REPORT OF THE

Commission on Electric Utility Restructuring

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

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EXECUTIVE SUMMARY

The Virginia Electric Utility Restructuring Act (Restructuring Act) provides the statutory framework for Virginia's transition from traditional regulation of electric utility generation to a market-based system in which competitive market forces will be relied upon to determine generation rates and ensure adequate capacity. The State Corporation Commission (SCC) and the Federal Energy Regulatory Commission (FERC) will continue to regulate the distribution and transmission of electric service, respectively.

The Commission on Electric Utility Restructuring, formerly the Legislative Transition Task Force, was established to work collaboratively with the SCC in conjunction with the phase-in of retail electric competition. The Restructuring Commission has actively monitored developments relating to the implementation of the Restructuring Act, and has acted as a gatekeeper to examine any proposals for legislation affecting electric utilities.

The Restructuring Commission met five times during the 2003-2004 interim. During these meetings it received testimony on numerous issues, including:

- The SCC's Report on the Development of a Competitive Retail Market for Electric Generation within the Commonwealth;
- Stranded costs;
- The status of federal legislation and FERC activity;
- The damage caused by Hurricane Isabel;
- The Blackout of 2003 and why Virginia's systems were not negatively impacted;
- The integrity of Virginia's transmission systems; and
- Proposed changes to the Restructuring Act.

The Restructuring Commission adopted a resolution establishing a methodology to address the issue of monitoring incumbent electric utilities' stranded costs. The resolution requests the Division of Consumer Counsel of the Office of the Attorney General:

1. On or before September 1, 2004, and annually thereafter, to report to the Restructuring Commission (i) the cost of service of each incumbent electric utility's generation; and (ii) the market prices for generation as calculated for wires charge purposes immediately prior to the reporting date. However, the first such report is to cover the period beginning July 1, 1999, and ending December 31, 2003.
2. In determining generation cost of service, to take into account factors such as the incumbent electric utility's applicable Annual Informational Filing to the SCC, any adjustments to such Filing made by the SCC, example ranges of returns on common equity, and such other factors as the Division deems relevant.
3. In determining market prices for generation, to take into account market prices as determined by the SCC and such other factors as the Division may deem relevant.
4. To continue to make such reports for each incumbent electric utility until the capped rates for such utility expire or are terminated pursuant to the provisions of § 56-582 of the Code of Virginia.

At its meeting on January 15, 2004, the Restructuring Commission endorsed six legislative proposals:

- **Extension of capped rates.** The Office of the Attorney General and the Secretary of Commerce and Trade recommended legislation that would extend, until December 31, 2010, the rate caps currently in place for incumbent electric utilities unless terminated sooner by the SCC upon a finding of an effectively competitive market for generation services in the service territory of an incumbent utility. Utilities not bound by a rate case settlement may petition the SCC for a change in rates after January 1, 2004. Current law limits such petition for a change in only the nongeneration components of rates. If capped rates are continued after July 1, 2007, an incumbent electric utility may at any time after July 1, 2007, petition the SCC for approval of a one-time change in its rates. If a majority of electric cooperatives elect to be exempt from certain provisions of the Act, then all cooperatives will be exempt, and if such election is made, the cooperatives will revert back to cost-of-service regulation. The bill provides for an extension of the fuel costs recovery tariff provisions (fuel factors) in effect on January 1, 2004, for any electric utility that purchases fuel for the generation of electricity and that was, as of July 1, 1999, bound by a rate case settlement adopted by the SCC that extended in its application beyond January 1, 2002. The fuel factors shall remain in effect until the earlier of (i) July 1, 2007, (ii) the termination of capped rates, or (iii) the establishment of tariff provisions as directed by the SCC.
- **Minimum stay requirements; wires charges.** Senator Watkins proposed changes to the Restructuring Act to authorize any large industrial or commercial customer who is returning to its incumbent electric utility or default provider after purchasing power from a competitive supplier to elect to accept market-based pricing as an alternative to being bound by the minimum stay period prescribed by the SCC. Customers exempted from minimum stay periods will not be entitled to purchase retail electric energy from their incumbent electric utilities thereafter at the capped rates unless such customers agree to satisfy any minimum stay period then applicable. This proposal also authorizes industrial and commercial customers, as well as aggregated customers in all rate classes, to switch to a competitive service provider without paying a wires charge if they agree to pay market-based prices if they ever return to the incumbent electric utility. Customers who make this commitment and obtain power from suppliers without paying wires charges are not entitled to obtain power from their incumbent utility at its capped rates.
- **Municipal and state aggregation.** Senator Watkins also advanced a proposal that would authorize a municipality or other political subdivision to aggregate the electric energy load of residential, commercial, and industrial retail customers within its boundaries on either an opt-in or opt-out basis, eliminate the requirement that customers must opt in to select such aggregation, and eliminate the requirement that such municipality or other political subdivision may not earn a profit from such aggregation.
- **Electrical generating facility certificates.** Delegate Parrish recommended extending by two years the expiration date of certain certificates granted by the SCC

to construct and operate electrical generating facilities. Only those certificates for which applications were filed with the SCC prior to July 1, 2002, will receive an extension.

- **Net Metering.** The MDV-Solar Energy Industries Association recommended a proposal to change the net metering maximum from 25 KW to 500 KW. The net metering provisions give customer-generators the opportunity to sell excess generated electricity to electric utilities. "Net energy metering" means measuring the difference, over the net metering period, between (i) electricity supplied to an eligible customer-generator from the electric grid and (ii) the electricity generated and fed back to the electric grid by the eligible customer-generator.
- **Air emissions trading.** The Restructuring Commission also endorsed a proposal that would prohibit the Commonwealth from selling, by auction or other manner, the set asides allocated to new sources of air emissions.

The Restructuring Commission remains committed to fine-tuning the Restructuring Act in order to provide for the effective deregulation of the generation component of retail electric service. However, if competition does not materialize as expected during the next few years, the Restructuring Commission will take whatever steps are necessary to maintain the Commonwealth's long-standing status as a state with reliable and low-cost electric service. Furthermore, the Restructuring Commission will continue to monitor federal and regional developments to ensure that Virginia does not cede to the federal government its authority to protect Virginia electricity consumers.

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COMMISSION ON ELECTRIC UTILITY RESTRUCTURING

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

Richmond, Virginia
May 2004

I. INTRODUCTION

The Virginia Electric Utility Restructuring Act, Chapter 23 (§ 56-576 et seq.) of Title 56 of the Code of Virginia, establishes the framework through which the generation component of retail electric service will be deregulated. The Commission on Electric Utility Restructuring, established by the 2003 Session of the General Assembly as successor to the Legislative Transition Task Force, is directed to work collaboratively with the Virginia State Corporation Commission in conjunction with the phase-in of retail competition in electric services within the Commonwealth. The duties of the Restructuring Commission include:

- Monitoring the work of the SCC in implementing the Restructuring Act, receiving such reports as the SCC may be required to make, including reviews, analysis, and impact on consumers of electric utility restructuring programs of other states;
- Determining whether, and on what basis, incumbent electric utilities should be permitted to discount capped generation rates;
- After the commencement of customer choice, with the assistance of the SCC, the Office of the Attorney General, incumbent electric utilities, suppliers, and retail customers, monitoring whether the recovery of stranded costs has resulted or is likely to result in the overrecovery or underrecovery of just and reasonable net stranded costs;
- Examining utility worker protection during the transition to retail competition;
- Examining generation, transmission and distribution systems reliability concerns;
- Examining energy assistance programs for low-income households;
- Examining renewable energy programs;
- Examining energy efficiency programs;
- Reporting annually to the Governor and each session of the General Assembly concerning the progress of each stage of the phase-in of retail competition, offering such recommendations as may be appropriate for legislative and administrative consideration in order to maintain the Commonwealth's position as a low-cost electricity market and ensuring that residential customers and small business customers benefit from competition;
- Receiving reports from the SCC pursuant to § 56-579 F of the Restructuring Act on its assessment of the success of the regional transmission entity (RTE) in facilitating the orderly development of competition in the Commonwealth;

- Receiving reports from the SCC pursuant to § 56-581.1 of the Restructuring Act on delays in any element of the provision of billing services and the underlying reasons therefor;
- Receiving reports from the SCC pursuant to subsection E of § 56-585 of the Restructuring Act regarding modification or termination of default service;
- Receiving reports from the SCC pursuant to § 56-592 of the Restructuring Act with its findings and recommendations regarding the development of its consumer education program;
- Receiving periodic updates from the SCC pursuant to § 56-592.1 of the Restructuring Act regarding the implementation and operation of its consumer education program; and
- Receiving the annual reports of the SCC pursuant to § 56-596 of the Restructuring Act on the status of competition in the Commonwealth, the status of the development of regional competitive markets, and its recommendations to facilitate effective competition in the Commonwealth as soon as practical.

The Restructuring Commission consists of 10 members: Senator Norment of James City County, chairman; Senator Stolle of Virginia Beach; Senator Watkins of Chesterfield County; Senator Saslaw of Fairfax County; Delegate Kilgore of Scott County; Delegate Parrish of Manassas; Delegate Plum of Fairfax County; Delegate Tata of Virginia Beach; Delegate Scott of Fairfax County (appointed during the 2003 interim to replace Delegate Moran of Alexandria); and Delegate Dudley of Rocky Mount (appointed during the 2003 interim to replace former Delegate Woodrum of Roanoke).

The Legislative Transition Task Force's first year of work is reported in Senate Document 54 of 2000; its second year of work is reported in Senate Document 39 of 2001; its third year of work is reported in Senate Document 27 of 2002; and its fourth year of work is reported in Senate Document 17 of 2003. The annual report of the joint subcommittee pursuant to Senate Joint Resolution 118 (1996) is Senate Document 28 (1997); the report pursuant to Senate Joint Resolution 259 (1997) is Senate Document 40 (1998); and the report pursuant to Senate Joint Resolution 91 (1998) is Senate Document 34 (1999). Printed copies of these reports are available through the General Assembly's bill room (telephone 804-786-6984). The reports may be accessed through the General Assembly's Legislative Information System website (http://leg1.state.va.us) through its searchable database of reports to the General Assembly. The Restructuring Commission's Internet website (http://dls.state.va.us/elecutil.htm) provides links to the text of the Restructuring Act and to some of the materials submitted at its meetings.

Pursuant to the statutory directive that the Restructuring Commission annually report to the Governor and the General Assembly concerning the progress of each stage of the phase-in of retail competition, this report describes its activities during the 2003-2004 interim.

II. RESTRUCTURING COMMISSION ACTIVITIES

The year 2003 was a watershed year for retail competition in Virginia. Increasing numbers of interested parties expressed concerns about the failure of retail competition to develop for electric generation services. Competing proposals to address the lack of competition were advanced and debated, and sharp divisions emerged regarding the optimal course. Proposals ranged from modifying the Restructuring Act in order to facilitate the development of retail competition, to indefinitely suspending portions of the Restructuring Act, to slowing down the implementation of the Restructuring Act by extending the capped rated period. Though it was not presented to the Restructuring Commission, another proposal would have repealed Virginia's Restructuring Act. The Restructuring Commission also continued to address contentious issues involving the monitoring of stranded costs recovery and the potential risks of ceding jurisdiction to the Federal Energy Regulatory Commission.

The Restructuring Commission ultimately supported proposals that would slow the deregulation process by extending capped rates, while at the same time reaffirming the basic goal of retail competition for the Commonwealth. Senate Bill 651, which the General Assembly enacted, extended capped rates to as late as December 31, 2010, and incorporated several other proposals that had received the endorsement of the Restructuring Commission.

The Restructuring Commission met on five occasions during the 2003-2004 interim: October 14, 2003; November 19, 2003; November 24, 2003; January 13, 2004; and January 15, 2004. The Restructuring Commission's initial meeting was held in Richmond on October 14, 2003. Delegate Allen Dudley and Delegate James Scott were introduced as the Restructuring Commission's newest members. The meeting featured presentations on the damage caused by Hurricane Isabel, the electricity blackout of August 2003, and the integrity of Virginia's transmission systems. Though these topics are not technically within the purview of the Restructuring Commission's duties, they were deemed appropriate to address given their importance to public confidence in the electric system.

During the first meeting Judith Williams Jagdmann, Deputy Attorney General, announced that the Offices of the Governor and Attorney General would be preparing for submission to the Restructuring Commission a proposal for legislation that would extend the existing capped rates pursuant to § 56-582 of the Restructuring Act for three years, until July 1, 2010, and require the phasing out or elimination of wires charges. Under the Restructuring Act as passed in 1999, it was expected that competition for generation services would develop in the Commonwealth during the capped rate period from July 1, 2001, through July 1, 2007, and perhaps as early as July 1, 2004. According to the October 10, 2003, letter from Secretary of Commerce and Trade Michael J. Schewel and Ms. Jagdmann to the members of the Restructuring Commission, a copy of which is attached as Appendix A, the intervention of unanticipated events, including the California energy crisis, the collapse of Enron, the doubling of natural gas prices, delays in Virginia utilities joining regional transmission entities, increased uncertainty with federal regulation, and weaker capital markets, have resulted in fewer than expected competitive suppliers making offers to retail customers in the Commonwealth. The authors of the letter state that it is most important that Virginia consumers not be the victims of a deregulated market lacking effective competition post-2007. They also cited the need to ensure

the reliable and cost-effective operations of Virginia utilities in regional transmission entities before capped rates are eliminated.

The agenda for the November 19, 2003, meeting of the Restructuring Commission included the presentation of two reports by the SCC. First, the SCC presented its August 29, 2003, status report on the development of a competitive retail market for electric generation within the Commonwealth as required by § 56-596 of the Restructuring Act. Second, the SCC presented its July 1, 2003, report on the activities of the stranded cost work group convened pursuant to the January 27, 2003, resolution of the Legislative Transition Task Force. The November 19, 2003, meeting also included briefings on the status of the SCC's consumer education program and on the status of a "stakeholder work group" convened by Ms. Jagdmann and Secretary Schewel to assist in the development of their proposed rate cap extension legislation.

The third meeting of the Restructuring Commission, held on November 24, 2003, provided interested parties the opportunity to comment on the SCC's reports on the development of a competitive retail market for electric generation within the Commonwealth and on stranded costs. Fifteen entities provided the Restructuring Commission with their reactions to the two reports and associated matters.

On January 13, 2004, the Restructuring Commission held its fourth meeting. The Restructuring Commission received information from proponents of various proposals for legislative action regarding Virginia's system of providing electric service. While several speakers offered specific legislative recommendations, others offered more general suggestions to the Restructuring Commission regarding the appropriate course of action. The meeting included a briefing on possible federal energy legislation and on current FERC proceedings.

The final meeting of the Restructuring Commission was held on the second day of the 2004 Session, on January 15, 2004. After receiving presentations on several legislative proposals that time did not allow to be made during the January 13 meeting, the Restructuring Commission acted on nine legislative proposals. The Restructuring Commission voted:

- To endorse unanimously the net energy metering proposal offered by the MDV Solar Energy Industries Association;
- To endorse unanimously the proposal offered by the Virginia Energy Providers Association regarding the extension of the term of certificates granted by the SCC for certain electric generation facilities;
- To endorse unanimously the proposal offered by the Virginia Energy Providers Association regarding the sale of air emissions credits allocated to new sources;
- To endorse unanimously the proposal offered by Senator Watkins regarding the minimum stay requirement and wires charges payable by switching customers;
- To endorse unanimously the proposal offered by Senator Watkins regarding municipal aggregation;
- Not to endorse the "coalition" proposal offered by Delegate Kilgore that provides for a suspension of portions of the Restructuring Act;

- Not to endorse the proposal offered by Delegate Morgan that requires a suspension of customer choice and requires the SCC to rebundle the generation, transmission, and distribution components of electricity rates;
- Not to endorse the proposal offered by Delegate Morgan that requires the SCC to calculate both the stranded costs of incumbent electric utilities using an asset valuation approach and the amounts recovered through wires charges and capped rates; and
- To endorse the proposal offered by the Office of the Attorney General and the Secretary of Commerce and Trade that extends the capped rate period until December 31, 2010, freezes the fuel factor of Dominion Virginia Power (DVP) until July 2007, allows Virginia's electric cooperatives to opt out of the provisions of the Restructuring Act, and retains the provision that wires charges will be eliminated by July 1, 2007.

During the January 15, 2004, meeting, the Restructuring Commission also endorsed a resolution offered by the Office of the Attorney General that requests the Division of Consumer Counsel of the Office of the Attorney General to report annually to the Restructuring Commission information regarding stranded costs using an accounting approach that employs an earnings test mechanism to show the amount a utility has earned over its cost of service, assuming an agreed upon rate of return. The report would also include a comparison of a utility's cost of service for generation to the prevailing market price of generation.

III. POLICY ISSUES ADDRESSED

A. THE PACE OF DEVELOPMENT OF COMPETITION

The paramount goal of the Restructuring Act is the development of a competitive retail market-based system for the provision of the generation component of electric service. The Act envisions a system where consumers, guided by prices and other market signals, will be able to select their electricity suppliers from among competing providers of generation services. Such a market-based system, under which competition is intended to effectively regulate prices, is envisioned by industry restructuring supporters as an improvement over the traditional system, under which utility providers were granted the exclusive franchise to serve consumers within designated territories and could charge regulated rates that ensured recovery of prudently incurred expenses and the opportunity to earn a fair return.

As the Commonwealth jettisons the traditional cost-of-service-based system of regulating the rates charged by electric utilities, however, the risk exists that competition will not develop to a sufficient extent such that market forces are an effective means of regulating the prices that suppliers may charge consumers. The lack of development of effective retail competition may result in a scenario where instead of being served by monopoly providers, whose prices are regulated based on their cost of service, consumers will be served by unregulated monopoly providers that are able to exercise market power.

1. Report on the Status of Competition in the Commonwealth

Section 56-596 of the Restructuring Act requires the SCC to report to the Restructuring Commission and the Governor, by September 1 of each year, on the status of competition in the Commonwealth, the status of the development of regional competitive markets, and its recommendations to facilitate effective competition in the Commonwealth as soon as practical. The SCC's third annual report on the status of competition, dated August 29, 2003, repeats previous conclusions that Virginia's progress in implementing effective consumer choice for electric generation has been slow. This conclusion confirms the concerns identified by the Office of the Attorney General and the Secretary of Commerce and Trade in their October 10, 2003, letter to the members of the Restructuring Commission.

The 2003 competition status report addresses the three issues required under § 56-596. Dr. Kenneth Rose, Senior Fellow at the Institute of Public Utilities at Michigan State University, presented Part I of the competition status report, which addresses the development of regional competitive markets. Howard Spinner, Director of the SCC's Division of Economics and Finance, presented Parts II and III of the report, which address the status of competition in the Commonwealth and the recommendations of the SCC and others to facilitate effective competition in the Commonwealth, respectively. The full text of the report can be accessed from the SCC's web site at http://www.state.va.us/scc/division/restruct/history.htm.

On November 19, 2003, Dr. Rose gave the Restructuring Commission an update and summary of his 2003 performance review of electric power markets. A copy of Dr. Rose's

materials, which cover both the retail markets and wholesale markets, is on the SCC's website at http://www.state.va.us/scc/caseinfo/reports/rose_ceur.pdf.

With regard to retail competition nationally, Dr. Rose observed that 16 states and the District of Columbia allow retail access. Of these 17 jurisdictions, all but three (Virginia, Ohio, and Texas) had rates that in 1996 exceeded the average U.S. price for electricity. Six states that had passed restructuring laws have repealed the legislation, delayed its implementation, or otherwise significantly changed it, and two limit retail access to large customers. Based on 1996 rates, Virginia is the lowest-price state in which retail access legislation remains in effect.

In the 17 jurisdictions that allow retail access, Dr. Rose reported that there is little, if any, effective retail competition for electric service in the residential and small commercial market. Some states have witnessed significant switching among larger customers. There is generally a correlation between higher-priced utilities and switching activity, which may explain why switching rates vary markedly among regions of particular states. While there are some higher-cost utilities with little or no switching to retail competitors, in general no low-priced utilities have high levels of retail switching.

Ohio and Texas have experienced appreciable residential switching. In Ohio, there is substantial residential switching but only in the areas served by three distribution utilities in the northern portion of the state with high-cost power. In the areas of Ohio where switching has occurred, Dr. Rose attributed 90 percent of the switching to municipal opt-out aggregation. He cautioned that aggregation by itself does not increase retail switching, as there is little activity in those areas of Ohio served by low-cost utilities.

Texas is the only state with substantial statewide competitive penetration in markets for residential (11 percent) or small commercial (17 percent) accounts. Market penetration in that state is explained by the requirement that customers who do not choose to take service from a nonaffiliated retail electric provider were automatically transferred to their utility's retail electric provider. These transferred customers are charged a regulated "price to beat" that includes "headroom," thereby allowing nonaffiliated providers to offer service at prices that both save customers money and allow the nonaffiliated providers to earn a profit on their sales. Consequently, small Texas consumers who stay with the affiliated provider of their former utility pay higher regulated charges than would be paid if the price to beat did not include headroom for the competitors.

Dr. Rose questioned the economic health of wholesale markets. The wholesale spot markets in all regions are highly correlated with natural gas prices. The continuing credit crunch and other factors have slowed the addition of new generation capacity. While there were four electric utility bankruptcies or restructurings from the Great Depression through 2000, there have been eight in the past three years. In his report, Dr. Rose observed that at the same time that generating companies are facing difficult financial conditions, there continues to be evidence that significant market power is being exercised in wholesale markets. He also cautioned that there has been very little independent analysis of wholesale markets. In response to questions from Senator Watkins, Dr. Rose stated that data from 2000 suggests that the exercise of market power has resulted in prices that may be as much as 50 to 60 percent higher than would be charged in

truly competitive markets. Senator Watkins suggested that the SCC join with utility regulatory commissions in other states to examine the performance of wholesale electricity markets.

Dr. Rose expressed puzzlement by the coincidence of the exercise of market power, which normally serves to increase the prices in the market and the profits of providers, and widespread industry financial distress. Such financial distress would ordinarily be alleviated by the exercise of market power. These coincident results illustrate the difficulty of fashioning electricity markets that ensure both the provision of safe and reliable service and the vigorous competition needed to forestall any exercise of market power.

Howard Spinner, Director of the SCC's Division of Economics and Finance, provided the Restructuring Commission with an overview of Part II of the competition status report. He reported that competitive activity has been slow to develop in Virginia's electricity market. By January 1, 2004, all of the customers of Virginia's investor-owned utilities and electric cooperatives, except for approximately 29,400 customers of Kentucky Utilities and approximately 7,000 customers served by Powell Valley Electric Cooperative, will have the right to switch to a competitive provider.

However, as was reported in last year's competition status report, the right to choose does not mean the ability to choose. Only one competitive service provider, Pepco Energy Services, is selling electricity to Virginia customers. This provider is selling environmentally friendly "green" power to approximately 2,300 residential customers and 22 commercial customers in DVP's service territory at a higher cost than the incumbent utility's price-to-compare. These figures represent a slight drop from the previous year, when approximately 2,375 residential customers and 23 commercial customers were buying electricity from this competitive service provider.

Mr. Spinner recounted SCC activities over the previous year in preparing the Commonwealth for the arrival of competition. The SCC has granted licenses to eight competitive service providers and 10 aggregators. Part II of the competition status report details activities regarding setting wires charges, consumer education, new generation facilities, the development of a competitive structure, and DVP's retail access pilot program.

With regard to the issue of wholesale market performance, Mr. Spinner stated his conviction that strategic bidding is occurring in PJM's wholesale market. Strategic bidding involves generating firms bidding prices above the variable production costs of their units, with the intent of forcing the market clearing price above competitive levels. Further analysis of market conduct would be difficult at the state level, he noted, because much relevant data is confidential.

Part III of the competition status report, which per § 56-596 is to include recommendations to facilitate effective competition in the Commonwealth, consists of two sections. The first is a compilation of recommendations, solicited by the SCC from electric utilities, competitive service providers, consumer groups, natural gas utilities, and business associations, to facilitate effective competition in the Commonwealth. The major obstacles to effective competition identified by respondents included (i) the existence of low capped rates of

the incumbent utilities, (ii) the existence and method of determining wires charges, (iii) the recovery of yet-to-be quantified stranded costs, (iv) the lack of a functional regional transmission organization, and (v) the lack of effective customer demand response programs. Mr. Spinner characterized the responses as similar to those from the previous year.

Part III C of this report discusses the SCC's recommendation that a suspension of the Restructuring Act is in the public interest because delaying implementation of the Act is a prerequisite to the preservation of Virginia's jurisdiction.

2. Responses to the Competition Status Report

At its November 24, 2003, meeting, the Restructuring Commission received comments from five persons regarding the SCC's report on the status of the development of a competitive retail market. The comments varied widely. One speaker disagreed with the SCC's competition status report; two other speakers took diametrically opposed views with respect to whether any lack of competition should affect implementation of deregulation in the Commonwealth.

The comments by Irene Leech of the Virginia Citizens Consumer Council (VCCC) (Appendix B) stress that Virginia will be in a risky position if it persists in implementing deregulation under its original schedule. Ralph L. "Bill" Axselle, Jr., of the Virginia Energy Providers Association (VEPA), and Richard A. Wodyka of PJM Interconnection, LLC, advised the Restructuring Commission that effective wholesale competition is a prerequisite to effective retail competition, and that any action to address the lack of retail competition in Virginia should not delay the provisions of the Restructuring Act establishing January 1, 2005, as the date by which incumbent electric utilities are required to transfer management and control of its transmission assets to a regional transmission entity.

Eric Matheson of Constellation New Energy took issue with many aspects of the SCC's competition status report. A copy of his presentation materials is attached as Appendix C. Rather than being concerned with market-based volatility, Mr. Matheson asserted that volatility sends market signals and creates incentives that improve efficiency. In his grading of retail competition, he gave the Commonwealth a failing grade only with respect to its transition costs, by which he referred to the wires charges. Wires charges are alleged to impose a penalty on competitive suppliers of between 19 percent and 31 percent of the price-to-compare. In other states, transition costs, default service pricing, cost allocations, and regional transmission organization membership were cited as barriers to competition. Mr. Matheson predicted that as states move past their transition periods, obstacles caused by transition costs and default service pricing will be removed and active, competitive retail markets will develop. Outside Virginia, he characterized competition for large customers as doing well in the face of substantial barriers. His conclusions for Virginia include recommendations that any stranded costs be quantified and reconciled against collections through capped rates and wires charge collections, and that default service pricing reflect both the retail and wholesale costs of retail supply service.

The comments of DVP's David Koogler (Appendix D) focused on the competition report's discussion of its retail access pilot programs. He stated that though the Act never envisioned full retail competition during the transition period, the new pilot programs will

promote development of the retail market. Mr. Koogler also provided specific examples of progress that has been achieved in implementing the restructuring of Virginia's electric utility industry, including the pursuit of membership in a regional transmission entity, the development of rules and procedures needed to support customer choice, and the capped rates.

