricity supply monopoly obsolete. The Public Utility Regulatory Policies Act of 1978 (PURPA) sought to encourage co-generation of electric power by non-utilities, and the subsequent development of small-scale, gas-fired combined-cycle power plants dramatically reduced the amount of investment and lead time required to build generating plants. Additional sources of emerging retail competition include distributed generation – that allows power users to generate their own electricity on-site using natural gas – and information technologies that facilitate sophisticated energy management, giving customers a greater opportunity to forego using electricity when it is relatively expensive.

Three federal actions have spurred electric restructuring. These are PURPA; the 1992 Energy Policy Act (that created a new industry of independent power producers), and initiatives by the Federal Energy Regulatory Commission to promote competition in wholesale electric markets and turn high-voltage transmission lines into open access facilities that can be used by any power producer or marketer to move power to customers.[172]

Dissatisfaction with regulation has also played a part – most notably in places that had relatively high electric rates, such as California, Pennsylvania, and the Northeast. Instead of protecting consumers from 'unreasonable' prices, regulation inflated power costs and hampered economic development as industry opted for states with lower-cost power.[173]

Gas

By reducing costs and shortening lead times, new drilling technologies have enabled competitive gas suppliers to alter exploration and production even more rapidly in response to changing demand. The principal federal initiative driving retail competition

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[171] See, e.g., W. Primeaux Jr. (1986), *Direct Electric Utility Competition* (Praeger, New York); R. Poole Jr (1982) *Unnatural Monopolies* (Lexington: DC Heath).

[172] FERC Order 888, its largest recent initiative to promote competition in wholesale power markets, was undertaken pursuant to the 1992 Energy Policy Act. Prior to 1992, FERC promoted 'wheeling' of electricity by transmission owners as a remedy for market power problems in merger cases.

[173] L. Courville, 'Regulation and Efficiency in the Electric Utility Industry,' *Bell Journal of Economics* Vol.5, pp.53-74; P.M. Hayashi and J.M. Trapani (1976) 'Rate of Return Regulation and the Regulated Firm's Choice of Capital-Labor Ratio: Further Empirical Evidence on the Averch-Johnson Effect,' *Southern Economic Journal* Vol.42, pp.384-97; H.C. Petersen (1975) 'An Empirical Test of Regulatory Effects,' *Bell Journal of Economics* 6, pp.111-26; R.M. Spann, 'Rate of Return Regulation and Efficiency in Production: An Empirical Test of the Averch-Johnson Thesis,' *Bell Journal of Economics*, Vol. 5, pp.8-52; E.R. Canterbery, B. Johnson, and D. Reading (1996) 'Cost Savings from Nuclear Regulatory Reform: An Econometric Model,' *Southern Economic Journal* (January, pp.554-66.

in natural gas has been the highly successful effort to deregulate interstate gas markets in the 1980s. Regulatory failure also played a role, as price controls led to gas shortages in consuming regions during the 1970s. Wellhead gas supply has always been highly competitive, and federal regulation of wellhead gas prices between 1954 and 1978 is now widely regarded as a mistake.[174] Retail gas competition has emerged as a means of ensuring that the benefits of competition at the wellhead reach all the way to the burner tip.

SCC Regulation and Its Effects on the Commonwealth

The State Corporation Commission has undertaken competitive restructuring initiatives in both the electric and gas industries. The procedure has been somewhat different in the two cases. For electricity, the SCC has frequently expressed strong doubts about the benefits of competition and often proceeded in response to legislation enacted by the General Assembly, including a comprehensive restructuring plan passed in 1999.[175] For gas, the Commission has allowed large customers to choose non-utility gas suppliers since the mid-1980s, and it approved retail competition pilot programs on its own initiative in 1997, prior to the passage of gas restructuring legislation. In March 2001, the Commission approved the plan of Washington Gas to extend retail choice to all of its customers over a two-year period.[176]

In taking these divergent approaches, the Commission appears driven by its assessment of the likelihood that competition would offer customers lower prices than they had historically received under regulation. In the mid-1980s, it was clear that large gas users could garner substantial savings by shopping for their own gas supplies, instead of buying high-cost gas that the local utility was purchasing from interstate pipelines. Obvious cost savings for a significant and influential constituency was sufficient to impel action.

In the late 1990s, investor-owned gas utilities approached the Commission on their own initiative seeking to establish retail choice programs for small customers. Virginia's regulatory system gave gas utilities no way to profit from sale of the gas commodity, because wholesale gas costs were (and are) simply passed through to customers.[177] Some of the utilities perceived retail choice as a profit opportunity, because competition would allow them to create retail affiliates that could potentially create value for customers by offering different pricing plans or bundling gas with other products and services. Since customers could still choose to buy gas at the wholesale price under traditional regulated utility service, the creation of additional competitive options created little or no downside risk for consumers and offered the prospect of innovative new pricing plans and services.

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174 See J. Ellig and J.P. Kalt (eds.) (1996) *New Horizons in Natural Gas Deregulation* (Westport, CT: Praeger).

175 See, e.g., *SCC Staff Report on the Restructuring of the Electric Industry* (July 1996), and *Draft Working Model for Restructuring the Electric Industry* (November 1997), available at www.state.va.us/scc/division/restruct/main/staff/teirstaff.htm.

176 *Order Granting Application,* Case No. PUE000474 (March 7, 2001).

177 Some other countries, such as the UK, have initiated price-cap regimes that permit costs to be passed on but have incentive structures to stimulate more efficient use of resources.

In electricity, the potential for savings was less clear, and key constituencies disagreed about the wisdom of competition. Virginia's electric rates are below the national average, largely because Virginia utilities rely heavily on low-cost coal and nuclear generation. There was no large, obvious source of new, low-cost competition.[178] Until the mid-1990s, the state's two largest investor-owned utilities took opposite positions on competition. Industrial customers strongly favored retail competition for all customers, but traditional consumer advocates were less sure that competition would benefit residential and small business customers. The potential for competition to reduce prices by creating incentives for firms to become more efficient was largely ignored. The Commission voiced its skepticism in a 1996 report. It proceeded to restructure only after the legislature passed comprehensive legislation. Some views were expressed that there is still a need for a change in philosophy by the SCC. With a move from viewing regulation as a backstop in case competition fails, that could well produce a self-fulfilling prophecy, to viewing regulation as a means of promoting competition.

Electricity

The Virginia Electric Utility Restructuring Act (Senate Bill 1269), which maintains a regulated monopoly over the transmission and distribution of electricity, reflects the General Assembly's determination that regulated monopoly at the retail level is not in the best interests of the Commonwealth. The Commonwealth initiated measures to liberalize the energy market. In the case of electricity it has gone further than many states in that while market entry has been allowed a price cap has been retained until 2007 unless the market become competitive – somewhat longer than the 2005 dates for Maryland and 2004 for Washington DC. Three major problems are seen to be associated with traditional monopoly regulation, higher consumer costs, hampered economic development, and new services forgone. The SCC has the remit to foster competition within this framework.

Some commentators, including the Commission itself, have questioned whether retail competition would benefit Virginia because the state already enjoys relatively moderate electricity prices. Indeed, it is extremely difficult to forecast the impacts of regulatory change. If this were not the case then presumably the regulatory authority would already have provided an efficient solution. There may, therefore, be an argument for retaining the *status quo* unless there are strong arguments to the contrary.

A difficulty is that the gains from competition can take time to materialize.[179] In the short term, as adjustments take pace, market entry is slow, and actors attempt to gain from freedom from controls so prices may rise. The passing on of the full costs of inputs (e.g., natural gas) can also affect short-term electricity prices in a deregulated situation. One recent analysis of this issue, conducted by the US Department of Energy (DOE) in 1999, suggests that Virginians pay more – though not drastically more – for power under

[178] Although some of the existing utilities have lower costs than others and couljjd be one source of competition. For example, Appalachian Power in southwest Virginia has some of the lowest costs and rates in the nation.

[179] At a macro scale competition may be limited if there are congestion bottlenecks in the system due to inadequate capacity the interstate transmission grid, see Kahn (2001) op cit.

regulated monopoly than they would pay in a competitive market. DOE estimated that in the region covered by the East Central Area Reliability Coordination Agreement (ECAR), which includes the Appalachian region of Virginia, competition would reduce prices by approximately 15% below regulated levels for residential and commercial customers and 5.6% for industrial customers by the year 2010. In the Southeastern Electric Reliability Council (SERC), which includes the rest of Virginia, prices would be about 10% below regulated levels for residential and commercial customers and remain essentially unchanged for industrial customers.[180] (See Exhibit 4E-1.).

Whether such gains will materialize is a long-term consideration. In the short term, removal of price caps in the US have tended to result, in part because of high fuel price, excessively competitive wholesale markets, and capacity issues, in higher electricity prices and instability in supply.[181]

Regardless of Virginia's relative power costs in the past, future power costs could pose an economic development issue in the longer term to the extent that other states – especially neighbors – successfully reduce prices by restructuring their electric markets. The short-term picture is not so clear. Pennsylvania, which participates in a wholesale market with New Jersey, Delaware, Maryland, and the District of Columbia, has adopted the most successful electric restructuring to date. The state's entire electric market is open to competition, and more than 20% of Pennsylvania customers have switched suppliers. The Pennsylvania Department of Revenue projected that average electricity prices in Pennsylvania will be 16.9% lower in 2004 than they would be if regulation had continued. Prices will be 14.6% lower for residential customers, 18.8% lower for commercial customers, and 17.9% lower for industrial customers. The Pennsylvania Public Utility Commission estimates that competition saved electricity customers $750 million in 1999.[182] The initial picture has changed, however, in recent years. While there were over 20 suppliers in 2000, the number had fallen to 2. The problem has been that the wholesale price of fuel has risen to that of the capped retail level removing the margin of profit.

Monopoly regulation also hampers the introduction of innovative pricing provisions and value-added services, including various forms of hedging, real-time pricing, 'green' power produced from renewable sources, and energy management services.[183] In

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[180] Calculated from information in US Department of Energy, Office of Economic, Electric, and Natural Gas Analysis (1999) *Supporting Analysis for the Comprehensive Electricity Competition Act*, Appendix A, Washington. Some care, however, should be taken over the results in this study that also imply that the Californian market would have benefited significantly from deregulation.

[181] In this context, the Virginia General assembly did not act to slow reform restructuring in 2001 whilst other states did (e.g., Arkansas, Connecticut, Florida, Georgia, Idaho, Kansas, Montana, Nevada, New York, North Carolina, Oregon, and West Virginia).

[182] Pennsylvania Department of Revenue (2000) *Electricity Generation, Customer Choice, and Competition: A Report to Governor Ridge and the General Assembly*, pp. E-5 and 2, Philadelphia. Some care should be taken with these figures, however, because some of the savings (possibly 60%) may be due to rate reductions rate reductions offered to both shopping and non-shopping customers in the state's restructuring process.

[183] S.C. Littlechild (2000) *Why We Need Electricity Retailers: A Reply to Joskow on Wholesale Spot Price Pass-Through*, DAE Working Paper 0008, University of Cambridge, Cambridge.

Virginia's retail competition pilot programs, electricity suppliers have offered fixed-price contracts and green power. Real-time pricing and energy management services for small customers await the full development of a competitive market in electricity supply and metering that could justify investments in the technologies necessary to offer such services. There is now a phased-in schedule for retail electric choice aimed at making Virginia more attractive to competitive suppliers and marketers because over 2.1 million customers will become available from January 2003.

Virginia's electric restructuring has not yet proceeded far enough to produce substantial price reductions, economic development benefits, or new services available to most customers. It has also been hit by higher oil prices. Additionally only about 5% of the retail market is open to competition under the pilot programs, and not much competition has emerged. The principal purpose of current pilot programs is to aid electric utilities in developing systems and operating procedures needed to facilitate customer choice. Competitive electric suppliers and marketers express reluctance to participate in pilot programs, preferring to wait until a substantial portion of the market is open to competition in order to spread fixed marketing costs over a larger base of potential customers.

The rate cap in Virginia has also proved to be too low to encourage market entry in the short term. Sufficient returns cannot be earned. This is a major problem if price caps are set too low and lack of large-scale market entry may then be inevitable irrespective of any initiatives that the SCC may take. There is also no shortage of capacity available from incumbents in the short term.[184]

Gas

No scholarly or government study has estimated or projected the effect of retail gas competition on prices, economic development, or development of new energy services in Virginia. One study did find that between 1975 and 1995, after controlling for other factors Virginia experienced industrial gas rates 13.7% lower than in most other states, with residential and commercial rates comparable to those in other states.[185] This result likely stemmed from Commission initiatives that allowed selective price discounting designed to keep individual large customers from leaving the system.

Only one state, Georgia, has implemented a statewide retail choice program for natural gas. The Georgia program produced price savings of between 7% and 12% in the first year. In Georgia's competitive retail gas market, individual customers can choose from many different price plans to fit their own risk tolerances, including variable price and multi-year fixed price options. Marketers offered a variety of new payment options, including electronic drafts, credit card payment, or payment at local supermarkets. One placed kiosks in supermarkets to educate consumers about retail competition and publicly

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184 Capacity is expanding at about the same rate as demand.

185 D.R. Hollas (1999)'Gas Utility Prices in a Restructured Industry,' *Journal of Regulatory Economics* Vol.16, pp. 179-81. Unbundling initiatives undertaken in three other states during that period, which allowed only large customers to purchase gas from non-utility suppliers, tended to reduce industrial rates by 8.9% while raising residential rates by 4.8%.

renounced telemarketing. Many gas marketers plan to expand their offerings to include telephone service, Internet access, home security, energy management, and appliance sales and service.[186] Thus, it appears likely that retail gas monopoly, like the retail electricity monopoly, has generated at least modest price increases and prevented some new services from materializing. More recently the program has run into difficulties due to the high costs of natural gas.

In Virginia, the Commission's principal gas restructuring initiatives prior to 2001 were pilot retail choice programs offered by Columbia Gas and Washington Gas Light. Columbia's program allows certain customers to choose their gas supplier, with the utility providing unbundled transportation of the gas to the customer.[187] Washington Gas Light's program allowed 30% of customers to opt for a competitive gas supplier.[188] In 2002, all Washington Gas customers in Virginia will be eligible to choose their own gas suppliers.

It is likely that customers who opted for competitive suppliers saved substantial amounts of money during the winter of 2000-01, because such suppliers often offered fixed-price contracts. Between 1999 and 2000, the cost of gas passed through to Northern Virginia customers by Washington Gas approximately doubled, from 36 cents to 70 cents (or more) per therm. In early 2000, however, customers could sign a two-year contract with a competitive supplier to purchase gas at a fixed price of 30.9 cents per therm – a 15% saving compared to the utility's price in the winter of 1999-2000 and a 44% saving compared to the utility's price in the winter of 2000-01. Of course, customers signing the fixed-price contracts might have regretted doing so if prices had fallen, but the actual course of events suggests the powerful risk management role that flexible contract terms can play under retail competition.

Best Practices

Independent researchers and utility commissioners across the nation have reached a general consensus on the appropriate role for utility regulators in restructured markets. Instead of engaging in ratemaking and detailed oversight of an entire industry's costs to ensure that rates are 'just and reasonable,' utility regulators should promote and preserve competition wherever possible and engage in consumer education and protection initiatives.[189]

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[186] G.R. Hall (2000) *Consumer Benefits from Deregulation of Retail Natural Gas Markets: Lessons from the Georgia Experience,* study prepared for AGL Resources, Inc., by PHB Hagler Bailly, Inc.

[187] Authorized from 10/1/97-10/1/99 in Case PUE970455; expanded in Case PUE990245.

[188] Authorized for 20% of customers from 12/31/98-12/31/2000; in Case PUE971024, 30% of customers became eligible and the pilot program was extended until the Commission ruled on Washington Gas Light's proposal to offer retail choice to all customers.

[189] *Proceedings of the Second NARUC/NRRI Commissioners Summit,'* National Regulatory Research Institute (April 20-21, 1998); R.E. Burns et. al. (1999) *Market Analyses of Public Utilities: The Now and Future Role of State Commissions*, National Regulatory Research Institute, Columbus; D.E. Wirick et. al.(1998) *Organizational Transformation: Ensuring the Relevance of Public Utility Commissions*, National Regulatory Research Institute, Columbus.

Such broad principles are easy to state, but determining the 'best' regulatory practices to move from monopoly to competition is a daunting task. A Virginia-based think tank, the Center for the Advancement of Energy Markets (CAEM), has developed a list of attributes of sound electric restructuring plans and subjected it to critical comment and review by representatives of industry, consumers, regulators, and academic experts. There is room to quibble about some of the details, but the list developed by CAEM provides a useful framework for understanding what types of measures are required to accomplish a transition to genuine competition.[190] CAEM conducts periodic surveys of utility commissions to ascertain their progress on each attribute.

Electricity

For electricity, CAEM has developed a list of 22 policy and market structure attributes characterizing the openness of the retail market to competition. The list covers a broad range of areas, including existence of a restructuring plan, billing provisions, the nature of transactions in the wholesale market, and nature of the Commission's customer education effort. Exhibit 4E-2 derives a list of 'best practices' by indicating the practice that allows the state to achieve the best score under each attribute.

Gas

Similarly in gas, CAEM is identifying key attributes of the regulatory system that are crucial in the development of a competitive market. The list of attributes and results of CAEM's first survey of utility commissions on gas restructuring are not yet available, but Exhibit 4E-3 presents a list of best practices in gas restructuring that are analogous to those developed by CAEM in electricity.

SCC Regulation, Best Practices, and Industry Trends

Regulation in the Future

Electricity

Virginia has made substantial progress but is still short of the competitive ideal and the actual achievements of some states with the most successful competitive markets. In the initial 2001 RED Index (which assesses the status of restructuring as of the end of the year 2000), Virginia received 30 out of a possible 100 points, ranking 18th nationally but this rose to 45 points (ranking 9th) in July 2001. The raw score represents a large increase from the previous year, when Virginia received only 4 points. The state's ranking has improved dramatically in the past two years, rising from 50th in 1998 and 49th in 1999 (Exhibit 4E-4.) Nevertheless, Virginia still falls well short of the ideal, 100-point score, and its score is approximately half that of the Number1 ranked state, Pennsylvania.

Compared to neighboring states, Virginia clearly lags Pennsylvania, Maryland, and DC; is approximately even with Delaware; and leads Tennessee, Kentucky, West Virginia, and North Carolina (Exhibit 4E-5.) As Exhibit 4E-6 shows, Virginia's score places it roughly in the middle range of jurisdictions that enacted electric restructuring legislation in 1999 or 2000.

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[190] For a full explanation of the attributes and scoring, see 'RED Index 2001' at www.caem.org.

Because Virginia's restructuring legislation is quite detailed, a comparison of total scores is actually a combined assessment of the General Assembly's and the Corporation Commission's restructuring efforts. To more closely identify the effect of the Corporation Commission's specific contributions, Exhibits E-5 and E-6 also include a score calculated using only those elements of the RED Index for which the restructuring legislation either granted the Virginia Corporation Commission substantial discretion or offered no instructions at all. This scoring method does not change the results very much.

Whether one evaluates the overall restructuring plan or just the elements on which the Commission has discretion, Virginia qualifies as neither a leader nor a laggard. Several states that are either nearby or enacted legislation at the same time as Virginia have made much greater progress in electric restructuring. Virginia appears to be part of a middle group that is headed toward a competitive market, but moving more slowly than the leaders.

Another way of assessing Virginia's progress is to compare its regulatory environment and restructuring plan to those of the states with possibly the most successful and least successful competition initiatives – Pennsylvania and California. Such a comparison also aids in assessing whether Virginia is likely to experience price spike and reliability problems similar to those experienced in California. Key factors to consider include:

- *Supply constraints.* California has not built a new major generating plant or transmission line in a decade, suggesting that the state would have faced serious problems regardless of whether it had restructured its electric market. Pennsylvania and Virginia, on the other hand, are much more open to new construction. In the PJM Interconnection, which includes Pennsylvania, New Jersey, Maryland, Delaware, Washington DC, and part of Virginia, 150 new power projects are planned that will increase capacity by more than 70% during the next five years.[191] The Electric Power Supply Association, the trade association for non-utility power generators, lists approximately 7,000 MW of new plants planned to commence operations in Virginia by the end of 2004.[192] Approximately 100,000 MW of new generating capacity have been proposed in the region that will be covered by the Alliance RTO, the regional transmission organization that will operate the transmission grid in Virginia and several neighboring states.
- *Forced reliance on a volatile spot market.* California's restructuring plan mandated that its utilities had to divest their fossil fuel plants, buy and sell all power through a day-ahead spot market (the Power Exchange), and refrain from hedging the resulting price risks. Pennsylvania and Virginia permit utilities to own power plants, hedge, sign long-term contracts, and buy both through centralized markets and bilateral deals.
- *Barriers to retail competition.* Retail competition constrains firms' ability to pass on price increases to their customers, increases pressure to find the lowest-cost power supplies, and encourages innovative pricing plans that discourage price spikes by

[191] Phillip G. Harris, "Where Electricity Deregulation Works," *Wall Street Journal* (May 16, 2001).
[192] See www.epsa.org. This new capacity is an amount equal to approximately one-quarter of the peak load of Virginia's four investor-owned utilities.

making demand more responsive to price.[193] In California, retail competition for smaller customers has been quashed by a 10% mandatory price cut, automatic pass-though of wholesale power costs, and accelerated stranded cost recovery charges that customers cannot avoid if they opt for competitive suppliers. In Pennsylvania, retail competition has been encouraged because stranded costs are recovered over a longer period and customers who switch to alternative suppliers make a smaller contribution to stranded costs. It is unclear at this time whether Virginia's policies on price regulation and stranded cost recovery will lead its retail market to resemble California or Pennsylvania more closely. Virginia's interim price caps incorporate rate reductions from the most recent rate cases, and customers may not be able to reduce their stranded cost charges by switching suppliers. The legislation on default service enacted in 2001 gives some cause for hope, because it employs competitive market benchmarks rather than cost-of-service principles to regulate the price of default service if the power market in Virginia is not competitive after 2007.

In short, several factors suggest that Virginia is unlikely to replicate California's unpleasant price spike experience, but there is still a possibility that some elements of Virginia's restructuring plan could constrain retail competition in ways similar to those in California.

Gas

CAEM's evaluation of state gas restructuring plans is not yet available. However, Exhibit 4E-3 lists Virginia's progress to date on a list of attributes similar to those examined by CAEM's RED Index for electricity. Virginia appears to have made about the same degree of progress on gas restructuring as on electricity restructuring, with more or less progress on specific attributes. For example, a larger percentage of the retail gas market is open to competition, but adoption of uniform business practices awaits the development of such practices by the Gas Industry Standards Board. Whether Virginia leads or lags other states is unknown at this time.

25. The SCC should continue to foster more pilot programs in natural gas supply and accelerate the development of competitive markets in energy provision wherever possible.

26. There are several remits under which the SCC is required to consider matters pertaining to the environment, economic development, and consumer protection. To allow these broader matters to be dealt with adequately, the SCC should seek ways of allowing the widest sets of evidence to be brought to bear in cases.

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[193] Experimental evidence shows that price spikes are much less severe when buyers can make bids that reveal their willingness to reduce consumption in response to price increases. The investments in technology allowing customers to track and adjust electricity usage in real time may be much less costly than construction of new generation or transmission capacity. See S.J. Rassenti, V.L. Smith, and B.J. Wilson (2001) *Demand-Side Bidding Will Control Market Power, and Decrease the Level and Volatility of Prices*, Working Paper, Economic Science Laboratory, University of Arizona.

Exhibit 4E-1: DOE's Estimated Percentage Reduction in Delivered Electric Prices due to Competition (Year 2010)

	ECAR	SERC
Residential	14.7	10.4
Commercial	16.5	11.0
Industrial	5.6	0
Total	12.1	6.9

Source: Calculated from information in US Department of Energy, Office of Economic, Electric, and Natural Gas Analysis, *Supporting Analysis for the Comprehensive Electricity Competition Act* (May 1999), Appendix A.

Table 4E-2: 'Best Practices' Derived from Attributes in the RED Index 2001

1. Deregulation plan: The state has adopted a detailed plan to move from monopoly to competition and required utilities to make filings to implement that plan.
2. Eligible customers: 100% of the market is open to competition.
3. Customer switching: More than half of customers have switched to non-utility suppliers. (Actually a possible *result* of best practices rather than a practice itself.
4. Competitive safeguards: Monopolized transmission and distribution facilities are separated from competitive businesses.
5. Uniform Business Practices: State has adopted Uniform Business Practices for all utilities incorporating national industry consensus standards , including standards for Electronic Data Interchange.
6. Billing: Utility is permitted (but not required) to send a consolidated bill that includes charges for competitive power supplier chosen by the customer, and competing suppliers can choose whether they will bill customers separately or through the utility.
7. Metering: Metering is treated as a competitive service that can be supplied by a third party.
8. Generation market structure: State has taken initiatives to ensure that generation is largely privately owned, with significant ownership by non-utilities.
9. Wholesale market model: Regulators permit all buyers and sellers of power to transact both through power pools and through bilateral contracts.
10. Stranded cost calculation: There are no stranded costs to recover, either because there were none, regulators have chosen to prohibit recovery, or all permitted recovery has occurred. Any previously-existing stranded costs were calculated through a market test, such as auction or divestiture.
11. Stranded cost implementation: There are either no stranded costs to recover, or recovery occurs through a fixed charge that does not impair competition.
12. Customer information: The utility provides standardized, comprehensive information provided to marketers for customers who do not object to dissemination.
13. Customer education: Regulators undertake a customer education plan that includes feedback to measure its effectiveness.
14. Default service: None exists because all customers have switched. If a default provider still exists, any company is eligible to take on that role.
15. Default provider price risk: If a default provider exists, price changes are passed on to customers transparently, as they are billed.
16. Default rates: Default rates provide customers with an incentive to switch suppliers.
17. Performance-based pricing: Distribution facilities are subject to performance-based regulation rather than cost-of-service regulation.
18. Network pricing: Pricing of transmission and distribution facilities conforms to five principles:

    1. Transmission prices vary by distance and congestion pricing is prevalent;
    2. Distribution prices reflect differences in cost based on geography and vintage (when facilities were built);
    3. Distribution prices are offered on a time of use or real time pricing basis;
    4. Customers can choose reliability of distribution service; and
    5. Customers can choose the amount of service that they desire.

19. Distributed generation: Commission has adopted policies facilitating the interconnection of distributed generation with the grid.
20. Regulatory convergence: State integrates its decisions on electric and gas restructuring.
21. Commission reengineering: Commission has reformed its own organization and practices to adapt to the competitive model.
22. Budget: Commission has sufficient resources in the interim period to pursue restructuring initiatives as well as other regulatory responsibilities.

Source: Center for the Advancement of Energy Markets, *RED Index 2001*, available at www.caem.org..

Exhibit 4E-3: Virginia's Score on RED Index 2001 Electricity Attributes

Attribute	Status	Score
Has the legislature and/or Commission established a detailed restructuring plan?	Yes	8
What percent of customers are eligible to switch suppliers?	5	5
What percent of the load has switched?	1	0
What safeguards separate transmission and distribution wires from generation and marketing of power?	Functional separation required.	3
What Uniform Business Practices has the state adopted for utilities?	Statewide standards, including standards for Electronic Data Interchange.	5
What form does billing take?	Supplier and utility are permitted to send their own bills.	1.5
Does the state allow metering to be a competitive service provided by a third party?	No action.	0
Generation market structure: Are assets publicly or privately owned, and has state encouraged non-utility ownership?	No action.	0
Wholesale market structure: bilateral contracts, pool, or both?	Both permitted.	2.5
Procedures for stranded cost calculation.	Administrative proceeding.	1.5
How are stranded costs recovered?	Varied.	0
Availability of utility's customer information to marketers.	Standardized, comprehensive information provided to marketers for customers who affirmatively permit dissemination.	1.5
Customer education by the Commission.	Commission will engage in customer education, including assessment of its success in improving customer understanding.	3
Default service provider.	Utility is default provider.	-1.5
Can default rates be adjusted retroactively?	Yes.	-3
How is default rate set?	Not yet implemented.	0
Are distribution facilities subject to performance-based rates?	No action.	0
Transmission pricing	Cost-of-service.	0
Commission's policy on distributed generation.	None adopted.	0
Are gas and electric restructuring linked?	Integrated decisionmaking on some issues.	1
Has Commission reformed its own organization and practices to adapt to the competitive model?	No action.	0
Is Commission budget during transition period adequate to accommodate both traditional activities and restructuring activities?	Budget increased.	2
Total score (maximum 100 points)		30
State rank (50 states + DC)		18

Source: Center for the Advancement of Energy Markets, *RED Index 2001*, available at www.caem.org..

Exhibit 4E-4: Virginia's Natural Gas Restructuring (as of March 2001)

Attribute	*Status*
Has the legislature and/or Commission established a detailed restructuring plan?	Yes
What percent of customers are eligible to switch suppliers?	15-50
What percent of the load has switched?	15-43
What safeguards separate operation of pipes from acquisition and marketing of gas?	Functional separation required.
What Uniform Business Practices has the state adopted for utilities?	Awaiting development of national standards by Gas Industry Standards Board
What form does billing take?	Utility must offer consolidated billing, but supplier is permitted to send its own bills.
Does the state allow metering to be a competitive service provided by a third party?	No action.
Transportation market structure: Can competitive suppliers/marketers obtain their own capacity on interstate pipelines, or must they purchase capacity held by the local distribution utility?	Suppliers/marketers can purchase capacity from any source.
Wholesale market structure: Are competitive suppliers/marketers required to purchase gas from any particular party or course?	No. Contracting is bilateral.
Procedures for stranded cost calculation.	Commission has determined there is no stranded cost because utilities can re-sell unused interstate pipeline capacity.
How are stranded costs recovered?	No stranded costs.
Availability of utility's customer information to marketers.	Information on past 12 months of usage provided to marketers for customers who affirmatively permit dissemination.
Customer education by the Commission.	Utilities volunteered to conduct customer education.
Default service provider.	Utility is default provider.
What price risk does the default provider bear?	Purchased Gas Adjustment clause.
How is default rate set?	Default rate is wholesale rate passed through by utility under Purchased Gas Adjustment clause.
Are distribution facilities subject to performance-based rates?	No action.
How is long-distance gas transmission priced?	Cost-of-service regulation by the Federal Energy Regulatory Commission.
Is bypass of the local utility permitted, and if so, how can the local utility respond?	Bypass permitted, and utility can offer economic development rates to retain large users on its system.
Are gas and electric restructuring linked?	Integrated decisionmaking on some issues.
Has Commission reformed its own organization and practices to adapt to the competitive model?	No action.
Is Commission budget during transition period adequate to accommodate both traditional activities and restructuring activities?	Budget increased.

Source: Author's assessment based on criteria similar to those developed in CAEM's RED Index for electricity.

Exhibit 4E-5: RED Index Scores and Rankings, Virginia and Neighboring Jurisdictions

Jurisdiction	Total 2001 Score	Rank	Score on VA SCC Discretionary Attributes	Rank
Pennsylvania	66	1	34	1
Maryland	56	4	25.9	3
District of Columbia	47	5	23.7	5
Delaware	31	17	8	18
Virginia	**30**	**18**	**16.5**	**12**
West Virginia	17	22	5.6	21
Kentucky	3	26	0	23
Tennessee	0	28	0	23
North Carolina	0	28	0	23

Source: Center for the Advancement of Energy Markets, *RED Index 2001*, available at www.caem.org..

Exhibit 4E-6: RED Index Scores and Rankings, Jurisdictions Enacting Electric Restructuring Legislation in 1999 or 2000

Jurisdiction	Year Legislation Enacted	Total 2001 Score	Rank	Score on VA SCC Discretionary Attributes	Rank
Maryland	1999	56	4	25.9	3
District of Columbia	2000	47	5	23.7	5
New Jersey	1999	47	5	20.2	7
Michigan	2000	40	11	17	11
Texas	1999	37	14	17.6	9
Ohio	1999	37	16	17.5	10
Delaware	1999	31	17	8	18
Virginia	**1999**	**30**	**18**	**16.5**	**12**
Oregon	1999	21	21	6.6	19
West Virginia	2000	17	22	5.6	21
Arkansas	1999	14	23	6	20
New Mexico	1999	9	24	1	22

Source: Center for the Advancement of Energy Markets, *RED Index 2001*, available at www.caem.org

GMU Final Recommendations

(Final Report - August 31, 2001)

Assessment of the SCC

1. The structure of regulation in Virginia has stood the test of time well and change should only be undertaken in the light of serious long-term problems. Many sectors overseen by the SCC have been going through major technical and structural changes. In itself this is not justification for change unless lack of change impairs the long-term efficiency with which Virginian's can access these services. The SCC should retain its role as the body responsible for economic regulation of the sectors currently under its oversight. (p. 22)

2. The SCC should remain as independent as possible from short term political pressures. (p. 23)

3. The basic principle of regulation should be to allow the market to function and only to intervene when there are demonstrable market failures that appropriate regulatory control can be demonstrated to reduce. (p. 23)

4. The Commonwealth's structure of regulation was initially designed to deal with fundamental market flaws as perceived at the time. Our understanding of how markets function has subsequently changed as has technology. It is important to ensure that the workings and decisions of the SCC continue to take full account of this. (p. 23)

5. It is important that the SCC collects salient data and that this data adequately reflects the implications of its actions on consumers as well as on the industrial sectors under its jurisdiction. One of the most effective forms of consumer protection is good information. (p. 23)

6. The SCC should continually review the data that industry is required to provide and limit them to those that are necessary to fulfil its regulatory requirements. In doing this it should seek to minimize the burden on the regulated industries of providing data and other information. (p. 23)

7. The activities of the SCC should continue to be self-funded to avoid problems that many states have in achieving efficiency and effectiveness because of a dependence on annual state budgetary decisions. (p. 24)

8. The notion that the number of Judges should in fact be increased to five, with one being replaced each year, should be seriously considered. This would require Constitutional change. (p. 26)

9. Adequate resources should be provided to reduce the turnover of staff in the Office of General Counsel. This turnover at a minimum impedes the speed at which cases can be brought. (p. 26)

10. The State Corporation Commission should continue to explore ways of improving the public understanding of how it internally handles potential ex parte conflicts. It should continually seek ways to mitigate potential conflicts. (p. 27)

11. The current process of dispute resolution, with its informal and formal elements seems to work well if a little slowly at times. There is no recommendation of further informal 'alternative dispute resolution' procedures being required. More formality generally leads to even slower decision-making. (p. 27)

12. The similarities and interconnections between the regulatory demands in the fields of gas, electricity and water regulation justify the creation of a Directorate of Energy. (p. 28)

13. The various divisions should develop a system of performance assessment procedures suitable to their own activities. These should be quantifiable where possible but also contain qualitative indicators. Performance measured against criteria should be part of annual division reports. (p. 29)

14. All divisions of the SCC should engage in more public information dissemination and information gathering. The banking division runs a number of courses for the industry as well as periodic seminars - this type of model may usefully be replicated elsewhere. (p. 29)

Insurance

15. To ensure that emerging issues related to deregulation are built into future agreements, and that industry agents and agencies can give opinions confidently in such jurisdiction, the Bureau of Insurance should identify other states or countries with which Virginia currently has no reciprocity agreements, but which are most likely to establish them in the near future. (p. 40)

16. To continue to identify specific areas where threats to consumers' privacy may be at risk from increased reliance on electronic commerce, and develop effective measures to counter those threats. (p. 40)

17. The Bureau of Insurance should continue to work with the National Association of Insurance Commissioners to develop uniform 'treatment of companies' and 'market conduct' standards or regulations. (p. 40)

Finance

18. There have been a number of changes to the Virginian Banking Code over the years. A full review of the code should now be conducted. This should not be taken to imply radical change is needed but is a matter of 'good housekeeping'. (p. 51)

19. The Bureau of Financial Institutions has developed successful ad hoc ties with other Bureaus and Divisions within the SCC. These should be continued although there would seem no good reason for any formalization of the process. (p. 52)

Securities and Retail

20. The Securities Division would benefit from having more attorneys working with it. At present there is only one attorney in the OGC who works with the Division that deals with a growing market. The implications of the 1999 Financial Modernization Act and some internal adjustment of SCC rules and operation commands are likely increase pressure on attorneys. (p. 65)

Telecommunications

21. There are a variety of methods for measuring the effects of competition that go beyond price. With competition as the broad goal, it is essential to determine how to measure the attainment of that goal. Therefore, a system needs to be designed to establish the baseline (current state of competition) and then to monitor over time. (p. 81)

22. The activities of the collaborative committee are critical to competition in the Commonwealth. Therefore, it is important to continue to take steps to move the process along as quickly as possible. (p. 81)

23. The citizens of the Commonwealth are primarily restricted to local telephone service provision by one firm. Considering that the telecommunications industry is evolving rapidly, it is recommended that the Commission take periodic snapshots of available services across major telecommunications markets to determine if those services are available in the Commonwealth. If it is found that the Commonwealth is lagging, then the Commission can enter into discussions with local telecommunications providers to determine why. (p. 81)

24. In order to enhance competition in the Commonwealth, the SCC should continue to find additional ways to allow competitors into the marketplace as rapidly as possible. The current financial difficulties of the smaller CLECs combined with the inherent economies of scale indicate that the most immediate source of competition will come from the larger and more established firms. The current arbitration impasse is blocking the largest potential competitors. Methods of circumventing this problem should be sought expeditiously. (p. 82)

Energy (Electricity and Gas)

25. The SCC should continue to foster more pilot programs in natural gas supply and accelerate the development of competitive markets in energy provision wherever possible. (p. 101)

26. There are several remits under which the SCC is required to consider matters pertaining to the environment, economic development, and consumer protection. To allow these broader matters to be dealt with adequately, the SCC should seek ways of allowing the widest sets of evidence to be brought to bear in cases. (p. 101)

Recommendations

(1st draft, 5/29/01)

Assessment of the SCC

1. The structure of regulation in Virginia has stood the test of time well and change should only be undertaken in the light of serious long-term problems. Many sectors overseen by the SCC have been going through major technical and structural changes. In itself this is not justification for change unless lack of change impairs the long-term efficiency with which Virginian's can access these services. *(p. 24)*

2. The SCC should retain its role as the body responsible for economic regulation of the sectors currently under its oversight. *(p. 25)*

3. The basic principle of regulations should be to allow the market to function and only to intervene when there are demonstrable market failures that appropriate regulatory controls can be demonstrated to reduce. *(p. 25)*

4. The Commonwealth's structure of regulation was initially designed to deal with fundamental market flaws as perceived at the time. Our understanding of how markets function has subsequently changed as has technology. It is important to ensure that the workings and decisions of the SCC take full account of this. *(p. 25)*

5. The SCC should review the data that industry is required to provide it with and limit them to those that are necessary to fulfil its regulatory requirements. In doing this it should seek to minimize the burden on the regulated industries of providing data. *(p. 25)*

6. The activities of the SCC should continue to be largely self-funded to avoid problems that many states have in achieving efficiency and effectiveness because of a dependence on annual state budgetary decisions. *(p. 25)*

7. The number of judges should be increased to five, with one judge being replaced each year. Three judges should be involved in each case. This would (a) speed up decision-making, (b) allow for more fresh blood to flow over the bench, and (c) move away from the stove-piping of current system. *(p. 26)*

8. Adequate resources should be provided to reduce the turn-over of staff in the Office of the Council General. This turnover at a minimum impedes the speed at which cases can be brought. *(p. 26)*

9. The possibility of establishing an Administrative Committee (made up of Commissions together with a Director) to act as a formal link between the divisions and the judge should be given more serious thought. This would provide a formal mechanism to assist in *ex parte* separation between staff and judges. It would also add a further mechanism for the linking of various divisions when coordinated measures are required. *(p. 27)*

10. The current process of dispute resolution, with its informal and formal elements seems to work well if a little slowly at times. There is no recommendation of further informal 'alternative dispute resolution' procedures being required. More formality generally leads to even slower decision-making. *(p. 27)*

11. The proposal that a Commissioner for Utilities to over see matters relating to energy, telecommunications and water should not be pursued. The types of issue that have to be dealt with in these fields in the 21st Century are different and the expertise required different. Separate Commissioners for energy and for communications would seem more appropriate. *(p. 28)*

12. The various divisions should develop a system of performance assessment procedures suitable to their own activities. These should be quantifiable where possible but also contain qualitative indicators. Performance measured against criteria should be part of annual division reports. *(p. 28)*

13. All divisions of the SCC should engage in more public information dissemination and information gathering. The banking division runs a number of courses for the industry as well as periodic seminars - this type of model may usefully be replicated elsewhere. *(p. 29)*

Insurance

14. To ensure that emerging issues related to deregulation are built into future agreements, and that industry agents and agencies can give opinions confidently in such jurisdiction, the Bureau of Insurance should identify other states or countries with which Virginia currently has no reciprocity agreements, but which are most likely to establish them in the near future. *(p. 39)*

15. Identify specific areas where threats to consumers' privacy may be at risk from increased reliance on electronic commerce, and develop effective measures to counter those threats. *(p. 39)*

16. Continue to work closely, or expand current work efforts, with the National Association of Insurance Commissioners to develop uniformity in quoting rates, insurance forms, and filing requirements either nationally or among states with reciprocity agreements.*(p. 39)*

17. The Bureau of Insurance should work with the National Association of Insurance Commissioners to develop uniform 'treatment of companies' and 'market conduct' standards or regulations. *(p. 39)*

Finance

18. There have been a number of changes to the Virginian Banking Code over the years. A full review of the code should now be conducted. This should not be taken to imply radical change is needed but is a matter of 'good housekeeping'. *(p. 50)*

19. The Bureau of Financial Institutions has developed successful ad hoc ties with other Bureaus and Divisions within the SCC. These should be continued although there would seem no good reason for any formalization of the process. *(p. 50)*

Securities and Retail

20. The Securities Division would benefit from having more attorneys working with it. At present there is only one attorney in the OGC who works with the Division that deals with a growing market. The implications of the 1999 Financial Modernization Act and some internal adjustment of SCC rules and operation commands are likely increase pressure on attorneys. *(p. 62)*

21. The Securities Division has the highest turnover rate in the SCC. Measures should be taken to retain competent staff. *(p. 63)*

Telecommunications

22. The current mission statement and the defined roles of the Division reflect an environment that is primarily concerned with rate regulation, but the activities that take up most of the staff's time are those related to the Telecommunications Act. It follows that the Division should be focused on competition, which should be reflected more strongly in its mission statement. *(p. 76)*

23. There are a variety of methods for measuring the effects of competition that go beyond price. With competition as the broad goal, it is essential to determine how to measure the attainment of that goal. Therefore, a system needs to be designed to establish the baseline (current state of competition) and then to monitor over time. *(p. 76)*

24. The activities of the collaborative committee are critical to competition in the Commonwealth. Therefore, it is important to take immediate steps to move the process along as quickly as possible. *(p. 76)*

25. The citizens of the Commonwealth are primarily restricted to local telephone service provision by one firm. Considering that the telecommunications industry is evolving rapidly, it is recommended that the Commission take periodic snapshots of available services across major telecommunications markets to determine if those services are available in the Commonwealth. If it is found that the Commonwealth is lagging, then the Commission can enter into discussions with local telecommunications providers to determine why. (p. 76)

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Energy (Electricity and Gas)

27. There needs to be a change in philosophy from viewing regulation as a backstop in case competition fails, that could well produce a self-fulfilling prophecy, to viewing regulation as a means of promoting competition. *(p. 93)*

28. The SCC should foster more pilot programs in retail energy supply and accelerate the development of competitive markets in energy provision. *(p. 93)*

29. There are several remits under which the SCC is required to consider matters pertaining to the environment, economic development, and consumer protection. To allow these broader matters to be dealt with adequately, the SCC should seek ways of allowing a wider set of evidence to be brought to bear in cases. *(p. 93)*

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(2nd Draft - July 13, 2001)

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FINAL REPORT

ON THE

VIRGINIA STATE CORPORATION COMMISSION

by

Dave Wirick

John Wilhelm

The National Regulatory Research Institute
1080 Carmack Road
Columbus, Ohio 43210
(614) 292-9007
www.nrri.ohio-state.edu

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Part I: The Purposes and Occasion for This Report

> *We shall deal with our economic system as it is and as it may be modified, not as it might be if we had a clean sheet of paper to write upon; and step by step we shall make it what it should be, in the spirit of those who question their own wisdom and seek counsel and knowledge...*
>
> Woodrow Wilson, First Inaugural Address, March 4, 1913

While claims of dramatic change and great challenge in a field are usually an exaggeration, that is probably not the case where the subject is the regulation in a rapidly changing environment of vital sectors of the economy. Current developments in industry organization, technology, customer expectations, Federal activities, and attendant public policy are altering the provision of public utility, insurance, financial institutions, and securities services in fundamental ways. Intimately related to all this are the state regulatory commissions as both responders to necessary change and initiators of change. These roles often center around changes in mission, process, timeliness, and interaction with stakeholders including legislators. Of particularly current importance to state commissions is the recent and continuing introduction of market forces and competition into the utility industries that will ultimately substantially transform at least some portions of traditional public utility regulation in ways that may mirror the earlier transformation in insurance, banking, and securities regulation.

As each state regulatory commission undertakes an effort to transform itself to meet the demands of this emerging environment, it is often useful to conduct a self-assessment to identify the major issues involved and the options available to ensure effective, ongoing protection of the public interest – to paraphrase President Wilson's words, to question the prevailing wisdom and seek counsel from others.

Such a self-assessment also presents an opportunity for external stakeholders and commission staff to provide input into the direction of commission change and their assessment of the effectiveness of the commission's activities. It is often helpful to engage an outside consultant to assist in the conduct of that exercise by generating and

collecting input from affected parties, drawing on the experience of other states, and providing an objective "eye" for analysis of problems that may not be apparent to those who are immersed in the state regulatory regime on a daily basis.

Because it had been more than a decade since the Virginia State Corporation Commission (SCC) had conducted a thorough review of its organization, structure, and procedures, in January of 2000, the SCC contacted Dave Wirick of the National Regulatory Research Institute (NRRI) to inquire about the NRRI's availability to conduct such a review. In late April, a preliminary meeting was held in Richmond, and soon after, the NRRI began to arrange for the study. In the SCC's letter to stakeholders, the Commission said:

> During the past few years, state and federal legislation has dramatically altered and restructured the telephone, energy, banking, and securities industries. Major changes have also impacted insurance, our clerk's office, and taxation. In addition, technology has become a much more important part of how the Commission operates. In view of these many changes, the Commission is conducting a comprehensive study of itself this year. We are examining our structure, organization, and procedures to ensure that the Commission can best serve the people of the Commonwealth....We have asked Messrs. Wirick and Wilhelm to focus on a broad array of areas and issues including communications and leadership, both internal and external; commission structure; staffing; management and coordination among divisions; commission process; external relations; and consumer protection.

In order to provide adequate input for this review, the SCC identified an extensive list of stakeholders, inside and outside the Commission, to be interviewed. The list included consumers and their representatives, service providers from all parts and sectors of the industries within the purview of the SCC (including securities, insurance, financial institutions, electric utilities, gas utilities, telecommunications carriers, and water utilities), attorneys, public officials, and others. In the case of utility stakeholders, letters were sent by the SCC asking for their participation. Interviews and collection of documents by the NRRI staff (Dave Wirick and John Wilhelm) began in June. Four visits were made to the SCC, and external stakeholders were contacted by phone and, in some cases,

interviewed in person. An extensive array of persons including the Judges, Division Directors, and external stakeholders, were interviewed. Multiple meetings were held with SCC staff, including meetings with the staff of each Division. In addition to the interviews, the NRRI staff provided the opportunity for SCC staff to provide confidential input to them via telephone, letter or e-mail. A number of those responses have been received to date. The NRRI also had access to a number of SCC documents, including relevant legislative and historical documents, the 1987 *Report of the Joint Legislative Audit and Review Commission on Organization and Management Review of the State Corporation Commission* and the comments received from utilities related to SCC Case CLK000311, the Revised Rules of Practice and Procedure.

Because of the size and scope of this review and a desire for some short-term feedback, the SCC, at the request of the Virginia General Assembly's Joint Subcommittee Studying the Regulatory Responsibilities, Policies and Activities of the State Corporation Commission (hereafter referred to as the Legislative Study Committee), asked that the NRRI provide an interim report in August. The purposes of that interim report were twofold: 1) to provide a preliminary analysis of three important issues--structures for administrative oversight of the SCC, options available for oversight of the public utility Divisions, and the scope of SCC regulation (i.e., the appropriateness of maintaining at the SCC the regulation of public utilities, insurance, financial institutions, and securities)-- and 2) to identify other issues that the NRRI team might explore in the course of the study. In addition to identifying issues to address in its final report, the NRRI preliminary recommendations were:

Recommendation #1: The SCC should consider the establishment of a Director of Administration. That position will assist the SCC coordinate and deliver effective and efficient internal, administrative services to its operating divisions.

Recommendation #2: The SCC should not establish a Director of Public Utilities at this time and instead consider more carefully the role of the staff, the current organization of the utility regulatory

functions, and other organizational options. Though this report identifies some limitations posed by the current organization of utility staff, we are reluctant to recommend the creation of a Director of Public Utilities. Instead, the SCC should remain open to all options because of problems that might be created by combination of the telecommunications and energy industries under one Director.

Recommendation #3: The SCC should continue to be assigned the regulation of public utilities, securities, insurance, and financial institutions and that the regulation of those industries be looked to as potential models for public utility regulation.

The interim report was presented to the SCC and to the Legislative Study Committee in late summer. Since the time of the presentation of the interim report, the NRRI has continued to gather information about the SCC from stakeholders by phone and in person.

It is our conclusion that those interim recommendations remain sound for the reasons identified in the interim report. The analytic sections of that interim report are attached to this final report as Appendix 1.

A report of this nature, prepared by persons who are external to the daily work of the SCC, is by definition limited in its ability to craft solutions that might comport with local conditions and circumstances. However, given the depth of our information gathering effort, the apparent candor of those we interviewed, and our substantial experience with regulatory agencies, we feel fairly confident that we have accurately identified the key issues affecting the SCC and that our proposed solutions have some merit.

Unfortunately, regulatory solutions cannot simply be imported from other jurisdictions; what works in one state may not be optimal in another. There is, in addition, no single, right answer to the regulatory dilemmas affecting states. It is our strongly held

opinion, however, that solutions can be created to these issues and that an effective and strong role can be devised for the SCC that is driven by the regulatory conditions in and needs of Virginia. There exists a large body of common interests among the regulatory stakeholders in Virginia, interests that include customer service and the maintenance of effective, professional regulatory mechanisms. Based on those common interests, creative and workable solutions are sure to emerge from the combination of this NRRI review and the legislative review, which is also in progress.

The purpose of this study is not to attempt to correct past perceived mistakes or to analyze historic events and lay blame for them. The past is only relevant to the extent that it sheds light on circumstances that may impact the SCC from this day forward. Our purpose, in fact, is to shift the focus of the SCC investigation from the past to the future. We are attempting, therefore, to find organizational and procedural methods that may assist the SCC accomplish its mission well into the 21st Century.

We have attempted to produce a report that responds to the needs of a variety of persons. For those who find value in the exchange of emotions, we have provided the opportunity for many people, both inside and external to the SCC, to vent if necessary and state their opinions in a safe environment with some assurance that their feelings will be taken into account and given adequate airing and with full assurance that their anonymity will be protected. For those who seek mental models with which to organize their experience, we have employed an integrative model of regulatory commission operations in these changing times and linked our findings to the extent possible with that model. And for those who seek action, our conclusions and recommendations are intended to point the SCC in the direction of potentially beneficial change.

It has been our pleasure to work with the Judges and staff of the SCC, the Legislative Study Committee, and the many stakeholders of the SCC. Our task has been made easier by their willingness to share their time and their ideas. We hope that our report, conclusions, and recommendations measure up to the level of trust they have afforded us.

Part II: Discussion and NRRI Recommendations

Section 1. Overall Findings

The SCC is, without question, an influential agency, unique in the nation in its breadth of responsibilities. According to the 1987 Report of the Joint Legislative Audit and Review Commission,

> The SCC has broad powers. Created as an independent agency outside the three branches of State government, it exercises legislative, judicial, and executive powers as set out in the *Constitution of Virginia*. In this capacity, it represents a departure from the separation of powers doctrine which affects the role and organization of the rest of the State government.

According to one observer, the SCC has "...become the single most influential public body in implementing Virginia's business and economic policies; its regulatory actions ultimately affect all Virginia citizens."[1] Being established by the *Constitution*, the SCC is more independent than other state agencies and has better continuity of staffing and leadership.

Overall, it appears that the SCC has been successful in accomplishing its broad and critical mission and is highly esteemed by many. It is, for the most part, regarded as a high-quality, effective organization that is tough but fair. The Judges and staff are cited, nearly universally by those interviewed, as being professional, knowledgeable, and hard working, and it is widely believed that they have a public interest orientation and that consumers are represented well, either by the Office of the Attorney General or the SCC, as is required by statute. Decisions are rarely overturned by the Virginia Supreme Court, and staff consistently refer to the SCC as an excellent place to work. The standards of comity in SCC interactions with the public and jurisdictional utilities are high. There is a

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[1] William J. Bridge, "The Virginia State Corporation Commission: A Primer," *Virginia Lawyer*, February 1996, 34.

feeling on the part of some that the SCC does not do a good enough job of letting people know of its considerable accomplishments.

Since its inception, additional regulatory responsibilities have been added to the SCC's list of responsibilities. The SCC was established in 1902 to regulate railroads, telephone and telegraph companies, to grant charters of incorporation in Virginia, and to administer corporate laws. Insurance regulation was added in 1906, banking regulation in 1910, rate regulation for public utilities in 1914, the regulation of investment securities in 1918, motor vehicles in 1923,[2] and trademarks in 1948, service marks in 1958, and franchise regulation in 1972 . The addition of these responsibilities can be taken as an endorsement of the early success of the SCC.

The Virginia SCC has also been a leader nationally. The SCC, for example, was among the first state commissions to allow long-distance competition and alternative methods of price regulation. In addition, SCC staff are prominent among their national peers and in the relevant professional organizations. Several respondents expressed the opinion, however, that the SCC appropriately has chosen not to be a national leader but to wait to judge the experiences of those who had been early adopters of innovative regulatory strategies in order to best serve the citizens of the Commonwealth. With regard to financial institutions, insurance, securities regulation, the Office of the Clerk, and Public Service Taxation, negative comments were hard to come by. The apolitical and professional structure established in Virginia for regulation of insurance, financial institutions, and securities appears to be the envy of regulators around the nation and is overwhelmingly supported by the external stakeholders of those divisions. One respondent argued that the current method of insurance regulation has produced some of the best insurance rates in the nation for Virginia's consumers. Another pointed out that in the banking crisis of the late 1980s and early 1990s, Virginia chartered banks faired well in terms of safety and soundness. Another stated that the Securities Division has created a balance between industry assistance and protection of the public, a balance that is not

[2] The 1995 General Assembly passed legislation moving the SCC's motor carrier responsibilities to the Virginia Department of Motor Vehicles and the Virginia State Police.

often created in other states. The Public Service Taxation Division and the Office of the Clerk were cited as being accessible and responsive. For the Office of the Clerk, which interacts with the public in encounters of typically short duration, being regarded as accessible and responsive is, perhaps, the best outcome that can be achieved and highest praise it can hope for.

The linking at the SCC of financial institution, insurance, and securities regulation in one agency, though not to our knowledge accomplished anywhere else in the U.S., is the model adopted by Japan, Canada, the United Kingdom, and Australia.[3] It is a model that may serve well into the future given the direction of those industries and the implications of the Gramm-Leach-Bliley Act, which allows financial holding companies to engage in such activities as insurance underwriting and sales, securities underwriting and dealing, and merchant banking.

In summary, with regard to its professionalism and past successes our conclusions are that:

- The SCC staff and Judges are hard working and highly competent.
- The SCC is committed to its tradition of public service.
- The SCC has been one of the national leaders in effective economic regulation.
- Stakeholders in the insurance, financial institutions, and securities industry very strongly support the placement of those functions at the SCC and the relative independence from political influence that the placement within the SCC provides.
- The combination of the regulation of public utilities, insurance, financial institutions, and securities companies within one agency is a regulatory model that seems to be justified, functional, and even better suited to

[3] George Nichols, President of the National Association of Insurance Commissioners, as quoted by Amy S. Friedman, "State Insurance Regulators Work to Keep Role," October 23, 2000

the current and evolving environment within the industries than was the case when those functions were assigned to the SCC.

! To extensively alter the basic structure of the SCC, in order to resolve problems that have arisen relatively recently, would be a mistake.

Despite the many laudatory comments, serious questions were raised during our investigation by many of the utility industry stakeholders interviewed for this report about the SCC's role in utility policy making and implementation of public utility law, whether or not it is acting within the constraints and intent of public utility legislation, the role and independence of staff, its response to utility industry changes, and its role in the future. Though these comments were nearly uniformly negative, there was some lack of consistency among them in terms of the impact of SCC actions, related, in some cases, to the perceived needs of the company the respondent represents.

It should not be surprising that the SCC's jurisdiction over energy and telecommunications markets received the most critical commentary by stakeholders. Those markets are currently undergoing more changes than other markets regulated by the SCC. Significant financial investments are at stake in a period of high volatility, and in that period of volatility stakeholders, policy makers, and the SCC are coping with uncertainty. As that volatility subsides, some amount of the contentiousness currently attendant to telecommunications and energy issues may naturally subside. The challenges today are to attempt to determine which criticisms of the SCC are "just" and which might be the simple result of uncertainty and change and to determine how the SCC might best function in these volatile times making appropriate use of the creative tension caused by change.

The bulk of the criticisms of the SCC addressed its performance in the transition to more competitive markets in the public utilities. In particular, its interaction with the Legislature was cited by some as being less than cooperative and supportive with regard to electric industry restructuring. Several people suggested that when the legislature asked the SCC how to create effective electricity markets, the SCC said, "you can't" – that the SCC gave the Legislature problems not solutions, leaving substantial hard feelings in

its wake. Some argue that the SCC has not adopted a pro-competitive posture, that it is acting as if the environment hadn't changed, or that it is attempting to slow change. In contradiction, others argue that the SCC's approach to competition in has been to handicap incumbent firms in favor of competitors and that it has exceeded its authority under the law, particularly with regard to the application of a "wires charge," which they believe was not the intention of the legislature. Others cite the failure of a collaborative effort on a pilot program due to SCC intervention at the Judge level after the process had reached what they regarded to be a fair conclusion.

In telecommunications, some argue that the SCC has not adequately embraced the potential for competition and that new entrants have been disadvantaged. SCC delays, it is argued, have created difficulties for new entrants which benefit the incumbent providers. One person interviewed suggested that the SCC is, in principle in favor of competition but, by moving slowly, has provided an advantage for incumbents. The creation of local competition, others argue, is not a priority of the SCC. Again in contradiction, others argue that the SCC staff has reacted to competition by attempting to ensure the success of new entrants to the disadvantage of incumbents. A criticism was also lodged about the SCC's refusal to arbitrate interconnection disputes as provided under Federal law. The result, it is argued, is that interconnection agreements, critical to telecommunications competition, are not being arbitrated at the state level, thereby forcing new entrants to seek redress at the Federal Communications Commission, which, it is alleged, is moving far too slowly. The SCC argues that it does not have the authority to waive the Commonwealth's sovereign immunity.

Across the utility sectors, some have concluded that the SCC has not made the cultural and behavioral shifts necessary to effectively employ competition; that the SCC approach is too heavily adversarial; and that the SCC has not moved quickly enough to create industry change. Overall, the comments of the utilities regulated by the SCC were more robustly negative than the comments of the attorneys who represent those utilities and often interact directly with the SCC. In its defense, the SCC argues that it is exercising necessary caution in order to protect the public during the course of industry change and

that part of its mission is to point out potential problems before they impact the public. Others also point out the massive amount of work accomplished by the SCC in developing rules for competition, developing electronic data interexchange protocols (EDI), meeting with competitive service providers, developing a phase-in plan, and developing a customer education plan.

Of additional concern is the direction that the SCC is perceived by utility stakeholders to be heading. Several respondents indicated they feel that the SCC is headed in the wrong direction, that what was once regarded as an effective regulatory body, one of the best in the nation, is no longer as effective and may not have adapted to the new regulatory environment.

It is problematic that neither those firms that would like to enter newly competitive markets nor the incumbent firms believe that the SCC is appropriately implementing legislation designed to create those more competitive markets. If one side were substantially more aggrieved than the other, one might be more easily able to draw conclusions about an inappropriate "tilt" in one direction or the other. It is also difficult, under these conditions, to find common ground. One might be tempted to conclude, in fact, that this substantial disagreement among the parties about the competitive stance of the SCC, coupled with the nearly unanimous regard for the competence of the staff and Judges, might be an indicator of considerable success on the part of the SCC. Indeed, before the advent of more competitive utility markets, balance between the parties (i.e., no one too well off; no one under hardship) was regarded as a fairly good indicator of regulatory commission success. More will be said later in this report about the importance of effective SCC performance assessment.

More, however, is obviously involved. That neither incumbents, new market entrants, nor the legislators who enacted restructuring policy are pleased with the SCC's implementation of competition is telling, as is the relative vehemence of the comments provided to the NRRI. Irrespective of its specific positions on key competitive issues and whether or not the SCC is anti-incumbent, anti-competitor, or appropriately balanced (a

determination that is beyond the scope of this study), our conclusions are that, with regard to utility industry restructuring:

- The SCC has not created an adequate understanding of its mission and effectiveness among many of its stakeholders;
- The SCC has not convinced its stakeholders that it is as firmly committed to competition as the Legislature, which in the final analysis must be the lead entity in the creation of policy;
- The SCC has not created an effective partnership with the Legislature;
- The SCC has not thus far successfully implemented non-adversarial processes that build consensus among stakeholders;
- The SCC may not be appropriately structured and armed with the right tools for success in changing times.

More will be said later in this report about the SCC structure and process.

Addressing these conclusions and preparing for the future will require difficult tasks that fall well outside the traditional mission and operations of a state regulatory commission. It is not surprising that the SCC may have struggled to accomplish these tasks. Commissions around the nation are struggling with the same issues. Recommendations addressing the accomplishment of these tasks will be listed in later sections of this report, principally in the section addressing SCC participation in the policy making process.

Our overall solution to repositioning the SCC for more competitive utility markets and for regulatory success in general is the application of a five-part model of regulatory agency success developed by the authors that is described below. For each of those five elements, the performance of the SCC is examined and recommendations for more active and complete implementation of those elements are suggested in sections following the general description of the model. Separate sections following the application of the five-part model detail other specifically identified SCC issues and problems that did not fit

neatly into the application of the model (SCC Organization, Performance Assessment, Staff Training, Recruitment, and Retention).

The Five-Part Model for Regulatory Commission Effectiveness

As indicated above, our recommendations are based on a five-part model for regulatory effectiveness illustrated in Figure 1.[4] That model is itself driven by our overall, national perceptions that regulatory commissions, in the evolving economic and social environment need to:

! Turn outward. In addition to the use of competitive markets, regulatory commissions need to and are becoming more attentive to the needs of consumers and the concerns of legislators. Creating methods of gathering more information and finding ways to encourage dialogue about utility sector issues are on the agenda in many states. Though some commissions regarded a relationship with the state legislature in the past as unnecessary or even inappropriate on the grounds of "judicial" independence, it is hard today to find a state regulatory commission that is not serious about bettering its legislative relationships.

! Attempt to become less adversarial. Regulation was predominantly based in the past on adversarial, quasi-judicial processes. There is now more recognition that those adversarial processes, though still effective for some purposes, are limited in others and create unintended outcomes that may not serve the public interest. According to Carrie Menkel-Meadow, adversarial processes force parties into "attack and defensive postures which then may inhibit creativity in

[4] This model was initially detailed in Dave Wirick, "The Building Blocks of Regulatory Success in the New Era," *NRRI Annual Regulatory Review*, forthcoming March 2001.

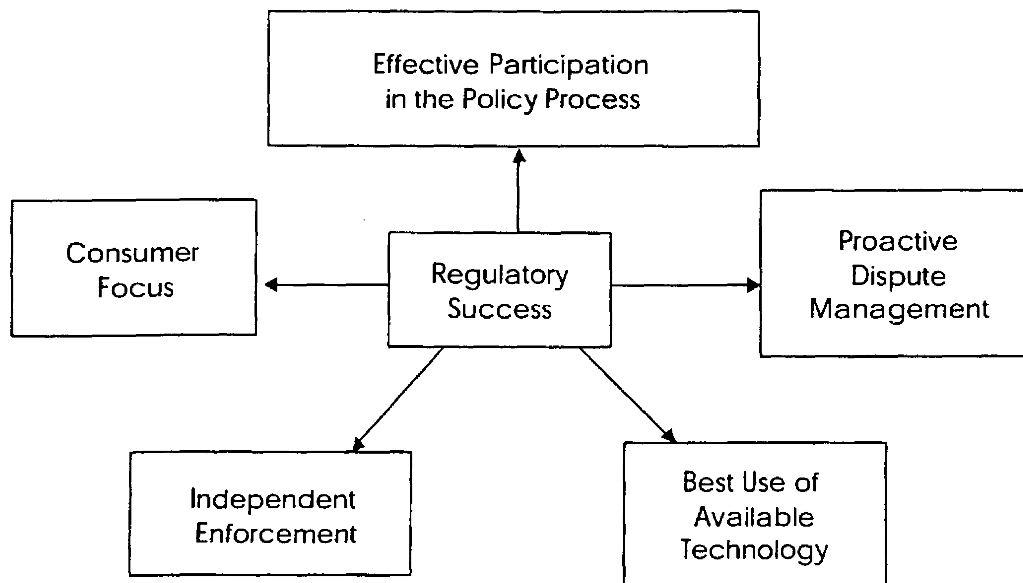

Figure 1: Five building blocks
of regulatory agency success.

finding solutions;"[5] according to Gregory Bateson, they lead to "symmetrical schmismogenesis" in which each party does more of the same thing in reaction to the other;[6] and according to Alfie Kohn, they lead to MEGA (mutually exclusive goal attainment), in which my success is dependent on your failure.[7] Today, alternative means of dispute resolution are getting more attention at federal and state regulatory commissions.

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[5] Carrie Menkel-Meadow as cited in Deborah Tannen, *The Argument Culture: Moving From Debate to Dialogue* (New York, NY: Random House, 1998), 164.

[6] Gregory Bateson as cited in Deborah Tannen, *The Argument Culture*, 165.

[7] Alfie Kohn, *No Contest: The Case Against Competition* (Boston, MA: Houghton Mifflin, 1986), 4.

- ! Reestablish consensus among stakeholders about regulatory methods and institutions. To be effective, regulatory processes and institutions must operate with the consent of those they govern. That consensus has eroded in some cases and many stakeholders are seeking new ways to pursue their legitimate interests, ways that may serve to end the monopoly that public service commissions maintained over the development of utility policy. Commissions are also actively seeking to build new relationships with legislators, relationships that were once thought unnecessary or which were damaged in the industry restructuring process.

If regulatory commissions are to remain relevant and effective, in addition to these general directions, they need to refocus their missions, processes, and skills. The five elements of our model for regulatory success include:

- ! Independent enforcement of industry laws and policies. Even though commissions are becoming more involved in industry-wide policy making, they will still need to accomplish company-specific functions. When individual firm issues are before a commission, due process protections must remain in place. When commissions exercise their power to sanction or penalize individual firms for violation of standards or take action against single firms for perceived unfair trade practices, they should continue to operate free of political influence using appropriate quasi-judicial procedures.
- ! Effective participation in policy making processes. When commissions are involved in the policy-making process, they must operate in concert with other policy making bodies. Legislators and other agencies have roles in policy making; the policy making "space" must, therefore, be shared between commissions, who hold substantial expertise in these

fields, and legislators, who are ultimately responsible for policy success or failure. Successful commissions will find ways to support legislative decision making and apply their expertise in the public interest, sometimes on an issue-by-issue basis as legislative preferences for involvement change.

! Proactive dispute management. William Ury has described a conflict management model that relies more on prevention and collaborative resolution than intervention, which has been the principle tool applied by regulatory commissions.[8] He suggests that a valid strategy for managing disputes is "contain if necessary, resolve if possible, best of all prevent."[9] That simple model, however, turns the typical model of regulatory commission operations on its head. Some regulatory agencies have begun to employ education as a means of preventing problems and collaborative processes as a means of resolving them. In the current economic, political, and societal environments, more use of these types of dispute transformation processes will be required.

! A consumer focus. The traditional focus of regulatory commissions has been on the industries that they regulate. Consumers are becoming more demanding of high levels of service in all areas. As these consumers become more demanding and powerful through access to information, public interest goals may be able to be effectively and efficiently accomplished through commission attention to their needs and decreased attention to the internal workings and financial structure of service providers.

! The best use of information technology. The availability of information and the speed with which it can be processed will surely change the

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[8] William Ury, *The Third Side*.

[9] Ibid., 113.

regulatory environment and regulatory institutions. Currently, regulatory commissions are seeking to employ modern information technology largely to support traditional processes through the use of electronic filing and docket management systems. A wider view of the use of information is required along with integration of information systems into the strategic direction and mission of the commission. New sources of information will be necessary for interacting with consumers and monitoring markets, and information that supports the performance assessment of commissions will need to be gathered. What is required is, in the terminology of the telecommunications industry, a "wider bandwidth" of commission information and an analysis of the "information ecology" of the regulatory process.[10]

Based on this model, our most general recommendation is:

Recommendation #4: The SCC should embark on a process of strategic planning and organizational redefinition based on independent enforcement of laws and policies, effective participation in the policy making process, proactive dispute management, a consumer focus, and the best use of information technology.

Appendix II to this report describes an implementation model for the types of strategic planning suggested here.

Implementing this five-part model of regulation will take time for all regulatory commissions, substantial change in commission skills and roles, and an extensive dialogue between the commissions and a wide array of stakeholders including legislators,

[10] The phrase "information ecology" is used and explained in William Davenport with Laurence Prusak, *Information Ecology: Mastering the Information and Knowledge Environment* (New York, NY: Oxford University Press, 1997).

consumers, and service providers. New commission skills will be required in information gathering and dissemination; mediation, arbitration, and facilitation; market analysis and monitoring; and consumer interaction. New roles for public utility commissioners around the nation will be required as well. Though their judicial role may be reduced, they will need to become policy leaders, advocates of conflict resolution, consumer advocates, legislative advisors, facilitators, and chief information officers, a role that will not require that they be the person at the commission most expert in the latest technology but a person insistent on the collection, dissemination, sharing, and use of the best available information that facilitates the accomplishment of the commission's mission.

In many ways, the SCC has already begun to move in these directions. Evidence of its efforts include (in a non-exhaustive list), the SCC's Revised Rules of Practice contain a provision for electronic filing of documents, the SCC has established a "Collaborative Committee" to consider and recommend market opening measures in telecommunications, a collaborative process is underway to craft a report on metering and billing, the Bureau of Insurance allowed the creation of an informal alliance of insurance carriers to address a potential insurance coverage shortage, the Bureau of Financial Institutions was cited as having "come a long way" under Commissioner Face in its use of information technologies, SCC staff have completed 54 settlements in the last few years, and Division of Securities and Retail Franchising is cited as being open to consumer input.

Each of five elements of the regulatory model, the status of the SCC's implementation of each, and a series of recommendations will be explored in turn in the following sections.

Part II: Discussion and NRRI Recommendations

Section 2. Independent Enforcement of Industry Laws and Policies

One traditional function of state regulatory commissions has been the establishment of rates for regulated companies. These rate-setting functions have, over time, atrophied in most segments of commission jurisdiction, to be replaced by a mix of industry wide policy making and the maintenance of effective markets through the analysis of and ruling on issues that effect single companies. These market maintenance activities are themselves a mix of enforcement activities against those firms that violate standards and consideration of single-company issues (e.g., requested mergers and acquisitions) that may diminish the effectiveness of workable markets or which might be regarded as unfair trade practices. With regard to the SCC's regulation of insurance, financial institutions, and securities, the distinction between industry-wide policy making and single-company activities seems to be clearly drawn. For public utility regulation, the distinctions are less clear, presumably due to the fact that public utility markets are not as "mature" as financial institutions, insurance, and securities markets, which have been competitive for decades.

In any event, despite the long-term movement towards competition and the resulting change in the emphasis of commission activities toward more policy making, regulatory commissions will, for the foreseeable future, still be involved in some instances in quasi-judicial activities. When those types of activities are undertaken, due process protections must be observed.

As commissions across the nation go, the SCC is regarded as being fairly "judicial" in its approach to performing its functions. This is both an advantage in terms of increased credibility and careful process and a disadvantage in terms of flexibility and consumer-friendliness. Staff and Judges were praised for their diligence, expertise, and ability to run a tight courtroom. With the exception of comments regarding utility regulation, the SCC was frequently described as "fair" in its determinations, though some utilities expressed concern that after-the-fact action by SCC Divisions prevented them from earning the rate of return allowed by SCC proceedings. Others expressed the opinion that audit staff is

adequately monitored and controlled and that appeals processes (formal and informal) are adequate. Though the exercise of power by field staff must be carefully monitored, allegations of improper coercion were not widespread and staff were generally complimented for their professionalism. Our overall conclusion in regard to the SCC application of judicial processes is that:

! In general, one traditional strength of the SCC is its professional application of quasi-judicial processes and due-process protection of those appearing before it, with the exceptions noted below.

Many stakeholders, however, were concerned in more general ways with the role of the SCC staff, particularly in regard to electricity issues. A two-way problem was cited – staff not adequately insulated from the Judges and staff too close to the Judges and able to influence them in contested matters without disclosure of that interaction to the other parties. Some were concerned that the Judges influence staff in the development of the staff case, though Judges encourage debate and disagreement if necessary. (It is a natural reaction for commission staff to attempt to meet the expectations of commissioners.)

Other stakeholders were concerned that there is not adequate *ex parte* separation between the staff and the Judges as will be described in more detail later in this section. The result, they contend, is that staff have an opportunity for "two bites of the apple" by presenting a staff position on the record and then being able to influence the decision of the Judges by contact off the record. If legal staff then write draft SCC orders, they are perceived as being allowed "three bites of the apple." These concerns were expressed by at least two of the parties to the SCC in the comments received to the SCC's Revised Rules of Practice and Procedure though SCC staff report that other stakeholders indicate that current rules work well. As a result, our conclusion is that:

! The role of public utility staff at the SCC is fairly widely perceived as being not adequately separated from the Judges for the purposes of

due process protection in contested cases. A more clearly defined relationship between advocacy staff and the Judges is warranted.

Creating the right balance between the advisory role of regulatory commission staff and their advocacy role is a constant challenge at all commissions. The SCC is a court of record and as such renders orders much like other courts. The hearings establish the case record, and the legal issues are often so complex that the judges/commissioners consult before issuing written orders, sometimes with dissenting opinions. On occasion, particularly when the issues under consideration are agreed to by stipulation between the parties, Judges/commissioners do rule directly from the bench with a written order to follow.

The SCC has adopted a model of Judge-staff interactions that minimizes *ex parte* separation between the Judges and the staff. Because the SCC staff is not regarded as a party to a case, the parties may independently contact them at any time. As a result, information provided to staff by one party may not be known to another.

The impact of fairly loose SCC *ex parte* separation is exacerbated by that fact that it appears that no "public meetings law" prohibits the Judges from discussing cases among themselves in private; one person interviewed complained that the SCC makes decisions in secret. Some other states also apply an *ex parte* staffing model similar to the SCC model, in which staff are regarded as participants but not parties. Other states employ more rigorous *ex parte* models. Some of the other models are:

! Creation of an *ex parte* wall "by memorandum" for each case. In this model, commission staff are identified as being on one side of the wall or the other on a case-by-case basis.

! Application of a "rule of reason," in which the role of staff is defined in each case based on the most effective use of the staff. This model is in use in New York and requires a high level of trust between the commission and the parties.

- ! Creation of an advocacy staff unit within the commission staff. This "public advocacy section" is permanently designated as "off limits" to commissioners within the context of cases before the commission.
- ! Creation of a permanent and nearly inviolable *ex parte* wall between commissioners and staff, a wall typically policed by an executive director.
- ! Designation of certain staff positions (e.g., division directors) as being both advisory and advocacy staff while the remainder of the staff is designated as advocacy staff.
- ! Separation of staff from commissioners by creation of a separate department of state government charged with the responsibility for advocacy in matters before the commission.

The challenge in creating workable models of *ex parte* separation is to create adequate separation without denying commissioners access to the staff expertise they need, particularly given the increasing complexity of issues that commissions must contend with. In our opinion, creation of a rigid and permanent *ex parte* wall, either as an internal method or organization or creation of a separate agency, may be wasteful and likely to create unhealthy isolation of the Judges from expertise that they (or any other person in a similar position) need. The first model listed above (i.e., the creation of a public advocacy section within the commission) is only now being attempted by one small state; no experience data is available. The fourth option (i.e., identifying certain positions as both advocacy and advisory), though in use in a neighboring state for some time, may be confusing and may not accomplish adequate *ex parte* separation in the minds of external stakeholders.

When the independence of staff from commissioners is secured, secondary problems can arise. Independent staff are not directly accountable to elected or appointed officials, as a result, they are free to adopt positions without oversight. If commissioners are not provided adequate staff assistance, the power of the independent staff can grow

unchecked, and commissioners may become unduly dependent on them. It is sometimes unclear whom independent staff represent.

We are usually reluctant to endorse or recommend the application of methods that will create stronger adversarial processes in an environment that is in need of more collaboration and less adversity. Nonetheless, it is our recommendation:

Recommendation #5: The SCC should adopt a stronger model of *ex parte* separation between the staff and Judges by implementing the least disruptive model possible and proceeding from there to adopt stronger models only if the model adopted does not create the perception of adequate due process protection. In our view, the least disruptive option may be identification of advocacy staff "by memorandum" in each Commission case (i.e., identification of which staff in each case serve an advocacy role). No matter the model adopted, Judges, though they are highly competent and hard-working individuals, must continue to receive adequate staff support and advice.

In Virginia, the Division of Consumer Counsel within the Office of the Attorney General is allowed to intervene on the behalf of consumers in SCC cases. There is a publicly funded consumer advocate or a separate division inside the commission exclusively responsible for consumer representation in many states including Virginia's neighbors, the District of Columbia, Maryland, and West Virginia. Consumer representation is accomplished by the office of the attorney general in Alabama, Arkansas, Iowa, Kentucky, Massachusetts, Michigan, Minnesota, Mississippi, Nevada, New Mexico, North Carolina, Oklahoma, Pennsylvania, Tennessee, and Washington.[11] Non-attorneys

[11] Utah Public Utilities and Technology Interim Committee of the Utah State Legislature Concerning HB 320 Interim Review–Utility and Consumer Advocate Agencies, "Survey of State Utility Consumer Advocates," June 14, 2000.

may not intervene in SCC formal proceedings as representatives of groups, though non-attorneys may intervene *per se*. The requirement that groups wishing to be represented must retain an attorney may create a cost barrier for some intervenors.

Like the comments provided about the SCC staff and Judges, those interviewed were complimentary in regard to the ability and professionalism of the Attorney General's office when it intervenes in cases. It was reported that what the Attorney General's office does, it does well. Some were concerned, however, that resources dedicated to that office may not be adequate, that turnover among that staff has been hurtful, and that the Attorney General's office chooses when to intervene and may not be present in cases deemed to be critical by some of the parties. A small staff in that office is responsible for consumer intervention across the full breadth of SCC responsibilities, though the intervention does not seem to be balanced across all industries and is focused on public utility issues. Some suggested that the SCC staff attempt to represent consumer views if the Attorney General's office does not intervene and it does not appear that consumers are otherwise being heard, as is required by Virginia law. Overall, with regard to consumer representation in SCC quasi-judicial processes, it is our conclusion that::

! Consumers are generally regarded as being adequately represented in SCC processes, and no structural change in consumer representation is immediately required though an increase in resources made available to the Attorney General would increase the ability of that office to intervene when deemed necessary and to become more active across the range of SCC issues. With additional resources, that office might also provide counsel for those intervenors unable to retain their own counsel.

Though this report is focused on the SCC and not the Division of Consumer Counsel and no structural changes in consumer representation is warranted, it is our recommendation, based on our interviews, that:

Recommendation #6: More resources should be provided to the Office of the Attorney General so that it might participate in more matters before the SCC and ensure representation of consumers across the full breadth of SCC responsibility.

Recommendation #7: The SCC and the Attorney General should create a dialogue to identify how to ensure that the Attorney General's office is engaged in all of the cases that warrant explicit consumer representation.

More will be said in a later part of this report about ways to make the SCC more "consumer friendly" and capable of outreach to consumers.

Finally, with regard to traditional, quasi-judicial operations, several internal issues arise. The first is the use of current information technology, which will be dealt with later in a separate section of this report. Concern was expressed, however, in regard to the fact that the SCC is still requiring annual filings from electric utilities no longer subject to rate regulation. The SCC argues that it has reduced filing requirements but that certain information is still required to support the continuing regulation of portions of utility service delivery and to provide information to the Division of Public Service Taxation, which is responsible for the assessment of state and local taxes.

The second internal issue relates to the SCC's application of quasi-judicial procedures is the organization of energy regulatory activities. There is an anomaly in the SCC's organization. The insurance, financial institutions, and securities regulatory functions are each consolidated under a single Division (i.e., The Bureau of Insurance, The

Bureau of Financial Institutions, and The Division of Securities and Retail Franchising). Each of these is headed by a Director, referred to by the somewhat confusing title of Commissioner, as required by statute. For public utility regulatory functions, however, responsibility is spread across five Divisions: Communications, Economics and Finance, Energy Regulation, Public Utility Accounting, and Public Service Taxation, though that last Division is nearly autonomous from other utility functions. A separate Division of Railroad Regulation manages railroad regulation functions. That separation of utility functions cannot be explained by the size of the Division alone as the Bureau of Insurance is larger than the combination of the utility Divisions. The utility Divisions are organized in a mix of sector-specific functions (e.g., Communications) and cross-utility, professional functions (e.g., Public Utility Accounting).

Some, but not all, external stakeholders interviewed expressed some displeasure at the difficulty involved in identifying the staff position that sometimes arises with regard to energy issues. It may be particularly hard for new market entrants to navigate their way through the staff Divisions. Of particular concern was the possibility that staff Divisions would adopt differing positions in the course of settlement proceedings. In addition, the distribution of responsibility for energy issues creates the appearance to external stakeholders of case-management difficulties.

The 1987 review of the SCC identified a problem in coordination of utility cases. It stated, "Repeated problems have arisen with utility case coordination. Because of the manager's (the Administrative Manager of Public Utilities within Accounting and Finance) unique reporting situation, no immediate superior was available to monitor activity in this area and to intervene to head off difficulties."

The NRRI Interim Report considered the establishment of a Director of Public Utilities at the SCC as a means of coordinating the activities of the public utility divisions. Because of the breadth of responsibility of the SCC, it is difficult to draw national parallels for coordination of public utility functions. In most states, the coordination of staff and its insulation from commissioners is accomplished by the Executive Director, who usually also is assigned administrative functions. In other states, an informal Director of Public Utilities

emerges in the person of the most dominant and knowledgeable person in the utility divisions. A Director of Public Utilities was used successfully for years in Ohio. In Florida, reporting to the Executive Director are a Deputy Executive Director-Administration and a Deputy Executive Director-Technical. The latter position effectively serves as Director of Public Utilities. A Director of Public Utilities exists in Mississippi and North Dakota.

Reasons cited in the Interim Report for allowing the utility Divisions to continue to report directly to the Judges include:

- ! It will be difficult to recruit a person with the requisite skills. The appropriate person would need expertise in each of the four utility sectors and superior communications and facilitation skills. Utility and regulatory generalists with an adequate depth of understanding of both energy and telecommunications are rare.
- ! It is important that the Judges receive a full range of options, rather than the staff-selected option so that Judges receive the full benefit of competing viewpoints. Over-insulation from the give and take of the debate and over-reliance on the viewpoint of one person would be harmful to the regulatory process. Put another way, a Director of Utilities would have the opportunity to exercise tremendous influence on the process; that influence could be toxic.
- ! Stakeholder recommendation of the establishment of a Director of Public Utilities is not uniform. While some cite the need, others do not support the expenditure and believe that the benefit would not exceed the cost.

After gathering more information since the distribution of the Interim Report our conclusions with regard to public utility issue coordination and organization are that:

- ! At this time, the establishment of a Director of Public Utilities is not warranted for the reasons listed above. This issue should, however, be considered in the SCC's planning processes, as stakeholders were

mixed about the creation of a Director of Public Utilities. That position would parallel the SCC's organization for regulation of insurance, financial institutions, and securities.

! Consolidation and reorganization of utility, especially energy, regulatory functions are warranted. More will be said in a later section of this report about our suggestions and recommendations for SCC reorganization. The planning process should address the issue of coordination of energy cases that was raised in the 1987 review.

The third internal issue attendant to application of quasi-judicial processes is the legal support available internally to SCC Divisions involved in substantive issues and quasi-judicial proceedings, support normally provided by the Office of General Counsel. Several internal staff of the SCC reported that the legal services they receive are not adequate; concerns there were strongest regarding support of the Bureau of Insurance, though complaints about the adequacy of legal representation were received from other Divisions as well. It was reported by several persons that the Kentucky Division of Insurance has at least twice the legal support as the Bureau of Insurance, which has three attorneys assigned to it. About half of the attorneys in the Office of the General Counsel are assigned to utility issues.

Like the comments directed toward the attorneys on the staff of the Attorney General, most of the comments about individual attorneys were complimentary. Turnover was cited as a problem. Other problems cited were what was deemed to be not enough support staff and the loss of experienced attorneys, to the extent that new attorneys are writing important orders. Several persons interviewed suggested that the Office of the General Counsel is "too flat" and that attorneys assigned supervisory duties, as well as substantive legal duties, do not dedicate enough time to management, though this comment may contradict the claims of others that experienced attorneys need to spend time on substantive issues.

Almost no comments were directed toward the Office of Counsel to the Commission and the Office of Hearing Examiners, which may be a compliment, though one person indicated that hearing examiners are sometimes slow.

Our recommendation with regard to internal legal services is:

Recommendation #8: The SCC should evaluate the organization and resources available to its Office of General Counsel and consider the addition of resources to that Division. Recruiting attorneys with negotiation and mediation skills might prove complementary to other recommended SCC directions. In order to attract attorneys specializing in regulatory work, higher salaries may need to be authorized and offered.

Part II: Discussion and NRRI Recommendations

Section 3. Effective Participation in the Policy Process

A hallmark of the SCC's establishment and operations is its degree of relative independence from the remainder of state government. In the current regulatory environment, agency independence is most appropriate when the agency is involved in the enforcement of existing legislation or involved in fact-finding of the type required for rate setting functions. Apolitical hearings are the best option when regulatory agencies are taking action against businesses that have violated clear guidelines. In the U.S. system, political involvement is imperative when agencies make policies that affect entire industries. Public utility commissions around the nation are moving from models of clear independence to models of greater involvement with state legislators as the role of those commissions shifts from individual-company rate-setting to industry-wide policy making.

Stated simply, where enforcement of the law is necessary, commissions should remain independent from political processes, though ultimately accountable to the public. But where policy making is necessary, commissions need to create case-by-case, issue-by-issue arrangements with state legislatures to determine the scope of policy making to be reserved to the commission.

As noted earlier, the Divisions that regulate insurance, financial institutions, and securities at the SCC seem to have struck a clear and workable balance with the General Assembly between policy making and enforcement. The Directors of those Divisions highly value the independence of the SCC in enforcement actions and are, reportedly, the envy of their professional peers around the nation. When they recognize the need to make policy affecting their respective industries, they gather input from external stakeholders and involve the Judges and the legislature by recommending policy changes.

As public utility markets reach the competitive maturity of those industries, the appropriate allocation of responsibility between the General Assembly and the SCC for enforcement and policy making may become more apparent, and the model of regulation employed by insurance, banking and securities regulators might well be emulated for utility regulation by the SCC and other agencies across the nation with public utility responsibility. In the meantime, the roles of the SCC and the General Assembly in utility industry policy making and the implementation of utility policy have evolved, will continue to evolve (particularly in the electric industry), and may experience additional "growing pains."

A number of concerns were expressed about the SCC's role in industry policy making. Overall, it was reported that the SCC tends to be reactive rather than proactive in making changes necessary for changing circumstances. Indeed, one respondent suggested that the role of a regulatory commission should be to seek change, something that the SCC has not, reportedly, actively sought.

With regard to public utility policy making, as noted earlier criticisms of the SCC's participation in the development of energy industry restructuring were common; it was widely reported that the SCC presented the General Assembly with problems and that it did not perform a productive role in recent industry restructuring efforts. Others argue that the SCC responded appropriately in order to exercise its responsibility to protect the public.

A number of respondents strongly expressed the sentiment that the SCC exceeded its authority in its implementation of energy industry restructuring after the legislation was passed and that it impeded implementation. Examples included service unbundling and the wires charge dispute mentioned earlier. Others argued that these are complex issues that may require judicial interpretation.

Overall, utility industry stakeholders (primarily electric industry stakeholders) indicated that they were frustrated with their lack of input into SCC policy making and a lack of SCC responsiveness to what they perceived as legislative mandates. Another stated that there was no comprehensive SCC policy toward competition,

no tools with which the SCC might change markets, and no willingness on the part of the SCC to create change. Others stated that legislative interactions are compounded by the lack of a single SCC spokesperson on utility issues; one person cited the fact that as many as twelve SCC staff might attend a legislative hearing on energy matters. The SCC argues that staff attend legislative hearings only in order to be available to answer complex legislative questions-- that the intention is to assemble a team of experts able to respond with the degree of accuracy and completeness the Legislature deserves and expects. It also notes that it has in recent years had a single spokesperson on legislative matters, who makes use of other staff experts as needed.

Our conclusions with regard to SCC participation in utility policy making processes, a major area of concern of SCC stakeholders, were listed earlier in this report. They are that:

- The SCC has not created an adequate understanding of its mission and effectiveness among many of its stakeholders;
- The SCC has not convinced its stakeholders that it is as firmly committed to competition as the Legislature, which in the final analysis must be the lead entity in the creation of policy;
- The SCC has not created an effective partnership with the Legislature;
- The SCC has not thus far successfully implemented non-adversarial processes that build consensus among stakeholders;
- The SCC may not be appropriately structured and armed with the right tools for success in changed times.

Our recommendations for remedy of these shortcomings are:

Recommendation #9: The SCC should establish a dialogue with legislative leaders on its role and actively seek out legislative guidance on important matters.

Recommendation #10: The SCC, as part of its strategic planning process, should clearly identify its role, its mission, and its vision for encouraging competitive utility markets. The recent activities of the SCC in regard to default service seem to address this recommendation.

Recommendations in other sections of this report will impact the policy-making and dispute resolution roles of the SCC as well.

Part II: Discussion and NRRI Recommendations

Section 4. Effective Conflict Management

In many instances, those interviewed noted a good working relationship with SCC staff that leads to informal problem resolution, particularly in regard to the regulation of securities, insurance, and financial institutions. Though no formal ADR process is in place, many important cases have been settled and stipulations are frequent. As a result, it is argued that few cases are fully litigated. Staff were cited as beginning to work toward settlements in gas regulation, and the annual local distribution company conference was cited as a useful example of more collaborative work.

On the other hand, one of the most strongly voiced complaints about the SCC addressed its ability to participate in collaborative efforts of dispute resolution in its utility regulation functions. In the NRRI interviews, a number of stakeholders expressed dissatisfaction with the lack of progress on the telecommunications collaborative effort established in October 1999, as well as with the difficulty in negotiating with the several divisions in energy regulation (where one negotiation was perceived as having failed because one Division did not agree with the settlement reached by external stakeholders and the other Divisions). Overall, it was stated by several respondents that the SCC is becoming more, not less, adversarial in its approach to industry, most notably in utility regulation. The lack of an established alternative dispute resolution (ADR) process and settlement process was cited as an impediment to better use of those processes, and the failure of notable collaborative efforts in the past was cited as a serious impediment to the willingness of stakeholders to participate in future collaborations. Better collaboration was cited by more that one person interviewed as the highest need of the SCC.

Our conclusions with regard to dispute resolution at the SCC are:

! The SCC does not make enough effective use of ADR, particularly in utility matters. These collaborative efforts are likely to be most

successful in markets with a wide array of stakeholders, which may not be the case in all SCC regulated markets.

! Because of recent SCC experiences with attempted ADR application in public utility issues, stakeholders are likely to enter any attempted ADR process with some suspicion.

The SCC does appear to be committed to employment of more collaboration. For example, the Office of the General Counsel and the Telecommunications Division recently concluded a collaborative to develop interim ADR guidelines. It is important to note that collaborative processes cannot be effective unless the SCC retains regulatory tools that can be used if collaboration is not effective and unless stakeholders make a commitment to participate actively in those processes.

Based on these conclusions, our recommendations in the area of effective dispute prevention and resolution are:

Recommendation #11: The SCC should create rules and procedures for ADR application that define parameters that ensure appropriate public notice and opportunity for participation. Statutory changes may also be required.

Recommendation #12: The SCC should identify appropriate opportunities for ADR, and promote its use as an alternative, though ADR is clearly not appropriate for all issues. The SCC should consider following the lead of the Federal Energy Regulatory Commission, which has established an office dedicated to informal dispute resolution.

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Part II: Discussion and NRRI Recommendations

Section 5. Consumer Focus

Overall, most SCC Divisions are perceived as being responsive to public inquiries, complaints, and requests for assistance. Of more expressed concern was the ability of the SCC to reach out to consumers to identify problems early and involve them in the consideration of issues. Consumer outreach is required by the electric industry restructuring legislation and in 1999 an Office of Managed Care Ombudsman was created within the Bureau of Insurance.

The Virginia Constitution requires that consumers be represented by the SCC unless that representation is provided elsewhere. Typically consumers are represented in quasi-judicial processes by the Office of the Attorney General and, according to some, by SCC staff if the Attorney General does not intervene. In addition, consumer-advocacy agencies attempt to apply their limited resources to representation of consumers before the SCC. The SCC, according to observers, does not discourage consumer participation.

On the other hand, these same judicial processes, which are designed to assure a fair and open regulatory process, can be intimidating to consumers, particularly when a commission runs a "tight courtroom," as is reportedly the case with the SCC. In docketed SCC proceedings, non-attorneys are prohibited from appearing as representatives of groups. An individual is allowed to represent themselves *pro se* and the process for signing up to make comments at SCC hearings is simple. Public witnesses cannot be cross-examined though cross-examination would be allowed in one of the Proposed Rules of Practice and Procedure. And while the SCC takes public comments, one observer says that it takes "gumption" on the part of consumers to negotiate the process. "Web casting" of SCC hearings is employed where possible.

Some suggest that the SCC does few "traveling" hearings. The SCC reports that though most quasi-judicial hearings occur in Richmond, the SCC staff has "gone on the road" to gather input from consumers particularly in regard to transmission line cases, small water company rate cases, and area code relief plans. Some stakeholders complain that there is no assistance provided to intervenors and consumers (e.g., to teach them how to participate), the Division of Information Resources is regarded as being largely "news media" focused, there is no aggregated complaint data reported to the public, there is no SCC-wide complaint handling process, and extensive information is not provided to consumers, with the exception of the Bureau of Insurance and the Division of Securities which has developed video tapes, consumer guides, and periodic consumer advisories. As a result, the level of organized consumer participation in SCC activities is cited as less than some desire. The SCC may experience an increase in consumer complaints and an increase in the demands of consumers for participation attendant to the continuation of telecommunications and electric industry restructuring, which has been the experience of other states.

Currently, at the SCC the most competitive industry (insurance) generates the most consumer inquiries. Inquiries in telecommunications have increased from about 2500 per year to nearly 13,000 per year since the introduction of competition. Because of this increase and the likely future increase in calls, more than one person interviewed suggested the establishment of a consumer call "triage" center, a point at which all incoming consumer callers would be screened, provided with basic information, or forwarded to the relevant operating Division. That option would have the benefit of allowing complaint handling staff to be centrally pooled, trained, and managed. At least two state public utility commissions (Ohio and Florida) have established this type of call center. The operating Divisions largely do not support the centralization of consumer complaints, principally due to the necessary specialization required to handle calls across the many jurisdictional

areas within the purview of the SCC. SCC staff cite the fact that consumer calls are often routed around the SCC before reaching the right person to handle the inquiry.

There was one comment about the need for more "self-service" ability in some areas of the Clerk's Office and better quality control in the Clerk's Call Center.

Based on the information collected, our conclusions related to consumer interactions are that:

- Though SCC judicial processes provide some opportunity for public participation, more opportunities for direct consumer participation will be required in the future.
- Improvements in consumer communication and education are required if the SCC is to properly address the needs of consumers and structure public utility markets to meet their needs.

In order to improve consumer involvement and communications with consumers, our recommendations are:

Recommendation #13: Other Divisions should follow the lead of the Bureau of Insurance and Division of Securities in creating consumer-friendly information to be distributed via various media. As one respondent noted, the SCC can improve its ability to "simplify and persuade."

Recommendation #14: The consumer complaint handling process should be standardized, automated, and coordinated across the SCC to allow better analysis, tracking, and response. Establishment of a "call center" should be studied further.

Recommendation #15: The SCC in concert with the Office of the Attorney General should undertake an effort to better involve consumers in SCC proceedings and policy making. Those efforts might involve assistance to consumer groups, consumer forums, assignment of additional resources to the Office of the Attorney General, and appropriate loosening of SCC judicial processes that might increase the ability of consumers to participate in those processes.

Part II: Discussion and NRRI Recommendations

Section 6. Use of Best Available Information Technology

At the SCC, there has been progress toward electronic filing; the draft "Revised SCC Rules of Practice and Procedure" opened that possibility, a possibility that was well-received by external stakeholders. Not all SCC orders are available on the website (though the SCC reports that all important orders are), the positions taken by staff are not posted, filings from other parties must be accessed through those parties rather than being made publicly available to all, and, though webcasting is reported to be increasing, no capability exists for distant stakeholders to listen to hearings. Some commented on the need for better electronic support of the functions of the Clerk's Office. Some were concerned with the lack of systems standardization throughout the SCC, which makes systems support more complicated, and duplicative collection and retention of information, which may require external stakeholders to supply identical information to two or more Divisions.

The Director of the Information Technology Division has apparently made substantial improvements thus far during his brief tenure; existing systems are being analyzed for their ability to meet needs, initiatives are underway to create electronic filing and to replace outdated docketing systems, the IT planning process is being evaluated, and an outreach program to Divisions has been proposed. Full integration of SCC information needs and information technologies with the strategic mission of the Commission has not been accomplished. One SCC staff person cautioned against the common tendency in all organizations to build electronic systems around bad processes.

Those interviewed, particularly those internal to the SCC, were in agreement that much improvement has been made in information system development and support; the ongoing revision of the case-management system was cited as an example. Additional improvement, it was posited, needs to be made. Currently, the Information Technology Division, which has 29 staff members, and makes use of consultants, is charged with information systems responsibilities for the entire SCC. Other Divisions have, however,

established their own information systems capacity to supplement the central-provided services. It can be argued that this dispersion of expertise is either duplicative and uncoordinated or appropriate in it allows the assignment of a person or persons expert in the specific information systems needs of each Division and immediately responsive to staff needs.

Our recommendations with regard to SCC information systems are:

Recommendation #16: The SCC should continue to integrate its information systems plan into an overall SCC strategic plan and should consider the potential for electronic support of its quasi-judicial processes as well as its need for information in more-competitive markets and their attendant regulatory processes.

Recommendation #17: The SCC should consider within the strategic planning process the best organization for provision of information systems support to its Divisions. The ad hoc development of support personnel within the "line" Divisions indicates that the centralized model, though perhaps best suited to some information system purposes, is imperfect.

Recommendation #18: Consideration should be given to the potential for information provision to consumers and other stakeholders to create a form of "regulation by information" that might further the objectives of the SCC (i.e., can information exchange be a regulatory tool in itself rather than merely supportive of other regulatory methods?).

Because of the need to invest in information systems to support effective regulatory processes, external stakeholders and the Legislature should be prepared for additional information system investment by the SCC. Those investments would seem to complement the Governor's Initiative on Implementing Electronic Government in the Commonwealth of Virginia.[12]

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[12] Office of the Governor, Executive Order 65 (00), "Implementing Electronic Government in the Commonwealth of Virginia."

Part II: Discussion and NRRI Recommendations

Section 7. SCC Organization

In the course of this report, several issues related to SCC organization have been mentioned. Among them are:

- ! Several divisions are employed in utility regulation, which makes communication and coordination difficult and complicates external development of agreement with staff, though cross-division coordination does occur and dialogue between division staff does take place. For example, the directors of the Bureau of Insurance, the Bureau of Financial Institutions, and the Division of Securities and Retail Franchising are meeting regularly to address issues and concerns arising from cross-over occurring in their industries ;
- ! The lack of separation between public utility staff advocacy and advisory functions;
- ! The lack of a single contact for consumers and little coordination and evaluation of complaint data;
- ! Organization for administrative oversight (i.e., the arguments for creation of a Director of Administration);
- ! Support for and encouragement of alternative methods of dispute resolution with the limitations noted earlier;
- ! Placement of the consumer outreach function, which is currently housed and managed by each Division;
- ! Coordination of information systems.

Because the best regulatory organization in any given circumstance is the product of a wide variety of local circumstances, which include staff skills and the political climate, it

is inappropriate for any consultant to attempt to identify the single best organizational pattern. Presenting some options, however, is totally within the realm of propriety.

The majority of the organizational problems noted by those interviewed are related directly to public utility regulation. Comments have been made earlier in this report about the need to better distinguish between the advisory and advocacy roles of public utility staff. Organizational options and a recommendation were also presented at that time. Similarly, the NRRI Interim Report cited the need for a Director of Administration at the SCC to resolve administrative difficulties. It was also suggested by one internal stakeholder that the Director of Administration might also be tasked with the responsibility of overseeing the timely flow of cases through the SCC.

One interesting overall organizational option for public utility regulation has been created by the Florida Public Service Commission. That Commission has recently organized itself to accommodate the current and evolving regulatory environment, even though electric industry restructuring in Florida is not as advanced as it is in Virginia. A table of organization for the Florida PSC is attached.[13]

The key to the Florida organization is the distinction between divisions that deal with competitive or partly competitive markets and those that deal with more traditional regulatory functions. The operating divisions (i.e., those that deal with regulatory issues) are a Division of Competitive Services, which deals with the creation of competitive safeguards, market development, and service quality in gas and telecommunications markets; a Division of Economic Regulation, which handles rate cases and more traditional industries (water and electricity in Florida); a Division of Policy Analysis and Intergovernmental Liaison, which provides analysis to the other Divisions, manages intergovernmental relations, and has been tasked to provide advice and options to the Commission; a Division of Regulatory Oversight, which manages certification, auditing, and regulatory reviews; a Division of Safety and Electric Reliability, which manages those two functions; and a Division of Consumer Affairs, which handles complaint resolutions for

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[13] Presentation by Mary A. Bane, Deputy Executive Director, Technical, Florida PSC to the NARUC Staff Subcommittee of Executive Directors, Indianapolis, Indiana, October 1, 2000.

all sectors and consumer information and conservation education. For every regulatory issue which arises, the Chairman designates one office as having primary responsibility; that Division then identifies other Divisions of "corollary responsibility."

Another interesting organizational option (suggested in an earlier Recommendation), that might address some of the concerns about the application of alternative methods of dispute resolution, is the establishment by the Federal Energy Regulatory Commission of its Dispute Resolution Service (DRS) located within the Commission.[14] The DRS, which was created in 1999, fosters the use of alternative methods of dispute resolution (ADR) in Commission proceedings and for disputes within the Commission. It convenes sessions, provides facilitation and mediation services, assists parties to screen disputes for ADR application, and develops programs for ADR education and training. It is neutral and independent; it is not involved in the Commission's substantive decisional processes and does not take positions on the issues raised or advocate a particular result.

Two of the concerns expressed by stakeholders involve consumer outreach and complaint handling. These functions are complicated at the SCC due to the breadth of its responsibilities. As a result, it is unclear that centralization of complaint handling would be advantageous. Consolidation of public utility complaint handling, as is the case at other public utility commissions (e.g., Ohio and Florida), might, however, be useful. Even if complaint handling is not centralized, uniformity of the information systems employed for tracking complaints might be helpful. In addition, additional resources might be added to the effort to inform and educate consumers, which was only cited as being well-developed in the Bureau of Insurance. That effort to better educate and inform might be deployed efficiently through the Information Resources Division.

In public utility regulation, there is some logic to the creation of an office that handles safety issues. Currently, a significant portion of the Energy Division is focused on pipeline safety and underground utility line damage prevention and the entirety of the Division of

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[14] Source: www.ferc.gov/public/drs.htm

Railroad Regulation supplements Federal railroad safety programs. In 1995, the Energy Division assumed responsibility for enforcement of the Underground Damage Prevention Act, which required a sizeable increase in safety-related staffing. In the Florida model, safety and electric reliability, both strong engineering functions, are consolidated into one Division.

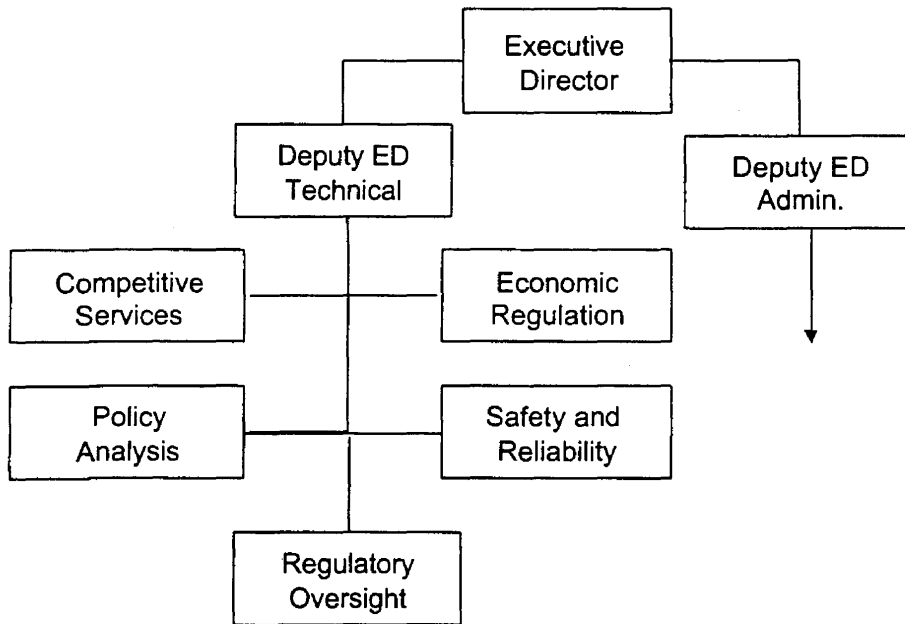
Our conclusions with regard to the organization of the SCC are:

- The SCC is in need of some reorganization particularly with regard to public utility regulation, administrative oversight, interaction with consumers, and the application of alternative means of dispute resolution.

Our recommendation is:

Recommendation #19: The SCC should embark on an effort, linked to its strategic plan and its effort to identify performance criteria (to be discussed later), to identify the best organization for pursuit of the public interest given its staffing, and the outcomes it intends to accomplish.

Florida PSC Abbreviated Table of Organization



Source: Author's construct based on FPSC T/O.

Part II: Discussion and NRRI Recommendations

Section 8. SCC Performance Assessment and Accountability

A frustration expressed by several respondents related to the relative lack of accountability of the SCC. Improving SCC performance assessment was cited by one person as being a "big deal."

Unfortunately, good performance measures for state regulatory commissions have been hard to come by. Balancing the interests of the regulated industry with the needs of consumers has long been regarded as the key measure of regulatory commission effectiveness. Balance is, however, very difficult to measure and highly subjective. Agency efficiency, though often pursued as a measure of performance, is also a poor indicator of performance, particularly in that "faster" regulatory decisions made with fewer resources are sometimes "poorer" regulatory decisions. Regulatory "failure," usually on the basis of legal or ethical violations by regulators, is a third and equally poor indicator of agency performance.

Fortunately, several state public utility regulatory commissions have begun the process of identifying "outcome" measures for regulatory agencies. These outcome measures are focused on whether or not regulatory commissions are accomplishing objectives that an array of stakeholders value and begin with the assumption that regulatory commissions exist to serve public interests that are embedded in or related to the provision of services to citizens of the state. In public utility regulation, those public interests might include the following, which are listed along with some of the performance measures that might be applied to them:[15]

- Consumer choice: the percentage of customers who have the opportunity to choose other than the incumbent provider, the number of

[15] The majority of these measures were developed in a meeting of the senior staff of a state regulatory commission facilitated by the lead author of this report. The name of the state cannot be disclosed at this time.

market entrants, customer awareness of options, public satisfaction, comparison of rates in other jurisdictions.

! Universal service: the percentage of people without service for reasons other than their own choice, universal access to assistance in acquiring service and resolving problems.

! Reliable service: the number of people subject to service outage times the hours of service outage, the number of outages, the number of property damage claims due to poor service quality.

! Safety: the number of deaths and injuries related to service provision, the magnitude and number of property damage accidents associated with utility plant.

! Regulation of monopoly services: affordability, comparison of rates in other jurisdictions, case processing time, regulatory lag.

! Environmental quality: number of hazardous material spills, citation by other environmental regulators of service providers.

! Economic development: number of jobs created or lost; utility service costs as a percentage of household income, comparison of rates in other jurisdictions.

! Overall: satisfaction with the commission as indicated by systematic assessment of stakeholders, including consumers (i.e., a "360 degree" evaluation of the performance of the commission).

These types of outcome measures can be created for any type of regulated industry. They require data collection and evaluation, and, as is obvious, few of them are entirely under the control of the state regulatory commission. Nonetheless, it is our opinion that performance assessment based on outcome indicators is imperative for state programs. Therefore our recommendations are:

Recommendation #20: The SCC should include, within the strategic planning process, an effort involving stakeholders to identify and apply outcome measures of its performance.

Recommendation #21: The SCC should employ those performance measures to position itself with the public and make the public aware of its substantial and beneficial impact on the Commonwealth.

Part II: Discussion and NRRI Recommendations

Section 9. Staff Training, Recruitment, and Retention

Nearly all of those interviewed cited the professionalism and expertise of the SCC staff. Staff themselves cite the SCC as being an excellent place to work. They appear to value the professionalism of the SCC, the benefits, the relatively good pay (as compared to other state agencies), the excellent equipment, casual dress (within limits), "flex" time, and education opportunities and benefits.

A number of those interviewed, however, expressed their concern about the ability of the SCC to retain knowledgeable staff. Retirements of key staff may be a problem in the near future. One respondent expressed his concern about the lack of opportunities for upward mobility in the Securities Division once the individual had risen above the junior examiner level and the lack of mobility between Divisions. Another suggested that the SCC isn't retaining good staff and that the focus of Human Resources has been on recruiting rather than retention. Turnover data show turnover rates at less than 10 percent per year for the past two years. The disparity between pay offered by the SCC and the regulated industries, particularly for attorneys and engineers, was cited as a factor in recruitment and retention.

Without question, the SCC has been able to assemble an array of highly competent staff. In the future, maintenance of that staff competence will be even more critical. Retaining staff at the SCC will likely be complicated by the opportunities for competent, SCC-trained staff in the private sector in the regulated industries. Complicating staffing problems even further will be the need for SCC staff to expand its skill base to encompass some of those skills noted earlier in this report as required in the future regulatory environment. By way of review, those skills include information gathering and dissemination; mediation, arbitration, and facilitation; market analysis and monitoring; and consumer interaction.

SCC managers were criticized by some for inadequate staff evaluation and not enough staff development and coaching. Nearly all senior SCC managers are "working managers."

Two persons interviewed expressed concern with building security. Based on our comparisons to other commissions we visit, the security at the SCC is less rigid than at most commissions, most of which require badges or sign-in for entry.

Our conclusions with regard to staff training and retention are that:

! Staff training and recruitment will be even more critical in the future for the SCC than in the past. Possibly the greatest threat to the ability of the SCC to continue to protect the public interest is an erosion of staff skills due to turnover or inability to recruit the appropriate staff.

! The existing SCC staff needs to be provided opportunities for refining existing skills and acquiring new skills that are appropriate in current and future regulatory environments.

! SCC managers under the duress of a high workload and rapid change may not have been able to devote adequate time to staff evaluation and coaching.

Our recommendations in this regard are:

Recommendation #22: The SCC should continue to dedicate resources to technical training and identify and fund training programs for the acquisition of the new skills identified in this report as required in the future.

Recommendation #23: The SCC should identify and invest in those staff members who have the capability for future leadership as a means of increasing their leadership skills and signaling to them their

potential for advancement at the SCC. SCC efforts to retain and recruit good staff might include collaborative efforts with stakeholders to consider "executive on loan" programs, mentoring programs, incentive pay, and other creative but non-traditional means of increasing staff capabilities and retention, like the current recruiting outreach to Virginia universities and apprentice programs.

Recommendation #24: Despite the pressures of the high workloads on managers, the SCC should attempt to provide more training to supervisors on staff coaching and evaluation and require those managers to dedicate sufficient time to those important activities.

Recommendation #25: The SCC should evaluate the level of security provided for staff in the Tyler Building.

Part II: Discussion and NRRI Recommendations

Section 10. Conclusions

Throughout this report, our approach has been to suggest that the SCC undertake a strategic planning process to address issues we have identified in lieu of suggesting the wholesale implementation of what might have worked elsewhere (i.e., SCC performance assessment, organization, recruiting and retention). Though some might have preferred that we provide more definitive recommendations, the only answers that will work for the SCC are those answers that have the support of the regulatory community. To be long-lasting and effective, change has to be initiated from inside the organization; while we might be able to provide potential direction to change, change initiatives must be home-grown. In addition, the outcomes derived by group efforts are more likely to be creative and driven by local circumstances.

Those group processes we suggest should not be convened with the intention of identifying SCC failures or problems but should be focused on finding the best regulatory models given the unique circumstances of the Commonwealth. They will take time and energy, but given skillful facilitation and good intentions, they will undoubtedly lead to great outcomes.

While the five-part model discussed earlier may have been useful for organization of this report, it also provides a model of regulatory leadership. The SCC, by all accounts, has the professional capability to lead the nation in the development of effective regulatory models, and the regulatory structure established by the Commonwealth of Virginia very early in the 20th Century is even more appropriate now than then. The goal of the SCC should, therefore, not be limited to the maintenance of good regulatory systems but should encompass the establishment and operation of superior regulatory systems as has been its tradition.

The next steps for the SCC, in our estimation, are:

- ! Initiation of a strategic planning process in concert with stakeholders.
- ! Continued dialogue with stakeholders, of which this report has been a start.
- ! Consideration of the recommendations listed in this report.

As the quotation from President Wilson that opened this report indicated, we will need to undertake a process to "step by step" make our economic system, and by inference the regulatory systems that govern that system, what they should be. Despite the problems elaborated in this report, the SCC is a sound organization, staffed by competent professionals, and well-suited to protect and serve the public interest. With some organizational modification, restructuring of the types described in this report, and ongoing attention to the need for change in a changing regulatory environment, it is our expectation that the SCC will continue to serve the citizens of the Commonwealth well into the future.

APPENDIX I

ANALYTIC PORTIONS OF THE NRRI INTERIM REPORT

Part 1: Mechanisms for SCC Administrative Oversight

The 1987 report of the Joint Legislative Audit and Review Commission on *Organization and Management Review of the State Corporation Commission* (House Document No. 15, 1987) concluded that the SCC organization and management structure was basically sound. That report recommended, however, that "the SCC Commissioners should limit their involvement in daily administrative matters and concentrate on high-level activities and matters that cannot be resolved at a lower level of the organization" and that "the SCC Commissioners should...delegate greater administrative authority" to the Executive Director, a position that does not now exist. Some concern was also expressed in the NRRI's first round of interviews about the current structure for SCC administrative operations. Representative, though sometimes contradictory, comments included the following. Those interviewed typically included Human Resources, the Office of the Comptroller, and Information Technology as administrative service Divisions; the Information Resources Division was rarely identified in these comments and is typically regarded by staff as being distinct.[16]

! *The three-judge structure works great for regulatory issues but less well for administrative issues. The solution is a Director of Administration.*

! *The only recourse for poor administrative services (provided to an SCC Division) is to go directly to the Judges. Some staff fear retribution.*

[16] Comments were not recorded verbatim but were transcribed as accurately as possible to ensure that the content of the remarks, if not the specific wording, was recorded.

- *The organization has no CEO since the Judges have a legal function.*
- *Some support staff and Divisions are not responsive to the needs of the other Divisions.*
- *The Judges have the best ability to determine if administrative issues get in the way.*
- *External stakeholders aren't impacted. Another layer of organization may not be helpful.*
- *The Judges need to be involved in high-level hiring and personnel issues. Not much of their time is eaten up by administrative issues.*
- *Generally, administrative services are good.*
- *There is a need for more administrative consistency.*
- *The key to the success of a Director of Administration is the authority delegated to him/her by the Judges.*
- *There is not much administrative direction from the Judges and little coordination of support functions.*
- *Relieving the Judges of administrative responsibility is more important than providing more leadership and management of administrative staff and Divisions.*
- *Though establishing a Director of Administration is a useful first step, changing the culture of the SCC is more important.*
- *There is a lot of power in some of the administrative Divisions and they need oversight.*
- *All the managers in the support Divisions are very strong and provide good support. A Director of Administration would add another layer without much return.*

State regulatory commissions around the nation tend to use one of three types of administrative control. They are:[17]

1. **Committee of the Whole**: Administrative authority rests with the body of sitting commissioners, with all administrative matters being decided either through consensus or by majority vote. The commission may have an Executive Director, usually appointed by majority vote of the commission.
2. **Commission Chair**: Sole administrative authority rests with the chair of the commission. The chair may or may not confer with, or follow the wishes of, the other commissioners. In regard to industry policy decisions (i.e., non-administrative issues), the chair has one vote and is a peer among equals. The commission may have an Executive Director, but he or she is typically appointed and supervised by the commission chair.
3. **Executive Director**: The Executive Director is the sole administrative authority. This frees commissioners from administrative duties so that they can deal exclusively with policy issues and decision making. Typically, the strong Executive Director model is also associated with a separate staff that independently acts as a party before the commission. The intention is to give staff independence by eliminating commissioner administrative control. Executive Directors are responsible *to* the commissioners and responsible *for* the staff. In some cases, state Executive Directors take interest in both administrative and substantive matters. In other cases, they focus on one or the other. About 70 percent of state public utility commissions employ some version of the Executive Director model.

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[17] The authors are indebted to Robert Burns of the NRRI for this typology.

Varieties of these models are employed by most state commissions. Legislatures and, in some cases, state constitutions, have acted to ensure that the entity with administrative power is unable to influence decisions on substantive policy matters. As indicated below, there is concern by some that administrative direction of Divisions by the Judges and policy direction of those Divisions by the Judges coincide. That administrative direction is intended to be limited to routine administrative matters, and there is some evidence that oversight by the Judges is limited to those routine administrative matters. In addition, some specialization among commissioners occurs at many public service commissions.

At the SCC, the model currently employed for overall SCC administrative oversight comes closest to the first option, the Committee of the Whole. The Chair has very little additional authority, as evidenced by the very small salary difference between the Chair and the other Judges. There is currently no Executive Director though the use of an Executive Director was attempted twice in the past. The position was eliminated in each case after an unsuccessful trial. The Judges currently are assigned to Divisions for administrative oversight. Those assignments do not frequently rotate.

It appears to some that the administrative oversight exercised by designated Judges also extends to technical oversight and issue leadership. External stakeholders, in several instances and particularly from the electric industry, expressed the opinion that the system for assigning administrative oversight to the Judges extends toward subject-area oversight and results in "balkanization and over-specialization" by the Judges. It was reported by one person that there had been some criticism in the past of Commissioners for not rotating their assignments and by another that legislation had been proposed but not passed that would require two-year rotation. Rotation of the Judges was strongly encouraged by at least one external stakeholder to ensure rotation of issue leadership among the sectors (e.g., banking and utilities). Another stakeholder expressed concern that rotation, especially frequent rotation, would limit necessary continuity of expertise.

There are three criteria that can be applied to the organization and supervision of administrative support functions within the SCC: 1) are the appropriate personnel involved

in administrative decision making (i.e., are individuals, who should be involved in other areas of concern unduly burdened by administrative matters)?, 2) are the services adequately provided and administrative decisions made in a timely manner?, and 3) does administrative oversight imply or allow too much subject-area oversight? Put another way, changes in the administrative control of the SCC should be considered if the time of the Commissioners could be freed to respond to more important matters, if administrative support services and decision making could be improved substantially, or if changes in administrative structures could result in better, more balanced decision making in non-administrative policy matters by the SCC.

Though the input received by the persons interviewed was clearly mixed, it appears that the second and third reasons for a change in the SCC administrative structure are most compelling. Evidence of the first criterion (that the time of the Judges is unduly occupied by administrative issues) was not extensive. Several of those interviewed stated that the Judges don't seem to be unduly burdened by administrative issues, that they best know their capability for handling administrative issues, or that they would be loathe to give up administrative oversight over administrative issues they deem important to the SCC. The 1987 Report of the Joint Legislative Audit and Review Commission, though suggesting further refinement and greater delegation, admitted that "the Commissioners are successful in focusing their efforts on essential and appropriate areas."

With regard to the second criterion (the adequacy of administrative services), comments were mixed. In any organization, it is difficult to satisfy internal clients with the provision of administrative services, especially when resources are limited. Enough concern was expressed, however, to indicate that additional administrative oversight and coordination of administrative services might be warranted. Though it is not clear that the administrative oversight exercised by the Judges extends to subject area oversight, separating Judges from direct administrative oversight would remove any suspicion of inappropriate intervention in the substantive work of those Divisions enabled by administrative control.

As was noted, comments by some external stakeholders about the coincidence of administrative and policy oversight were often coupled with a suggestion to frequently rotate the administrative oversight among the Judges. Other options available to the SCC for improving the oversight over and coordination of administrative services are:

- ! Establish the position of Executive Director. Executive Directors at regulatory commissions typically oversee substantive and administrative issues and staff. Because of the breadth of the issues with which the SCC deals, it is unlikely that any person could provide effective oversight over the full range of SCC functions.
- ! Assign additional administrative duties to the Chair. No one suggested this as a viable option. The Judges work well together; creation of additional hierarchy among them would not likely be useful. Assigning the administrative responsibilities to one Judge might overburden that Judge and prevent him from full participation in substantive issues.
- ! Establish a position of Director of Administration for the SCC. This option was suggested by a number of those interviewed, principally as a means of buffering the power of the existing administrative Divisions and equalizing the impact of the Judges over the regulatory Divisions (by those who feel that administrative oversight extends to policy oversight). This position would have direct oversight over the administrative divisions, indirect oversight of administrative matters within the policy divisions, but no authority or oversight over substantive policy matters. It would likely limit the direct access of the current administrative Division heads to the Judges; that limitation was suggested as necessary by some of those interviewed and a needless separation of the Judges from the expertise of the Division Directors by others.

There is no clear answer to the reported perceived problems of administrative oversight of the SCC. That the use of an Executive Director failed on two prior occasions provides some evidence that the creation of a Director of Administration might encounter problems now. Still, the SCC is a large agency with complex administrative needs, and there seems to be some dissatisfaction among employees with the current level of administrative support provided and the level of coordination among administrative functions. External stakeholders provided a variety of reactions to the idea of the establishment of a Director of Administration but were more concerned with how oversight of substantive issues is provided. In total, and as an interim recommendation, it appears that the benefits, both real and perceived, of creating a Director of Administration would outweigh the costs.