3. Proposals to Address Lack of Effective Competition

The Restructuring Commission received five proposals from interested entities that attempt to address the fact that effective competition for generation services has not developed in Virginia as quickly as had been hoped.

a. Extension of Capped Rate Period

As discussed above in part II of this report, during the Restructuring Commission's October 14, 2003, meeting, Ms. Jagdmann announced that the Offices of the Governor and Attorney General would be preparing for submission to the Restructuring Commission a proposal for legislation that would extend the existing capped rates pursuant to § 56-582 of the Act to July 1, 2010. The proposal would also require the phasing out or elimination of wires charges. Ms. Jagdmann cited the intervention of unanticipated events, including the California energy crisis, the collapse of Enron, the doubling of natural gas prices, delays in Virginia utilities joining regional transmission entities, increased uncertainty with federal regulation, and weaker capital markets as reasons for fewer than expected competitive suppliers making offers to retail customers in the Commonwealth. The October 10, 2003, letter from Ms. Jagdmann and Secretary Schewel (Appendix A) states that it is important that Virginia consumers not be the victims of a deregulated market lacking effective competition post-2007.

When enacted in 1999, § 56-582 of the Act required the SCC to establish capped rates, effective from January 1, 2001, and expiring on July 1, 2007, for each service territory of every incumbent utility. The capped rates were the rates in effect for each incumbent utility as of July 1, 1999, or, if the utility was not bound by a rate case settlement that applied beyond January 1, 2002, the rates established pursuant to a rate application filed by an incumbent electric utility with the Commission prior to January 1, 2001. With respect to DVP, the rate cap extended rates that had been put in effect during the mid-1990s following a rate case settlement.

The Restructuring Act provides that after January 1, 2004, the Commission, upon the petition of a utility, may terminate the capped rates upon a finding of an effectively competitive market for generation services within the service territory of the utility. The Restructuring Act also authorizes the SCC to adjust capped rates during the capped rate period to address specific changes in circumstances, including changes in a utility's fuel costs, changes in the taxation of utility revenues, and financial distress of a utility beyond its control.

As enacted, the Restructuring Act provided that after July 1, 2007, the cap on generation rates would cease, and consumers would thereafter either purchase generation service from the competitive provider of their choice or receive default service from the provider designated by the SCC under § 56-585 of the Act. Rates for default service are to be approved by the SCC based either on proposals submitted in a competitive bidding process or established based on the

prices for generation capacity and energy in a competitive regional electricity market. If no such market is found to exist, the SCC would set proxy default service rates at levels that approximate those that would likely exist if there was a competitive regional electricity market.

Following their announcement of their intent to prepare legislation extending the capped rate period and addressing wires charges and the fuel factor, Ms. Jagdmann and Secretary Schewel convened a meeting of interested persons to discuss their proposal. Meetings were held on October 23, 2003, and November 6, 2003. Written comments were submitted to Ms. Jagdmann in early November. Several groups, including American Electric Power-Virginia, the Alliance for Lower Electric Rates Today (ALERT), the Virginia Committee for Fair Utility Rates (VCFUR), and the Old Dominion Committee for Fair Utility Rates (ODCFUR), countered that a reexamination of the entire Act is justified. At the Restructuring Commission's November 19, 2003, meeting, Ms. Jagdmann reported that wide differences existed among the interested parties, and that the Attorney General's Office was reviewing their comments and expected to produce a draft of legislation by the second week of December.

The draft legislation was presented to the members of the Restructuring Commission on January 9, 2004 (Appendix E). Major elements of the draft legislation include:

- Extending the end of the capped rate period from July 1, 2007, until December 31, 2010, unless sooner terminated by the SCC upon a finding by the SCC, after January 1, 2004, that an effectively competitive market for generation services is found to exist within the service territory of the petitioning utility;
- Freezing DVP's fuel costs recovery tariff provisions in effect on January 1, 2004, until July 1, 2007;
- Requiring DVP's fuel costs recovery tariff provisions to be adjusted for the period from July 1, 2007, through December 31, 2010, to allow recovery of fuel costs for such 42-month period, without adjustment for any prior under-recovery or over-recovery of fuel costs;
- Exempting all electric cooperatives from certain provisions of the Act, if a majority of the cooperatives so elect, and allowing the cooperatives, by vote of a majority of them, to return to being subject to such provisions of the Act;
- Allowing any incumbent electric utility other than DVP, after January 1, 2004, to petition the SCC for a one-time change in its rates, rather than only in the nongeneration components of its rates;
- Allowing any incumbent electric utility other than DVP, after July 1, 2007, to petition the SCC for another one-time change in its rates; and
- Retaining July 1, 2007, as the last date when switching customers may be required to pay wires charges.

When Ms. Jagdmann presented the proposal to the Restructuring Commission on January 13, 2004, she reiterated the intent of the Offices of the Attorney General and the Governor to ensure that Virginia's consumers not be victimized by a deregulated market lacking effective competition in 2007. Secretary Schewel joined Ms. Jagdmann in characterizing the rate cap extension proposal as one that slows down the process of transitioning to a competitive retail market and preserving the work that has been expended in this endeavor over the past several

years. Secretary Schewel noted that the cost of a kilowatt of capacity has declined in recent years as the result of product innovations driven by free market competitive forces. He reminded members that part of California's energy crisis resulted from a law that froze the utilities' fuel factors, and cautioned that Virginia should avoid making the same mistake.

Thomas F. Farrell, II, President and Chief Operating Officer of Dominion, described the rate cap extension proposal as providing rate stability and a safety net for consumers through 2010. He concurred with the statement that the fact that competition has not developed as quickly as had been anticipated is no reason to throw out five years of effort. In support of this argument, he cited a January 9, 2004, update to the November 2002 study of the effect of capped rates prepared by Chmura Economics & Analytics (CEA). A copy of the updated CEA study is attached as Appendix F.

The updated CEA study concludes that the extension of capped rates proposed by the Offices of the Attorney General and the Governor would save DVP's residential customers between $1.48 and $1.8 billion, with as much as $700 million of forecast savings coming during the rate cap extension period. The updated CEA study finds that base residential electricity rates would have risen between 8.4 percent and 11.7 percent from 2001 to 2010 in nominal dollars under probable rates had caps not been imposed. Per the study, if base rates were not capped but rather allowed to increase at the rate of inflation as measured by the consumer price index, base rates would be 22.3 percent higher from 2001 through 2010. The updated CEA report does not expressly address factors that have led to lower base rates in other jurisdictions, such as the termination of high-cost power purchase agreements, the use of more efficient turbine technologies, and lower costs of capital. The SCC's Arlen Bolstad reminded the Restructuring Commission that the SCC had provided an analysis of the initial version of the original version study in January 2003, and advised that staff was available to address the updated CEA study.

At the January 13, 2004, meeting, the VEPA spoke in favor of the proposed rate cap extension. VEPA spokesman Bill Axselle described it as a balanced, middle ground approach that provides flexibility and a long-term perspective by allowing the potential for competition to develop but does not preclude a future decision that retail competition may not work. Arlen Bolstad reported that the SCC had not taken a position on the proposal. Daniel Carson stated that American Electric Power-Virginia (AEP) did not support the proposal in its current form, and Jackson Reasor of the Virginia, Maryland and Delaware Association of Electric Cooperatives stated that at this point Virginia's electric cooperatives were not supporting the proposal. Joseph H. Richardson of Allegheny Power stated that while his company neither supported not opposed the proposal, the Restructuring Commission should consider the unique circumstances of the different utilities in Virginia and avoid a "one-size-fits-all" approach. Guy Tripp, speaking for Delmarva Power & Light Company, echoed Mr. Richardson's comments that any approach should address the different concerns of the different utilities. He further observed that it may be premature to act on a proposal to extend the rate caps because the General Assembly will have three sessions after the 2004 Session in which it could extend the rate caps before their scheduled July 2007 expiration. Thomas B. Nicholson, representing the Virginia Alliance for Retail Energy Marketers,[2] cautioned that a combination of capped rates, a frozen

[2] The members of the Virginia Alliance for Retail Energy Marketers are Constellation New Energy, Inc., Direct Energy Marketing, Inc., Strategic Energy, LLC, and Washington Gas Energy Services, Inc.

fuel factor, and continued wires charges could lock in artificially high prices and freeze out competitive entry if wholesale market prices, fuel costs, or both, decline after rates are capped and fuel charges are frozen.

As discussed in following sections of this report, much of the opposition to the capped rate extension proposal centered around concerns that extending the rate caps to 2010 would allow utilities, notably DVP, to continue charging higher rates than are justified. Section 56-584 of the Act provides that an incumbent electric utility's just and reasonable net stranded costs, to the extent they exceed zero value in total for the utility, shall be recoverable through capped rates, paid by nonswitching customers, and wires charges, paid by customers who switch to competing providers. As wires charges and capped rates were scheduled to cease under the Act's terms by July 1, 2007, opponents alleged that extending the capped rate period beyond 2007 would extend the right of incumbent electric utilities to collect, through a portion of the capped rates, revenue that was intended to be used to offset the utility's stranded costs. Opponents stated their belief that extending for three and one-half years the authority of incumbent electric utilities to collect moneys for stranded cost recovery is improper because the utilities either have no stranded costs or have already recovered any such stranded costs.

The comments of the Virginia Chemistry Council (Appendix G), submitted to Ms. Jagdmann and Secretary Schewel during the work group discussions of the rate cap extension proposal, summarize many of the points raised by opponents of the rate cap extension. The comments aver that Virginia utilities have no stranded costs, that DVP's capped rates are producing significant earnings above its costs and a reasonable rate of return, and that without stranded costs such earnings are not justified. The comments suggest that, rather than extending the capped rate terms, legislation should provide that the cap on rates be set at a level found by the SCC to be the reasonable cost of providing such service with a reasonable rate of return.

The Restructuring Commission voted at its January 15, 2004, meeting to endorse the rate cap extension proposal offered by the Office of the Attorney General and Secretary of Commerce and Trade, with Delegate Dudley casting the only negative vote.

b. Suspension of Retail Competition

Concerns regarding the lack of development of retail competition for electric generation services in Virginia led several groups to recommend that Virginia suspend the retail choice provisions of the Restructuring Act. The suspension proposal was backed by a coalition that originally consisted of ALERT, American Electric Power, Texas Industries-Chaparral Steel (Virginia), ODCFUR, Old Dominion Electric Cooperative, Retail Merchants Association of Greater Richmond, Virginia Retail Merchants Association, Virginia Agribusiness Council, Virginia Citizens Consumer Council, VCFUR, Virginia Farm Bureau, Virginia Forest Products Association, and the Virginia, Maryland and Delaware Association of Electric Cooperatives. The proposal initially had the support of Delegate Kilgore.

Dubbed the "consensus proposal" by its advocates, the suspension proposal was presented at the Restructuring Commissions meetings on January 13 and 15, 2004. A copy of the proposal is attached as Appendix H. In relevant part, the draft legislation:

- Declares that there is a moratorium on the effectiveness of certain sections of the Restructuring Act, which moratorium will not be lifted until the sections are reenacted by the General Assembly;
- Directs the Restructuring Commission to analyze whether, and on what basis, customer choice would be viable in the Commonwealth, and to make recommendations regarding the reinstatement of choice to the General Assembly;
- Returns incumbent electric utilities to the ratemaking jurisdiction of the SCC on a cost-of-service basis pursuant to Chapter 10 of Title 56;
- Authorizes, except as otherwise provided, the SCC to continue to regulate the generation, transmission, and distribution of retail electric energy;
- Retains requirements related to the transfer of management and control of transmission assets to regional transmission entities, including the SCC's responsibilities concerning such transfers; and
- Retains authorization for the conduct of pilot programs encompassing retail customer choice.

Michael Carlin of ALERT testified that the coalition was built around the theme that the market structure has not been successful and competition has not developed. Members believe that consumers are paying more under capped rates than they would if rates had remained regulated. He cited an analysis by the SCC staff of DVP's annual information filing (AIF) indicating that its customers will overpay between $384 million and $449 million annually if capped rates remain in effect. According to Mr. Carlin, the coalition seeks a suspension of the retail structure until consumers will benefit from choosing their supplier in a functioning competitive marketplace. The coalition supports restoring the SCC's ability to set rates and protect consumers from unnecessary higher electricity costs that produce no associated benefits. The coalition favors the continued development of wholesale markets by the construction of new generation facilities and the development of regional transmission entities, as well as pilot programs and the continued oversight of market development by the Restructuring Commission. He specifically noted that the coalition opposes extending the rate cap period. He asserted that rates were capped to allow utilities to recover stranded costs, but because there has been no competition, utilities have not incurred any stranded costs. He cautioned that under an extension of capped rates, consumers are likely to see continued excess charges for electricity. He advocated moving from capped rates to regulated rates in 2004. Continuing to allow utilities to charge capped rates through their scheduled July 2007 expiration, he argued, will result in continued overpayments.

Mark Rowsell of Texas Industries-Chaparral Steel (Virginia) spoke in support of the suspension proposal; a copy of his comments is attached as Appendix I. He asserted that prices for electricity charged under the Act have been much higher and more volatile than originally anticipated. He cautioned that to allow for market rates where there is no market is an invitation for major conflict, and asked that until a viable and transparent electricity market develops in Virginia, the SCC should be given the authority to set rates based upon cost-of-service principles. Though Texas has been cited as an example of successful implementation of retail competition, Mr. Rowsell opined that his company was better off under regulated rates than under the current retail choice regime.

George Payton testified on behalf of the Retail Merchants Association of Greater Richmond that suspension of the Act is the best course of action. The members of his association aggregated their load in an unsuccessful attempt to arrange a deal with competitive suppliers.

Edward Petrini, speaking on behalf of VCFUR, which consists of large industrial customers of DVP, and ODCFUR, which consists of large industrial customers of AEP, criticized the rate cap extension proposal. He urged the Restructuring Commission to suspend the retail choice provisions in the 2004 Session in order to avoid a continuation of excessive rates and excessive earnings. He asserted that the freeze of Dominion's fuel factor until 2007, as provided in the rate cap extension proposal, would freeze the fuel factor at a historically high level. The fuel factor originally requested by DVP for 2004 would have increased rates by $441.7 million. A settlement proposal, which was ultimately affirmed by the SCC, reduced the proposed fuel factor increase to $386 million and amortized the increase through June 2007.

Daniel Carson of AEP stated that Virginia should have a public policy on restructuring that is uniform across the Commonwealth. Since enactment in 1999, the Act has not produced the results that were intended. There is no sense in continuing to facilitate choice among competitive providers when there are no competitive suppliers out there. He acknowledged some reticence about moving to market pricing in 2007. Retail markets cannot develop under the current structure, which structure is only creating winners and losers, a result that is likely to be exacerbated going forward. He suggested that it is necessary to focus on wholesale markets and keep the option of reactivating retail choice on the table. He also urged a comprehensive study of where Virginia is today compared to the assumptions in place when the Act was adopted in 1999, and noted the initial need to answer the basic public policy question of whether it is practical and desirable for every consumer to have retail choice.

Jackson Reasor of the Virginia, Maryland and Delaware Association of Electric Cooperatives served as chair of the joint subcommittee studying restructuring of the electric utility industry from 1996 to 1999. Speaking in favor of the suspension proposal, he noted that he had been optimistic that retail choice would be a reality, but that many things had not worked out as had been hoped. He stated his belief that the electric utility industry is very different from other industries and that electricity is a different commodity from any other due to the absolute need for it and that it must be produced at the moment it is needed. Consequently, he concluded that retail choice has not worked, is not working, and is not likely to work in the foreseeable future. Though there is a hope that it may work in the future, before successful retail choice is possible, there needs to be a well-developed wholesale market.

When Delegate Kilgore addressed the consensus proposal at the January 15, 2004, meeting, he stated that pausing and suspending retail choice provisions of the Act would restore cost-of-service-based rate regulation, keep the Commonwealth's commitment to the development of viable wholesale markets, allow pilot programs to develop, and continue the Restructuring Commission's oversight role.

Thomas B. Nicholson of the Virginia Alliance for Retail Energy Marketers spoke against the consensus proposal during the January 13, 2004, meeting. Suspension of retail choice, he contended, will not lower prices for consumers, guarantee better or more reliable service, or ensure preservation of state jurisdiction. As an alternative course, Mr. Nicholson suggested that the SCC should properly allocate cost allocations between a utility's unbundled generation, transmission, and distribution cost "buckets," thereby avoiding having monopoly transmission and distribution services artificially subsidize competitive generation services. After a utility's costs are properly allocated, he recommended that the SCC conduct hearings to determine an incumbent electric utility's just and reasonable net stranded costs. Until it is known whether a utility has any such stranded costs, wires charges represent an unsubstantiated barrier to entry.

Thomas F. Farrell, II, of Dominion spoke against the proposal to suspend retail choice, which he said is producing and will continue to produce major savings for consumers. He characterized the proposal as a one-size-fits-all solution that lacks the flexibility needed to permit each provider to address its own issues. Labeling the proposal anti-consumer legislation, Mr. Farrell indicated that it would require the filing of contested rate cases and result in higher rates. He dismissed fears that prices will rise after 2007 when rate caps expire, and said Dominion's projections are that wholesale prices, and thus retail prices, will decline after 2007.

The Restructuring Commission voted at its January 15, 2004, meeting not to endorse the retail choice suspension proposal offered by Delegate Kilgore and the consensus group, though three members (Delegate Kilgore, Delegate Tata, and Delegate Dudley) voted to endorse the proposal.

c. Minimum Stay Requirements and Wires Charges for Switching Customers

In its 2002 report on the status of competition, the SCC identified two proposals that had been suggested as means to facilitate effective competition by providing additional incentives for customers to switch to competing suppliers.

One such proposal provided that large commercial and industrial customers that have switched to a competitive provider and that later return to their incumbent utility should be able to avoid minimum stay requirements if they agree to accept market-based prices rather than capped rates. SCC rules impose a 12-month minimum stay requirement on customers who leave their local distribution company and then return to their local distribution company during high demand periods. Under this proposal, customers that agree to accept this option would be allowed to shop again immediately upon returning to their incumbent provider, rather than waiting 12 months. However, any customers exempted from any applicable minimum stay periods would not be entitled to purchase retail electric energy from their incumbent electric utilities thereafter at the capped rates unless such customers agree to satisfy any minimum stay period then applicable while obtaining retail electric energy at capped rates.

The second proposal identified in the 2002 competition status report provided that a large commercial or industrial customer that commits to market-based pricing upon returning to its incumbent utility should be allowed to switch to a competitive service provider without paying a wires charge. This proposal is intended to enhance the ability of large energy users to shop for

competitive power because the absence of a wires charge would escalate the consumer's potential savings. Customers who make this commitment and thereafter purchase electricity from a competitive supplier without paying wires charges to their incumbent electric utilities would not be entitled to obtain power from their incumbent electric utility at its capped rates.

The proposals were introduced in the 2003 Session by Senator Watkins as Senate Bill 891 and Senate Bill 892. On February 4, 2003, both bills were referred by the Senate Committee on Commerce and Labor to the Legislative Transition Task Force, predecessor to the Restructuring Commission.

In the interim, Senator Watkins revised the proposals and combined their provisions into a single item of legislation. The legislative proposal was presented to the Restructuring Commission at its January 15, 2004, meeting. The measure was intended to address the problem of the lack of development of competition by removing barriers to consumer switching. He noted that it was intended to supplement, and not be an alternative to, the rate cap extension proposal.

Major elements of the draft legislation (Appendix J) include:

- Exempting a customer who purchases electric energy from a competitive supplier and who is otherwise subject to a minimum stay period (currently 12 months unless otherwise authorized) from the minimum stay requirement if the customer agrees to purchase electric energy from the incumbent provider or default service provider at market-based rates;
- Prohibiting customers exempted from minimum stay periods from purchasing retail electric energy from their incumbent electric utilities at its capped rates unless such customers agree to satisfy any then-applicable minimum stay period;
- Authorizing industrial and commercial customers, as well as aggregated customers in all rate classes, subject to such demand criteria as may be established by the SCC, to switch to a competitive service provider without paying a wires charge for the duration of the capped rate period ending July 1, 2007, if they agree to pay market-based prices if they ever return to the incumbent electric utility; and
- Prohibiting customers who make such an agreement and then obtain power from suppliers without paying wires charges from purchasing power from their incumbent utilities at capped rates, but permitting them to purchase electric energy from their incumbent utilities at market-based rates for generation capacity and energy.

The Restructuring Commission unanimously voted at its January 15, 2004, meeting to endorse Senator Watkins' proposal regarding minimum stay requirements and wires charges for switching customers.

d. Municipal Aggregation

Senator Watkins' second proposal represented an attempt to accelerate the pace of retail switching by emulating the municipal aggregation programs implemented in portions of Ohio.

In Ohio, municipalities have been authorized to use opt-out aggregation, pursuant to which customers of a utility in a locality that adopts an aggregation program will be switched to the competitive supplier selected to serve the aggregated load unless they affirmatively elect not to participate in the aggregation program. Section 56-589 of the Restructuring Act has allowed municipal aggregation since its enactment in 1999, but required that the aggregation only be allowed on a voluntary, opt-in basis in which each such customer must affirmatively select such municipality or other political subdivision as its aggregator. The Restructuring Act has also provided that the municipality or other political subdivision may not earn a profit but must recover the actual costs incurred in such aggregation.

Senator Watkins proposal was presented to the Restructuring Commission at the January 15, 2004, meeting. The draft legislation (Appendix K) eliminates the requirement that municipal aggregation be on a voluntary, opt-in basis, and allows aggregations to be conducted either on an opt-in or opt-out basis, and eliminates the requirement that the municipality not earn a profit by its aggregation program but must recover its actual costs. The Restructuring Commission unanimously voted at its January 15, 2004, meeting to endorse Senator Watkins' municipal aggregation proposal.

B. STRANDED COSTS AND THEIR RECOVERY

A great deal of the Restructuring Commission's energy was expended on the complex and controversial issue of stranded costs and their recovery. As noted above, many advocates of a suspension of the Restructuring Act's retail choice provisions attribute, at least in part, the lack of the development of retail competition in Virginia to the Act's requirement that some switching customers pay a wires charge -- a stranded cost recovery mechanism -- to their incumbent utility. Wires charges are not the only barrier to competition, because even in the substantial areas of the state where wires charges are not in effect, there is no competition. The debate over extending the capped rate period also implicates the issue of stranded cost recovery because under the Restructuring Act capped rates were intended to serve two purposes -- to protect consumers from price volatility prior to the development of effective competition, and to allow the incumbent utility to recover its stranded costs from customers who do not switch to a competitive provider.

The Restructuring Commission is required, pursuant to § 30-205, to monitor, after the commencement of customer choice and with the assistance of the State Corporation Commission and the Office of the Attorney General, the incumbent electric utilities, suppliers, and retail customers, whether the recovery of stranded costs, as provided in § 56-584, has resulted or is likely to result in the overrecovery or underrecovery of just and reasonable net stranded costs. However, the Restructuring Act neither defines stranded costs nor provides any formula or statutory framework for their calculation. Section 56-584 of the Restructuring Act provides:

> Just and reasonable net stranded costs, to the extent that they exceed zero value in total for the incumbent electric utility, shall be recoverable by each incumbent electric utility provided each incumbent electric utility shall only recover its just and reasonable net stranded costs through either capped rates as provided in § 56-582 or wires charges as provided in § 56-583.

According to the Congressional Budget Office, stranded costs "can be defined as the decline in the value of electricity-generating assets due to restructuring of the industry."[3] In traditional regulated markets, utilities had the exclusive right to sell power to retail customers at rates set by regulators. The rates were set at levels sufficient to allow the utility to recover its costs of prudently incurred investments in electricity-generating assets together with a reasonable return. The portion of a utility's investment in electricity-generating assets, including contracts to purchase power, that is not paid back through the rates paid by customers is considered the net booked value of the asset.

In a deregulated system, a utility has no assurance that it will continue to collect revenue to pay for its investments in these assets. If retail competition introduces market-based prices that are lower than what the utility charged under regulated rates, the utility risks losing revenue in two ways. First, the utility may lose customers to competitors, because the utility will no longer have a monopoly over the provision of service in its territory. Second, the utility's revenue from sales to its remaining customers will decline to the extent it is deterred from charging rates that exceed this lower, market-based price. As the utility's earnings from its electricity-generating assets fall, the value of these assets also falls (because the market value of an asset is determined by the present value of the revenue stream generated by the asset).

If the market value of the utility's generation-related assets is less than the net booked value of the assets, then the utility can be said to have "stranded" costs, which equal the amount by which the book value of the assets exceeds the assets' market value. This difference in values is "stranded" in the sense that it is a portion of the utility's investment that the utility can no longer be expected to recover because of the shift from the traditional regulated system to a market-based system.

The move to a restructured system was expected to create windfall gains or losses for utilities with electricity-generating assets. Utilities that experience windfall gains are likely to be ones that own highly depreciated generating plants or facilities with low fuel costs, which may be able to charge higher market prices than they could under regulation. On the other hand, utilities that invested large amounts in high-cost power generating facilities and entered into above-market cost power purchase contracts, as was required by the federal Public Utility Regulatory Policies Act of 1978 (PURPA), are more likely to have stranded costs. However, whether stranded costs are to be incurred is generally expected to turn on whether the market price for power is less than the rates that such a utility was charging under the traditional system, assuming there are no impediments to transmitting and delivering such lower-priced power to consumers.

The decision by states that have enacted restructuring legislation to compensate utilities for stranded costs is rooted in the theory of the "regulatory compact," which holds that utilities, in exchange for fulfilling their obligation to serve all customers within certificated service territories, will be allowed to recover their prudently incurred costs of providing service through regulated rates. Under this theory, an abandonment of this traditional, cost-of-service-based system must allow a utility to recover the prudent investments that it incurred while it was

[3] Electric Utilities: Deregulation and Stranded Costs, Congressional Budget Office (Washington, D.C., October 1998) at 3.

regulated to the extent that these investments are rendered uneconomical by the transition to the new competition-based system.

As was noted in last year's report of the Legislative Transition Task Force, stranded cost recovery was one of the most critical policy hurdles the joint subcommittee studying restructuring of the electric utility industry addressed as it developed Virginia's restructuring bill. The joint subcommittee created a stranded costs restructuring commission to address issues pertaining to stranded costs recovery. The report of the Stranded Costs Restructuring Commission is appended to the 1999 report of the Joint Subcommittee Studying Restructuring of the Electric Utility Industry (Senate Document 34).

1. Stranded Cost Report

At its meeting on January 27, 2003, the Legislative Transition Task Force requested the SCC to convene a work group for the purpose of developing consensus recommendations on two issues by July 1, 2003. The first issue was to develop definitions of "stranded costs" and "just and reasonable net stranded costs." The second issue was to develop a methodology to be applied in calculating each incumbent electric utility's just and reasonable net stranded costs and the amounts recovered, or to be recovered, to offset just and reasonable net stranded costs. The work group was then to use the methodology and definitions developed in the first stage of its work to quantify the amount of each incumbent electric utility's just and reasonable net stranded costs and the amount that each incumbent electric utility has received, and is expected to receive over the balance of the capped rate period, to offset just and reasonable net stranded costs from capped rates and from wires charges. This second report was due by November 1, 2003.