Cautions are necessary, however. A Director of Administration will require a broad set of skills that includes communication, mediation, and facilitation in addition to the standard set of administrative skills. Put another way, that individual's approach to the job and communications skills are probably more important than his or her administrative skill set, particularly given that each of the current administrative Division Directors are regarded as highly skilled in their areas of purview. In addition, care should be taken to ensure that the Director of Administration does not unduly limit access to the Judges for important administrative issues requiring the input of the Directors of the support Divisions and that Judges have input into a limited but important set of administrative actions, like the hiring of Division Directors, which is required by the Virginia Constitution. A careful balance between "gatekeeping" and coordination is required. Additional consideration of the establishment of a Director of Administration will be given in the final NRRI report to the SCC.

Part 2: Mechanisms for Oversight of Public Utility Regulation

There is an anomaly in SCC organization. The insurance, financial institutions, and securities regulatory functions are each consolidated under a single Division (i.e., The

Bureau of Insurance, The Bureau of Financial Institutions, and The Division of Securities and Retail Franchising). Each of these is headed by a Director, sometimes referred to by the somewhat confusing title of Commissioner. For public utility regulatory functions, however, responsibility is spread across five Divisions: Communications, Economics and Finance, Energy Regulation, Public Utility Accounting, and Public Service Taxation. A separate Division of Railroad Regulation manages railroad regulation functions. That separation cannot be explained by size alone as the Division of Insurance is larger than the combination of the utility Divisions. These six utility Divisions are organized in a mix of sector-specific functions (e.g., Communications) and cross-utility, professional functions (e.g., Public Utility Accounting).

The 1987 review identified a problem in coordination of utility cases. It stated, "Repeated problems have arisen with utility case coordination. Because of the manager's (the Administrative Manager of Public Utilities within Accounting and Finance) unique reporting situation, no immediate superior was available to monitor activity in this area and to intervene to head off difficulties."

It was suggested by a number of respondents that the establishment of a Director of Public Utilities would assist in case coordination and perform other functions. According to one person interviewed, a Director of Public Utilities was used three times in the past. In each case, it was reported that the person did not directly communicate to the Judges the opinions of the utility Division Directors, and they began to work around the Director of Public Utilities. Other comments received in the NRRI interviews to date include:

- *It may be difficult to recruit a top-notch, Jack-of-all-trades to oversee all the current public utility functions.*
- *External stakeholders feel that they need to keep in touch with the Directors of each of the Divisions. They need to "shop" for the staff position on issues.*
- *For the legislature, there needs to be a single spokesperson for technical, utility issues.*

- *If there were a Director of Public Utilities, competing viewpoints among the staff might be resolved before reaching the Judges, thus depriving the Judges of alternative approaches and competing viewpoints.*
- *A Director of Public Utilities is an excellent idea. Communications is not always good between Divisions, and there is no single point of contact for outsiders.*
- *Though staff viewpoints are usually compatible, a Public Utilities Director would still help. Someone needs to coordinate issues and keep track of cases and staff requirements.*
- *A Director of Public Utilities may be a bottleneck and impediment to communications between the Division Directors and the Judges.*
- *A person with oversight over all the utility Divisions wouldn't understand all the intricate issues.*
- *There is not much communication across the public utility Divisions.*
- *Communications and Energy Regulation may be overloaded.*

In addition, some external stakeholders expressed the opinion that staff needs more independence; some even suggested that additional *ex parte* separation of the staff from the Judges would be useful. Though this change might be warranted, extreme caution should be exercised prior to its adoption. In general, state commissions around the nation are attempting to dismantle some of the extensive legal processes that may have partly handicapped rapid response to policy issues. Separating staff from the Judges would likely reduce the degree of staff support provided to the Judges at a time when utility issues are becoming more complex. Many commissions are, in fact, attempting to increase the level of staff support provided directly to commissioners. Staff independence also creates its own problems in that staff in other states are sometimes viewed as being

too independent and unaccountable to elected or appointed officials. More consideration of this issue will be provided in the final NRRI report.

As in the discussion of the creation of a Director of Administration, some external stakeholders were concerned with the specialization of the Judges and the balance of their input on utility issues. More frequent rotation was again suggested as a partial solution. Little concern was expressed by communications industry stakeholders about the specialization of the Judges, the need for rotation, or need for a Director of Utilities. That may be the result of the fact that due to the types of regulation employed for the telecommunications industry, telecommunications industry stakeholders tend to deal most often solely, or more nearly solely, with the Telecommunications Division rather than the full array of public utility Divisions. Telecommunications statutes are clear in their detailing of SCC duties. More frequent complaints about utility structure from electric stakeholders may also be related to the recent, apparently heated, debates over electric industry restructuring.

Because of the breadth of responsibility of the SCC, it is difficult to draw national parallels for coordination of public utility functions. In most states, the coordination of staff and its insulation from commissioners is accomplished by the Executive Director, who usually also is assigned administrative functions. In other states, an informal Director of Public Utilities emerges in the person of the most dominant and knowledgeable person in the utility divisions. A Director of Public Utilities was used successfully for years in Ohio. In Florida, reporting to the Executive Director are a Deputy Executive Director-Administration and a Deputy Executive Director-Technical. The latter position effectively serves as Director of Public Utilities. A Director of Public Utilities exists in Mississippi and North Dakota.

At this time, it appears that the establishment of a Director of Public Utilities may not be adequately warranted. Reasons for allowing the utility Divisions to continue to report directly to the Judges include:

- It will be difficult to recruit a person with the requisite skills. The appropriate person would need expertise in each of the four utility sectors and superior communications and facilitation skills. Utility and regulatory generalists with an adequate depth of understanding of both energy and telecommunications are rare.
- It is important that the Judges receive a full range of options, rather than the staff-selected option so that Judges receive the full benefit of competing viewpoints. Over-insulation from the give and take of the debate and over-reliance on the viewpoint of one person would be harmful to the regulatory process. Put another way, a Director of Utilities would have the opportunity to exercise tremendous influence on the process; that influence could be toxic.
- Stakeholder recommendation of the establishment of a Director of Public Utilities is not uniform. While some cite the need, others do not support the expenditure and believe that the benefit would not exceed the cost.

Other organizational options are available, however, with which to coordinate and manage public utility functions. One alternative to the creation of a Director of Public Utilities might be to consolidate the five current public utility Divisions into two sector-specific Divisions (Communications and Energy), reducing the number of public utility Divisions and Directors from five to two. That consolidation would simplify the organization, lessen the need for coordination across utility Divisions, and limit the need for stakeholders to "shop" for the staff opinion. In addition, market conditions in energy and telecommunications are, currently, significantly different, thereby providing more justification for the separation of telecommunications activities from energy activities. In the future, that separation may need to be reconsidered as market conditions further converge. The creation of two sector-specific Divisions could be regarded as an interim, trial step towards the eventual creation of a single Utility Division. The "rolling up" of the

current five Divisions into two Divisions would need to be accomplished carefully, in part to ensure that all necessary regulatory capabilities were available in each Division and that appropriate personnel assignments were made.

A second option, which may be even more "future oriented" might be to organize the SCC into traditional and competitive functions. Several state public utility commissions have experimented with or are considering the creation of something like a division of competitive services. That option has the advantages of assembling in one unit the expertise necessary for the oversight of largely-competitive markets and confirming the fact that competitive markets require different regulatory methods than traditional markets.

A third option would be to allow the Office of the General Counsel to take the lead in coordination of staff across the utility Divisions as the staff case is being prepared and presented. Legal staff could not be expected to provide the analytic lead in all cases but might serve as a focal point of case coordination. At other utility regulatory commissions across the nation, the staff counsel sometimes assumes the lead role in preparation of the staff case, in part due to the legal nature of proceedings. This leadership is sometimes informal.

A fourth option is to simply assign, by agreement between the Divisions, a case manager from one of the Divisions for every case. That individual would be responsible for keeping each case "on track," coordinating efforts between Divisions, and serving as a point of contact. The assignment of a responsible individual for a case has been occasionally employed at the SCC.

Not enough information is available at this time for the NRRI to make any recommendations about these or other options; they are, therefore, only options that might be considered in the future. The organization and coordination of the public utility functions will be further considered in the final NRRI report. Also considered will be the proper role for and independence of the staff.

Part 3: The Scope of SCC Regulatory Functions

As noted earlier, the SCC is unique in that public utility, financial institutions, securities, and insurance regulation is contained within one agency. According to the 1987 Report of the Joint Legislative Audit and Review Commission,

> The SCC has broad powers. Created as an independent agency outside the three branches of State government, it exercises legislative, judicial, and executive powers as set out in the *Constitution of Virginia*. In this capacity, it represents a departure from the separation of powers doctrine which affects the role and organization of the rest of the State government.

The SCC was established in 1902 to regulate railroads, telephones, telegraphs, and other transportation companies, to grant charters of incorporation in Virginia, and to administer corporate laws. Insurance regulation was added in 1906, banking regulation in 1910, rate regulation for public utilities in 1914, the regulation of investment securities in 1918, motor vehicles in 1923,[18] trademarks in 1948, service marks in 1958, and franchise regulation in 1972. In 1971, the *Constitution of Virginia* was amended, giving the General Assembly more authority over the jurisdiction and work of the SCC, though the basic structure and functions of the SCC were reaffirmed.

In 1975, the Commission on State Governmental Management (the Hopkins Commission) focused much of its work on the SCC. It made 12 recommendations for changes in the functions of the SCC; two (the transfer of the Fire Marshall Division and the creation of a Department of Aviation outside the SCC to assume the duties of its former Division of Aeronautics) were acted upon. The transfer of the Securities Division, Bureau of Banking, and Bureau of Insurance to a proposed Office of Agriculture, Commerce and Labor was recommended but not implemented.

A hallmark of the SCC's establishment and operations is its independence from the remainder of state government. In the current regulatory environment, agency

[18] The 1995 General Assembly passed legislation moving the SCC's motor carrier responsibilities to the Virginia Department of Motor Vehicles and the Virginia State Police.

independence is most appropriate when the agency is involved in the enforcement of existing legislation or involved in fact-finding of the type required for rate setting functions. Apolitical hearings are the best option when regulatory agencies are taking action against businesses that have violated clear guidelines. In the U.S. system, political involvement is imperative when agencies make policies that affect entire industries. Public utility commissions around the nation are moving from models of clear independence to models of greater involvement with state legislators as the role of those commissions shifts from individual-company rate-setting to industry-wide policy making. Where enforcement of the law is necessary for individual firms, commissions should remain independent from political processes, though ultimately accountable to the public. But where policy making is necessary, commissions need to create case-by-case, issue-by-issue arrangements with state legislatures to determine the scope of policy making to be reserved to the commission.

At the SCC, insurance, financial institutions, and securities regulation seem to have struck a clear and workable balance with the General Assembly between policy making and enforcement. The Directors of those Divisions highly value the independence of the SCC in enforcement actions and are, reportedly the envy of their professional peers around the nation. When they recognize the need to make policy affecting their respective industries, they involve the Judges and the legislature. As public utility markets reach the competitive maturity of those industries, the appropriate allocation of responsibility for enforcement and policy making may become more apparent, and the model of regulation employed by insurance, banking and securities regulators might well be emulated for utility regulation by the SCC and other agencies across the nation with public utility responsibility. In the meantime, the roles of the SCC and the General Assembly in utility industry policy making and the implementation of utility policy have evolved, will continue to evolve (particularly in the electric industry), and may experience additional "growing pains."

With regard to whether it is appropriate to house such disparate regulatory functions in one agency, it can, in fact, be argued that the Virginia *Constitution* and General Assembly were prescient in assigning these once disparate functions to the SCC.

Regulatory issues across these industries will likely continue to converge. All of them have experienced to greater or lesser degrees the transition from monopoly to competitive or partly competitive markets, federal preemption, provider proliferation and the expansion of service-offering types. This convergence is likely to accelerate in the future.

Initially, therefore, it is our recommendation that these regulatory functions be maintained at the SCC for two principal reasons: 1) the maintenance of an independent agency for enforcement of the law governing these economic entities and 2) maintenance of the expertise within one agency for the economic oversight of these increasingly complex, convergent, and interrelated issues. Continued work will be necessary to carve out a good policy making partnership between the General Assembly and the SCC for the public utilities. It is possible, however, that in the fairly near future other state governments will look to the Virginia model for economic regulation of these key sectors. In its final report, the NRRI will more fully explore the phenomenon of regulatory convergence across these industries.

APPENDIX II

THE CREATION OF DYNAMIC REGULATORY AGENCIES: AN IMPLEMENTATION GUIDE[19]

The five-part model for regulatory success that was described earlier suggests that successful regulatory agencies need to have various attributes to position themselves for success in changing circumstances. These attributes (Figure 2) include being:

- Outwardly focused. For too long, public utility regulatory agencies have focused on their internal processes and dynamics. In the meantime, the environment shifted and some players in the regulatory game sought solutions outside public utility commissions and established dialogues with state legislatures that dramatically changed the regulatory landscape. Now, public utility commissions also need to turn their attention toward their interactions with key players outside the commission–legislators, utilities, the economic development community, and, most importantly, consumers of public utility services.
- Multi-dimensional. In the past, quasi-judicial processes effectively sustained public utility regulation in an environment in which ratecases were the principal means of interaction between utilities and regulators. Now, policy making, consensus building, dispute resolution, the provision of information, and consumer interaction are sharing the regulatory stage. As a result, commissions need to build an array of

[19] This model was created by the authors not as a part of this contract but as a chapter in a forthcoming NRRI report entitled *The Creation of Dynamic Regulatory Institutions.*

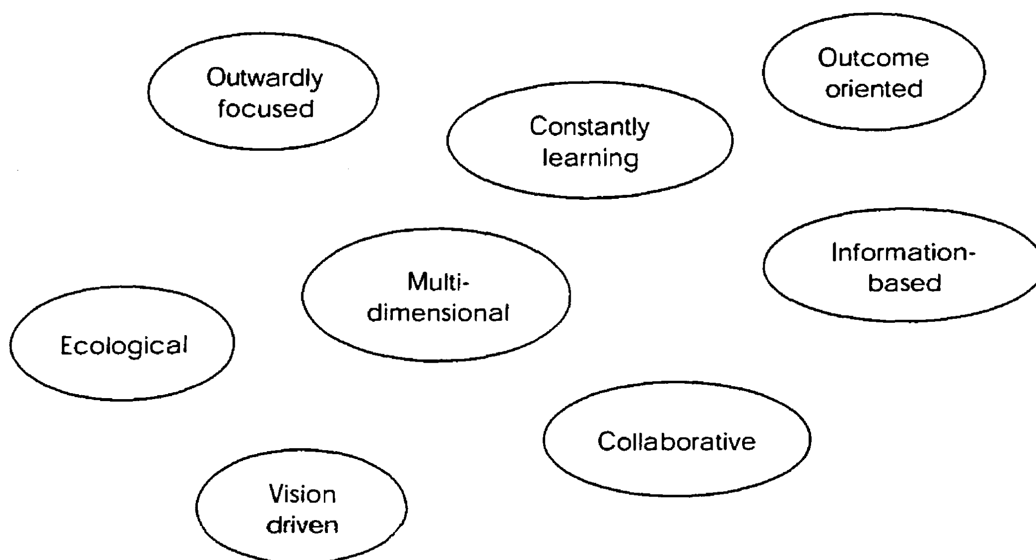

Figure 2: Characteristics of dynamic regulatory agencies.

regulatory methods suited to local circumstances and changing conditions.[20]

! Outcome oriented. Performance evaluation for public utility commissions has been an imperfect art that has relied on measures of balance, efficiency, or regulatory failure. In the future, effective regulatory agencies must be able to justify their worth to legislators and to citizens. Outcome measures of performance, which several states are in the process of applying, are the key.[21]

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[20] For more information about the alternative roles that public utility commissions can apply, see David Wirick, *New Models of Regulatory Commission Performance: The Diversity Imperative* (Columbus, Ohio: NRRI, 1999).

[21] For more information about regulatory commission performance assessment and the development of outcome indicators of performance, see David Wirick, et al., *Organizational Transformation: Ensuring the Relevance of Public Utility Commissions* (Columbus, Ohio: NRRI, 1998), Chapter Six.

! Ecological. According to Arie de Geus, who studied companies with extremely long lives, environmental sensitivity is one of the four key determinants of organizational success. (The others are a strong sense of identity, tolerance, and conservative financing).[22] The organizations that have been able to survive for extended periods, he says, "remained in harmony with the world around them" and "managed to react in a timely fashion to the conditions of society around them."[23] Dynamic regulatory agencies will recognize that they exist in concert with their environments, a recognition that was clouded in the past by attempts to achieve effective command and control regulation. In order to develop links to their external environments, and to maximize regulatory efficiency, regulatory agencies will need to establish alliances with other agencies with partial regulatory purview.

! Constantly learning. In order to maintain the flexibility to reinvent themselves as circumstances change, regulatory agencies need to be constantly involved in and committed to a process of constant learning. Today's regulatory solution will not fit tomorrow's circumstances, and the adaptation for tomorrow will not fit the circumstance of the day after. If regulatory agencies are to remain optimally effective, relevant, and vital, they will need to engage in an open dialogue to identify trends, expectations, threats, and opportunities. According to Peter Senge, organizational learning is based on five "learning disciplines," which are personal mastery (i.e., learning to expand our personal capacity to create the results we most desire), mental models (i.e., reflecting upon, continually clarifying, and improving our pictures of the world), shared vision (i.e., building a sense of commitment in a group by developing

[22] Arie de Geus, *The Living Company*, (Boston, Massachusetts: Harvard Business School Press, 1997), 6.

[23] Ibid.

shared images of the future we seek to create), team learning (i.e., transforming conversational and collective thinking skills), and systems thinking (i.e., a way of thinking about, and language for describing and understanding, the forces and interrelationships that shape the behavior of systems).[24]

! Outcome oriented. Organizations exist in order to accomplish purposes. Without the ability to measure performance against outcomes clearly linked to those purposes, organizations will not have the ability to maximize the deployment of resources or defend themselves against critics who attempt to argue that they do not accomplish the necessary public interest outcomes. Making an organization accountable can be frightening to those who staff and manage the organization, is a serious undertaking that requires the collection of performance data, requires the application of judgement in that few government agency performance measures lie entirely within the control of the agency, but, nonetheless, is mandatory for agencies that seek optimal performance.

! Collaborative. In any endeavor, including economic, social, or administrative regulation, the exercise of power is always met by a responsive exercise of power. Therefore, agencies that rely predominantly on the flexing of their muscles will be met with a response from those they govern, a response that will seek to either challenge or subvert. In some instances, punitive action against those who clearly violate market rules for example, the exercise of regulatory power is mandatory. For the most part, however, regulatory agencies rely on the consent of those they govern, and establishing consensus on regulatory outcomes and regulatory methods is imperative for long-term

[24] Peter Senge et al., *The Fifth Discipline Fieldbook: Strategies and Tools for Building a Learning Organization* (New York, NY: Currency Doubleday, 1994), 6.

success of a regulatory regime. Just as power begets power, collaboration begets cooperation. Wherever possible, successful regulatory agencies, of which one example is the Securities and Exchange Commission, hold power in reserve.

! Information Based. Even now, the stock-in-trade of regulatory agencies is the exchange of information with regulated entities, the public, and other affected parties. Given the increasing speed with which information can be processed and transmitted and the ability of organizations and people to gather and assimilate information, the regulatory agency of the future will rely extensively on information exchange to not only streamline processes but to accomplish its mission. Peter Drucker says that government agencies of the future "will be knowledge-based, composed largely of specialists who direct and discipline their own performance through organized feedback from colleagues and customers."[25] The key to the ability of those feedback loops to direct regulatory action will be a continual dialogue between regulatory agencies and their customers and constituents.

! Vision Driven. No human endeavor can achieve spectacular results without engaging both the hearts and the minds of those involved. In organizations, the tool best suited for mobilizing hearts and minds is the organization's vision, a concept no more complex than the identification of the result that the organization most deeply desires to achieve, described in present tense.[26] Unlike the organization's mission, which is often externally prescribed or defined in terms of basic purposes, articulation of the organization's vision allows for more

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[25] Peter Drucker, *The New Realities in Government and Politics/in Economics and Business/in Society and World View* (New York, NY: Harper and Row Publishers, 1989), 207

[26] Peter Senge, et al., *The Fifth Discipline Fieldbook* (New York, NY: Currency Doubleday, 1994), 201, 302.

creativity by those who currently reside in or are responsible for the organization. Visions, to be effective, need to be doable yet a stretch, understandable, and motivating. The achievement of that vision, once articulated, becomes the simple standard for evaluation of the organization's attempt to change itself.

Creating regulatory agencies that are described by these characteristics will be a challenge complicated by the fact that regulatory agencies are complex, specialized entities, facing regulatory environments that are changing at different speeds for each utility sector. For change to be successful, deeply embedded in the organization, and long-lasting, it cannot merely focus on one or two elements of regulatory operations. It will need to address human resources, the organization of the agency, information systems, performance assessment, process and regulatory methods, enabling legislation and rules, and strategic alliances. It will need to be informed by strategic intelligence, and, as a by-product of changes in the other elements, it will need to change the organization's culture. The key for evaluation and change of each of these elements is, once again, the context provided by the unique strategic vision established for the agency. The key question for each element is: how must this element change in order for us to achieve our vision?

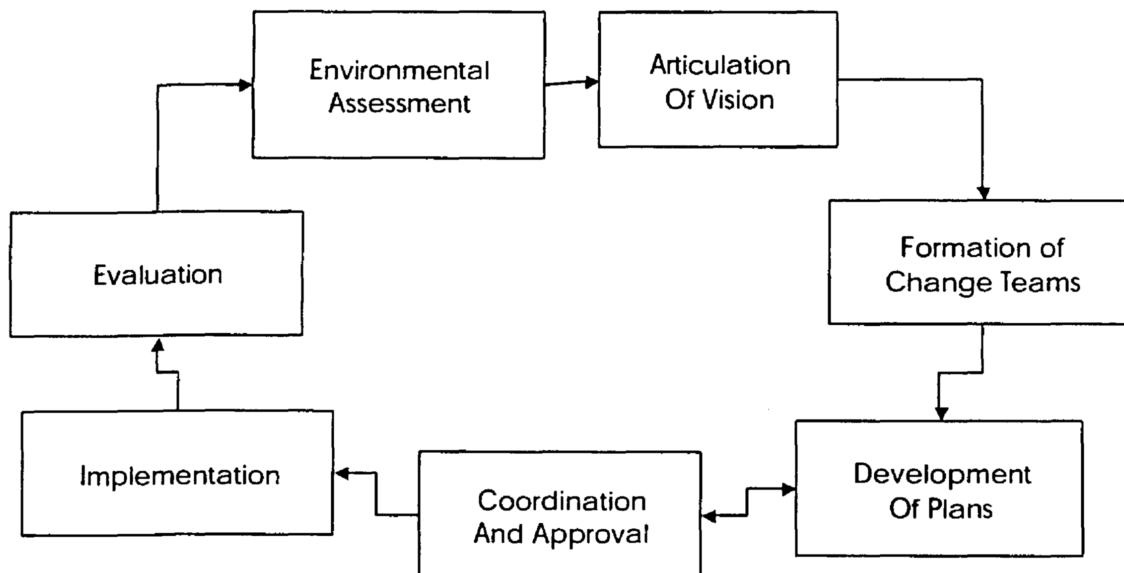
In addition to being a complex task, the types of change required for the creation of regulatory agencies that meet the criteria listed above cannot be imposed from the outside but must be self-generated (though outside facilitation can be useful). According to Jerry Sternin, who is pioneering a change method described as "amplifying positive deviance" (the key to which is the identification and replication of informal solutions that people in similar circumstances have developed–a version of the types of "emergent" organizational solutions described earlier):[27]

> The traditional model for social and organizational change doesn't work. It never has. You can't bring permanent solutions in from the outside....Set up

[27] David Dorsey, "Positive Deviant," *Fast Company*, December 2000, 286-288.

a situation in which people–including those who need to change the way that they operate–can discover, on their own, a better way to do things. Raise questions, but let the group come up with the answers on its own.

Figure 3 illustrates one planning process that can be applied to the creation of regulatory change. It is based on the model employed by the Iowa Utilities Board, in which staff teams were created with extensive ability and responsibility for recommending organizational change. Planning processes, of course, should be designed to fit state specific purposes and, unfortunately in that environments always change, must be iterative and to a degree never-ending, though periods of intense planning activity can be offset with periods of less-intense activity. Ultimately, however, any regulatory or organizational "answer" must be regarded as temporary, to be adjusted or replaced when feedback is gathered about its success and as environmental circumstances change.



This is one planning process that can be adopted; processes can and should be designed to fit state-specific circumstances.

Figure 3: The creation of dynamic regulatory agencies:
A planning process.

This planning model begins with an environmental assessment. That assessment may include stakeholder (and consumer) interviews or surveys; scenario planning (as described by Peter Schwartz et al.); and identification of commission strengths, weaknesses, opportunities, and threats. Too often, environmental assessment begins and ends with a short exercise involving only those internal to the organization. No private sector enterprise would launch a product based only on the opinions of the product developers; prior to product introduction, products are tested on real consumers. Similarly, regulatory agencies, if they are to successfully interact with their environments, need to gather data from those who are impacted by their activities and spend time questioning assumptions. Learning from the environment is optimized by time spent interacting with people and organizations that are the least like the commission.[28] Because of the nature of adversarial, quasi-judicial processes, regulatory commissions have not commonly been engaged in an open and active dialogue with their external environments. The creation of dynamic regulatory agencies requires an accurate, intentional, and ongoing dialogue with those environments to identify current conditions and future trends.

With that assessment of the commission's environment, the development of a compelling vision can begin. That vision provides the basic context in which all strategy, change and organizational health can arise.[29] According to Burt Nanus, there is no more powerful engine driving an organization toward excellence and long-range success than an attractive, worthwhile and achievable vision of the future, widely shared.[30]

Tools applicable for vision creation might include systems thinking (as described by Peter Senge), Advanced Change Theory (Robert Quinn), the use of metaphors (Gareth Morgan), and Learned Optimism (Martin Seligman). Ultimately, the development of a

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[28] Anna Muoio, "GM Has a New Model for Change," *Fast Company*, December 2000, 64.

[29] David Kyle, *The Four Powers of Leadership: Presence, Intention, Wisdom, Compassion* (Deerfield Beach, Florida: Health Communications, 1998), 168.

[30] Burt Nanus, *Visionary Leadership* (San Francisco, CA: Jossey-Bass, 1992) as cited in David Kyle, *The Four Powers of Leadership: Presence, Intention, Wisdom, Compassion* (Deerfield Beach, Florida: Health Communications, 1998), 168.

compelling agency vision relies on the strength of its leadership, which must be the source of vision, its principal voice, and a force that focuses the agency's energies on pursuit of the vision.[31]

If teams are to be a component of the change process, and they should be, there are a number of considerations that effect the formation and operation of those teams. Who should the teams be composed of? Staff? From which commission divisions? Managers? Commissioners? External stakeholders? In that it is probably infeasible to address all of the elements of commission regulation in the first iteration, which of the elements listed earlier should be addressed in that first iteration of the change process? Should the simplest or the most difficult be addressed first? How will teams be led? Self-elected leadership or appointed leadership? Who might facilitate the work of the teams? External facilitators? Internal facilitators? What resources will teams have at their disposal? Consultants? Data collection? Staff time? Secretarial support? A number of resources are available to guide the formation, motivation, and management of team efforts.

Once the vision is in place and work teams created, the development of specific and tangible change initiatives can begin. The team activities that are required by this planning process can be aided by outside facilitation, and the application of the concepts inherent in systems thinking (Peter Senge et al.), Organizing Genius (Warren Bennis et al.), organizational ecology (Arie de Geus), balancing advocacy and inquiry (Senge et al.), self-organizing systems (various authors including Robert Quinn and John Briggs and David Peat), conflict resolution (William Ury), and the Amplification of Positive Deviance (Jerry Sternin). The specific plans for change that address the chosen elements of commission operations and that evolve from this process will require coordination.

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[31] David T. Kyle, *The Four Powers of Leadership: Presence, Intention, Wisdom, Compassion* (Deerfield Beach, Florida: Health Communications, Inc., 1998), 167.

In summary, the keys to this type of change implementation effort are:

! The development of an accurate understanding of the environment the organization operates within, determination of the correct environmental "fit," and creation of an active, ongoing dialogue with players in the environment.

! Soliciting the input of stakeholders and ensuring that they have some ability to participate in the change creation process.

! Applying systems thinking and questioning assumptions so that the right questions can be asked and answered.

! Creating a vision by the leadership of the organization and ensuring that the vision is widely shared by participants so that it may serve as the context within which all of the change initiatives can be integrated.

! Performing the hard work of managing the teams and implementing change initiatives.

! Making a commitment to ongoing change (i.e., to change as a way of organizational life).

Without question, creating the type of organizational change is not an endeavor that should be undertaken lightly. It will require time and effort and, if done correctly, shake the foundations of the status quo. To some extent, however, regulatory agencies have no choice but to embark on the creation of new types of regulatory models and agencies. Times have changed, the old models of regulation are under assault, and without change, public interest outcomes may not be adequately attended to.

National Regulatory Research Institute
David Wirick/John Wilhelm
Final Report
Summary of Recommendations

1. The SCC should consider the establishment of a Director of Administration. (p. 3)

2. The SCC should not establish a Director of Public Utilities at this time. (p. 3)

3. The SCC should continue to be assigned the regulation of public utilities, securities, insurance and financial institutions. (p. 4)

4. The SCC should embark on a process of strategic planning and organizational redefinition. (p. 17)

5. The SCC should adopt a stronger model of ex parte separation between the staff and judges. (p.23)

6. More resources should be provided to the Office of the Attorney General. (p. 25)

7. The SCC and the Attorney General should create a dialogue to identify how to ensure that the Attorney General's Office is engaged in all of the cases that warrant explicit consumer representation. (p. 25)

8. The SCC should evaluate the organization and resources available to the Office of General Counsel. (p. 29)

9. The SCC should establish a dialogue with legislative members. (p. 32)

10. The SCC, as a part of its strategic planning process, should clearly identify its role, its mission, and its vision for the encouragement of more-competitive utility markets. (p. 33)

11. The SCC should create rules and procedures for alternative dispute resolution application. (p. 35)

12. The SCC should identify appropriate opportunities for alternative dispute resolution, and promote its use. (p. 35)

13. Other Divisions should follow the lead of the Bureau of Insurance and Division of Securities in creating consumer-friendly information. (p. 38)

14. The consumer complaint handling process should be standardized, automated, and coordinated. (p. 38)

15. The SCC in concert with the Office of the Attorney General should undertake an effort to better involve consumers in SCC proceedings and policy making. (p. 39)

16. The SCC should continue to integrate its information systems plan into an overall SCC strategic plan. (p. 41)

17. The SCC should consider with the strategic planning process the best organization for provision of information systems support to its Divisions. (p. 41)

18. Consideration should be given to the potential for information provision to consumers and other stakeholders to create a form of "regulation by information". (p. 41)

19. The SCC should embark on an effort, linked to its strategic plan and its effort to identify performance criteria, identify the best organization for pursuit of the public interest. (p. 46)

20. The SCC, within the strategic planning process, should involve stakeholders in the identification and application of measures of agency performance. (p. 50)

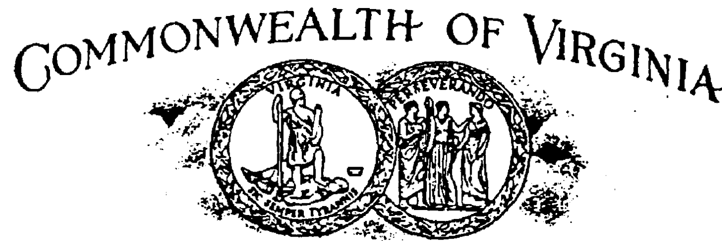
21. The SCC should employ those performance measures to position itself with the public and make the public aware of its substantial and beneficial impact. (p. 50)

22. The SCC should continue to dedicate resources to technical training. (p. 52)

23. The SCC should identify and invest in those staff members who have the capability for future leadership. (p. 52)

24. Despite the pressures of the high workloads on managers, the SCC should attempt to provide more training to supervisors. (p. 53)

25. The SCC should evaluate the level of security provided for staff. (p. 53)



CLINTON MILLER
CHAIRMAN

THEODORE V. MORRISON, JR.
COMMISSIONER

HULLIHEN WILLIAMS MOORE
COMMISSIONER

JOEL H. PECK
CLERK OF THE COMMISSION
P.O. BOX 1197
RICHMOND, VIRGINIA 23218-1197

STATE CORPORATION COMMISSION

April 9, 2001

Mr. Dave Wirick
Mr. John Wilhelm
The National Regulatory Research Institute
1080 Carmack Road
Columbus, Ohio 43210

Re: Final Report on the Virginia State Corporation Commission ("Report")

Dear Sirs:

We are in receipt of the above-referenced Report, and we would like to thank you for your efforts in this matter. The State Corporation Commission ("Commission") will consider all of the recommendations that you included in the Report.

A wide audience, with varying degrees of sophistication and understanding of the Commission, will undoubtedly scrutinize the Report. Many of these individuals may not comprehend some of the nuances of the regulatory process, nor may they be familiar with many of the details enumerated in the Report. For this reason, we are compelled to address a few passages of the Report that are factually inaccurate.

For example, on page 10 of the Report, you note that --

"[a] criticism was also lodged about the SCC's refusal to arbitrate interconnection disputes as provided under Federal law. The result, it is argued, is that interconnection agreements, critical to telecommunications competition, are not being arbitrated at the state level, thereby forcing new entrants to seek redress at the Federal Communications Commission, which, it is alleged, is moving far too slowly. The SCC argues that it does not have the authority to waive the Commonwealth's sovereign immunity."

Left unanswered, this portrayal of the Commission might lead the untrained observer to believe the Commission is reluctant or recalcitrant to carry out the mandates of federal law.

The Commission readily began arbitrating interconnection agreements pursuant to the 1996 Telecommunications Act soon after it was enacted. As you are probably aware, however, certain parties appealed to federal court certain agreements that the SCC had arbitrated.

TYLER BUILDING, 1300 EAST MAIN STREET, RICHMOND, VA 23219-3630 TELECOMMUNICATIONS DEVICE FOR THE DEAF-TDD/VOICE: (804) 371-9206

The Commission argued to the federal district court that the Eleventh Amendment to the United States Constitution barred that court from asserting jurisdiction over the Commission. Instead, the Commission asserted that the sole avenue for review is an appeal of right to the Virginia Supreme Court. The federal court, however, held that the Commission, by undertaking review of interconnection agreements pursuant to the 1996 Act, had waived the state's Eleventh Amendment sovereign immunity. Due to the fact that the Commission is not empowered to waive the Commonwealth's sovereign immunity, a right that resides in the General Assembly, the Commission was compelled to cease arbitrating these agreements.

You should also be aware that the United States Supreme Court has accepted a case that will determine whether the Fourth Circuit's view, which is in accord with the position taken by the Commission, or whether the position taken by other Circuit Courts of Appeals, should prevail as the law of the land. The United States Supreme Court may ultimately reject the Commission's position, but your characterization misses most of the complexity and subtlety of the basis for the Commission's actions to date.

Another area of concern to us can be found on pages 18 and 34 of the Report. These pages discuss the number of SCC cases that are settled, that settlements are a recent development, and the fact that no mechanism is in place for alternative dispute resolution --

"SCC staff have completed 54 settlements in the last few years..."

"Staff were cited as beginning to work toward settlements in gas regulation..."

"The lack of an established alternative dispute resolution (ADR) process and settlement process was cited as an impediment to better use of those processes, and the failure of notable collaborative efforts in the past was cited as a serious impediment to the willingness of stakeholders to participate in future collaborations."

It is unfortunate that this reference to 54 settlements seriously understates the number of cases the Commission settles each year. And we were surprised to see your statement that this has been a recent practice with regard to natural gas cases.

Over the past five years, settlements were reached in 17 of 25 cases in which a natural gas company was either seeking an increase in annual operating revenue or SCC staff was conducting an annual financial review. And, while the reference to 54 settlements most likely refers to selected public utility cases, the stand-alone number fails to capture the magnitude of the public utility cases that were settled.

The casual reader may be interested in knowing that these settled cases resulted in the largest rate reductions and refunds in the history of Virginia's two largest electric utilities, a combined $700 million for Virginia Power customers and a combined $56 million to AEP-Virginia customers. Other settlements of significance included the merger of Dominion Resources and Consolidated Natural Gas that involved the spin-off of Virginia's third largest natural gas company - Virginia Natural Gas, and the functional separation plans of both Allegheny Power and Delmarva Power and Light.

In addition, several recent settlements have been reached in the telecommunications area. For example, intrastate access charges will be reduced by an estimated $270 million over the next five years for Verizon Virginia Inc. (formerly Bell Atlantic-Virginia) and $101 million for Verizon South Inc. (formerly GTE South) as a result of agreements reached between these companies and staff.

The Report also fails to mention hundreds of other cases that are settled each year in other areas within the Commission's jurisdiction. For example, last year the Commission settled at least 200 insurance cases as well as numerous securities cases. In addition, it is not unusual to have as many as 50 cases a month settled regarding alleged violations of Virginia's Underground Utility Damage Prevention Act -- a total of more than 600 last year. There were also a half dozen settlements of cases involving alleged violations of laws involving natural gas pipeline safety.

Our point in this discussion is simply that it should be readily apparent that the great majority of cases under the Commission's purview in any division are disposed of through negotiated settlements.

Finally, we think it is important to note that in many cases that are litigated, the parties and SCC staff work together to greatly narrow the scope of contested issues prior to hearing. The Commission encourages parties, as well as SCC staff, to work out as many differences as possible during the pre-hearing phase. By the time of the hearing, many of the facts and issues are stipulated, which allows the parties to concentrate their energy and resources solely on those issues remaining in dispute.

On page 36, you incorrectly assert that --

> *"[p]ublic witnesses cannot be cross-examined though cross-examination would be allowed in one of the Proposed Rules of Practice and Procedure."*

Cross-examination of public witnesses is permitted under the present Rules, although it is done infrequently. One of the Proposed Rules of Practice and Procedure would simply specifically incorporate this practice into the Rules.

Your Report also omits the numerous avenues through which the various divisions of the Commission provide information to the public and the industries we regulate.

We are not attempting here to address the issues in the Report or areas of the Report that may be, in our opinion, incomplete. It is submitted, however, that the aforementioned statements in the Report are erroneous enough to potentially mislead readers. It is for that reason that we are sending this response to the Report. Our exclusion from this letter of other matters in your Report should not be taken as either an endorsement or rejection of the merits of those unaddressed issues.

Sincerely,

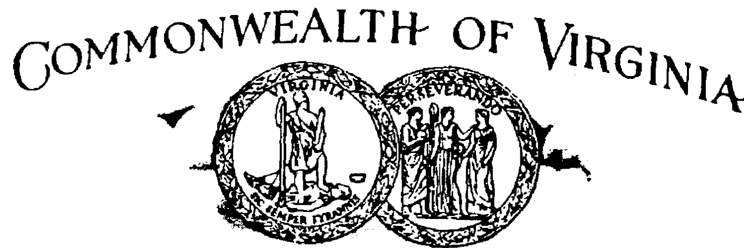
Chairman Clinton Miller

Commissioner Theodore V. Morrison, Jr.

Commissioner Hullihen Williams Moore

KEN SCHRAD
DIRECTOR

ANGELA P. BOWSER
ASSISTANT DIRECTOR



PO BOX 1197
RICHMOND, VIRGINIA 23218-1197
(804) 371-9141
TDD/VOICE: (804) 371-9206
FAX (804) 371-9211

http://www.state.va.us/scc

STATE CORPORATION COMMISSION
INFORMATION RESOURCES

June 29, 2001

The Honorable Thomas K. Norment, Jr., Chairman
Members, Joint Subcommittee Studying the SCC
Kenneth J. Button, School of Public Policy, George Mason University

Dear Senator Norment, Members Joint Subcommittee, and Mr. Button:

The State Corporation Commission appreciates the opportunity to submit written comments on the first interim report of the George Mason University study team. The SCC has involved its staff to review the report. Our primary objective has been to ensure that the information in the report, as it applies to the Commission's current operations, is "technically correct."

Some members of the GMU study team spent several days in March meeting with the Commissioners and certain key members of the SCC staff. A considerable amount of information was shared with the study team. Follow-up interviews occurred and additional support information was provided.

The SCC has analyzed, in the limited time frame allowed, all aspects, findings and conclusions contained in this first interim report. And, as per the instruction of the chairman at the June 15 meeting, the SCC has attempted to clarify those areas of the report that question, in concept, the Commission's current approach to regulation.

The Commission wishes to emphasize that in carrying out its regulatory responsibilities, it is implementing the laws enacted by the General Assembly. As such, the Commission must adhere to the Code of Virginia regarding the degree of competition or regulation required by statute.

In many proceedings at the Commission, differing parties offer conflicting points of view regarding the same statutory language. The Commission's primary goal in every decision - whether administrative, legislative, or judicial - is to strive to implement legislative intent as determined by the rules of statutory construction.

Frankly, there are some sections of the GMU first draft that the Commission and staff are unable to decipher. We would be happy to work directly with the GMU study team if our responses do not provide sufficient data or explanation to be of assistance in the development of the next draft of the report.

We have and continue to invite members of the joint subcommittee to make individual inquiries of the Commission or its staff for any information a member might deem helpful in fully understanding the various functions and responsibilities of the SCC. In extending such an offer, members are reminded that the Commissioners must exercise care in not discussing issues related to pending cases.

Sincerely,

Ken Schrad

cc: Chairman Miller
Commissioner Morrison
Commissioner Moore
Amigo R. Wade, Legislative Services, Senior Attorney
David Rosenberg, Legislative Services, Staff Attorney

COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

Response of the

State Corporation Commission

to the

1st Draft Report of SCC Study

June 29, 2001

Response of the State Corporation Commission

to the

1st Draft Report of SCC Study

June 29, 2001

Executive Summary

The first draft report can best be described as an "exposure draft." It contains --

- a set of recommendations for consideration;
- certain assumptions made by the study team to support them;
- some misstatements, errors or mistakes that may simply be misunderstandings by the study team; and
- perceived problem areas the Commission may be able to remedy itself.

The SCC's internal study ["Final Report of the Virginia State Corporation Commission" by David Wirick and John Wilhelm - March 2001] identified numerous steps the SCC should consider for self-improvement. The Commission continues its review of the 25 recommendations made by Mr. Wirick and promises to look for formal and informal opportunities to implement those that will be helpful and can be reasonably incorporated into current operations.

Obviously, the Commission wants to make sure that if it embarks on any such changes, it does in fact address beneficial suggestions raised in both the SCC's internal study and the legislative study. In other words, the Commission wishes to coordinate the best of both studies.

The Commission is prepared to work with the GMU study team to make sure the final report is "technically correct." A list identifying factual errors with suggested corrections, clarifications and additions has been provided. The list includes a reference to the pages on which they occur. The version of the report posted to the study's web site was used. Since the GMU study team has stated it will be correcting typographical errors, they have not been identified.

Comments have been provided on each of the 29 recommendations contained in the GMU draft report. Given the importance of this report, the Commission is confident that the subcommittee is interested in a final product that is factually correct, complete in its relevant information, and balanced.

Of particular concern to the Commission is Dr. Kenneth Button's characterization at the subcommittee's June 15 meeting that the "ethos of the Commission is not correct." The problem may be that GMU has focused on regulation or deregulation in Virginia as a whole without adequately distinguishing between the role of the General Assembly in

establishing the basic policy and parameters for regulated entities and the actions of the Commission in implementing the laws enacted by the General Assembly.

Specifically, the General Assembly has not directed or allowed the Commission to let markets function until it can be shown that they are "broken." Rather, the Code of Virginia, in the vast majority of cases, requires the Commission to protect the consumer directly through restrictions, examinations and other means of regulation.

Through its oversight of highly competitive industries like insurance, banking and securities and its oversight of what have been monopoly services such as public utilities, the Commission believes it understands the "basic principle" of competitive markets. But, even in competitive markets the General Assembly has directed the Commission to take appropriate steps to avert isolated instances of a "market failure."

There is no greater evidence of this than in insurance and banking legislation. Clearly, it is the wish of the General Assembly that this Commission not wait until a bank fails or an insurance company becomes insolvent before taking "regulatory" action. The filing of financial information and the routine examination of banks and insurance companies are necessities that may be a small burden for these institutions, but critical to the safety and soundness of the industry as a whole and the ultimate protection of Virginia consumers.

The Virginia Securities Act has the primary purpose of protecting Virginia investors from fraud and misrepresentation. Nowhere has the SCC seen greater evidence of the opportunity to "make a buck" lead to questionable practices that prey on the nest eggs of unsuspecting and less savvy Virginians. Adequate protections under Virginia law promote investor confidence and a greater willingness to invest in Virginia companies searching for capital.

In telecommunications, Virginia introduced the concept of local telephone competition a year before the Federal Telecommunications Act of 1996. The General Assembly, however, did not direct or imply that the Commission should shift from focusing on protecting the consumer to promoting competition as GMU seems to suggest. Rather, the Commission is to do both. It may deregulate incumbent local exchange companies, but only after it finds that local service is "subject to competition." The primary standard is a finding that competition or the potential for competition in the market place is or can be an effective regulator of the price of those services. In making that determination, the Commission may consider the ease of market entry, the presence of other providers, and other factors deemed relevant by the Commission. In addition, the Commission must adopt safeguards to protect consumers and competitive markets.

In the Electric Utility Restructuring Act, the General Assembly has given the following direction to the Commission: in all decisions related to implementation (many of them to be decided in the coming months) the Commission "shall take into consideration, among other things, the goals of advancement of competition and economic development in the Commonwealth." However, the Act also provides a

number of consumer protections during the transition period -- none more prominent than rate caps on the incumbent utility companies through July 2007. But protection is not only afforded to consumers; it is also afforded to the utility companies through the imposition of the wires charge to recover potential stranded costs.

And, much like the mechanism set out for the telecommunications industry, the General Assembly has provided that the rate cap protection for customers and the industry may not be removed except upon the request of an incumbent electric utility. Before such a request may be granted, the Commission must find that "an effectively competitive market for generation services" has developed in the utility's service territory.

The Commission recognizes that once markets become truly competitive, competition can be an effective regulator and provide consumer protection. Until that point is reached, however, the Commission seeks to balance "promotion of competition" as GMU urges with "protection of the consumer" as the law requires.

One measure of the Commission's ability to "do the job" the General Assembly has instructed may be the direct right of appeal of any SCC decision to the Virginia Supreme Court. Such appeals are rarely made. When they are, Commission decisions are seldom overturned.

When the opportunity presents itself, the Commission seeks legislative clarification or direction through the legislative process. This has been accomplished by suggesting its own legislative proposals, advising lawmakers or the appropriate legislative committees of the need for legislation, or encouraging others to seek legislative solutions when the Commission determines it is unable to address a particular issue under existing law.

The Commission continues to stand ready to assist lawmakers, industry and the general public on matters that fall under the purview of the SCC. It invites and welcomes every opportunity to share with the Commonwealth the intellectual, technological and institutional expertise of Commission staff as demonstrated, in part, by extensive outreach activities. These include hundreds of meetings, seminars, presentations and talks to groups and organizations representing the industry and consumers, as well as a wealth of brochures, consumer guides and informational pamphlets.

Such activities are not, in the Commission's opinion, the characteristics of a "secret service" as described by Dr. Button in his presentation to the subcommittee on June 15. Instead, the Commission spends time and resources on meeting the responsibilities with which it has been charged, not public relations campaigns touting its performance.

Response of the State Corporation Commission
to the
1st Draft Report of SCC Study
June 29, 2001

Analytical Review

Factual Errors and Corrections

- Organizational structure states the bureaus are part of divisions. Should read - "The bureaus and the divisions are shown in Exhibit 1.1." - p. 5
- Motor vehicles should read motor carriers. - p. 6
- The Comptroller's Office was left off of the organizational chart. - p. 8
- Proper title is Commissioner, not Judge on exhibit 1.2. - p. 9
- The chart omits Title 13.1, Chapter 8 and Title 59.1, Chapter 6 for the Division of Securities and Retail Franchising. - p. 10
- The number of actual employees for Securities should be 32. - p. 11
- Motor carriers (licensing responsibilities transferred to the Department of Motor Vehicles and enforcement responsibilities transferred to the Virginia State Police in 1995). - p. 12
- Three provisions within the constitutional powers and duties of the SCC. Currently states statutory. - p. 13
- It's the Office of General Counsel not Council General. - p. 26
- Securities omitted from list of divisions with directors. - p. 27
- Titles V, VI, & VII omitted from exhibit 4A1. - p. 43
- 4B. Should be titled Financial Institutions. - p. 44
- The correct number of state-chartered institutions should be 108 banks with 1027 branches; $47 billion in assets; 59 bank holding companies; 924 mortgage lenders and brokers; 73 credit unions; 37 money order sellers; 38 check cashers; 14 non-profit debt counseling agencies. Other numbers for various entities are correct. - pp. 47 & 48
- Footnote 73 should read a 20% decline in revenue, not shortfall. - p. 47
- The Federal Reserve does not "time" exams to fit between exams conducted by the Bureau of Financial Institutions. Instead, exams are scheduled based on size and condition of the institution, as needed. - p. 49
- Section 4C should be titled Securities and Retail Franchising. - p. 55
- The statement, "the states remain free to supplement or duplicate federal requirements to whatever extent they choose" is incorrect. States have concurrent jurisdiction with the federal Securities and Exchange Commission and the states are free, within certain recently imposed limits, including the National Securities Markets Improvement Act and Gramm-Leach-Bliley Act, to regulate the securities industry. - p. 58

- Reference should be made to franchise, trademark and service mark registration responsibilities. - p. 60
- Franchise investigations should be included in the section on audits and investigations. - p. 61
- The last reference to SRF should be the SCC, "..tried by the SCC for civil violations." - p. 61
- The Securities Division does not have the highest turnover rate in the SCC. The division has lost only one employee in the last year and no more than three in the past two years. - p. 62
- Exhibit 4C-2 fails to list statistical data for registration of franchises, securities, trademarks or service marks. - p. 64
- The report states the top seven activities of the division but then only lists six items. - p. 68
- The SCC does not regulate telegraph companies. - p. 69
- There are 20 incumbent telephone companies and cooperatives, not just the 3 stated in the report. - p. 70
- SCC data indicate the market shares of Verizon and Sprint are 85% and 8% respectively rather than 90% and 10%. - p. 71
- GTE, now Verizon South, is a local exchange telephone company - the second largest in Virginia. Prior to the merger with Bell Atlantic, GTE had applied for a CLEC certificate. - p. 71
- This report, as did the Wirick report, stumbles over the Commission's position regarding the arbitration of interconnection agreements. For the record, the Commission states once again that it readily began arbitrating interconnection agreements pursuant to the 1996 Telecommunications Act soon after it was enacted. However, certain parties appealed to federal court certain agreements that the SCC had arbitrated. The Commission argued to the federal district court that the Eleventh Amendment to the United States Constitution barred that court from asserting jurisdiction over the Commission. Instead, the Commission asserted that the sole avenue for review is an appeal of right to the Virginia Supreme Court. The federal court, however, held that the Commission, by undertaking review of interconnection agreements pursuant to the 1996 Act, had waived the state's Eleventh Amendment sovereign immunity. Due to the fact that the Commission is not empowered to waive the Commonwealth's sovereign immunity, a right that resides in the General Assembly, the Commission was compelled to cease arbitrating these agreements. This issue is now awaiting a decision by the U.S. Supreme Court. - p. 71
- SCC rules governing CLECs (not statutory law) establish the rates of CLECs. Rates that are lower than the incumbent will automatically be accepted. Higher rates can be requested. - p. 71
- The SCC has granted certificates to more than 200 CLECs, not 104. As of the time of this writing, 205 had received certificates, 23 have been cancelled, withdrawn or merged with another CLEC, leaving a net total of 182. - p. 72
- The last line of Exhibit 4D-1 should be Payphone Providers, not pay telephones. - p. 76

Suggested Clarifications and Additions

- The report might well mention that there are perceived advantages of a national charter. - p. 44
- Recognition should be made that the dual state/federal system of financial institution oversight allows for the threat of conversion from a state-charter to a federal-charter and vice versa. Plus, the expansive policies given to federal savings institutions by the Office of Thrift Supervision has made such the "charter of choice" for those companies that operate or want to operate broadly across state lines. - p. 44
- Coordination between state and federal banking agencies is not a new development as implied. Examinations have been performed jointly and the respective examination reports of each have been shared. - p. 45
- The section on branch banking in Virginia needs to acknowledge that banks also may have branched interstate by merging de novo banks, as some states allow. - p. 46
- Although state-chartered banks are able to engage in insurance brokerage, it should be clarified that the underwriting of insurance is not permitted. - p. 47
- The Bureau is unaware of any interpretation of Virginia law as to whether a state-chartered bank may or may not engage in "municipal revenue bond underwriting." - p. 47
- Length of an examination depends on two things - the size of the bank <u>and</u> the financial condition of the institution. - p. 49
- It is preferable to refer to the "examination" of banks rather then interchanging with the term "inspection." - p. 49
- Streamlining the procedures for branching has been a continuous process over the years commensurate with law changes. For example, §6.1-39.3. - p. 50
- States are the only direct governmental authority over broker-dealer agents. So, it is important to include them when referring to "registration of broker-dealers <u>and their agents</u>." - pp. 58, 59 & 60
- Investment advisor representatives are subject to state regulation only. When referring to investment advisers add, "<u>and their representatives</u>." - p. 59
- The following acronym needs to be identified in the report - SRO stands for self-regulatory organization. - pp. 58 & 59
- The IARD is not yet fully operational so it would be better to say, "will provide investment advisors and state registered investment advisor representatives a one-stop filing system." - p. 59
- The 1999 Financial Services Modernization Act (GLBA) dropped the barriers between merchant and investment banking and allowed banks, securities and insurance firms to operate in each other's markets. - p. 59
- Notification registration provides for 'blue-chip' Virginia companies meeting specified asset, net worth or earnings requirements for non-Virginia issuers. - p. 60
- It would be more accurate to state that, ".., whereas the SEC typically performs only disclosure pre-registration review." - p. 62

- The collaborative committee and OSS testing are further along than implied in the report. For example, OSS testing metrics have been in place since August 2000. - p. 69
- There are considerably more factors than just "difficulty in understanding telephone bills" that have caused the number of complaints to rise in Virginia. They include billing errors (i.e. slamming and cramming) and out of service conditions. As a result, staff is considering new service standard requirements to replace those currently in use. - p. 72
- The SCC is unfamiliar with the acronym DPSC. - p. 72
- Much of the work that has occurred in Virginia since passage of the 1996 Telecommunications Act has not been included which understates the Commonwealth's progress toward a competitive telecommunications market. This includes the number of certificates granted and the more than 450 interconnection agreements approved. - p. 73
- The report did not mention that OSS testing is underway which is important to Verizon Virginia's goal of entering the long distance market. However, it was Verizon's choice to begin such testing in their larger states first -- New York, Pennsylvania, Massachusetts and New Jersey. - p. 74
- The Virginia Electric Utility Restructuring Act maintains a regulated monopoly over the transmission and distribution of electricity. - p. 86
- The report refers to a 1999 Department of Energy report that suggests Virginians pay slightly more for electricity under regulation than they would pay in a competitive market. Current information appears to contradict that statement and brings into question the validity of the DOE report. For example, SCC staff is unaware of any state in which rates have not escalated significantly when price caps were lifted and the market set the rates. The DOE report projected that delivered prices in California and Southern Nevada would fall from 9.26 cents per kilowatt-hour to 7.7 cents/kWh in 2000. In fact, price escalations were enormous; Nevada halted power plant sales and stopped restructuring; and the FERC has recently established wholesale price caps in 11 western states. The DOE report did not foresee a number of things including the rapid rise in natural gas prices and the impact of those gas prices on competitive electric prices. - p. 86
- One potential hurdle in the development of a competitive electricity market in Virginia that the report fails to mention is the limitations of the existing interstate transmission grid. There are restrictions on the amount of competitively priced electricity that can move in or out of the control areas of Virginia's incumbent utilities. - p. 86
- The report contains a dated analysis of the savings customers have reaped from competition in Pennsylvania. Approximately two-thirds of those savings are associated with rate reductions offered to both shopping and non-shopping customers in the state's restructuring settlement process. Virginians, too, have enjoyed such savings resulting from rate settlement cases involving the state's two largest electric companies in 1998 that, over the time period of those settlements, totaled more than $750 million. - p. 87

- No competitors are taking new customers in Pennsylvania at this time. In recent months, large numbers of shopping customers have returned to the incumbent utilities. As of April 1, 2001, the percent of customers in Pennsylvania that had switched stood at 15 percent of which 300,000 were required to switch to a competitive default provider. Approximately eight percent of customers have switched voluntarily. - p. 87
- Pennsylvanians are still protected by retail price caps, some of which extend until 2009, and have yet to see price signals generated by an unrestrained market. - p. 87
- In Virginia, we now have a phase-in schedule for retail electric choice that opens the Virginia market more quickly than some had envisioned. This should make Virginia more attractive to competitive suppliers and marketers because more than 2.1 million customers will be available to them by January 1, 2003. In addition, Virginia's largest natural gas company is giving choice to all of its customers by the end of this year and SCC staff is working with our second and third largest natural gas companies with respect to their plans to offer choice. - pp. 87-88
- The report appears to suggest that Virginia still has a long way to go toward opening retail access and ultimate competition in the electric industry. However, it fails to mention that the General Assembly did not endorse an attempt to slow electric industry restructuring in Virginia while other states such as Arkansas, Connecticut, Florida, Georgia, Idaho, Kansas, Montana, Nevada, New York, North Carolina, Oregon, West Virginia have slowed down. - pp. 89-91
- Although much has been learned from the gas pilot programs in Virginia, the report does not acknowledge that four competitive gas suppliers participating in those pilots went out of business. The decision not to honor their contracts to supply gas occurred when the wholesale price of gas (which is unregulated) skyrocketed during the winter months of 2000-2001. - p. 90
- It should be noted that most new power plants being built or planned in Virginia are fueled with natural gas. This increased demand may dramatically affect natural gas prices that may in turn affect electricity prices and the ability of gas-fired generation to compete with existing coal and nuclear generation owned by Virginia's incumbent utilities. - p. 90
- Since retail choice for electricity begins a statewide phase-in on January 1, 2002, the recommendation to foster more pilot programs should refer specifically to natural gas programs for which there is no statutory timeline for statewide implementation. - p. 92
- Further discussion should be offered to support recommendation 29. The SCC's response may help clarify the existing practice. - p. 92

RESPONSES TO RECOMMENDATIONS

1. The structure of regulation in Virginia has stood the test of time well and change should only be undertaken in the light of serious long-term problems. Many sectors overseen by the SCC have been going through major technical and structural changes. In itself this is not justification for change unless lack of change impairs the long-term efficiency with which Virginian's can access these services.

Since this appears to be a statement rather than a recommendation, the Commission has no comment.

2. The SCC should retain its role as the body responsible for economic regulation of the sectors currently under its oversight.

Again, this appears to be a statement of confidence in the SCC's ability to oversee these industries and there is no need for comment.

3. The basic principle of regulations should be to allow the market to function and only to intervene when there are demonstrable market failures that appropriate regulatory controls can be demonstrated to reduce.

Through its oversight of highly competitive industries like insurance, banking and securities and its oversight of what have been monopoly services such as public utilities, the Commission believes it understands the "basic principle" of competitive markets. But, even in competitive markets the General Assembly has directed the Commission to take appropriate steps to avert isolated instances of a "market failure."

There is no greater evidence of this than in insurance and banking legislation. Clearly, it is the wish of the General Assembly for this Commission not to wait until a bank fails or an insurance company becomes insolvent before taking "regulatory" action. The filing of financial information and the routine examination of banks and insurance companies are necessities that may be a small burden for these institutions, but critical to the safety and soundness of the industry as a whole and the ultimate protection of Virginia consumers.

In these competitive markets, regulation serves a more complex role than can be characterized simply as a promoter of competition. In general, regulation should serve to support a functional as well as a competitive marketplace. Minimum standards regarding solvency, for example, set forth basic rules for competitors to be let into the game. In the healthy insurance marketplace, for example, you want long-term players that will be there with the financial wherewithal to pay off long-term obligations.

Consumers need to have confidence that the entity they are dealing with will be solvent. Regulation also helps to ensure a level playing field among competitors who robustly but fairly attempt to win the consumer's business. Commission staff reviews marketing materials and contract language to determine if they are understandable, readable, and consistent. The mission is to encourage competitive markets with the proper balance between protecting the interests of consumers and fulfilling our legislatively charged duty to regulate Virginia's businesses responsibly.

The Commission, in its role as a regulator, often assists General Assembly members regarding legislation in terms of the possible consequences to Virginia's competitive marketplace. When commenting on legislation before committee, to an individual legislator, or in a fiscal impact statement, Commission staff often advises on the bill's potential impact on the particular market segment in question. Staff also outlines potential shortfalls and costs as well as the advantages and disadvantages of competition for certain market participants.

We have also been known to point out that it is within the prerogative of the General Assembly to determine public policy on certain social issues which might override apparent concerns about government intrusion into the dynamics of the market. General Assembly members generally seem to appreciate the fact that the Commission attempts to frame the issues in terms of their effect on the marketplace, given the members' appropriate concern for the impact of any legislation on Virginia's businesses and consumers when they are attempting to make public policy decisions.

As a measure of the SCC's ability to effectively monitor a competitive market, one need only look to Virginia's insurance market. It shows healthy competition overall and statistics indicate that Virginia has one of the most competitive markets for private passenger automobile, homeowners and workers' compensation insurance in the country.

The latest National Association of Insurance Commissioners (NAIC) report ranks Virginia 45th among the states (one being the highest) in terms of combined average auto premiums (liability, collision, and comprehensive). According to the most recently published report from NAIC on homeowners insurance data (1998), Virginia had the lowest average premium among the states for a homeowners special coverage form (HO-3) policy for coverage amounts in the range of $100,000 to $124,999.

Oregon performs an annual study designed to rank the 51 jurisdictions with regard to workers' compensation rates. Oregon's methodology was established several years ago and provides a good relative indicator of workers' compensation premium costs. According to the 2000 Oregon study, Virginia ranks the best of all 51 jurisdictions, with Florida, Louisiana, and California being the highest ranked states and Virginia, Indiana, and South Carolina the lowest ranked states.

The Virginia Securities Act's primary purpose is to protect Virginia investors from fraud and misrepresentation. Nowhere has the SCC seen greater evidence of the opportunity to "make a buck" lead to questionable practices that prey on the nest eggs of

unsuspecting and less savvy Virginians. Adequate protections under Virginia law promote investor confidence and a greater willingness to invest in Virginia companies searching for capital.

In telecommunications, Virginia introduced the concept of local telephone competition a year before the federal Telecommunications Act of 1996. The General Assembly, however, did not direct or imply that the Commission should shift from focusing on protecting the consumer to promoting competition as GMU seems to suggest. Rather, the Commission is to do both. It may deregulate incumbent local exchange companies, but only after it finds that local service is "subject to competition." The primary standard is a finding that competition or the potential for competition in the market place is or can be an effective regulator of the price of those services. In making that determination, the Commission may consider the ease of market entry, the presence of other providers, and other factors deemed relevant by the Commission. In addition, the Commission must adopt safeguards to protect consumers and competitive markets.

In the Electric Utility Restructuring Act, the General Assembly has given the following direction to the Commission: in all decisions related to implementation (many of them to be decided in the coming months) the Commission "shall take into consideration, among other things, the goals of advancement of competition and economic development in the Commonwealth." However, the Act also provides a number of consumer protections during the transition period -- none more prominent than rate caps on the incumbent utility companies through July 2007. But protection is not only afforded to consumers; it is also afforded to the utility companies through the imposition of the wires charge to recover potential stranded costs.

And, much like the mechanism set out for the telecommunications industry, the General Assembly has provided that the rate cap protection for customers and the industry may not be removed except upon the request of an incumbent electric utility. Before such a request may be granted, the Commission must find that "an effectively competitive market for generation services" has developed in the utility's service territory.

The Commission recognizes that once markets become truly competitive, competition can be an effective regulator and provide consumer protection. Until that point is reached, however, the Commission seeks to balance "promotion of competition" as GMU urges with "protection of the consumer" as the law requires.

4. The Commmonwealth's structure of regulation was initially designed to deal with fundamental market flaws as perceived at the time. Our understanding of how markets function has subsequently changed as has technology. It is important to ensure that the workings and decisions of the SCC take full account of this.

The Commission agrees it should always try to operate on the basis of the most current state of available knowledge. It continues to monitor and study the current state

of economic and social philosophy and theory, as well as technological innovations, ongoing research and development and other disciplines, to the extent they are relevant to the Commission's activities.

The Commission is also very concerned about all issues related to information technology. Both industry and consumer expectations have exploded in recent years, and the demands are great on the Commission to expand current efforts to do business electronically. The Commission is committed to keeping pace with the ever-changing environment of electronic commerce and electronic government. The Commission is virtually re-inventing itself by web-enabling its forms and filing processes. Considerable progress has been made in this area and the Commission is conducting a great deal of its business via the Internet and web-based technology.

The SCC's new Rules of Practice and Procedure allow for large volumes of information to be filed in an electronic format. And, the Commission continues to make progress on accepting the filing of documents sent via an electronic means.

5. The SCC should review the data that industry is required to provide it with and limit them to those that are necessary to fulfil its regulatory requirements. In doing this it should seek to minimize the burden on the regulated industries of providing data.

The Commission agrees. We are constantly evaluating whether we are asking regulated industries to provide more data than necessary for us to fulfill our legal responsibilities. But, we still require certain information to accomplish the goal of developing and maintaining a competitive environment that includes reasonable consumer protection.

The Commission has reduced filing requirements in all areas of its regulatory responsibilities, cut back on duplicative filings by accepting for Virginia's purposes the same information in the form required by federal agencies or other states, and we continue to make progress with accepting filings electronically.

State or federal law requires a considerable amount of the information collected by the Commission. However, the Commission has stepped forward and sought to amend state laws to reduce such requirements.

In 1996, for example, the Bureau of Insurance recommended legislation to the Virginia General Assembly to repeal §§38.2-2228 and 38.2-2228.1 (medical malpractice claims reports and commercial liability claim reports). The Commission also supported the repeal in 1997 of §§38.2-1905.1 and 38.2-1905.2 (commercial liability supplemental reports and competition hearings) sought by the insurance industry.

In 1997, the Commission sought changes to the language in §56-234.3 that stated electric utilities "shall annually file with the Commission a five and a ten-year projected

forecast of its programs of operations." Recognizing the change in the industry, the Commission offered amending legislation to provide that each electric utility "shall file with the Commission a projected forecast of its programs of operation, on such terms and for such time periods as directed by the Commission." We now only ask for a limited amount of data through the year 2007, the end of price caps.

In 2001, clarifying legislation was offered to no longer require telephone cooperatives to file tariffs with the SCC's Division of Communications. The rates of these cooperatives are no longer regulated.

6. The activities of the SCC should continue to be largely self-funded to avoid problems that many states have in achieving efficiency and effectiveness because of a dependence on annual state budgetary decisions.

This reflects the current practice. Since the joint subcommittee was interested in a brief explanation of how the SCC is funded, we offer the following.

The State Corporation Commission is responsible for administering several programs. Each program/subprogram is supported by its own special fund.

We have five divisions that collect the various special funds that support their operations along with other activities --

(1) The Clerk's Office collects the special fund revenues to support its operation as well as certain general fund and literary fund monies. For the fiscal year that ended June 30, 2000 the Clerk's Office collected $6,678,000 that was deposited directly into the general fund, $136,000 deposited into the literary fund and $19,040,000 in special fund collections. Per the Code of Virginia, the Office transfers one half of our Registration Fee collections (i.e. special fund) to the general fund and the remainder is to be used by the Commission to support the operation of its Clerk's Office. Any excess funds remaining from the Registration Fee and other special fund collections (after expenses and an amount set aside as a reserve) must be transferred to the general fund. This requirement prevents us from building a large surplus. The excess balance is transferred each year in June.

(2) The Securities and Retail Franchising Division collects the special fund revenues that are used to support its operations. It will also collect revenues, depending on penalties assessed in Commission cases, which are deposited into the literary fund. For the fiscal year that ended June 30, 2000 the Securities Division collected $8,256,000 in special fund revenues and $91,700 for the literary fund. Per the Code, any excess fees remaining after expenses and an amount set aside as a reserve must be transferred to the general fund.

Combined, the Clerk's Office and the Securities Division made direct payments or transfers to the General Fund that totaled $20,973,000 last fiscal year.

(3) The Bureau of Financial Institutions operates out of its own special fund. It does not collect any general fund monies. However, it may, from time to time, collect literary fund money. Last fiscal year, its special fund collections were $10,481,000 and $12,250 for the literary fund.

(4) The Bureau of Insurance generates its operating budget by assessing the insurance industry through the collection of special fund monies. Last fiscal year, the Bureau collected $18,087,000 for its special fund monies while collecting $251,678,500 in general fund revenue. The Bureau further collected $25,874,000 in agency and trust funds. This money is reconciled and then transferred to other state agencies such as the Department of State Police and the Department of Fire Programs, for various programs established by the Virginia General Assembly. In addition, the Bureau calculates refunds due to insurance companies as a result of participation in the Uninsured Motorist fund. Finally, the Bureau collected and deposited $1,174,300 to the literary fund.

(5) The final division that collects revenue is the Public Service Taxation Division (PST). It collects special fund, trust and agency, general fund, and at times literary fund monies. PST's special fund revenues not only support its operation but the operation of the Virginia Relay Center in Norton, Va., the SCC's Railroad Division and the SCC's five public utility divisions. These same special fund dollars will support the Commission's new educational program on the restructuring of Virginia's electric and natural gas industries. Last fiscal year, these collections totaled $28,530,000. For trust and agency fund monies last year, PST collected $445,100 in rolling stock tax revenue. These funds are then distributed to the various counties, cities and towns of the Commonwealth. Last fiscal year, PST collected $97,853,000 for the general fund of the Commonwealth along with $550 for the literary fund. This division also has one other revenue source that supports the Underground Utility Damage Prevention Act which last year totaled $1,326,000.

7. The number of judges should be increased to five, with one judge being replaced each year. Three judges should be involved in each case. This would (a) speed up decision-making, (b) allow for more fresh blood to flow over the bench, and (c) move away from the stove-piping of current system.

This recommendation questions whether the SCC should continue to operate under its current three Commissioner structure that is complemented elsewhere in the report for its level of expertise, its stability, and its insulation from political trends.

The stated purpose for the recommendation is to speed up the decision-making process. However, the Commission is not aware that the length of time involved in receiving a decision from the Commission is unreasonable. Nor has anyone suggested that the Virginia Commission takes longer to decide cases than other state commissions.

Instead, the Commission and its divisions will do their best to expedite a case or a particular administrative responsibility when such treatment is appropriate. For those cases that do seem to take an inordinate amount of time, it is usually because there are contentious issues in which all parties have a right to "due process." Denying such would only make Commission decisions more susceptible to appeal to the Virginia Supreme Court.

The report also offered little discussion on the logistics of a panel of five judges with only three assigned to each case. This recommendation does not appear to take into account the current use of the SCC's four hearing examiners who are an important part of the formal process that result in final decisions of the Commission.

If a three-of-five judge panel is used, there is a possibility that decisions could be rendered by a minority of the Commissioners. Any split decision among the three chosen to hear a case will most certainly lead the losing party to seek an opinion from the whole Commission. This may add a layer of complexity and another delay in the process that the recommendation was trying to avoid.

The recommendation, as we understand it, also appears to mandate frequent turnover and implies that a Commissioner would be limited to a single five-year term with no opportunity to be re-elected to the position by the General Assembly.

As the members of the joint subcommittee are aware, Article IX, §1 of the Constitution of Virginia provides for a term of six years for the Commissioners. This provision would have to be amended to implement the GMU proposal for five-year terms. Since the Constitution does not prohibit a Commissioner from succeeding him or herself, if GMU seeks term limits, it would seem prudent to include such a provision in the Constitution as well.

The General Assembly has two different methods by which the Constitution may be amended. Article XII, §1 of the Constitution requires a majority vote of both houses of the General Assembly, followed by a general election of the House of Delegates, followed by another majority vote of the General Assembly, which is followed by a referendum of the voters. The second option is the calling of a constitutional convention, which, after approving any amendments, must submit them to the voters for a referendum. Either of these routes, at the discretion of the General Assembly, would be required to change the terms of the Commissioners to five years.

Additionally, while the Constitution provides for up to five Commissioners, §12.1-6 of the Code of Virginia provides that "[t]he Commission shall consist of three members." The General Assembly would have to amend this statute to accomplish three things proposed in recommendation #7: (1) changing the number of Commissioners from three to five; (2) changing the term of service from six to five years; and (3) prohibiting a Commissioner from succeeding himself or herself. The second change would require a constitutional amendment to become effective, as discussed above. The third may need such a change as well.

It should also be noted that §12.1-8 provides that "[a] majority of the commissioners shall constitute a quorum for the exercise of judicial, legislative, and discretionary functions of the Commission." GMU proposes that "[t]hree judges should be involved in each case." If three Commissioners decide a case, by a 2-1 decision, then it seems readily apparent that a three-judge panel does not satisfy the statutory dictates that "a majority of the commissioners shall constitute a quorum for the exercise of judicial, legislative, and discretionary functions of the Commission." If the two Commissioners who did not hear the case sided with the dissenting Commissioner, a two-Commissioner decision would not constitute a "majority of the commissioners" pursuant to §12.1-8. The decision rendered would thus appear to be statutorily defective and subject to attack without an amendment to either this statute or GMU's recommendation.

Section §12.1-9 of the Code of Virginia requires that "at least one member of the Commission shall have the qualifications prescribed for judges of courts of record." While traditionally all of the Commissioners have had such qualifications, the General Assembly may wish to consider whether one of five commissioners having the qualifications for judges would be sufficient.

As you consider this recommendation, we suggest you consult representatives of Virginia's regulated industries and its consumer organizations who have experienced both the SCC's structure and those of other states where the commission is comprised of five or seven members and the process of appointment is considerably more political in nature.

8. Adequate resources should be provided to reduce the turnover of staff in the Office of the Council General [sic]. This turnover at a minimum impedes the speed at which cases can be brought.

The SCC's Office of General Counsel is comprised of good attorneys who do good work. The industries we regulate and the law firms that represent them recognize the quality of our attorneys and are not shy about making offers that may attract them away from the Commission. It is a fact of life in the government sector – the state cannot keep pace with the higher salaries paid in the private sector.

This Commission has also hired attorneys who have worked for the regulated industries and made a career choice to join the SCC's legal team. There are several reasons why high quality individuals choose careers in the public sector, including quality of life issues.

We will continue to take the necessary steps to attract and retain an adequate number of competent staff attorneys to assist the Commission with its legal workload.

9. The possibility of establishing an Administrative Committee (made up of Commissions [sic] together with a Director) to act as a formal link between the divisions and the judge [sic] should be given more serious thought. This would provide a formal mechanism to assist in *ex parte* separation between staff and judges. It would also add a further mechanism for the linking of various divisions when coordinated measures are required.

The Commission is unable to fully understand this recommendation based on the written report. Comments made to the legislative subcommittee by the GMU study team did little to further clarify the proposed structure of such an administrative committee.

The study team says the recommended administrative committee is a solution to a recommendation in the Wirick report that would "provide some structure with a more formal buffer between the advisory role of the administration and the advocacy role."

The committee would be comprised of the various commissioners. But, the makeup of the committee is unclear because of the confusing use of the term commissioners as it applies to the judges, certain division directors, and the apparent omission of other directors who do not now have but are proposed to be given the title of commissioner.

Whatever the membership, the proposed committee members "would de facto serve both advocacy and advisory roles and would be responsible for identifying staff to serve additional advocacy roles." To offer support for its recommendation, GMU explains that "[t]here has been expressed some concern about the closeness of the administrative processes within the SCC and the judicial processes."

The GMU recommendation does not address what communications would be possible by those on the "Administrative Committee" with those not on it. Since the Commissioners would be on the committee, would they be barred from any contact with so-called "advocacy" staff? Would the director of the affected division be barred from communicating with subordinate employees if they were designated as advocacy staff on a given case? Or, would those advocacy staff be permitted to send memoranda to the director, who could then forward them to the Commissioners? It is fairly easy to set up a structure, but it is more realistic (and practical) to try to determine how such a structure would actually operate.

No Commission decisions are cited as having been unfairly based on illicit ex parte contacts, nor is there any citation to Supreme Court opinions reversing Commission decisions that were determined to be based on an over-reliance on staff communications or positions.

Secondly, and more importantly, GMU apparently was unaware of the recent proceeding promulgating new Commission Rules of Practice and Procedure. One of the issues handled as part of that proceeding was ex parte contact between staff and the Commissioners (and Hearing Examiners) and between parties and the Commissioners (and Hearing Examiners). The Commission sent a letter on May 30, 2001, to members of the legislative subcommittee (who had previously expressed interest in this case) advising them of the decision and including a copy of the final order, as well as the revised rules.

It should be noted that, prior to the hearing on the new rules, Commission staff and the parties who had submitted comments on the rules met, at the direction of the Commissioners, to narrow the issues in controversy. In fact, only two parties disagreed at the hearing with the language of Rule 60 (pertaining to communications between staff and Commissioners/Hearing Examiners), and no party has appealed the Commission's final order in this proceeding.

As set out more thoroughly in the final order, the Commissioners squarely addressed the issue of ex parte communications in this proceeding. In the order, the Commission strengthened the previous rule by prohibiting staff from providing facts or legal arguments to Commissioners or Hearing Examiners in a pending proceeding without providing notice to all parties involved.

Apparently, the GMU study team was unaware of the collaborative process that resulted in the final language of Rule 60.

10. The current process of dispute resolution, with its informal and formal elements seems to work well if a little slowly at times. There is no recommendation of further informal 'alternative dispute resolution' procedures being required. More formality generally leads to even slower decision-making.

The Commission now has two conflicting recommendations regarding alternative dispute resolution (ADR). The Wirick report encourages formal rules and procedures for ADR and promotion of its use. The GMU study discourages it. The Commission has put out for comment an ADR procedure for telecommunications interconnection issues and disputes. If adopted, it would formalize a procedure to address issues that arise between carriers that cannot be resolved informally. The Commission will consider both of the recommendations in making decisions on the further use of ADR.

11. The proposal that a Commissioner for Utilities to over see matters relating to energy, telecommunications and water should not be pursued. The types of issues

that have to be dealt with in these fields in the 21st Century are different and the expertise required different. Separate Commissioners for energy and for communications would seem more appropriate.

The need for such was also addressed in the Wirick report and the Commission will consider both. We did notice that this recommendation and recommendation #9 (administrative committee) seem to confuse various position titles at the Commission. There are the three Commissioners (aka Judges) who head the agency, two division directors with the title of Commissioner of Insurance and Commissioner of Financial Institutions, and 15 other division directors (which include titles such as Clerk, General Counsel, and Comptroller).

The Code of Virginia (§12.1-16) authorizes the title Commissioner to the individuals who head the SCC's Bureau of Insurance and the SCC's Bureau of Financial Institutions. This section authorizes the Commission to delegate to the Commissioner of Financial Institutions and the Commissioner of Insurance duties imposed by law upon the Commission with respect to banking and insurance, as it may deem proper.

12. The various divisions should develop a system of performance assessment procedures suitable to their own activities. These should be quantifiable where possible but also contain qualitative indicators. Performance measured against criteria should be part of annual division reports.

There are two recommendations in the Wirick report that also address performance assessment and accountability that are under Commission consideration. The GMU interim report states that the study team will address each of the plans and performance measures that already exist for each division of the Commission in the next version of its report.

The Commission provided copies of its 2000-2002 budget narrative to each member of the legislative subcommittee at its first meeting. That document identifies the mission statement of each division, critical issues facing that division and the goals, objectives and strategies for meeting each of those critical issues.

The Commission's divisions perform a critical analysis of regulatory objectives throughout the year. Since Virginia law mandates the majority of the activities of each division, staff is highly involved in each session of the General Assembly. After each session has ended, staff gives careful consideration to any changes in or expansion to our regulatory authority and where and how staff will respond to meet the challenges.

Once the objectives are identified, goals are set for the successful achievement of these regulatory duties and resources necessary to fulfill those statutory mandates are identified.

Commission staff is held accountable for meeting these regulatory challenges including the best ways to approach issues. This includes an assessment of the personnel involved and other resources that may be required. The expectations of performance identified for each employee are discussed during quarterly meetings with supervisors. Each employee, including senior management, undergoes an annual performance appraisal. An independent consultant completed a review of the SCC's performance management process earlier this year and commended the Commission for the effectiveness of a program that ties rewards to performance.

In addition, there is an effective indicator of the level of the performance of the Bureau of Insurance of which the GMU study team should be aware in its review of performance measures for the Commission's divisions. In response to many insurer insolvencies in the late 1980s and a call by many parties for increased federal regulation of insurance, the state insurance departments, through the auspices of the National Association of Insurance Commissioners (NAIC), developed a program for effective solvency regulation. The Bureau of Insurance, along with its fellow state insurance regulators, worked to devise standards to demonstrate the adequacy of a state's statutory and administrative authority to regulate insurer solvency. The Accreditation Program was adopted in 1990, and the individual states began working to improve their laws, regulations and processes in response thereto. This program was designed to improve the quality of regulation and, as a result, consumers' and fellow regulators' confidence in an insurance department's abilities. Since that time, almost every state has taken the steps to become accredited, and solvency regulation is one of the strongest foundations of the state-based system of insurance regulation. In April 1992, Virginia was the 10th state to pass successfully the accreditation compliance audit, and Bureau staff received an accreditation certificate at the June 1992 NAIC Summer National Meeting. In May 1997, Virginia was awarded its second round accreditation with one of the highest scores ever achieved on second round accreditation reviews.

The Accreditation Program is not simply a measurement of a state's ability to regulate an insurer's corporate and financial affairs. The program also analyzes a state's overall level of performance to determine if the state has the necessary resources to carry out its statutory and regulatory authority and that the department has in place organizational and personnel practices designed for effective regulation. This is a rigorous review by an independent review team. We would suggest that this Accreditation Program is a clear indicator of the effectiveness of a Commission division.

Also, the SCC's Bureau of Financial Institutions has achieved professional accreditation by the Conference of State Bank Supervisors. CSBS is the professional association of state officials responsible for chartering, regulating, and supervising the nation's state-chartered banks and state-licensed branches and agencies of foreign banks. Since 1902, CSBS has been the primary advocate for the state banking system nationwide, fulfilling this mission by representing the state banking system on Capitol Hill, among federal regulatory agencies and the courts. CSBS is a leading provider of

education and training for state bank examiners, and serves as the central clearinghouse for information on the state banking system.

The mission of CSBS is to assure the ability of each state banking authority to provide safe, sound, and well-regulated financial institutions to meet the unique financial needs of local economies and citizens. In support of that mission, CSBS sponsors a comprehensive state banking department performance Accreditation Program to enhance the professionalism of state banking departments and their personnel.

The Bureau earned is accreditation on July 30, 1999, following a rigorous evaluation designed to ensure that the Bureau met national standards of professionalism and performance. The process involved an exhaustive examination of every aspect of the Bureau's operations. The Accreditation Program involves a comprehensive review of the critical elements that assure a banking department's ability to discharge its responsibilities through an investigation of its administration and finances, personnel policies and practices, training programs, examination policies and practices, supervisory procedures, and statutory powers.

13. **All divisions of the SCC should engage in more public information dissemination and information gathering. The banking division runs a number of courses for the industry as well as periodic seminars – this type of model may usefully be replicated elsewhere.**

Although this recommendation seems to conflict with recommendation five, it does not. Instead, the emphasis is on how the information is presented. It takes considerably more work, but divisions are constantly looking for ways to take the dry, statistical information they gather in the regulatory process and present it in useful, meaningful ways for the consuming public.

The Commission is proud of its outreach efforts. We just have not made a lot of noise about it. The Commission will take this opportunity to make some noise. Over the past 18 months, Commission staff has conducted hundreds of meetings, seminars, presentations, and talks to groups and organizations representing both industry and consumers. A comprehensive list of those contacts can be made available.

There are numerous information booklets and brochures available from SCC divisions and all of them are posted to the SCC web site for printing at the home or office of Virginians. Most popular are the auto and homeowners insurance shopping guides produced by the Bureau of Insurance because they present comparison rate information in a manner friendly to consumers.

New and much more visible public outreach efforts are already underway or will soon start, including major media and advertising exposure. These include:

- the Virginia Energy Choice education program

- the Underground Utility Damage Prevention Awareness program
- the Office of Managed Care Ombudsman in the Bureau of Insurance
- and, involvement in the Financial Literacy 2001 program of state securities administrators.

14. To ensure that emerging issues related to deregulation are built into future agreements, and that industry agents and agencies can give opinions confidently in such jurisdiction, the Bureau of Insurance should identify other states or countries with which Virginia currently has no reciprocity agreements, but which are most likely to establish them in the near future.

The Bureau of Insurance assumes that the term "reciprocity agreements" in the recommendation is designed to encourage cooperative agreements with state, federal and international regulators. In this area, the Bureau already has a number of such agreements in place:

- The Bureau was the first state to enter into agreements regarding continuing education for agents (CE) with every state that has adopted a CE law. These agreements will no longer be required when the amendments to the agent licensing law enacted by the Virginia General Assembly become effective (all amendments to Chapter 18 of Title 38.2 will be effective by January 1, 2003).

  The Bureau proposed these amendments to incorporate those provisions of the NAIC Producer Licensing Model Act that are necessary for compliance with the requirements of the federal Gramm-Leach-Bliley Financial Services Modernization Act (GLBA). The new agents licensing law will provide reciprocal treatment for non-resident agents not only in the area of CE, but in other critical licensing areas such as defining lines of authority and the granting of limited licenses. The new law obviates the need for specific CE reciprocity agreements with individual states.

- The states, including Virginia, in response to the enactment of GLBA, designed a uniform application for admission for insurers who wish to be licensed in more than one state. This Uniform Certificate of Authority Application (UCAA) eliminates the need for insurers to file different applications in different formats. Nearly all of the 50 states, Virginia included, accept this application, and then each state performs its independent review of the application to determine if the insurer meets the requirements of the state's laws. Insurers and regulators worked together through the NAIC to develop the UCAA, which has the support of the insurance industry.

- The General Assembly, at the request of the Bureau, also enacted new language and conformed existing provisions of Title 38.2 concerning the

confidential treatment of information held by the Commission and the circumstances under which the Commission may disclose the information. Disclosures may generally be made to regulatory or law enforcement officials of any state or country and to the NAIC, its subsidiaries or affiliates. The enactment of these provisions was supported by industry because with such provisions, the Bureau can share its examination workpapers and reports with federal regulators, and as a result, it is less likely that federal regulators will choose to subject insurers to separate examinations. The legislation also protects confidential information provided by other regulators in the hands of the Commission and then gives the Bureau access to such information. Of course, such information sharing should strengthen cooperative regulatory efforts across jurisdictions as well as across the financial services sectors.

- The Bureau of Insurance has entered into information-sharing agreements with the federal Office of the Comptroller of the Currency and the Office of Thrift Supervision. We are currently negotiating agreements with the Federal Deposit Insurance Corporation and the Federal Reserve. Such agreements help foster information sharing.

- Commissioner of Insurance Al Gross is the Zone Secretary for the NAIC Southeastern Zone states. In that capacity, he serves as the coordinator for zone examinations and decides which state from the Southeastern Zone will represent the zone on the financial condition examination of an insurance company licensed in more than one zone of the U.S. or more than three states in a single zone. The zone examination process is an example of the states' level of cooperation with each other in the performance of their regulatory duties and in relieving the industry of unnecessary and duplicative regulatory burdens.

- The Bureau has participated on several occasions in multi-state examinations of insurance companies conducted by a group of states in response to a problem with a particular insurer. These examinations have been of an insurer's conduct in the marketplace, as well as financial examinations.

- The Bureau participates in national databases provided to the states through the auspices of the NAIC. This includes the Financial Repository Database (FRD), which contains the annual and quarterly financial statement data of more than 5,000 U.S.-domiciled insurers; the Regulatory Information Retrieval System (RIRS), which contains data regarding regulatory actions against insurance entities; the Producer Database (PDB), a national database consisting of information regarding insurance agents and brokers; and the Complaints Database (CDS), a database that contains information regarding consumer complaints filed with state insurance departments that is used by states during market conduct examinations of companies.

- The Bureau, in cooperation with the U.S. Department of Commerce and other federal agencies, has hosted delegations from Poland, Brazil, China, Saudi Arabia, Russia, Japan (in cooperation with the Virginia Workers' Compensation Commission), Egypt and Vietnam to assist these international regulators in their efforts to develop regulatory frameworks for their insurance markets.

15. Identify specific areas where threats to consumers' privacy may be at risk from increased reliance on electronic commerce, and develop effective measures to counter those threats.

Privacy protection is not new in Virginia, where Chapter 6 of Title 38.2 has been the law for 20 years. The Bureau's Consumer Services Sections are available to help consumers who believe their privacy rights have been violated. In addition, the Market Conduct Section examines insurance companies to make sure that they are complying with all of the laws in Virginia, including the privacy protection laws in Chapter 6.

With the enactment of GLBA, the Bureau was charged with amending Virginia's privacy protection laws in accordance with the new federal law. Once GLBA was enacted, any failure on our part to enact legislation on privacy that was consistent with GLBA could put insurers at a competitive disadvantage with the banks in the marketing of competing products.

The Bureau worked with representatives of the financial services industries on language that was enacted effective July 1, 2001. Virginia's law is now consistent with the provisions of GLBA while protecting the privacy of Virginia citizens especially in the area of health information.

16. Continue to work closely, or expand current work efforts, with the National Association of Insurance Commissioners to develop uniformity in quoting rates, insurance forms, and filing requirements either nationally or among states with reciprocity agreements.

At the subcommittee meeting on June 15, GMU apparently suggested that the Virginia Bureau of Insurance could be more active in the NAIC process. This came as quite a surprise since the Bureau is one of the most active states in the NAIC process. Commissioner Gross has chaired the Financial Condition Committee for the last four years. The Financial Condition Committee is the standing parent committee to all financial regulation working groups and task forces, which total more than 40 groups. He is actively involved in supporting the work of this committee, and the Bureau's work on this one committee takes up a substantial amount of Commissioner Gross' time as well as that of Deputy Commissioner Doug Stolte and the Financial Regulation Division staff.

Mr. Stolte has worked closely for seven years with regulators from ten other states to develop a comprehensive basis for statutory accounting principles that provide uniform financial reporting standards for use by insurers and insurance regulators across the country. This is one major example of a project to which the Bureau has devoted substantial time to achieve national uniformity without infringing on state-based regulatory requirements. And, he continues to serve as chair of the NAIC/AICPA Working Group, which works on accounting issues affecting the insurance industry that arise between regulators and the American Institute of Certified Public Accountants (AICPA).

Commissioner Gross is also chair of the NAIC Trade Working Group, which provides support to the Office of the U.S. Trade Representative as well as the states and industry on international trade matters related to insurance and insurance regulation.

He co-chairs the Insurance Holding Company Working Group that focuses on interstate cooperation in regard to group-wide supervision of holding companies. He serves as the Southeastern Zone Secretary. Finally, Commissioner Gross is a member of the NAIC Executive Committee and Financial Regulation Standards and Accreditation Committee, both of which are very active committees coordinating the ongoing activities of various working groups and task forces working on issues of uniformity in insurance regulation.

In addition, members of the Bureau staff serve on the following NAIC committees, task forces and working groups:

- Examination Oversight Task Force
- Accounting Practices and Procedures Task Force
- International Accounting Standards Working Group
- Risk Assessment Working Group
- Coordinating with Federal Regulators Working Group
- Securities Valuation Office Working Group
- Financial Analysis Working Group
- Insurance Group Review Subgroup of the Insurance Holding Company Working Group
- Emerging Accounting Issues Working Group
- Statutory Accounting Principles Working Group
- Workers' Compensation Task Force
- Market Conduct Examination Oversight Task Force
- Improvements to State-Based Systems Working Group
- Catastrophic Insurance Working Group
- Statistical Handbook Working Group
- Market Conduct Examination Monitoring and Handbook Working Group
- NAIC/IAIABC (International Association of Industrial Accidents Boards and Commissions) Joint Working Group

- Life Insurance and Annuities Committee
- Regulatory Framework Task Force
- Regulatory Re-engineering Task Force
- Health Insurance Task Force
- NAIC/HCFA Liaison Committee

The Commission is proud of the level and quality of work that the Bureau staff has contributed to the ongoing activities at the NAIC.

17. The Bureau of Insurance should work with the National Association of Insurance Commissioners to develop uniform 'treatment of companies' and 'market conduct' standards or regulations.

The Bureau does work with other state regulators through the auspices of the NAIC (as noted above) to develop uniform regulatory standards and processes across state lines in an effort to preserve and improve the state-based system of insurance regulation. However, uniformity is both more appropriate and more easily achieved in some areas of regulation than in others. Currently, more uniform standards for company licensing and the licensing of agents are being developed, along with more uniform standards for insurance-product approval across state lines.

18. There have been a number of changes to the Virginian Banking Code over the years. A full review of the code should now be conducted. This should not be taken to imply radical change is needed but is a matter of 'good housekeeping'.

This recommendation apparently results from a suggestion by E. Joseph Face, Jr., the Commissioner of Financial Institutions, during discussions with the GMU study team. Of course, any such review is the responsibility of the Virginia Code Commission. The Bureau would be prepared to assist the Code Commission with any such recodification of Title 6.1 if and when it occurs.

19. The Bureau of Financial Institutions has developed successful ad hoc ties with the other Bureau and Divisions within the SCC. These should be continued although there would seem no good reason for any formalization of the process.

The Commission is proud of the Bureau's accomplishments that include the following:

- The establishment of communication procedures with the Bureau of Insurance and the Division of Securities and Retail Franchising to keep each other informed of material changes in the subsidiary or affiliate for which each division is primarily responsible as a result of GLBA provisions on banks, insurers and securities firms.

- Record numbers of application filings in 1998 and 1999 while reducing the time to process them.
- Assessments on financial institutions have been reduced 31 times since 1984 saving those institutions $8.6 million in fees that could have been collected under the laws and regulations in place.
- Reduced bank branch application fees and bank branch application processing time.
- Quick approval of bank branches after Hurricane Floyd to ensure continuous banking services.
- Use of new state-of-the-art examination software tools developed jointly by interagency cooperation, which reduced on-site examination time.
- Signing the revised Interstate Nationwide Cooperative Agreement in 1997 to further assist states in efforts to maintain competitive, responsive, safe and sound financial services for their citizens in an interstate environment.
- Reached agreement with Tennessee bank commissioners on interstate reciprocity.
- Multi-state Interstate Trust legislation in 1999.
- Credit Union Parity Act in 1999.
- Opposed federal fees on state-chartered banks and bank holding companies that were included in President Clinton's FY 1998 and 1999 budget.
- Redesign of annual reports for easier reading by users and accessibility via the SCC web site.
- Survey "customers" for useful information.
- Initiated long range planning – identify potential long-term problems and solutions.
- Formed the Virginia Bank Directors' College.
- Quarterly meetings with new mortgage lenders and brokers to discuss compliance exam issues.
- Newsletters to various regulated industries.

20. The Securities Division would benefit from having more attorneys working with it. At present there is only one attorney in the OGC who works with the Division that deals with a growing market. The implications of the 1999 Financial Modernization Act and some internal adjustment of SCC rules and operation commands are likely to increase pressure on attorneys.

The Division of Securities and Retail Franchising actually has the benefit of one full time and one part-time attorney. One, as stated, is assigned exclusively to the work of the division. The other splits time between legal matters involving financial institutions and any legal questions raised by the Securities Division as they apply to trademarks and service marks.

The Office of General Counsel is currently reviewing the need for additional legal assistance for the division.

21. The Securities Division has the highest turnover rate in the SCC. Measures should be taken to retain competent staff.

The Commission and the division were surprised by this recommendation. The Division of Securities and Retail Franchising lost only one employee last year and just three in the past two years.

22. The current mission statement and the defined roles of the Division reflect an environment that is primarily concerned with rate regulation, but the activities that take up most of the staff's time are those related to the Telecommunications Act. It follows that the Division should be focused on competition, which should be reflected more strongly in its mission statement.

The report correctly lists at the bottom of page 68 the top six (although the narrative states there are seven) activities of the Division of Communications requiring the majority of our resources. Interestingly, none of these are related to rate regulation (Number 1, of course, is "responsibilities relating to implementing the Telecommunications Act of 1996"). Then at the middle of page 69, apparently because the word "competitive" comes after the word "regulated" in the stated goals of the division, it is characterized as having an "attitude" that focuses on regulation first and competition second. Ironically, the cited reference for this statement is the division's page on the SCC web site. The wording actually comes from the goals stated in the division's 2002-2004 Budget Activities Narrative. Actually, the web site clearly lists the top two responsibilities of the division to be "overseeing the implementation of competition in the telecommunications market" and "developing and implementing alternatives to traditional forms of regulation as competitive markets develop" -- in that order.

23. There are a variety of methods for measuring the effects of competition that go beyond price. With competition as the broad goal, it is essential to determine how to measure the attainment of that goal. Therefore, a system needs to be designed to establish the baseline (current state of competition) and then to monitor over time.

The report suggests and discusses the use of price comparisons as a measure of the success of local competition. It is important to note that regulated local rates for the large companies operating in Virginia [Verizon-VA (formerly Bell Atlantic and C&P Telephone), Verizon South (formerly GTE and Contel), Sprint-United, and Sprint Centel] have not increased since the early to mid-1980s. While basic local telephone rates have remained the same, there have been other factors outside the SCC's jurisdiction that have added charges to the local telephone bill. They include increases in charges allowed by the Federal Communications Commission (FCC) such as the Subscriber Line Charge and the Number Portability Charge, as well as other taxes and surcharges beyond the SCC's

control. In addition, the General Assembly has authorized such add-on charges as the Public Rights-of-Way fee, the Virginia Relay Center fee and the E-911 tax.

A possible reason there has not been more interest in local competition is that local rates, especially for residential service, are already low. In fact, the industry argues that, in many cases, the basic rate for a dial tone line is below cost.

Several years ago, the former GTE & Contel companies filed a rate case citing a need, among other things, to restructure local rates to prepare for local competition. Its proposed restructure significantly increased local rates for most customers. When this was put out for public comment, the SCC was inundated with complaints and objections from customers. They submitted more than 8,000 letters and filed 127 petitions with approximately 16,000 signatures in opposition to these increases.

Whatever method is used to measure the effects and success of competition needs to take into account whether existing market conditions are conducive to competition, and, if not, whether it is in the public interest for the SCC to step in to make them so. In other words, it will not play well with the general public if they are told that local telephone rates need to increase in order to give them a competitive choice.

The General Assembly included some very specific consumer safeguards in the enabling legislation (§56-265.4:4). For example, the General Assembly directed the SCC to ensure that local competition "reasonably protects the affordability of basic local exchange telephone service" and "reasonably assures the continuation of quality local exchange telephone service." In addition, the SCC must ensure local competition "will not unreasonably prejudice or disadvantage any class of telephone company customers or telephone service providers, including the new entrant and any incumbent local exchange telephone company, and is in the public interest."

Similar wording is included in §56-235.5. This section enables the SCC to approve alternative regulatory plans for incumbent local exchange companies, which in part was passed to allow more flexibility to prepare for competition.

24. The activities of the collaborative committee are critical to competition in the Commonwealth. Therefore, it is important to take immediate steps to move the process along as quickly as possible.

The report is critical of the collaborative committee (bottom of page 69) by reporting that some interviewed stakeholders observed that it has "...been slow to get started and the atmosphere is somewhat adversarial." It may be true that Virginia is not as far along as some states, but many of those states (New York, for example) have been the early targets of competitive initiatives because of market potential and available resources. The collaborative stakeholders in Virginia have given us positive feedback on the process and leadership. The stakeholders have indicated it is much better than in other states, including the effort to push deadlines and issues along. Further, Commission

staff and the parties have been going to great lengths to keep the process from becoming adversarial.

25. The citizens of the Commonwealth are primarily restricted to local telephone service provision by one firm. Considering that the telecommunications industry is evolving rapidly, it is recommended that the Commission take periodic snapshots of available services across major telecommunications markets to determine if those services are available in the Commonwealth. If it is found that the Commonwealth is lagging, then the Commission can enter into discussions with local telecommunications providers to determine why.

The report (page 71, first full paragraph) incorrectly portrays the level of competition in Virginia by saying CLECs "coverage" is less than 1%. It is unclear whether this reference is to geographical coverage or actual customers served, but SCC staff assumes it is the latter. A recent analysis by the SCC's Division of Economics and Finance revealed that CLECs (twenty-five) currently serve approximately 4.5% of the access lines (nearly 250,000) in Virginia. It is likely this number is understated since companies do not always respond to informal staff inquiries. Consumers in major metropolitan areas of the Commonwealth have several CLECs available from which to choose. Thus, the staff of the Commission is taking snapshots of the developing local competitive market, and the pictures being developed are much more focused than this report portrays.

A May 2001 FCC report shows that Virginia has more CLEC lines than SCC staff has been able to quantify. It indicates Virginia has approximately 414,000 CLEC lines representing 9% of the total lines reported in the Commonwealth. The national average is 8%, so by this measure, Virginia is doing better than average. This study also shows the largest CLEC percentages are in states that have 271 authority (Bell company permission to enter the long distance market). At the time of the FCC report, this included -- New York (20%) and Texas (12%).

It has been the industry's decision as to which states it will target to begin the critical process of testing Operational Support Systems (OSS), and generally this is a function of the size of each state and its market potential. For example, Verizon targeted New York first, and then moved to Pennsylvania, Massachusetts and New Jersey before coming to Virginia. OSS testing is extremely expensive, time-consuming, and labor intensive. It cannot be done everywhere at the same time.

26. In order to enhance competitors in the Commonwealth, the SCC should find a way to allow competitors into the marketplace as rapidly as possible. The current financial difficulties of the smaller CLECs combined with the inherent economies of scale indicate that the most immediate source of competition will come from larger and more established firms. The current arbitration impasse is

blocking the largest potential competitors. Methods of circumventing this problem should be sought expeditiously.

The SCC has granted certificates to over 200 CLECs, and has approved nearly 450 interconnection agreements. These are the two most critical regulatory requirements that must be accomplished prior to providing local service, and the Commission has made this process relatively easy. In fact, the report acknowledges this (page 71, first full paragraph) concerning certificates, although the number granted is understated.

Of course, the SCC has no control over CLEC financing and the current condition of financial markets that have negatively impacted numerous small CLECs (and presumably some large ones such as AT&T).

Further, the Division of Communications has made it a top priority to expeditiously handle informal complaints filed by CLECs against incumbents. The division has a good track record in getting many of these complaints satisfactorily resolved.

When a complaint is elevated to a formal case, the Commission takes prompt action. For example, Cavalier Telephone filed a formal petition over its concern that new customers were being prematurely disconnected by Verizon (Case PUC000262) before service with Cavalier could be started. This left customers without dial tone for days and, in some instances, weeks. When the complaint was filed, there were claims of hundreds of such disconnections each month. The most recent report indicates only two such drops occurred. SCC staff continues to monitor this situation with reports being filed each month.

It is important to note that the Virginia General Assembly passed legislation enabling local competition in 1995, and the SCC promulgated local competition rules by December of 1995, both coming before passage of the federal Telecommunications Act of 1996. The Commission continues to actively pursue market-opening conditions through the collaborative process and the SCC has alternative dispute resolution procedures out for comment. OSS testing for Verizon is well underway with all activity being monitored and kept on track by an SCC hearing examiner.

Ironically, the 11th amendment sovereign immunity "impasse" came about as the Commission was trying to perform its job of conducting arbitrations under provisions of the federal act. But, that impasse did not block the largest potential competitors from entering Virginia's local telephone market. AT&T and MCI were among the first companies to be granted CLEC certificates in Virginia, and were participants in the early arbitrations conducted by this Commission.

27. There needs to be a change in philosophy from viewing regulation as a backstop in case competition fails, that could well produce a self-fulfilling prophecy, to viewing regulation as a means of promoting competition.

The Commission has addressed the essence of this recommendation in its response to recommendation #3. The response to recommendation #26 and the following response to recommendation #28 are evidence that the Commission takes seriously its charge to advance competition in the new competitive markets for both local telephone service and the supply of electricity and natural gas.

It does not matter whether the underlying philosophy is regulation or competition, the goal of the Commonwealth and this Commission is reliable service at reasonable (or in the case of telecommunications, affordable) rates.

One measure of how well Virginia is doing is the most recent comparison of the average electric rates paid by customers of investor-owned utility companies. Prepared by the Edison Electric Institute for the period ending December 1998, Virginia's average rate for all customers ranks 10th lowest of the 49 states. (Nebraska is not included since there are no investor-owned utilities in that state.)

Virginia's average rate is 5.4 cents per kilowatt-hour. The average for the state's largest utility, Dominion Virginia Power, is 5.56 cents/kWh. The average for the second largest utility, AEP-Virginia, is 4.55 cents/kWh. This compares to average rates in excess of 10 cents/kWh for Vermont, Connecticut, New Jersey, New York and New Hampshire. Wyoming and Idaho are the lowest with average rates just under 4 cents/kWh.

Virginia's ranking is even more impressive when comparing the average rates for industrial customers. Virginia ranks eighth best with an average rate of 3.74 cents/kWh. Dominion Virginia Power's average is 3.79 cents/kWh and AEP-Virginia's is 3.53 cents/per kWh. This compares with average rates of approximately 8 cents/kWh in Connecticut, Massachusetts, New Jersey and New Hampshire. Again, Idaho and Wyoming rank the lowest at 2.73 cents/kWh and 3.27 cents/kWh respectively.

28. The SCC should foster more pilot programs in retail energy supply and accelerate the development of competitive markets in energy provision.

Since the passage of the Virginia Electric Utility Restructuring Act (the "Act") in 1999, the Commission staff has been involved in a variety of efforts to implement directives of the Act. Clearly, the emphasis has been to accelerate the development of a competitive energy supply market in Virginia. To suggest otherwise diminishes the extent of progressive activity that has been accomplished and continues even now.

<u>Retail Pilot Programs</u>

The Commission and General Assembly saw the value of pilot retail access programs as tests of the necessary systems and rules before the transition to full retail access. Three electric retail choice pilot programs were put in place after hearings to determine the parameters. Virginia Power's pilot (PUE980813) began in two phases, September 1, 2000, in the Richmond area and January 1, 2001, in Fairfax. AEP-

Virginia's program (PUE980814) began October 1, 2000. Rappahannock Electric Cooperative (PUE990088) began a program on January 1, 2001.

Staff assisted these utilities in implementing their pilot programs by speaking at supplier forums, monitoring the lottery process, reviewing marketing programs, and other such efforts. And, staff monitors the pilot programs for many things including customer activity, competitive service provider ("CSP") activity, and customer complaints.

The first natural gas retail choice program in Virginia was sponsored by Columbia Gas of Virginia and approved by the SCC in September 1997. The length of the pilot has been extended several times by the Commission. However, its size has stayed the same in that it is limited to approximately 37,000 customers in the company's Gainesville service area. Approximately 7,500 customers have selected a competitive supplier. However, several hundred returned to Columbia Gas for their supply of natural gas because a handful of competitive suppliers terminated their contracts when the wholesale price of gas (which is unregulated) skyrocketed during the winter months.

Virginia's largest natural gas retail choice pilot program was proposed by Washington Gas Light (WGL) and approved by the SCC in 1998. Over the years, the pilot has expanded its level of eligible customers in Northern Virginia. As of March 1, nearly 37,000 customers were participating in the pilot program. Again, several hundred customers returned to Washington Gas when certain suppliers terminated their contracts last winter.

On March 15, 2001, WGL became the first natural gas utility in Virginia to receive approval to offer retail choice to all of its 377,000 Virginia customers, including those served by its Shenandoah Gas division in the Winchester area. WGL intends to implement retail choice throughout its service territory by January 1, 2002.

SCC staff is currently working with Columbia Gas of Virginia and Virginia Natural Gas, the state's second and third largest natural gas companies, to determine when retail choice can be offered to more or all of their customers. Depending on its analysis, staff may recommend to the Commission that it consider its authority under §56-235.8 to direct a gas utility to file a retail choice plan.

Phase-in Plans

The Commission recently expedited the availability of choice to the bulk of Virginians. Under the Virginia Electric Utility Restructuring Act, the transition to retail access is scheduled by the Act to begin January 1, 2002 and to be completed by January 1, 2004. The Act allowed the SCC to accelerate or delay that schedule, but the delay cannot be for more than one year.

In the fall of 2000, staff met with interested parties to discuss the phase-in schedule and whether it could be accelerated. A staff report was issued in December 2000 (PUE000740). Comments were received in February 2001, and a supplemental staff report was issued which recommended giving most Virginians the opportunity to

choose by January 1, 2003. Dominion Virginia Power urged the Commission to stay on a two-year phase in schedule.

The Commission approved phase-in schedule allows all customers of AEP-Virginia, Allegheny Power and Delmarva Power (Conectiv) the right to shop on January 1, 2002. All of Dominion Virginia Power's customers will be able to shop by January 1, 2003 allowing the company to phase-in its two million customers in one-third increments. The first third has choice on January 1, 2002, the second third on September 1, 2002, and the final third on January 1, 2003. Kentucky Utilities and Virginia's 13 electric cooperatives are being given the full two years to offer choice to their customers by January 1, 2004.

Retail Access Rules

Before the pilot programs could begin, a set of rules was needed to guide the participants. The Commission ordered a work group to assist staff in developing interim pilot rules ("Interim Rules"). These Interim Rules were issued in May 2000, after a hearing (PUE980812). The Interim Rules covered codes of conduct for energy providers, standards of conduct among affiliates, and licensing procedures for CSPs and aggregators.

The Commission ordered another work group, led by staff, (PUE010013) to revisit the Interim Rules and recommend changes. The Commission issued permanent rules on June 19, 2001, just six months after initiating the rule making proceeding. The quick decision gives all stakeholders sufficient time to prepare for the statewide transition to full retail choice beginning on January 1, 2002.

Electronic Data Interchange (EDI)

EDI involves the computer to computer exchange of business information between utilities and energy providers. It includes information such as customer enrollment, billing and usage. In April 1999, the Virginia Electronic Data Transfer (VAEDT) working group was established under leadership of staff. It met every other week until June 2000, when it filed with the Commission its EDI Test Plan, Implementation Guidelines and Data Dictionaries.

Staff monitors EDI testing among trading partners. Standards continue to be refined as experience is gained through pilots. The VAEDT continues to expand its membership as CSPs consider entering Virginia's market. It meets monthly to resolve evolving business communications issues. Staff also participates in a regional effort to create uniform EDI guidelines among states. And, staff maintains an EDI web site available to assist utilities and CSPs.

Uniform Business Practices (UBP)

Staff actively participates in national efforts to promote consistent business practices among all energy market participants. UBP includes items in both our EDI standards and our Interim Rules. For instance, UBP addresses licensing, customer

information, enrollment, switching, billing, metering, performance standards and dispute resolutions.

Licensing

Staff has established an efficient mechanism for processing licensing applications. There is an internal deadline of no more than 45 days from application to issuance and staff has met that deadline with every application thus far.

The Commission has issued 11 licenses to electric CSPs and 10 licenses to aggregators. Also, there have been 17 licenses issued to natural gas CSPs. The SCC web site gives potential new suppliers access to the licensing requirements and contains a sample license application form.

Consumer Education

The Act directed the Commission to develop a consumer education program regarding electric choice. In February 1999, a working group led by Commission staff was formed to address consumer education during the pilot programs. Working with the utilities, the pilot programs filed with the Commission included consumer education components from this working group.

In July 1999, a committee was formed to help develop a consumer education plan for statewide choice, both electricity and natural gas. The plan developed by the Commission with input from the committee was filed with the Legislative Transition Task Force ("LTTF") in December 1999. In the 2000 General Assembly session, legislation was passed adopting the SCC consumer education plan and associated funding mechanism. The plan is titled "Virginia Energy Choice."

Accomplishments so far include a web site and a toll-free phone number that were established in August 2000. The first newspaper ads introducing Virginia Energy Choice were published in fall 2000. Staff has made more than 65 presentations to various community groups and organizations.

In October 2000, a request for proposals was issued to public relations/advertising firms for handling the education effort over the next five years. Fourteen companies responded and four were selected for interview and formal presentations. The winning firm was announced in April.

The Virginia Energy Choice education advisory committee was formed in December 2000 and has met five times to help guide the Commission's education effort.

Functional Separation

A proceeding was held to promulgate regulations for the functional separation of incumbent electric utilities' generation, transmission and distribution by January 2002, as directed by the Act. The order in that case (PUA000029) was issued in October 2000.

Functional separation plans for Allegheny Power and Delmarva were negotiated among staff, companies and the Attorney General's Office. The Commission accepted these plans.

Functional separation plans by the other three investor-owned utilities and twelve electric cooperatives have been filed. Orders on those plans must be issued by January 1, 2002.

Rate Case/Cost Unbundling

All electric utilities except Virginia Power were allowed by the Act to file a rate case before January 1, 2001, for rates that would be in effect until at least 2004 and possibly until 2007. No IOUs filed a rate case, but five electric cooperatives did.

In July 2000, a Commission order was issued detailing rate case rules (PUA990054). All electric utilities reduced rates effective January 1, 2001, to reflect the state tax law changes.

Those utilities that did not file rate cases will, as part of their functional separation filings (described above), furnish cost information enabling the Commission to separate, or "unbundle" these utilities' rates into their generation and other component parts. Unbundled generation rates will be used to calculate "wires charges," the surcharge paid (if applicable) to incumbent electric utilities by their customers who purchase generation from competitive suppliers. Wires charges serve as a mechanism for stranded cost recovery for Virginia's incumbent electric utilities during the transition to full retail generation competition.

Billing and Metering

The Act required the Commission to submit a report by January 1, 2001, to the LTTF providing a recommendation as to whether metering and billing services should be opened to competition. The Commission held a proceeding (PUE000346) in which interested parties were asked to evaluate and comment on a draft metering and billing plan developed by staff. Using input from that hearing, the Commission filed a report with the LTTF on December 12, 2000. That report was used by the LTTF to develop legislation related to competitive metering and billing passed by the 2001 Session of the General Assembly.

Staff is working on the implementation of that legislation now, with some competitive metering and billing potentially beginning January 1, 2002, with full competition by January 2003. Several companies including Dominion Virginia Power, Allegheny Power and Potomac Edison have asked the Commission to delay implementation.

Regional Transmission Entities ("RTE"s)

The Act required all incumbent utilities to join or establish an RTE by January 2001. In July 2000, the Commission issued an order (PUE990349) setting rules for the transfer of control and management of transmission assets to the RTEs joined by

Virginia's electric utilities. The utilities have submitted their RTE plans to the SCC and FERC. The Commission is participating in FERC proceedings regarding RTEs.

Electric Utility Consumption Tax

As a result of deregulation, effective January 1, 2001 electric companies will no longer pay a gross receipts tax. This tax has been replaced with a net corporate income tax and a consumption tax. The conversion to this tax has resulted in numerous meetings with the stakeholders of the electric companies, Virginia localities, the Virginia Department of Taxation, and members of the Virginia State legislature. In addition, staff has met with the electric industry over the past year to develop a form that captures all of the necessary data and documentation needed for the remittance of each monthly payment for deposit into the state treasury.

Assessment of Independent Power Producers

Electric suppliers whose generation facilities were previously assessed locally will begin reporting those facilities, as well as any new facilities, to the Commission for central assessment in 2002. This will result in approximately 75 new facilities in addition to the traditional electric companies currently being assessed by the Commission. Staff has held meetings with the stakeholders over this past year to discuss reporting requirements and assessment methods that will be used to determine the assessed values of these facilities. As a result of this legislation, the Public Service Taxation Division has begun viewing these properties and gathering as much information as possible in order to develop a database on these generating facilities.

Net Energy Metering

The Commission was directed by the Act to establish by regulation a net energy metering program. This was to be in place by July 2000, and allow an eligible customer to feed back to the electric grid power generated from solar, wind or hydro sources. The Commission issued rules in May 2000 (PUE990788).

Distributed Generation

The Commission is directed by the Act to develop rules and regulations for distributed generation connections. Staff has held several meetings with stakeholders to receive input for proposed rules.

Other Related Issues

Staff has met with many potential independent power producers. As many as 20 new generating facilities are being contemplated for construction in Virginia.

Three have already received approval - Commonwealth Chesapeake (PUE960224), Wolf Hills (PUE990785), and an expansion of the Doswell facility (PUE000092). Three others have filed completed applications with the SCC: Tenaska (PUE010039), Cin-Cap Martinsville (PUE010169), and Loudoun County Power (PUE010171). Two other applications are under review and two more are expected soon.

In addition, the SCC has initiated a proceeding in which it will consider new filing requirements for applications to build and operate electric generating facilities in Virginia (PUE010313). These revised rules will incorporate recent changes in Virginia law regarding the construction and operation of such facilities in a new competitive electricity market.

Staff has started an ongoing research and analysis project on the issue of market power. A report was issued in November 2000, with our preliminary findings. A second report was filed in May 2001. A report is due on September 1 to the LTTF reporting on the status of competition in the Commonwealth, the status of the development of regional competitive markets, and the Commission's recommendations to facilitate effective competition in the Commonwealth as soon as practical.

Staff has contacted a number of competitive service providers not yet licensed in Virginia. Staff solicited their input as to what the Virginia market needs to attract them; staff inquired about their interest in providing default service; and staff has attempted to send the message that Virginia will soon be open to competition and we hope to see them active in our state.

29. There are several remits under which the SCC is required to consider matters pertaining to the environment, economic development, and consumer protection. To allow these broader matters to be dealt with adequately, the SCC should seek ways of allowing a wide set of evidence to be brought to bear in cases.

This recommendation appears to refer to the criteria that apply to the granting of certificates for electric generating facilities, high voltage transmission lines and intrastate natural gas pipelines. The SCC relies on the statutory language including that set forth in §56-46.1 in granting certificates for electric facilities for regulated utilities. It states that the Commission, before approving the construction of an electric generating facility or transmission line, "shall give consideration to the effect of that facility on the environment and establish such conditions as may be desirable or necessary to minimize adverse environmental impact." It continues to note that the Commission "may consider the effect of the proposed facility on economic development within the Commonwealth and shall consider any improvements in service reliability that may result from the construction of such facility."

The criteria for construction and operation of electric generation facilities that will not be in the rate base of a regulated utility are different (i.e. merchant plants). Code section 56-265.2 provides that the Commission "may permit the construction and operation...upon a finding that such generating facility and associated facilities including transmission lines and equipment (i) will have no material adverse effect upon the rates paid by customers of any regulated public utility in the Commonwealth; (ii) will have no material adverse effect upon reliability of electric service...and (iii) are not otherwise contrary to the public interest."

Section 56-265.2:1 is the Code section that dictates the criteria that must be considered for gas pipelines, and appears to be the provision the GMU study team reviewed. It directs the Commission to consider the effects of any proposed pipeline on the environment, public safety and economic development, but relates only to natural gas pipelines.

The Commission makes every effort to involve interested parties in these and other matters of importance. Notice is published in newspapers of general circulation in the area where such a proposed facility may be built. Copies of the scheduling order are sent to each local governing body in the vicinity of the proposed facility. The Commission also requires the applicant to make the application available for public viewing in a public facility (local library, town hall, etc.) near the intended project.

Scheduling orders also provide instructions to the public on how to obtain an application from the SCC or from the applicant. News releases announcing the public hearing and other important case dates are issued and local news reporters are encouraged to advise the public, in their stories, of the SCC's schedule for considering the application. The scheduling order is always available on the SCC's web site for viewing or printing. The Commission web casts the audio of some of its Richmond hearings via the Internet.

During these hearings, the Commission always invites public witnesses to speak first. The SCC's procedures allow a great deal of latitude as to who can participate and the Commission is generous in its receipt of evidence offered for submission to the record. For cases with a high degree of local interest, the Commission will schedule hearings in or near the affected area offering a day and an evening session for the convenience of those unable to appear at a Richmond hearing or take time away from work.

Despite these efforts, the public sometimes claims it is unaware that the Commission is considering such projects. The SCC's approval in 1999 of an intrastate natural gas pipeline resulted in some criticism that property owners along the proposed corridor were unaware of the application while it was pending before the SCC. A proposed legislative remedy that would have required affected property owners to receive direct mail notice of such a project did not get out of committee during the 2001 General Assembly session. The proposed change in Virginia law would have mirrored an existing federal requirement that applies to any proposed interstate pipeline project.

The Commission has an agreement of understanding with the Virginia Department of Environmental Quality (DEQ) to advise the Commission of any and all potential environmental impacts of such projects. DEQ coordinates a response that involves a number of state and local agencies with direct knowledge of the potential environmental, historical, cultural, or aesthetic implications of such projects.

A review of the record in the SCC's recent approval of a 765,000-volt transmission line in Southwest Virginia indicates that more than 500 public witnesses

testified during local hearings for this case (PUE970766). The transcript exceeded 3,700 pages. Documents in the case exceeded 8,500 pages.

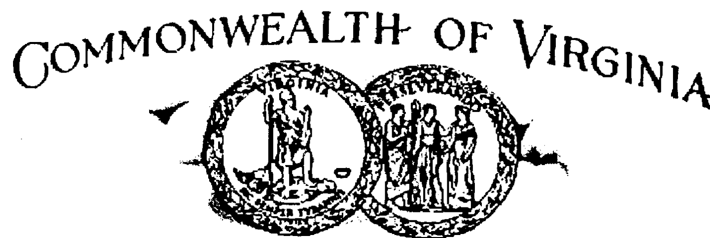
The Commission's final order acknowledged the deep concerns, feelings and passionate involvement of those directly impacted by the line. Their participation did make a difference. The Commission directed the company building the line to go beyond satisfying the minimum requirements set by the various state and federal environmental agencies. The SCC said, "When additional measures, which exceed the minimum effort necessary to comply with the law and regulations, are identified by the agencies, we expect the company to implement these measures to the extent practical."

The company is required to submit quarterly progress reports during construction until the line is in operation. The SCC's Division of Energy Regulation will monitor all mitigation measures.

KEN SCHRAD
DIRECTOR

ANGELA P. BOWSER
ASSISTANT DIRECTOR

COMMONWEALTH OF VIRGINIA



PO BOX 1197
RICHMOND, VIRGINIA 23218-1197
(804) 371-9141
TDD/VOICE: (804) 371-9206
FAX (804) 371-9211

http://www.state.va.us/scc

STATE CORPORATION COMMISSION
INFORMATION RESOURCES

September 17, 2001

The Honorable Thomas K. Norment, Jr., Chairman
Members, Joint Subcommittee Studying the SCC

Dear Senator Norment and subcommittee members:

The State Corporation Commission appreciates the opportunities it has been given to respond to each draft of the study report as it has evolved over the past six months. Following the last meeting of the joint subcommittee, Dr. Kenneth Button of the George Mason University study team spent most of Monday, July 30, meeting with the Commissioners and the directors of those SCC divisions upon which the narrative of the report primarily focuses.

Throughout this process, the Commission's primary objective has been to ensure that the information in the report, as it applies to the Commission's current operations, is "technically correct." The Commission also has freely expressed to Dr. Button the pros and cons of various recommendations. In doing so, the Commission fully recognizes that these recommendations are policy matters appropriately left to the General Assembly to decide. The Commission strives to ensure that lawmakers have all of the facts necessary to make any such policy decisions.