On March 3, 2003, the SCC entered an order docketing Case No. PUE-2003-00062, which established the procedure for complying with the Legislative Transition Task Force's January 27, 2003, resolution. The work group convened by the SCC held four meetings during which issues related to the definitions and methodologies were discussed.

On July 1, 2003, the SCC delivered to the Restructuring Commission its report addressing definitions of "stranded costs" and "just and reasonable net stranded costs" and methodologies for monitoring the overrecovery or underrecovery of stranded costs. A copy of the SCC's July 1, 2003, report on stranded costs can be accessed through the SCC's website at http://www.state.va.us/scc/division/eaf/comments_strandedcosts.htm.

The SCC's July 1 report describes the approach to stranded costs incorporated in the Restructuring Act as very different from approaches employed in other jurisdictions. The report observes that stranded costs are not easy to measure and are invariably controversial. Methods used or considered to determine stranded costs differ by whether stranded costs are quantified before or after restructuring takes place, whether they are based on estimates or on an actual market valuation of assets (as determined by sales required by asset divestiture requirements), and whether they look at a utility's assets individually or on an aggregate basis.

Ronald Gibson, Director of the SCC's Division of Public Utility Accounting, presented an overview of the July 1 stranded cost report at the Restructuring Commission's November 19,

2003, meeting. He advised that the work group did not develop consensus recommendations on either the definitions of "stranded costs" and "just and reasonable net stranded costs" or the methodologies for monitoring or measuring the overrecovery or underrecovery of stranded costs.

With respect to the definitional issues, differences among participants involved whether such costs should be defined as lost revenues or loss in economic value, and whether the definition should include stranded cost components, such as transition costs. DVP asserted that no further definition of just and reasonable net stranded costs is necessary because such costs are defined by the methodology for determining wires charges in § 56-583 of the Restructuring Act. Ultimately, the SCC staff recommended defining stranded costs as a utility's net loss in economic value arising from electric generation-related costs that become unrecoverable due to restructuring and retail competition. The SCC Staff recommended defining just and reasonable net stranded costs as a utility's net loss in economic value arising from prudently incurred, verifiable and non-mitigable electric generation-related costs that become unrecoverable due to restructuring and retail competition.

With respect to the methodology for monitoring or measuring the recovery of stranded costs, the work group's deliberations focused on four options:

- DVP's monitoring approach, which includes reporting to the Restructuring Commission (i) the over- and under-recovery of stranded costs collected through wires charges paid by switching customers, (ii) actual "above-market" or "potential" stranded cost exposure under capped rates, (iii) amounts expended from funds available under capped rates to mitigate potential stranded costs, and (iv) additional expenditures that increase stranded costs during the transition period.
- Staff's asset valuation approach, which calculates just and reasonable net stranded costs by comparing asset values based on net present value cash flows that arise from remaining in a regulated market (cost plus a fair return) to the net present value cash flows that arise in a competitive market over the life of the assets. The overrecovery or underrecovery of these stranded costs is determined by subtracting from this amount the recoveries via capped rates (using the portion of the capped rates that exceeds actual costs plus a fair return) and wires charges.
- Staff's accounting approach, which was offered for use in conjunction with the step of staff's asset value approach when amounts collected from capped rates are calculated in determining the overrecovery or underrecovery of stranded costs, or as an alternative to DVP's monitoring approach. Based on an earnings test mechanism, it would compare actual generation costs (including a fair return) to market-based rates for the test year to calculate the potential stranded cost exposure.
- VCFUR/ODCFUR approach, which is similar to the staff's asset value methodology to calculate total just and reasonable net stranded costs, and an earning test analysis to calculate recoveries of stranded costs via capped rates. The difference from the Staff's asset value approach is that this approach calculates the net present value of the difference between the revenues that arise from remaining in a regulated market and the revenues that arise in a competitive market using a single discount rate, while the Staff's approach uses different discount rates in the net present value calculations

in order to recognize the differences in risk associated with regulated and competitive markets.

DVP's monitoring approach generally was supported by incumbent electric utilities and the Virginia Independent Power Producers. Mr. Gibson remarked that this approach has the advantage of ease of calculation. The principal disadvantage of the approach is its failure to comply with the Task Force resolution's request that the recommended methodology be able to be used to calculate a utility's just and reasonable net stranded costs; this approach does not calculate the utility's total stranded costs. In addition, it gives the impression that a yearly calculation of stranded costs is developed. However, by comparing current capped generation rates to actual market prices, it fails to show the effect that mitigation efforts have had on the utility's actual generation costs. Mr. Gibson suggested that a better comparison would be between market prices for generation and the utility's actual costs of generation, rather than to the capped generation rates that are based on 1996 costs.

In addition, DVP's monitoring approach fails to calculate the amount of just and reasonable net stranded costs that have been recovered through the utility's capped rates. Section 56-584 of the Restructuring Act provides that just and reasonable net stranded costs are to be collected through capped rates from customers who stay with the utility. DVP's monitoring approach only examines the amount of just and reasonable net stranded costs that have been recovered through wires charges paid by switching customers. Mr. Gibson noted that the SCC Staff's accounting approach provides an alternative to DVP's monitoring approach, as it provides a more accurate calculation of potential stranded cost exposure by comparing the utility's generation costs plus a fair return to the prices experienced during the year. Annual recoveries of stranded costs during the capped rate period can be examined using an earnings test mechanism that measures stranded cost recoveries as those earnings from capped rates that exceed costs and a fair return.

Mr. Gibson described the third and fourth reporting elements of the DVP's monitoring approach (amounts expended to mitigate potential stranded costs and additional expenditures that increase stranded costs) as unnecessary because mitigation costs and other expenditures are included in the utility's costs used in the SCC staff's alternative accounting methodology.

The SCC staff's primary proposal complies with the requirements of the Task Force resolution's request for the methodology that can be used to calculate a utility's just and reasonable net stranded costs and the amounts collected through the Restructuring Act's stranded cost recovery mechanisms. The approach received general support from consumer groups and competitive service providers who participated in the work group. The Staff's asset valuation approach was criticized by incumbent electric utilities that participated in the work group and the Virginia Independent Power Producers as being complex and inconsistent with the Restructuring Act. Consumer Counsel of the Attorney General's Office cautioned that this approach likely would require involved proceedings with expert testimony subject to cross examination, but stated that:

> While many details regarding the calculation mechanics and assumptions will have to be addressed in order to apply this proposal, it appears that the conceptual framework is not

inappropriate, and is consistent with lost revenues approaches that have been used in other jurisdictions to quantify stranded costs.

In response to concerns that the asset valuation methodology relies on speculative projections regarding prices and costs, Mr. Gibson observed that electric utilities are required today to file similar studies in applications involving asset transfers and in tax assessment studies. In addition, DVP used such a similar approach in estimating its potential stranded costs in 1997 to be $2.5 billion.

Mr. Gibson advised the Restructuring Commission that the SCC could not proceed with the second phase of the project requested by the Legislative Transition Task Force's January 27, 2003, resolution, which called for a report due by November 1, 2003, that calculates each incumbent electric utility's just and reasonable net stranded costs and its associated recoveries from capped rates and from wires charges during the capped rate period. As the stranded cost work group did not develop consensus recommendations regarding the definition of stranded costs or the method for their calculation, the SCC asked the Restructuring Commission whether it wished the SCC to make such calculations and, if so, whether it wanted the SCC to employ a particular methodology or to determine which methodology should be employed.

2. Responses To Stranded Cost Report

The Restructuring Commission received comments on the SCC's July 1, 2003, stranded cost report from interested parties at its meeting on November 24, 2003. Meade Browder of the Office of the Attorney General's Division of Consumer Counsel identified the crux of the debate over stranded cost issues as the fact that the Restructuring Act did not require an up-front determination of utilities' just and reasonable net stranded costs, but does require the Restructuring Commission to monitor the underrecovery or overrecovery of such costs. With regard to the proposed definitions of stranded costs and just and reasonable net stranded costs, Mr. Browder noted that the definitions recommended by the SCC staff follow the recommendations of the Attorney General's Office. With respect to a stranded cost quantification methodology, he reiterated the comments submitted during the work group process that the asset valuation method is not inappropriate, and is consistent with lost revenues approaches that have been used in other jurisdictions, including Texas.

Edward Petrini, representing the VCFUR, concurred that the VCFUR's position on the methodology for calculating stranded costs is essentially identical to that recommended by the SCC Staff. He stated that the timeliness and importance of the Restructuring Commission's consideration of stranded costs cannot be over-emphasized. Under the Restructuring Act, a utility's just and reasonable net stranded costs are to be recovered through wires charges and capped rates, and if the capped rates and wires charges produce revenue that exceeds the utility's costs, the excess is available for stranded cost recovery. However, Mr. Petrini contends that because DVP has no stranded costs, and because its revenues significantly exceed its cost of service plus a fair return, the utility's customers are paying unjustified, excessive rates. In support of this position, he cited the SCC Staff's analysis of DVP's earnings from 1999 through 2002, which shows that the utility accumulated $886 million for stranded cost recovery. He asserts that the situation is exacerbated by the Restructuring Act's provision allowing a utility's

capped rates to be adjusted for increases in its fuel costs. Since 1998, the portion of Virginia Power's capped rates that recovers its fuel costs has increased from 1.050 cents/kWh to 1.613 cents/kWh, and would go to 2.331 cents/kWh if Dominion's 2003 fuel factor increase request had been implemented as requested.

Mr. Petrini and Louis Monacell, representing the ODCFUR, introduced Jeff Pollock of the energy consulting firm of Brubaker & Associates, who was retained by the ODCFUR and the VCFUR to determine whether AEP and DVP have stranded costs. A copy of Mr. Pollock's presentation is attached as Appendix L. Mr. Pollock testified that based on a methodology developed by Moody's Investors Services, rather than having stranded costs, AEP has $874 million in stranded benefits and DVP has $1.2 billion in stranded benefits. The Moody's methodology was described as an example of an asset valuation methodology that provides a snapshot of stranded costs by using publicly available data to determine whether the regulatory net book value of generation assets can be sustained in a competitive market environment.

With respect to his conclusion that DVP has $1.2 billion in stranded benefits, Mr. Pollock observed that the utility's 1997 Transition Cost Report used a detailed asset valuation of its generation fleet and non-utility generator contracts to calculate that it faced $2.5 billion of potentially stranded costs. The 1997 valuation estimated the free cash flows from the generation fleet operating in fully competitive markets through 2015, using an assumption that competitive suppliers would serve all of DVP's customers on January 1, 2003. Mr. Pollock asserts that by correcting two flaws in the utility's 1997 analysis (extending the estimated useful life of its generation fleet to 2035 rather than 2015, and using a capacity value that encourages competition), he determined that DVP would have $2.7 billion of stranded assets. Four other flaws cited in DVP's 1997 analysis, including its ignoring of market power, were not addressed by Mr. Pollock. He added that since the 1997 analysis was conducted, market prices for electricity have increased, which increases the value of the utility's generation fleet, and the utility has extended the lives of its nuclear plants by 20 years, which allows the utility to profit in competitive markets because the operating cost of a nuclear plant is 15 percent (or less) of the wholesale market price of electricity.[4] In addition, several of DVP's power purchase contracts have either expired or been renegotiated, which has reduced the utility's commitment under purchased power contracts by approximately $1 billion on a net present value basis.

Mr. Pollock also stated that unless customers switch from their current regulated utility, the utility has no stranded costs, and that because only a few customers have switched suppliers, no costs have been stranded. In response to a question from Senator Watkins regarding market power, Mr. Pollock conceded that if Virginia's utilities became members of a regional transmission entity, its vertical market power would be lessened. However, he cautioned that the utility would still be able to exercise horizontal market power to the extent that it continued to have a concentration of generation resources in a market area.

Several persons stated that an incumbent utility has not incurred any actual stranded costs unless its customers have switched to a competitor. Yet an incumbent utility may still not suffer any actual stranded costs by the switching of its customers to a competitive provider during the

[4] In its order approving DVP's fuel factor increase for 2004, the SCC observed that the recent 20-year extension of the federal licenses for DVP's four nuclear reactors in Virginia creates an increase in value of between $1.95 billion and $4.27 billion.

transition period, to the extent that the utility is fully compensated for its lost revenues through the payment of wires charges. If there is little or no switching to competitors during the transition period, which is the time that the utility is collecting moneys to offset its potential just and reasonable net stranded costs, any moneys collected from wires charges and capped rates will necessarily exceed its actual stranded costs. However, stranded cost recovery mechanisms are intended to reimburse incumbent utilities for the potential stranded costs they may incur over the remaining useful life of the utility's assets, which extends long after the end of the transition period. The controversy over quantifying stranded costs be phrased as whether the Restructuring Commission should attempt to determine whether the stranded cost recovery mechanisms included in the Restructuring Act are likely to under- or over-compensate a utility for the potential stranded costs it is expected to incur after the transition period. Moreover, a utility, in theory, may incur stranded costs even if few or no customers switch to a competitor if the utility lowers the retail price of its generation to match the prices charged by its competitors. Under this example, the difference in the revenue it would have collected under regulated rates and the revenue it collects under the lower market-based prices could be viewed as a measure of its stranded costs.

Michael Swider of Strategic Energy LLC, a competitive service provider active in other states, supports the SCC Staff's recommended asset valuation methodology. Other than requiring incumbent electric utilities to sell off their assets, the asset valuation method is the best method of determining their value. Accurately quantifying stranded costs is important because they are the justification for wires charges, which he called a barrier to competition. A copy of his comments is attached as Appendix M.

Ray Bourland of Allegheny Energy reminded the members of the Restructuring Commission that his utility is in different circumstances than other utilities. Pursuant to agreements regarding Allegheny's functional separation plan, the utility transferred its generation assets to other entities and signed a stipulation that it would recover its stranded costs only from capped rates. He cautioned the Restructuring Commission not to do anything that would cause the delicate and complex agreement to unravel.

Irene Leech of the VCCC concluded that if the Restructuring Commission wants to ensure that stranded cost recoveries are monitored as the Restructuring Act requires, it should direct the SCC to use the methodology it believes is most fair and not allow parties to influence the method. A copy of her comments is attached as Appendix N.

The Virginia Independent Power Producers (VIPP) and DVP spoke in opposition to the SCC Staff's recommended asset valuation approach. August Wallmeyer of the VIPP, which generates 20 percent of the power that DVP sells in the Commonwealth, asserts that the asset valuation approaches recommended by the SCC Staff and the VCFUR and ODCUR are inconsistent with the basic approach to stranded cost recovery set out in the Restructuring Act. Mr. Wallmeyer, whose comments are attached as Appendix O, described DVP's monitoring approach as a useful indicator of whether an underrecovery or overrecovery of stranded costs may occur in the future. The VIPP opposed use of the SCC Staff's accounting approach on grounds that nothing in the Restructuring Act authorizes the SCC to use an earnings test

mechanism. In Mr. Wallmeyer's opinion, such an approach would require the utility and the SCC Staff to engage in complex annual rate cases.

Bill Axselle of the VEPA contended that economic development was one of the underlying purposes of the Restructuring Act. Revenues collected under the Restructuring Act's stranded costs recovery mechanisms were intended to be available to make the utilities able to compete effectively in a competitive environment, in contrast to the fate of Virginia's banks following the advent of consolidations in the financial sector in the 1980s. He noted that it could be said that the parties involved in the development of the Restructuring Act made a deal regarding the collection of stranded costs over the transition period, and it would be wrong to change the deal prematurely. Mr. Axselle offered no comment on the corollary proposition, viz., whether extending the end of the capped rate period from July 1, 2007, through 2010 would likewise constitute a change to the terms of the "deal" for stranded cost recovery. Mr. Axselle did urge the Restructuring Commission to exercise caution in proceeding on the very complex issue of stranded cost recovery.

The VCFUR approach was likewise criticized for implicitly requiring annual rate cases to determine the amount of "excess" earnings from capped rates that should be considered available for stranded cost recovery. According to the VIPP, only DVP's monitoring approach is consistent with the key concept underlying the Restructuring Act's stranded cost provisions: that stranded costs are not to be administratively determined and recovered on a dollar-for-dollar basis through discrete rate mechanisms, as in other jurisdictions.

William G. Thomas, representing DVP, asserted that the January 27, 2003, resolution of the Legislative Transition Task Force that requested the SCC to convene the work group on stranded costs required that the consensus recommendations it was to develop be "consistent with the provisions of the Act." Mr. Thomas' comments reflected his view that only the approach advanced by DVP is consistent with the provisions of the Act. In support of this view, he cited testimony in 1998 by Richard Williams, the former director of the Division of Economics and Finance, that reliance on an up-front, one-time projection of market prices over the remaining useful life of a utility's assets, as would be required under an asset valuation methodology, can lead to a public policy disaster. It was noted that a 15 percent change in the assumptions regarding future market prices of electricity would produce a completely different result. The joint subcommittee established by Senate Joint Resolution 91 of 1998, which grappled with developing a methodology for measuring stranded costs, rejected a divestiture approach and did not require a "going in" rate case to quantify stranded costs.

Mr. Thomas stated that in place of the divestiture approach, the members of SJR 91 accepted a revenue loss method for determining stranded costs that had been suggested by Mr. Williams. Under this approach, stranded costs or benefits were to be defined as the difference between regulated embedded rates and competitive market prices. As with the method of calculating wires charges, the unbundled generation portion of the utility's rate would be compared to the market rate for generation. Mr. Thomas stressed that this stranded cost recovery approach was a negotiated element of the "deal" that produced the Restructuring Act, as were the July 1, 2007, expiration of the capped rate period, the utility's waiver of the right to

reimbursement for certain transition costs such as computer system changes, and the agreement not to address stranded benefits.

With respect to the appropriate definition of stranded costs, Mr. Thomas favored a proposal, offered by the Office of the Attorney General, that defined such costs as a utility's lost revenues arising from electric generation-related costs that become unrecoverable due to restructuring and retail competition. Under the method proposed by DVP, stranded cost revenues collected annually will be compared with that which would have been collected had the SCC's forecasted market price been realized. At the end of the capped rate period, this would enable a determination of whether the amount of stranded cost revenue, to which each utility would be entitled under the Act, had been overrecovered or underrecovered. This approach uses actual historical data and requires no amendment of the Act to define stranded costs or to prescribe a monitoring methodology. He asserted that it is not in conflict with the Act's principle of deregulation of generation, and operation under the capped rates will continue to drive efficiency improvements and stranded cost mitigation as intended.

With respect to the appropriate methodology for monitoring stranded costs, Mr. Thomas expressed his view that a quantification of stranded costs is contrary to the Restructuring Act.[5] The SCC Staff's approach was criticized as requiring a going-in stranded cost case, annual rate cases, and the need for the General Assembly to amend the Act to address numerous controversial issues, such as the date as of when the quantification of a utility's stranded costs would be determined. Moreover, opening a protracted procedure to quantify stranded costs will inject great uncertainty into the ability of utilities to plan and budget for the future and will send a signal to the financial community that Virginia's utilities are exposed to a substantial financial risk. Efforts to quantify stranded costs would threaten the financial viability of Virginia's utilities and impair their ability to effectively plan and maintain an adequate infrastructure. A copy of DVP's objections to the quantification of stranded costs is attached as Appendix P.

3. Proposals to Address Stranded Cost Issue

a. Calculating Stranded Costs and Amounts Collected for their Recovery

At the January 15, 2004, meeting, the Restructuring Commission received information regarding Delegate Harvey B. Morgan's proposal to address stranded costs issues. The proposal would codify the asset valuation methodology for quantifying incumbent electric utilities' just and reasonable net stranded costs that was recommended by the SCC Staff in its July 1, 2003, report to the Restructuring Commission. In addition, if a utility has overcollected stranded costs, the bill prohibits the utility from continuing to collect wires charges and requires its capped rates to be reduced, for the remainder of the capped rate period, to an amount equal to its costs of providing service plus a reasonable return. If the utility is expected to under-collect its stranded costs over the remainder of the capped rate period, the utility's capped rates will be increased to help avoid an under-recovery of stranded costs.

[5] Though the Act does not expressly require a "going-in" case to quantify stranded costs, § 56-584 provides that utilities may recover their stranded costs "to the extent they exceed zero value in total for the utility" through wires charges and capped rates. There has been no discussion of whether the requirement that stranded costs exceed zero value in total requires a determination that a utility will incur stranded costs, rather than receive stranded benefits, before collecting revenues for stranded cost recovery through wires charges and capped rates.

Major elements of the draft legislation (Appendix Q) include:

- Requiring the SCC to calculate the amount of each incumbent electric utility's just and reasonable net stranded costs as of the date of the commencement of customer choice (January 1, 2002);
- Defining a utility's "just and reasonable net stranded costs" as the net loss in the economic value of the utility that is attributable to prudently incurred, verifiable and nonmitigable electric generation-related assets that become unrecoverable due to restructuring and retail competition;
- Requiring the SCC to conduct proceedings for each utility to determine the amount by which the unrecovered booked value of all of the utility's generation-related assets and related costs is greater than the market value of the utility's generation-related assets, based on the net present value of the cash flows that reasonably would be expected to be generated from such assets in a competitive market, using reasonable estimates of market prices for the applicable future periods, and adjusted for anticipated operations and maintenance costs, over the life of the assets;
- Requiring the SCC to calculate the amount that the utility has collected for their recovery, through capped rates (based upon earnings test information filed by the utility under the Commission's applicable rate case regulations and annual informational filing requirements) and wires charges, if the utility is determined to have just and reasonable net stranded costs;
- If a utility had no just and reasonable net stranded costs or has collected its just and reasonable net stranded costs, eliminating the utility's authority to collect wires charges and reducing the utility's capped rates to reflect its cost of service plus a fair return; and
- Allowing a utility to increase its capped rates if the amounts collected through capped rates and wires charges will not permit it to recover its just and reasonable net stranded costs during the balance of the capped rate period.

The Restructuring Commission voted not to endorse Delegate Morgan's stranded cost proposal.

b. Stranded Cost Resolution

By letter dated January 12, 2004, Deputy Attorney General Jagdmann advised the members of the Restructuring Commission that the use of the SCC Staff's accounting approach as a stand-alone method would be appropriate as a practical compromise approach for monitoring stranded cost recoveries (Appendix R). Ms. Jagdmann acknowledged that the most controversial aspect of this approach will likely be the determination of the appropriate return on equity percentage, but noted that protracted proceedings could be avoided by presenting the data to the Restructuring Commission in several scenarios using various returns on equity.

On January 15, 2004, Ms. Jagdmann presented a resolution to the Restructuring Commission that incorporates the proposal outlined in her January 12 letter. The resolution, a copy of which is attached as Appendix S, requests the Division of Consumer Counsel of the Office of Attorney General to:

- Report annually, commencing September 1, 2004, to the Restructuring Commission (i) the cost of service of each incumbent electric utility's generation and (ii) the market prices for generation as calculated for wires charge purposes immediately prior to the date of the report, with the first report covering the period from July 1, 1999, through December 31, 2003;
- Take into account, in determining generation costs of service, factors such as the incumbent electric utility's applicable annual informational filing to the SCC, any adjustments to the filing made by the SCC, example ranges of return on common equity, and such other factors as the Division of Consumer Counsel deems relevant;
- Take into account, in determining market prices for generation, market prices as determined by the SCC and such other factors as the Division of Consumer Counsel deems relevant; and
- Continue to make such reports for each incumbent electric utility until the capped rates for such utility expire or are terminated pursuant to the provisions of § 56-582.

The Restructuring Commission unanimously voted at its January 15, 2004, meeting to adopt the resolution presented by the Office of the Attorney General.

c. Phasing Out Wires Charges

At the Restructuring Commission's January 13, 2004, meeting, Michel A. King, President of Old Mill Power Company, presented a proposal to phase out wires charges prior to July 2007. He characterized wires charges as the greatest single impediment to the development of a robust competitive electricity market in Virginia. Wires charges, which are currently payable only by customers in DVP's service territory who switch to a competing supplier, were said to be particularly effective at thwarting competition.

Reasons cited by Mr. King for this conclusion are that they remain in full force throughout what was intended to be a transition period for the development of full retail competition; they are recalculated annually and therefore create a significant amount of cost uncertainty for competitive suppliers and their prospective customers; and they are based on wholesale prices in neighboring electricity markets in such a way that any potential "head room" for competitive suppliers, and thus any potential savings that could be passed on to consumers that is created by decreasing wholesale prices in such neighboring electricity markets is erased by the wires charge calculations.

Under the Old Mill Power Company's proposal (Appendix T), on July 1, 2004, the wires charge would be reduced to 67 percent of the full wires charge that was in effect on January 1, 2004; beginning July 1, 2005, the wires charge would be reduced to 33 percent of the full wires charge that was in effect on January 1, 2004; and beginning July 1, 2006, and thereafter, the wires charge would be zero. The Restructuring Commission took no action with respect to the wires charge phase-out proposal.

C. RISK OF CEDING JURISDICTION TO THE FERC

The status of competition both within the Commonwealth and in other jurisdictions has led the SCC to doubt the ability of retail electric competition to provide, at the present time, lower prices for Virginians than would have been charged under the traditional regulation of the industry. As previously mentioned with regard to its August 29, 2003, report on the status of competition, the SCC recommended that the General Assembly take action to preserve Virginia's jurisdiction relating to its electric utility industry by suspending two elements of the Act. Such a suspension would entail rebundling the components of retail electric rates and continuing a moratorium on transferring control over transmission assets to RTEs.

The SCC offered the same recommendation to the Legislative Transition Task Force in the December 2002 addendum to the 2002 report on the status of competition. The December 2002 addendum was prompted by the SCC's concerns that under the FERC's proposed rules for a standard market design (SMD), Virginia will not be able to ensure the same price and reliability protection that it can at present. Problems flowing from implementation of SMD rules include the elimination of native load preferences, the questionable ability of the FERC to oversee monitoring efforts, the potential exercise of market power by wholesale suppliers, increased costs resulting from use of locational marginal pricing (LMP), and regional resource adequacy requirements.

1. Background

Federal and state jurisdiction over the regulation of electric utilities is a complex issue. In Public Utilities Commission v. Attleboro Steam & Electric Co., 273 U.S. 83 (1927), the Supreme Court held that the Commerce Clause barred state regulation of interstate wholesale sales of electricity due to the burden such regulation would impose on interstate commerce. The Federal Power Act of 1935 (FPA) placed under federal regulation the aspects of electricity service that were held under Attleboro and other cases to be beyond the scope of state jurisdictional authority. Section 201(b)(1) of the FPA granted to federal regulators jurisdiction over all facilities for transmission or sale of electric energy at wholesale in interstate commerce. Section 201 (c) provides that "electric energy shall be held to be transmitted in interstate commerce if transmitted from a State and consumed at any point outside thereof; but only insofar as such transmission takes place within the United States." Under § 201(d) of the FPA, "[t]he term 'sale of electric energy at wholesale' when used in this subchapter, means a sale of electric energy to any person for resale." Thus, in every state except Alaska, Hawaii, or Texas, wholesale sales are held to be sales in interstate commerce, and are subject to federal jurisdiction exclusively. Clearly, under the FPA the FERC has jurisdiction over the wholesale transmission of electricity, including the rates for such service. However, the FPA did not grant to the FERC jurisdiction over facilities used in local distribution, used only for transmission of electric energy in intrastate commerce, or for the transmission of electric energy consumed wholly by the transmitter.

The SCC's concern regarding the ceding of jurisdiction over the electric utility industry turns in part on the question of who has the jurisdiction to regulate the components of bundled electricity rates. In New York v. FERC, 122 S. Ct. 1012, 1027-1028 (2002), the Supreme Court

held that FERC has jurisdiction over the transmission component of unbundled retail rates. Three of the justices also said that FERC's authority extends to bundled transmission rates as well. Though the FERC has traditionally not attempted to exercise jurisdiction over the components of bundled rates, the FERC's proposed SMD rules are an attempt by the agency to expand the limits of its traditional jurisdiction. The institution of retail choice programs, which necessarily involve the unbundling of retail rates in order to allow shopping for generation service based on price, has witnessed an expansion of FERC's claimed jurisdiction. For example, in adopting Order 888, the FERC has asserted that its jurisdiction arises as a result of a state retail program. The proposed SMD rules would apply to both bundled and unbundled states. It has been suggested that states with bundled rates are in a better position to challenge the legality of this proposed expansion of the FERC's jurisdiction than are those states whose rates have been unbundled.[6]

The issue of whether the FERC also has jurisdiction to impose SMD rules on states that have not unbundled their rates or allowed utilities to transfer control of their transmission systems to an RTE is currently unresolved. However, the SCC has concluded that it is likely that the FERC's SMD rules would apply in Virginia, regardless of whether the Commonwealth has allowed the transfer of control of its utilities' transmission systems to federally regulated regional transmission entities, because retail electricity rates in Virginia have been unbundled. In short, the SCC's concerns over the ceding of jurisdiction to the FERC do not involve limiting the federal government's well-established jurisdiction over elements of wholesale sales or transmission of electric power; rather, they involve the question of whether the expansion of federal jurisdiction inherent in the proposed SMD rules can be curtailed by rebundling retail rates and deferring the transfer of oversight over transmission assets to RTEs.

On April 28, 2003, the FERC responded to criticism of the proposed SMD rules by issuing a White Paper titled Wholesale Market Platform. However, the SCC concluded that the White Paper neither clarifies the SMD proposal nor alleviates its concerns with the SMD notice of proposed rulemaking. Moreover, the U.S. Department of Energy's April 30, 2003, report to Congress assessing various potential impacts of the proposed SMD rulemaking shows that a majority of the areas of the country will either have no benefit or have retail rates actually increase as a result of SMD. The SCC notes that Virginia customers, as a result of moving to retail competition under Virginia law and the pricing and other requirements of SMD, will likely see significant rate increases when the capped rate period ends in 2007.

SCC Deputy General Counsel Arlen Bolstad reviewed developments with the federal energy bill and FERC-related activity at the January 13, 2004, meeting. The Energy Policy Act of 2003, designated H.R. 6, became stalled in November 2003 when the Senate failed to adopt the conference committee report, which had previously been adopted by the House of Representatives. Mr. Bolstad's remarks focused on three aspects of the bill. Section 1232 would have stated the sense of Congress that state membership in regional transmission organizations should be voluntary. With respect to SMD, the language in the conference committee report would have suspended FERC's authority to promulgate standard market design rules and

[6] See the memorandum prepared by Susan N. Kelly, Esq., dated January 24, 2003, attached as Appendix F to the 2003 Report of the Legislative Transition Task Force (Senate Document 17).

prevented such rules from taking effect prior to January 1, 2007. The provisions in the energy bill dealing with native load protection were described as engendering much uncertainty.

2. SCC's Recommendation to Suspend Portions of the Act

In part III of its 2003 competition status report, the SCC renewed its recommendation that the General Assembly suspend portions of the Act. Suspension of the Act would require rebundling the components of retail electric rates and continuing a moratorium on transfers of control over transmission assets to RTEs. The General Assembly could allow other aspects of the Act to continue to evolve while these two elements of the Act are temporarily suspended. Such a pause in implementation of the Act was described as the best course to preserve Virginia's ability to protect its citizens from the problems that are likely to result from the ceding of regulatory authority to FERC and RTEs. Reversing the Act's requirements that retail rates be unbundled and deferring the requirement that utilities join an RTE would give Virginia the opportunity to wait until the FERC has finalized its SMD rules, courts have determined whether the proposed rules are valid, or Congress has acted. After these alternatives have run their course, Virginia could then make an informed decision on whether to proceed with retail competition. The SCC believes that delaying the decision of whether to be subject to the FERC's SMD rules would not significantly affect the Commonwealth. The SCC concludes that even more distressing than the absence to date of sought-after competitive activity is the likelihood that the implications of the SMD rules will be detrimental to Virginia's electricity consumers.

Howard Spinner presented the SCC's recommendations at the Restructuring Commission's November 19, 2003, meeting. He observed that the rebundling of retail electric rates could be accomplished at little cost by making a simple tariff filing, and that customer bills could for informational purposes continue to show separately the costs of generation, transmission and distribution services. The suspension of these key portions of the Act is in the public interest, he asserted, because delaying implementation is a prerequisite to the preservation of state jurisdiction. Though it is a prerequisite to continued state jurisdiction, it does not guarantee that Virginia will retain jurisdiction in the long run. In light of the uncertainty created by pending federal energy legislation and other circumstances, Mr. Spinner contended that suspending certain portions of the Act will allow Virginia to retain the maximum degree of control over electric industry outcomes that will impact this Commonwealth. If rates remain unbundled or control of the transmission system is transferred to an RTE, then Virginia's choice likely will have been made, and it will be difficult if not impossible to reverse the choice.

In response to a comment by Senator Watkins regarding the need for an unbiased examination of the operation of wholesale electricity markets, Mr. Spinner concurred that it is not clear that all parties have the same incentive to conduct a critical examination. Many high-cost states in the northeast have committed to a competition while states in the southeast have objected to the FERC's proposals that would require RTE membership. Mr. Spinner stated that the FERC is trying to promote competition, and has no incentive to be critical of how markets are actually working.

The reaction of interested persons to the SCC's suspension proposal was mixed. Mr. Urchie Ellis spoke at the January 13, 2004, meeting in favor of the SCC's proposal to suspend

provisions of the Act in order to preserve jurisdiction. Irene Leech of the VCCC, speaking at the November 24, 2003, meeting, recognized the need to protect the Commonwealth's jurisdiction. Bill Axselle of the Virginia Energy Providers Association urged the Restructuring Commission not to change the deadline for utilities to join an RTE. Mr. Axselle asked that the SCC act as quickly as possible on AEP's and DVP's pending applications to join PJM. He stated that there is no need to make a decision regarding the rebundling of rates until Virginia has become a part of PJM and has observed the implementation of the proposed DVP retail access pilot programs. Richard Wodyka of PJM Interconnection LLC stated that a robust, nondiscriminatory and competitive wholesale market is a prerequisite to retail competition. He denied that DVP or AEP would be required to shed load for economic reasons if they became members of PJM, and described PJM's market monitor as an independent office that can be a resource for the provision of information regarding the operation of PJM's wholesale market.

At the January 13, 2004, meeting of the Restructuring Commission, Mr. Bolstad reiterated the SCC's recommendation that retail competition be suspended. He remarked that the proposal offered by Delegate Morgan conforms to the SCC's recommendation contained in the August 29, 2003, competition status report. He noted that while FERC, under § 205 of the FPA, has had jurisdiction over the rates, terms and conditions of transmission service provided in interstate commerce for many years, it has been an article of faith that federal and state regulators have had joint jurisdiction over the ownership and control of such assets. Concern that FERC's SMD initiative will change the jurisdiction of states with respect to the control of system assets has prompted the SCC to recommend that provisions of the Act be suspended, as discussed above, in order that the General Assembly can reexamine important issues when the agencies, courts and Congress have addressed the FERC's proposal and answered the question of whether the traditional role of states in regulating the industry should be curtailed or maintained.

In response to a question from Delegate Scott regarding the ability to rebundle rates in the future, Secretary Schewel questioned the validity of the assumption that rebundling will protect Virginia by eliminating FERC's jurisdiction. In fact, the SCC's position has not been that rebundling would eliminate FERC's jurisdiction; rather, it has been that if Virginia does not rebundle, the FERC would clearly have jurisdiction over unbundled services, while if Virginia does rebundle, the FERC may not be able to extend its jurisdiction to certain aspects of Virginia's utility industry. Ms. Jagdmann agreed that while the FERC has traditionally stopped short of attempting to regulate elements of bundled service, the agency appears to no longer recognize any distinction between those states that have unbundled and those that are still bundled. She added that nothing in the proposed rate cap extension legislation would prevent Virginia from coming back and rebundling in the future.

Delegate Morgan prefiled the draft "rebundling" legislation (Appendix U) as House Bill 264. Major elements of the legislation include:

- Suspending customer choice until July 1, 2007, unless the SCC finds that rate unbundling will not result in the Commonwealth ceding its jurisdiction and authority to ensure reliable service at reasonable rates;
- Directing the SCC to immediately rebundle incumbent electric utilities' rates; and

- Requiring the SCC to take, during the period when customer choice is suspended, such actions as the SCC finds necessary to protect the Commonwealth's jurisdiction to ensure reliable electric service at reasonable rates.

The Restructuring Commission voted at its January 15, 2004, meeting not to endorse Delegate Morgan's rebundling proposal.

Delegate Morgan also announced at the January 15, 2004, meeting that he and members of the consensus group had agreed upon an amendment to the suspension proposal to require the rebundling of rates. Delegate Morgan announced that if his amendment to the suspension proposal is adopted, he would neither push for the adoption of, nor withdraw, his stranded cost proposal or his rebundling proposal. The amendment to the suspension proposal, a copy of which is attached as Appendix V, requires the SCC to direct the immediate rebundling of the generation, transmission, and distribution components of incumbent electric utilities' retail electricity rates. Thereafter, for so long as the affected section remains in effect, the retail rates shall be bundled rates. However, the SCC shall permit, on an experimental basis, the unbundling of the components of retail rates in order to implement retail customer choice pilot programs.

As previously noted, the Restructuring Commission voted not to endorse the consensus suspension proposal. This action obviated the need for the Restructuring Commission to consider Delegate Morgan's proposed amendment to the suspension proposal.

3. Transferring Control of Transmission Assets to PJM

Closely related to the issue of the effect of FERC's proposed rules are the implications of utilities' transferring control of their transmission assets to the PJM Interconnection, LLC, regional transmission entity. House Bill 2453 of the 2003 Session delayed the date by which incumbent electric utilities with transmission capacity must join an RTE from January 1, 2001, to January 1, 2005, subject to SCC approval. Prior to approving a request to join an RTE, the Commission must determine that the action will (i) ensure that consumers' needs for economic and reliable transmission are met and (ii) meet the transmission needs of electric generation suppliers that do not own, operate, control or have an entitlement to transmission capacity. In addition, requests for approval shall include a study of comparative costs and benefits, including an analysis of the economic effects of the transfer on consumers and the effects of transmission congestion costs.

AEP and DVP both have cases pending at the SCC seeking approval of proposals to join PJM. RTEs are intended to operate transmission grids and ensure short-term system reliability, independent of control by incumbent utilities and other market participants. The Act recognizes that the development of a competitive retail market for electric generation requires incumbent utilities to transfer ownership or control of their electric transmission assets to an RTE. The Act's requirement that incumbent utilities with transmission capacity join an RTE is intended to ensure that such utilities, which traditionally controlled the generation, distribution and transmission of electricity, do not use their control of transmission assets to favor their power over power offered by competing suppliers. PJM operates both a multistate transmission system

and associated electricity trading markets. The PJM structure, which complies with the SMD model proposed by the FERC, may result in the ceding of control over the dispatch of generation to the RTE. In addition, some long-term resource adequacy planning will be overseen by the RTE. At a meeting of the Legislative Transition Task Force in November 2002, the concern was expressed that a reduction in SCC oversight may follow if the incumbent utilities join PJM. One member commented that the Restructuring Act contemplated RTE oversight of transmission but not generation services.

At the January 13, 2004, meeting, Mr. Bolstad discussed the proceeding instituted by the FERC under § 205(A) of PURPA against Virginia and Kentucky on November 25, 2003. Section 205(A) of PURPA, which deals with pooling arrangements, authorizes FERC to exempt public utilities from any provision of state law or regulation that prohibits or prevents the voluntary coordination of utilities, where such coordination is designed to obtain economic utilization of facilities and resources. The section provides that the FERC is not authorized to make such an exemption if it finds that the state law or regulation is either required by federal law or is designed to protect the public health, safety or welfare, or the environment or to conserve energy or to mitigate the effects of fuel shortages.

The PURPA § 205 proceeding seeks to exempt AEP from requirements of the Restructuring Act, including those requiring that the SCC approve any transfer of a utility's ownership or control of transmission capacity to an RTE and that the SCC consider a cost-benefit study as part of its consideration of an application to join an RTE. In its order instituting the proceeding, the FERC made a preliminary finding that the laws of Virginia and Kentucky are preventing AEP from fulfilling its voluntary commitment to join PJM, which commitment was a condition in its merger proceedings with another utility in 1999.

The SCC, with participation by the Office of the Attorney General, has been actively opposing the FERC's attempt to override the provisions of the Restructuring Act. The hearing was scheduled to begin January 26, 2004, and the administrative law judge was ordered to issue a ruling by March 15, 2004. The SCC expressed concern with the FERC's theory that it may assume the power to determine whether state legislation was designed to protect the public health, safety and welfare. Mr. Bolstad also stated that the SCC is concerned that the expedited schedule and other aspects of the proceeding raise issues of whether participants have been provided due process.

Several states have joined Virginia and Kentucky in opposing the FERC in this proceeding, which is the first attempt in the 25 years since PURPA was enacted that FERC has tried to use § 205(A) to preempt a state law or action. The proceeding represents an attempt to expand FERC's jurisdiction that is entirely distinct from the questions surrounding the scope of FERC's jurisdiction under the Federal Power Act discussed above. The fact that Kentucky has not unbundled its rates is irrelevant in the PURPA proceeding; Kentucky is a party because its Public Service Commission refused to allow an affiliate of AEP operating in that state to join PJM.

Speaking on behalf of PJM, Phillip Abraham spoke against any proposal that would give the SCC authorization to delay or disapprove the pending applications of DVP and AEP to join

PJM. He urged Virginia to stay the course on the RTE issue and to avoid any further delays. He described the argument that Virginia should preserve its jurisdiction as weak at best. He observed that the bulk transmission system is part of interstate commerce and is subject to federal regulation.

D. EXTENSION OF TERM OF GENERATION FACILITY CERTIFICATES

At the Restructuring Commission's January 13, 2004, meeting, August Wallmeyer of the VEPA presented a proposal to extend by two years the terms of certain certificates of convenience and necessity to construct and operate electrical generating facilities. The extension would apply to certificates for which applications were filed with the SCC prior to July 1, 2002. The certificates for the facilities as issued by the SCC stated that they would expire two years following the date of the order granting the certificate if construction on the facility had not commenced.

Mr. Wallmeyer stated that the extensions would apply to four generating facilities (Fluvanna, Warren, Tenaska, and White Oak). He asserted that the extensions were appropriate because the construction of the facilities was delayed by issues regarding the scope of the SCC's review of environmental and other matters addressed in permits issued by other agencies. Such issues were resolved by the enactment of Senate Bill 554 in the 2002 Session, which became effective July 1, 2002. He blamed this issue for delays of between 402 and 512 days. No one spoke in opposition to the measure, and there was no discussion of the precedent posed by a legislative amendment to the specific terms of a permit.

A copy of the certificate extension proposal, which had been introduced by Delegate Parrish as House Bill 59, is attached as Appendix W. The Restructuring Commission unanimously voted at its January 15, 2004, meeting to endorse the proposal.

E. AIR EMISSIONS CREDITS ALLOCATED TO NEW SOURCES

At the Restructuring Commission's January 13, 2004, meeting, August Wallmeyer of the VEPA also presented a proposal to prohibit the Commonwealth from selling, by auction or other manner, the pollution credits or allowances that had been set aside for allocation to new sources of air emissions. The proposal involves the Commonwealth's air emissions banking and trading program, pursuant to which electrical generating facilities may trade air pollution credits or allowances. The program's regulations applicable to the electric power industry are required to foster competition in the electric power industry, encourage construction of clean, new generating facilities, and provide an initial allocation period of five years. In addition, since 2001 the program has been required to provide new source set-asides of five percent for the first five plan years and two percent per year thereafter.

The proposal addresses a provision in the 2003 budget bill that authorized the Department of Environmental Quality to auction the NOx emissions credits allocated under the NOx SIP call as set asides for new sources, with the requirement that any revenue generated

shall be deposited to the general fund of the state treasury. The proposal would overturn this by requiring that the emissions credits that are set aside for new sources be provided without charge.

A copy of the air emission credit proposal is attached as Appendix X. The Restructuring Commission unanimously voted at its January 15, 2004, meeting to endorse the proposal.

F. NET ENERGY METERING

Peter Lowenthal, Executive Director of the MDV Solar Industry Association, appeared before the Restructuring Commission on January 13, 2004, to request endorsement of an amendment to the net energy metering provisions of the Act. Specifically, Mr. Lowenthal asserted that the nonresidential limit set forth in the definition of "eligible customer-generators" in § 56-594 should be expanded from 25 kW to 500 kW.

Section 56-594 currently provides that the SCC shall establish a program giving eligible customer-generators the opportunity to participate in net energy metering, which allows such generators who both feed power to and take power from the electric grid to be billed for the difference. Currently, a nonresidential customer that owns and operates an electrical generating facility can be an eligible customer-generator only if the facility has a capacity of not more than 25 kW.

According to Mr. Lowenthal, net metering for nonresidential applications must be greater than 25 kW to attract any interest from industry due to low capacity factors for many renewable fuels, including solar, wind, and biomass. Because solar and other renewable fuels have low capacity factors, energy is rarely exported. For example, a 25 kW system solar system with an 18 percent capacity factor would produce annually 4.5 kW, which is too low to interest larger commercial building owners who have roof space sufficient for solar installations.

The MDV Solar Industry Association's proposal (Appendix Y) was considered at the Restructuring Commission's January 15, 2004, meeting. The Restructuring Commission unanimously voted to endorse the proposal.

IV. OTHER TOPICS REVIEWED

A. RESPONSE TO HURRICANE ISABEL

On October 14, 2003, the Restructuring Commission was briefed on the responses of Virginia's electric utilities to the damage caused by Hurricane Isabel. At the outset, Chairman Norment noted that while this issue is not within the statutory scope of the Restructuring Commission's duties, addressing this issue is relevant to the public's confidence in Virginia's system of electric service. As the disruptions caused by the hurricane primarily affected the distribution transmission systems, which will remain regulated after retail choice for generation providers is implemented, the responses of Virginia's electric utilities to the storm's damage is not directly affected by the Restructuring Act.

Janet Clements, Chief Deputy of the Department of Emergency Management, testified that Isabel hit Virginia on September 18, 2003. Ultimately, 99 jurisdictions in the Commonwealth were declared by the President to be major disaster areas. Cooperation and coordination among Dominion Virginia Power and the electrical cooperatives was very good in all phases of the preparation for and response to the damage caused by Isabel. Longstanding working relationships and advanced planning efforts assisted in a coordinated response to the crisis. A copy of Ms. Clements's testimony is available on the Restructuring Commission's website.

The remarks of Kenneth D. Barker, Vice President for Customer Planning at Dominion Delivery, focused on his company's preparation, execution and communication. Isabel was the most devastating storm Dominion had ever encountered. The storm cut through the heart of Dominion's service territory, and packed severe wind gusts, ultimately leaving 1.8 million customers, or 82 percent of its customers, without service for some period of time. He described Isabel as a "storm of trees" in which most damage was caused by trees falling from along and outside utility rights-of-way. An unprecedented combination of weather events, comprised of the three-year drought spanning 2000 to 2002 and the record rainfall in 2003, left trees vulnerable to being uprooted by strong winds. Barker stated that DVP's after-tax system damage totaled $128 million. The operations and maintenance costs will not result in higher bills for customers because DVP's rates are capped pursuant to the provision of the Restructuring Act.

Ray Bourland, Director of State Affairs for Allegheny Power, testified that 46,000 of its 87,000 customers in Virginia lost power for some period of time. By September 25, 2003, power had been restored to all affected customers. Rob Omberg, Assistant Vice President for Governmental Affairs for the Virginia, Maryland and Delaware Association of Electric Cooperatives, testified that 12 cooperatives sustained damage as a result of Isabel. Thomas Dick reported that nine members of the Municipal Electric Power Association of Virginia reported significant outages as a result of storm damage.

Bill Stephens, director of the SCC's Division of Energy Regulation, advised the Restructuring Commission that SCC staff conducts a review after every major storm that affects the ability of utilities to provide electric service. A review of the response to Hurricane Isabel has been initiated and the SCC will be conducting meetings across the service territories of

affected utilities to collect information. The SCC will also be coordinating meetings to address potential communications issues between DVP and the electric cooperatives. A total of 700 consumers called the SCC regarding electric utility service following the storm.

B. BLACKOUT OF AUGUST 2003

On August 14, 2003, at approximately 4:10 p.m., electric service for an estimated 50 million North Americans was blacked out in an area extending from Detroit to New York City and from Ontario, Canada, to Ohio. Though no Virginians lost electric service as a result of the blackout, the disruptions caused by the sudden loss of power prompted the Restructuring Commission to examine the causes of the system failure and the reasons that the Commonwealth was spared.

Robert O. Hinkel, General Manager for RTO Integration at PJM Interconnection LLC, testified that PJM lost approximately seven percent of its load. Its load loss occurred in New Jersey and Pennsylvania as control systems began opening transmission tie lines to isolate PJM from those regions experiencing severe voltage drops and line overloads. With some isolated exceptions, PJM member companies had restored power to all customers by 4:00 a.m. on August 15, 2003. Several features worked in unison to isolate the outage within a small portion of PJM and to inhibit further movement of the blackout, including a comprehensive regional planning process and coordinated real-time operations, which provides for continuous monitoring of the transmission system so as to detect problems and prevent overloads. An outline provided by Mr. Hinkel is available on the Restructuring Commission's website.

Thomas F. Farrell, II, President and Chief Operating Officer of Dominion, testified that DVP's system reacted well when faced with the crisis. After the blackout began, the system sensed voltage frequency irregularities and sensed a flow resend of 600 megawatts at its Possum Point generation facility. Units automatically adjusted output, thus preventing a cascading outage. The crisis containment provided evidence that the grid is connected to other systems that are integrated much like an interstate highway. It is impossible to stop electricity from flowing through Virginia, as the Commonwealth is part of an interconnected grid. The need exists to establish policies to deal with the issues the blackout presented. Fragmented control over the electrical system is not as effective as fully integrated control over large segments of the grid.

Mr. Farrell noted that the blackout offers an opportunity to focus on the goal of improving grid reliability. He offered four recommendations for improving system reliability. First, he supports provisions of the proposed federal energy legislation that give existing reliability councils the authority to set and enforce mandatory reliability standards. Second, both state and federal governments should take steps to eliminate delays in siting major transmission lines, which should include giving FERC backstop authority over multistate lines particularly when multiple federal agencies conduct project reviews. Third, the development of regional transmission organizations should be promoted in a manner that allows states to protect native load for the first use by the state's customers. Fourth, amending federal tax laws to allow accelerated depreciation of new transmission facilities would provide an incentive for the system's expansion.

Stuart Solomon, Vice President for Public Policy and Regulatory Services at AEP, testified that the cascading power system failure occurred within a matter of seconds. While the root cause that triggered the failure is unknown, the critical events occurred in Northern Ohio outside of AEP's system. The AEP system was not shut down by the power surges that shut down other systems because its protective systems automatically balanced the system's load and generation as required.

Mr. Solomon stated that the transmission grid was designed for local generators and local customers. As the system grew, interconnections within the system were made to improve reliability and to facilitate the exchange of power. Recently the amount of power transmitted over the grid through wholesale transactions has increased greatly. However, the system was not designed to deal with the volume of wholesale transactions occurring today. Former Energy Secretary Bill Richardson's comments that we have a "Third World" grid are wrong; the problem is the stress resulting from the increased number of transactions.

Mr. Solomon offered four recommendations. First, regulatory certainty regarding cost recovery is necessary. The current environment requires that a utility obtain approvals from multiple jurisdictions regarding the recovery of its investments, which results in uncertainty. Second, continuous improvements in communications among the entities that oversee the grid are needed. Third, mandatory transmission reliability standards are essential. Finally, the need exists to resolve some of the jurisdictional conflicts between the states and federal agencies, especially FERC. A consensus is needed regarding whether the primary purpose of the transmission grid will be for reliability or for market development. FERC appears to be shifting the balance in favor of markets, which concerns Mr. Solomon because markets cannot develop without system reliability. An outline provided by Mr. Solomon is attached as Appendix Z.

In response to questions, Mr. Solomon noted that AEP is not now a member of PJM or the Midwest Independent System Organization (MISO), but PJM is its reliability coordinator. He noted that AEP has been attempting to build a 765 kV transmission line in Southwest Virginia since 1990, and would like to see the route approval process accelerated. Delays in the approval process were attributed to federal agencies, some of which do not appear to be "on the same page" with other agencies. He also commented that a larger grid system is good for reliability in part because it allows for more flexibility in dealing with problems. Like DVP, AEP also has worked to ensure that language providing protection for a state's native load is included in the pending federal energy legislation.

Cody Walker of the SCC's Division of Energy Regulation testified that investigations into the August 14 blackout remain underway. It appears that protective actions were sufficient to push back the system outages that were causing the cascading blackout. However, until the analysis of the blackout's cause is complete, it will be difficult to say why Virginia was not affected. His short answer as to why the cascading blackout stopped before affecting Virginia is "physics" to the extent that the system reached a point where there were sufficient resources that could respond automatically to push back the disturbance that was causing the cascade. Ramping up the output at generation facilities helped stop the blackout.

In the past, such an event would have triggered a review of system integrity by the SCC; now the review will be done in the context of RTE applications before the SCC. Mr. Walker noted that the SCC would assess, as part of its review, whether Virginia's transmission system was threatened with collapse. Until the root cause of the cascading blackout is identified, it is difficult to assess the threat posed to Virginia's system.