There is evidence throughout the final report that the SCC's written comments and verbal discussions with the GMU study team have been read and heard. Many of these have been added as footnotes to the report. We urge careful reading of these footnotes that, in many instances, offer significant points of clarification that the casual reader could easily miss by reading only the narrative portion of the report.

Following its review of the final report, the Commission wishes to take this opportunity to bring to your attention the following:

- Recommendation 8 - increasing the number of Judges to five

  This is a public policy matter for consideration by the General Assembly. The Commission asks subcommittee members to again review the Commission's written response to the first draft report regarding this recommendation. The final report now leaves the impression that something is yet to be implemented as a result of the 1971

amendments to the Virginia Constitution. The Constitution simply provides that membership may be increased to five. There is no constitutional mandate. The issue of the cost to add two Commissioners was raised at an earlier meeting of the subcommittee. The current first year estimated cost for two additional Commissioners is slightly more than $1 million. The current second year cost estimate is approximately $780,000. Succeeding year costs would most likely keep pace with the cost of inflation.

- Recommendation 9 - staff in the Office of General Counsel

  Despite several attempts by the Commission to ensure that the correct name of the division be cited in this recommendation, it still reads "Office of the Council General." Oddly, the correct name of the division appears almost everywhere else in the report.

- Recommendation 10 - handling potential ex parte conflicts

  The Commission notes that neither statute nor case decision prohibits ex parte communications in administrative processes conducted under Virginia's Administrative Process Act. It appears then, that the Commission, through Rules of Practice and Procedure that have been in place since the early 1970's, has addressed the ex parte issue more than has been the case generally with most state agencies, or as is required by statute. The SCC's rules apply to all pending formal proceedings, encompassing much more than simple enforcement or adjudicatory actions. While it may be that the SCC still has work to do to address any potential perception or appearance problem, the Commission does, in fact, have rules in place to address the issue. Those same rules were revised this year after significant involvement by the parties to whom they apply.

- Recommendation 12 - Directorate of Energy

  The Commission currently has a Director of Energy Regulation who oversees electric, natural gas and water utilities. The SCC encourages any member of the General Assembly, the regulated industry or the public to consider this director to be the "single point of contact." The same holds true for the Commission's current Director of Communications. Both work closely with the directors of Public Utility Accounting, Economics and Finance, and Public Service Taxation, and when necessary the Office of General Counsel, to coordinate any matter involving their respective sectors - energy or telecommunications. The Commission will take the steps necessary to ensure that these two directors involve the proper area of expertise within the SCC and that the public is made aware of any organizational realignment. The advantage is that those needing answers from Commission staff will know where they can initiate such questions and still benefit from the full compliment of SCC staff whether the matter involves rates and service, accounting standards, economic trends, financing, taxation, or law.

- Exhibit 1.1 - Organizational structure chart

  Under the category Financial Services, the box for the Division of Securities and Retail Franchising is labeled Division of Securities and Real Estate.

  Under the category Public Utilities, accounting is misspelled in the box for the Division of Public Utility Accounting.

  Under the category Legal Support, the box for the Office of General Counsel misspells it as "council."

  Under the category Administration, technology has been omitted from the name of the Information Technology Division.

- Section 4D - Telecommunications

  The report still says the collaborative committee has been slow to get started and is somewhat adversarial. It further says the committee's leaders need to provide more guidance and establish specific goals and timelines. Dr. Button, on July 30, was provided a handout that gave specific details of the progress of this committee, including goals and timelines. It was also pointed out that industry participants have given the Division of Communications positive feedback on its process and leadership as compared to other state collaboratives in which they have participated.

  The report continues to state that AT&T and MCI have been impeded in their entry to the residential market in Virginia because of the Commission's decision to stop arbitrating interconnection agreements. This statement was modified somewhat in the final report by adding footnote 159, but the assertion remains. This issue was discussed in detail in the SCC's response to the first draft report. In addition, it was discussed at the July 30 meeting with Dr. Button. The facts remain that AT&T and MCI were among the first companies granted CLEC certificates by this Commission in 1996, and were in the first wave of arbitration conducted by this Commission in 1996 and 1997. Interconnection agreements have been in place since that time. Because the companies were unsuccessful at negotiating new interconnection agreements (the original ones were for a three-year period), they currently are having arbitrations done by the FCC in lieu of the SCC. The companies had the option to conduct these arbitrations under state law, but chose not to. The existing agreements remain in effect until these arbitrations at the FCC are concluded.

Under the discussion of *Price*, the report states that "by law," CLECs cannot charge more than the incumbent. It should state "by Commission rule." Ironically, this was incorrect in the May (Interim Report) draft, correct in the July (Second) draft, and incorrect again in the Final Report. When this error was identified in the SCC's response to the first draft, it was also noted that a CLEC might request higher rates. When requested, those rates have been approved.

Under the discussion of *Service Quality*, the report states that studies show service quality improves in a competitive environment, and that there is no evidence of it deteriorating under incentive regulation. This statement remains even though it has been pointed out twice that this is not consistent with the staff's experience in Virginia and is inconsistent with the staff's general knowledge of service quality throughout the country. The referenced studies were done in the 1980-1991 period and the 1990-1996 period, which is prior to local competition, and for the most part, predates incentive regulation.

Under the discussion of *Profits*, the report states there is strong evidence that rate of return regulation provides a company with higher profits than price caps. This is incorrect as was pointed out to Dr. Button in the July 30 meeting. He strongly agreed it was wrong, was surprised it was there, and said it surely would be taken out. It remains.

Regarding Exhibit 4D-4 on *Telephone Costs*, it was pointed out to Dr. Button on July 30 that these charts need further explanation as they bear little or no relation to actual rates in Virginia. No explanation was added.

Throughout the Telecommunications section, most references to exhibits are wrong. Either the exhibits are labeled incorrectly or there are more exhibits than corresponding references.

- Section 4E - Energy (Electricity and Gas)

Under the section *Electricity*, the SCC finds confusing the added language to the first full paragraph on page 95 of the final report that is associated with footnote 181. It reads --

> "Whether such gains will materialize is a long-term consideration. In the short term, removal of price caps in the US have tended to result, in part because of high fuel price, excessively competitive wholesale markets, and capacity issues, in higher electricity prices and instability in supply."

The Commission does not understand the reference to --"excessively competitive wholesale markets" – as being one of the factors leading to higher electricity prices and instability in supply.

During the July 30 meeting, SCC staff advised Dr. Button that the Center for the Advancement of Energy Markets (CAEM) had updated its RED Index. The update, released on July 13, shows that Virginia has moved up in rank from #18 in January to the #9 position with an overall score increasing from 30 to 45, respectively. Unfortunately, the final report still references the January ranking of #18. Although the Commission believes that aspects of the CAEM report are quite subjective, it appears Virginia continues to make progress in opening its energy supply market to competition as measured by the RED Index.

On a final note, the Commission wants to take this opportunity to inform the joint subcommittee that the Clerk's Office is in the process of establishing a toll-free number that business entities operating in Virginia and the general public can use to make corporate-related inquiries. The toll-free number, 1-866-SCC-CLK1, is expected to be operational by the end of the month.

The Commission looks forward to continued involvement with the joint subcommittee as it proceeds to the next phase of its study. As we have offered before, the Commission continues to invite members of the joint subcommittee to make individual inquiries of the Commissioners or SCC staff for any information a member might deem helpful in fully understanding the various functions and responsibilities of the SCC. In extending such an offer, members are reminded that the Commissioners must exercise care in not discussing issues related to pending cases.

Sincerely,

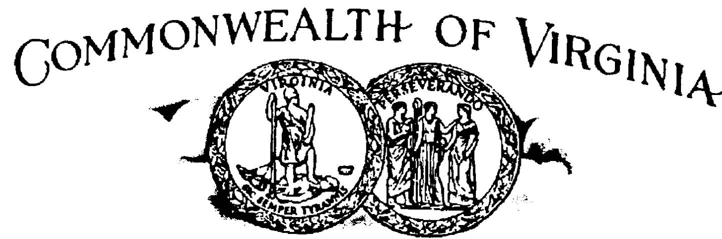
Ken Schrad

cc: Chairman Miller
Commissioner Morrison
Commissioner Moore
Philip R. de Haas, Counsel to the Commission
Amigo R. Wade, Legislative Services, Senior Attorney
David Rosenberg, Legislative Services, Staff Attorney

bcc: SCC Division Directors

KEN SCHRAD
DIRECTOR

ANGELA P. BOWSER
ASSISTANT DIRECTOR



PO BOX 1197
RICHMOND, VIRGINIA 23218-1197
(804) 371-9141
TDD/VOICE: (804) 371-9206
FAX (804) 371-9211

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STATE CORPORATION COMMISSION
INFORMATION RESOURCES

November 15, 2001

The Honorable Thomas K. Norment, Jr., Chairman
Members, Joint Subcommittee Studying the SCC

The State Corporation Commission again submits for your review a comprehensive written response to the report of the George Mason University study team and the recent public comments received by the joint subcommittee. This submission, along with previous responses, is provided to help your understanding of the SCC's current work and the structure used to accomplish it efficiently, effectively, and within the framework established by the Code of Virginia.

The Commission considers this information important to the subcommittee when considering any potential recommendations that may affect the functional operation of the agency. The SCC does not apologize for the length and complexity of its response. It has been frustrating to repeatedly provide the consultant such detail only to see it ignored or dismissed as having little bearing on several of the general, broad recommendations that remain in the George Mason University report.

The subcommittee is best served if the Commission communicates and explains, in detail, the regulatory responsibilities with which it has been charged through legislation enacted by the General Assembly. The Commission and the subcommittee can then make informed decisions for improving, where necessary, the SCC's service to the Commonwealth, the industries subject to the SCC's jurisdiction, and Virginians served by those industries.

Sincerely,

Ken Schrad

cc: Chairman Miller
Commissioner Morrison
Commissioner Moore
Amigo R. Wade, Legislative Services, Senior Attorney
David Rosenberg, Legislative Services, Staff Attorney

COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

Response of the

State Corporation Commission

to the

Final Report of SCC Study

November 15, 2001

Executive Summary

Over the course of the past year, two consultants have completed their separate independent analysis of the State Corporation Commission[1]. Each offered a set of recommendations designed to improve upon an institution of state government that both consultants found to be effective and well respected.

This "check-up" of the Commission's operational efficiency and effectiveness is a good thing. Many of the recommendations have generated healthy discussion. They have given the Commission much to think about. Now, it is time to decide which have merit, which deserve further consideration, and which require the Commission to find a better way to accomplish its regulatory responsibilities as directed by the General Assembly through the enactment of legislation.

Before acting on any of the recommendations, the Commission must go beyond theoretical wishes and perceptual misconceptions. It must look for clearly identified issues and problems. Once the issues are analyzed and understood, the pros and cons of suggested solutions can be weighed. This methodical analysis will ensure that constructive steps are taken to improve the Commission's ability to serve the Commonwealth and its citizens.

The GMU study contains a number of recommendations that encourage the Commission to continue doing exactly what it has been doing. Obviously, it is easy to agree with these recommendations.

Some recommendations involve adjustments to internal staffing assignments or identify a need to increase the number of employees to handle the increasing workload involved with developing, monitoring and maintaining competitive markets. These recommendations may involve monetary decisions that are clearly within the SCC's purview. The Commission, of course, must stay within the authorized parameters of the Commission's special fund appropriation approved by the General Assembly.

Other recommendations suggest the need to enhance the public's understanding and awareness of the SCC. The Commission is doing more than ever through outreach, consumer education, and electronic access to information. However, more can be done to keep lawmakers, the regulated industry and the public informed of the Commission's duties, responsibilities, procedures and decisions. The emphasis must go beyond raw information. Facts need to be supplemented with explanations that help the public understand the Commission's role in preserving the overall public interest and the resulting benefit to the Commonwealth as a whole.

---

[1] Final report on the Virginia State Corporation Commission by David Wirick and John Wilhelm of the National Regulatory Research Institute, March 2001; Study of Regulatory Responsibilities, Polices and Activities of the State Corporation Commission by George Mason University School of Public Policy, August 2001.

Several recommendations are controversial and involve public policy decisions that would require legislative action and, perhaps, an amendment to the Virginia Constitution.

In order to aid the subcommittee with its work[2], the SCC has placed each of the 26 GMU study recommendations into the following general categories. Some of the recommendations have been abbreviated for this executive summary.

***

Category I - Recommendations for continuing current practices

1. The SCC should retain its role as the body responsible for economic regulation of the sectors currently under its oversight.

2. The SCC should remain as independent as possible from short term political pressures.

7. The activities of the SCC should continue to be self-funded.

11. There is no recommendation of further informal 'alternative dispute resolution' procedures being required.

15. The Bureau of Insurance should identify other states or countries with which Virginia currently has no reciprocity agreements, but which are most likely to establish them in the near future. (Insurance section)

17. The Bureau of Insurance should continue to work with the National Association of Insurance Commissioners. (Insurance section)

19. The Bureau of Financial Institutions has developed successful ad hoc ties with other Bureaus and Divisions within the SCC. These should be continued. (Financial Institutions section)

22. The activities of the collaborative committee are critical to competition in the Commonwealth. Therefore, it is important to continue to take steps to move the process along as quickly as possible. (Telecommunications section)

25. The SCC should continue to foster more pilot programs in natural gas supply and accelerate the development of competitive markets in energy provision wherever possible. (Energy section)

Category II - Recommendations involving internal staffing

9. Adequate resources should be provided to reduce the turnover of staff in the Office of the Council General.

[2] Senate Joint Resolution 173/House Joint Resolution 187 (2000).

12. The similarities and interconnections between the regulatory demands in the fields of gas, electricity and water regulation justify the creation of a Directorate of Energy.

20. The Securities Division would benefit from having more attorneys working with it. (Securities section)

Category III - Recommendations for improved information and understanding

5. It is important that the SCC collects salient data and that this data adequately reflects the implications of its actions on consumers as well as on the industrial sectors under its jurisdiction. One of the most effective forms of consumer protection is good information.

6. The SCC should continually review the data that industry is required to provide and limit them to those that are necessary to fulfil its regulatory requirements. In doing this it should seek to minimize the burden on the regulated industries of providing data and other information.

10. The State Corporation Commission should continue to explore ways of improving the public understanding of how it internally handles potential ex parte conflicts. It should continually seek ways to mitigate potential conflicts.

13. The various divisions should develop a system of performance assessment procedures suitable to their own activities. These should be quantifiable where possible but also contain qualitative indicators. Performance measured against criteria should be part of annual division reports.

14. All divisions of the SCC should engage in more public information dissemination and information gathering.

21. A system needs to be designed to establish the baseline (current state of competition) and then to monitor over time. (Telecommunications section)

26. There are several remits under which the SCC is required to consider matters pertaining to the environment, economic development, and consumer protection. To allow these broader matters to be dealt with adequately, the SCC should seek ways of allowing the widest sets of evidence to be brought to bear in cases. (Energy section)

Category IV - Recommendations for public policy/legislative consideration

3. The basic principle of regulation should be to allow the market to function and only to intervene when there are demonstrable market failures that appropriate regulatory control can be demonstrated to reduce.

4. The Commonwealth's structure of regulation was initially designed to deal with fundamental market flaws as perceived at the time. Our understanding of how markets function has subsequently changed as has technology. It is important to ensure that the workings and decisions of the SCC continue to take full account of this.

8. The notion that the number of Judges should in fact be increased to five, with one being replaced each year, should be seriously considered. This would require Constitutional change.

16. To continue to identify specific areas where threats to consumers' privacy may be at risk from increased reliance on electronic commerce, and develop effective measures to counter those threats. (Insurance section)

18. There have been a number of changes to the Virginian Banking Code over the years. A full review of the code should now be conducted. (Financial Institutions section)

23. It is recommended that the Commission take periodic snapshots of available services across major telecommunications markets to determine if those services are available in the Commonwealth. (Telecommunications section)

24. The current arbitration impasse is blocking the largest potential competitors. Methods of circumventing this problem should be sought expeditiously. (Telecommunications section)

***

Regardless of how each recommendation is organized, the Commission does wish to restate its concerns with certain recommendations that remain in the final report prepared by the GMU study team.

The notion to increase the number of Judges to five (recommendation #8 and accompanying text) leaves the impression that something is yet to be implemented as a result of the 1971 amendments to the Virginia Constitution. The Constitution simply provides that membership may be increased to five. There is no constitutional mandate. The current first year estimated cost for two additional Commissioners is slightly more than $1 million. The current second year cost estimate is approximately $780,000. Succeeding year costs would most likely keep pace with the cost of inflation.

Despite several attempts to get the report to use the correct name of the SCC's Office of General Counsel (recommendation #9), it still says "Office of the Council General." Other spelling and grammatical errors remain throughout the report.

The Commission, through Rules of Practice and Procedure that have been in place since the early 1970's, has addressed the ex parte issue (recommendation #10) more than has been the case generally with most state agencies with administrative processes

conducted under Virginia's Administrative Process Act. The SCC's rules apply to all pending formal proceedings, encompassing much more than simple enforcement or adjudicatory actions. While it may be that the SCC still has work to do to address any potential perception or appearance problem, the Commission does, in fact, have rules in place to address the issue. Those same rules were revised earlier this year after significant involvement by the parties to whom they apply.

The Commission has a Director of Energy Regulation (recommendation #12) who oversees electric, natural gas and water utilities. The Commission also has a Director of Communications to oversee local and intrastate telephone service. The George Mason University consultant, in a meeting with the Commissioners, acknowledged that no real problem had been identified in this area. He did suggest that it might be appropriate for the Commission to "change for the sake of change," even if the solution addresses a problem that is only perceptual. The Commission is not inclined to take a significant structural step to meet such a frivolous goal.

The proposed "Directorate of Energy" inserts an additional layer of bureaucracy and goes against the recent trend to flatten organizations and reduce the power of hierarchies. No one person or small group of people at the top has all the answers. The Commission believes the industry and the public are best served if they have direct access to the very people with the expertise to answer specific questions or solve particular problems.

For convenience, the SCC encourages any member of the General Assembly, the regulated industry or the public to consider the Director of Energy Regulation and the Director of Communications to be the "single point of contact" regarding their industry sectors. Both work closely with the directors of Public Utility Accounting, Economics and Finance, Public Service Taxation, the Office of General Counsel, and other utility divisions when necessary to coordinate any matter involving their respective industries. These two division heads will also assume the lead in communicating and encouraging the development of competitive markets involving their respective sectors. The Commission will take the steps necessary to ensure that these two directors involve the proper area of expertise within the SCC and that the public is made aware of this structural arrangement.

Finally, the Commission must point out that the Energy Section of the final report fails to acknowledge Virginia's climbing status in the Retail Electricity Deregulation (RED) Index prepared by the Center for the Advancement of Energy Markets (CAEM). The update, released July 13, 2001, shows that Virginia has moved up in rank from #18 in January 2001 to the #9 position with an overall score increasing from 30 to 45. The final report, released in early September, still references the January ranking of #18.

While the Commission finds many aspects of the CAEM report questionable and quite subjective, it was the consultant who relied on this report to "assess Virginia's progress" toward the development of a competitive energy supply market. When Virginia's rank was #18, the report found that Virginia "falls far short of other states" with competitive markets. Although Virginia moved to #9 within a six-month period and

well before release of the consultant's final report, the consultant dismisses the need to update the report by advising the study subcommittee that "anywhere in the top 20 is pretty good."

The consultant's response to this particular matter is illustrative of the difficulty the Commission has had identifying specific problems or issues that need to be addressed internally by the Commission or externally by the General Assembly. Despite a great deal of hard work by the Commission and its staff that improved Virginia's position, the report ignores these facts and retains its evaluation based on the old ranking.

In contrast, a member of the joint subcommittee identified and expressed to the Commission the need to give Virginia businesses a toll-free number to take care of matters handled by the Clerk's Office of the Commission. The SCC agreed and responded quickly. The new 1-866-SCC-CLK1 (866-722-2551) number is now in operation and the number will be appearing in the state government sections of telephone directories as new editions are distributed statewide over the coming months.

The Commission continues to be most receptive to working with the joint subcommittee to identify real and tangible problems and implement workable solutions.

General Discussion of Final Report Recommendations and Public Comments

The SCC has placed each of the 26 GMU study recommendations into four general categories:

I. Continuing current practices
II. Internal staffing
III. Information dissemination
IV. Public policy/legislative

Each final report recommendation is restated in its entirety. The Commission's response follows. Public comments as they pertain to a particular recommendation or to the Commission generally have also been addressed within these four categories.

All of the recommendations in the first category and many of the public comments were endorsements of current Commission practices or complimentary of previous experiences at the Commission. The Commissioners greatly appreciate these statements of support and the expressed confidence in the agency's ability to carry out the responsibilities with which it has been charged. There is no need for further comment except, "Thank you."

Category I - Recommendations for continuing current practices

1. *The structure of regulation in Virginia has stood the test of time well and change should only be undertaken in the light of serious long-term problems. Many sectors overseen by the SCC have been going through major technical and structural changes. In itself this is not justification for change unless lack of change impairs the long-term efficiency with which Virginian's can access these services. The SCC should retain its role as the body responsible for economic regulation of the sectors currently under its oversight.*

2. *The SCC should remain as independent as possible from short term political pressures.*

5. *The activities of the SCC should continue to be self-funded to avoid problems that many states have in achieving efficiency and effectiveness because of a dependence on annual state budgetary decisions.*

11. *The current process of dispute resolution, with its informal and formal elements seems to work well if a little slowly at times. There is no recommendation of further informal 'alternative dispute resolution' procedures being required. More formality generally leads to even slower decision-making.*

15. *To ensure that emerging issues related to deregulation are built into future agreements, and that industry agents and agencies can give opinions confidently in such jurisdiction, the Bureau of Insurance should identify other states or countries with which Virginia currently has no reciprocity agreements, but which are most likely to establish them in the near future. (Insurance section)*

17. *The Bureau of Insurance should continue to work with the National Association of Insurance Commissioners to develop uniform 'treatment of companies' and 'market conduct' standards or regulations. (Insurance section)*

19. *The Bureau of Financial Institutions has developed successful ad hoc ties with other Bureaus and Divisions within the SCC. These should be continued although there would seem no good reason for any formalization of the process. (Financial Institutions section)*

22. *The activities of the collaborative committee are critical to competition in the Commonwealth. Therefore, it is important to continue to take steps to move the process along as quickly as possible. (Telecommunications section)*

25. *The SCC should continue to foster more pilot programs in natural gas supply and accelerate the development of competitive markets in energy provision wherever possible. (Energy section)*

<u>Category II - Recommendations involving internal staffing</u>

8. *Adequate resources should be provided to reduce the turnover of staff in the Office of the Council General. This turnover at a minimum impedes the speed at which cases can be brought.*

SCC response –

> Despite several attempts to ensure that the correct name of the division be cited in this recommendation, it still reads "Office of the Council General."
>
> The SCC's Office of General Counsel is comprised of good attorneys who do good work. The industries we regulate and the law firms that represent them recognize the quality of SCC attorneys and are not shy about making offers that may attract them away from the Commission. It is a fact of life in the government sector – the state cannot keep pace with the higher salaries paid in the private sector.
>
> This Commission has also hired attorneys who have worked for the regulated industries and made a career choice to join the SCC's legal team. There are several reasons why high quality individuals choose careers in the public sector, including quality of life issues.

To the extent prudent management of its resources permit, the Commission will continue to take the necessary steps to attract and retain an adequate number of competent staff attorneys to assist the Commission with its legal workload.

12. *The similarities and interconnections between the regulatory demands in the fields of gas, electricity and water regulation justify the creation of a Directorate of Energy.*

SCC response –

One of the most puzzling recommendations arising from the study is a call for a Directorate of Energy. It is puzzling because the joint legislative subcommittee and this Commission have received numerous and conflicting views as to the prudence of this proposed change.

Ironically, the Commission may be responsible for putting this issue on the table. One of the directives the Commission gave to David Wirick, the consultant hired by the SCC to perform a thorough review of its organization and structure, was to explore the pros and cons of placing the various public utility divisions under one director. What began as a "snowflake" of an idea has become a "blizzard" of swirling recommendations.

As such, it is important to review the findings of the study consultants and the comments received from interested stakeholders to determine whether facts support what some stakeholders and members of the subcommittee have characterized as such a "sensible idea." The Commission is most interested in evidence that indicates the current structure is not working. The Commission admits its current structure may not be perfect. Perfection, however, is a high standard to achieve and the current structure is functioning well.

The George Mason University consultant, in a meeting with the Commissioners, acknowledged that no real problem had been identified in this area. He did suggest that it might be appropriate for the Commission to "change for the sake of change," even if the solution addresses a problem that is only perceptual. This Commission is not inclined to take a significant structural step to meet such a frivolous goal. Instead, it hopes to find real solutions to actual problems. The factual basis upon which the Commission might take action is not yet clear.

The following is a synopsis of opinions regarding this issue:

Final Report on the SCC by David Wirick
Recommendation # 2
"The SCC should not establish a Director of Public Utilities at this time and instead consider more carefully the role of the staff, the current organization of the utility regulatory functions, and other organizational options. Though this report identifies some limitations posed by the current organization of utility staff, we are reluctant to recommend the creation of a Director of Public Utilities.

Instead, the SCC should remain open to all options because of problems that might be created by combination of the telecommunications and energy industries under one Director."

SCC response –

One of the concerns expressed by Wirick applies whether there is a director over public utilities generally or two directors – one over energy and the other over communications. The concerns are the potential isolation of the Commissioners and the diminished role of the accounting, economic and tax experts in utility matters. Such a structure could inadvertently reduce their input and the Commissioner's ability to call on such expertise. Wirick recommended that each of the current utility divisions should continue to report directly to the Commissioners. To do otherwise, according to Wirick, would result in "over-reliance on the viewpoint of one person that would be harmful to the regulatory process," and that a single director "would have the opportunity to exercise tremendous influence on the process, an influence that could be toxic."[1]

These rather strong sentiments reflect the point that rather than one voice to the Commissioners on various issues, the Commission and the public interest are better served by the sometimes conflicting thoughts of the energy, accounting and economics divisions. Divergent views may create tension. But, that very tension can sometimes provide creative solutions.

Stakeholders interviewed by Wirick were mixed about the creation of a Director of Public Utilities. So, he urged the Commission to explore a full range of options[2]. One was to create two sector-specific divisions as an interim trial step toward the eventual creation of a single Utility Division. A second option was to organize the utility sectors into two functions – traditional and competitive. A third option was to allow the Office of General Counsel to take the lead in coordinating staff across the utility divisions. And, a fourth option was to simply assign, by agreement among divisions, a case manager from one of the divisions for every utility case.

Since the Wirick report did not offer a preferred course of action, the Commission decided not to embrace any of the suggestions while the joint legislative study was in progress. The Commission believed additional information and possible alternatives might surface during the development of recommendations for the final report of the legislative study.

[1] Final Report on the Virginia State Corporation Commission, March 2001, p. 27.
[2] Ibid, pp. 66-67.

Final Report of George Mason University

Recommendation # 12

"The notion of an overall 'Public Utilities Directorate' that would include energy, water and telecommunications is also a somewhat dated one. There are significant differences in the issues confronting telecommunications and energy. While periodic reviews of any regulatory agency may result in changes in structure, there is a much stronger case at present for creating a Director for Energy embracing gas and electricity and water. A carefully structure[d] energy directorate would seem to offer synergies in thought, approach and application across closely related sectors."

SCC response –

The GMU recommendation evolved from the time of the early draft reports to the final report. The early drafts appeared to follow the first of Wirick's alternative options by suggesting the creation of two sector-specific positions – a Commissioner for energy and a Commissioner for communications. This approach apparently was designed to fit with another GMU recommendation, the creation of an Administrative Committee made up of various industry sector commissioners (an elevated title like that of the heads of the Bureau of Insurance and the Bureau of Financial Institutions). When the administrative committee recommendation was abandoned, the GMU final report only called for the creation of a Directorate of Energy.

Dominion Virginia Power

"The idea of creating additional Commissioner/Director positions to head the Staff's energy and telecommunications functions warrants careful consideration. These positions should not be formed by simply renaming or reclassifying existing director-level jobs. The Commissioners of Energy and Telecommunications should have extensive authority to supervise all Staff functions dealing with these industries and coordinate work among the various divisions. The Commissioners would simplify the regulatory environment by offering a single point of contact for many of the dealings regulated entities have with the Staff. Creation of the jobs would also give the General Assembly a focal point for its inquiries into Commission policy, procedure and regulations regarding these two industries."

SCC response –

The company apparently supports the interim recommendation of GMU to identify a single person to oversee each sector – energy and telecommunications. As for the company's statement that, *"[t]hese positions should not be formed by simply renaming or reclassifying existing director-level jobs,"* the assumption is that the company is concerned that "form should not triumph over substance" rather than any lack of confidence in our existing directors of Energy Regulation

and Communications. The problem may be that the proposal itself is one of "form over substance." These two directors along with the other utility division directors fulfil the services to the public as required by law and contribute valuable advice to the Commission in the performance of its duties. Considering the proven track record of accomplishments the SCC staff has achieved through coordination of the various functional responsibilities of the utility divisions, the Commission does not see a failure of the current structure.

<u>*Virginia Committee for Fair Utility Rates*</u>

"...[t]he creation of an Energy Directorate would add cost and another layer of bureaucratic reporting, thereby potentially complicating decision-making in the energy area, but it is not clear that the current structure, in which the Energy Regulation Division coordinates with other divisions with particular expertise in accounting, economics and finance (i.e., the Division of Public Utility Accounting and the Economics and Finance Division) is ineffective in assisting the SCC in making policy on electric, natural gas, and water issues. In any event, the Report reveals no serious long term problems that would warrant such a change."

SCC response –

The Virginia Committee apparently is satisfied with the status quo. Like other stakeholders, it works regularly with Commission staff. Unlike some other stakeholders, it recognizes and appreciates the level of coordination that already occurs among the utility divisions. The Commission appreciates the Committee's position that "if it is not broke, what are you trying to fix?"

<u>*American Electric Power*</u>

"...[w]e agree with the recommendation calling for the establishment of a "Director of Utilities" position. This is, in our opinion, far preferable to suggestions contained in the interim report."

SCC response –

The company's written statement says "director of utilities." This could be construed to mean someone to oversee both the energy and telecommunications sectors. However, the company clarified later that it is looking for a director of energy.

<u>*James C. Roberts*</u>

"Because of the many different factors and considerations that go into this particular regulatory area, I believe it would be desirable to have a Director [of Energy Regulation] charged with coordinating the activities of those involved in that area of regulation."

SCC response –

Mr. Roberts was extremely complimentary of the Commission and staff. His recognition of the SCC's workload and its commitment to the public interest and the implementation of more competitive approaches to regulation is greatly appreciated. These accomplishments were achieved under the existing structure of the public utility divisions.

<u>The Current Structure</u>

In analyzing the recommendation and the various public comments, there needs to be an understanding of the current structure of the public utilities section.

There are seven SCC divisions[3] now involved in fostering retail choice and promoting the move to competition in the utility industry. Of the seven, two – the Division of Communications and the Division of Energy Regulation – can be considered the lead divisions with specific oversight of the rates charged and the service rendered by their respective sectors. Three other utility divisions – Public Utility Accounting, Economics and Finance, and Public Service Taxation -- have responsibilities that support both the energy and telecommunications sectors. Two other staff divisions are involved. The Office of General Counsel provides legal services to the five previously mentioned divisions and the Division of Information Resources has been charged with educating and informing consumers about the new competitive retail market for electricity and natural gas.

The list below shows how these divisions have worked together to accomplish a multitude of tasks in preparation for retail competition in the energy sector. The lead division is listed first. However, the work could not have been accomplished without the sharing of division personnel and expertise. In tandem, the emphasis of staff has been to accelerate the development of a competitive energy supply market in Virginia.

ENERGY-RELATED ACTIVITIES

Retail Pilot Programs (Energy Regulation, Economics and Finance, Public Utility Accounting, General Counsel, Information Resources)

Virginia Power's pilot (PUE980813) began in two phases, September 1, 2000, in the Richmond area and January 1, 2001, in Fairfax. AEP-Virginia's program (PUE980814) began October 1, 2000. Rappahannock Electric Cooperative (PUE990088) began a program on January 1, 2001.

[3] The seven are the Division of Energy Regulation, the Division of Communications, the Division of Public Utility Accounting, the Division of Economics and Finance, the Division of Public Service Taxation, the Office of General Counsel, and the Division of Information Resources.

Staff assisted these utilities in implementing their pilot programs by speaking at supplier forums, monitoring the lottery process, reviewing marketing programs, and other such efforts. And, staff monitors the pilot programs for many things including customer activity, competitive service provider (CSP) activity, and customer complaints.

The first natural gas retail choice program in Virginia was sponsored by Columbia Gas of Virginia and approved by the SCC in September 1997. The length of the pilot, limited to the company's Gainesville service area, has been extended several times by the Commission. The latest extension also directed the company to file, by December 31, 2001, a plan to expand its retail choice program to more or all of its customers beginning on July 1, 2002.

Virginia's largest natural gas retail choice pilot program was implemented by Washington Gas Light (WGL) and approved by the SCC in 1998. Over the years, the pilot has expanded its level of eligible customers in Northern Virginia. On March 15, 2001, WGL became the first natural gas utility in Virginia to receive approval to offer retail choice to all of its 377,000 Virginia customers, including those served by its Shenandoah Gas division in the Winchester area. WGL expects all customers to have the opportunity to choose by January 1, 2002.

Phase-in Plans (Economics and Finance, Energy Regulation, General Counsel, Information Resources)

The Commission expedited the availability of choice to the bulk of Virginians. Under the Virginia Electric Utility Restructuring Act, the transition to retail access begins January 1, 2002 and must be completed no later than January 1, 2004. The Act allows the SCC to accelerate or delay that schedule, but the delay cannot be for more than one year.

In the fall of 2000, staff met with interested parties to discuss whether the phase-in schedule could be accomplished in less than the maximum two years allotted by the Act. A staff report was issued in December 2000 (PUE000740). Comments were received in February 2001, and a supplemental staff report was issued which recommended giving most Virginians the opportunity to choose by January 1, 2003. Dominion Virginia Power urged the Commission to stay on a two-year phase-in schedule allowing it until January 1, 2004 to complete its transition to full retail choice.

The Commission approved phase-in schedules allow all customers of AEP-Virginia, Allegheny Power and Delmarva Power (Conectiv) the right to shop on January 1, 2002. All of Dominion Virginia Power's customers will be able to shop by January 1, 2003 allowing the company to phase-in its two million customers in one-third increments. The first third has choice on January 1, 2002, the second third on September 1, 2002, and the final third on January 1, 2003. In recognition of issues unique to them, Kentucky Utilities and Virginia's electric

cooperatives are being given two years to offer choice to their customers by January 1, 2004.

Retail Access Rules (Energy Regulation, Economics and Finance, Public Utility Accounting, General Counsel, Information Resources)

Before the pilot programs could begin, a set of rules was needed to guide the participants. The Commission convened a work group of interested stakeholders to assist staff in developing interim pilot rules (Interim Rules). These Interim Rules were issued in May 2000, after a hearing (PUE980812). The Interim Rules covered codes of conduct for energy providers, standards of conduct among affiliates, and licensing procedures for CSPs and aggregators.

The Commission convened another work group led by staff in case PUE010013 to revisit the Interim Rules and recommend changes. The Commission issued permanent rules on June 19, 2001, just six months after initiating the rule making proceeding. The expedited decision gave all stakeholders sufficient time to prepare for the statewide transition to full retail choice beginning on January 1, 2002.

Electronic Data Interchange (Economics and Finance, Energy Regulation)

Electronic data interchange (EDI) involves the computer-to-computer exchange of business information between utilities and energy providers. It includes information such as customer enrollment, billing and usage. In April 1999, the Virginia Electronic Data Transfer (VAEDT) working group was established under leadership of staff. It met every other week until June 2000, when it filed with the Commission its EDI Test Plan, Implementation Guidelines and Data Dictionaries.

Staff monitors EDI testing among trading partners. Standards continue to be refined as experience is gained through the pilots. The VAEDT continues to expand its membership as CSPs consider entering Virginia's market. It meets monthly to resolve evolving business communications issues. Staff also participates in a regional effort to create uniform EDI guidelines among states. And, staff maintains an EDI web site available to assist utilities and CSPs.

Uniform Business Practices (Economics and Finance, Energy Regulation)

Staff actively participates in national efforts to promote consistent business practices among all energy market participants. Uniform business practices (UBP) include and affect items in both our EDI standards and our Interim Rules. For instance, UBP addresses licensing, customer information, enrollment, switching, billing, metering, performance standards and dispute resolutions. Virginia's leadership role at the national level regarding the development of such standards has been recognized by both regulatory and industry experts.

CSP Licensing (Economics and Finance, Energy Regulation, Public Utility Accounting, General Counsel, Information Resources)

Staff has established an efficient mechanism for processing licensing applications for competitive service providers (CSPs). There is an internal deadline of no more than 45 days from application to issuance and staff has met that deadline with every application thus far.

The Commission has issued 11 licenses to electric CSPs and 10 licenses to aggregators. Also, there have been 17 licenses issued to natural gas CSPs. The SCC web site gives potential new suppliers access to the licensing requirements and contains a sample license application form.

Consumer Education (Information Resources, Energy Regulation, Economics and Finance, General Counsel)

The Act directed the Commission to develop a consumer education program regarding electric choice. In February 1999, a working group involving SCC staff and the electric utilities directed to implement pilot programs was formed to coordinate consumer education for these programs. The pilot programs filed with the Commission included consumer education components developed by this working group.

In July 1999, SCC staff formed a consumer education advisory committee comprised of utility companies and consumer representatives to help develop a consumer education plan for statewide choice for both electricity and natural gas. The plan developed by the Commission with input from the committee was filed with the Legislative Transition Task Force (LTTF) in December 1999. In the 2000 General Assembly session, legislation was passed adopting the SCC consumer education plan and associated funding mechanism. The plan is titled "Virginia Energy Choice."

A Virginia Energy Choice education advisory committee was formed in December 2000 and has met seven times to help guide the Commission's education effort. Accomplishments include a web site and a toll-free phone number. A comprehensive television, radio and newspaper advertising campaign has already commenced.

Staff and its outreach team have made more than 100 presentations to various community groups and organizations about Virginia Energy Choice.

Functional Separation/Unbundling Cases (Energy Regulation, Public Utility Accounting, Economics and Finance, General Counsel)

Proceedings were held to promulgate regulations for the functional separation of incumbent electric utilities' generation, transmission and distribution by January 2002, as directed by the Act. The order in that case (PUA000029) was issued in October 2000.

Functional separation plans for Allegheny Power and Delmarva were negotiated among staff, companies and the Attorney General's Office. The Commission accepted these plans.

Functional separation plans by the other three investor-owned utilities and twelve electric cooperatives have been filed, comments have been received and public hearings held. Orders on those plans must be issued by January 1, 2002.

Rate Cases/Annual Informational Filings (Public Utility Accounting, Energy Regulation, Economics and Finance, Public Service Taxation, General Counsel)

All electric utilities except Virginia Power were allowed by the Act to file a rate case before January 1, 2001, for rates that would be in effect until at least 2004 and possibly until 2007. No IOUs filed a rate case, but five electric cooperatives did.

In July 2000, a Commission order was issued detailing rate case rules (PUA990054). All electric utilities reduced rates effective January 1, 2001, to reflect the state tax law changes.

Wires Charges/Projected market price for generation
(Energy Regulation, Public Utility Accounting, Economics and Finance, General Counsel)

Those utilities that did not file rate cases did, as part of their functional separation filings (described above), furnish cost information enabling the Commission to separate, or "unbundle" these utilities' rates into their generation and other component parts. Unbundled generation rates will be used to calculate "wires charges," the surcharge paid (if applicable) to incumbent electric utilities by their customers who purchase generation from competitive suppliers. Wires charges serve as a mechanism for stranded cost recovery for Virginia's incumbent electric utilities during the transition to full retail generation competition.

Billing and Metering (Energy Regulation, Economics and Finance, General Counsel)

The Act required the Commission to submit a report by January 1, 2001, to the LTTF providing a recommendation as to whether metering and billing services should be opened to competition. The Commission held a proceeding (PUE000346) in which interested parties were asked to evaluate and comment on a draft metering and billing plan developed by staff. Using input from that hearing, the Commission filed a report with the LTTF on December 12, 2000. That report was used by the LTTF to develop legislation related to competitive metering and billing passed by the 2001 Session of the General Assembly.

Staff is working on the implementation of that legislation now, with some competitive metering and billing potentially beginning January 1, 2002, with full competition by January 2003. Several companies including Dominion Virginia Power, Allegheny Power and Potomac Edison have asked the Commission to delay implementation.

Regional Transmission Entities (Energy Regulation, General Counsel)

The Act required all incumbent utilities to join or establish a regional transmission entity (RTE) by January 2001. Following workgroups, notice and pubic comments, the Commission issued an order (PUE990349) in July 2000 setting rules for the transfer of control and management of transmission assets to the RTEs that Virginia's electric utilities join. The utilities have submitted their RTE plans to the SCC and Federal Energy Regulatory Commission (FERC). The Commission is participating in FERC proceedings regarding RTEs as required by the Restructuring Act. Proceedings were established for all five investor-owned utilities owning transmission assets. Two cases, Delmarva and Kentucky Utilities have concluded. Because of uncertainty in the federal review and approval process for Regional Transmission Organizations (RTOs are the Federal acronym for our RTEs) the proceedings for Virginia Power and AEP-Virginia have been suspended. The proceeding for Potomac Edison has been continued for further information following the Commission's interim order approving the company's plan.

Electric Utility Consumption Tax (Public Utility Accounting, Public Service Taxation, Energy Regulation, General Counsel, Information Resources)

As a result of restructuring, effective January 1, 2001, electric companies no longer pay a gross receipts tax. This tax has been replaced with a net corporate income tax and a consumption tax. The conversion to this tax has resulted in numerous meetings with the stakeholders of the electric companies, Virginia localities, the Virginia Department of Taxation, and members of the Virginia State legislature. In addition, staff has met with the electric industry to develop a

form that captures all of the necessary data and documentation needed for depositing monthly payments into the state treasury.

Tax assessment of Independent Power Producers (Public Service Taxation, General Counsel, Energy Regulation)

Electric suppliers whose generation facilities were previously assessed locally for taxation purposes will begin reporting those facilities, as well as any new facilities, to the Commission for central assessment in 2002. This will result in staff assessment of approximately 60 additional facilities as well as the traditional electric companies' facilities currently being assessed by the Commission. Staff held meetings with the stakeholders over this past year to discuss reporting requirements and assessment methods that will be used to determine the assessed values of these facilities. As a result of new legislation regarding the assessment of these facilities, the Public Service Taxation Division has begun viewing these properties and gathering as much information as possible in order to develop a database on these generating facilities.

Net Energy Metering (Economics and Finance, Energy Regulation, General Counsel)

The Commission was directed by the Act to establish by regulation a net energy metering program. This was to be in place by July 2000, and would allow an eligible customer to feed back to the electric grid power generated by the customer from solar, wind or hydro sources. Workgroups, notice of proposed rules, written comments and a public hearing all led to the adoption of rules by the Commission in May 2000 (PUE990788).

Distributed Generation (Energy Regulation, Economics and Finance, General Counsel)

The Commission is directed by the Act to develop rules and regulations for distributed generation connections. Staff has held several meetings with stakeholders to receive input for proposed rules.

New power plants (Energy Regulation, Economics and Finance, Public Service Taxation, General Counsel)

Staff has met with many potential independent power producers. More than two dozen new generating facilities are being contemplated for construction in Virginia. Nine have already applied for a construction certificate from the SCC. These applications are being processed with all deliberate speed.

In addition, the SCC has initiated a proceeding in which it will consider new filing requirements for applications to build and operate electric generating facilities in Virginia (PUE010313). These revised rules will incorporate recent changes in Virginia law regarding the construction and operation of such facilities in a new competitive electricity market.

Electric/Natural gas company mergers (Public Utility Accounting, Economics and Finance, Energy Regulation, General Counsel)

There have been a number of mergers involving electric and natural gas companies including E.ON AG, PowerGen PLC, LG&E Energy Corp., and Kentucky Utilities Company; Conectiv, Potomac Electric Power Company, and New RC, Inc.; NiSource, Inc. and Columbia Energy Group; etc. Staff conducts an investigation of each such merger and makes appropriate recommendations to ensure that Virginia consumers are not adversely affected as defined by Virginia law. In most, if not all, of these applications, the prospective merging/acquiring parties have fully accepted staff recommendations.

Status of competition/market power (Economic and Finance, Energy Regulation, General Counsel)

Staff is conducting ongoing research and analysis of the development of competitive markets in Virginia and the region and on the issue of market power. A report was filed with the LTTF on August 30, 2001 and annual reports are due by each September 1 during the transition period.

Staff has contacted a number of competitive service providers including those not yet licensed in Virginia. Staff solicited their input as to what the Virginia market needs to attract them; staff inquired about their interest in providing default service; and staff has attempted to send the message that Virginia will soon be open to competition and we hope to see them active in our state.

TELECOMMUNICATIONS-RELATED ACTIVITIES

There have been an equally impressive number of coordinated accomplishments in the Communications sector.

Competitive Local Exchange Carriers (Communications, Economics and Finance, General Counsel)

More than 200 firms have received certificates as competitive local exchange carriers (CLECs) over the past three years. Each applicant is reviewed to ensure that the entity has both the financial resources and the technical and managerial expertise to deliver the services it seeks to provide. Ironically, staff has also had to review several requests for certificate cancellation and termination of service because some new CLECs experienced financial difficulty and were no longer capable of providing telecommunications service.

Local Exchange Competition (Communications, Economics and Finance, Information Resources)

The activity of all local exchange telephone service providers is monitored to assess the level of competition occurring in Virginia and to ensure that companies are providing services for which they have filed approved tariffs. Staff also monitors the activity of facilities-based interexchange carriers in Virginia.

Collaborative Committee on Market Opening Conditions (Communications, Economics and Finance, Public Utility Accounting)

The Commission, in case PUC000026, directed staff to create a collaborative committee in which various industry stakeholders work together to resolve issues that inhibit the development of an effective competitive market for local telephone service. This includes establishing carrier performance standards (PUC010206) and a performance assurance program for Verizon Virginia (PUC010226).

Operation Support System Testing (Communications, Public Utility Accounting, General Counsel)

Staff is actively involved in the third-party testing of the operation support systems ("OSS") of Bell Atlantic-Virginia Inc., now Verizon-Virginia Inc. ("Verizon"), in Case No. PUC000035. In this regard, KPMG Consulting, Inc., ("KPMG"), under the direction of the Commission, is testing whether Verizon offers competing carriers nondiscriminatory access to its operation support system functions as required by the Telecommunications Act of 1996. Verizon must demonstrate, on a state-by-state basis, that its systems and functions are accessible to potential competitors in order to meet the criteria establish by the Federal Act in order to gain Federal approval to enter the long distance market in that state.

Telecommunications company mergers (Public Utility Accounting, Economics and Finance, Communications, General Counsel, Information Resources)

There have been a number of major mergers involving Virginia telephone companies including Bell Atlantic/GTE, AT&T/MediaOne, MCI/WorldCom, etc. Staff conducts an investigation of each such merger and makes appropriate recommendations to ensure that Virginia consumers are not adversely affected as defined by Virginia law.

Telephone Relay Service Collections (Public Service Taxation, Communications, Economics and Finance, Public Utility Accounting)

Each telephone company with local exchange lines in Virginia collects and sends to the Commission the Virginia Relay Service charge that is currently set at 16 cents per month per access line. The evolving competitive market makes monitoring of these collections particularly challenging.

Small Company Streamlined Regulation (Communications, Public Utility Accounting, and General Counsel)

In 1985 and 1986, rules for telephone cooperatives (PUC850019) and small investor-owned telephone companies (PUC860017) were developed that allow these companies more flexibility in increasing rates without having to go through a traditional rate case and receive formal Commission approval.

Pay Telephone Rules and Registration Fee Collection (Communications, Public Service Taxation, Public Utility Accounting, General Counsel)

Pay telephone rules were developed in 1993 (PUC930013) and revised rules are currently out for public comment (PUC010186). These rules concern, among other things, registration procedures, fees, and collections for companies providing public pay telephone service in Virginia, as well as associated service quality rules for public pay telephones.

Affiliate Applications and Affiliate Exemption Cases (Public Utility Accounting, Communications, General Counsel)

These divisions jointly review all affiliate application cases involving telecommunications companies. In 1996, several companies requested exemptions from certain affiliated interest filing requirements, which required a coordinated effort among these divisions (PUA960044, 46, and 47).

Post Divestiture Rate Cases (Communications, Public Utility Accounting, Economics & Finance, and General Counsel)

During 1984-85, several rate cases were required by the Bell System divestiture. These cases involved restructuring decades-old rate structures and long distance serving arrangements, as the traditional end-to-end service responsibility of the Bell System was split and divided between the new post-divestiture entities. Even non-Bell companies were involved because of the restructuring of how long distance service was to be provided and how the revenues were to be divided among the various participants in the new serving arrangements. The Commission

staff effort required the application of expertise from several divisions to investigate and analyze all the issues involved in these cases, ranging from rate design and tariff revisions to rate-of-return analysis, revenue requirement determination, and legal analysis.

Task Force on Regulatory Alternatives (Communications, Public Utility Accounting, Economics & Finance, and General Counsel)

During 1987-88, a staff task force functioned to analyze proposed alternative regulatory plans, to produce its own recommended alternative regulatory plan, and to report to the Commission. This task force involved industry and consumer representatives under the leadership of the communications division. Studying the regulatory methods under consideration by this task force required reliance on a broad array of staff skills. This effort resulted in the Experimental Plan for Alternative Regulation, which was voluntarily adopted by the large Virginia local exchange carriers effective January 1, 1989.

Experimental Plan Cost Allocation Principles and Guidelines (Communications, Public Utility Accounting, General Counsel)

The Experimental Plan required a separation of each participating company's earnings and rate base between competitive services and all other services. Competitive services were exempt from earnings regulation, while all other services were subjected to traditional rate-of-return evaluations. A task force comprised of industry and staff representatives led by the Communications division developed the principles and guidelines proposed for making this separation. The staff's work on this task force necessarily involved the contribution of accounting expertise to add to the cost allocations methods and telephone company operations expertise contributed by the communications division. The Commission established the final principles and guidelines in a 1989 Order.

Evaluation of Cost Allocation Manuals (Communications, Public Utility Accounting)

After the Commission established the principles and guidelines required by the Experimental Plan, the participating companies were required to produce cost allocation manuals detailing the application of the principles and guidelines to their actual data. The staff was required to evaluate these cost allocation manuals and report its findings to the Commission. This staff report was necessarily a joint effort of the two divisions named above.

Cost Allocation / AIF Audits (Communications, Public Utility Accounting)

The Experimental Plan and its successor, the Modified Plan, required the separation of the participating companies' earnings and rate base between competitive services and other services. The earnings and rate base of the other services were evaluated by the Commission by using the traditional Annual Informational Filing (AIF) process. The separation of costs and investment prior to production of a traditional AIF involved cost allocation and telephone company operations knowledge not normally possessed by accounting personnel. Coordinated auditing, therefore, by the Communications and Public Utility Accounting divisions was required to evaluate the cost and investment separations as well as the traditional earnings evaluation done in the AIF process.

Experimental Plan Evaluation (Communications, Economics & Finance, Public Utility Accounting, General Counsel)

Since the Experimental Plan necessarily had a limited life, the Commission had to evaluate it and make appropriate modifications in 1993. The coordinated effort of all the divisions named above was required to supply the Commission with a comprehensive evaluation by the staff.

Annual Revenue Allocation Factor Determination (Communications, Public Utility Accounting)

The Experimental and Modified Plans required an annual staff determination of a ratio to be used by the companies to allocate some of their revenues between competitive and other services. The Communications division required the annual assistance of the Public Utility Accounting division to supply data and consultation on proper accounting for uncollectible revenues.

Development of Incentive Regulatory Plans (Communications, Economics & Finance, Public Utility Accounting, General Counsel)

In 1994, the Commission conducted a proceeding to develop new incentive regulatory plans for the large local exchange carriers in Virginia. The staff work to supply the Commission with comprehensive information necessarily involved a coordinated effort of the divisions named above.

GTE Rate Case (Communications, Economics & Finance, Public Utility Accounting, General Counsel, Information Resources)

In 1995, GTE filed what became a traditional rate case. Due to the broad array of issues in such a case, the coordinated effort of the divisions named above was required to supply the Commission with the information needed for its decision.

Unbundled Network Element Pricing Case (Communications, Public Utility Accounting)

The Telecom Act of 1996 required state commissions to determine prices to be charged by incumbent local exchange carriers for providing parts of their networks for use by other carriers. The Commission's determination of these prices, by a 1999 order, involved staff analysis of much complicated data. The assistance of the Public Utility Accounting division was required to analyze some of the data to ensure that the proper expertise was applied to all of the data.

Competitive Service Classification Cases (Communications, Economics & Finance)

The alternative regulatory plans used in Virginia since 1989 require a formal action by the Commission to classify a service as competitive and, therefore, grant pricing freedom to the company offering that service. In testimony, the staff supplies analyses of the companies' proposals each time a service is proposed for the competitive classification. To provide comprehensive and accurate testimony, the Communications division requires occasional consultation with the Economics & Finance division concerning definitions and formal economic analysis.

SCC discussion on current structure -

Considering the array of cases in which utility divisions work cooperatively, it might appear that consolidation of functions into one super division or two industry sector divisions could be easily achieved. However, these divisions can and often do work independently (always with legal representation from the Office of General Counsel) on matters that only involve an aspect of utility law that is the responsibility of that particular division.

During the year 2000, the Division of Public Utility Accounting received more than 70 applications filed under the Public Utilities Affiliates Act and the Utility Transfers Act. The division consults with other SCC divisions, but is primarily responsible for coordinating all aspects of review and processing of the application including preparation of a recommendation for Commission consideration. These cases are identified as PUA cases.

During the year 2000, the Division of Economics and Finance received nearly 50 applications involving financial issues, primarily the issuance of securities, from regulated utility companies. Again, the division has coordinating responsibility

for these matters and consults with other SCC divisions, as necessary. The division then prepares a recommendation for Commission consideration. These cases are identified as PUF cases.

During the year 2000, the Division of Communications was primarily responsible for filing staff reports in more than 100 cases. It too involved other utility divisions, as needed. But, Communications staff took the lead in any case identified as a PUC case.

During the year 2000, the Division of Energy Regulation was primarily responsible for filing staff reports in nearly 75 cases. These cases are identified as PUE cases and will often involve contributions from the staff experts of the other utility divisions. The Energy Regulation Division also investigated 3,100 alleged violations of Virginia's Underground Utility Damage Prevention Act which resulted in approximately 600 settlement offers being presented to the Commission for acceptance.

The interplay of divisions as described above can best be portrayed in the following chart --

TABLE OF DIVISION COORDINATION OF SCC UTILITY-RELATED RESPONSIBILITIES

	DIVISIONS						
	PUE	PUC	PUA	PUF	PST	OGC	IRD
Tasks							
Energy Regulation							
Retail Pilot Programs	✓		✓	✓		✓	✓
Phase-in Plans	✓			✓		✓	✓
Retail Access Rules	✓			✓		✓	✓
Electronic Data Interchange	✓			✓			
Uniform Business Practices	✓			✓			
CSP Licensing	✓			✓		✓	✓
Consumer Education	✓			✓		✓	✓
Functional Separation	✓		✓	✓		✓	
Rate Case/Cost Unbundling	✓		✓	✓	✓	✓	
Billing and Metering	✓			✓		✓	
Regional Transmission Entities	✓					✓	
Electric Utility Consumption Tax	✓		✓		✓	✓	✓
Assessment of Independent Power Producers	✓				✓	✓	
Net Energy Metering	✓			✓		✓	
Distributed Generation	✓			✓		✓	
New power plants	✓			✓		✓	
Electric/Natural gas company mergers	✓		✓	✓		✓	
Status of competition & analysis of market power	✓			✓		✓	
Communications							
Competitive Local Exchange Carriers		✓		✓		✓	
Local Exchange Competition		✓		✓			✓
Collaborative Committee on Market Opening Conditions		✓		✓			
Operation Support System (OSS) Testing		✓	✓			✓	

Communications Tasks (continued)	PUE	PUC	PUA	PUF	PST	OGC	IRD
Telecommunications company mergers		✓	✓	✓		✓	✓
Telephone Relay Service Collections		✓	✓	✓	✓		
Small Company Streamlined Regulation		✓	✓			✓	
Pay Telephone Rules and Registration Fee Collection		✓	✓		✓	✓	
Affiliate Applications and Affiliate Exemptions		✓	✓			✓	
Post Divestiture Rate Cases		✓	✓	✓		✓	
Task Force on Regulatory Alternatives		✓	✓	✓		✓	
Experimental Plan Cost Allocation Principles and Guidelines		✓	✓			✓	
Evaluation of Cost Allocation Manuals		✓	✓				
Cost Allocation/AIF Audits		✓	✓				
Experimental Plan Evaluation		✓	✓	✓		✓	
Annual Revenue Allocation Factor Determination		✓	✓				
GTE Rate Case		✓	✓	✓		✓	✓
Development of Incentive Regulatory Plans		✓	✓	✓		✓	
Unbundled Network Element Pricing Case		✓	✓	✓		✓	
Competitive Service Classification Cases		✓		✓			

<u>**Division Key**</u>:

PUE - Division of Energy Regulation
PUC - Division of Communications
PUA - Division of Public Utility Accounting
PUF - Division of Economics and Finance
PST - Division of Public Service Taxation
OGC - Office of General Counsel
IRD - Division of Information Resources

SCC discussion on possible structural change -

Clearly, the Commission's workload in the utility sector is spread among and shared by the various utility divisions. And, in many instances, one particular division has primary responsibility of a particular matter requiring Commission action.

It has always been the expectation of this Commission that the work by all divisions be performed efficiently and effectively and as required by law. No one has convinced the Commission that the current structure has hindered that expectation.

The Commission does recognize, however, that its internal satisfaction with division performance may not be so obvious to those with an external view of the Commission. The Commission also knows that its operations, like most, can be improved.

This search for improvement is the very reason the Commission performed a study of itself and why the Commission is very much interested in what the joint legislative subcommittee studying the SCC has to say. The challenge is to take a structure that, according to two consultants' reports, is functioning well and make it better. In so doing, the primary goal remains – to implement the laws of the Commonwealth and to serve the public in the best way possible.

The Commission will back up and review the range of possibilities. The choices basically come down to three with an array of hybrid approaches. They are:

- one director of public utilities where all utility-related disciplines are consolidated under the control of a single individual.
- two separate directors – communications and energy – placing each of these industry sectors under the control of a single individual.
- more transparent coordination among the existing utility divisions beyond what currently takes place.

The first two approaches appear to be an equivalent structure to the current organization of the SCC's Bureau of Insurance and the Bureau of Financial Institutions. However, such consolidation of the utility divisions is not as easy as it seems. It would require the collapse of two divisions, Public Utility Accounting and Economics and Finance, or the dividing of their respective staffs by placing some in the energy fold and others in the communications fold.

As Wirick noted in his report, the "rolling up" of current divisions into two would need to be accomplished carefully, in part to ensure that all necessary regulatory capabilities remain available in each division and that appropriate personnel assignments are made. Such a move would diminish certain economies of scale that these divisions employ today. The accountants, economists and financing

experts in these two divisions have the skills to work in either public utility sector. As industry issues rise and fall between energy and communications in terms of their frequency and complexity, staff is assigned to complete the work as needed in either area. In addition, staff members in these divisions have been able to apply much of what was learned preparing for the competitive local exchange telephone market to the soon to be launched competitive energy supply market.

The proposed "Directorate of Energy" inserts an additional layer of bureaucracy and goes against the recent trend to flatten organizations and reduce the power of hierarchies. No one person or small group of people at the top has all the answers. The industry and the public are best served if they have direct access to the very people with the expertise to answer specific questions or solve particular problems.

There are major issues now in electric restructuring that are being dealt with by at least six SCC divisions. Much of the coordination that occurs now could perhaps be better formalized in some way. There also have been particular situations where one staff person has been named to take the lead for a particularly large project. The Commission has probably erred at times by making this assignment known only internally, leaving external stakeholders in search of that key individual. Without a doubt, careful coordination of utility-related matters is paramount to successfully achieving an effective competitive energy supply market in Virginia.

The Commission reminds the subcommittee that the SCC currently has a Director of Energy Regulation who oversees electric, natural gas and water utilities and a Director of Communications who oversees local and interexchange telephone companies, both incumbent and competitive carriers, operating in Virginia.

For convenience, the SCC encourages any member of the General Assembly, the regulated industry or the public to consider the Director of Energy Regulation and the Director of Communications to be the "single point of contact" regarding their industry sectors. Both work closely with the directors of Public Utility Accounting, Economics and Finance, and Public Service Taxation, the Office of General Counsel, and other utility divisions when necessary to coordinate any matter involving their respective industries. The Commission will take the steps necessary to ensure that these two directors involve the proper area of expertise within the SCC and that the public is made aware of this structural arrangement.

No one should expect these two single individuals to know each and every detail of the industry sectors they oversee. However, these two directors can be expected to coordinate all regulatory matters regarding their respective sectors. In so doing, they will rely heavily on the directors and staff of Public Utility Accounting (the lead on PUA cases), Economics and Finance (the lead on PUF cases), and Public Service Taxation (the lead on PST cases), and when necessary the Office of General Counsel and the Division of Information Resources. Most

importantly, these two division heads will also assume the lead in communicating and encouraging the development of competitive markets involving their respective sectors.

Also under Commission consideration is the practicality of identifying all utility-related Commission cases under one of two industry categories – energy cases (PUE) and communications cases (PUC). Such a change would eliminate the practice of identifying certain cases as PUA, PUF, and, perhaps, PST. The difficulty, however, is that sometimes these cases apply generically to both sectors, especially with regard to the adoption of rules. One benefit of identifying cases in this manner would ensure that such cases would flow through the directors of each industry sector. Each would then be fully aware of all matters affecting their sectors regardless of the utility division that was primarily responsible for the issues arising from that case.

And, the Commission has under consideration the need for a separate safety section for public utility matters.[4] Such a free-standing, autonomous unit may be appropriate in light of the increasing responsibilities of the Commission for natural gas pipeline safety and underground utility line damage prevention, as well as the SCC's involvement in the Federal railroad track and equipment safety program.

The Commission believes it is reasonable to wait for any formal suggestions or recommendations that come from the joint legislative subcommittee. If the subcommittee agrees with the Commission's stated intent or has additional ideas to offer, the Commission will then be in position to take further action.

The Commission wants Virginia's utility industry and Virginians served by that industry to benefit from any resulting organizational realignment that it decides to implement. If done correctly, those seeking answers from Commission staff will know where to start and be confident that the full complement of staff is at their disposal to address inquiries regarding competitive markets, prices and rates, service conditions, accounting standards, economic trends, financing, taxation, law, and consumer education.

20. *The Securities Division would benefit from having more attorneys working with it. At present there is only one attorney in the OGC who works with the Division that deals with a growing market. The implications of the 1999 Financial Modernization Act and some internal adjustment of SCC rules and operation commands are likely [to] increase pressure on attorneys. (Securities section)*

[4] Wirick Report, pp. 45-46.

SCC response –

The Commission's General Counsel is evaluating the need to hire another attorney to assist with securities-related matters. If warranted, a new attorney could be added as soon as the coming fiscal year.

Category III - Recommendations for improved information and understanding

3. *It is important that the SCC collects salient data and that this data adequately reflects the implications of its actions on consumers as well as on the industrial sectors under its jurisdiction. One of the most effective forms of consumer protection is good information.*

SCC response –

The Commission expects every regulatory division to develop helpful information for consumers. Every division of the SCC is incorporating consumer education and information in its business plan.

There are numerous information booklets and brochures available from SCC divisions and all of them are posted to the SCC web site for printing at the home or office of Virginians. Most popular are the auto and homeowners insurance shopping guides produced by the Bureau of Insurance because they present comparison rate information in a manner friendly to consumers.

The Commission just released its consumer guide for energy choice. Within weeks, thousands of these guides have been requested and a media advertising effort announcing availability of the guide is just now starting.

The informational materials that the SCC regularly provides consumers are too numerous to list here. The Commission has compiled many of the materials for easy viewing in several large binders that have been given to legislative staff. The materials are available for review by any member of the subcommittee who desires.

4. *The SCC should continually review the data that industry is required to provide and limit them to those that are necessary to fulfil its regulatory requirements. In doing this, it should seek to minimize the burden on the regulated industries of providing data and other information.*

SCC response –

The Commission agrees. We are constantly evaluating whether we are asking regulated industries to provide more data than necessary for us to fulfill our legal responsibilities. But, we still require certain information to accomplish the goal

of developing and maintaining a competitive environment that includes reasonable consumer protection.

The Commission has reduced filing requirements in all areas of its regulatory responsibilities, cut back on duplicative filings by accepting for Virginia's purposes the same information in the form required by federal agencies or other states, and we continue to make progress with accepting filings electronically.

State or federal law requires a considerable amount of the information collected by the Commission. However, the Commission has stepped forward and sought to amend state laws to reduce such requirements.

In 1996, for example, the Bureau of Insurance recommended legislation to the Virginia General Assembly to repeal §§38.2-2228 and 38.2-2228.1 (medical malpractice claims reports and commercial liability claim reports). The Commission also supported the repeal in 1997 of §§38.2-1905.1 and 38.2-1905.2 (commercial liability supplemental reports and competition hearings) sought by the insurance industry.

The Bureau has also reviewed the comments of Mr. George Poffenberger, Jr., to streamline the agent licensing process. Many of his concerns have been and are being addressed by various national initiatives through the National Association of Insurance Commissioners (NAIC). Virginia is one of many states that has recently taken major steps toward reciprocity and uniformity with other states regarding licensing and appointment of agents, as is required under the Financial Services Modernization Act of 1999 (GLBA). No state operates under a scheme similar to that proposed by Mr. Poffenberger.

Virginia, however, is implementing many changes for the specific purpose of streamlining the licensing and appointment processes and these will become effective on September 1, 2002, pursuant to Senate Bill 913 adopted by the 2001 session of the General Assembly. These changes are being implemented with the goal of being in conformance with changes being made in other states so that Virginia can be considered "reciprocal" under GLBA and ultimately "uniform" under NAIC initiatives. If Virginia were to adopt the scheme proposed by Mr. Poffenberger, it is unlikely that Virginia would qualify as a reciprocal state and, pursuant to federal law, Virginia could be placed in the position of giving up the ability to license insurance agents.

Mr. Poffenberger may be confusing the licensing process with the appointment process. An agent who applies for a license and is issued that license is permitted by statute to solicit business on behalf of any insurer licensed in the Commonwealth of Virginia to issue policies of the type authorized by the agent's license. Once the license is issued, it is between the agent and the various insurers to negotiate a contract for representation, and for each insurer to appoint

the agent to represent it in Virginia. This filing is made by the insurer to notify the Bureau of the appointment.

As a regulatory agency, it is imperative that the Bureau be able to keep track of which companies an agent is authorized to represent, and the Bureau issues an acknowledgment of each such appointment so that the appointing insurer and the agent are aware that the appointment has been recorded. Simply allowing an agent to sell on behalf of any insurer would increase the potential for harm to consumers because of disputes concerning the authority of agents to bind insurance companies. Also, insurmountable problems with respect to investigation and possible initiation of disciplinary proceedings against agents would result.

Mr. Poffenberger's proposal would not recognize the various types of authority that can be granted (such as Life, Health, Personal Lines, Property and Casualty, and a host of restricted licenses). To issue one generic license to an agent would not permit the Commission to make any determination as to the qualifications or training of the applicant.

Virginia is an active participant in the NAIC's Producer Information Network, as are the majority of states. Insurers that participate in this network are able to appoint an agent in numerous states at the same time, and may do so on behalf of all authorized companies in their holding company system at the same time. This is a fully automated process, and has already substantially reduced the paperwork for those insurers and states participating in the network. It does not appear that the insurers that Mr. Poffenberger represents are yet participating in this network.

The Bureau is already investigating means of issuing both licenses and appointment acknowledgments on line, which will, when implemented, address substantially all of Mr. Poffenberger's stated concerns.

In 1997, the Commission sought changes to the language in §56-234.3 that stated electric utilities "shall annually file with the Commission a five and a ten-year projected forecast of its programs of operations." Recognizing the change in the industry, the Commission offered amending legislation to provide that each electric utility "shall file with the Commission a projected forecast of its programs of operation, on such terms and for such time periods as directed by the Commission." We now only ask for a limited amount of data through the year 2007, the end of price caps.

In 2001, clarifying legislation was offered that no longer requires telephone cooperatives to file tariffs with the SCC's Division of Communications. The rates of these cooperatives are no longer regulated.

9. *The State Corporation Commission should continue to explore ways of improving the public understanding of how it internally handles potential ex parte conflicts. It should continually seek ways to mitigate potential conflicts.*

SCC response –

The General Assembly has, by statute, directed the Commission (§12.1-25) to prescribe Rules of Practice and Procedure and to specifically address meetings and communications between commissioners and parties or staff (§12.1-30.1). The Commission, through rules that have been in place since the early 1970s, has addressed the ex parte issue more than has been the case generally with most state agencies with administrative processes conducted under Virginia's Administrative Process Act.

The SCC's rules apply to all pending formal proceedings, encompassing much more than simple enforcement or adjudicatory actions. While it may be that the SCC still has work to do to address any potential perception or appearance problem, the Commission does, in fact, have rules in place to address the issue. Those same rules were revised earlier this year after significant involvement by the parties to whom they apply.

One of the issues handled as part of that proceeding[5] was ex parte contact between staff and the Commissioners (and Hearing Examiners) and between parties and the Commissioners (and Hearing Examiners). The Commission sent a letter on May 30, 2001, to members of the legislative subcommittee (who had previously expressed interest in this case) advising them of the decision and including a copy of the final order, as well as the revised rules.

It should be noted that, prior to the hearing on the new rules, Commission staff and the parties who had submitted comments on the rules met, at the direction of the Commissioners, to narrow the issues in controversy. In fact, only two parties disagreed at the hearing with the language of Rule 60 (pertaining to communications between staff and Commissioners/Hearing Examiners). No party appealed this or any other portion of the Commission's final order in this proceeding.

As set out more thoroughly in the final order, the Commissioners squarely addressed the issue of ex parte communications in this proceeding. In the order, the Commission strengthened the previous rule by prohibiting staff from providing facts or legal arguments to Commissioners or Hearing Examiners in a pending proceeding without providing notice to all parties involved.

[5] Final Order in Case CLK000311 entered on April 30, 2001.

13. *The various divisions should develop a system of performance assessment procedures suitable to their own activities. These should be quantifiable where possible but also contain qualitative indicators. Performance measured against criteria should be part of annual division reports.*

SCC response –

There are two recommendations in the Wirick report that also address performance assessment and accountability that are under Commission consideration.

The Commission provided copies of its 2000-2002 budget narrative to each member of the legislative subcommittee at its first meeting. That document identifies the mission statement of each division, critical issues facing that division and the goals, objectives and strategies for meeting each of those critical issues.

The Commission's divisions perform a critical analysis of regulatory objectives throughout the year. Since Virginia law mandates the majority of the activities of each division, staff is highly involved in each session of the General Assembly. After each session has ended, staff gives careful consideration to any changes in or expansion to our regulatory authority and where and how staff will respond to meet the challenges.

Once the objectives are identified, goals are set for the successful achievement of these regulatory duties and resources necessary to fulfill those statutory mandates are identified.

– It is important that the use of information technology (IT) be part of the Commission's strategic planning process. This is both necessary and critical to the success of most regulatory initiatives.

The SCC's Information Technology Division meets regularly with the divisions to discuss the various IT plans and projects of each. In addition, divisions include systems initiatives, and the strategic goals/objectives that they apply to, in their biennium and annual budgets. All major IT plans and projects are reviewed and approved by the Commissioners, and periodic reviews are conducted with them as projects progress.

IT strategic planning is always difficult at best. However, three significant factors make it even more difficult at the SCC.

The first of these is the widely differing regulatory responsibilities of the various divisions. As stated above, the Commission attempts wherever possible to take advantage of reusable efforts and economies of scale. However, the structural

differences between and among the regulated industries, and the resulting framework required for their regulation, makes this a very complex effort.

The second factor is the rapid and extensive changes that continue to take place in the IT industry as a whole. The impact of these changes makes planning more than a year or two in advance a futile exercise, except at a very conceptual level. In many cases planning assumptions based upon current technology will be obsolete within six months to a year.

The third, and perhaps most difficult factor, arises because of the fact that the plans of the Commission are subject to change due to the actions of the General Assembly. This is of course both necessary and important, but can make the planning process more reactive and short-term in nature.

Nevertheless, the SCC continues to make strides in implementing current technologies to support its many functions. However, it is neither possible nor feasible to be at the leading edge of technology across all industries and regulatory structures. The resulting economic impact and upheaval to the industries we regulate, and to the Commission as a whole, would create an intolerable level of risk. Planning therefore must take into consideration what is economically practical and acceptable in terms of the possible consequences. The Commission believes it is achieving the proper balance.

Commission staff is held accountable for meeting these challenges including the best ways to approach issues. This includes an assessment of the personnel involved and other resources that may be required. The expectations of performance identified for each employee are discussed during quarterly meetings with supervisors. Each employee, including senior management, undergoes an annual performance appraisal. An independent consultant completed a review of the SCC's performance management process earlier this year and commended the Commission for the effectiveness of a program that ties rewards to performance.

In addition, there are effective indicators of the level of the performance of SCC divisions.

With respect to the Bureau of Insurance, the National Association of Insurance Commissioners (NAIC) has a program for effective solvency regulation. The program was developed in response to many insurer insolvencies in the late 1980s and increased interest in the federal regulation of insurance. The Bureau of Insurance, along with its fellow state insurance regulators, worked to devise standards to demonstrate the adequacy of a state's statutory and administrative authority to regulate insurer solvency. The Accreditation Program was adopted in 1990, and the individual states began working to improve their laws, regulations and processes in response thereto. This program was designed to improve the quality of regulation and, as a result, consumers' and fellow regulators' confidence in an insurance

department's abilities. Since that time, almost every state has taken the steps to become accredited, and solvency regulation is one of the strongest foundations of the state-based system of insurance regulation. In April 1992, Virginia was the 10th state to successfully pass the accreditation compliance audit, and Bureau staff received an accreditation certificate at the June 1992 NAIC Summer National Meeting. In May 1997, Virginia was awarded its second round accreditation with one of the highest scores ever achieved on second round accreditation reviews.

The Accreditation Program is not simply a measurement of a state's ability to regulate an insurer's corporate and financial affairs. The program also analyzes a state's overall level of performance to determine if the state has the necessary resources to carry out its statutory and regulatory authority and that the department has in place organizational and personnel practices designed for effective regulation. This is a rigorous review by an independent review team. This Accreditation Program is a clear indicator of the effectiveness of the Bureau.

Also, the SCC's Bureau of Financial Institutions has achieved professional accreditation by the Conference of State Bank Supervisors (CSBS). CSBS is the professional association of state officials responsible for chartering, regulating, and supervising the nation's state-chartered banks and state-licensed branches and agencies of foreign banks. Since 1902, CSBS has been the primary advocate for the state banking system nationwide, fulfilling this mission by representing the state banking system on Capitol Hill, among federal regulatory agencies and the courts. CSBS is a leading provider of education and training for state bank examiners, and serves as the central clearinghouse for information on the state banking system.

The mission of CSBS is to assure the ability of each state banking authority to provide safe, sound, and well-regulated financial institutions to meet the unique financial needs of local economies and citizens. In support of that mission, CSBS sponsors a comprehensive state banking department performance Accreditation Program to enhance the professionalism of state banking departments and their personnel.

The Bureau earned its accreditation on July 30, 1999, following a rigorous evaluation designed to ensure that the Bureau met national standards of professionalism and performance. The process involved an exhaustive examination of every aspect of the Bureau's operations. The Accreditation Program involves a comprehensive review of the critical elements that assure a banking department's ability to discharge its responsibilities through an investigation of its administration and finances, personnel policies and practices, training programs, examination policies and practices, supervisory procedures, and statutory powers.

Finally, the Commission must point out that the final report fails to acknowledge Virginia's climbing status in the Retail Electricity Deregulation (RED) Index prepared by the Center for the Advancement of Energy Markets (CAEM). The update, released July 13, 2001, shows that Virginia has moved up in rank from #18 in January 2001 to the #9 position with an overall score increasing from 30 to 45, respectively. The final report, released in early September, still references the January ranking of #18.

While the Commission finds many aspects of the CAEM report questionable and quite subjective, it was the consultant who relied on this report to "assess Virginia's progress" toward the development of a competitive energy supply market. When Virginia's rank was #18, the report found that Virginia "falls far short of other states" with competitive markets. Although Virginia moved to #9 within a six-month period and well before the issuance of the consultant's final report, the consultant dismissed the need to update the report by advising the study subcommittee that "anywhere in the top 20 is pretty good."

The consultant's response to this particular matter is illustrative of the difficulty the Commission has had identifying specific problems or issues that need to be addressed internally by the Commission or externally by the General Assembly. Despite a great deal of hard work by the Commission and its staff that improved Virginia's position, the report ignores these facts and retains its evaluation based on the old rating.

14. *All divisions of the SCC should engage in more public information dissemination and information gathering. The banking division runs a number of courses for the industry as well as periodic seminars – this type of model may usefully be replicated elsewhere.*

SCC response –

The Commission performs well in its outreach efforts. It has a long history of sponsoring conferences for representatives of the various industry sectors it oversees. These include seminars on electricity, natural gas and telecommunications. Although matters pending before the Commission cannot be discussed during these meetings, all attendees benefit from the informal opportunity to share information and learn about general trends, ideas and issues from both a state and national perspective.

The Commissioners also meet, upon request, with industry and consumer representatives on an informational basis. These meetings are scheduled solely for the purpose of keeping the Commissioners apprised of new developments or planned announcements. All participants fully understand that no matter currently pending before the Commission can be discussed.

And, to the extent proper, the Commissioners encourage these representatives to use every available opportunity to directly advise them of any problems, concerns, or calls for corrected action regarding the administration of the Commission's duties.

At the staff level, SCC employees have conducted hundreds of meetings, seminars, presentations, and talks to groups and organizations representing both industry and consumers. The activities of the past 18 months are too numerous to list here. However, a list is provided in the same binders that contain the consumer informational materials available from the SCC.

New and much more visible public outreach efforts are already underway or will soon start, including major media and advertising exposure. These include:

- the Virginia Energy Choice education program
- the Underground Utility Damage Prevention Awareness program
- the Office of Managed Care Ombudsman in the Bureau of Insurance
- and, involvement in the Financial Literacy 2001 program of state securities administrators.

These are not public relations efforts to promote the good name of the State Corporation Commission. They are specific consumer education and consumer assistance programs performed by the SCC and appropriate under its mandate from the legislature. They carry a considerable price tag.

For example, raising the awareness level of Virginians of their new opportunity to choose their supplier of electricity or natural gas will take at least five years at an estimated cost of $30 million. This particular program, and its funding mechanism, was approved by the General Assembly. It includes extensive and expensive media advertising and an aggressive effort to reach out to community-based organizations. The help of such organizations is vital in order to spread the word about this new opportunity to shop for energy services. The program also includes a telephone call center for handling hundreds of consumer questions about the new competitive energy supply market. Virginia's utility industry is cooperating and helping the SCC implement this program.

20. *There are a variety of methods for measuring the effects of competition that go beyond price. With competition as the broad goal, it is essential to determine how to measure the attainment of that goal. Therefore, a system needs to be designed to establish the baseline (current state of competition) and then to monitor over time. (Telecommunications section)*

SCC response –

Whatever method is used to measure the effects and success of competition needs to take into account whether existing market conditions are conducive to

competition, and, if not, whether it is in the public interest for the SCC to step in to make them so. In other words, it will not play well with the general public if they are told that local telephone rates need to increase in order to give them a competitive choice.

The General Assembly included some very specific consumer safeguards in the enabling legislation (§56-265.4:4). For example, the General Assembly directed the SCC to ensure that local competition "reasonably protects the affordability of basic local exchange telephone service" and "reasonably assures the continuation of quality local exchange telephone service." In addition, the SCC must ensure local competition "will not unreasonably prejudice or disadvantage any class of telephone company customers or telephone service providers, including the new entrant and any incumbent local exchange telephone company, and is in the public interest."

Similar wording is included in §56-235.5. This section enables the SCC to approve alternative regulatory plans for incumbent local exchange companies, which in part was passed to allow more flexibility to prepare for competition.

A recent analysis by the SCC's Division of Economics and Finance revealed that 25 competitive local exchange carriers (CLECs) currently serve approximately 4.5% of the access lines (nearly 250,000) in Virginia. It is likely this number is understated since companies do not always respond to informal staff inquiries. Consumers in major metropolitan areas of the Commonwealth have several CLECs available from which to choose. Thus, the staff of the Commission is taking snapshots of the developing local competitive market.

A May 2001 FCC report shows that Virginia has more CLEC lines than SCC staff has been able to quantify. It indicates Virginia has approximately 414,000 CLEC lines representing 9% of the total lines reported in the Commonwealth. The national average is 8%, so by this measure, Virginia is doing better than average. This study also shows the largest CLEC percentages are in states that have 271 authority (Bell company permission to enter the long distance market). At the time of the FCC report, this included New York (20%) and Texas (12%).

The degree to which Virginia makes this information generally known is discussed in the answer to recommendation 23 listed under Category IV.

26. *There are several remits under which the SCC is required to consider matters pertaining to the environment, economic development, and consumer protection. To allow these broader matters to be dealt with adequately, the SCC should seek ways of allowing the widest sets of evidence to be brought to bear in cases. (Energy section)*

SCC response –

This recommendation appears to refer to the criteria that apply to the granting of certificates for electric generating facilities, high voltage transmission lines and intrastate natural gas pipelines. The SCC relies on the statutory language including that set forth in §56-46.1 in granting certificates for electric facilities for regulated utilities. It states that the Commission, before approving the construction of an electric generating facility or transmission line, "shall give consideration to the effect of that facility on the environment and establish such conditions as may be desirable or necessary to minimize adverse environmental impact." It continues to note that the Commission "may consider the effect of the proposed facility on economic development within the Commonwealth and shall consider any improvements in service reliability that may result from the construction of such facility."

The criteria for construction and operation of electric generation facilities that will not be in the rate base of a regulated utility are different (i.e. merchant plants). Code section 56-580 D is designed to replace section 56-265.2 with respect to generation. While much of 56-580 D is drawn from 56-265.2 B, the requirement to determine that a proposed facility will have no material adverse effect upon the rates paid by customers of any regulated public utility in the Commonwealth has been eliminated. So, the Commission now "may permit the construction and operation...upon a finding that such generating facility and associated facilities including transmission lines and equipment (i) will have no material adverse effect upon reliability of electric service provided by any regulated public utility and (ii) are not otherwise contrary to the public interest."

And, when considering the application under this section of the Virginia Electric Utility Restructuring Act, the Commission must be mindful of the directive under 56-596 to advance competition. It says, "In all relevant proceedings pursuant to this Act, the Commission shall take into consideration, among other things, the goals of advancement of competition and economic development in the Commonwealth."

Section 56-265.2:1 is the Code section that dictates the criteria that must be considered for gas pipelines. It directs the Commission to consider the effects of any proposed pipeline on the environment, public safety and economic development.

The Commission makes every effort to involve interested parties in these and other matters of importance. Notice is published in newspapers of general circulation in the area where such a proposed facility may be built. Copies of the scheduling order are sent to each local governing body in the vicinity of the proposed facility. The Commission also requires the applicant to make the application available for public viewing in a public facility (local library, town hall, etc.) near the intended project.

Scheduling orders also provide instructions to the public on how to obtain an application from the SCC or from the applicant. News releases announcing the public hearing and other important case dates are issued and local news reporters are encouraged to advise the public, in their stories, of the SCC's schedule for considering the application. The scheduling order is always available on the SCC's web site for viewing or printing. The Commission also web casts the audio of some of its Richmond hearings via the Internet.

During these hearings, the Commission always invites public witnesses to speak first. The SCC's procedures allow a great deal of latitude as to who can participate and the Commission is generous in its receipt of evidence offered for submission to the record. For cases with a high degree of local interest, the Commission will schedule hearings in or near the affected area offering a day and an evening session for the convenience of those unable to appear at a Richmond hearing or take time away from work.

Despite these efforts, the public sometimes may be unaware that the Commission is considering such projects. The SCC's approval in 1999 of an intrastate natural gas pipeline (a certificate that has since been surrendered) resulted in some criticism that property owners along the proposed corridor were unaware of the application while it was pending before the SCC. This occurred although notices were published in local newspapers and news reports were written about the discussions and actions of local governing bodies pertaining to the project.

A legislative remedy was adopted in 2001. It requires affected property owners to receive direct mail notice of such a project. The change in Virginia law mirrors an existing federal requirement that applies to any proposed interstate pipeline project.

The Commission has an agreement of understanding with the Virginia Department of Environmental Quality (DEQ) to advise the Commission of any and all potential environmental impacts of such projects. DEQ coordinates a response that involves a number of state and local agencies with direct knowledge of the potential environmental, historical, cultural, or aesthetic implications of such projects.

A review of the record in the SCC's recent approval of a 765,000-volt transmission line in Southwest Virginia indicates that more than 500 public witnesses testified during local hearings for this case (PUE970766). The transcript exceeded 3,700 pages. Documents in the case exceeded 8,500 pages.

The Commission's final order acknowledged the deep concerns, feelings and passionate involvement of those directly impacted by the line. Their participation did make a difference. The Commission directed the company building the line to

go beyond satisfying the minimum requirements set by the various state and federal environmental agencies. The SCC said, "When additional measures, which exceed the minimum effort necessary to comply with the law and regulations, are identified by the agencies, we expect the company to implement these measures to the extent practical."

The company is required to submit quarterly progress reports during construction until the line is in operation. The SCC's Division of Energy Regulation will monitor all mitigation measures.

Category IV - Recommendations for public policy/legislative consideration.

3. *The basic principle of regulation should be to allow the market to function and only to intervene when there are demonstrable market failures that appropriate regulatory control can be demonstrated to reduce.*

SCC response –

Through its oversight of highly competitive industries like insurance, banking and securities and its oversight of what have been monopoly services such as public utilities, the Commission believes it understands the "basic principle" of competitive markets. But, even in competitive markets the General Assembly has directed the Commission to take appropriate steps to avert isolated instances of a "market failure."

There is no greater evidence of this than in insurance and banking legislation. Clearly, it is the wish of the General Assembly for this Commission not to wait until a bank fails or an insurance company becomes insolvent before taking "regulatory" action. The filing of financial information and the routine examination of banks and insurance companies are necessities that may be a small burden for these institutions, but critical to the safety and soundness of the industry as a whole and the ultimate protection of Virginia consumers.

In these competitive markets, regulation serves a more complex role than can be characterized simply as a promoter of competition. In general, regulation should serve to support a functional as well as a competitive marketplace. Minimum standards regarding solvency, for example, set forth basic rules for competitors to be let into the game. In the insurance marketplace, for example, you want long-term players that will be there with the financial wherewithal to pay off long-term obligations.

Consumers need to have confidence that the entity they are dealing with will be solvent. Regulation also helps to ensure a level playing field among competitors who robustly but fairly attempt to win the consumer's business. Commission staff reviews marketing materials and contract language to determine if they are understandable, readable, and consistent. The mission is to encourage

competitive markets with the proper balance between protecting the interests of consumers and fulfilling our legislatively charged duty to regulate Virginia's businesses responsibly.

The Commission, in its role as a regulator, often assists General Assembly members regarding legislation in terms of the possible consequences to Virginia's competitive marketplace. When commenting on legislation before committee, to an individual legislator, or in a fiscal impact statement, Commission staff often advises on the bill's potential impact on the particular market segment in question. Staff also outlines potential shortfalls and costs as well as the advantages and disadvantages of competition for certain market participants.

We have also been known to point out that it is within the prerogative of the General Assembly to determine public policy on certain social issues which might override apparent concerns about government intrusion into the dynamics of the market. General Assembly members generally seem to appreciate the fact that the Commission attempts to frame the issues in terms of their effect on the marketplace, given the members' appropriate concern for the impact of any legislation on Virginia's businesses and consumers when they are attempting to make public policy decisions.

As a measure of the SCC's ability to monitor effectively a competitive market, one need only look to Virginia's insurance market. It shows healthy competition overall and statistics indicate that Virginia has one of the most competitive markets for private passenger automobile, homeowners and workers' compensation insurance in the country.

The latest National Association of Insurance Commissioners (NAIC) report ranks Virginia 45th among the states (one being the highest) in terms of combined average auto premiums (liability, collision, and comprehensive). According to the most recently published report from NAIC on homeowners insurance data (1998), Virginia had the lowest average premium among the states for a homeowners special coverage form (HO-3) policy for coverage amounts in the range of $100,000 to $124,999.

Oregon performs an annual study designed to rank the 51 jurisdictions with regard to workers' compensation rates. Oregon's methodology was established several years ago and provides a good relative indicator of workers' compensation premium costs. According to the 2000 Oregon study, Virginia ranks the best of all 51 jurisdictions, with Florida, Louisiana, and California being the highest ranked states and Virginia, Indiana, and South Carolina the lowest ranked states.

The Virginia Securities Act's primary purpose is to protect Virginia investors from fraud and misrepresentation. Nowhere has the SCC seen greater evidence of the opportunity to "make a buck" lead to questionable practices that prey on the nest eggs of unsuspecting and less savvy Virginians. Adequate protections under

Virginia law promote investor confidence and a greater willingness to invest in Virginia companies searching for capital.

In telecommunications, Virginia introduced the concept of local telephone competition a year before the federal Telecommunications Act of 1996. The General Assembly, however, did not direct or imply that the Commission should shift from focusing on protecting the consumer to promoting competition as GMU seems to suggest. Rather, the Commission is to do both. It may deregulate incumbent local exchange companies, but only after it finds that local service is "subject to competition." The primary standard is a finding that competition or the potential for competition in the marketplace is or can be an effective regulator of the price of those services. In making that determination, the Commission may consider the ease of market entry, the presence of other providers, and other factors deemed relevant by the Commission. In addition, the Commission must adopt safeguards to protect consumers and competitive markets.

In the Virginia Electric Utility Restructuring Act, the General Assembly has given the following direction to the Commission: in all decisions related to implementation (many of them to be decided in the coming months) the Commission "shall take into consideration, among other things, the goals of advancement of competition and economic development in the Commonwealth." However, the Act also provides a number of consumer protections during the transition period -- none more prominent than rate caps on the incumbent utility companies through July 2007. But protection is not only afforded to consumers; it is also afforded to the utility companies through the imposition of the wires charge to recover potential stranded costs.

And, much like the mechanism set out for the telecommunications industry, the General Assembly has provided that the rate cap protection for customers and the industry may not be removed except upon the request of an incumbent electric utility. Before such a request may be granted, the Commission must find that "an effectively competitive market for generation services" has developed in the utility's service territory.

The Commission recognizes that once markets become truly competitive, competition can be an effective regulator and provide consumer protection. Until that point is reached, however, the Commission seeks to balance "promotion of competition" as GMU urges with "protection of the consumer" as the law requires.

4. *The Commonwealth's structure of regulation was initially designed to deal with fundamental market flaws as perceived at the time. Our understanding of how markets function has subsequently changed as has technology. It is important to ensure that the workings and decisions of the SCC continue to take full account of this.*

SCC response –

The Commission agrees it should always try to operate on the basis of the most current state of available knowledge. It continues to monitor and study the current state of economic and social philosophy and theory, as well as technological innovations, ongoing research and development and other disciplines, to the extent they are relevant to the Commission's activities.

The Commission is also very concerned about all issues related to information technology. Both industry and consumer expectations have exploded in recent years, and the demands are great on the Commission to expand current efforts to do business electronically. The Commission is committed to keeping pace with the ever-changing environment of electronic commerce and electronic government. The Commission is virtually re-inventing itself by web-enabling its forms and filing processes. Considerable progress has been made in this area and the Commission is conducting a great deal of its business via the Internet and web-based technology.

Information Technology (IT) support at the Commission is provided across a broad range of regulatory divisions with varied responsibilities and functionality. Differences between these environments makes it a challenge to try to deliver similar solutions to Divisions with dissimilar needs. One size does not fit all.

However, wherever possible, the Information Technology Division (ITD) tries to install systems that are applicable enterprise-wide, or at least usable across multiple divisions.

Among the IT efforts that have been undertaken are:

- A comprehensive Financial (Oracle Government Financials) and Human Resources application package that is used across the Commission for all Procurement, Accounts Payable, General Ledger, and Human Resource Information functions (this system is currently being upgraded to an intranet-enabled version).

- The Energy, Communications, and Information Resources Divisions have implemented a Complaint Handling package (GoldMine Support and Service). This application is also available to other divisions if the need arises (the Bureau of Insurance needed a more comprehensive system than could be provided economically in a packaged solution, so they developed a custom application that interfaces to their internal operational systems).

- A new comprehensive Case Management application is being implemented on an enterprise-wide basis. This system will provide information on all Commission cases, along with electronic versions of all documents pertaining to them. The SCC's new Rules of Practice and Procedure already allow for

large volumes of information to be filed in an electronic format. This new application will allow the Commission to go beyond its experimental program and allow all documents (large or small) to be sent via an electronic means to Document Control Center of the Clerk's Office for official filing.

- An Integrated Document Management System (IDMS) project is currently underway that will eventually allow all Commission documents to be stored in an electronic format. This system also will allow all filed documents to be available via the SCC web site. Currently, the SCC only makes SCC orders and other select documents available electronically for viewing or printing via the Internet.

- Common industry-standard network and desktop operating systems, application suites, database technologies, telecommunications, and Internet/intranet infrastructure components are in place for use by the entire Commission. Hardware and software standards also ensure that common platforms for computing are installed across all divisions.

Clearly, there is significant common ground and cooperation across the SCC in the IT area. The Commission recognizes that information technology is a key ingredient in the successful achievement of its regulatory duties and responsibilities.

6. *The notion that the number of Judges should in fact be increased to five, with one being replaced each year, should be seriously considered. This would require Constitutional change.*

SCC response –

Some subcommittee members and at least two members of the public discouraged the adoption of this recommendation for their own reasons. The Commission estimates that the first year cost for two additional Commissioners is slightly more than $1 million. The second year cost estimate is approximately $780,000. Succeeding year costs would most likely keep pace with the cost of inflation.

The recommendation and accompanying text leaves the impression that something is yet to be implemented as a result of the 1971 amendments to the Virginia Constitution. The Constitution simply provides that membership may be increased to five. There is no constitutional mandate.

While the Constitution does provide for up to five Commissioners, §12.1-6 of the Code of Virginia states that "[t]he Commission shall consist of three members." The General Assembly would have to amend this statute to accomplish two things: (1) change the number of Commissioners from three to five; and (2) change the term of service from six to five years. The second change would require a constitutional amendment to become effective.

Article IX, §1 of the Constitution of Virginia provides for a term of six years for the Commissioners. The General Assembly has two different methods by which the Constitution may be amended. Article XII, §1 of the Constitution requires a majority vote of both houses of the General Assembly, followed by a general election of the House of Delegates, followed by another majority vote of the General Assembly, which is followed by a referendum of the voters. The second option is the calling of a constitutional convention, which, after approving any amendments, must submit them to the voters for a referendum. Either of these routes, at the discretion of the General Assembly, would be required to change the terms of the Commissioners to five years.

Additionally, Section §12.1-9 of the Code of Virginia requires that "at least one member of the Commission shall have the qualifications prescribed for judges of courts of record." While traditionally all of the Commissioners have had such qualifications, the General Assembly may wish to consider whether one of five commissioners having the qualifications for judges would be sufficient.

Finally, there has been little recognition of the work of the SCC's four hearing examiners and their contribution to the decision making process at the SCC. Until 1979, the Commissioners presided over all public hearings required by law. Legislation was adopted (§12.1-31) that year allowing the Commission to create a full time hearing examiner. Over the years, that office has been expanded to four examiners, all attorneys.

Cases are assigned by a Commission order. The hearing examiner responsible for the case conducts the public hearing, and at its conclusion, submits a fully documented and comprehensive report that culminates in a series of findings of fact, conclusions of law, and a recommended decision.

The number of cases handled annually by the Office of Hearing Examiners has averaged around 65 per year. While this represents approximately half of the total hearings conducted annually by the Commission, the hearing examiners often are assigned time-consuming cases that involve complex technical and legal issues.

This ability to share the burden of the Commission's caseload with this office ensures that a full and complete record is developed, a thorough analysis of the issues is conducted, and a just and reasonable decision is rendered for each case in the most timely manner possible under due process.

16. *To continue to identify specific areas where threats to consumers' privacy may be at risk from increased reliance on electronic commerce, and develop effective measures to counter those threats. (Insurance section)*

SCC response –

The General Assembly is well aware of consumer protection issues that are being addressed by various committees or commissions specifically charged with over-seeing emerging information technology issues. SCC staff monitors the activities of these legislative bodies and the legislative proposals that result.

Privacy protection in the area of insurance law is not new to Virginia, where Chapter 6 of Title 38.2 has been the law for 20 years. The Consumer Services Sections of the Bureau of Insurance are available to help consumers who believe their privacy rights have been violated. In addition, the Market Conduct Sections examine insurance companies to make sure that they are complying with all of the laws in Virginia, including the privacy protection laws in Chapter 6.

With the enactment of the federal Gramm-Leach-Bliley Financial Services Modernization Act (GLBA), the Bureau was charged with amending Virginia's privacy protection laws in accordance with the new federal law. Once GLBA was enacted, any failure on Virginia's part to enact legislation on privacy that was consistent with GLBA would have put insurers at a competitive disadvantage with the banks in the marketing of competing products.

The Bureau worked with representatives of the financial services industries on language that was enacted effective July 1, 2001. Virginia's law is now consistent with the provisions of GLBA while protecting the privacy of Virginia citizens especially in the area of health information.

18. *There have been a number of changes to the Virginian Banking Code over the years. A full review of the code should now be conducted. This should not be taken to imply radical change is needed but is a matter of 'good housekeeping'. (Financial Institutions section)*

SCC response –

This recommendation directly results from a suggestion by Commissioner of Financial Institutions E. Joseph Face, Jr., during discussions with the GMU study team. While the Bureau will continue bringing proposed minor "housekeeping" amendments to the General Assembly as needed, a thorough rewrite of Title 6.1 would be the responsibility of the Virginia Code Commission. The Bureau is prepared to assist the Code Commission with any such recodification if and when it occurs.

23. *The citizens of the Commonwealth are primarily restricted to local telephone service provision by one firm. Considering that the telecommunications industry is evolving rapidly, it is recommended that the Commission take periodic snapshots of available services across major telecommunications markets to determine if those services are available in the Commonwealth. If it is found that the Commonwealth is lagging, then*

the Commission can enter into discussions with local telecommunications providers to determine why. (Telecommunications section)

SCC response –

The Virginia Electric Utility Restructuring Act requires the Commission to prepare a report each September 1 on the status of competition in the retail electric supply market. This report is designed to assess the status of regional competition, the status of competition in Virginia, and offer any recommendations for enhancing competition. This information is being used by the General Assembly's Legislative Transition Task Force to monitor Virginia's transition to this new competitive market. It is also being used by the Commission to fulfil its legislative directive to advance competition in the Commonwealth.

When the SCC floated the notion of developing such a report on the status of local telephone competition to telephone industry representatives, they saw little value in publicly reporting Virginia's progress. Perhaps the General Assembly would be interested in such a report prepared by the SCC. The Commission's gathering of information necessary to prepare such a report may be much more successful with such an expressed legislative interest.

24. *In order to enhance competitor (sic) in the Commonwealth, the SCC should continue to find additional ways to allow competitors into the marketplace as rapidly as possible. The current financial difficulties of the smaller CLECs combined with the inherent economies of scale indicate that the most immediate source of competition will come from the larger and more established firms. The current arbitration impasse is blocking the largest potential competitors. Methods of circumventing this problem should be sought expeditiously. (Telecommunications section)*

SCC response –

The Commission readily began arbitrating interconnection agreements pursuant to the 1996 Telecommunications Act soon after it was enacted. However, certain parties appealed to federal court certain agreements that the SCC had arbitrated. The Commission argued to the federal district court that the Eleventh Amendment to the United States Constitution barred that court from asserting jurisdiction over the Commission. Instead, the Commission asserted that the sole avenue for review is an appeal of right to the Virginia Supreme Court. The federal court, however, held that the Commission, by undertaking review of interconnection agreements pursuant to the 1996 Act, had waived the state's Eleventh Amendment sovereign immunity. Due to the fact that the Commission is not empowered to waive the Commonwealth's sovereign immunity, a right that resides in the General Assembly, the Commission was compelled to cease arbitrating these agreements. The sovereign immunity issue is now awaiting a decision by the U.S. Supreme Court.

In the meantime, parties to disputed interconnection agreements have a choice. The Commission will gladly arbitrate the matter if the parties agree to do so under state law meaning any appeal of the SCC's ruling will go to the Virginia Supreme Court. Or, they can go to the Federal Communications Commission and have the matter arbitrated under Federal law. Any legal challenge of the FCC decision would be handled in Federal court. Despite the SCC's invitation to arbitrate under state law, no party has chosen to do so.

The comments of WorldCom and Cox Virginia Telecom address this matter by suggesting that the General Assembly adopt legislation allowing the SCC to act as an agent of the Federal government and give it express authority to arbitrate under Federal law. The telecommunications industry suggests it would be best to have the Virginia commission making decisions involving Virginia issues. Such a directive will mean that the Commonwealth (namely the Commission) will be defending in Federal court decisions the Commission finds to be lawful under the Federal act <u>and</u> in the overall interest of the Commonwealth.

Public Comment

July 20, 2001 Meeting

MEMORANDUM

TO: Dr. Kenneth J. Button

FROM: Edward L. Flippen

DATE: June 27, 2001

Dr. Button, I strongly recommend that you delete from your final report your recommendation that the number of judges on the SCC be increased from three to five. I was on the legal staff of the Commission from 1975 until 1980 (when I left as Deputy General Counsel). Since leaving, I have continued to practice before the Commission for over 20 years. I have been involved in over 200 cases. Based on my experience, I am very doubtful the SCC process can be sped up by increasing the number of judges to five. The cases tend to be complex and all the judges analyze the cases and are involved in the decision making. With five judges, the analysis will be more, but I doubt the outcome will be materially different than with three judges.

Also, your idea of cases being heard by three-judge panels (if the Commission is increased to five judges) is unlikely to be workable. Under the Virginia Constitution, the Commission consists of the judges. Thus, unless the Constitution is changed to allow less than the full Commission to render decisions, losing litigants could always appeal to the full Commission in an attempt to obtain a different result. Such a development would simply slow things down. Besides, the present hearing examiner process works quite well.

Additionally, an increase in fees would be required to cover the salaries, staff, benefits, overhead, travel, etc., associated with appointing two more Commissioners. I

could not support such additional fees (estimated at $800,000 annually), particularly if it is more likely than not that the process would become less efficient.

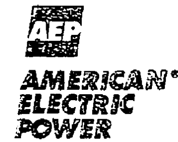
I also note that changing the terms of the Judges to rotating five-year terms would require a constitutional amendment. Such an amendment is not realistic given the good overall performance of the Commission. Further, if the General Assembly felt that some form of rotation was necessary, they would not reappoint judges at the end of their six-year terms – they would reelect a new judge after each six-year term. The General Assembly certainly has authority to do that. But the Commission needs the expertise that comes from the experience the judges gain over many years of hearing and resolving complex cases, and that probably explains the infrequency with which the General Assembly rotates judges off the Commission.

E.L.F.

ELF/gc
#69024

cc: Amigo R. Wade, Legislative Services, Senior Attorney
David Rosenberg, Legislative Services, Staff Attorney

American Electric Power
Three James Center
Suite 702
1051 E. Cary Street
Richmond, VA 23219-4029



June 29, 2001

Dr. Kenneth J. Button
School of Public Policy
Mail Stop 3C6
George Mason University
4400 University Drive
Fairfax, VA 22030-4444

Dear Dr. Button:

R. Daniel Carson, Jr.
Virginia President
804 698 5510

American Electric Power (AEP) is pleased to offer initial comments on the Interim Report prepared by George Mason University (GMU) and dated May, 2001.

AEP is an electric utility serving the western part of Virginia and subject to regulation by the State Corporation Commission. It endorses the legislature's study initiative, as it did the National Regulatory Research Institute (NRRI) study commissioned by the SCC itself.

It bears mention that AEP has, for several years now, been supportive generally of electric utility industry restructuring, believing that restructuring and the introduction of competition to the generation function of the industry is both appropriate and inevitable. AEP supported passage of the 1999 Electric Utility Restructuring Act in Virginia, having been closely involved with the three years of study leading to its passage. The Company's position has been, and is today, that competition will, over time, produce lower costs, higher efficiency, and greater innovation than will regulation. AEP also is of the belief that Virginia's success or lack thereof in moving to competitive markets for generation services will be largely dependent upon the work and support of the State Corporation Commission.

There are several major areas in the Interim Report on which AEP wishes to comment at this stage of the study of the Commission. The Company's silence on other subjects should not be interpreted to signify agreement with anything in the Interim Report. Time and the initial form of the Report have not permitted the Company to conclude with confidence that it has identified every issue or recommendation on which it may ultimately choose to comment. The Interim Report appears to require substantial additional organizational and editing work, in addition to revision to respond to substantive comments by the Joint Subcommittee and others. The Company may have additional comment as the Joint Subcommittee's work progresses and as may be deemed appropriate by the Joint Subcommittee.

1. *Expansion of Commission From Three to Five Members*

The Interim Report (pp.2, 25-26) recommends that the number of members of the Commission ("Judges") be expanded from the current three to five and that each Judge serve a 5-year term. The intent of such an expansion would be to increase the speed and efficiency at which the Commission could conduct its decision-making process. However, there is no reason to believe that any efficiencies would be achieved, and the proposal would likely add inefficiency as a practical matter.

The speed of the Commission's decision-making in any particular matter is governed more by the complexity of the issues it must decide, the blend of its legislative and judicial responsibilities, and the form of its legal procedures (trial-type hearings, discovery, etc.), rather than by the number of Judges. Moreover, the assignment of some proceedings to

hearing examiners has already added substantial resources devoted to deciding contested matters. However, structural and operational barriers, such as the lack of integrated and coordinated positions among Staff divisions, as discussed below, do contribute to slower decision-making. Any perceived delay in Commission decision-making would not be remedied by adding more Judges. The expansion could, in fact, create practical difficulties that would impede decision-making.

If five Judges were permitted to sit in panels of three, but were required to act only by a majority as required under current law, there could be many instances in which a two to one vote on the panel would require votes by the other Judges who have not heard the evidence and argument. Current law would permit those Judges to review the record and vote, but they would require time to review the record. There would be uncertainty about the validity of the panel's result until the non-panel Judges had made their views known. The procedure would likely delay a final decision, not facilitate it.

If a Commission panel were permitted to act on less than a quorum, the procedure would create a potential for inconsistent results among different panels with each result decided by a minority of the Judges. The consequences would be either unworkable inconsistency in policy results or the need for an additional level of procedure at the Commission to resolve the inconsistent panel results. A procedure analogous to the en banc procedures of many appellate courts could be used, but it would add an entirely new level of formal procedure to the Commission's decision-making process. Again, the additional procedures would slow decision-making rather than expedite it.

AEP is not at all convinced that expansion of the Commission will be helpful. The three judge Commission is adequate in size. To the extent that expediency and balanced and informed case involvement on the part of the Commission is a concern, it is best addressed by continuity in the service of the Judges and not by mandating increased turnover, as the Interim Report suggests.

2. Commission Staff Participation in Contested Cases.

The Interim Report (pp. 2, 26-27) discusses the creation of an "Administrative Committee" as a measure to create "a formal link between the divisions and the judge" and "to assist in *ex parte* separation between staff and judges." It also concludes that a proposal for an overall director for the utilities function should not be pursued because each industry within the general classification "utilities" presents unique regulatory issues (pp. 2-3, 28). However, the Report recommends that each division of the Commission Staff should be subject to "more stringent performance review procedures" to define the goals and increase the public accountability of the Staff (pp. 3, 28).

Each of these concerns relates to a need for structural changes and coordinated and integrated operations among Staff divisions to ensure coherent and uniform positions. While the other major regulatory functions of the Commission (the Bureau of Insurance, the Bureau of Financial Institutions, the Clerk's Office and the Division of Securities and Retail Franchising) are organized around a single administrator who can direct the entire Staff function, the responsibility for Staff level decisions in each public utility industry (electric, natural gas, telephone and water) is fragmented among several divisions.

To take the electric industry as an example, a participant in any major proceeding before the Commission is likely to deal with four divisions – the Office of the General Counsel, the Division of Energy Regulation, the Division of Public Utility Accounting and the Division of Economics and Finance. Each of these divisions may perform part of the analysis of a matter and present the results in any formal hearing process that is conducted. Particularly where

professional disciplines overlap, there is no assurance that differences in positions from division to division will be coordinated and consistent. In short, participants outside the Commission cannot be assured that any one division position represents the conclusion of the entire Staff.

The same is true for natural gas utilities and water utilities whose cases typically involve the same four divisions. Telephone company matters concern three of the same four divisions and a fourth division also, the Division of Communications, which performs a function analogous to the function that the Division of Energy Regulation undertakes for the other utility industries. The most pressing concern of the Study should be coordination among the several utility divisions, not coordination between utility regulation as a whole and other regulatory functions of the Commission such as financial institutions or insurance.

In AEP's view, an "administrative committee" would not address the concern for coordination among the utilities divisions. It would not create the leadership of a single staff-level official who could direct several Staff units to a unified Staff position. Rather, any committee organization would only move the debate among equivalent directors of divisions to another forum. A single "Chief of Staff" for energy matters, similar in rank and authority to the Commissioner of Insurance or the Clerk of the Commission, should be responsible for directing the several utilities divisions to unified positions. The energy "Chief of Staff" should have authority to resolve disagreements and inconsistencies in individual proceedings and to implement any strategic planning and performance review standards that may be adopted for the public utilities divisions.

The Interim Report further suggests that operational and procedural concerns are linked to the issue of ex parte communications between Staff members or divisions and the Judges, and that such communications would be addressed by creation of an "administrative committee" system. There are other alternatives, however, ranging from the Commission's recently revised rule to separate advocacy and advisory staffs. The Commission's consultants from the National Regulatory Research Institute, Mr. Dave Wirick and Mr. John Wilhelm, in their Final Report to the Commission of March 2001, suggested a procedure by which Staff members would be assigned "by memorandum" on a case-by-case basis to be either advocates for the Staff or advisors to the Commission. In the advocate role, ex parte communications between the Judges and the assigned Staff members would not be permitted. AEP's position is that the "administrative committee" process recommended in the Report is not a preferable alternative to any of these other measures that respond to concerns about ex parte communications.

3. *Goal Setting and Public Accountability*

The Interim Report (pp. 28-29) "strongly concurs" with recommendations of the National Regulatory Research Institute report that performance review standards should be established for Commission divisions to increase efficiency within the Commission and to increase the public accountability of the divisions. AEP agrees with the Interim Report's recommendations. As a general rule, a lack of recognized standards can prevent effective management internally and create an inability for others to monitor, reasonably predict, and adequately respond to, processes and outcomes. In particular, the Company agrees with the statement in the Interim Report that such standards "should provide at a minimum clear verbal statements of how each directorate [division] sees its role and how it is going about achieving it."

4. *Conduct of the Joint Subcommittee's Study*

AEP appreciates the opportunity to comment on GMU's Interim Report. The Company participated, via interviews, in the GMU study process earlier, and in the NRRI study commissioned by the SCC itself, and the comments contained herein are consistent with our input provided during those interviews.

Looking ahead, the Company understands that the Joint Subcommittee's study process will involve the following steps:

1. GMU's preparation of a final report (following its receipt of stakeholder and SCC comments on the Interim Report);
2. A Joint Subcommittee hearing of public comment on the final GMU report; and
3. Disposition of the recommendations by the Joint Subcommittee.

Organizational effectiveness studies often involve the employment of consultants who facilitate in-depth study by teams staffed with employees of the organization under study. This "bottom-up" approach works well largely because it recognizes the expertise, experience and institutional knowledge vested in those employees. AEP suggests that a similar approach may have beneficial application here and should be considered. That approach would be to provide the Commission and its staff the opportunity to address issues and produce a set of recommendations for the Joint Subcommittee in response both to the GMU final report and the NRRI study. This process step would also allow the Commission and its utility staff entities an opportunity to develop plans and goals alluded to by the Interim Report (p. 28), and to further their roles in achieving the public policy goals established for the Commonwealth by the General Assembly.

Again, AEP thanks the Joint Subcommittee for the opportunity to contribute to its study through these comments and future activities.

Sincerely,

R. Daniel Carson, Jr.

copy - Members of the Joint Subcommittee
Amigo R. Wade, Esquire
The Honorable Clinton Miller, Chairman
The Honorable Hullihen W. Moore
The Honorable Theodore V. Morrison, Jr.

COMMENTS OF WORLDCOM, INC. ON THE
INTERIM REPORT REGARDING THE
STUDY OF REGULATORY RESPONSIBILITIES, POLICIES AND ACTIVIES OF
THE STATE CORPORATION COMMISSION

WorldCom is focusing its comments on the section of the report dealing with telecommunications issues, specifically Section 4D, starting on page 66 and the subsequent recommendations. WorldCom generally supports the recommendations relating to telecommunications (numbers 22 through 26) of the Interim Report. Specifically:

a) as reflected in Recommendation 22, in telecommunications, both large and small new entrants, are, with few exceptions, heavily dependent on the incumbent provider. ***The Commission must focus more on regulation (or "refereeing") between carriers as a means of promoting more competition.***

b) as reflected in Recommendation 24, WorldCom agrees that the Collaborative Committee established by the Commission is critical to competition. ***Immediate steps must be taken to significantly improve the Collaborative's effectiveness***.

c) As reflected in Recommendation 26, the impasse over arbitrations under the Federal Telecommunications Act has the effect of ceding to the FCC implementation of local competition in Virginia. ***The Commission must regain its role as implementer of local competition in the Commonwealth. This will facilitate the entry of more competitors into the marketplace more expeditiously.***

THE "DUAL ROLE" AS A THREAT TO COMPETITION

Citing the competition that has been emerging in the telecommunications industry, the Interim Report correctly notes that "[t]he 'last mile', the distance from the consumer to the telecommunications network, is the focal point of this competition." Interim Report, p. 67. **Indeed, because of the economics of local exchange service, Interim Report, p. 73-75, new entrants like WorldCom, are heavily dependent on the local network of the incumbent telephone companies in order to provide service in competition with those incumbent companies**. The report discusses alternative last mile technologies

on pages 67-68. Except in the case of large customers in urban areas, it makes little financial sense for new entrants to build their own fiber optic last mile facilities (or any other last mile facilities, for that matter). Cable systems may provide some competition, but upgrading those systems is expensive and time consuming, and at best, it leaves a "choice" of two monopolies. Alternate technologies such as terrestrial wireless, satellite wireless, or power lines have not proven economical. Dial-up and DSL technologies are based on traditional copper "last mile" facilities that are owned and controlled by the incumbent carriers.

Because of this dependent competition, local competition, especially in the residential markets, has been slow to develop. Verizon is fond of arguing in all the states that it operates that "the big IXCs [interexchange carriers]," like AT&T and WorldCom are simply slow rolling local entry in order to delay Verizon's re-entry into the long distance market and that AT&T and WorldCom enter local markets as soon as Verizon gets long distance authority from the FCC. That attack makes for good rhetorical flourish, but it is simply not credible. First, it's absurd to argue that IXCs can somehow prevent Verizon from re-entering the long distance market. The FCC decides when Verizon can re-enter the market based on the criteria set out in the Federal Act, and Verizon alone controls the timing of those filings. As for the argument that AT&T and WorldCom will somehow be incented to enter the local market when Verizon gets long distance authority, well, Verizon never lets the facts get in the way of good rhetoric. The facts are these: Verizon has long distance authority now in New York (in December 1999) and Massachusetts (in April 2001). WorldCom entered the local residential market in New York in December 1998 (a year ahead of Verizon's long distance entry); WorldCom has not entered the Massachusetts local residential market (because the rates Verizon charges for network elements make entry uneconomic). Further, WorldCom entered the Pennsylvania residential local market in August 2000; Verizon just filed for their long distance authority in Pennsylvania at the FCC in June 2001. In jurisdictions outside Verizon territory, WorldCom has entered the residential local markets in Illinois and Michigan, and Ameritech/SBC has yet to file long distance applications in those states. The only state where the incumbent's long distance authority and WorldCom's local entry were more or less coincident was Texas. In sum, there is very little if any correlation between an incumbent's long distance entry and WorldCom's residential local market entry. To the extent there is any correlation at all, nobody should confuse (as Verizon seems to) correlation with causation. The bottom line is that WorldCom will enter markets where it makes financial/economic sense to do so.

Dependent competition has significant implications for regulation, as the report recognized. Dependent competition puts the incumbent telephone company in the enviable **"dual role" of being both a supplier and a competitor** to the new entrants to the local markets. Recognizing this, policy makers have **three general alternatives to address this dual role:**

First is some form of structural remedy. In the long distance market, AT&T's dual role (prior to 1984) was remedied by divesting the local networks from the long distance network. That divestiture led to a blossoming of competition in the long distance markets. At some point, perhaps soon, policy makers may need to address the incumbent carrier's dual role with a similar divestiture. Pennsylvania has flirted with a structural separation of Verizon. A structural separation of Verizon is very different from a divestiture, because under a structural separation, although the dual roles of Verizon would be placed into two separate affiliates, ultimate owner ship of the affiliates remains with the parent company. Thus, ultimate financial incentives to discriminate against dependent competitors remains. Ultimately, in the face of massive Verizon resistance, the Pennsylvania PUC backed away from full structural separation.

Second, and at the opposite end of the spectrum is re-monopolization of the markets. Left unchecked, the incumbent carrier has the incentive and ability to marginalize, if not crush, their dependent competitors. The demise of the data CLECs (e.g., Northpoint) is, at least in part, a result of this dependent relationship.

The **third** alternative is more focused and stronger regulation on the relationship between dependent carriers and the incumbent carriers. Verizon's recent mantra has been "deregulation." According to Verizon's argument, deregulation is the panacea for all the ills facing the industry. If only they were deregulated, says Verizon, they'd invest in the infrastructure and otherwise bring great things to consumers. Policymakers should be wary of monopolists bearing messages of deregulation. Monopolies are bad enough; unregulated monopolies are worse. Until and unless the dual role issue is properly addressed, Verizon will need to be regulated in order to prevent them from abusing their bottleneck control of the local network facilities. The Interim Report correctly recognizes this in its "Contestable Market" discussion on pages 16-17 (regarding the need to regulate in the 21st Century).

Absent a structural remedy, the only means of bringing about any real local telephone competition is strong and effective carrier to carrier regulation.

USING "BEST PRACTICES" TO DEAL WITH INCUMBENT TACTICS

The Interim Report discusses the basics of what is necessary to bring out strong and effective carrier to carrier regulation, and WorldCom supports the Reports recommendations as far they go. Specifically, implementation of the "best practices" noted on pages 75 and 76 of the Interim Report would go a long way towards bringing out more effective regulation (and spurring competition in the local telephone markets). It has been WorldCom's experience that incumbent carriers use a **variety of tactics to delay the implementation of local competition.**

1) **LEGAL:** There is the straight up legal assault against pro-competition requirements. These battles are largely being fought in the courts, with critical provisions of the Federal Act now before the Supreme Court for the second time as a result of incumbent challenges to FCC regulations.

2) **FINANCIAL:** There are the financial barriers. To the extent they are forced to offer such things a network elements to their dependent competitors, the incumbents, not surprisingly, seek to charge high rates for those elements. The rate issues are typically resolved through massive and complex rate cases, where the incumbent typically has greater power because of its greater control of information.

3) **TECHNICAL:** There are the technical obstacles. Interconnection of networks always raises technical issues. This has been true back to the early days of long distance competition. The incumbents often hide behind technical issues, creating regulatory mountains out of technical molehills. The incumbents tend to be good at finding "issues," but poor at finding solutions.

4) **OPERATIONAL:** There are the operational issues. Dependent competitors need to interact with incumbents on a daily basis. New entrants place orders for elements that the incumbent hopefully provisions and maintains properly. These interactions occur many, many times on a daily basis and are extremely difficult to police.

The sum and substance of this is that **delay benefits the incumbent and there are a multitude of areas where the incumbent can inject delay.** Traditional regulatory approaches are not conducive to reducing the delay. With this background, it's important to design a regulatory approach that is geared toward minimizing the potential for delay. The "best practices" does just that. For example, the first five "best practices" noted on page 75 of the Report (strong, frequent collaborative process; judge participation; commission driving the process; rejection of unreasonable positions and push for resolution; establishing strict timelines) address the problem of delay directly.

THE NEED FOR STRONG ENFORCEMENT

Most important is strong enforcement by the Commission. Without the potential for strong enforcement when discriminatory behavior (or otherwise poor service) is demonstrated, the incumbent not only has no incentive to provide proper service, the incumbent is actually incented to encourage litigation. Specifically, if after months and months of expensive litigation in front of the

Commission the worst that the incumbent has to fear is an admonishment to "don't do that again," the incumbent has essentially won. It not only has provided poor service to its competitor, it has dragged that competitor through more delay, and at the end the competitor gets merely what the competitor should have been getting in the first place. The incumbent must feel the sting of poor performance, otherwise the poor performance will simply continue. WorldCom has a pending complaint against Verizon at the Commission regarding alleged poor delivery of circuits that WorldCom needs to provide service to end users. Litigation of the case will take months. Verizon will have no incentive to settle if it does not feel the potential for a strong negative result at the end of the litigation. Verizon will have no incentive to provide nondiscriminatory service if, at the end of the litigation Verizon receives only a slap on the wrist (assuming WorldCom otherwise proves its case). In contrast, the possibility of strong enforcement would incent Verizon to resolve the case and, hopefully, provide nondiscriminatory service to begin with. The Interim Report recognizes this problem by noting that "best practices" include the imposition of "penalties and fines for noncompliance."

CONCLUSIONS

All of this leads back to the basic recommendations of the Interim Report. **The Commission must focus its regulatory efforts on relations between the incumbent and dependent competitors,** understanding the "dual role" of the incumbent carrier. (Recommendation 22) Effective alternative means of addressing issues raised by the dual role must be implemented. **The existing collaborative process should be revamped to incorporate the "best practices" noted in the Interim Report.** (Recommendation 24) Most important of the "best practices is that **the Commission needs to enforce service requirements of the incumbent with the threat of strong penalties or fines.** Weak enforcement encourages poor performance and litigation. Lastly, the **Commission should ensure it has a strong voice in local competition issues**. The impasse over arbitration under the Federal Act has delayed the resolution of local issues and driven new entrants to seek arbitration and resolution of issues at the FCC, rather than the SCC.

June 29, 2001

WARD INSURANCE

June 27, 2001 (original letter prepared May 25, 1998)

To whom it may concern:

I am filing a complaint regarding the Bureau of Insurance, Property and Casualty Division (Bureau) and the State Corporation Commission (Commission). Their actions need legislative review.

My specific dispute is with my attorney who represented me in this matter. Ultimately, he is responsible.

However, it is the actions of the Bureau that created the environment that facilitated the events that took place. Further the State Corporation Commission has not been accountable. In fact the Commission has operated to frustrate my efforts to seek justice.