An underlying issue involved in the discussion of the blackout's cause and rapid spread was the role of RTEs. Mr. Walker noted that there are two schools of thought on the issue, with one argument being that a wide control area could prevent system failures, and the other being that a system with an increasing focus on wheeling power over the transmission system would stress the system to a greater extent and make such problems more prevalent in the future. The failure in this case was believed to begin within MISO, which was the first FERC-approved RTO. As PJM is structurally different from MISO, the question will be whether PJM can apply its approach to a broader region. A related question is whether a bigger PJM will be better than its predecessor, or whether the risks are becoming so large that PJM should reassess its planned expansion. PJM originally was a tight power pool serving the Pennsylvania, New Jersey and Maryland region, as well as the Delmarva region of Virginia, and has had a long history of operating its system.

Mr. Walker also noted that there is a national debate now on the question of creating regional RTOs. FERC planned to move quickly on the SMD rules, but has slowed its process in the face of much opposition. He added that, in general, states in the South have rejected the idea of RTEs on grounds that the current system is working well and that SMD would have a detrimental effect on the region. In response to Delegate Tata's question regarding whether these Southern states are correct, Mr. Walker demurred.

C. INTEGRITY OF VIRGINIA'S TRANSMISSION SYSTEM

Dan Carson of AEP testified that the utility is a multistate utility operated as a single integrated system. Such an organizational structure has provided very efficient operation in the past, and is partly responsible for rates in Virginia being among the lowest in the country. Because the demand of its Virginia customers exceeds Virginia-based generation, AEP must rely on its multi-state pool of generation facilities to meet Virginia's needs.

Mr. Carson stated that there is a need for reinforcement of the system in Virginia. In 1990, AEP proposed a 765 KV live segment from Wyoming, West Virginia, to Jackson Ferry, Virginia. The need for the line remains critical. Electricity consumption in the area to be served by the line has more than doubled since the last major reinforcement project was completed in 1973. The existing system cannot continue indefinitely to deliver increasing amounts of electricity to increasing numbers of customers. The line was approved by the SCC on the basis of reliability of service for AEP's Virginia customers and tangential benefit of west to east transfer capability. Though the utility has also received required federal approvals, the Sierra Club has noticed an appeal of the Forest Service's issuance of a permit to allow the line to cross the Jefferson National Forest. The projected in-service date for the line is in the summer of 2006. The project cost is estimated at between $280 and $300 million.

Mr. Carson summarized that AEP's transmission system serving Virginia has worked well, but is in need of an improvement that already has been approved and is underway. Until that improvement is completed, the integrity of the system is less than desirable.

In response to a question as to why AEP wanted to join PJM if integrity now is adequate, Mr. Carson noted that the system needs major reinforcement. The new line into Virginia territory would add both capacity and system redundancy. He noted that AEP's interest in joining PJM is not directly related to the 765 kV line that is now under construction.

Thomas F. Farrell, II, President and Chief Executive Officer, Dominion Energy, testified that the Dominion system contains 6,000 miles of transmission lines, 80 percent of which are in Virginia. DVP's outstanding reliability record is illustrated by data showing that the average customer loses only 1.5 to three minutes annually due to transmission-related outages. Spending on the transmission system is up by 15 percent over the period from 1998 to 2002. Distribution spending is up by 26 percent over the period from 1992 to 2002, with the operating and maintenance portion increasing by 49 percent, and the capital portion increasing by 15 percent.

The practices employed by DVP to maintain a robust, reliable transmission system include real-time contingency planning, load growth planning, and new investment. Recent investments include an increase in capital expenditures of more than 50 percent from 1998 to 2002, though he cautioned that investments are affected by a permitting process that is becoming more time consuming. Other practices used by the utility include reliability planning with other utilities in the Eastern Interconnect and spending on maintenance, which ranges from $35 to $40 million annually, and new technologies.

Mr. Farrell asserted that joining PJM will improve the integrity of the transmission grid and give the Commonwealth several benefits, including a better platform for regional planning; enhanced reliability; uniform, enforceable reliability rules; and increased likelihood that the construction of badly needed transmission lines across multiple states will be completed.

In response to questions about how PJM's use of LMP will affect who pays for transmission system upgrades, Mr. Farrell noted that LMP, by imposing a financial penalty on providers that are contributing to system congestion, is designed to send market signals that grid congestion exists and additional expenditures are needed to upgrade transmission or generation systems. The issue of the interaction between Virginia's capped rates, LMP, and who will pay the costs of system upgrades will have to be worked through. In response to Senator Watkins's concern that the financial burden of the system improvements will be borne by those who use the transmission system, Mr. Farrell said that the issue of who bears the costs would capture everyone's attention when it is addressed. The presentation outline provided by Mr. Farrell is available on the Restructuring Commission's website.

Cody Walker of the SCC's Energy Regulation Division testified that the tools for examining the integrity of the system are different today from those used in the past. Historically, the SCC has looked at reliability of the bulk power system from a number of perspectives, and viewed reserve margins on actual and projected bases. The SCC also has

monitored generating units' performance. In the context of a rate proceeding, the SCC would reward utilities that had outstanding generating performance by allowing a higher return on equity. In the future, the marketplace will determine reserve margins, and interaction of supply and demand will influence system reliability. In addition, the SCC will examine reliability issues as part of its review of the pending applications of AEP and DVP to transfer control of their transmission assets to the PJM RTE.

With regard to transmission reliability, the SCC expects utilities to adhere to the NERC criteria. In recent years, the SCC has approved a number of high-capacity transmission lines. With regard to AEP's 765 KV line, SCC shares AEP's frustration. The SCC found in 1995 that a need existed for the project. After the Forest Service withheld approval, AEP withdrew its original route and proposed an alternate route. The SCC approved the revised route for the 765 kV line in May 2001. The Forest Service approved the revised route in December 2002.

D. STATUS OF CONSUMER EDUCATION PROGRAM

Section 56-592.1 of the Restructuring Act directs the SCC to establish and implement a consumer education program, and to provide periodic updates to the Restructuring Commission concerning the program's implementation and operation. The annual report on the Virginia Energy Choice consumer education program is included at pages 20-27 of part II of the SCC's August 29, 2003, competition status report.

SCC Division of Information Resources Director Kenneth Schrad reported to the Restructuring Commission on the status of the Virginia Energy Choice program at the November 19, 2003, meeting. A summary of the status of the consumer education program is attached as Appendix AA. The most recent statewide survey conducted in January 2003 showed that the consumer education program had raised the level of public awareness of retail energy choice to 46 percent.

Mr. Schrad noted that budget amendments transferred revenues that had been earmarked for this program to the general fund. As a result, most of the program's activities have been curtailed from January 2003 through the end of the current biennium on June 30, 2004. Activities have been restricted to maintaining a toll-free telephone number and the SCC's Virginia Energy Choice website (www.vaenergychoice.org).

E. CONSUMER ADVISORY BOARD

When enacted in 1999, § 56-595 of the Restructuring Act established a 17-member Consumer Advisory Board comprised of representatives from all classes of consumers and with geographical representation. In its first four years of existence, the Consumer Advisory Board developed recommendations in areas of assisting low-income consumers in meeting their energy needs, energy efficiency, and renewable energy, and provided the Legislative Transition Task Force with the perspective of a variety of interests that may otherwise have little opportunity to comment on issues pertaining to the Restructuring Act and its implementation.

Senate Bill 1315 of the 2003 Session renamed the Legislative Transition Task Force as the Commission on Electric Utility Restructuring, repealed § 56-595, and relocated its provisions to the new Chapter 31 (§ 30-201 et seq.) of Title 30. The primary purpose of Senate Bill 1315 was to conform legislation pertaining to those collegial bodies with legislative members to the legislative guidelines adopted by the Joint Rules Committees. New § 30-208 reduced the number of members of the Consumer Advisory Board from 17 to eight in accordance with guidelines providing that an advisory body should not have more members than the legislative body to which it is to report. The seven citizen members of the reconstituted Consumer Advisory Board are William Lukhard, Jack Hundley, Roy Byrd, John E. Greenhalgh, Steven T. Walker, Oswald F. Gasser, Jr., and Madge Bush. The other member of the Board is to be a member of the Restructuring Commission designated by its chairman to serve as a nonvoting liaison member. The Consumer Advisory Board, which is limited to meeting on the call of the chairman of the Restructuring Commission, did not meet during 2003.

F. DOMINION VIRGINIA POWER'S RETAIL ACCESS PILOT PROGRAMS

David Koogler, Director of Regulation and Competition at DVP, addressed the status of DVP's retail pilot programs at the November 24, 2003, meeting. Three separate pilot programs were approved by the SCC: a competitive bid supply program; a municipal aggregation program; and a commercial and industrial large customer pilot. Each of the pilot programs is scheduled to remain in effect through July 2007. DVP agreed initially to waive one-half of its wires charges for all participating customers. The 50 percent reduction in DVP's wires charge is intended to give competitors significantly greater opportunity to compete profitably with the incumbent utility. DVP expects a total of approximately 65,000 of its current customers to switch to competitive providers under the three pilot programs. Mr. Koogler reported that there has been a great deal of interest by potential pilot program participants. More firms have volunteered for the large customer pilot than can be accommodated, which requires DVP to use a lottery to determine who may participate. A copy of Mr. Koogler's remarks is attached as Appendix D. The pilot programs were scheduled to start in February, but no competitive service providers agreed to participate in the programs. DVP has filed a request to revise the pilot programs in order to make them more attractive to competitive suppliers. The proposed changes include the complete elimination of the wires charges for pilot participants who switch to a competitor.

G. ENERGY INFRASTRUCTURE DATA COLLECTION

By resolution of the Legislative Transition Task Force adopted January 27, 2003, the SCC was requested to collect the data necessary to monitor the dedication of generating facilities to the provision of electric bulk power supply in the Commonwealth. The SCC's report dated July 1, 2003, was delivered to members of the Restructuring Commission. The report is available on the SCC's website at www.state.va.us/scc/caseinfo/reports/infra_070103.pdf. The SCC notes that with the advent of the restructuring of our electric utility industry, Virginia utilities have reduced planned reserve margins and expect to rely largely on the market for the provision of capacity to serve load growth and to provide adequate reserves. However, the FERC's proposed SMD rules acknowledge that the market cannot be relied upon to provide an adequate generation resource base, and FERC envisions RTEs establishing resource adequacy requirements subject to federal jurisdiction.

V. BILLS AFFECTING THE RESTRUCTURING OF THE ELECTRIC UTILITY INDUSTRY

As previously noted, the Restructuring Commission acted at its January 15, 2004, meeting on legislative proposals pertaining to the electric utility industry. This section of the report traces the disposition of electricity industry-related bills during the 2004 Session of the General Assembly.

A. OMNIBUS LEGISLATION: SENATE BILL 651

Legislation that incorporated the five proposed amendments to the Restructuring Act that had received the endorsement of the Restructuring Commission was introduced by Senator Norment as Senate Bill 651. The omnibus legislation combines the recommendations (i) by the Offices of the Attorney General and the Secretary of Commerce and Trade to extend the capped rate period, limit DVP's ability to seek increases in its fuel factor, authorize utilities other than DVP to file two petitions for base rate increases, and allow electric cooperatives to opt out of the Act's provisions; (ii) by Senator Watkins to amend the minimum stay and wires charge requirements applicable to switching customers who agree not to be able to buy generation at capped rates if they return to their incumbent provider; (iii) by Senator Watkins to allow opt-out municipal aggregation; (iv) by the VEPA to extend by two years the expiration date of certain certificates granted by the SCC to construct and operate electrical generating facilities; and (v) by the MDV Solar Energy Industry Association to increase the amount of electricity an eligible nonresidential customer-generator's facility can produce from 25 kilowatts to 500 kilowatts.

The Senate Committee on Commerce and Labor reported an amendment in the nature of a substitute to Senate Bill 651 on January 26, 2004. A provision was added to the original bill authorizing an investor-owned distributor that has been designated a default service provider under § 56-585 to petition the SCC to construct a coal-fired generation facility that utilizes Virginia coal and is located in the coalfield region of the Commonwealth to meet its native load and default service obligations, regardless of whether such facility is located within or without the distributor's service territory. A distributor that constructs such facility shall have the right to recover the costs of the facility, including allowance for funds used during construction, life-cycle costs, and costs of infrastructure associated therewith, plus a fair rate of return, through its rates for default service. The distributor's petition shall include a plan that proposes default service rates to ensure such cost recovery and fair rate of return. The provision recites that the construction of such facility that utilizes energy resources located within the Commonwealth is in the public interest. The SCC is directed to liberally construe the provisions of Title 56 when determining whether to approve such facility.

Another major amendment to the bill provided that the capped rates of any incumbent electric utility other than DVP shall be adjusted for the timely recovery of prudently incurred costs for system reliability and compliance with state or federal environmental laws and regulations. The Committee substitute also made the following additional changes to the introduced legislation:

- The proposed amendments to § 56-577 that would allow electric cooperatives to elect to be exempt from retail choice provisions of the Act were removed;
- The proposed amendments to the minimum stay requirements were amended to, among other things, (i) make the provision contingent upon the availability of capped rate service and the transfer of management and control of transmission assets to a regional transmission entity after approval by the SCC, and (ii) specify that the market-based costs that may be charged a returning customer include the actual costs of procuring such electric energy from the market, additional administrative and transaction costs associated with procuring the energy, and a reasonable margin;
- The proposed amendment to authorize utilities other than DVP to file two petitions for base rate increases was amended to provide that a petition filed after July 1, 2007, by a utility that has not retained total ownership of its generation may seek an amendment only to the nongeneration components of capped rates; and
- The proposed amendments to the wires charge provision for industrial and commercial customers who switch upon agreeing to pay market-based rates if they return to their incumbent provider were amended to (i) apply only to customers within the large industrial and large commercial rate classes, (ii) make the provision contingent upon the availability of capped rate service and the transfer of management and control of transmission assets to a regional transmission entity after approval by the SCC; (iii) provide that such switching customers will not be eligible, after the end of capped rates, to purchase electricity from the designated provider of default service; (iv) specify that the market-based costs that may be charged a returning customer include the actual costs of procuring such electric energy from the market, additional administrative and transaction costs associated with procuring the energy, and a reasonable margin; and (v) specify that the wires charge exemption program will be made available on a first-come, first-served basis until the most recent total peak billing demand of all customers transferred to licensed suppliers equals 1,000 megawatts or eight percent of the utility's prior year Virginia adjusted peak load within the 18 months after the program's commencement date.

As amended, Senate Bill 651 was unanimously approved by the Senate Commerce and Labor Committee.

The Senate Commerce and Labor Committee amendment in the nature of a substitute to Senate Bill 651 was amended on the Senate floor on January 29, 2004, to add language reciting that the provision concerning the construction of a coal-fired generation facility that utilizes Virginia coal in the coalfield region of the Commonwealth is intended to ensure a reliable and adequate supply of electricity and to promote economic development. This portion of the bill was also amended to require the SCC to consider any such petition in accordance with its competitive bidding rules and in accordance with the provisions of the Act. With these amendments, the bill passed the Senate by a vote of 29 to 10, with one abstention.

An amendment in the nature of a substitute to Senate Bill 651 was reported by the House Committee on Commerce and Labor by a vote of 12 to 9 on March 4, 2004. The amendment in the nature of a substitute included the following revisions to the engrossed version:

- Establishing a procedure under which incumbent electric utilities that have divested themselves of generation assets may recover increases in their purchased power costs after July 1, 2007, in accordance with the terms of any Commission order approving the divestiture; and
- Clarifying the provision that authorizes incumbent utilities other than DVP to recovery costs for system reliability and compliance with environmental laws to limit such utilities to one case in any 12-month period, require that the capped rate increase cover only the incremental increases in such costs to the extent such costs are prudently incurred on and after July 1, 2004, and exclude generation reliability costs from eligibility for the rate increases covered by this provision.

The House of Delegates passed the committee amendment in the nature of a substitute by a vote of 68 to 32. The Senate concurred in the House's changes to the bill, and Senate Bill 651 was signed by the Governor and will become effective July 1, 2004. A copy of the enacted version of this legislation is attached as Appendix BB.

B. MUNICIPAL AGGREGATION: SENATE BILL 116

Senator Watkins had received the Restructuring Commission's endorsement of his municipal aggregation proposal at its January 15, 2004, meeting. The terms of the proposal were incorporated into the omnibus restructuring legislation, Senate Bill 651. The measure had been prefiled by Senator Watkins on January 7, 2004, as Senate Bill 116.

The measure provides that a municipality or other political subdivision may aggregate the electric energy load of residential, commercial, and industrial retail customers within its boundaries on either an opt-in or opt-out basis, and eliminates the requirement that customers must opt in to select such aggregation. It also eliminates the requirement that such municipality or other political subdivision may not earn a profit from such aggregation.

As the measure had been incorporated into Senate Bill 651, it was not acted on following its referral to the Senate Commerce and Labor Committee. Senate Bill 116 was carried over by the committee to the 2005 Session.

C. MINIMUM STAY AND WIRES CHARGES: SENATE BILL 117

Senator Watkins' proposal regarding minimum stay requirements and wires charges was also endorsed by the Restructuring Commission at its January 15, 2004, meeting. The terms of the proposal were incorporated into Senate Bill 651. Senator Watkins had prefiled this proposal on January 7, 2004, as Senate Bill 117.

As introduced, Senate Bill 117 authorized any large industrial or commercial customer returning to its incumbent electric utility or default provider after purchasing power from a competitive supplier to elect to accept market-based pricing as an alternative to being bound by

the minimum stay period prescribed by the SCC. The minimum stay period currently is 12 months unless otherwise authorized. Customers exempted from minimum stay periods will not be entitled to purchase retail electric energy from their incumbent electric utilities thereafter at the capped rates unless such customers agree to satisfy any minimum stay period then applicable. Senate Bill 117 also allows industrial and commercial customers, as well as aggregated customers in all rate classes, to switch to a competitive service provider without paying a wires charge if they agree to pay market-based prices if they ever return to the incumbent electric utility. Customers who make this commitment and obtain power from suppliers without paying wires charges are not entitled to obtain power from their incumbent utility at its capped rates.

As the measure had been incorporated into Senate Bill 651, it was not acted on following its referral to the Senate Commerce and Labor Committee. Senate Bill 117 was carried over by the committee to the 2005 Session.

D. EXTENSION OF CERTIFICATES: HOUSE BILL 59 AND SENATE BILL 239

Delegate Parrish and Senator Norment patroned House Bill 59 and Senate Bill 239, respectively. These identical measures codified the request made by the VEPA and endorsed by the Restructuring Commission for a two-year extension of the expiration date of certificates of public convenience and necessity previously issued by the SCC for electrical generating facilities for which applications were filed with the Commission prior to July 1, 2002. The text of the measure was incorporated into Senate Bill 651.

House Bill 59 was passed by the House of Delegates and Senate without a negative vote, and was signed into law by the Governor. A copy of the bill as enacted is attached as Appendix CC.

Senate Bill 239 was not acted on following its referral to the Senate Commerce and Labor Committee. The legislation was carried over by the committee to the 2005 Session.

E. AIR EMSSIONS TRADING: SENATE BILL 386

Though the Restructuring Commission endorsed the VEPA's recommendation for legislation that prohibits the Commonwealth from selling the emissions credit set asides allocated to new sources of air emissions, the measure was not incorporated into the omnibus Senate Bill 651 because it did not amend the provisions of the Act. Consequently, it was introduced in the 2004 Session by Senator Norment as Senate Bill 386.

Senate Bill 386 was reported unanimously by the Senate Committee on Agriculture, Conservation and Natural Resources and the Senate Finance Committee, and passed the full Senate without a negative vote. The bill was amended in the House Appropriations Committee to provide that the legislation shall be not construed to interfere with, apply to, or affect the auction of Virginia's allocation of nitrogen oxide pollution credits set aside for new sources of electric power generation and other facilities for the years 2004 and 2005 as authorized by the

appropriations act enacted in the 2003 Session. As amended, the measure was unanimously passed by the House. A copy of Senate Bill 386 as enacted is attached as Appendix DD.

F. RESTRUCTURING ACT SUSPENSION: HOUSE BILL 1437

At its January 15, 2004, meeting, the Restructuring Commission voted not to endorse the consensus bill that called for the suspension of the retail choice provisions of the Restructuring Act. Delegate Morgan introduced such legislation in the 2004 Session as House Bill 1437. The proposal indefinitely suspends retail competition for electric energy in the Commonwealth. It also directs the Restructuring Commission to monitor the development of competitive wholesale electric markets and make future judgments as to the viability of retail customer choice in the Commonwealth. The bill does not disturb the provisions of the Act that relate to the transfer of management and control of transmission assets to regional transmission entities and does not affect the development of pilot programs.

In the House Committee on Commerce and Labor, the measure was amended to require the SCC to direct the immediate rebundling of the generation, transmission, and distribution components of incumbent electric utilities' retail electricity rates and to authorize a default service provider to petition the SCC to construct a coal-fired generation facility that utilizes Virginia coal and is located in the coalfield region of the Commonwealth to meet its native load and default service obligations, which amendment is identical to the amendment added to Senate Bill 651 in the Senate Commerce and Labor Committee. As amended, the bill was tabled in the House committee by a vote of 15 to 7.

G. REBUNDLING RATE COMPONENTS: HOUSE BILL 264

Legislation implementing the SCC's recommendation to suspend customer choice and rebundle incumbent electric utilities' rates was introduced by Delegate Morgan as House Bill 264. The Restructuring Commission had decided not to endorse this proposal. The bill was carried over in committee to the 2005 Session without discussion.

H. STRANDED COSTS: HOUSE BILL 265

The Restructuring Commission declined to endorse Delegate Morgan's proposal that would require the SCC to calculate on an annual basis the stranded costs of each incumbent electric utility. The measure also authorizes the State Corporation Commission to reduce or eliminate an incumbent utility's wires charges, capped rates, or both, if after notice and hearing, it determines that a utility has collected its stranded costs.

Delegate Morgan introduced such measure as House Bill 265. The bill was carried over to the 2005 Session by the House Commerce and Labor Committee without discussion.

I. REPEAL OF THE RESTRUCTURING ACT: HOUSE BILL 1268

Delegate Robert Orrock introduced House Bill 1268 in the 2004 Session, which bill repeals the Restructuring Act and abolishes the Restructuring Commission. The measure retains provisions authorizing the SCC to approve the construction and operation of all electrical generating facilities. The bill also permits electric cooperatives to recover their costs relating to implementation of the Act if those costs were incurred prior to the repeal of the Act.

The proposal was not presented to the Restructuring Commission for its consideration. House Bill 1268 was referred to the House Committee on Commerce and Labor, where it was carried over to the 2005 Session without discussion.

VI. CONCLUSION

The activities of the Commission on Electric Utility Restructuring during the 2003-2004 interim reflect three central objectives: a firm commitment to bringing competition to the generation component of Virginia's electric utility industry; a recognition that adjustments to the Restructuring Act may be appropriate to ensure that effective competition develops in the Commonwealth; and a desire to provide consumers with some protection from market-based prices prior to the date when competition has developed into an effective means of regulating the price of generation. Though Senate Bill 651 is a complex item of legislation, it advances each of these objectives.

The Restructuring Commission remains committed to fine-tuning the Restructuring Act in order to provide for the effective deregulation of the electric utility industry. However, if competition does not materialize as expected during the next few years, the Restructuring Commission will take whatever steps are necessary to maintain the Commonwealth's long-standing status as a state with reliable and low-cost electric service. Furthermore, the Restructuring Commission will continue to monitor federal and regional developments to ensure that Virginia does not cede its authority to protect its citizens.

Respectfully submitted,

Senator Thomas K. Norment, Jr., Chairman
Delegate Allen W. Dudley
Delegate Terry G. Kilgore
Delegate Harry J. Parrish
Delegate Kenneth R. Plum
Senator Richard L. Saslaw
Delegate James M. Scott
Senator Kenneth W. Stolle
Delegate Robert Tata
Senator John Watkins

COMMONWEALTH of VIRGINIA

Office of the Governor

Michael J. Schewel
Secretary of Commerce and Trade

October 10, 2003

The Commission on Electric Utility Restructuring
The Honorable Thomas K. Norment, Jr., Chairman
The Honorable Allen W. Dudley
The Honorable Terry G. Kilgore
The Honorable Harry J. Parrish
The Honorable Kenneth R. Plum
The Honorable Richard L. Saslaw
The Honorable James M. Scott
The Honorable Kenneth W. Stolle
The Honorable Robert Tata
The Honorable John Watkins

Dear Commission Members:

As the Commission on Electric Utility Restructuring ("the Commission") is aware, when the General Assembly passed the Electric Utility Restructuring Act in 1999, it was expected that competition for generation services would develop in the Commonwealth during the capped rate period from July 1, 2001, until July 1, 2007, and perhaps even as soon as July 1, 2004. (See § 56-582 C.) Unfortunately, unanticipated events intervened, such as the California energy crisis, the collapse of Enron, the doubling of natural gas prices, delays in Virginia utilities joining regional transmission entities, increased uncertainty with federal regulation, and weaker capital markets in general and particularly for generation plant developers. The combination of these and other events has resulted in fewer than expected competitive suppliers making offers to retail customers in the Commonwealth.

While these unforeseen events will likely pass, it is most important that we assure that Virginia consumers are not the victims of a deregulated market lacking effective competition post-2007. We also need to ensure the reliable and cost-effective operations of Virginia utilities in regional transmission entities before capped rates are eliminated.

For these and other reasons, the Offices of the Governor and Attorney General urge the Commission to consider legislation that would extend the existing capped rates pursuant to Section 56-582 of the Virginia Code for three years, until July 1, 2010. To further stimulate competition, such extension would also require the phasing out or elimination of wires charges.

P.O. Box 1475 • Richmond, Virginia 23218 • (804) 786-7831 • Fax (804) 371-0250 • TTY (804) 786-7765

Our offices will draft proposed legislation for submission to the Commission. We will continue to work with the stakeholders as we have in the past.

Sincerely yours,

Michael J. Schewel
Secretary of Commerce and Trade

Judith Williams Jagdmann
Deputy Attorney General

VCCC
VIRGINIA
CITIZENS CONSUMER COUNCIL

Virginia Citizens Consumer Council

Status of Competition in Virginia

November 24, 2003

- Essentially there is no competition and even high cost states have not seen cost savings for consumers. This is true throughout the US and even the world.
- Many states and countries have halted the move toward a deregulated market, especially at the retail level.
- Virginia's rates are below the national average and especially in our rural areas, this is essentially the only economic development tool. Rates need to be kept low. If not, the rest of the state needs to be prepared to provide massive resources to these areas.
- There are many unanswered questions nationally about the rules of the game and it appears that Congress has clearly told FERC to delay SMD. Thus, there are unlikely to be solid answers for some time.
- If Virginia persists in forcing deregulation on the current schedule when nationally the market has not developed as fast as anticipated when the law was passed and when most other states are not doing so, we will be the only low cost state doing so.
- If Virginia persists in forcing deregulation on the current schedule, we will be the national guinea pig for deregulation of low cost states, much like California was the guinea pig for high cost states. This is a very risky position to take and very unlike Virginia's normal way of doing business.
- The EURC should consider the total public interest – not just the most often heard and most politically powerful voice - as it makes these critical decisions that affect all consumers, all businesses and all communities.

Irene E. Leech, Ph.D.
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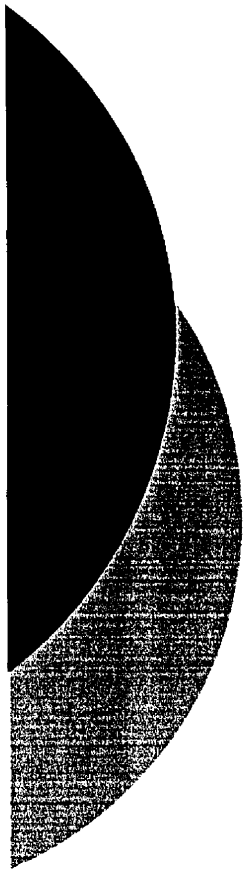

Overview

- **What is the 2003 Status Report?**
- **What's Wrong with Market-Based Volatility?**
- **What's Wrong with Retail Competition In Virginia?**
- **What's Wrong with Retail Competition Outside Virginia?**
- **Conclusions**

What is the 2003 Status Report

1. List of statistics for shopping levels and SOS rates
2. Discussion of volatility in pricing (wholesale and retail)
3. Discussion of market power and industry instability
4. An attempt to associate the 2003 black-out with SMD

What the 2003 Status Report is NOT.

- A reasoned analysis of the state of competition within the context of:

1. **Development of wholesale markets**
2. **Changes in fuel prices**
3. **Transition cost impacts**
4. **Transition pricing impacts**
5. **Changes in renewable fuel requirements**
6. **Impact of migration risk**
7. **RTO membership**
8. **Other Retail Choice Rules**

What's Wrong with Market Based Volatility

- Volatility in LMP – establishes least cost generation unit solution
- Volatility in Capacity and LMP – provides incentive for new generation construction
- Capacity payments provide incentive to minimize plant down time
- Volatility may or may not occur at retail level (balanced billing, fixed price options)
- Volatility existed prior to deregulation (fuel price adjustments) – delayed market signal
- Without LMP – DSM is less effective (thus, long term costs are higher).

What's wrong with Retail Competition in Virginia?

Criteria	Grade
Transition Costs	F (through 6/30/07)
Default Service Pricing	C (through 6/30/07)
Cost Allocation	C
RTO Membership	C
Minimum Stay Restrictions	C
Customer Lists	B
Retail Supplier Fees	A

Wires charge Example: DVP

Rate Class	PTC	Wires Charge	% Penalty
Residential	5.828	1.818	31%
GS-1	5.435	1.415	26%
GS-2	5.143	1.533	30%
GS-3	4.362	0.882	20%
GS-4	3.917	0.747	19%

What's Wrong with Retail Competition outside Virginia?

1. Transition Costs (MD, PA, NJ, CA)
2. Default Service Pricing (PA, DE, MD, DC, MA, CT)
3. Cost Allocation (all states, except TX, NY and MD (starting 2004)
4. RTO Membership (Midwest states, and VA)

Transition vs. Post Transition

- Transition costs and default service pricing are often major obstacles in the transition period
- All Mid-Atlantic states, are still in their transition periods (exception – BGE "P" rate class customers)
- Default service pricing often set at or below market rates due to transition cost recovery and/or no fuel adjustment mechanisms.

Post transition Markets

- Duquesne Light Company
  - Overall reduction in rates (17% system wide, 21% reduction in residential rates)
  - High level of retail choice participation (all segments)
  - Active, competitive retail market
- Texas
  - Retail Model
  - High level of retail choice participation (all segments)
- Maine
  - High level of retail choice participation (large C&I)
  - Lower current SOS residential rates than Virginia Power
- Maryland – July 2004

Conclusions: Implications for Virginia

- Stranded costs, if any, need to be quantified and reconciled against collections through capped rates and wires charge collections
- Virginia has a fuel adjustment clause that does allow some correlation to market prices during the transition period
- Post transition prices should be determined in a competitive bid process to ensure market based pricing. Length of wholesale contracts should reflect the level of likely competition for a given class of customers.
- Default service pricing needs to reflect both retail and wholesale costs of retail supply service

Conclusions: Status of Retail Competition outside Virginia

- Retail choice, especially for large customers is strong in all post- transition markets
- Post-transition market-based rates for residential customers in the Northeast can and does result in reasonable prices for residential customers
- Post transition markets continue to evolve and improve over time

Status Report: Dominion Retail Pilot Programs
Remarks of David Koogler to Commission on Electric Utility Restructuring
November 24, 2003

Good afternoon, Mr. Chairman and members of the Commission. My name is David Koogler and I am Director of Regulation and Competition at Dominion Virginia Power. Thank you for the opportunity to comment on the State Corporation Commission's Report on the Status of Competition in the Commonwealth. As you recall, both Mr. Spinner and Mr. Schrad last week referred to our retail access pilot programs, and I would like to provide you with an update on their implementation.

We're excited about them. The programs are designed to stimulate development of retail competitive markets in Virginia and give all customers – from homeowners to large commercial and industrial operations – the chance to gain firsthand experience with retail choice.

And we're very pleased by the enthusiastic reception we are receiving from our customers.

For example, our pilot for commercial and industrial customers already has more volunteers than it can accommodate. We'll need a lottery to select the participants. Among those that have volunteered are a significant number of big-name retailers – including Target, Wal-Mart, TJ Maxx-Marshall's, Arby's, Kohl's, Lowe's and Farm Fresh.

For another pilot that's focused on residential and small business customers, we've already had 11,900 volunteers, including about 2,900 commercial and 9,000 residential customers. Volunteers have already claimed more than two thirds of the available slots for residential customers in the eastern Virginia area. That figure is remarkable, since the first letters explaining the program to residential customers in that area – and seeking volunteers – were sent out just a week ago – Monday, November 17.

The interest shown in these programs by customers and competitive suppliers indicates that stakeholders are embracing Virginia's transition to retail choice in the supply of electricity. We believe the pilots will be a major step forward along the Commonwealth's path to restructuring.

And we believe much progress has already been made as we near the midpoint of the transition period. Let me offer three specific examples.

- First, the capped rate provisions of the Restructuring Act are providing substantial benefits for Virginia consumers. You may recall the study performed last year by the respected Richmond consulting firm of Chmura Economics and Analytics. It found the capped rate provisions of the restructuring program will save Dominion's residential customers up to $871 million through the end of the transition period in mid-2007.

- Second, the Commonwealth's restructuring program is making progress on another front as incumbent utilities fulfill the requirements of the Act by pursuing membership in a regional transmission organization. This summer Dominion applied for permission to join PJM Interconnection LLC, one of the nation's oldest and most respected regional transmission organizations.

    - We are optimistic that our PJM membership will enhance the development of retail competition by giving both customers and competitive suppliers access to generation assets across a broad geographical area. In fact, it is widely understood, in the jurisdictions that have adopted restructuring, that a robust and properly functioning wholesale market – in the form of membership in an RTO – is the key to successful retail competition. And as the SCC Staff noted in the Commission's annual status report on competition, stakeholders view "the lack of a fully functional RTO" as "the major obstacle" to an active competitive market in Virginia.

    - Our PJM membership should also boost the reliability of the electric system in the Commonwealth and provide significant savings to Virginia consumers. In fact, a recent cost-benefit study found that Dominion membership in PJM would produce nearly $500 million in projected customer savings.

- And third, Virginia has made great progress in developing the rules and procedures needed to support customer choice. In fact, the Center for the Advancement of Energy Markets – a leading pro-competition group – recently gave the Commonwealth some of the highest marks in the country for developing the regulatory framework for retail access. CAEM

ranked Virginia 13th among jurisdictions worldwide with respect to general infrastructure and environment for retail competition.

It is true that, so far, competitive suppliers have not been very active in making offers to customers in Virginia. But the situation shouldn't come as a surprise to anyone familiar with the restructuring process. The Act never envisioned full retail competition during the transition period. Retail markets don't emerge overnight; they develop at a measured and deliberate pace. That is the reason practically every jurisdiction in the United States that adopted restructuring also put in place an extended, multi-year transition period.

We believe our new pilot programs will begin to change the situation and promote development of the retail market. The General Assembly clearly had that expectation when it passed HB 2319 earlier this year, Del. Plum's bill that paved the way for the pilots. As the SCC said in approving these programs back in September, the pilots will "further the goal of advancing competition in the Commonwealth."

The pilots consist of three separate programs.

- A Competitive Bid Supply program that will use competitive bidding for the SCC to select the lowest cost supplier for blocks of residential and small business customers. This program will provide valuable information on the use of competitive bidding to select default providers in the future.

- A municipal aggregation program to help cities and counties form buying groups to obtain better deals for the supply of electricity to their citizens.

- And a third program to make it easier for large commercial and industrial customers to obtain power from competitive providers. Customers participating in this pilot will seek their own supplier and negotiate their own individual bilateral contract.

All three will be fully implemented in 2004 and will operate until the conclusion of the capped rate period in 2007. Under these programs, we expect approximately 65,000 customers of all sizes to switch to competitive service providers licensed by the SCC.

All three pilots involve substantial reductions in the wires charges that are paid by customers who buy power from competitive providers. This should encourage participation by both suppliers and customers and stimulate competition. The reduction should provide greater opportunities for customer savings and at the same time allow suppliers to recover their operating costs.

The current structure of the pilots reflects changes in their design that the Company agreed to make in response to the constructive input offered by the many stakeholders that participated in the SCC's regulatory review process.

After we submitted our application for the pilots to the SCC in March, we held a series of meetings with interested parties. Included were a number of competitive service providers and consumer representatives, and the Commission staff. The Company agreed to make several substantial changes to the design of the pilots in response to the feedback that the parties offered. The Staff commended this process in their July report that endorsed the programs and recommended the Commission approve them.

- For example, responding to stakeholders' suggestions, we extended the programs' time period. We had originally proposed that the pilots run for two years – 2004 and 2005. Now they will run until the end of the capped rate period – currently scheduled for July 1, 2007.

- We also agreed to conduct an initial "screening for savings" in the Competitive Bid Supply pilot. If our screening indicates a customer is not likely to save money by participating, the customer won't be included in the program.

As I said earlier, we're in the early stages of rolling out these programs, but we are very excited about the level of interest from customers.

We're explaining our Competitive Bid Supply pilot program and seeking volunteers through a letter mailed to all of our 2 million residential and small business customers in Virginia. We sent out the first letters on Monday, November 17, to customers in eastern Virginia. Starting today and continuing through December 15, these letters will go to all other eligible customers in our service area. I have provided you with a copy of the letter and fact sheet being mailed to customers.

And through the end of last week, 548 accounts have volunteered to participate in the Commercial and Industrial pilot. These accounts represent far more load than the pilot's approved limit of 200 megawatts – more than 50 percent above the approved limit, to be exact. Therefore, we will need to conduct a lottery to select the participants. Although there hasn't been a great deal of interest to date from industrial customers, we have seen a significant number of major retail chains – including department stores, restaurants, grocery stores and home improvement centers - volunteer for the program.

Just last Thursday, November 20, we conducted a Municipal Aggregation pilot forum for localities; those attending included the cities of Falls Church, Charlottesville, Hampton and Fairfax, and the counties of York, Chesterfield, Charles City and Fairfax. Earlier this year, we held two educational forums on municipal aggregation; both were well attended. At last week's meeting, the localities heard proposals from consultants interested in performing a feasibility study for them to evaluate the costs and benefits of municipal aggregation. Those in attendance selected a consultant to perform the evaluation, and Dominion has agreed to pay for the study.

We're also pleased that a number of suppliers have expressed strong interest in the pilots. Some have indicated they are awaiting the determination of the Price to Compare before deciding if the economics are right for their participation. The following Competitive Service Providers and Aggregators have been involved in various stages of the pilot development process, and we believe they are interested in participating in some capacity in the pilots:

- Constellation New Energy
- Pepco Energy Services
- Washington Gas Energy Services
- Old Mill Power Company
- Strategic Energy
- Dominion Retail
- New Era Energy
- Energy Window
- Compass Energy

Media outlets are also showing a great deal of interest in the pilots, with featured coverage on television and radio stations throughout the state. And the Company has recently experienced significant increases in customer calls and visits to our web site as the communications about the pilots roll out.

At this point, all we can do is publicize the pilots and seek volunteers. Competitive service providers will not be able to make offers to individual customers or bid on the Competitive Bid pilot until we are able to compute the discounted wires charge and the Price to Compare for pilot participants. We will be able to make those calculations after the SCC issues its final order in the Company's current fuel case. We expect the order in the near future.

We are currently mid-way through the transition period specified in the Restructuring Act. We've already seen many positive developments from the Commonwealth's decision to implement restructuring. We're very pleased by the interest that a diverse group of stakeholders are showing in these programs. And we're confident our pilots will be another big step forward in the development of robust retail competition in Virginia.

Thank you. I'd be happy to answer any questions you may have.

COMMONWEALTH of VIRGINIA

Office of the Attorney General
Richmond 23219

Jerry W. Kilgore
Attorney General

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Richmond, Virginia 23219
804 - 786 - 2071
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January 9, 2004

Commission on Electric Utility Restructuring
The Honorable Thomas K. Norment Jr., Chairman
The Honorable Allen W. Dudley
The Honorable Terry G. Kilgore
The Honorable Harry J. Parrish
The Honorable Kenneth R. Plum
The Honorable Richard L. Saslaw
The Honorable James M. Scott
The Honorable Kenneth W. Stolle
The Honorable Robert Tata
The Honorable John Watkins

Re: Electric Utility Restructuring

Dear Commission Members:

Enclosed for your consideration is draft legislation prepared by the offices of the Secretary of Commerce and Trade and the Attorney General. The Governor and Attorney General are comfortable offering this for discussion purposes. We believe this type of approach offers a fair balance between the interests of all stakeholders, including consumers, utilities and competitive suppliers.

Very truly yours,

Michael J. Schewel
Secretary of Commerce and Trade

Judith Williams Jagdmann
Deputy Attorney General

Enclosure

AMENDMENTS TO § 56-249.6

§ 56-249.6. Recovery of fuel costs.

A. 1. Each electric utility which purchases fuel for the generation of electricity ***and which was not, as of July 1, 1999, bound by a rate case settlement adopted by the Commission that extended in its application beyond January 1, 2002*** shall submit to the Commission its estimate of fuel costs, including the cost of purchased power, for the twelve-month period beginning on the date prescribed by the Commission. Upon investigation of such estimates and hearings in accordance with law, the Commission shall direct each company to place in effect tariff provisions designed to recover the fuel costs determined by the Commission to be appropriate for that period, adjusted for any over-recovery or under-recovery of fuel costs previously incurred.

2. The Commission shall continuously review fuel costs and if it finds that ~~the utility~~ ***any utility described in Subsection A. 1*** is in an over-recovery position by more than five percent, or likely to be so, it may reduce the fuel cost tariffs to correct the over-recovery.

B. All fuel costs recovery tariff provisions in effect on January 1, 2004 for any electric utility which purchases fuel for the generation of electricity and which was, as of July 1, 1999, bound by a rate case settlement adopted by the Commission that extended in its application beyond January 1, 2002, shall remain in effect until the earlier of (i) July 1, 2007, (ii) the termination of capped rates pursuant to the provisions of § 56-582.C, or (iii) the establishment of tariff provisions under subsection C. Any such utility shall continue to report to the Commission annually its actual fuel costs, including the cost of purchased power until July 1, 2007.

C. Unless capped rates are terminated pursuant to the provisions of § 56-582.C prior to July 1, 2007, the Commission shall direct each electric utility described in subsection B to submit to the Commission its estimate of fuel costs, including the cost of purchased power, for the forty-two month period beginning July 1, 2007 and ending December 31, 2010. Upon investigation of such estimate and hearing in accordance with law, the Commission shall direct each such utility to place in effect tariff provisions designed to recover the fuel costs determined by the Commission to be appropriate for such period, without adjustment for any over-recovery or under-recovery of fuel costs previously incurred. Such tariff provisions shall remain in effect until the capped rates for such utility expire or are terminated pursuant to the provisions of § 56-582.

D. 1. In proceedings under subsections A and C, the ~~The~~ Commission may, to the extent deemed appropriate, offset against fuel costs and purchased power costs to be recovered ~~hereunder~~ the revenues attributable to sales of power pursuant to interconnection agreements with neighboring electric utilities.

2. In proceedings under subsections A and C, the ~~The~~ Commission shall disallow recovery of any fuel costs that it finds without just cause to be the result of failure of the utility to make every reasonable effort to minimize fuel costs or any decision of the utility resulting in unreasonable fuel costs, giving due regard to reliability of service and the

need to maintain reliable sources of supply, economical generation mix, generating experience of comparable facilities, and minimization of the total cost of providing service.

3. The Commission is authorized to promulgate, in accordance with the provisions of this section, all rules and regulations necessary to allow the recovery by electric utilities of all of their prudently incurred fuel costs ***under subsections A and C***, including the cost of purchased power, as precisely and promptly as possible, with no over-recovery or under-recovery, in a manner that will tend to assure public confidence and minimize abrupt changes in charges to consumers.

The Commission may, however, dispense with the procedures set forth above for any electric utility if it finds, after notice and hearing, that the electric utility's fuel costs can be reasonably recovered through the rates and charges investigated and established in accordance with other sections of this chapter.

AMENDMENTS TO § 56-577

§ 56-577. Schedule for transition to retail competition; Commission authority; ***exemptions;*** pilot programs.

A. ***Subject to the provisions of subsection C., the*** ~~The~~ transition to retail competition for the purchase and sale of electric energy shall be implemented as follows:

1. Each incumbent electric utility owning, operating, controlling, or having an entitlement to transmission capacity shall join or establish a regional transmission entity, which entity may be an independent system operator, to which such utility shall transfer the management and control of its transmission system, subject to the provisions of § 56-579.

2. On and after January 1, 2002, retail customers of electric energy within the Commonwealth shall be permitted to purchase energy from any supplier of electric energy licensed to sell retail electric energy within the Commonwealth during and after the period of transition to retail competition, subject to the following:

a. The Commission shall separately establish for each utility a phase-in schedule for customers by class, and by percentages of class, to ensure that by January 1, 2004, all retail customers of each utility are permitted to purchase electric energy from any supplier of electric energy licensed to sell retail electric energy within the Commonwealth.

b. The Commission shall also ensure that residential and small business retail customers are permitted to select suppliers in proportions at least equal to that of other customer classes permitted to select suppliers during the period of transition to retail competition.

3. On and after January 1, 2002, the generation of electric energy shall no longer be subject to regulation under this title, except as specified in this chapter.

4. On and after January 1, 2004, all retail customers of electric energy within the Commonwealth, regardless of customer class, shall be permitted to purchase electric energy from any supplier of electric energy licensed to sell retail electric energy within the Commonwealth.

B. The Commission may delay or accelerate the implementation of any of the provisions of this section, subject to the following:

1. Any such delay or acceleration shall be based on considerations of reliability, safety, communications or market power; and

2. Any such delay shall be limited to the period of time required to resolve the issues necessitating the delay, but in no event shall any such delay extend the implementation of customer choice for all customers beyond January 1, 2005.

The Commission shall, within a reasonable time, report to the General Assembly, or any legislative entity monitoring the restructuring of Virginia's electric industry, any such delays and the reasons therefor.

C. 1. Commencing on July 1, 2004, if a majority of cooperatives file a written notice to the Commission, with copy to the Commission on Electric Utility Restructuring,

Electing to be exempt from §§ 56-581.1, 56-582, 56-583, 56-584, 56-585, 56-587, and 56-590, then all cooperatives shall thereafter be exempt from such sections of this chapter. In addition, upon acknowledgement of receipt of such notice by the State Corporation Commission:

a. All cooperative's rates shall be (i) their capped rates established pursuant to § 56-582 until July 1, 2007, and (ii) determined thereafter by the Commission pursuant to Chapter 10 (§ 56-232 et seq.) of this title; and

b. Any order of the Commission that (i) issued a license to any cooperative pursuant to § 56-587, or (ii) approved any cooperative's functional separation plan under § 56-590 shall have no further force and effect.

2. If cooperatives have elected an exemption under this subsection, a majority of cooperatives may, at any time thereafter, file a written notice to the Commission, with copy to the Commission on Electric Utility Restructuring, waiving such exemption. Upon acknowledgement of receipt of such notice by the State Corporation Commission, all cooperatives shall thereafter be subject to §§ 56-581.1, 56-582, 56-583, 56-584, 56-585, 56-587, and 56-590, and any order of the Commission previously rendered inoperative by the provision of subsection C.1.b. shall again be in full force and effect.

~~C.~~ ***D.*** The Commission may conduct pilot programs encompassing retail customer choice of electricity energy suppliers for each incumbent electric utility that has not transferred functional control of its transmission facilities to a regional transmission entity prior to January 1, 2003. Upon application of an incumbent electric utility, the Commission may establish opt-in and opt-out municipal aggregation pilots and any other pilot programs the

Commission deems to be in the public interest, and the Commission shall report to the Legislative Transition Task Force on the status of such pilots by November of each year through 2006.

~~D.~~ *E.* The Commission shall promulgate such rules and regulations as may be necessary to implement the provisions of this section.

~~E.~~ *F.* By January 1, 2002, the Commission shall promulgate regulations establishing whether and, if so, for what minimum periods, customers who request service from an incumbent electric utility pursuant to subsection D of § 56-582 or a default service provider, after a period of receiving service from other suppliers of electric energy, shall be required to use such service from such incumbent electric utility or default service provider, as determined to be in the public interest by the Commission.

AMENDMENTS TO § 56-582

§ 56-582. Rate caps.

A. The Commission shall establish capped rates, effective January 1, 2001, ~~and expiring on July 1, 2007,~~ for each service territory of every incumbent utility as follows:

1. Capped rates shall be established for customers purchasing bundled electric transmission, distribution and generation services from an incumbent electric utility.

2. Capped rates for electric generation services, only, shall also be established for the purpose of effecting customer choice for those retail customers authorized under this chapter to purchase generation services from a supplier other than the incumbent utility during this period.

3. The capped rates established under this section shall be the rates in effect for each incumbent utility as of the effective date of this chapter, or rates subsequently placed into effect pursuant to a rate application filed by an incumbent electric utility with the Commission prior to January 1, 2001, and subsequently approved by the Commission, and made by an incumbent electric utility that is not currently bound by a rate case settlement adopted by the Commission that extends in its application beyond January 1, 2002. If such rate application is filed, the rates proposed therein shall go into effect on January 1, 2001, but such rates shall be interim in nature and subject to refund until such time as the Commission has completed its investigation of such application. Any amount of the rates found excessive by the Commission shall be subject to refund with interest, as may be ordered by the Commission. The Commission shall act upon such applications prior to commencement of the period of transition to customer choice. Such rate application and the Commission's approval shall give due consideration, on a forward-looking basis, to the justness and reasonableness of rates to be effective for a period of time ending as late as July 1, 2007. The capped rates established under this section, which include rates, tariffs, electric service contracts, and rate programs (including experimental

rates, regardless of whether they otherwise would expire), shall be such rates, tariffs, contracts, and programs of each incumbent electric utility, provided that experimental rates and rate programs may be closed to new customers upon application to the Commission. Such capped rates shall also include rates for new services where, subsequent to January 1, 2001, rate applications for any such rates are filed by incumbent electric utilities with the Commission and are thereafter approved by the Commission. In establishing such rates for new services, the Commission may use any rate method that promotes the public interest and that is fairly compensatory to any utilities requesting such rates.

B. The Commission may adjust such capped rates in connection with the following: (i) utilities' recovery of fuel costs pursuant to § 56-249.6, (ii) any changes in the taxation by the Commonwealth of incumbent electric utility revenues, (iii) any financial distress of the utility beyond its control, (iv) with respect to cooperatives that were not members of a power supply cooperative on January 1, 1999, and as long as they do not become members, their cost of purchased wholesale power and discounts from capped rates to match the cost of providing distribution services, and (v) with respect to cooperatives that were members of a power supply cooperative on January 1, 1999, their recovery of fuel costs, through the wholesale power cost adjustment clauses of their tariffs pursuant to § 56-231.33. Notwithstanding the provisions of § 56-249.6, the Commission may authorize tariffs that include incentives designed to encourage an incumbent electric utility to reduce its fuel costs by permitting retention of a portion of cost savings resulting from fuel cost reductions or by other methods determined by the Commission to be fair and reasonable to the utility and its customers.

C. A utility may petition the Commission to terminate the capped rates to all customers any time after January 1, 2004, and such capped rates may be terminated upon the Commission finding of an effectively competitive market for generation services within the service territory of that utility. If the capped rates are continued after January 1, 2004, an incumbent electric utility which is not, as of the effective date of this chapter, bound by a rate case settlement adopted by the Commission that extends in its application beyond January 1, 2002, may petition the Commission for approval of a one-time change in ~~the nongeneration components of such~~ *its* rates*, and if the capped rates are continued after July 1, 2007, such incumbent electric utility may at any time after July 1, 2007, petition the Commission for approval of a one-time change in its rates.*

D. Until the expiration or termination of capped rates as provided in this section, the incumbent electric utility, consistent with the functional separation plan implemented under § 56-590, shall make electric service available at capped rates established under this section to any customer in the incumbent electric utility's service territory, including any customer that, until the expiration or termination of capped rates, requests such service after a period of utilizing service from another supplier.

E. During the period when capped rates are in effect for an incumbent electric utility, such utility may file with the Commission a plan describing the method used by such utility to assure full funding of its nuclear decommissioning obligation and specifying the amount of the revenues collected under either the capped rates, as provided in this section, or the wires charges, as provided in § 56-583, that are dedicated to funding such

nuclear decommissioning obligation under the plan. The Commission shall approve the plan upon a finding that the plan is not contrary to the public interest.

F. The capped rates established pursuant to this section shall expire on December 31, 2010, unless sooner terminated by the Commission pursuant to the provisions of subsection C., hereof.

AMENDMENTS TO § 56-583

§ 56-583. Wires charges.

A. To provide the opportunity for competition and consistent with § 56-584, the Commission shall calculate wires charges for each incumbent electric utility, effective upon the commencement of customer choice, which shall be the excess, if any, of the incumbent electric utility's capped unbundled rates for generation over the projected market prices for generation, as determined by the Commission; however, where there is such excess, the sum of such wires charges, the unbundled charge for transmission and ancillary services, the applicable distribution rates established by the Commission and the above projected market prices for generation shall not exceed the capped rates established under § 56-582 A 1 applicable to such incumbent electric utility. The Commission shall adjust such wires charges not more frequently than annually and shall seek to coordinate adjustments of wires charges with any adjustments of capped rates pursuant to § 56-582. No wires charge shall be less than zero. The projected market prices for generation, when determined under this subsection, shall be adjusted for any projected cost of transmission, transmission line losses, and ancillary services subject to the jurisdiction of the Federal Energy Regulatory Commission which the incumbent electric utility (i) must incur to sell its generation and (ii) cannot otherwise recover in rates subject to state or federal jurisdiction.