Specifically, the Bureau operates in such a manner to involve an attorney in a compromised position. How does this happen? Based on my research and experience, it appears attorneys are held to a level of conduct defined by the Virginia Code of Professional Responsibility. Attorneys enjoy this level of conduct when dealing with other attorneys held to the same standard. However employees of an administrative agency do not honor the same standard of conduct in their dealings with an attorney. Unless the attorney follows well established practices he can easily find himself in a compromised position. This is what occurred with my attorney. He accepted the Bureau's statements concerning their authority,

> (5) *Excerpt from letter dated July 18, 1995 from my attorney.*
> "He articulated the most 'egregious' violation resulting from the investigation is the failure to comply with the terms and conditions of the previous settlement order. He further indicated from a historical perspective the Commission always revokes a license for this contemptuous behavior."

He conveyed those positions to me without legal research. I accepted the statements of my attorney based on his communications with the Bureau. In making my decision to settle or contest, I relied on those statements. As a result, I was deprived the opportunity to make an informed decision; part of my constitutional right to due process.

Further, in this compromised position the attorney is compelled to align with the Commission to defend against legal action from his client. This is what occurred with my attorney. I am faced not only with attempting legal action against an attorney, difficult at best; I am also encountering the Commission, a formidable opponent.

213 MCLAWS CIRCLE, STE 1 • WILLIAMSBURG VA • 23185
PHONE: (757) 229-5600 • FAX: (757) 229-7732

(15) *Except from letter dated May 16, 1997 from the malpractice claims supervisor for my attorney.*
"This letter represents our final position in this matter. I understand that our position comports with that of the State Corporation Commission."

When I filed a complaint with my attorney for his actions,

(14) *Letter dated March 4, 1997 to my attorney.*
'... "Mr. Ward and Ward Insurance services failed to obey the Commission's settlement order dated July 21, 1993."

"Based on the Bureau's investigation, Mr. Ward and Ward Insurance Services have committed acts which would subject them to the penalties provided in Sections 38.2-218 and 38.2-1831 of the Code. The Code provides for a penalty of up to $5000 for each knowing or willful violation, a penalty up to $1000 for each unintentional violation and/or the suspension or revocation of Mr. Ward's and the agency's licenses to transact the business of insurance."

The preceding paragraphs are from a letter dated 22 May 1995 from Gail Kimpfler, Supervisor, Agent Investigations Section, Property and Casualty Division to you, my attorney.

Throughout the Bureau's investigation of my agency, Ms. Kimpfler asserted she could revoke my license because I had violated an order of the Commission. My file, including correspondence between the Bureau and you, substantiates this dictum.

The statutory code did not exist to corroborate her assertions. The reference to 38.2-1831 lists several reasons an agent's license can be suspended or revoked. Violating an order of the Commission was not one of those reasons in 1995. Strangely enough, the proposal to authenticate her statement was prepared on 22 November 1995.

" Proposal: That 38.2-1831 be amended to include a provision which will allow the Commission to suspend or revoke an agent's license for failing or refusing to obey a Commission order which has been entered against that person....
Reason needed: 38.2-1831 lists a number of reasons the Commission may use to refuse to issue or suspend or revoke an agent's license. The new provision is needed because there is no statutory authority for the

Commission to suspend or revoke an insurance agent's license for violating an order of the Commission. "

The proceeding is from a document, provided to me by the Division of Legislative Services, dated 11-22-95 and titled 'Proposal for Consideration by the Virginia General Assembly During its 1996 Session'.

You failed to comply with the order of the Commission and she's going to take your license was your final instruction to me in the phone conversation on 20 July 1995. Had you checked the Code, you would have known she didn't have a leg to stand on.

As my attorney, you failed to validate the statutory authority Ms. Kimpfler claimed she possessed. As my attorney, I relied on you for legal advice.

On this critical point, as well as other aspects of my encounter with the Bureau of Insurance, you failed to provide me with legal guidance. This is apparent as a result of my research on the 'legal parameters' of package selling. Just as in the case of HB295, a new proposal to provide the statutory authority the Bureau did not possess; a new proposal SB542 was developed to establish 'legal parameters' that did not exist in 1995.

In summary, I don't know why you agreed to represent me in Ward Insurance Service v. Bureau of Insurance but to be my legal advocate was not your agenda.

This is a statement of my claim. Please remit it to your carrier."

My attorney sought refuge at the Commission for a defense.

(13) *Excerpt from letter dated February 17,1997 from my attorney.*
"The Commissioner and his staff attorneys have clearly indicated there is no question they had the authority to suspend or revoke your license in 1995 for a failure to obey a previous order of the Commission. If your concern is HB295 that was approved on February 28,1996, then I understand why you may have been chagrined that I voted for that Bill. That bill merely codified in the Code of Virginia that which the Commission was already authorized to do."

Eventually, I discovered the defense was a falsehood; not legally substantiated. Ultimately, these falsehoods, now made by the Commission, served to defeat my efforts to seek justice from my attorney in this matter.

> (23) *Excerpt from letter dated December 11, 1997 from a State Corporation Commission Judge.*
> "Therefore, I do not consider that the 1996 General Assembly legislation to which you refer changes the law in a substantive way, but rather codified and clarified the law as decided[1] by the Supreme Court of Virginia."

The Bureau incorporates deceptive practices in order to accomplish their agenda. Obtaining settlement orders is the Bureau's primary goal. It is paramount to all other considerations including enforcement of statutes[2] and safeguarding due process[3]. Several players function independently but the overall effect is a well-planned scheme to deceive and to gain settlements using the attorney to expedite the process.

I observed several practices to support these assertions.

Their written correspondence is inconsistent with their authority. The initial letter discussing the findings of the investigation indicated I was subject to revocation of my license for my acts.

> (1) *Excerpt from Letter dated May 22, 1995 from Head of Agents Investigations.*
> "Based on the Bureau's Investigation, Mr. Ward and Ward Insurance Services have committed acts which would subject them to the penalties provided in Sections 38.2-218, and 38.2-1831 of the Code. The Code provides for a penalty of up to $5000 for each knowing or willful violation, a penalty up to $1000 for each unintentional violation and/or the suspension or revocation of Mr. Ward's and the agency's licenses to transact the business of Insurance."

With the issuance of this letter, I was regularly advised that revocation of my license was the penalty.

> (2) *Excerpt from letter dated June 13, 1995 from my attorney.*

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[1] Does the Supreme Court of Virginia decide law or interpret law?

[2] Statutes are the documented position of the legislature and statutes circumscribe the Bureau's authority.

[3] A constitutional right that provides protection for all citizens, if observed. Unfortunately, the responsibility to observe constitutional rights lies in the hands of powerful entities. Powerful organizations that review their own accountability.

"She harshly indicated they would seek the maximum civil penalties available and revocation of you license. I expressed to her my displeasure with the manner in she framed those alternatives. She unabashedly indicated it was designed to force settlement."

(4) *Excerpt from letter dated June 27, 1995 from the Head of Agents Investigations.*
"Furthermore, the Commission could revoke Ward's and the agency's licenses."

It was under this threat that I signed the settlement order. Despite the claimed authority, in November of that year, well over 4 months after I settled, the Commission prepared a proposal for the 1996 General Assembly to amend the Code. This proposal requested the very authority already presented to me as statutory authority; the possessed authority on which I based my decision to settle.

(11) *Excerpt from a document from the Division of Legislative Services, dated 11-22-95 and titled 'Proposal for Consideration by the Virginia General Assembly During its 1996 Session'.*
"Proposal: That 38.2-1831 be amended to include a provision which will allow the Commission to suspend or revoke an agent's license for failing or refusing to obey a Commission order which has been entered against that person....

Reason needed: 38.2-1831 lists a number of reasons the Commission may use to refuse to issue or suspend or revoke an agent's license. The new provision is needed because there is no statutory authority for the Commission to suspend or revoke an insurance agent's license for violating an order of the Commission. If an insurance agent violates an order of the Commission, the agent may be fined for such violation, but in order to suspend or revoke the agent's license, the Commission must find that the agent is incompetent or untrustworthy under subsection 10 of 38.2-1831."

Verbal communications are inconsistent with the written correspondence. As discussed previously, the initial letter, May 22, 1995, discussing the findings of the investigation indicated I was subject to revocation of my license for my acts [reference quote (1)]. And as I indicated, with the issuance of this letter I was regularly advised that was the penalty [reference quote (2) and (4)]. These warnings continued even though the Deputy Commissioner issued a letter, June 19, 1995, detailing a different consequence.

(3) *Excerpt from letter dated June 19, 1995 from the Deputy Commissioner.*
"In addition, it appears that your clients have violated the terms of the Order entered by the State Corporation Commission on July 21, 1993, in Case No. INS 930340, subjecting them to the penalties set for the in section 12.1-33, which provides for a fine up to one thousand dollars ($1000) for each day they failed to obey said Order."

According to this subsequent letter, I was subject to a fine. I was never made fully aware of this alternative in any verbal communications with Bureau staff. As recent as two days prior to the deadline I was again warned, validated by a July 18, 1995 letter, [reference quote (5)] that I was subject to revocation of my license. Further, I was advised revocation of my license for this act was a long-standing practice of the Commission. Recently, I found out that fact simply is not true. The authority of the Commission is statutory authority. Statutory authority did not allow for the revocation of an agent's license in 1995 for failure to obey an Order [reference quote (3) and (11)].

The written correspondence, when appropriate to fulfill their agenda, is inconsistent with the events that occurred. The warnings contained in the July 18, 1995 letter [reference quote (5)] consistent with the May 22, 1995 letter [reference quote (1)] contains the reasons for my decision to settle. However, the Deputy Commissioner conveyed the settlement offer to the Commission with a memorandum.

(7a) *Excerpt from a memorandum dated July 26, 1995 to the Office of General Counsel.*
"It appears the offer of settlement is in accordance with the terms of the Bureau's letter of June 19,1995, copy attached."

This memorandum associated the settlement offer with the June 19, 1995 letter [reference quote (3)], as my reason for settling. Identifying the settlement offer with that letter was necessary because it reflected the proper penalty for my acts in 1995. The Bureau was careful to convey to the Commission the proper penalty letter. However, the reason contained in the June 19, 1995 letter is not the reason I chose to settle. Although, the Deputy Commissioner may have believed that memorandum reflected the true events. It did not. Not only was I told falsehoods to encourage me to settle, my reasons for settling are not even documented properly. I believe that is a further violation of my due process. Further, I believe the conveyance of the settlement offer associated with the June 19th penalty letter represents a falsehood made to the Commission by the Bureau. Language in the settlement offer is inconsistent with the Order issued by the Commission with respect to violation of the law.

(7b) *Excerpt from the settlement offer prepared by the Bureau of Insurance.*
"This offer is being made solely for the purpose of a settlement and does not constitute, nor should it be construed as, an admission of any violation of law."

(7c) *Excerpt from the settlement Order dated June 19,1995 issued by the Commission.*
"Based on an investigation by the Bureau of Insurance, Earl E. Ward and Ward Insurance Services have violated the provisions of Section 38.2-502.1, 38.2-502.5, 38.2-512 of the Code of Virginia,..."

The Bureau's overriding agenda is to obtain settlement orders. That goal exceeds all other considerations. I disagreed with the other allegations made against me and wanted to address those issues in a hearing. By misrepresenting the penalty for a transgression that the Bureau convinced me I could not change[1], I waived my opportunity to a hearing based on false authority [reference quote (1) and (11)]. It appears the Bureau either wanted the settlement offer at all costs or they did not want these other issues adjudicated[2]. A hearing on those issues would establish standards to which agents and the Bureau would have to operate. The Bureau prefers to sanction agents on issues that have not been adjudicated.

(6) *Excerpt from letter dated July 18,1995 from my attorney.*
"Mr. Thomas further indicated in each and every instance where the attention of the Bureau of Insurance is directed to the packaged marketing of liability policy with an AD&D/or motor club, they have sanctioned that agent."

It is part of their deceptive operation. Furthermore, what statute is providing the authority to sanction an agent for package selling? In our discussions, the Bureau accepted that agent's can package sell.

If due process constraints obstruct their efforts to obtain settlements then these rights are abandoned. The groundwork for obtaining the settlement offer was laid using the May 22, 1995 letter [reference quote (1)]. With it's issuance began the warnings concerning revocation of my license [reference quote (2) and (4)]. I questioned the rationale behind revocation. It simply was outrageous based on my transgression. I continued to question the justification of revocation. The Bureau knew or should have

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[1] At the time, the issue of failing to obey a prior order was never questioned. I accepted their position without question. However, based on research, their position concerning failure to obey a prior order is in great question.

[2] I believe the Bureau would have dropped the complaint had I chosen a hearing. I know now their other accusations had no basis. I have come to realize this fact as a result of discovery.

known I was not properly informed when I made my decision to settle as demonstrated by the July 18, 1995 letter [reference quote (5)]. Because of my continued questioning, the Bureau found it necessary to abandon my constitutional rights to due process, to make an informed decision, in order to obtain the settlement offer.

Accountability for their actions is not a serious concern of the Commission. It doesn't exist when the same people who participate in the scheme are supposed to provided accountability. In summary, I was told falsehoods so that I would settle rather than contest the charges. My reasons for my decision are not properly documented with the Commission. For both of these reasons and possibly more, my constitutional right to due process was violated. In the process, the Commission was, also told falsehoods. I asked the Commission to review these events according to their provisions addressing accountability.

> (16) *Excerpt from letter dated October 20, 1997 sent to Commissioner Gross.*
>
> "According to the Rules of Practice and Procedure of the State Corporation Commission, Rule 3:3, Review of Acts of Officers and Employees, I am making a complaint concerning the administrative action of an employee. Specifically, in 1995 false and fraudulent representations were made by Gail Kimpfler, the Head of Agents Investigations, Property and Casualty Division to obtain the settlement order no. INS950100. The foundation for the misrepresentation was established by letter dated 22 May 1995 from the Head of Agents Investigations. I was informed that I was subject to the penalties contained in Sections 38.2-218 and 38.2-1831 of the Code for failing to obey a prior order with the emphasis placed on the revocation of my insurance agent's license. I maintain additional correspondence confirming those misrepresentations.
>
> Although my displeasure with the treatment I was exposed to in 1995 has been well documented with the Bureau, the matter I am documenting today is a different issue and should not be confused with any previous discussions. It was approximately one year after settlement that I became aware of the critical deception concerning the authority claimed by the Head of Agents Investigation. Authority presented as statutory authority by letter dated 22 May 1995 and, therefore, I did not question. Authority on which I relied on to make my decision concerning the pending matter with the Bureau. The 'Proposal for Consideration by the Virginia General Assembly During its 1996 Session' dated 11-22-95 requesting an amendment to 38.2-1831 is the document that sensitized me to the deceptive. This proposal requested the exact authority which was professed in 1995; revocation of license for failing to obey an order.

I have delayed in registering my complaint in order to confirm this essential issue concerning the authority possessed by the Bureau when an agent fails to obey a previous order. After much examination I can find no other explanation. The authority to revoke my license in1995 for failing to obey a prior order was a false representation. Authority misrepresented with the intent that I sign the settlement offer and waive my right to a hearing.

Please review this administrative action and advise me of your corrective measure."

(17) *Excerpt from letter dated November 12, 1997 from Commissioner Gross.*

"This will acknowledge receipt of your October 20, 1997 letter which was received in this office on October 28,1997. My staff and I have reviewed your letter. This matter was settled by the Commission as to all outstanding issues[1]. No further action is appropriate."

(18) *Excerpt from letter dated November 13, 1997 to Commissioner Morrison. (this letter is quite lengthy and primarily reiterates the positions in the 3.3 letter)*

"Based on Rule 3.3 of the SCC Rules of Practice and Procedure, I filed a complaint with the Commissioner of Insurance against the administrative action of an employee. If the complaint is not resolved I am to file a complaint for review by the Commissioner under whose supervision the division head acted, as provided in Rule 5.4. With this letter, I am requesting an informal proceeding; a review of my complaint....Therefore I will contact you in a week for a status of the review."

(19) *Excerpt from letter dated November 20, 1997 from Stewart Farrar, Solicitor General.*

"Commissioner Theodore V. Morrison, Jr. of the State Corporation commission has received your letter to him of November 13, 1997, and he asked me to review the matter and advise him on the subject. I am in the process of doing so, and you will be contacted again in the near future."

(21) *Excerpt from letter dated November 26, 1997 from Commissioner Morrison.*

"This will acknowledge receipt by me on November 26 of your letter of November 13 by which you file an informal proceeding to complain of

[1] That is accountability?

the alleged misconduct by one or more State Corporation Commission employees.

At the conclusion of an investigation of this matter I shall promptly notify you of my decision. In the meantime, you may submit any further information you deem relevant, and I would hope that you might do this within 14 days of this date."

Even though victimized in this process, the Commission took a defensive posture. The authority in question was claimed based on association with an unpublished Supreme Court decision; the same defense used by my attorney. This case was claimed even though the Commission's authority is statutory authority not case law.

(22) *Excerpt from letter dated December 11, 1997 from a State Corporation Commission Judge.*
"I also find that it is relevant to consider a case decided by the Virginia Supreme Court shortly before the letter just discussed. In the case of Carolyn Pence v. State Corporation Commission, Record No. 942023, May 8, 1995 (Unpublished), the Supreme Court of Virginia upheld the State Corporation Commission's revocation of an insurance agent's license...case.

Therefore, I do not consider that the 1996 General Assembly legislation to which you refer changes the law in a substantive way, but rather codified and clarified the law as decided by the Supreme Court of Virginia."

The inconsistency between the authority claimed and the authority documented by the Deputy Commissioner to the Commission was not addressed [reference quote (18) and (22)].

Filing a complaint with the Bar about my attorney appeared to be my only option. Because of the serious nature of filing a complaint with the Bar, I attempted to seek a legal opinion. I retained an attorney and he agreed to thoroughly review the events that lead up to the entry of the settlement order in 1995.

(20) *Excerpt from letter dated November 25, 1997 from my newly hired attorney (attorney 2) to investigate a malpractice claim.*
"When you bring me the rest of the papers, I will begin a thorough review of the actions leading up to the entry of the settlement dated July 21, 1995 between Ward Insurance Services and the State Corporation Commission. I will endeavor to determine, to the extent possible, what precisely

transpired, the state of the law at the time, and render my own legal opinion concerning the propriety of same."

Again, the Commission, by some mechanism, intervened and turned my 'ethical' attorney into a zealous advocate for their position.

(24) *Excerpt from letter dated April 1, 1998 from attorney 2.*
"I spoke today with Michael Thomas, who was principal litigator and is now a hearings officer for the State Corporation Commission in Richmond.... Mr. Thomas advised that he was aware of only two instances in which the Commission took revocation action against agents who did not comply with orders, and those agents were ... and Earl Ward.[1]

Although...language contained in his July 18, 1995 letter, that 'the Commission always revokes a license for this contemptuous behavior' is strong and could well be read to mean that the Commission has a long-standing practice on many incidents to do so, I do not believe that it is substantively a misstatement of the facts as I understand them."

His amended attitude is apparent in the divergence of his legal opinion from our original agreement. I attempt to re-focus him.

(25) *Excerpt from letter dated April 19, 1998 to attorney 2.*
"The Commission's own document communicating to the General Assembly clearly states, 'there is no authority for the Commission to suspend or revoke an insurance agent's license for violating an order of the Commission'. However, that is the exact authority that was quoted to us in 1995. For '...the failure to comply with the terms and condition of the previous settlement order...the Commission always revokes a license...' is the authority provided by ...in the July 18, 1995 letter. The authority provided in the amended statute 38.2-1831, '...The Commission may...revoke the license of any licensee...' when '...the licensee...Has failed or refused to obey any order of the Commission...' is the authority that was quoted to us in 1995. However, that authority was not available until July 1, 1996."

[1] This statement is simply not true. The Commission took no revocation action against Earl Ward. They didn't have to. The Bureau of Insurance had secured a settlement agreement. Beyond that, my attorney is supposed to be looking at documentation from the time in question not speaking to a cover-up participant who clearly has the motivation to re-characterize the events.

Finally, In the course of my personal research, I discovered another anomaly. The settlement order I signed states, "This offer is being made solely for the purpose of a settlement and does not constitute, nor should it be construed as, an admission of any *violation of law*" [reference quote (7b)]. However the order issued reads, "It appearing from an investigation and subsequent allegations by the Bureau of Insurance that Defendants, duly licensed by the Commission ...*violated Virginia Code* " [reference quote (7c)]. If there is no adjudication then how can it be said I violated the Code? If I made an offer of settlement with the understanding that it did not mean I violated the law then how can I be issued an Order that states I violated the Code? I have checked in the Annual Report of the State Corporation Commission. This appears to be a common practice for many of the orders read as mine does.

I have exhausted all remedies available at the Commission to file complaints. Because of their involvement, the Commission refuses to address the issues of my complaint in a forthright manner [reference quote (22) and (23)]. The fraudulent scheme the Bureau of Insurance has developed is difficult to penetrate. Only someone persistent in seeking the truth could have the knowledge I have gained. The tightly knit alliance does not make it easy to gain understanding. Further, my attorney is a State Senator and advertises specialization in administrative law. If he can become ensnared in this scheme then little hope exists for the agent to gain justice when dealing with the Bureau and the Commission.

It is my understanding many changes have occurred at the Bureau of Insurance as a result of my complaints. The head of agent investigations was replaced, as well as the Commissioner of Insurance.

> (12) *Excerpt from letter dated November 18,1996 from my attorney.*
> "I know there were several lingering concerns you had. I think it is important to put all of this in prospective as its relates to your disagreement with Gail Kimpfler and Steven Foster. As you are aware, Mrs. Kimpfler left the Bureau and went back into the private sector. She left the Bureau under less than desirable circumstances.
>
> Also, Steven Foster has now left the Bureau. A new Commissioner has been appointed.
>
> I believe both Mrs. Kimpfler and Mr. Foster left as a result of the accumulated dissatisfaction by consumers and legislators alike."

Essentially, the Head of Agents Investigations and the Commissioner of Insurance departed due to my continuing complaints. However, my position is unchanged. My opportunity for adjudication has been lost along with my constitutional rights that were

supposed to protect me. The Commission knowingly maintains a fraudulently obtained order and with an inaccurate public record I have lost my good name.

I have made serious allegations against the Bureau of Insurance and the State Corporation Commission. I believe I have the paperwork to substantiate these allegations. Fraudulent statements were made to me [reference quote (1) and (5)] and to the Commission by the Bureau [reference quote (7a)] in order to effect their agenda; obtaining settlement offers. The net effect is my constitutional right to due process was violated. The parties who could have addressed these complaints chose to align their forces against me. I have studied these events from all angles. To protect the citizens that are subject to the regulatory arm of the Bureau of Insurance their fraudulent scheme requires legislative attention.

This letter up to this point was written in 1998 and sent to the 3 State Corporation Commission judges. I have updated the format of the letter and am presenting it to the legislature for the first time. I believe this subcommittee has the mission to address these issues. Following is the first letter I submitted to this subcommittee[1].

Amigo Wade
Division of Legislative Services
General Assembly Building, Second Floor
910 Capitol Street
Richmond, Virginia 23219

RE: Issues for Consideration - SJR 173/HJR 187 (2000)

To joint subcommittee:

The Senate Joint Resolution No. 173 resolves to " ...study the regulatory responsibilities, policies and activities of the State Corporation Commission ...on the lives of the citizens of the Commonwealth...". This resolution defines the framework by which I write to you today.

I am a citizen of the Commonwealth and a small-businessman, an insurance agent, therefore regulated by the Bureau of Insurance. I had an opportunity to experience the policies and activities of the Bureau of Insurance and, subsequently the policies and activities of the State Corporation Commission.

The final act in my encounter with the State Corporation Commission, Bureau of Insurance characterizes my entire experience. I sought remedy for the activities of the

[1] By the way, as a result of submitting this letter to this subcommittee, I dealt with retaliation.

State Corporation Commission, Bureau of Insurance through rule 3:3 (Review of Acts of Officers and Employees) and, subsequently rule 5:4 (Informal Proceedings–Complaint). The intent of these rules, defined by the Rules of Practice and Procedure of the State Corporation Commission, appear to impose accountability on the State Corporation Commission and it's divisions.

I was denied an informal hearing not on the merits of my complaint but for reasons best described as bureaucratic maneuvering. In practice, the State Corporation Commission is in a position to obviate the rules intended to impose accountability. Even though the State Corporation Commission is charged with protection of the citizen of the Commonwealth, it appears the self-regulated are unregulated.

My complaint has merit and needs reviewed. During my experience, I encountered what I believe to be collateral fraud, color of law, conspiracy, due process violations, ex post facto laws and an inconsistency between the agreement and the order[1]. A legal review of my documentation may reveal other violations.

My positions are well documented in my paperwork. My paperwork is extensive and can be made available upon request.

I believe this sub-committee charged with a review of the regulatory responsibilities, policies and activities of the State Corporation Commission can benefit from knowledge of my experience.

Respectfully submitted,
Earl E. Ward

I discussed the Bureau's actions at length with David Wirick, National Regulatory Research Institute, the consultant hired by the State Corporation Commission and who prepared a review of their procedures. He found my information shocking. The subcommittee could have been made aware of the Bureau's actions by reviewing his report, except it was not addressed.

This is the impact the Bureau of Insurance has on the citizens of the Commonwealth. The Bureau did not develop this mentality just to deal with me. I'm just the person who documented their actions. I have a legal problem and I have suits filed to address some of them. However, as a result of my experience, I know the Bureau has too much power and precious little accountability. Alternate Dispute Resolution (ADR) is the exact

[1] Malfeasance can now be added to this list.

solution that is needed. This should be first and foremost the primary action taken if the Bureau is concerned about an agent's actions. ADR is a win-win solution. All participants will benefit including the consumers of insurance products, the group on which the Bureau is supposed to be focused.

Respectfully submitted,

Earl E. Ward
Ward Insurance Service

JULY 2, 2001

(1)	May 22, 1995 letter from the Head of Agents Investigations
(2)	June 13, 1995 letter from the Head of Agents Investigations
(3)	June 19, 1995 letter from the Deputy Commissioner
(4)	June 27,1995 letter from the Head of Agents Investigations
(5)	July 18,1995 letter from my attorney (page 1)
(6)	July 18,1995 letter from my attorney (page 2)
(7a, b, c)	July 26,1995 memo to the Office of General Counsel
(8)	June 27,1995 letter from the Head of Agents Investigations
(9)	offer of settlement generated by the Bureau
(10)	order issued by the State Corporation Commission
(11)	Proposal ...38.2-1831...
(12)	Nov 18, 1996 letter from my attorney
(13)	Feb 17, 1996 letter from my attorney
(14)	Mar 4, 1997 complaint to our attorney
(15)	May 16, 1997 letter from his claims supervisor
(16)	Rule 3:3 complaint per Rules of Practice and Procedure
(17)	Nov 12, 1997 response from the Bureau
(18)	Rule 5:4 complaint per Rules of Practice and Procedure
(19)	Nov 20, 1997 acknowledgment from the Commission
(20)	Nov 25, 1997 agreement with new attorney
(21)	Nov 26, 1997 acknowledgment from the Commission
(22)	Dec 11, 1997 response from the Commission
(23)	Dec 11, 1997 letter to my attorney explaining position
(24)	April 1, 1998 letter from my attorney (bottom page 1 and middle page 2)
(25)	April 19, 1998 letter to my attorney inquiring about his change in posture

Public Comment

September 19, 2001 Meeting

STATEMENT OF R. DANIEL CARSON, JR.
AMERICAN ELECTRIC POWER

TO THE JOINT SUBCOMMITTEE STUDYING THE STATE CORPORATION COMMISSION

September 19, 2001

Mr. Chairman; members of the subcommittee:

My name is Dan Carson; Virginia President of American Electric Power Company, which serves the western part of the state.

As one of "the regulated", and given that it has participated by interview in both the NRRI and GMU studies, AEP has both reason and some responsibility to comment today, and appreciates the opportunity to do so.

We were encouraged by the Commission and its staff to comment candidly for the NRRI study and we did... and we were equally candid for the GMU study.

We provided written comments to Dr. Button on his interim report, and in those comments (a copy of which we sent to the Commission), we spoke to some of the structural changes which GMU recommended concerning the Commission and its staff; Likewise, we comment today on the final report.

With respect to the need for coordination among the various utilities divisions, we agree with the recommendation calling for the establishment of a "Director of Utilities" position. This is, in our opinion, far preferable to suggestions contained in the interim report.

Our second comment concerns the issue which was discussed extensively in your last meeting and earlier today and is described in the final report as "the closeness of the administrative processes within the SCC and the judicial processes." We agree that the expressed concerns about this issue merit further study by the Commission and perhaps formal structural change.

As a general comment, we commend the Subcommittee and the SCC for the study processes in question. Periodic organizational effectiveness studies can be a good thing for all types of organizations. They've obviously been popular within the business community for years now, as businesses have had to respond to changing business conditions through reorganization. We've done them, as have others in this room. Such studies can be constructive and one has to approach them with that goal in mind.

The apparent next step (at least apparent to us) is internal Commission review of and significant involvement of the SCC with the 25 NRRI recommendations and the recommendations from the final GMU report, and its development of appropriate responses to those recommendations... presumably for the subcommittee's review. We endorse that step, and we respectfully suggest from our experience that benchmarking against comparable organizations can be helpful; furthermore, we offer any assistance or involvement the Commission considers necessary.

Our final comment is that we interpret the GMU and NRRI recommendations in two parts: (1) The structural and operational issues for which the studies made recommendations, and which the Commission will be considering. And, a second matter being that of policy direction... that is, consistency of Commission goals with legislative policy direction in the area of electric utility competition. The latter policy direction issue has at times has seemed unresolved or unclear... to us at least.

In our earlier written comments, we expressed our agreement with the twostudies' suggestion that goals (and even a vision) should be set by the Commission and its staff, along with plans outlined for monitoring and achieving those goals ... our assumption being that such goals would embrace the public policy goal of advancing electric utility industry competition within the Commonwealth.

Some higher degree of single-mindedness between the General Assembly and the SCC as to the goals and plans for competition -- whatever that agreement produces -- is very important to us. We're restructuring our company, investing much time and dollars in preparing for competitive markets, and complying with the terms of Restructuring Act whose implications are huge for us and for our customers, and whose provisions we're relying on.

Thank you.

George "Brother" Poffenberger, Jr., CLU ChFC
Astro Insurance Agency
3239 Oates Lane
Ruther Glen, VA 22546

Bus 804 448-4514
Fax 804 448-4517
Toll-free 800 937-0014
brother@bealenet.com
www.astroinsurance.com

CLARICA

To the Honorable Tommy Norman and State Corp. Commission

I would like to make a proposal to streamline the application of licensing Agents in the State. Currently an agent must apply to any company on an individual basis so that they my sell for that given company. This creates a large amount of paperwork and in today's society with computers and fax machines the state could reduce this.

In my sample of an individual I show you one person holding 20 individual licenses, that person has 45 more.

If the State could issue one license good for any company then you could reduce the amount of paperwork. The agent could still be required to have a letter of certification within 90 days from the state for contracting with a company but this could either be e-mailed or faxed, reducing postage.

Any consideration for the reduction in this paperwork on a company-by-company basis would be appreciated.

Thank you

George Poffenberger Jr CLU ChFC

Comments of Cavalier Telephone
on the
Final Report regarding the Study of the Regulatory Responsibilities, Policies and Activities of the State Corporation Commission
September 19, 2001

Cavalier Telephone is a facilities-based Competitive Local Exchange Carrier (CLEC) headquartered in Richmond. Currently, Cavalier has over 105,000 access lines in service and is easily the largest CLEC in the Commonwealth. It is the principal competitive company in Virginia providing its service ubiquitously to the residential market. Cavalier does this through the leasing of the "last mile" from the monopoly phone company, Verizon.

With respect to the role of the VSCC and competitive entry, the report misses the mark. Competition in the Commonwealth is reeling: customer complaints are at an all-time high; more and more competitive companies are going bankrupt; and new investments and growth have come to a standstill.

Cavalier's opinion is that competition in telecommunications is not where it should be and feels that the SCC needs to come to the conclusion that competitors are at an extreme disadvantage. The SCC needs to admit this publicly and begin a chain-of-events designed to promote competition beginning with the items listed below.

- The current process for competitive interconnection, designed by Verizon, is wholly inadequate and discriminatory. The SCC needs to address these issues in the arbitration of interconnection agreements and order Verizon to overhaul its current OSS systems. Time and time again, this system has proven it does not work, while the whole time Verizon touts "competition is great and we are doing everything we can to help it grow."
- Currently, no competitor can satisfy the SCC's Service Quality Standards as they are written today. For instance, Cavalier quotes customers 15-30 days before service can be provided, while Verizon can provide service in 1-5 days. The main reason is that competitors must rely on Verizon's OSS system. That puts companies like Cavalier at a severe competitive disadvantage. The SCC needs to effectively govern relationships between carriers and do what it is was ordered to do, and that is to promote competition in the Commonwealth.
- The SCC needs to have a fixed timetable for the handling of disputes and complaints. For instance, other state commissions have imposed fixed timetables to render a decision or handle disputes. Currently, there is no such policy or procedure in Virginia. Disputes can effectively sit at the SCC for months or even years before they may be heard or a decision is rendered. Not only does this policy harm competition, it also makes it easier for the monopoly to strengthen its grip on Virginia's telecommunications environment. Over the past two years, Cavalier has brought to this commission numerous issues in which it sought relief and consideration. To date, these issues still have not been resolved.

Cavalier appreciates the opportunity to submit comments in the hopes they will ultimately help breed a true form of telecommunications competition in Virginia and turning a monopolistic environment into one that is a benefit to the consumers of the Commonwealth. Cavalier also truly believes the General Assembly must continue to set the standard to ensure the SCC has the power, authority and appropriate direction it needs to carry out public policies now and in the future.

9/19/2001

CHRISTIAN & BARTON, L.L.P.

ATTORNEYS AT LAW

909 EAST MAIN STREET, SUITE 1200 • RICHMOND, VIRGINIA 23219-3095
TELEPHONE (804) 697-4100 • FACSIMILE (804) 697-4112
DIRECT DIAL: (804) 697-4124
EMAIL: *estephens@cblaw.com*

September 18, 2001

Senator Thomas K. Norment, Jr., Chairman
Senator Charles J. Colgan
Senator Richard L. Saslaw
Senator Kenneth W. Stolle
Delegate Harvey B. Morgan
Delegate Kathy J. Byron
Delegate Joseph P. Johnson, Jr.
Delegate L. Karen Darner
Delegate Thelma Drake
Delegate John A. Rollison
Edward L. Flippen, Esq.
Mr. Andrew B. Fogarty
Mr. William E. Fitzgerald
Mr. Robert W. Woltz, Jr.
Judith Williams Jagdmann, Esq.
Members, Joint Subcommittee Studying the State Corporation Commission
General Assembly Building
910 Capitol Street
Richmond, Virginia 23219

Re: Comments of Cox Virginia Telcom, Inc. on the *Study of Regulatory Responsibilities, Policies and Activities of the State Corporation Commission Reference: SJR 173/HJR 187 (2000)*, School of Public Policy, George Mason University

Dear Senator Norment and Members of the Joint Subcommittee:

On behalf of Cox Virginia Telcom, Inc. ("Cox"), we appreciate the opportunity to submit these comments to the Joint Subcommittee on the *Study of Regulatory Responsibilities, Policies and Activities of the State Corporation Commission Reference: SJR 173/HJR 187 (2000)* ("Study").

Cox is a Competitive Local Exchange Carrier ("CLEC") that provides telephone services to both commercial and residential customers in Virginia. The federal Telecommunications Act of 1996 (the "Act") allows CLECs to compete with Incumbent Local Exchange Carriers ("ILECs") through several means, including having access to an ILEC's network elements on an unbundled basis, purchasing telecommunications

services at a wholesale from ILECs and reselling them to consumers, and building their own facilities and interconnecting with an ILEC's network.[1] Of these methods, the Federal Communications Commission ("FCC") has recognized that facilities-based competition offers the greatest long-term benefits for consumers:

> [W]e have recognized that the greatest long-term benefits to consumers will arise out of competition by entities using their own facilities. Because facilities-based competitors are less dependent than other new entrants on the incumbents' networks, they have the greatest ability and incentive to offer innovative technologies and service options to consumers. Moreover, facilities-based competition offers the best promise of ultimately creating a comprehensive system of competitive networks, in which today's incumbent LECs no longer will exert bottleneck control over essential inputs, but will compete on a more equal basis with their rivals.[2]

Cox is a facilities-based competitor. It is one of the few facilities-based CLECs in Virginia.

Since 1996, Cox has been appearing before the SCC and working with members of its Division of Communication. Cox concurs with the Study's finding that the current SCC Judges are "knowledgeable and hard working"[3] and that the "Judges and staff are professional and well informed."[4] Cox submits this letter, not to suggest any structural changes to the SCC, but to comment on the SCC's participation in arbitrations under the Act.

A critical element to the competitive provisions under the Act is the means by which CLECs enter into interconnection agreements with ILECs. The process starts by a CLEC making a request for interconnection with an ILEC under the Act.[5] The parties then negotiate the terms of an interconnection agreement. If the parties cannot resolve all their differences, they may seek arbitration of open issues with a state commission between the 135th and 160th day after the CLEC had requested interconnection with an

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[1] 47 U.S.C. § 251(c).

[2] First Report and Order and Further Notice of Proposed Rulemaking in WT Docket No. 99-217, Fifth Report and Order and Memorandum Opinion and Order in CC Docket No. 96-98, and Fourth Report and Order and Memorandum Opinion and Order in CC Docket No. 88-57, released on October 25, 2000, ¶ 4.

[3] Study, p. 24.

[4] Study, p. 75.

[5] 47 U.S.C. § 252(a).

ILEC.[6] The state commissions, in turn, must conclude any unresolved issues between the parties not later than 9 months after the date on which the ILEC received the request for interconnection.[7] Therefore, when a state commission such as the SCC arbitrates interconnection disputes under the Act, the unresolved issues must be decided within 9 months after the ILEC receives a CLEC's request for interconnection. This was the method by which Cox was able to finalize its initial interconnection agreements with both of Verizon's predecessors in 1997.[8]

In 1999, Verizon notified Cox that it would not agree to renew the interconnection agreements without modification. As a result, Cox requested that Verizon begin negotiating the terms of a new interconnection agreement. Although these negotiations resulted in agreement on most of the terms and conditions, the parties were unable to reach agreement on every provision deemed by either party or both parties to be necessary for inclusion into an interconnection agreement. As a result, Cox filed with the SCC its Petition for Declaratory Judgment and Conditional Petition for Arbitration or Alternative Petition for Dismissal on July 27, 2000.[9] The Petition requested that the SCC issue a Declaratory Judgment that the requested arbitration of the interconnection terms and conditions between Cox and Verizon would be conducted by the SCC pursuant to § 252 of the Act.[10] However, the SCC declined to make such a declaration "as such ruling might be considered an exercise of jurisdiction under the Act and, therefore, a waiver of the Commonwealth's sovereign immunity."[11] It explained that it had "found no authority . . . that would empower us to waive the Commonwealth's constitutional immunity from suit under the Eleventh Amendment to the U.S. Constitution."[12] As a result, the SCC granted Cox's alternative request to dismiss its Petition so that it could proceed before the FCC.[13]

The SCC having declined to arbitrate the issues involving the interconnection agreement between Cox and Verizon under § 252 the Act, Cox requested the FCC take

[6] 47 U.S.C. § 252(b)(1).
[7] 47 U.S.C. § 252(b)(4)(C).
[8] *See, e.g., Petition of Cox Fibernet Commercial Services, Inc. for arbitration of unresolved issues from interconnection negotiations with Bell Atlantic-Virginia pursuant to § 252 of the Telecommunications Act of 1996*, Case No. PUC960104, Order Approving Agreement (March 17, 1997); *Petition of Cox Fibernet Commercial Services, Inc. for arbitration of unresolved issues from interconnection negotiations with GTE South, Inc. pursuant to the Telecommunications Act of 1996*, Case No. PUC 960118, Order (April 23, 1997).
[9] *Petition of Cox Virginia Telcom, Inc. v. Verizon Virginia Inc. f/k/a Bell Atlantic – Virginia Inc., for Declaratory Judgment and conditional petition for arbitration of unresolved issues by the State Corporation Commission pursuant to Section 252 of the Telecommunications Act of 1996 or alternative petition for dismissal*, Case No. PUC 000212, Order of Dismissal (November 1, 2000).
[10] *Id.*
[11] *Id.*, at 3.
[12] *Id.*, at 4.
[13] *Id.*, at 5. *See, e.g.*, 47 U.S.C. § 252(e)(5).

jurisdiction of the arbitration pursuant to 47 U.S.C. § 252(e)(5) (a subsection entitled "Commission to act if State will not act"), which the FCC agreed to do. At that point, in many respects, the arbitration process had to start again; indeed, a state commission must refuse to act before the FCC will conduct an arbitration under the Act. In addition, whereas arbitration with the SCC would have been under the statutory time deadline that would have required completion within 9 months after Verizon had received Cox's request for interconnection, the FCC ruled that its arbitrations under 47 U.S.C. § 252(e)(5) when a state commission refuses to act are not controlled by this same deadline.[14] The arbitration between Cox and Verizon is still pending before the FCC.

The United States Supreme Court has agreed to hear the issue of whether a state waives its sovereign immunity by participating in the arbitration of interconnection agreements under 47 U.S.C. § 252.[15] However, Cox respectfully suggests that the Commonwealth should not wait for that Court's determination, but rather should allow or empower the SCC to adopt the "best practice" of "arbitrat[ing] without fear of violating sovereign immunity."[16] When Cox compares its experience with the SCC in 1996 and 1997, with the current case at the FCC, Cox finds that the arbitration at the SCC was quicker and less expensive than arbitration by the FCC. Cox concurs with the Study's suggestion that "[m]ethods of circumventing the [arbitration impasse] should be sought expeditiously."[17]

Cox appreciates the opportunity to provide these comments, and hopes that the Joint Subcommittee will find them of value. Please feel free to contact me at the above phone number if you have any questions.

Very truly yours,

E. Ford Stephens

574085.1

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[14] *See, e.g., Procedures for Arbitrations Conducted Pursuant to Section 252(e)(5) of the Communications Act of 1934, as amended*, 2001 FCC LEXIS 414, ¶ 12 (January 19, 2001).
[15] *Bell Atlantic Maryland, Inc. v. MCI WorldCom, Inc.*, 240 F.3d 279 (4th Cir. 2001), *cert. granted*, 121 U.S. 2548 (2001).
[16] Study, pp. 80-81.
[17] Study, p. 81.

Dominion Comments for George Mason University
School of Public Policy
Regarding "Study of Regulatory Responsibilities, Policies and Activities of the State Corporation Commission" (SJR 173/HJR 187)
Submitted June 29, 2001

Commissioners of Energy and Telecommunications

Today various industries in the Commonwealth have undergone or are undergoing restructuring. There is a growing consensus that elements of the Commission's structure and organization need to be reexamined in light of this new environment and recent policy mandates by the General Assembly.

Two recently issued reports[1] acknowledge the changing nature of the SCC's oversight responsibility and discuss proposals for realignment of the Staff departments dealing with telecommunications and energy. Both note that supervision of these sectors is now split among five divisions, each with a director reporting to the Judges. The reports also discuss creation of a Director (or Commissioner) of Public Utilities within the staff or, alternatively, creation of separate Commissioners of Energy and Telecommunications.

SCC oversight of both the banking and insurance industries creates a precedent for this model. Both industries have undergone rapid change and increased competition. Commissioners with broad management and policymaking authority head the Staff divisions that deal with both sectors, and this structure assists these divisions in responding effectively to these new challenges.

The idea of creating additional Commissioner/Director positions to head the Staff's energy and telecommunications functions warrants careful consideration. These positions should not be formed simply by renaming or reclassifying existing director-level jobs. The Commissioners of Energy and Telecommunications should have extensive authority to supervise all Staff functions dealing with these industries and coordinate work among the various divisions. The Commissioners would simplify the regulatory environment by offering a single point of contact for many of the dealings regulated entities have with the Staff. Creation of the jobs would also give the General Assembly a focal point for its inquiries into Commission policy, procedure and regulations regarding these two industries.

The organization of the Staff divisions overseeing the telecommunications and energy sectors should also be evaluated. It may be possible to consolidate or reorganize the various divisions to streamline the Staff structure and ensure that the new Commissioners of Energy and Telecommunications have the support and supervisory control needed to manage these functions adequately.

[1] *Final Report on the Virginia State Corporation Commission,* The National Regulatory Research Institute (March 2001); *Study of Regulatory Responsibilities, Policies and Activities of the State Corporation Commission, Interim Report,* School of Public Policy, George Mason University (May 2001).

Advancing Competition and Economic Development

As the industries supervised by the Commission undergo restructuring, there has been a growing understanding that the SCC's actions have a growing impact on competition and economic development. This new understanding of the SCC's broader role received legislative endorsement during the 2001 General Assembly session with the passage of Senate Bill 1420. The legislation created a new section of the Code of Virginia which states that "In all relevant proceedings pursuant to the [Electric Utility Restructuring] Act, the Commission shall take into consideration, among other things, the goals of advancement of competition and economic development in the Commonwealth." Va. Code § 56-596A (effective July 1, 2001).

As the Commonwealth moves forward to implement the legislative mandate, it will be important that governmental stakeholders, including the SCC, the Executive Branch and the General Assembly work to achieve the policy goals of advancing competition and economic development. Consideration should be given to an enhanced Executive Branch role in providing information and analysis to the SCC. This would assist the Commission in examining the impact of pending cases on competition and economic development.

Participation by the Executive Branch in relevant SCC proceedings would likely provide a needed perspective that would benefit the Commission at it moves from regulation to competition in the electric industry.

Comments by James C. Roberts to Joint Subcommittee Studying the Regulatory Responsibilities, Policies and Activities of the State Corporation Commission

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My name is James C. Roberts. I am a partner in the law firm of Troutman Sanders Mays & Valentine and have been continuously engaged in the private practice of law in our Richmond offices since June of 1957.

In the summer of 1968, I was selected by the American Insurance Association to serve as its Virginia Legislative and Regulatory Counsel, a position I continue to hold. Thus, beginning with that date and continuing to the present, I have maintained a very active practice before the State Corporation Commission.

While at the beginning my practice before the Commission was confined to the area of insurance regulation, it was not long before it expanded into other areas falling under the Commission's regulatory jurisdiction. As a result, my practice before the Commission has included the handling of well over 100 cases in the regulated areas of insurance, banking, telecommunications and electric energy.

I have read with considerable interest the Report of the School of Public Policy of George Mason University issued in August, and ask that you permit me here to comment on two issues raised by such report.

The first such issue relates to the recommendation that you consider increasing the number of Judges from 3 to 5, to serve five year terms with one being

replaced each year. It is my sincere and strong belief that this change should not be made.

The report before you mentions "concern" having been expressed "about the perceived slow speed at which some decisions" are made. While I have no knowledge of the source of such concerns, I can tell you that my own experience has been completely to the contrary. Throughout my entire practice career I have been engaged in a litigation based practice. Likewise, my practice before the Commission has had me trying many cases in contested settings. Not once during those many experiences have I felt that the Commission was slow in arriving at its decisions. Indeed, it has always been my observation that the Commission is quite prompt in doing so.

Likewise, I disagree with the expressed "concern" that in some spheres the Commission "has been slow to implement more competitive oriented approaches to regulations." When one considers the amount of work on the part of the Commission devoted to the development of fair and effective rules covering competitive practices and efforts to educate regulated business entities and the public regarding the same, and when one considers the many necessary steps that need to be taken to ensure that the public interest is served, it is easy to understand that much thought and work goes into the process of bringing about workable transitions of this sort.

In the mid-1980s, I participated in the drafting of a statute enacted by the General Assembly to deregulate the business of long distance telecommunication service. Many of you will recall that the Commission gave its full cooperation to bringing that result about. As a consequence, Virginia was the first state in our nation to have

deregulation of such long distance service. Today, there are some 60 long distance carriers serving Virginians.

Later, as we moved into the 1990s, the Commission itself adopted and promoted an experimental plan for alternative regulation of local exchange carriers. As it became evident that the experimental plan was working, the Commission participated in the drafting of necessary legislation to empower it to adopt for local exchange carriers regulation not based upon rate of return. I also believe it worthy to note that the Commission enacted rules for local exchange telephone competition even before the Congress passed the Telecommunications Act of 1996.

Finally, I am aware that you already have before you Mr. Flippen's memorandum to Dr. Button dated June 27, 2001. Rather than repeat what he has said in that memorandum, I will tell you that I fully concur with the observations contained in the second, third and fourth paragraphs thereof.

Throughout the thirty-three years of my practice before the Commission I have been greatly impressed with the quality and dedication of its judges. They have worked well together and have given our Commonwealth the benefit of a regulatory climate that stands second to none in our nation. Rather than speeding up the process, I believe that expanding the size of the Commission will slow that process down.

My second and final comment relates to the recommendation of the report that the Commission create a new position, Director of Energy Regulation. Because of the many different factors and considerations that go into this particular regulatory area, I believe it would be desirable to have a Director charged with coordinating the activities

of those involved in that area of regulation. Thus, I consider this recommendation a good one.

I greatly appreciate the opportunity you have afforded me to make these few comments.

James C. Roberts

**COMMENTS OF WORLDCOM, INC.
ON THE**

**FINAL REPORT REGARDING THE
STUDY OF REGULATORY RESPONSIBILITIES, POLICIES AND ACTIVIES OF THE
STATE CORPORATION COMMISSION
SEPTEMB ER 19, 2001**

INTRODUCTION

WorldCom has submitted earlier comments on the Interim Report of the Joint Study Committee. WorldCom reiterates those earlier comments and provides these additional comments both to emphasize our original views of the report and to comment on this final report. WorldCom's comments will again focus primarily on the section of the report dealing with telecommunications issues, specifically Section 4D, but we will also comment on general recommendations as well.

WorldCom generally supports the final report's observations on the SCC and the recommendations. The bottom line of all these comments is that "Business as Usual" may no longer be appropriate for regulation in Virginia, given the rapidly changing environment in telecommunications.

WorldCom has specific comments on the recommendations and observations as follows:

SPECIFIC COMMENT NUMBER 1

Recommendation No. 2 states that "The SCC should remain as independent as possible from short term political pressures." (Final Report, page ii)

WorldCom does not disagree, but we strongly believe that the General Assembly should provide stronger long-term policy guidance and provide regular oversight of the SCC and its implementation of public policy.

Regulation has a powerful impact on the development of telecommunications competition in the Commonwealth. While the original intent of a constitutionally separate Commission is sound, the General Assembly can and should have a hand in

setting the policy priorities of the Commonwealth and overseeing the SCC to ensure those policies are implemented. For example, the General Assembly set forth public policy endorsing local competition in 1995. The Congress acted a year later, making local telecommunications national public policy, and giving state commissions the authority to implement the federal law. Yet, six years after the General Assembly acted and five years after Congress acted, Virginia is a long way from breaking Verizon's monopoly stranglehold of the local market.

The General Assembly should examine why this competition has not developed more quickly in the Commonwealth and make any necessary changes to the authority of the SCC to overcome problems identified. For example, the SCC has said that it does not have authority to arbitrate disputes between Verizon and competitors under the Federal Telecommunications Act, and that it does not have authority to examine or implement the structural separations of Verizon's wholesale and retail entities to prevent anti-competitive behavior by Verizon. Further, there may be issues relating to the SCC's authority to curb anti-competitive behavior by incumbent monopolies through fines and penalties. The General Assembly should examine each of these areas and give the SCC the necessary authority and direction to implement competition in the state's telecommunications industry.

SPECIFIC COMMENT NUMBER 2

Recommendation No. 3 states that "The basic principle of regulation should be to allow the market to function and only to intervene when there are demonstrable market failures that appropriate regulatory control can be demonstrated to reduce." (Final Report, page ii)

WorldCom agrees.

As important as knowing when to regulate is knowing when NOT to regulate. Unnecessary regulation is worse than simply unnecessary, it is costly for businesses attempting to operate in the Commonwealth and can have significant adverse impacts on carriers.

The corollary is knowing when regulation is appropriate or necessary. The failure to regulate when regulation is necessary can be equally bad. For example, local service in Virginia is still essentially a monopoly. Specifically, Verizon continues to control local networks that are not subject to any substantial market forces. As a result, the SCC needs to focus its attention on regulating Verizon and its local network. The lack of local competition cannot be attributed solely to "weak financial markets," "bad business plans," or a "glut in fiber capacity." It is directly attributable to Verizon's control of essential local facilities and Verizon's dual role as both chief supplier and competitor to companies like WorldCom.

WorldCom recommends that the Legislature provide additional guidance to the SCC on those areas where regulation may be necessary and those areas where regulation is not necessary.

SPECIFIC COMMENT NUMBER 3

The Final Report praises the collaborative process and performance standards for Verizon as "good ideas" but it is critical of the SCC's slow start and adversarial atmosphere (Final Report, page 75).

Again, WorldCom agrees.

Critical to a successful regulatory process is not only making good decisions, but making timely decisions. Regulatory processes that have no clear direction or end point are often of little value to new entrants who are trying to break the current monopoly status quo. We endorse the statement in the Final Report that says "Further delays in the collaborative process could benefit the incumbents and delay competition" (Final Report, page 75). We would go one step further to state that further delays will only strengthen Verizon's ability to harm competitors and keep them out of the market, thus denying consumers a choice for local telephone service.

The Final Report also states that stakeholders believe that the SCC needs to push harder to resolve disputes, and further, needs to respond more quickly to critical business needs. One comment is illustrative: "It is felt that the Commission espouses a belief in competition, but does not do all that it can to ensure competition in the Commonwealth." (Final Report, page 75).

SPECIFIC COMMENT NUMBER 4

The Final Report's Recommendation No. 24 recommends that methods should be found to address the impasse in the arbitration of interconnection agreements between Verizon and competitors.

WorldCom agrees, but we believe the recommendation should go further.

As noted previously, the SCC will not arbitrate disputes between Verizon and potential new entrants like WorldCom because of issues relating to the 11th Amendment to the US Constitution. The SCC says it lacks authority to waive sovereign immunity and be subject to suit in Federal Courts; therefore, the SCC says it lacks authority to perform arbitrations as directed by the Federal Telecommunications Act of 1996.

This decision by the SCC was unprecedented, and Virginia may be unique in the nation in this respect.

But this distinction has not been without a price. Because of this action by the SCC, WorldCom has been forced to seek redress from the Federal Communications Commission. As a result, resolution of local competition issues between WorldCom and Verizon (and by extension the potential for widespread residential local telephone competition in Virginia) have been delayed by approximately one year. Further, the rules of the road for local competition in Virginia will no longer be set by the SCC, but rather will be set by the Federal Communications Commission in Washington, DC.

WorldCom believes that the General Assembly should review this matter and consider legislation to specifically allow the SCC to waive sovereign immunity on issues relating to the implementation of the Federal Telecommunications Act. We would hope that the Final Report's recommendations would be strengthened to reflect this position.

CONCLUSION

WorldCom appreciates the opportunity to submit comments on this Final Report. These comments, in addition to the comments submitted June 29, 2001 on the Interim Report, reflect WorldCom's views on how the SCC can more effectively deal with the challenges of transforming a monopoly telecommunications market into a competitive one. We further believe the General Assembly has an appropriate and continuing role in ensuring that the SCC has the authority, resources and direction it needs to carry out these public policies.

September 19, 2001

Comments of The New Power Company
Before the Public Hearing
Of the
Joint Subcommittee. Studying the Responsibilities, Policies & Activities
of the State Corporation Commission
Pursuant to SJ173/HJ187
September 19, 2001

Honorable Senators, Delegates and Members of the Joint Subcommittee:

My name is Martha Duggan and I am the Director of Government Affairs for The New Power Company ("NewPower"). I appreciate the opportunity to submit these comments on the "Study of Regulatory Responsibilities, Policies and Activities of the State Corporation Commission" dated August 2001, and regret that I am unable to attend in person today's Public Comment forum.

The New Power Company is the first independent, national marketer of natural gas and electricity to residential and small commercial customers. We currently serve 780,000 customers in 10 states, including Virginia, where we are licensed by the State Corporation Commission as a Competitive Service Provider ("CSP") for electricity and natural gas. NewPower has actively participated in proceedings initiated by the Commission to implement restructuring legislation and offer comments here form the perspective of a new and non-traditional player on the regulatory scene in Virginia.

My comments today fall into two categories: first, observations on the workings of the Commission as we begin to restructure energy markets; second, comments on the report itself.

NewPower's experience with the Commission has been largely positive. What new energy market entrants look for in the regulatory arena is: (i) fairness, equity and efficiency in rules regarding market participation, (ii) access to regulators and staff for

guidance and clarification, (iii) ability to participate in developing rules, and (iv) processes that are not overly burdensome.

It is NewPower's observation that the Commission and Staff appreciate that the presence of new market participants like NewPower is critical if we are to successfully open energy markets to competition. Commission Staff has done an outstanding job of reaching out to companies like NewPower to encourage our participation in working groups and proceedings. Staff has been very creative in the difficult task of coordinating schedules and recognizing the extra burden of travel on companies not located in Virginia.

As a point of reference, consider the traditional utility organization with a staff of a minimum of 5 to 10 Regulatory Affairs specialists devoted to managing the regulatory relationship in one state. Contrast that organization with a typical energy marketing company with 1 Regulatory Affairs specialist (if any!) dedicated to participating in regulatory developments in anywhere from 5 to 50 states. This means that we non-traditional players must carefully allocate resources among states and proceedings, as we lack the "opportunity" to collect these types of costs from our customers. For that reason, we are grateful for Staff's initiatives that encourage our participation. Litigation or collaborative efforts that are not well-defined in scope or time schedule are luxuries that marketing companies simply cannot afford, and we appreciate the Commission's sensitivity to our situation. The longer a proceeding lasts, the more it costs to participate, the lower the savings we can offer to customers.

While the Commission and its Staff appear to be taking steps to transforming themselves into "stewards of competition," the August 2001 report appears to be lacking in certain respects. For example, the report lacks much mention of the need to address how the Commission will relate to the new market participants in as manner that will ensure that the benefits of competition, e.g., lower prices, new products, services and technology are widespread throughout the Commonwealth of Virginia. NewPower urges that this joint subcommittee not misconstrue this as a recommendation that Competitive

Service Providers become regulated entities – quite the contrary must be the case if we are to successfully open energy markets. Nonetheless, the August 2001 report is content with recommending that regulatory intervention is appropriate only where "there are demonstrated market failures that appropriate regulation can reduce." While we don't disagree with this observation, NewPower would urge that consideration be given to a more proactive role for the Commission during the transition to competitive markets. That role includes monitoring developments and ensuring that market failures are avoided before they happen. The report is correct in its observation that the rate cap in Virginia is too low to encourage markets entry in the short term. NewPower would argue that there is a role for the Commission in reviewing and recommending revisions to the current constraints in order that the benefits of competitive markets, well described in the August 2000 report, not be delayed in Virginia.

Thank you for the opportunity to comment on these critical issues.

Respectfully submitted,

Martha A. Duggan
Director, Government Affairs
The New Power Company
3102 N. 6th Street
Arlington, VA 22201
Phone: 703-312-6705
Fax: 703-524-8373
E-mail: Martha.Duggan@NewPower.com

Cascade Mountain

Property Owners Association

P.O. Box 353, 456 Cascade Trail, Fancy Gap, Virginia 24328
540-728-0679

September 19, 2001

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

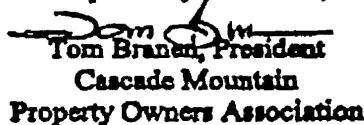
Some Observations:

- Under the present legislation, the property owners of Cascade Mountain are being required to deed the entire water system to a newly formed company and have it apply for a "Certificate of Public Convenience and Necessity" in order to continue to provide drinking water to 81 households on the mountain.
- I called the SCC to set up a meeting to discuss this and with only 2 days notice, Mr. Mark Tufaro, an assistant utilities analyst, agreed to meet with me in his office on August 24th to discuss this issue.
- I found Mr. Tufaro to be very cooperative, well versed on the subject, and eager to do what he could to help us through this process.
- I had many questions about how this transition would affect our present method of operating the water system at Cascade Mountain. The Board of Directors has provided water to the homeowners successfully for 23 years.
- Mr. Tufaro answered all of my questions in a very open and easy to understand manner. He convinced me that to comply with this directive would not be as problematic as we had originally thought.

Conclusion

I came away from our meeting convinced that the State Corporation Commission would be fair, cooperative, and easy to work with in this endeavor, not some bureaucracy that would have us beating our heads against the wall.

Respectfully submitted,



Tom Branen, President
Cascade Mountain
Property Owners Association

VCCC Comments on Final SCC Report
September 19, 2001

The State Corporation Commission is charged with representing the public interest. The public interest consists of balancing the business interest and the consumer interest. The public interest is not served if there is an imbalance between these two naturally competing interests.

Neither the final report nor the process of creating it have balanced those interests. Only the Attorney General's office represents consumers directly on the panel, and it must also consider the business interest. At none of the meetings prior to the completion of the report were consumer representatives allowed to speak, despite requests to do so. Copies of comments on the study from VCCC that were sent to the study team are attached. The study team never contacted or discussed the report with anyone from VCCC (despite repeated invitations to do so) or as far as we know, any other consumer representative.

Similarly, the SCC has been criticized for not communicating adequately with or responding to the legislature. However, over the past several years VCCC members have observed situations where one of the SCC judges repeatedly attended legislative hearings before finally being allowed to participate and other situations where SCC staff recommendations were presented but appeared to not even be considered before decisions were made.

While some recommendations in the report are supportive of consumer concerns, other consumer concerns have not been addressed in any way. Consumers are interested in the competitive market when it is fair, dependable and responsive to our needs. When there is undue market power exercised, fraud, and unfair treatment of consumers, consumers are not satisfied. A policy which demands that the there be no regulation unless there is market failure and regulation can be proven to correct the problem, does not meet consumer needs. For example, price fluctuation is technically not a market failure in economic terms. However, for a consumer it is a market failure.