B. Customers that choose suppliers of electric energy, other than the incumbent electric utility, or are subject to and receiving default service, prior to the ***earlier of (i) July 1, 2007, or (ii) the termination by the Commission of capped rates pursuant to the provisions of § 56-582.C*** ~~expiration of the period for capped rates, as provided for in § 56-582,~~ shall pay a wires charge determined pursuant to subsection A based upon actual usage of electricity distributed by the incumbent electric utility to the customer (i) during the period from the time the customer chooses a supplier of electric energy other than the incumbent electric utility or (ii) during the period from the time the customer is subject to and receives default service until ***the earlier of (i) July 1, 2007, or (ii) the termination by the Commission of capped rates pursuant to the provisions of § 56-582.C*** ~~capped rates expire or are terminated, as provided in § 56-582.~~

C. The Commission shall permit any customer, at its option, to pay the wires charges owed to an incumbent electric utility on an accelerated or deferred basis upon a finding that such method is not (i) prejudicial to the incumbent electric utility or its ratepayers or

(ii) inconsistent with the development of effective competition, provided that all deferred wires charges shall be paid in full by July 1, 2007.

D. A supplier of retail electric energy may pay any or all of the wires charge owed by any customer to an incumbent electric utility. The supplier may not only pay such wires charge on behalf of any customer, but also contract with any customer to finance such payments. Further, on request of a supplier, the incumbent electric utility shall enter into a contract allowing such supplier to pay such wires charge on an accelerated or deferred basis. Such contract shall contain terms and conditions, specified in rules and regulations promulgated by the Commission to implement the provisions of this subsection, that fully compensate the incumbent electric utility for such wires charge, including reasonable compensation for the time value of money.

Applying Economic Models to Forecast Potential Savings to Residential Utility Customers During an Imposed Capped Rate Period: January 2004 Update

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Introduction

Dominion Virginia Power engaged Chmura Economics & Analytics (CEA) in 2002 to apply economic models to forecast the potential savings to residential utility customers during an imposed capped rate period. The study found that Virginia residential consumers are enjoying marked savings under capped rates compared to what they would have spent for electricity under probable rates that may have been implemented had the caps not been imposed. In particular, for the Dominion Virginia Power residential class, CEA analysis shows total savings ranging from $780 million to $871 million over the entire capped rate period (1998 through 2007). Savings are shown as 2001 dollars.

The purpose of this report is to update through 2010 the estimated savings to residential utility customers for Dominion Virginia Power.

Results of the Updated Study through 2010

The updated study indicates that Virginia residential consumers will continue to enjoy marked savings under capped rates compared to what they would have spent for electricity under probable rates that may have been implemented had the caps not been imposed. For the Dominion Virginia Power residential class, the CEA analysis shows (see Table 1):

- Total savings ranging from $1,478 million to $1,808 million over the entire capped rate period (1998 through 2010). Savings are shown as 2001 dollars.
- Average savings for residential customers ranging from $814 to $996 over the entire period, based on the number of Dominion Virginia Power residential customers as of December 2001 (approximately 1.82 million). Assuming the number of residential customers as of August 2003, the savings range from $789 to $966 per customer (approximately 1.87 million).
- Average annual savings for residential customers ranging from $63 to $77 ($61 to $74 for August 2003 customers) during the period. This represents annual savings of between 6.1 and 7.6 percent (6.0 and 7.3 percent for August 2003 customers) for the typical residential customer.[1]

[1] According to Dominion Virginia Power estimates, the typical residential customer uses 1,000-kilowatt hours a month. The average monthly bill for this customer is $84.41. The typical residential customer therefore spends $1,012.92 on electricity annually. Using the savings per customer per year from Table E-2, this translates into average savings ranging between 6.18 percent to 7.56 percent (6.00 and 7.33 percent for August 2003 customers) per year.

- Consumer savings on electricity during the capped rate period also generate an additional $251 million to $307 million in economic activity in Virginia through the multiplier effect. This occurs because spending on retail goods has a stronger impact on the economy than spending on electricity. The savings provided to Dominion Virginia Power customers from lower electricity prices will ripple through the economy as consumers spend those savings on other goods.
- Base residential electricity rates would have risen 8.4% to 11.7% from 2001 to 2010 in nominal dollars under probable rates had caps not been imposed.
- If base rates were not capped and changed by the rate of inflation as measured by the consumer price index (CPI), base rates would be 22.3% higher from 2001 to 2010.

Table 1: Itemized Real Estimated Savings (2001 Dollars) to Residential Customers[2]

	Total Estimated Savings	Savings per Year	Savings per Customer per Year	Savings per Customer for Fixed Rate Period
SCC 1998-2001	$287,972,738	$71,993,185	$39.65 ($38.46)	$158.62 ($153.85)
CEA A-Baseline, 2002-2010	$1,086,574,020	$120,730,447	$66.50 ($64.50)	$598.50 ($580.49)
CEA B-Baseline, 2002-2010	$1,328,328,022	$147,592,002	$81.30 ($78.85)	$731.66 ($709.65)
CEA A-Strong Growth 2002-2010	$998,657,667	$110,961,963	$61.12 ($59.28)	$550.07 ($533.53)
CEA B-Strong Growth 2002-2010	$1,258,756,745	$139,861,861	$77.04 ($74.72)	$693.34 ($672.48)
Dominion Extraordinary expenses	$191,235,621	$34,770,113	$19.15 ($18.58)	$105.33 ($102.17)

Note: 'Baseline' assumes continued economic expansion, 'Strong Growth' assumes a very rapid economic growth. See page 19 of the original confidential study dated October 4, 2002 for an explanation of the different lag structures in models A and B.

[2] The number of Dominion Virginia Power's residential customers (1,815,500) as of December 2001 is used as the basis for calculations in this table. In parentheses, the number of residential customers (1,871,807) as of August 2003 is used as the basis for calculations.

Table 2: Total Real Estimated Savings (2001 Dollars) for Models A and B Under Two Separate Macroeconomic Scenarios, 1998-2010[3]

	Total Estimated Savings	Savings per Year	Savings per Customer per Year	Savings per Customer for Fixed Rate Period
CEA A-Baseline 1998-2010	$1,565,782,378	$120,444,798	$66.34 ($64.35)	$862.45 ($836.51)
CEA B-Baseline 1998-2010	$1,807,536,381	$139,041,260	$76.59 ($74.28)	$995.61 ($965.66)
CEA A-Strong Growth 1998-2010	$1,477,866,026	$113,682,002	$62.62 ($60.73)	$814.03 ($789.54)
CEA B-Strong Growth 1998-2010	$1,737,965,104	$133,689,623	$73.64 ($71.42)	$957.29 ($928.50)

Note: 'Baseline' assumes continued economic expansion, 'Strong Growth' assumes a very rapid economic growth. See Appendix B for estimated savings from 2007 through 2010.
"Total Estimated Savings" includes savings from SCC-imposed cap (1998-2001) and avoidance of Dominion Virginia Power extraordinary expenses recovery.

Reasons for Higher Savings in Updated Study

Estimated savings for the updated report are much larger than in the original report. Of course, part of the increased savings is due to the additional three and a half years for which savings are estimated. However, when updated data are used to estimate savings for 1998 through 2007, which was the period used in the last study, the amount of savings is higher for the following three reasons:

1. Actual data and forecasts for electricity use increased since the last study
2. Load forecasts are substantially higher in the updated study
3. The anticipated economic rebound did not occur as quickly as anticipated

Higher savings occur because average non-fuel residential rates per kwh tend to increase during times when the economy is growing at relatively slow rates, such as recessions. Higher average rates occur when the fixed capacity of the utility is distributed over a smaller base of customers. For that reason, the savings to consumers are larger during recessions when compared to the fixed cap rate.

[3] The number of Dominion Virginia Power's residential customers (1,815,500) as of December 2001 is used as the basis for calculations in this table. In parentheses, the number of residential customers (1,871,807) as of August 2003 is used as the basis for calculations.

As an example, Table 3 shows the CEA A-Baseline estimated savings from 2002 through 2007, which are $219,377,645 higher than the original study. As a result, customer savings per year are $21.97 higher than previously estimated.

The remainder of this report provides further detail around the three reasons for the higher savings estimates.

Table 3: Change in Estimated Savings

CEA A – Baseline[4] 2002-2007	Total Estimated Savings	Total Estimated Savings per Year	Total Estimated Savings per Customer per Year
Original Study	$302,751,378	$55,045,705	$30.32
Updated Data*	$522,129,023	$94,932,550	$52.29
Difference	$219,377,645	$39,886,845	$21.97

*Includes new actual data from 2002Q1 to 2003Q2 and new forecasts from 2003Q3 to 2007Q2.

Electricity Use

From 2002 through 2007, electricity usage is expected to grow an average 3.1% rather than the 0.7% estimate used in the original study. Instead of experiencing the slight decrease in 2002 that was forecast, actual use increased over 10% during 2002 (see Figure 1). In addition, the new forecast for energy use calls for an average increase of 1.7% from 2003 through 2007 compared with 1.0% in the original study.

Table 4, which shows the sensitivity analysis to electricity use from the original study, is included below. According to the sensitivity analysis, if electricity use were 2% above its forecast, the estimated savings to residential customers would be between $401 and $501 million. Given that use is 2.4% above its previous forecast for this time period, it is not surprising that the estimated savings are now in the neighborhood of $457 and $621 million.

[4] See Appendix A for all scenarios.

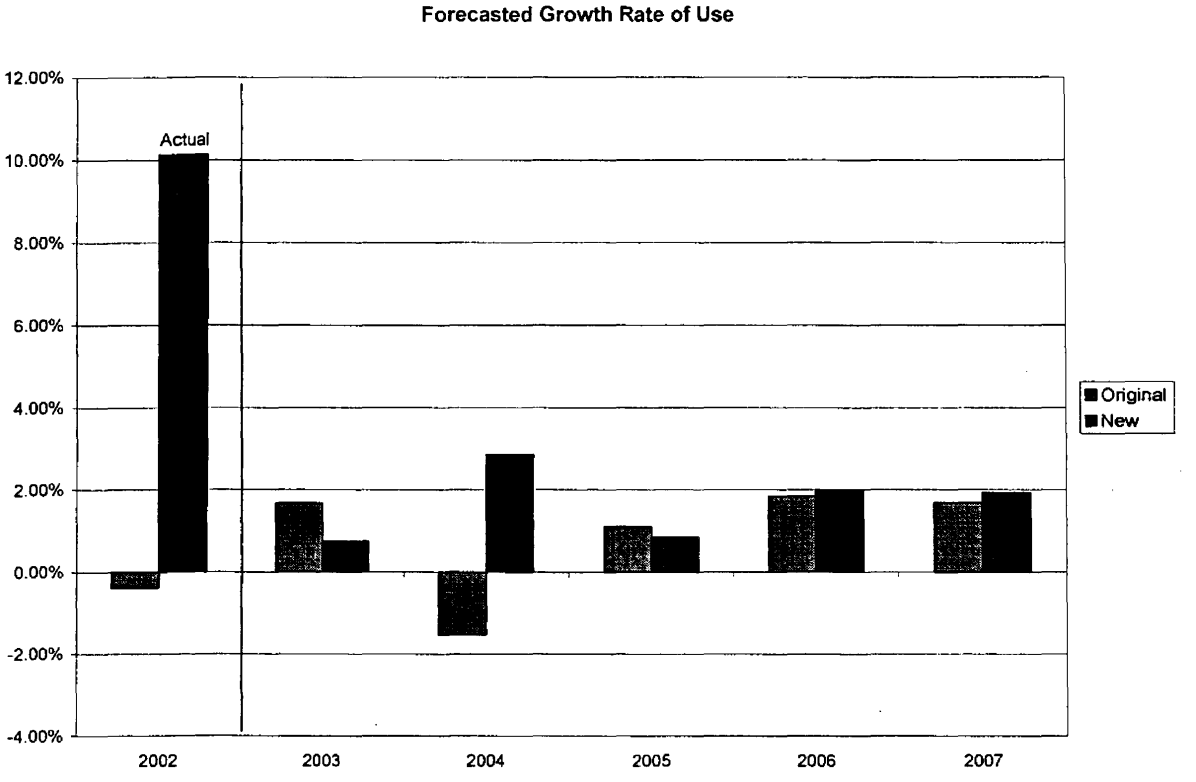

Figure 1. Forecasted Growth Rate of Use

Table 4: Sensitivity of Real Savings (2001 Dollars) Results to Changes in 'Use,' 2002-2007[5]
(Total estimated savings shown in first row and estimated savings per customer per year shown in the second row)

	USE (PERCENTAGE POINTS ABOVE OR BELOW CURRENT FORECAST USE)					
Model	-2	-1	-0.5	+0.5	+1	+2
A – Baseline	$213,670,353	$256,998,031	$279,550,974	$326,492,288	$350,904,050	$401,669,528
	$21.40	$25.74	$28.00	$32.70	$35.14	$40.23
B – Baseline	$269,887,078	$315,505,641	$339,233,562	$388,585,329	$414,233,146	$467,533,867
	$27.03	$31.60	$33.97	$38.92	$41.48	$46.82
A – Slow Growth	$246,307,732	$291,108,770	$314,416,800	$362,905,845	$388,110,550	$440,500,835
	$24.67	$29.15	$31.49	$36.34	$38.87	$44.12
B – Slow Growth	$297,394,578	$344,315,536	$368,710,856	$419,430,440	$445,778,922	$500,515,120
	$29.78	$34.48	$36.93	$42.01	$44.64	$50.13

Note: 'Baseline' assumes slow recovery from recession, 'Slow Growth' assumes a very slow recovery from recession.

Load

As shown in Table 5 and Figure 2, load forecasts in the updated study are generally much higher than those in the original study. On average, the load forecast from 2002 through 2007 is 873 MW higher in the updated study. The difference between the data used in the original and updated study widens considerably after 2004 to 1,200 MW.

Forecast discrepancies of this magnitude cause the model to estimate larger savings as shown in Table 6 from the sensitivity analysis in the original study. According to Table 6, if the load forecast were 1,240 MW higher than previously forecast, the estimated savings would increase to between $487 and $638 million dollars from 2002 to 2007.

[5] The results in Table 4 illustrate how variations in the forecasted growth rate of 'use' changes the estimated savings derived from Models A and B. The second row of Table 4 shows the percentages by which 'use' varies from the forecast in the model. According to the first column of data in Table 4 under the heading '–2%,' a decline in 'use' that is 2 percentage points less than the forecast in the model leads to a savings of $213,670,353 for Model A with the Baseline forecast. Under these assumptions, savings to residential customers are $213,670,353 for 2002 through 2007. By comparison, the estimated savings from Model A with the Baseline forecast totals $302,711,856. Over the past ten years, the average error in forecasting use has been less than 1.0%.

Table 5: Load Forecasts

Date	Original (MW)	Update (MW)	Difference
2002Q1	14,084	13,679	-405
2002Q2	13,164	14,598	1,434
2002Q3	15,864	16,439	574
2002Q4	12,518	13,261	743
2003Q1	14,216	14,639	423
2003Q2	13,350	12,869	-480
2003Q3	*16,111*	*15,909*	-202
2003Q4	*12,685*	*13,004*	320
2004Q1	*13,766*	*14,861*	1,094
2004Q2	*13,075*	*14,005*	930
2004Q3	*15,591*	*16,925*	1,334
2004Q4	*12,348*	*13,237*	889
2005Q1	*13,887*	*15,153*	1,267
2005Q2	*13,278*	*14,333*	1,055
2005Q3	*15,817*	*17,299*	1,482
2005Q4	*12,476*	*13,509*	1,032
2006Q1	*14,107*	*15,437*	1,330
2006Q2	*13,521*	*14,644*	1,123
2006Q3	*16,094*	*17,666*	1,572
2006Q4	*12,686*	*13,787*	1,101
2007Q1	*14,331*	*15,727*	1,396
2007Q2	*13,763*	*14,952*	1,189
Average 02 to 07	*13,942*	*14,815*	873
Average 04 to 07	*13,910*	*15,110*	1,200

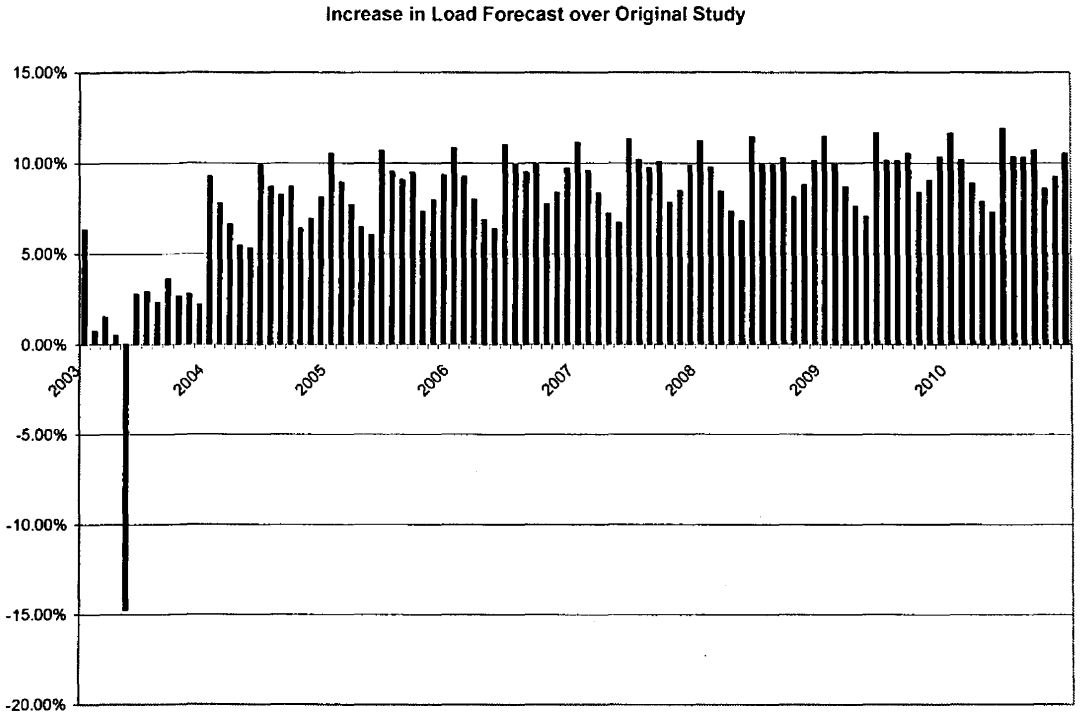

Figure 2. Increase in Load Forecast over Original Study

Table 6: Sensitivity of Real Savings (2001 Dollars) Results to Changes in 'Load,' 2002-2007[6]

(Total estimated savings shown in first row and estimated savings per customer per year shown in the second row)

	LOAD (AMOUNT ABOVE OR BELOW CURRENT FORECAST)					
Model	-1,230	-1,000	-500	+500	+1,000	+1,230
A - Baseline	$118,636,269	$153,059,561	$227,892,805	$377,559,293	$452,392,537	$486,815,830
	$11.88	$15.33	$22.82	$37.81	$45.31	$48.75
B - Baseline	$119,050,841	$164,778,617	$264,186,825	$463,003,241	$562,411,449	$608,139,224
	$11.92	$16.50	$26.46	$46.37	$56.32	$60.90
A - Slow Growth	$154,255,458	$188,678,750	$263,511,944	$413,178,482	$488,011,726	$522,435,018
	$15.45	$18.90	$26.39	$41.38	$48.87	$52.32
B - Slow Growth	$149,200,958	$194,928,733	$294,336,942	$493,153,358	$592,561,566	$638,289,341
	$14.94	$19.52	$29.48	$49.39	$59.34	$63.92

Note: 'Baseline' assumes slow recovery from recession, 'Slow Growth' assumes a very slow recovery from recession.

Economic Variables

Table 7 compares the original economic forecasts to the updated forecasts, which shows that economic growth has been slower than that which was predicted by Economy.com. The unemployment rate was projected to be below 6% by the second quarter, with a 3-month T-bill rate of 3.58%. Sluggish economic activity has caused the Federal Reserve Board to lower the federal funds rate target an additional 75 basis points since the last study was completed, resulting in low short-term interest rates. Also, the CPI forecast was revised lower to reflect reduced inflationary pressure.

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[6] The sensitivity of the savings estimates to changes in 'load' is shown in Table 6 where the second row in the table represents the year-over-year standard deviation in 'load' from 1992 through 2001. For example, 1,230 megawatts (the first value in the second row of the table), is the year-over-year standard deviation in 'load' from 1992 through 2001, which represents a forecast error of 9.4% which is unlikely based on the size of 'load'. The original study noted "It is unlikely that the forecast error will be as great as 1,230 megawatts. The average 'load' in 2001 was 13,110 megawatts. If Dominion Virginia Power's forecasts for 2002 through 2007 were off by 1,230 megawatts per year, this would result in a 9.4% forecasting error."

The impacts on estimated savings from 2002 through 2007 are shown in Table 6. Under the likely scenario that the forecast is off by less than 500 megawatts of the actual value, residential savings are $149,000 to $200,000 lower (higher) than previously estimated for each megawatt. For example, model A under the baseline scenario estimates savings as $302,711,856. If forecasted 'load' is lowered by 500 megawatts in each year, estimated savings would be $227,892,805. The impact on savings if 'load' is changed by one unit is calculated as ($302,711,856 - $227,892,805)/500 or $149,638.

Table 7: Variance in Actual and Forecasted Economic Data from Original Study

	Unemployment Rate			3-month T-bill			CPI (Q/Q percentage point change)		
Date	Original	Update	Difference	Original	Update	Difference	Original	Update	Difference
2002Q1	5.6%	5.6%	0.0	1.78%	1.72%	-0.06	0.25%	0.28%	0.03
2002Q2	5.9%	5.8%	-0.1	1.79%	1.72%	-0.07	0.68%	0.86%	0.18
2002Q3	6.0%	5.8%	-0.2	1.79%	1.64%	-0.15	0.56%	0.54%	-0.02
2002Q4	6.0%	5.9%	-0.1	2.24%	1.33%	-0.91	0.50%	0.50%	0.00
2003Q1	5.9%	5.8%	-0.1	2.80%	1.16%	-1.64	0.52%	0.96%	0.44
2003Q2	5.8%	6.1%	0.3	3.58%	1.03%	-2.55	0.56%	0.55%	-0.01
2003Q3	*5.7%*	6.3%	0.6	*4.29%*	1.07%	-3.22	*0.63%*	0.32%	-0.31
2003Q4	*5.5%*	6.2%	0.7	*4.92%*	1.19%	-3.73	*0.63%*	0.47%	-0.16
2004Q1	*5.4%*	6.1%	0.7	*5.16%*	1.19%	-3.97	*0.59%*	0.54%	-0.05
2004Q2	*5.4%*	6.0%	0.6	*5.36%*	1.40%	-3.96	*0.59%*	0.57%	-0.02
2004Q3	*5.4%*	5.8%	0.4	*5.35%*	2.20%	-3.15	*0.59%*	0.62%	0.03
2004Q4	*5.4%*	5.6%	0.2	*5.35%*	2.77%	-2.58	*0.59%*	0.64%	0.05
2005Q1	*5.4%*	5.5%	0.1	*5.35%*	3.27%	-2.08	*0.62%*	0.63%	0.01
2005Q2	*5.4%*	5.4%	0.0	*5.35%*	3.69%	-1.66	*0.62%*	0.61%	-0.02
2005Q3	*5.4%*	5.4%	0.0	*5.35%*	3.87%	-1.48	*0.62%*	0.63%	0.01
2005Q4	*5.3%*	5.3%	0.0	*5.35%*	4.31%	-1.04	*0.62%*	0.62%	0.00
2006Q1	*5.3%*	5.3%	0.0	*5.35%*	4.72%	-0.63	*0.60%*	0.60%	0.00
2006Q2	*5.2%*	5.2%	0.0	*5.18%*	4.84%	-0.34	*0.60%*	0.60%	0.00
2006Q3	*5.2%*	5.2%	0.0	*5.10%*	4.90%	-0.20	*0.60%*	0.59%	-0.01
2006Q4	*5.2%*	5.2%	0.0	*5.10%*	4.90%	-0.20	*0.60%*	0.59%	-0.01
2007Q1	*5.2%*	5.2%	0.0	*5.10%*	4.90%	-0.20	*0.57%*	0.58%	0.01
2007Q2	*5.2%*	5.2%	0.0	*5.10%*	4.90%	-0.20	*0.57%*	0.57%	0.00

Summary

Together, the three factors described in this update along with increased non-fuel residential rate per kwh after rebilling led to higher estimated savings from the model. Figure 3 shows the new Model A-Baseline Scenario where the projected base rates are slightly higher than in the original model. As noted earlier, the forecasted electricity use is over 2% higher than earlier estimated.

In summary, when more electricity is used, savings increase. Total savings are projected to range from $1,478 million to $1,808 million over the entire capped rate period (1998 through 2010) is expected. Savings are shown as 2001 dollars.