Please take the time to adequately consider the wide range of consumer needs, just as you have fully studied business needs before making final recommendations in this study.

Irene E. Leech, Ph.D.
President

SCC Study
Comments from the Virginia Citizens Consumer Council
Part 2

Given Dr. Button's comments at the last meeting of the SCC Study and the lack of evidence that VCCC's concerns were addressed in the second draft of the report, this is a follow-up response. In the first response, most of the examples given related to energy. This was done for two reasons. Primarily, it appeared that the draft document was relying heavily on energy examples. Secondly, the examples given appeared to be very biased and not representative so these attempted to provide some balance.

The following are the primary concerns of the Virginia Citizens Consumer Council and suggestions where, from the consumer perspective, the report must be strengthened. The term citizen consumer is used here because business is sometimes referred to as a type of consumer. We are particularly concerned about individuals, families, and small businesses that are typically not represented by the paid lobbyist community.

1. **Overall, there is lack of evidence of adequate consideration and involvement of consumers in preparation of this report and in its recommendations.** While industry representatives were widely interviewed and consulted, that there was limited, if any, consultation with consumer leaders. Just as there are references to concerns of specific industry groups, there should be references to concerns of specific consumer groups. Although not as organized to speak as business, consumers are major constituents of the SCC.

2. It is critical to remember that the SCC has a major responsibility for consumer protection. The focus of the agency should remain independent and it should continue to attempt to balance the interests of both consumers and business. Neither party should always have an advantage as both are important for an effective market system.

3. Consumer involvement in decision making at the SCC is vital. Virginia should consider setting aside funding to assure this involvement. Some states fund a consumer advocate in their entity similar to the SCC. By using more and more informal mechanisms, the cost of involvement in SCC decisions is increasing substantially for consumers. These time and money costs are making it increasingly difficult to assure adequate and consistent consumer involvement. Continuing provision of webcasts and other means of citizen participation is important. The SCC is a leader among state government agencies in providing this mechanism and in its website development. Written publications and staff presentations at public meetings should also continue. The SCC should also continue its cooperation with and active communication with other state agencies.

4. The report indicates that the SCC lacks an ethos of competition. We have found that the SCC aggressively supports competition, even making decisions to assist the competitive market that disadvantage consumers. There are situations where competition does not adequately serve all consumers.

5. The current structure with three judges elected by the General Assembly for six-year terms on a rotating basis works. Under no conditions should the SCC be made more political or more pressured to make decisions with political demands being of utmost importance. One clear advantage of the current independent status of the SCC is its ability to look at issues far less political pressure than must decision makers in other branches, especially the legislature.

6. The report states that the public interest has changed in recent years. Certainly, the specific topics of interest have changed, but the underlying concerns have not. Consumers continue to want to get the best price for reliable products and services, information and education so they can fairly participate in the marketplace, a marketplace free of fraud and scams. Consumers are interested in neither regulation nor competition for their own sakes. They are interested in the outcome. On that level, specifics and political emphases have changed over time, but the real public interest has not.

7. Consumers support use of alternative dispute mechanisms IF they do not systematically disadvantage citizen consumers AND as long as the process does not reduce transparency or involvement. Similarly, streamlining collaborative processes should not be done at the expense of reducing or not providing appropriate citizen consumer involvement. . Any action that happens behind closed doors and which fails to include all affected parties in its development, is suspect and will lead to problems.

8. Along with suggesting that the SCC develop performance assessment procedures and measures, the report should recognize that some important features are not easily or cheaply measured and resources must be provided for these actions.

9. The report should recognize multiple possibilities for the increase in customer complaints in the telephone area. Difficulty of understanding bills is but one. Other problems consumers have regularly experienced include those caused by lack of cooperation from competing companies. When providers really do not want to compete, but want to be unregulated monopolies, they can make it difficult for consumers and their competitors.

10. The energy examples are unfairly biased, often do not represent what has happened recently in the marketplace and do not adequately represent the situation facing Virginia consumers. Energy references need to balance recent occurrences and realities in the current consumer marketplace so they are not so slanted toward the positives of energy deregulation. Please explain how Virginia can experience lower energy rates by 2010 when our rates are currently below the national average and the states with whom we will compete have much higher rates.

11. Although no problems have been reported with the current administrative arrangement which has no formal separation of the three judges and the staff , and the recently adopted rules attempt to clarify the procedures to assure that they are fair, concern has been raised. It has been said that this does not "look right." With all due respect to the individual involved, it is hard to criticize this arrangement when one study commission member is the key industry representative in a critical active case at the SCC. Many would say that this situation doesn't "look right." Specific instances where the current SCC administrative arrangement has caused problems should be the impetus to change rather than unspecific perceptions – unless all decisions concerning all related matters, including study commission membership, are made with the same standard.

Once again, VCCC continues to be willing to discuss these comments and other issues with the study team. I can be reached at 540-268-5373 between now and August 20 and at 540-231-4191 during the day thereafter. My email address is ileech@vt.edu.

Irene E. Leech, President

SCC Study
Comments from the Virginia Citizens Consumer Council

The State Corporation Commission plays a critical role for citizens of Virginia. Its independence from other parts of state government, and particularly its non-political structure are keys to its value. In general, the SCC stands between citizen consumers and businesses, assuring that there is a fair balance of power between these critical players in our economy. Often the needs and desires of these players conflict, and the SCC must balance the public good. Sometimes their decisions and actions will please consumers, sometimes business, sometimes both, other times neither, and that is to be expected.

The Virginia Citizens Consumer Council (VCCC) does not always agree with the SCC in its actions. In the fairly recent past, we appealed a SCC decision to the State Supreme Court and won on behalf of consumers. However, we believe in the critical role of the SCC and do not support changes that could affect the Commission's ability to impartially balance the needs of citizen consumers and business or that would make politics more central to its operation.

These comments will address VCCC's response to the draft report and suggestions for areas where, from the citizen consumer perspective, it could be strengthened. The term citizen consumer is used here because business is sometimes referred to as a type of consumer. We are particularly concerned about individuals, families, and small businesses that are typically not represented by the paid lobbyist community.

1. It is critical to remember that the SCC has a major responsibility for consumer protection. Businesses will not be successful and competition does not work when some businesses take advantage of consumers and of other businesses. There are times when the business benefit conflicts with the best solution for citizen consumers. We consider the current energy deregulation effort as one where this is true. Because Virginia's fuel and overall energy production costs are comparatively low, business is eager to change as quickly as possible to a situation where they can sell power to anyone. Knowing that our energy prices are currently comparatively low and that sellers want to make as much profit for their shareholders as possible, citizen consumers are concerned that the energy available in Virginia will soon increase in cost and would prefer to delay deregulation.

Business has been vocal about perceived slowness of SCC implementation of deregulation. However, consumers believe that it is happening far faster than is prudent, especially given the facts that in states that have deregulated so far (which all had much higher energy prices than Virginia when they began), prices have generally gone up rather than down. Even in Pennsylvania, a state often cited as one where energy deregulation is a success, rural consumers do not have a choice of energy providers and some providers have already failed. These realities concern consumers.

Some suggest that Virginia's pilot programs have not been successful because there have not been sufficient numbers of consumers participating. VCCC believes that the primary problem is that Virginia's prices are lower than the national average and that competitors cannot make a profit at those rates. We believe that we have low rates, dependable power, reasonable reserves and a good mix of fuels because the SCC has done a good job in the past. There are many unresolved issues concerning the way that FERC will operate and whether deregulated markets can really work. Virginia does not need to experience a market failure, as some other states have, and the deregulated market is still largely an untested experiment nationwide. Currently, Virginia is the ONLY state still moving forward with energy deregulation. All other states in progress, as we are, have stepped back and are waiting to assure that it should be done. Thus, IF the SCC is moving slowly, VCCC believes that is prudent action. The American governance system is set up to provide checks and balances and the current SCC structure allows it to provide a check and balance to the politically motivated legislative environment. In the long run, politically appropriate decisions are not always best for the overall well being of society (both economically and socially).

2. The report addresses several concerns of citizen consumers, including involvement of them in processes and provision of information and education to them. While the staff at the SCC are generally quite helpful, the processes used are often expensive in terms of both time and money resources for consumers. Some states provide financial support to ensure citizen consumer participation. Virginia could improve its consumer friendliness by taking such action. Most citizen consumers volunteer their time and resources to participate and there are limits to their ability to donate these resources. There is a need to increase the staff and funding for the consumer division of the Attorney General's office and for SCC staff. Another valuable step would be creating a consumer advocate within the SCC.

As the first part of state government to make web casts of hearings available to anyone in the state, the SCC is clearly a leader among state agencies. It should be encouraged to continue making such efforts to provide transparency and involvement for citizens at low to no cost to consumers.

Parts of the SCC have excellent written materials, websites, etc. to provide information and education to consumers. The largest citizen education effort ever is underway for energy choice. These are critically important and should be expanded. Centralized, effective telephone hotlines and other strategies should become more available and visible. Technology provides outstanding opportunities for the SCC to take the lead in providing accurate, current, easy to access, understandable and useful information that will allow citizen consumers to make the best selections among increasingly technical and diverse options. The SCC should continue to collaborate with agencies such as the Office of Consumer Affairs.

3. The report indicates that the SCC lacks an ethos of competition. Through VCCC interactions with the SCC in recent years, we have not found this to be true. We have found that the SCC fully supports competition – to the extent of making decisions, such

as the recent decision to allow consumers to opt-out of information sharing among energy suppliers rather than require the more consumer privacy protective opt-in action. When the Energy Education Committee first met, the Judge was VERY clear that making competition work is THE goal of the effort. We cannot provide any recent examples of situations where the Commission has approached a problem from a regulation first perspective.

4. The current structure with three judges elected by the General Assembly for six-year terms on a rotating basis works. There is no evidence that increasing the number of judges to five would make decisions/actions occur more quickly. The nature of the decisions/actions made requires care and involvement of many parties. The report notes several areas where staffing levels are low and where staff turnover is greater than is efficient. Possibly the problems found could be resolved with increases in staff, salaries and benefits, and/or other actions. Clearly, increasing the number of Commissioners from 3 to 5 would increase costs that would have to be borne by both business and consumers. These would be expensive additions. Other actions are more needed by consumers and are more cost effective.

The current selection process for Commissioners appears to be relatively bi-partisan and apolitical. The newest appointee was a Republican selected during the time when Democrats controlled the legislature. Electing a Commissioner each year would likely place more political pressure on the SCC and would not be a wise change.

The SCC deals with very complex issues. The experience and knowledge that each Commissioner builds over time is critical to the SCC's success. The current system where each Commissioner takes the lead for certain areas is effective. Should there be annual or even two or three-year rotation of this leadership, Virginia would lose valuable resources and increase costs. Since these appointments are reviewed every six years, there is opportunity for the legislature to influence the SCC, but there is less likelihood of the negative effects of politics on the Commission.

5. The report states that the public interest has changed in recent years. Certainly, the specific interests have changed, but the underlying concerns have not. Consumers continue to want to get the best price for reliable products and services, information and education so they can fairly participate in the marketplace, a marketplace free of fraud and scams. Consumers are interested in neither regulation nor competition for their own sakes. They are interested in the outcome. On that level, specifics and political emphases have changed over time, but the real public interest has not.

6. There is movement to alternative dispute resolution in many aspects of life. Consumers support this, as long as the ADR does not systematically disadvantage citizen consumers and as long as the process does not reduce transparency or involvement. For some issues, such as determining locations for rail lines, power plants, and gas lines, it is critical that communities and citizen consumers have adequate involvement. Less formal procedures are wonderful when they increase involvement but are problematic when they do not. Similarly, streamlining collaborative processes should not be done at the expense

of reducing or not providing appropriate citizen consumer involvement. Any action that happens behind closed doors and which fails to include all affected parties in its development, is suspect and will lead to problems.

7. The report suggests that the SCC develop performance assessment procedures and measures. This is a useful suggestion. However, care must be taken to recognize that all important features are not easily or cheaply measured and resources must be provided for these actions.

8. As noted on page 38 of the draft report, many citizen consumers are concerned that actions at the state and national level that are dismantling steps taken as a result of financial crises of the Great Depression, are being done for the wrong reasons. Care must be taken to assure that Virginia does not swing too far in its efforts to refresh its decisions.

9. The draft report indicates that the increase in customer complaints in the telephone area could be caused by difficulty of understanding bills. Other problems consumers have regularly experienced include those caused by lack of cooperation from competing companies. When the "old" company cuts service off before the "new" one starts it, consumers become frustrated and this is often not a problem caused by the consumer. When providers really do not want to compete, and possibly lose customers, they can make it difficult for consumers.

10. On page 73 of the draft document there is a reference to the "Attorney Generals Virginia Citizens Consumer Counsel." Possibly there is a typo, but the idea of systematically and representatively involving citizens across the Commonwealth is important.

11. Were the consumers and academic experts who were involved in the CAEM project representatives of the citizen consumer community? If not, this needs to be noted.

12. The energy section seems slanted toward the positives of energy deregulation and seems to lack balance of the realities that have occurred or could occur for citizen consumers. Although Virginia will be the first comparatively low cost state to deregulate, and our program continues in the current environment where all others have slowed or stopped, Virginia is not described as a leader, but as being middle of the pack. Clearly, Virginia is taking a tremendous leadership role nationally and is far ahead of the position described. Traditionally slow and careful, Virginia is moving with unprecedented speed toward the deregulated marketplace. Also, in the final report, please explain how Virginia can experience lower energy rates by 2010 when our rates are currently below the national average and the states with whom we will compete have much higher rates.

13. VCCC believes that recommendation 27 is not needed. The SCC is clearly supporting competition (e.g. as described above) and we see no sign that failure of competition will become a self-fulfilling prophecy.

14. Recommendations 28-29 do not follow logically from the text. They appear without discussion or justification. What else could the SCC have done to foster more pilot programs? Only Dominion Virginia Power's was even marginally successful. The SCC has moved to quickly increase the number of consumers having access to choice in a bid to increase the critical mass available to competitors. That is what potential competitors said was lacking. Recommendation 29 was not discussed at all in the body of the report.

VCCC will be glad to discuss these comments and other issues with the study team.

Irene E. Leech, President

CHRISTIAN & BARTON, L.L.P.
ATTORNEYS AT LAW

909 EAST MAIN STREET, SUITE 1200 • RICHMOND, VIRGINIA 23219-3095
TELEPHONE (804) 697-4100 • FACSIMILE (804) 697-4112
DIRECT DIAL: (804) 697-4135 EMAIL: *epetrini@cblaw.com*

September 18, 2001

Senator Thomas K. Norment, Jr., Chairman
Senator Charles J. Colgan
Senator Richard L. Saslaw
Senator Kenneth W. Stolle
Delegate Harvey B. Morgan
Delegate Kathy J. Byron
Delegate Joseph P. Johnson, Jr.
Delegate L. Karen Darner
Delegate Thelma Drake
Delegate John A. Rollison
Edward L. Flippen, Esq.
Mr. Andrew B. Fogarty
Mr. William E. Fitzgerald
Mr. Robert W. Woltz, Jr.
Judith Williams Jagdmann, Esq.
Members, Joint Subcommittee Studying the State Corporation Commission
General Assembly Building
910 Capitol Street
Richmond, Virginia 23219

Re: Comments of the Virginia Committee for Fair Utility Rates and the Old Dominion Committee for Fair Utility Rates on the *Study of Regulatory Responsibilities, Policies and Activities of the State Corporation Commission Reference: SJR 173/HJR 187 (2000)*, School of Public Policy, George Mason University

Dear Chairman Norment and Members of the Joint Subcommittee

On behalf of the Virginia Committee for Fair Utility Rates and the Old Dominion Committee for Fair Utility Rates, we appreciate the opportunity to submit these comments to the Joint Subcommittee on the *Study of Regulatory Responsibilities, Policies and Activities of the State Corporation Commission Reference: SJR 173/HJR 187 (2000)* ("Final Consultant Report" or "Report"). The Virginia Committee for Fair Utility Rates ("Virginia Committee") consists of 19 of Virginia Power's large industrial customers, and the Old Dominion Committee for Fair Utility Rates ("Old Dominion Committee") consists of 10 of AEP-

Virginia's large industrial customers.[1] Both the Virginia Committee and the Old Dominion Committee routinely participate before the State Corporation Commission ("SCC") in rate and regulatory matters, and they have done so for many years.

I. INTRODUCTION AND SUMMARY

The Report contains several worthwhile recommendations. It also contains recommendations, however, that would require major changes in the SCC's structure and operations that cause the Committees concern. In particular, the Report recommends that the "notion that the number of Judges should in fact be increased to five, with one being replaced each year, should be seriously considered." (Report at ii) As the Report recognizes, Article IX, Section 1 of the Virginia Constitution requires Commissioners to serve a term of six years, so the proposal to reduce their terms would require an amendment to the state's constitution.

The Report also recommends that the SCC create a "Directorate of Energy" that would embrace the regulation of natural gas, electricity and water, with the intention of "isolat[ing]" the role of an "overall Director of energy" [sic] from the roles of the divisions now separately responsible for gas and electricity regulation.

The Report recommends that the "structure of regulation in Virginia has stood the test of time well and change should only be undertaken in the light of *serious long term problems*." (Report at i; emphasis added) The Committees agree with this recommendation. The Joint Subcommittee should make recommendations for major changes in the SCC's structure and operations only if it determines that clear and convincing evidence requires such changes.

The Report, however, does not reveal "serious long term problems" or clear and convincing evidence that would warrant the recommendations for increasing the number of Commissioners and reducing their terms, and for creating an "Energy Directorate," as described above.

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[1] The members of the Virginia Committee are: Abbott Laboratories; Alcoa, Inc.; Anheuser-Busch, Inc.; Canon Virginia, Inc.; E.I.du Pont de Nemours & Co., Inc.; Ford Motor Company; General Motors Corporation; Honeywell; International Paper; Nabisco Brands, Inc.; National Welders Supply (Chesterfield); Newport News Shipbuilding & Dry Dock Co.; Praxair, Inc.; R.R. Donnelley Company & Sons; Sentara Norfolk General Hospital; Smurfit-Stone Container Corporation; United States Gypsum Company; Wayn-Tex, Inc.; and Westvaco Corporation. The members of the Old Dominion Committee are: Celanese Acetate, LLC; Corning Incorporated; Dan River Mills; Glad Manufacturing Company; Georgia-Pacific Corporation; Goodyear Tire & Rubber Company; Grief Bros./Virginia Fibre Corporation; Lorillard, Inc.; R. R. Donnelley; and Rock-Tenn.

II. DISCUSSION

The recommendation in the Report for the creation of an Energy Directorate would add cost and another layer of bureaucratic reporting, thereby potentially complicating decision-making in the energy area, but it is not clear that the current structure, in which the Energy Regulation Division coordinates with other divisions with particular expertise in accounting, economics and finance (*i.e.*, the Division of Public Utility Accounting and the Economics and Finance Division) is ineffective in assisting the SCC in making policy on electric, natural gas, and water issues. In any event, the Report reveals no serious long term problems that would warrant such a change.

As to the proposal to increase the number of Commissioners from three to five, the Report suggests that such an increase "may" reduce "perceived difficulties" described in the report. (Report at 25) Those "perceived difficulties" appear to relate to the speed of decision-making and the SCC's commitment to competition. Specifically, the Report mentions the "perceived slow speed" with which "some" decisions are arrived at, although it acknowledges that it is difficult to assess the "validity" of this suggestion.

Parties in SCC proceedings are free to seek expeditious treatment, and, in appropriate circumstances, the SCC routinely grants such treatment. While there doubtless are circumstances when individual parties disagree with SCC rulings on such issues in a particular case, the Committees are not aware of undue delays in SCC proceedings.

The Report also suggests that "in some spheres" the SCC has been slow to implement more competitive [sic] oriented approaches to regulation." (Report at 24) In particular, the Report acknowledges an "argument" that, with respect to price caps for electricity, "there is the need to protect the public from excessive conservatism" during changing times (Report at 25), and, in fact, the Report appears to raise questions about the existence of price caps, which, it suggests, are "too low to encourage market entry in the short term." (Report at 96)

The existence of price caps under the Virginia Electric Utility Restructuring Act is, of course, the result of a comprehensive *legislative* enactment for restructuring the industry, not the result of a Commission order. The Restructuring Act, in turn, reflects a careful, and, the Committees believe, appropriate balancing by the General Assembly of the need to move toward a more competitive environment while protecting electric customers and utilities during the transition to that environment. The Committees do not believe that Virginia's economy or its consumers would be well served by removing the

price caps prior to their expiration or termination, as provided in the Act. In any event, such a change would require an amendment to the Act.

The SCC has voiced concern from time to time about the implications for the Virginia retail electricity market, which is regulated by the SCC, of a lack of sufficient competition (*i.e.*, the potential for the exercise of market power) and price volatility in wholesale markets, which are regulated by the Federal Energy Regulatory Commission ("FERC"). Recent experience in other jurisdictions has dramatically illustrated the consequences for states and for the rates and service of their retail customers of flawed wholesale markets. The Committees share those concerns and find no fault with the SCC for expressing them. Expressions of concern about market power in the wholesale market hardly reveal a *lack* of commitment to retail competition and may reasonably be interpreted as demonstrating precisely the opposite.

The Report suggests that an increase in the number of Commissioners would "share the burden more widely and potentially allow for a greater breath [sic] of expertise to be brought to each case." (Report at 25) While any increase in the number of Commissioners, almost by definition, would, in theory, increase the potential breadth of expertise (and so would any increase above five, to, say, seven or more), however, an increase in the number of Commissioners from three to five also may complicate and delay decision-making as more Commissioners strive for consensus. There are other ways, of course, to enhance the expertise available to the decision-making process (such as, for example, increased use of outside consultants). The breadth of expertise among the current Commissioners, in any event, does not appear to present a serious long-term problem. On the contrary, the Report acknowledges that the current Commissioners themselves "are seen as knowledgeable" and that they have attracted "[l]ittle criticism." (Report at 24)

The Report also argues that an increase in the number of Commissioners from three to five, and a limitation on their terms to five years, would allow for the annual "introduction" of individuals by the General Assembly who "would reflect a bias towards [sic] the more pressing shorter term issues without impeding longer term stability." (Report at 25) As the Report recognizes, however, "a largely politically independent SCC" is "generally [a] well received idea. " (Id.) The annual addition of a new Commissioner (or the annual legislative review of sitting Commissioners), by making the composition of the SCC an annual subject of debate in the General Assembly, is much more likely to politicize the SCC than the current, typically biennial nomination and election process. There is no suggestion, moreover, that the SCC is insufficiently sensitive to "shorter term" issues. On the contrary, the Report seems critical of an excessive SCC concern with the short-term impact of price caps.

III. CONCLUSION

In sum, the Report does not reveal serious long-term problems in the SCC's regulation of the electric industry, or provide clear and convincing evidence, that would warrant the recommendations for significant restructuring of the SCC described above. Virginia now stands at the very threshold of the opening of competition in its electric market. Full customer choice is scheduled to commence for most incumbent electric utilities on January 1, 2002, and it will proceed faster, due to SCC action, than certain of the utilities have advocated. A better approach would be to await the further development of competition in the electric market in Virginia and in other jurisdictions, including the wholesale markets, before considering the significant steps, described above, to restructure the SCC.

We hope you find these comments helpful, and we would be happy to answer any questions that they may cause. Please feel free to contact me at the above phone number or my colleague, Louis R. Monacell (804-697-4120) with any questions.

Very truly yours,

Edward L. Petrini

cc Louis R. Monacell, Esq.

#573670

Public Comment

November 19, 2001 Meeting

COMMONWEALTH *of* VIRGINIA

Office of the Attorney General
Richmond 23219

Randolph A. Beales
Attorney General

900 East Main Street
Richmond, Virginia 23219
804 - 786 - 2071
804 - 371 - 8946 TDD

November 19, 2001

The Honorable Thomas K. Norment, Jr., Chairman
Members, Joint Subcommittee Studying the State Corporation Commission

Re: Report of the School of Public Policy, George Mason University

Dear Senator Norment and Subcommittee Members:

On behalf of the Division of Consumer Counsel ("Consumer Counsel"), within the Office of the Attorney General, I am providing these comments on the Report of the School of Public Policy of George Mason University, dated August 2001 ("Report"). These comments emphasize four points.

First, Consumer Counsel agrees with the Report's overriding conclusion – that is, the State Corporation Commission ("SCC") should continue to have responsibility over the sectors it currently regulates. (Report at 22-23.) The Report sees no reason to change that, and neither do we.

Second, the Report recommends creating a Directorate of Energy, which would encompass electricity, natural gas, and water. (Report at 27-28.) On this issue, Consumer Counsel agrees that it is appropriate to have one person, with expertise and authority over these areas, to coordinate policy and to serve as the primary point of contact.

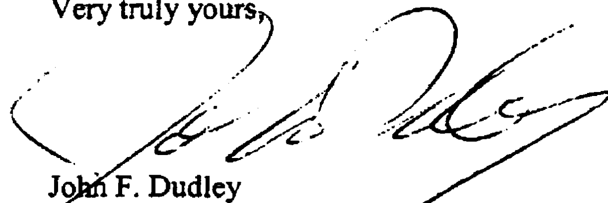
Third, the Report notes that one of the most effective forms of consumer protection is good information. (Report at 23.) Accordingly, Consumer Counsel agrees with the Report's conclusion that the SCC should continue to collect relevant data. (Id.) We also agree that there should be a continuing review of data collection requirements. For example, as industries evolve, certain data collection may become unnecessary – and the need for new types of data may arise. We simply need to ensure that any data collection burden remains warranted.

Finally, the Report appears to suggest that regulation is only needed after there is a demonstrable market failure. (Report at 23.) We recognize that markets need to be given a chance to work. Consumer Counsel is concerned, however, with an approach

that may wait until consumers are harmed before taking action. This is an area where balance is needed. For example, the Virginia Electric Utility Restructuring Act recognizes the need for, and includes, consumer protections as we transition to competitive markets. The Commonwealth should continue to ensure that consumers are protected as competition evolves.

Consumer Counsel appreciates the opportunity to make these comments.

Very truly yours,



John F. Dudley
Senior Assistant Attorney General & Chief
Insurance and Utilities Regulatory Section

cc: Judith Williams Jagdmann
Deputy Attorney General

Joint Subcommittee Studying the Regulatory Responsibilities, Policies and Activities of the State Corporation Commission

SJR 173/HJR 187 (2000)

VIRGINIA ASSOCIATION of FAMILY and CONSUMER SCIENCES

Statement to the SCC Study Committee

The Virginia Association of Family and Consumer Sciences (VAFCS) is a 308 member association of professionals whose mission is to effect the optimal well-being of families and individuals. Our members are located across the Commonwealth and we work in business, secondary and college teaching, extension and as community volunteers.

The State Corporation Commission provides a vital role in answering consumer questions about insurance, utilities, and financial institutions. They have proven to be a very reliable source of resources and critical information that impacts on the economic welfare of Virginia families and professionals working closely with consumers.

The SCC website and publications make timely information available to many consumers and professionals across the state. They are recognized as a neutral and unbiased source. The Energy Choice Program is just beginning but it is clear that it will be very helpful to consumers as we move to the deregulated energy market.

The SCC has earned the respect and proven to be a reliable and beneficial agency for our membership. We see them as a vital and useful part of state government. They clearly and fairly address complicated issues of public concern ranging from insurance products to fuel costs and operating structure.

VAFCS also depends upon the SCC to assure that consumers are fairly represented as regulatory decisions are made. They attempt to balance the interests of consumers and business so that the public interest is served, an extremely difficult task.

VAFCS finds the State Corporation staff, educational literature, website and other resources useful and critical for consumers in today's quickly changing marketplace.

/s/ Doris Trant
President

/s/ Judith Midkiff
Executive Administrator

November 19, 2001

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Webmaster: Rob Harris (rharris@leg.state.va.us)

Joint Subcommittee Studying the Regulatory Responsibilities, Policies and Activities of the State Corporation Commission

SJR 173/HJR 187 (2000)

VIRGINIA CITIZENS CONSUMER COUNCIL

Statement to State Corporation Commission Study Committee
November 19, 2001

The Virginia Citizens Consumer Council appreciates this opportunity to address the SCC Study Committee. We believe that the SCC plays a critical role for consumers that was not adequately addressed in the GMU study.

The SCC is charged with representing the public interest. That means that it must balance the business and consumer interests. Sometimes one or the other or even both groups will naturally be dissatisfied with SCC decisions. That is to be expected.

This study has appeared to focus primarily on the business interest and to weighing the balance more favorably toward business. Consumers are very concerned about the potential damage that could occur.

It is imperative that the consumer interest be adequately represented whenever decisions are made at the SCC. Sometimes the Attorney General's Office represents consumers at the SCC but that office does not have sufficient resources to participate in every case that affects consumers. Also, that office must weigh the needs of all consumers - not just residential and sometimes those needs conflict.

Occasionally, a consumer group such as VCCC participates in processes at the SCC. However, we do not have the magnitude of resources necessary to always participate. We are volunteers - contributing our time and expenses to participate. The recent energy deregulation decisions are an excellent example of the challenges volunteer consumer groups face. Although we were invited to participate in the process related to billing, we did not have a person who could commit a day or more a week from January through March. It is unlikely that we would ever have someone who could do that, but it was especially not possible during a time when the legislature was in session.

Over the last few months, a number of cases have been heard related to energy deregulation. VCCC planned to participate in two but found it only possible to do one. The use of informal negotiations in an attempt to reduce or avoid a formal hearing meant that our participation costs were significantly higher than costs of previous cases. Although our attorney agreed upon a reduced rate and limited his participation to the most critical segments of the hearing, the case exceeded our anticipated budget before the hearing began. Because participants must provide copies of materials to all other participants and there were a number of participants, there were also very high copying and mailing costs.

Webcasts of hearings have allowed consumer participants to follow the progress of hearings without the necessity of actually being in Richmond and in the courtroom. Innovations such as these help reduce participation costs and are extremely helpful. It will be wonderful when more of state government adopts this method of doing business so that the pubic can be more fully involved.

From time to time it has been suggested that Virginia consider ways to assure that the consumer interest is always represented. Some states do this by funding a consumer advocate. Another alternative is providing intervener funds for established consumer groups so that they can participate. Either of these options could enhance consumer participation.

The consumer education and information efforts of the SCC are important and well done. The consumer insurance publications are thorough and are kept current. They are readily available for consumer use.

The Energy Choice program is an example of a top-notch, cost effective consumer education program. It should position consumers to function more effectively and help the competitive marketplace work more quickly.

SCC staff are responsive, knowledgeable and fair .They provide requested information in a reasonable time and are professional. They appear to fairly balance the interests of consumers and business as they attempt to represent the public interest.

Any changes made at the SCC should not hinder, limit or reduce the priority of consumer friendly actions and activities that currently exist. With their 800 telephone numbers, information provided through publications, internet resources and staff, and webcasts of hearings, the SCC is currently the segment of state government that provides tremendous support to consumers.

Because it is critical that consumers be adequately represented in decisions made at the SCC, the most important change that this study committee could recommend would b~ funding consistent consumer participation.

Irene E. Leech, Ph.D.
President

VCCC Office
P.O. Box 12460
Richmond, VA 23241
804-344-4321
email-VCCC@aol.com

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Webmaster: Rob Harris (rharris@leg.state.va.us)

Public Comment

October 22, 2002 Meeting

"David G Hutchison, Sr."
<DGHutchisonSr@cvalink.com>

09/18/2002 09:33 AM

To: <awade@leg.state.va.us>
cc:
Subject: SCC

Senator Thomas K. Norment
Subcommittee Chairman

9-18-02

In responding to the newspaper article today (Panel request input on how SCC operates). I would like to express a few comments. My personal experiences with the SCC have be from the consumer standpoint. Mostly with the Verizon Telephone Company.

I recently complained that SCC has become very insensitive to the citizen and more receptive to the corporate entity. In the name of de-regulation the only land line telephone service in my area is Verizon. In a recent letter from Tammy Wilson of the SCC, saying in effect that's tough they have nothing to do with the fact there is no competition. Verizon just freely ups the monthly basic phone rate, if you don't like it just cut it off attitude!! If necessary one day I will.

I purpose a regulation to control basic service rate increases to protect the elderly and lower income individuals. The land line service is part of the infrastructure and should be protected . Just like the highway, electric service,etc.

Thank You
David G. Hutchison, Sr.

Urchie B. Ellis
Attorney at Law
7900 Marilea Road
Richmond, Virginia 23225
Home Phone 804-272-5923

September 23, 2002

To all Members of the Joint Subcommittee to study the Regulatory, Responsibilities, etc. of the SCC (SJR 45) Senators Norment (Chairman), Colgan, Saslaw, and Stolle, and Delegates Morgan, Byron, Johnson, Darner, Rollison , Drake

The Subcommittee had meeting on Sept. 17, and indicated that it would like to have comments from the public as to how the Commission could be improved.

As a lawyer who has practiced before the SCC fo some years, and been substantially involved in the legislative hearings on electric deregulation, and has participated extensively in the Virginia Power Functional Separation case before the SCC, and has been a close observer of SCC matters generally, I would like to submit the following comments:

(1) The SCC is an excellent organization and functions quite well. There is an acute need to encourage and support the full authority of the SCC. It has done a good job of protecting the public for 100 years.

(2) The complaints you may hear probably come from those vested interests who are regulated by the SCC and would like to diminish the SCC authority----in order to benefit the vested interests. Frequently the losers in cases are unhappy with the court, or commission, or the other lawyers, etc.

(3) These vested interests who want to profit from reducing the authority of the SCC have resources to hire extensive lobbyists and lawyers, and make large presentations.

(4) The public---the real public----does not have much resources, and has few voices to represent it in any way. It does not have high paid lobbyists and lawyers, or other funds, to promote the public views.

(5) There should be no more meddling with the SCC authority. It is needed !!!

Respectfully yours,

Urchie B. Ellis

cc: Amigo R. Wade, Legislative Services
Please distribute copies to the Subcommittee members.

September 26, 2002

Amigo R. Wade, Esquire
Division of Legislative Services
General Assembly Building
910 Capital Street
Richmond, Virginia 23219

Dear Mr. Wade:

My response is to an article in the September 18 edition of The Times Dispatch regarding the State Corporation Commission study. I have been hoping since 1993 that there might be, some day, an opportunity to relate my very disappointing experience with the Commission regarding an unfair and, I believe, illegal act by Virginia Power. I was a 45% partner in Peak Power Production Company which was formed with two financial partners from Chicago to develop some Schedule 19 generation plants in Virginia. I was also the sole owner of I.P.S. Group, Inc., a Richmond based construction/engineering company which began business in 1980. Our arrangement was that Peak Power would own the generating plants and I.P.S. group would design, build and operate the plants under contract. Peak Power would sell the electricity to Virginia Power under the Schedule 19 agreements over a 30-year period. I began talking with Virginia Power in early 1992 about securing several contracts and asked how many agreements we were allowed. I stated we would like to build ten 3-megawatt plants. The man, whose name I do not recall and he retired during the year, said they had a total of 200 megawatts available for the year and that there was absolutely no problem with our having 30 megawatts. I told him that we would like to do ten plants a year for a few years. I received a letter from Virginia Power dated June 8, 1992 stating that ten contracts were available to us. Events followed as listed below:

- Our attorney prepared contracts for ten 3-megawatt plants using Virginia Power's standard form which had been approved by the Commission. He had prepared several contracts previously for other clients and Virginia Power had accepted them without hesitation. I signed the contracts for Peak Power and had them hand delivered to the utility on July 27, 1991. A few days later our attorney called and said that Virginia Power had called him and stated that they preferred to originate the documents in their office. I asked if he had any problem with this and he said he did not, that the same standard form would be used. I asked that he have them proceed. I believe now this was a delay tactic. I received a call several days later from our attorney and he said the contracts for the ten plants were ready for our signature. I went to Virginia Power's downtown office on a Friday, in August I believe, and signed ten documents. I was told they would be executed and ready for pickup on the following Monday.

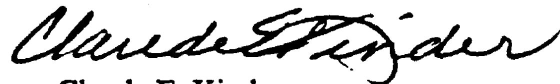
* On Monday, our attorney called and told me that Virginia Power had informed him that they were not going to execute the agreements and that they were closing down the program. Virginia Power had not, and did not *for several weeks*, request that the State Corporation Commission approve the closing down of the program. Since the program was sanctioned under PURPA, I would assume that PURPA's approval would also be required. Our attorney advised that an appeal to the Commission was appropriate. We and four or five other parties caught in this unfortunate situation filed appeals and hearings began in October, I believe, and continued for several days. It appeared that the commissioners focused on issues related to the details of the proposed plants such as size, location, equipment used and heat rates rather than on Virginia Power's failure to fulfill its obligations under the Schedule 19 program. The ruling issued in early 1993 favored Virginia Power by a 2-1 vote. The dissenting opinion written by Judge Moore who had been on the Commission a very short time, stated, and I paraphrase, " Virginia Power not only acted improperly, they broke the law." As I recall, Virginia Power offered us contracts which required longer operating hours at substantially lower rates. I am certain that a copy of the order is on file at the Commission for your review. By the way, this program was reviewed by the Commission in January 1992 and Virginia Power consented to its being continued without modifications. Six months later, they reneged and the Commission backed them.

* We filed a lawsuit in District Court but after spending more than $50,000 in legal expenses for the hearings and wasting 12-15 months of time, I realized that Virginia Power could outspend and outwait us, and we accepted a settlement of $750,000 for five contracts. They apparently believed we were entitled to only five even though they had committed to ten in their June 8, 1992 letter and submitted ten contracts to us for signature. We had signed an option in 1992 for a 15-year supply of natural gas for the ten plants at a price of $1.10/mmbtu at the well-head in West Virginia. In addition, we had a deal to sell the balance of the gas supply from these wells for the owner with our receiving one-half of the difference between our sell price and $1.10. We estimate that Peak Power's pretax profit on the generating plant operation over the 30-year period would have exceeded $220,000,000. Our investment in the plants would have been in the $50,000,000 range. Our profit on the gas sale arrangement would have been significant. Because of the time required for the hearings and the ruling of the Commission, we lost this gas option and the $100,000 deposit we made to secure the deal. In addition, my company had invested heavily in selecting sites for the plants, hiring three senior level engineers to assist with design, construction and operation of the plants and in gearing

up to begin construction. I personally lost an expensive house and I am still trying to pay off a very large debt obligation. By focusing on what I believed was a done-deal because of the high regard I held for Virginia Power as an ethical institution, I had neglected I.P.S. Group's core business feeling we would have all we could handle with these 10 plants. Our funding source in New York City told us that we would not be required to personally guarantee the loans. They said that they were familiar with this Schedule 19 program and that they were convinced that Virginia Power was a reputable, first-class company.

My credit reputation and my comfortable retirement life have been destroyed because a public utility with no competition and a guaranteed earnings level acted improperly, immorally and, I believe, illegally and there was no one around to hold them accountable. I am willing to testify under oath and I have supporting documents. My telephone number is 804-673-4149.

Yours very truly,



Claude E. Kinder

September 23, 2002

Amigo R. Wade
Division of Legislative Services
910 Capitol Street
Richmond, VA 23219

TRANSCRIBED FROM ORIGINAL

Dear Mr. Wade,

In reference to an article in the Richmond Times Dispatch Sept. 18, 2002, I am very interested in the fact that someone in the State of Virginia is sharing a concern relating to the SCC.

I have some very important facts that the State Legislature should incorporate for the benefit of the consumers. The SCC has made a nightmare out of our property at Indian acres of Thornburg, Va. They have set the property owners up as customers for P O River Water Co. and also set up a contractual basis which is also illegal. This violates our deeds to the property. Many people lost their property. Actually the SCC's duties is to set up rates, rules and regulations. They have overstepped their boundaries and something needs to be done about it.

I would like to meet with you to bring documents in and state my case. I have documents at the property and will be going up this weekend to obtain them. This issue has been ongoing for several years and something needs to be acted on in the Virginia State Legislation. Senator Houck of Spotsylvania County contacted the attorney in your Division but he could find nothing to protect the citizens.

When you dig wells on your property and is issued a certificate of necessity and convenience it should be stipulated that the water (wells) could never be separated from the company. How could you run an association of 6,000 + owners with no water.

Mr. Wade, I'm sure this sounds like French to you as you have to hear the whole case. I'm only hitting a few highlights. That's the reason I need to make an appointment with you. The SCC has destroyed our place and we are now operating under a state granted monopoly. We have lost thousands of members. Please help us.

I will appreciate hearing from you at your earliest convenience.

Sincerely,

Ms. Grace B. Layfield

P. S. I am speaking for thousands not just myself. This is a very critical issue.

Matrix of Consultants' Recommendations

GMU REPORT	WIRICK REPORT
I. MISSION	**I. MISSION**
1) SCC should retain role as the body responsible for economic regulation of the sectors currently under its oversight.	3) SCC should continue to be assigned the regulation of public utilities, securities, insurance and financial institutions.
2) SCC should remain as independent as possible from short term political pressures.	
3) Basic principle of regulation should be to allow market formation and only intervene when there are demonstrable market failures that appropriate regulation can address.	10) Should define mission with respect to competitive markets.
	4) Should embark on a process of strategic planning and organizational redefinition. (Adoption of NRRI's 5-part model of a regulatory agency)
	9) Establish a dialogue with legislative members.

Matrix of Consultants' Recommendations

GMU REPORT	WIRICK REPORT
II. STRUCTURE	**II. STRUCTURE**
General 4) The SCC's structure should take account of how markets change. 8) Give serious consideration to increasing the number of Judges from three to five with one being replaced each year.	
Office of General Counsel 9) Adequate resources should be provided to reduce turnover in the office.	*Office of General Counsel* 8) Evaluate the organization and resources available to the Office and consider additional resources to the division.
Ex parte Separation 10) Continue to explore ways of improving public understanding of how it internally handles potential ex parte conflicts and seek ways to mitigate potential conflicts.	*Ex parte Separation* 5) Adopt a stronger model of ex parte separation between staff and judges. (Recommends designating staff on a case by case basis via memorandum)
Alternative Dispute Resolution 11) No change in ADR procedures.	*Alternative Dispute Resolution* 11) Create rules and procedures for ADR application. 12) Identify appropriate opportunities for ADR and promote its use as an alternative.

Matrix of Consultants' Recommendations

GMU REPORT	WIRICK REPORT
II. STRUCTURE (continued)	**II. STRUCTURE (continued)**
Staffing/Staff Development	*Staffing/Staff Development*
	1) Creation of a Director of Administration should be considered.
12) Creation of a Directorate of Energy that would oversee gas, electricity and water regulation should be considered.	2) Creation of a Director of Public Utilities is not needed at this time.
	19) Reorganization with regard to the public utility regulatory sections, administrative oversight, interaction with consumers and application of ADR.
	22) Continue to dedicate resources to technical training.
20) More attorneys working with the Securities Division.	23) Identify and invest in staff with leadership potential.
	24) More training to supervisors on staff coaching and evaluation.
	25) Evaluate security of the building.

Matrix of Consultants' Recommendations

GMU REPORT	WIRICK REPORT
III. FUNDING/APPROPRIATIONS 7) SCC should continue to be self-funded.	**III. FUNDING/APPROPRIATIONS** 6) More resources should be provided to the Office of the Attorney General's Division of Consumer Counsel to increase its ability to intervene and become more active across the range of SCC issues. 2) Evaluate resources available to the Office of General Counsel. *(See II. Structure)*

Matrix of Consultants' Recommendations

GMU REPORT	WIRICK REPORT
IV. PERFORMANCE ASSESSMENT 13) Divisions should develop systems of performance assessment procedures that are quantifiable where possible. Performance measurement should be a part of annual reports.	**IV. PERFORMANCE ASSESSMENT** 4) Should embark on a process of strategic planning and organizational redefinition. 16) Continue to integrate its information systems plan into an overall strategic plan. 17) As a part of the strategic planning process analyze provision of information systems support to Divisions. 19) Using performance criteria identify the best reorganization with regard to public utility organization, administrative oversight, interaction with consumers and application of ADR.*(See II. Structure)* 20) Involve stakeholders in the identification and application of measures of agency performance. 21) Employ performance measures to position itself with the public and make the public aware of its substantial and beneficial impact.

Matrix of Consultants' Recommendations

GMU REPORT	WIRICK REPORT
V. CONSUMER/PUBLIC RELATIONS 6) Review the data that industry is required to provide and limit them to that which is necessary to fulfill its regulatory requirement. (minimize burden on regulated industries) 14) All divisions should engage in more public information and information gathering.	**V. CONSUMER/PUBLIC RELATIONS** 13.) Create consumer friendly information to be distributed via media. 14.) Standardize, automate and coordinate consumer complaint handling process. 15.) Try to involve consumers in SCC proceedings and policy making. 18.) Give consideration to the potential for providing information to consumers and other stakeholders to create a type of "regulation by information" that might further objectives of SCC. 21.) Increase public awareness. *Office of the Attorney General* 6) More resources should be provided to the Office of the Attorney General.*(See III. Funding/Appropriations)* 7) More dialogue between the SCC and the Office of Attorney General to ensure engagement in cases that warrant consumer representation.

Matrix of Consultants' Recommendations

GMU REPORT	
VI. DIVISION SPECIFIC RECOMMENDATIONS *Insurance* 15) Identify states or countries with which Virginia currently has no reciprocity agreements. 16) Develop effective measures to counter threats to consumers' privacy in light of increased reliance on electronic commerce. 17) Continue work with National Association of Insurance Commissioners to develop uniform standards and regulations. *Finance* 18) Conduct a review of state banking laws. 19) Continue ad hoc ties with other Bureaus and Divisions within the SCC.	

Matrix of Consultants' Recommendations

GMU REPORT	
VI. DIVISION SPECIFIC RECOMMENDATIONS *Telecommunications* 21) Design a system to establish current state of competition to allow monitoring over time. 22) Take steps to move the activities of the collaborative committee along as quickly as possible. 23) Take periodic "snapshots" of available services across major telecommunications markets to determine if those services are available in the state. 24) Continue to find additional ways to allow competitors into the marketplace as rapidly as possible; seek methods of circumventing the current arbitration impasse.	

Matrix of Consultants' Recommendations

GMU REPORT	
Energy 25) Continue to foster more pilot programs in natural gas supply; accelerate development of competitive markets in energy provision wherever possible. 26) Should seek ways to allow for the consideration of broader evidence on the environment, economic development and consumer protection when dealing with energy issues.	

Overview of the Status of Implementation Actions

State Corporation Commission

September 17, 2002

Joint Subcommittee Studying the SCC
September 17, 2002

Senator Norment, members of the joint subcommittee, I'm Ken Schrad, Director of the Division of Information Resources at the SCC -- the person the Commission assigned to follow your work and make sure the SCC has been responsive to your requests.

The Commission appreciates the opportunity to summarize the efforts it has taken to improve itself since your last meeting on November 19, 2001.

Let me emphasize that the observations and suggestions offered by this panel and by those who offered public comments to this panel over the past two years have been valuable to the Commission. This kind of feedback helps us do our jobs better. You cannot help but take to heart a little constructive criticism and be a little surprised when the blinders come off and you see how others perceive your work.

The healthy discussion generated as a result of this check-up is useful information. The Commission must take all of it into consideration when making decisions to improve its operational efficiency and effectiveness.

Both the George Mason University report (prepared at your direction) and the Wirick report (prepared for the Commissioners), gave the Commission a "thumbs up" for the work that it does. Both reports found areas where the SCC can improve. Neither report questioned the quality of the SCC's work nor found any critical problem that required immediate attention.

Does that mean the Commission thinks it is perfect? No. Although perfection is a high standard to achieve, the Commission wants its structure to function as close to perfection as possible. Thus, whenever the Commission identifies an opportunity to make a change that can make a real difference, it is ready, willing and able to do so. That is the very reason the Commission initiated the Wirick study in February 2000 – an internal top-down review to make sure the Commission is keeping pace with the dynamic changes that have occurred in the industries it oversees.

And, as so directly pointed out by Chairman Norment at the close of your last meeting, there are times when perceptions are bigger than reality. The Commission, which decides cases based on the facts in evidence and applicable law, has gained a greater appreciation for how it is perceived.

The Commission acknowledges it must take into account not just the "cold" process of carrying out its work but also any "warm" impressions of how well it fulfilled its public interest obligation.

So, what has the Commission done, to improve its process and the perception of those who observe the process?

One structural change implemented by the Commission gives the Chairman the dominant role in administrative matters affecting all SCC divisions. This "strong chairman" structure means the chairman is now the "chief operating officer" for the agency.

The Chairman will continue to be elected annually by a majority of the Commission. The traditional annual rotation of the chairmanship among the three Commissioners is expected to continue except for special circumstances that may dictate otherwise. For example, this year, Clinton Miller served a second consecutive year as chairman. Why? He was the primary architect of this structural change, so he was best prepared to serve in that capacity in its first year.

The opportunity to rotate the chairmanship preserves the ability to distribute administrative responsibilities among the three Commissioners so that the sole burden of such responsibility is not repeatedly placed on one particular Commissioner.

The Chairman serves as the Commission's primary point of contact for anyone making a general request of the agency (i.e., event invitations, speaking engagements, and information requests). The Chairman is also the primary point of contact for all division-related administrative matters (i.e., operations, budget, and personnel).

All SCC divisions now report to the Chairman. The Chairman does, as often as needed, confer with the other Commissioners regarding administrative issues.

The Chairman can delegate administrative responsibilities, as required, to the other two Commissioners. The delegation will be made at the Chairman's discretion to ensure the orderly and timely disposition of administrative issues.

When conducting Commission hearings (those not assigned to a hearing examiner), the Chairman presides or will designate one of his colleagues to preside over a particular case.

Already, Chairman Miller has used this new structure to improve coordination and ensure consistency of administrative oversight throughout the Commission.

For example, all three Commissioners jointly hold regular (at least monthly) meetings to go over administrative and operational matters with division directors. There is a meeting involving all the utility-related divisions. There is a meeting involving all financial services-related divisions. There is a meeting involving all administrative support divisions.

These meetings are not to talk about pending cases. Instead, they are designed to improve the flow of communication up to the Commission, down to the divisions, and across divisions about administrative issues and general regulatory issues to the benefit of

the Commissioners and all of the divisions. The Chairman leads these meetings. The new counsel to the commission makes sure the discussions do not wander into pending cases awaiting a Commission decision.

To expand on the issue of what you all know as "ex parte" communication, there has been considerable thought given to the need to ensure that the Commissioners are separated from the Commission staff on non-administrative matters. Generally, these matters include formal case proceedings pending before the Commission or technical issues at the staff level that involve a particular industry under the Commission's oversight.

As such, it is important to reiterate the SCC's rule as it applies to staff generally and the rule regarding the staff's participation in regulatory proceedings.

The rule states -- The Commissioners and hearing examiners shall be free at all times to confer with any member of the Commission staff. However, no facts nor legal arguments likely to influence a pending formal proceeding and not of record in that proceeding shall be furnished ex parte to any Commissioner or hearing examiner by any member of the Commission staff.

Remember, in regulatory proceedings, the Commission staff may appear and participate in any proceeding in order to see that pertinent issues on behalf of the general public interest are clearly presented to the Commission. The staff may conduct investigations and discovery, evaluate the issues raised, testify and offer exhibits, file briefs and make arguments, and be subject to cross-examination when testifying.

Neither the Commission staff collectively nor any individual member of the Commission staff shall be considered a party to the case for any purpose by virtue of participation in a proceeding.

Despite these rules, amended in 2001 with the full participation of parties who regularly are the subject of SCC proceedings, the Commission realized there was still a desire for a "visible" separation between itself and its staff. It had to be something that would show that the Commission was not relying upon the same SCC staff for advice when deciding a case in which staff may have advocated a particular position.

The perceived need for such a visible barrier led to the creation of two positions that complement the written rules – "Counsel to the Commission – Business & Financial" and "Counsel to the Commission - Utilities." Both of them are in the audience today, Duke DeHaas and John Dudley, respectively.

Borrowing a term from one of the SCC study reports, these two gentlemen provide, when necessary, a "buffer" between the Commission and Commission staff.

These counsel are the Commission's lawyers. As the titles suggest, each counsel primarily focuses on certain areas of SCC responsibility. However, the counsel can and

do work together and share responsibilities when the Commission decides it is efficient and effective to do so.

The Commissioners rely on these counsel in non-administrative matters whenever legal issues or facts of a technical nature are such that direct involvement by SCC staff in formulating a Commission decision must be avoided, as required by SCC rule.

The Counsel to the Commission then communicates with SCC staff, if needed, to ensure that the Commission has at its disposal the professional, knowledgeable, and technical expertise of its staff. This structure preserves the staff as a valuable resource to the Commission while ensuring the integrity of Commission decisions that are made in the overall public interest. {To help communicate this new structure to administrative law attorneys, an article was published earlier this year in the newsletter for that section of the State Bar. Copies have been provided.}

This structure in no way minimizes the role of the Office of General Counsel (OGC). The Commission will continue encouraging the OGC and SCC staff to conclude matters in a timely manner. Cases must continue to move while giving all parties a reasonable opportunity to present positions and develop a full record upon which a decision can be made.

OGC has added an attorney position, as suggested in both reports, in the securities area bringing the total to two. Four full-time attorneys and one part-time attorney handle insurance cases. Two attorneys work on banking cases. Eight attorneys do mostly utility work.

As for the rest of the divisions, each has a distinct administrative or regulatory responsibility designed to assist the Commission in the completion of its duties. This structure is in line with the Commission's internal needs and is always subject to change by the Commission.

In fact, the Commission recently created a new division by carving out a specialized section of the Energy Regulation Division and merging it with the Railroad Regulation Division to form a Division of Utility and Railroad Safety under the direction of Massoud Tahamtani. This structural change results from a suggestion in the Wirick report that all public utility safety investigation and enforcement be consolidated.

The Commission determined it was a natural merger of duties. Especially since inspection and investigation for compliance with safety regulations as grown over the years. This specifically involves natural gas pipelines, hazardous liquid pipelines, prevention of damage to underground utility lines, and railroad track and equipment. These functions also qualify for some federal money since the work of SCC inspectors is done at the request of the Federal Office of Pipeline Safety and the Federal Railroad Administration.

This change did not alter the number of SCC divisions (16). But, for the benefit of industry and the general public, the Commission invites the use of the SCC's designated "single points of contact" for each of the primary industry sectors:

Director of Communications William Irby – telecommunications industry
Director of Energy Regulation Bill Stephens – electric, natural gas, and water
Commissioner of Insurance Al Gross – insurance industry
Commissioner of Financial Institutions Joe Face – financial industry
Director of Securities and Retail Franchising Ron Thomas – investment industry
Clerk of the Commission Joel Peck – business entity filings

These individuals have been given specific direction by the Commission to coordinate all regulatory matters regarding their respective sectors. In so doing, they will rely heavily on their staff, the directors of other SCC divisions like Economics & Finance, Public Utility Accounting, Utility & Railroad Safety, Public Service Taxation, and when necessary the Office of General Counsel (legal) and my division, the Division of Information Resources (legislative, media, and public affairs).

Most importantly, these division directors will also assume the lead in communicating and encouraging the development of competitive markets involving their respective sectors.

The simplified channel for public access to the Commission staff does not preclude anyone from directly contacting any director or any other staff member of an SCC division. Many industry and public representatives with an ongoing working relationship with the Commission already know the best individual resource for directing a question or expediting a pending division-level matter.

The Commission wants such working relationships to continue and invites the development of further such relationships to promote accessibility to the staff and timely responses from staff.

In order to complement the "structure by industry sector" organization, the Commission now identifies all formal cases under one of the following industry categories:

Communications cases	(PUC)
Energy cases	(PUE)
Insurance cases	(INS)
Financial institution cases	(BFI)
Securities cases	(SEC)
Business entity cases	(CLK)

This change occurred in April when the SCC implemented a new computer-based, case management system which tracks all documents filed in a case. The Commission has been posting Commission orders to its web site since 1998. But, soon [within the next 30-60 days], the web site (by mirroring the case management system) will make every

public document filed in a case available electronically to the general public much like all proposed legislation is available via the General Assembly legislative information system. This feature, which is easier said than done, addresses several recommendations in both reports regarding improved access to Commission information and so-called "regulation by information."

This is not the only area where computer technology has been improved at the SCC. Last April, the corporate information system -- used by the Clerk's Office to keep tabs on more than 200,000 business entities registered as corporations, limited liability companies, general partnerships or limited liability partnerships -- became web accessible. It now gets 2000 visits a day from people checking on name availability or trying to identify the registered agent and the principals associated with these entities. And, it's available 24 hours a day, seven days a week.

This has not yet made a significant reduction in phone traffic to the Clerk's Office during normal business hours. In time, it should. The toll free number for corporate information, implemented at the suggestion of this study committee (specifically Del. Rollison), still averages between 1600 and 1800 calls a day. Many of the calls are thanking the Clerk for putting the information on the web.

The Bureau of Insurance continues to actively participate in regulatory initiatives of the National Association of Insurance Commissioners (NAIC)... many of which are designed to help streamline regulatory processes for insurance companies and insurance agents. This is consistent with the GMU report.

The Bureau was recently reaccredited by the NAIC for another five years, thanks in part to the General Assembly which willingly keeps Virginia's insurance laws up to date, and of course, the Commission, which keeps the regulations up to date.

The Bureau has also been publicly recognized for completing all 12 "Uniform Regulation through Technology Initiatives." It means Virginia is on board with 39 other insurance departments to eliminate licensing and approval barriers in multiple states.

While working to help industry, the Bureau also performed well to help consumers. In the past fiscal year, the Bureau recovered almost $8 million dollars in benefits and savings for Virginians. The total includes life and health and property and casualty refunds, insurance benefits, interest payments, reimbursements, additional claims payments, and reinstated coverage.

The Bureau of Financial Institutions is also using technology to speed examinations of state-chartered banks and credit unions. The "draft" exam report is now available right away, rather than a month or so later.

And, the Bureau has enhanced the ability for consumers to lodge a complaint against a state-chartered institution by using the Bureau's web site. The site is also offering more

consumer information materials, including the newly developed "Consumer Guide to Pay Day Lending," a result of new legislation and regulation this year.

The Securities Division has jumped on the recommendation in both reports to increase consumer outreach efforts. Thirty-four presentations to more than 1,000 people around the state have been made regarding investor-related issues and tips to avoid being a victim of securities fraud. Another 12 such presentations are already set for the remainder of the year.

Securities, Insurance, and Virginia Energy Choice will all be visible and available to those who visit the Better Living Center at the Virginia State Fair later this month.

The Commission is involving stakeholders earlier in the process than ever before. Staff routinely convenes such stakeholder sessions when developing proposed rules or regulations. These processes have proved successful in the development of retail access rules for electricity and natural gas; competitive metering; consolidated billing; and now in the development of default service.

A collaborative has been used to establish new performance standards and a remedy plan for Verizon when providing service to Verizon's competitors. This will be a critical element of the SCC's future role in resolving disputes between Verizon and competitors. The SCC adopted rules for alternative dispute resolution to accelerate the handling of such disputes. And, new service quality standards for local telephone service to residential and business customers are being developed with the help of stakeholder input and a statewide survey of telephone customers.

The Commission continues progress in advancing competition in both telecommunications and energy.

In just four months, the Commission completed its work on determining whether Verizon Virginia satisfied a 14-point checklist of opening its network to competition. The SCC, as directed by the Telecommunications Act of 1996, was charged with the detail work and submitting its findings to the Federal Communications Commission.

Verizon filed an application in March, an aggressive schedule was set, and the work was completed in July. The evidence and testimony involved volumes of material, including a five-day hearing. A 170-page report was prepared which found that viable competitive local exchange providers do have a reasonable opportunity to compete in Verizon's service territory. Sixty-six competitors do so and have gained about 17% percent of the access lines. The report was forwarded to the FCC on August 1.

In electric restructuring, the Commission just submitted its annual report on the status of competition in the Commonwealth and the regional energy supply market. In preparing the report, the Commission invited stakeholders to solicit ideas for facilitating competition. The invitation included questions regarding our performance and what we could do better.

There are 20 ideas set forth in the report --all for consideration by the Legislative Transition Task Force, chaired by Sen. Norment -- that may foster the development of competition. Electric utilities, competitive suppliers, business groups, electric consumers, and others offered these proposals.

One suggestion, which requires legislation, is designed to provide more incentives and opportunities for industrial and large commercial customers to switch suppliers. If retail market activity becomes attractive for large customers, it may ultimately improve the chance of competitive offers being made to residential customers.

The Commission also continues to build awareness of the new energy supply market through its major education and information initiative – Virginia Energy Choice. Nearly 50% of Virginians now say they are very aware of the opportunity to choose a competitive supplier, up 33% from 18 months ago. That's encouraging even though market conditions are such that no competitive offers are currently being made to the more than 2 million customers who now have the opportunity to choose a competitive electric supplier.

Our survey research shows they are still very much interested in choice (76%). More than 60% understand that it will take time for a competitive market to develop and only around 14% say they are frustrated with the lack of competitive offers.

While the advertising effort has been cut back by 50 percent, the outreach to community-based organizations has not. Nearly 700 organizations have been contacted and more than 200 presentations and events have been held to provide information to residential and small business consumers about this fundamental change in the way they will purchase electricity and natural gas supply service in the coming years.

Clearly, the Commission is doing more outreach than ever before, involving stakeholder meetings more than ever before, handling cases more efficiently and expeditiously than ever before, and trying to be more responsive to lawmakers, industry and the public than ever before.

Has the Commission changed since the beginning of this study in 2000? Yes.
Will it continue to look for ways to improve? Yes.

The Commission will always be receptive to suggestions and when criticism is received, find workable solutions. It has two consultants' reports and the record of public comments made by and to this task force, to which the Commission can refer, in order to make further improvements as the SCC begins its second century of service to the Commonwealth in 2003.

Thank you. I would be happy to take questions or share any observations you have with the Commissioners.