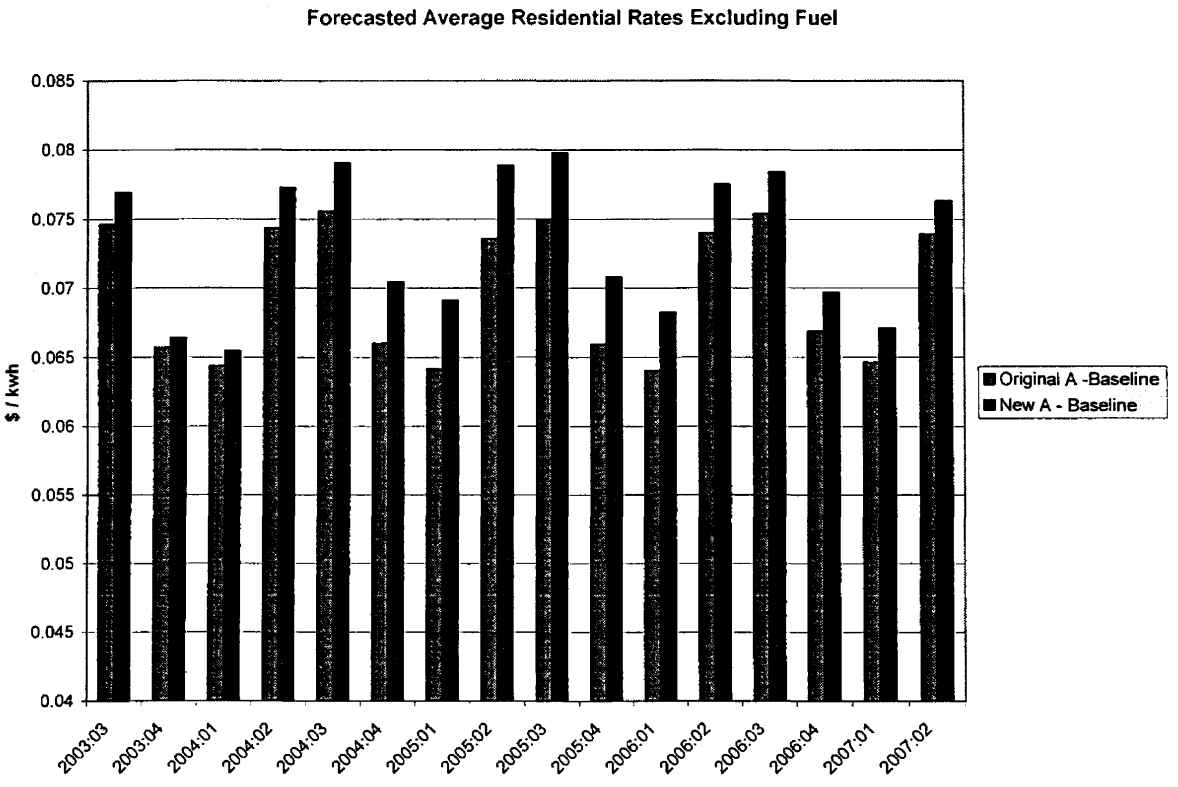

Figure 3. Forecasted Average Residential Rates Excluding Fuel

Table A-1: Itemized Real Estimated Savings (2001 Dollars) to Residential Customers[7]

	Total Estimated Savings	Savings per Year	Savings per customer per Year	Savings per Customer for Fixed Rate Period
SCC 1998-2001	$287,972,738	$71,993,185	$39.65 ($38.46)	$158.62 ($153.85)
CEA A-Baseline 2002-2007	$522,129,023	$94,932,550	$52.29 ($50.72)	$287.60 ($278.94)
CEA B-Baseline 2002-2007	$621,228,267	$112,950,594	$62.21 ($60.34)	$342.18 ($331.89)
CEA A-Strong Growth 2002-2007	$457,483,633	$83,178,842	$45.82 ($44.44)	$251.99 ($244.41)
CEA B-Strong Growth 2002-2007	$565,453,551	$102,809,737	$56.63 ($54.93)	$311.46 ($302.09)
Dominion Extraordinary expenses	$191,235,621	$34,770,113	$19.15 ($18.58)	$105.33 ($102.17)

Note: 'Baseline' assumes continued economic expansion, 'Strong Growth' assumes a very rapid economic growth.

[7] The number of Dominion Virginia Power's residential customers (1,815,500) as of December 2001 is used as the basis for calculations in this table. In parentheses, the number of residential customers (1,871,807) as of August 2003 is used as the basis for calculations.

Table A-2: Total Real Estimated Savings (2001 Dollars) for Models A and B Under Two Separate Macroeconomic Scenarios, 1998-2007[8]

	Total Estimated Savings	Savings per Year	Savings per Customer per Year	Savings per Customer for Fixed Rate Period
CEA A-Baseline 1998-2007	$1,001,337,382	$105,403,935	$58.06 ($56.01)	$551.55 ($534.96)
CEA B-Baseline 1998-2007	$1,100,436,626	$115,835,434	$63.80 ($61.88)	$606.13 ($587.90)
CEA A-Strong Growth 1998-2007	$936,691,992	$98,599,157	$54.31 ($52.68)	$515.94 ($500.42)
CEA B-Strong Growth 1998-2007	$1,044,661,910	$109,964,412	$60.57 ($58.75)	$575.41 ($558.10)

Note: 'Baseline' assumes continued economic expansion, 'Strong Growth' assumes a very rapid economic growth.
"Total Estimated Savings" includes savings from SCC-imposed cap (1998-2001) and avoidance of Dominion Virginia Power extraordinary expenses recovery.

[8] The number of Dominion Virginia Power's residential customers (1,815,500) as of December 2001 is used as the basis for calculations in this table. In parentheses, the number of residential customers (1,871,807) as of August 2003 is used as the basis for calculations.

Appendix B – Estimated Savings from 2007 through 2010

Table B-1: Total Real Estimated Savings (2001 Dollars) for Models A and B Under Two Separate Macroeconomic Scenarios, 2007-2010[9]

	Total Estimated Savings	Savings per Year	Savings per Customer per Year	Savings per Customer for Fixed Rate Period
CEA A-Baseline 2007-2010	$564,444,997	$161,269,999	$88.83 ($86.16)	$310.90 ($301.55)
CEA B-Baseline 2007-2010	$707,099,755	$202,028,501	$111.28 ($107.93)	$389.48 ($377.76)
CEA A-Strong Growth 2007-2010	$541,174,034	$154,621,153	$85.17 ($82.61)	$298.09 ($289.12)
CEA B-Strong Growth 2007-2010	$693,303,194	$198,086,627	$109.11 ($105.83)	$381.88 ($370.39)

Note: 'Baseline' assumes continued economic expansion, 'Strong Growth' assumes a very rapid economic growth.

[9] The number of Dominion Virginia Power's residential customers (1,815,500) as of December 2001 is used as the basis for calculations in this table. In parentheses, the number of residential customers (1,871,807) as of August 2003 is used as the basis for calculations.

Virginia Chemistry Council

Suite 425
1001 East Broad Street
Richmond, VA 23219

November 3, 2003

The Honorable Michael J. Schewel
Secretary of Commerce and Trade
Office of the Governor
Commonwealth of Virginia
P.O. Box 1475
Richmond, Virginia 23218

The Honorable Judith Williams Jagdmann
Deputy Attorney General
Office of the Attorney General
900 East Main Street, 2nd Floor
Richmond, Virginia 23219

Re: Comments of Virginia Chemistry Council

Dear Secretary Schewel and Deputy Attorney General Jagdmann:

On behalf of the Virginia Chemistry Council (VCC)[1], we are presenting these comments to the proposal of October 10, 2003, to the Commission on Electric Utility Restructuring to extend existing capped rates, authorized pursuant to § 56-582 of the Code of Virginia, for three years, until July 1, 2010, and to phase out or eliminate wires charges.

First, we feel as others[2] that Virginia utilities presently have no stranded costs; rather, the generation assets of Dominion Virginia Power and American Electric Power in Virginia are worth more in the market over their useful lives than the book value of such assets. While the Restructuring Act provides for a monitoring of whether stranded costs are over or under collected, the Act provides for no remedy. Thus, new legislation is needed.

Second, we are of the opinion that Dominion Virginia Power's "capped rates" are producing significant earnings above costs and a reasonable rate of return. Without stranded costs such earnings are not justified. Not satisfied with such earnings, Dominion Virginia Power seeks additional, significant fuel-related increases over and above its

[1] The membership of VCC is comprised of Celanese, Ciba Specialty Chemicals, Dupont, and Honeywell.
[2] Alliance for Lower Electricity Rates Today, Virginia Committee for Fair Utility Rates, and Old Dominion Committee for Fair Utility Rates.

present earnings. The present "capped rate" provisions of the law do not preclude such increases.

Third there is the almost total absence of any competitive suppliers making offers to retail customers in the Commonwealth. There also have been delays in Virginia utilities joining regional transmission entities. This lack of competition, when coupled with the doubling of natural gas prices with the concomitant significant increases in market electricity prices, argues for continued regulation of rates by the State Corporation Commission.

We would suggest that, absent competition and with a lack of stranded costs, legislation should be introduced to declare there are no stranded costs, and to eliminate the wire charges. Furthermore, absent competition it is unfair to have consumers pay rates in excess of the cost of providing electricity (including a reasonable rate of return). Accordingly the legislation should provide that the "cap" on such rates should be set at a level found by the State Corporation Commission to be the reasonable cost of providing such service with a reasonable rate of return.

We appreciate the opportunity to present these comments.

Sincerely yours,

E. A. (Win) Winslow
Chairman
Virginia Chemistry Council

SENATE BILL NO. _____ HOUSE BILL NO. _____

A BILL to amend and reenact §§ 30-205, 56-231.34:1, 56-577, and 56-596 of the Code of Virginia, and to amend the Code of Virginia by adding in Chapter 23 of Title 56 sections numbered 56-597 and 56-598, relating to electric utility restructuring.

Be it enacted by the General Assembly of Virginia:

1. That §§ 30-205, 56-231.34:1, 56-577, and 56-596 of the Code of Virginia are amended and reenacted, and that the Code of Virginia is amended by adding in Chapter 23 of Title 56 sections numbered 56-597 and 56-598 as follows:

§ 30-205. (Expires July 1, 2008) Powers and duties of the Commission.

The Commission shall have the following powers and duties:

1. Monitor the work of the State Corporation Commission in implementing Chapter 23 (§ 56-576 et seq.) of Title 56, receiving such reports as the Commission may be required to make pursuant thereto, including reviews, analyses, and impact on consumers of electric utility restructuring programs in other states;

2. ~~Determine~~ Analyze whether, and on what basis, retail customer choice would be viable in the Commonwealth and make recommendations to the General Assembly when it determines that action should be taken to reinstitute retail customer choice in the future, including, but not limited to, recommendations as to the viability of retail customer choice for particular classes of customers and the reestablishment, if and as appropriate, of stranded cost recovery for incumbent electric utilities ~~should be permitted to discount capped generation rates established pursuant to § 56-582~~;

3. Monitor, ~~after the commencement of customer choice and~~ with the assistance of the State Corporation Commission and the Office of Attorney General, the incumbent electric utilities, suppliers, and retail customers, ~~whether the recovery of stranded costs, as provided in § 56-584, has resulted or is likely to result in the overrecovery or underrecovery of just and~~

~~reasonable net stranded costs;~~ encourage the development of viable competitive wholesale electric markets, and monitor the benefits of such markets for electric customers in the Commonwealth;

~~4. Examine (i) utility worker protection during the transition to retail competition, (ii) generation, transmission and distribution systems reliability concerns, and (iii) energy assistance programs for low-income households;~~

~~5~~4. Establish one or more subcommittees of its membership, to meet at the direction of the chairman of the Commission, for any purpose within the scope of the duties prescribed to the Commission by this section; and

~~6~~5. Report annually to the General Assembly and the Governor on the ~~progress of each stage of the phase-in of~~ development of wholesale electricity markets and their impact on Virginia electric customers and on its judgments as to the future viability of retail competition in the Commonwealth and offer such recommendations as may be pertinent to such subjects and appropriate for legislative and administrative consideration~~ in order to maintain the Commonwealth's position as a low-cost electricity market and ensure that residential customers and small business customers benefit from competition~~.

§ 56-231.34:1. Separation of regulated and unregulated businesses.

A. No cooperative that engages in a regulated utility service shall conduct any unregulated business activity, other than traditional cooperative activities, except in or through one or more affiliates of such cooperative~~, provided that a cooperative that provides regulated utility services shall have the right to offer and make unregulated sales of electric power to its members within its certificated service territory~~. No such affiliates, formed to engage in any business that is not a regulated utility service, shall engage in regulated utility services.

B. The Commission shall promulgate rules and regulations, governing the conduct of the cooperatives, to promote effective and fair competition between (i) affiliates of cooperatives that are engaged in business activities which are not regulated utility services and (ii) other

persons engaged in the same or similar businesses. The rules and regulations shall be effective by July 1, 2000, and shall include provisions:

1. Prohibiting cost-shifting or cross-subsidies between a cooperative and its affiliates;

2. Prohibiting anticompetitive behavior or self-dealing between a cooperative and its affiliates;

3. Prohibiting a cooperative from engaging in discriminatory behavior towards nonaffiliated entities; and

4. Establishing codes of conduct detailing permissible relations between a cooperative and its affiliates. In establishing such codes, the Commission shall consider, among other things, whether and, if so, under what circumstances and conditions (i) a cooperative may provide its affiliates with customer lists or other customer information, sales leads, procurement advice, joint promotions, and access to billing or mailing systems unless such information or services are made available to third parties under the same terms and conditions, (ii) the cooperative's name, logos or trademarks may be used in promotional, advertising or sales activities conducted by its affiliates, and (iii) the cooperative's vehicles, equipment, office space and employees may be used by its affiliates.

C. Nothing in this article shall be deemed to abrogate or modify the Commission's authority under Chapter 4 (§ 56-76 et seq.) of this title.

§ 56-577. Retail competition; Commission authority; pilot programs.

A. ~~The transition to retail competition for the purchase and sale of electric energy shall be implemented as follows:~~

~~1.~~ Each incumbent electric utility owning, operating, controlling, or having an entitlement to transmission capacity shall join or establish a regional transmission entity, which entity may be an independent system operator, to which such utility shall transfer the management and control of its transmission system, subject to the provisions of § 56-579.

~~2. On and after January 1, 2002, retail customers of electric energy within the Commonwealth shall be permitted to purchase energy from any supplier of electric energy~~

~~licensed to sell retail electric energy within the Commonwealth during and after the period of transition to retail competition, subject to the following:~~

~~a. The Commission shall separately establish for each utility a phase-in schedule for customers by class, and by percentages of class, to ensure that by January 1, 2004, all retail customers of each utility are permitted to purchase electric energy from any supplier of electric energy licensed to sell retail electric energy within the Commonwealth.~~

~~b. The Commission shall also ensure that residential and small business retail customers are permitted to select suppliers in proportions at least equal to that of other customer classes permitted to select suppliers during the period of transition to retail competition.~~

~~3. On and after January 1, 2002, the generation of electric energy shall no longer be subject to regulation under this title, except as specified in this chapter.~~

~~4. On and after January 1, 2004, all~~B. All retail customers of electric energy within the Commonwealth, regardless of customer class, shall be permitted to purchase electric energy from any supplier of electric energy licensed to sell retail electric energy within the Commonwealth.

~~B. The Commission may delay or accelerate the implementation of any of the provisions of this section, subject to the following:~~

~~1. Any such delay or acceleration shall be based on considerations of reliability, safety, communications or market power; and~~

~~2. Any such delay shall be limited to the period of time required to resolve the issues necessitating the delay, but in no event shall any such delay extend the implementation of customer choice for all customers beyond January 1, 2005.~~

~~The Commission shall, within a reasonable time, report to the General Assembly, or any legislative entity monitoring the restructuring of Virginia's electric industry, any such delays and the reasons therefor.~~

C. The Commission may conduct pilot programs encompassing retail customer choice of electricity energy suppliers ~~for each~~upon application of an incumbent electric utility ~~that has not transferred functional control of its transmission facilities to a regional transmission entity prior to January 1, 2003. Upon application of an incumbent electric utility, the Commission may establish~~ . Such pilot programs may include opt-in and opt-out municipal aggregation pilots and any other pilot programs the Commission deems to be in the public interest, and the Commission shall report to the ~~Legislative Transition Task Force~~ Commission on Electric Utility Restructuring on the status of such pilots by November of each year through 2006.

D. The Commission shall promulgate such rules and regulations as may be necessary to implement the provisions of this section.

E. ~~By January 1, 2002, the Commission shall promulgate regulations establishing whether and, if so, for what minimum periods, customers who request service from an incumbent electric utility pursuant to subsection D of § 56-582 or a default service provider, after a period of receiving service from other suppliers of electric energy, shall be required to use such service from such incumbent electric utility or default service provider, as determined to be in the public interest by the Commission.~~Nothing in this title shall be interpreted to preclude timely completion of the regulatory process with regard to regional transmission entities as set forth in § 56-579 or to inhibit retail competition in pilot programs established pursuant to subsection C.

§ 56-596. Advancing competition.

~~A. 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.~~

~~B.~~ By September 1 of each year, the Commission shall report to the Commission on Electric Utility Restructuring and the Governor information on the status of ~~competition in the Commonwealth,~~ pilot programs conducted under § 56-577 and the status of the development of regional competitive markets~~, and its recommendations to facilitate effective competition in~~

~~the Commonwealth as soon as practical~~. This report shall include any recommendations of actions to be taken by the General Assembly~~, the Commission, electric utilities, suppliers, generators, distributors and regional transmission entities it considers to be in the public interest. Such recommendations shall include actions regarding the supply and demand balance for generation services, new and existing generation capacity, transmission constraints, market power, suppliers licensed and operating in the Commonwealth, and the shared or joint use of generation sites~~ concerning the future viability of retail customer choice in the Commonwealth. The Commission may investigate as necessary to develop recommendations for such reports.

§ 56-597. Commission regulation of retail electric energy.

Except as otherwise provided in this chapter, the Commission shall continue to regulate, pursuant to this title, the generation, transmission, and distribution of retail electric energy in the Commonwealth by incumbent electric utilities.

§ 56-598. Suspension of effectiveness.

There is a moratorium on the effectiveness of this chapter, except that such moratorium shall not apply to §§ 56-576, Subsections A, C, and D of 56-577, subsection D of § 56-578, 56-579, subsections D and E of § 56-580, subsection B of § 56-581, 56-586.1, 56-594, 56-596, 56-597, and 56-598, as amended, which shall continue in full force and effect. The moratorium shall not be lifted, and such provisions shall not again become effective, until reenacted.

#

Presentation of Mark Rowsell on Behalf of TXI - Chaparral Steel (Virginia) to the Commission on Electric Utility Restructuring January 13, 2004

Mr. Chairman and members:

My name is Mark Rowsell and I am the General Manager of Engineering and Utilities of Texas Industries-Chaparral Steel (Virginia). Chaparral operates a state-of-the-art steel recycling facility in Dinwiddie County, Virginia, and produces a wide range of structural steel products. I have been employed with the company since groundbreaking began in 1998. TXI has invested well in excess of $550 million in the construction of this facility, directly employs over 400 workers and is the largest taxpayer in Dinwiddie County. The mill can recycle about 1.4 million tons of scrap steel annually at full production. As a steel recycling mill, the facility provides these contributions to the economy of the Commonwealth of Virginia in an environmentally responsible manner.

The Chaparral facility requires significant quantities of electric power to operate and is one of Virginia Power's largest single customers. Since the cost of power represents a substantial portion of the variable cost of production, the economy and stability of power rates are essential to Chaparral's success.

Chaparral's decision to locate the Facility in the Commonwealth of Virginia was driven, in large part, by expectations that it would have the opportunity to access economically priced electricity from Virginia Power. Reality has fallen short of Chaparral's original expectations.

Prices charged to Chaparral under the Restructuring Act have been much higher and more volatile than originally anticipated. Last year, Chaparral had to shift to a tariff rate in order to moderate the extremely high prices it was facing under its original electric supply agreement. The tariff rate however is still significantly higher than the mill requires in order to compete with other steel recyclers in neighboring states.

While the price of electricity has been increasing, the market price for structural steel has fallen significantly. Operating results under these economic conditions have been very disappointing.

Chaparral has had no success in trying finding an alternative energy supplier.

In my opinion, the chief impediment to competition in Virginia is the wires charge. Chaparral's informal attempts to shop for competitive electricity rates have always been impeded by the specter of the wires charge.

As I understand them, wires charges were designed to assist utilities in recovering "stranded costs" incurred over the transition period. However, as has been repeatedly demonstrated by various parties and the Commission, a proper asset valuation analysis would likely demonstrate that Virginia Power has significantly over-recovered revenues throughout the transition period.

Chaparral believes that it is time for the EURC to formally recognize that there are no stranded costs, at least in the case of Virginia Power, and to proceed on that basis as soon as possible.

Furthermore, "capped rates" under the Act offer no protection from massive rate spikes, as was painfully demonstrated in the recent Virginia Power fuel case. Under Virginia Power's original

request for a fuel increase, high load factor industrial customers would have seen their overall electric costs increase by 18 percent.

Left unmitigated, fuel increases like this would seriously damage industrial customers and other large energy consumers in the Commonwealth, some beyond repair.

It is completely incongruous for a utility with no stranded costs to seek a nearly a half-billion dollar fuel increase while it has over-collected nearly $900 million in excess revenues.

Chaparral operates in a highly competitive, energy-intensive industry and generally supports competition. However, to allow for "market rates" where there is no market is an invitation for major conflict

Until a viable and transparent electricity market develops in Virginia, the State Corporation Commission should be given the authority to set rates based upon cost of service principles.

Our other steel facilities are in Texas, a state touted as a shining example of retail competition. However, given our experience there, it is my opinion that we were better off under regulated rates than under the current retail choice regime.

Chaparral therefore supports the Delegate Kilgore's Bill because it will:

- Suspend the retail electric competition structure,
- Restore the Commission's rate authority,
- Encourage the development of competitive wholesale energy markets including demand-side resource markets
- Retain pilot programs, and
- Maintain oversight of electric restructuring by the EURC.

I thank you for your time.

04 - 0401840 **01/12/2004 2:02 PM** **CNorwood**

SENATE BILL NO. _____ HOUSE BILL NO. _____

A BILL to amend and reenact §§ 56-577 and 56-583 of the Code of Virginia, relating to electric utility restructuring; minimum stay requirements; wires charges.

Be it enacted by the General Assembly of Virginia:

1. That §§ 56-577 and 56-583 of the Code of Virginia are amended and reenacted as follows:

§ 56-577. Schedule for transition to retail competition; Commission authority; pilot programs.

A. The transition to retail competition for the purchase and sale of electric energy shall be implemented as follows:

1. Each incumbent electric utility owning, operating, controlling, or having an entitlement to transmission capacity shall join or establish a regional transmission entity, which entity may be an independent system operator, to which such utility shall transfer the management and control of its transmission system, subject to the provisions of § 56-579.

2. On and after January 1, 2002, retail customers of electric energy within the Commonwealth shall be permitted to purchase energy from any supplier of electric energy licensed to sell retail electric energy within the Commonwealth during and after the period of transition to retail competition, subject to the following:

a. The Commission shall separately establish for each utility a phase-in schedule for customers by class, and by percentages of class, to ensure that by January 1, 2004, all retail customers of each utility are permitted to purchase electric energy from any supplier of electric energy licensed to sell retail electric energy within the Commonwealth.

b. The Commission shall also ensure that residential and small business retail customers are permitted to select suppliers in proportions at least equal to that of other

customer classes permitted to select suppliers during the period of transition to retail competition.

3. On and after January 1, 2002, the generation of electric energy shall no longer be subject to regulation under this title, except as specified in this chapter.

4. On and after January 1, 2004, all retail customers of electric energy within the Commonwealth, regardless of customer class, shall be permitted to purchase electric energy from any supplier of electric energy licensed to sell retail electric energy within the Commonwealth.

B. The Commission may delay or accelerate the implementation of any of the provisions of this section, subject to the following:

1. Any such delay or acceleration shall be based on considerations of reliability, safety, communications or market power; and

2. Any such delay shall be limited to the period of time required to resolve the issues necessitating the delay, but in no event shall any such delay extend the implementation of customer choice for all customers beyond January 1, 2005.

The Commission shall, within a reasonable time, report to the General Assembly, or any legislative entity monitoring the restructuring of Virginia's electric industry, any such delays and the reasons therefor.

C. The Commission may conduct pilot programs encompassing retail customer choice of electricity energy suppliers for each incumbent electric utility that has not transferred functional control of its transmission facilities to a regional transmission entity prior to January 1, 2003. Upon application of an incumbent electric utility, the Commission may establish opt-in and opt-out municipal aggregation pilots and any other pilot programs the Commission deems to be in the public interest, and the Commission shall report to the Legislative Transition Task Force on the status of such pilots by November of each year through 2006.

D. The Commission shall promulgate such rules and regulations as may be necessary to implement the provisions of this section.

E. 1. By January 1, 2002, the Commission shall promulgate regulations establishing whether and, if so, for what minimum periods, customers who request service from an incumbent electric utility pursuant to subsection D of § 56-582 or a default service provider, after a period of receiving service from other suppliers of electric energy, shall be required to use such service from such incumbent electric utility or default service provider, as determined to be in the public interest by the Commission.

2. Effective July 1, 2004, and subject further to the availability of capped rate service under § 56-582, retail customers of electric energy (i) purchasing such energy from licensed suppliers and (ii) otherwise subject to minimum stay periods prescribed by the Commission pursuant to subdivision 1, shall nevertheless be exempt from any such minimum stay obligations by agreeing to purchase electric energy at market-based rates from incumbent electric utilities or default providers concurrent with seeking to purchase electric energy from such utilities or providers after a period of obtaining electric energy from another supplier. Such rates shall be determined and approved by the Commission after notice and opportunity for hearing. The methodology established by the Commission for determining such rates shall be consistent with the goals of (a) promoting the development of effective competition and economic development within the Commonwealth as provided in subsection A of § 56-596, and (b) ensuring that neither incumbent utilities nor retail customers that do not choose to obtain electric energy from alternate suppliers are adversely affected.

3. Notwithstanding the provisions of subsection D of § 56-582 and subdivision C 1 of § 56-585, however, any such customers exempted from any applicable minimum stay periods as provided in subdivision 2 shall not be entitled to purchase retail electric energy from their incumbent electric utilities thereafter at the capped rates established under § 56-582, and expiring on July 1, 2007, unless such customers agree to satisfy any minimum stay period then applicable while obtaining retail electric energy at capped rates.

4. The Commission shall promulgate such rules and regulations as may be necessary to implement the provisions of this subsection.

§ 56-583. Wires charges.

A. To provide the opportunity for competition and consistent with § 56-584, the Commission shall calculate wires charges for each incumbent electric utility, effective upon the commencement of customer choice, which shall be the excess, if any, of the incumbent electric utility's capped unbundled rates for generation over the projected market prices for generation, as determined by the Commission; however, where there is such excess, the sum of such wires charges, the unbundled charge for transmission and ancillary services, the applicable distribution rates established by the Commission and the above projected market prices for generation shall not exceed the capped rates established under § 56-582 A 1 applicable to such incumbent electric utility. The Commission shall adjust such wires charges not more frequently than annually and shall seek to coordinate adjustments of wires charges with any adjustments of capped rates pursuant to § 56-582. No wires charge shall be less than zero. The projected market prices for generation, when determined under this subsection, shall be adjusted for any projected cost of transmission, transmission line losses, and ancillary services subject to the jurisdiction of the Federal Energy Regulatory Commission which the incumbent electric utility (i) must incur to sell its generation and (ii) cannot otherwise recover in rates subject to state or federal jurisdiction.

B. Customers that choose suppliers of electric energy, other than the incumbent electric utility, or are subject to and receiving default service, prior to the expiration of the period for capped rates, as provided for in § 56-582, shall pay a wires charge determined pursuant to subsection A based upon actual usage of electricity distributed by the incumbent electric utility to the customer (i) during the period from the time the customer chooses a supplier of electric energy other than the incumbent electric utility or (ii) during the period from the time the customer is subject to and receives default service until capped rates expire or are terminated, as provided in § 56-582.

C. The Commission shall permit any customer, at its option, to pay the wires charges owed to an incumbent electric utility on an accelerated or deferred basis upon a finding that

such method is not (i) prejudicial to the incumbent electric utility or its ratepayers or (ii) inconsistent with the development of effective competition, provided that all deferred wires charges shall be paid in full by July 1, 2007.

D. A supplier of retail electric energy may pay any or all of the wires charge owed by any customer to an incumbent electric utility. The supplier may not only pay such wires charge on behalf of any customer, but also contract with any customer to finance such payments. Further, on request of a supplier, the incumbent electric utility shall enter into a contract allowing such supplier to pay such wires charge on an accelerated or deferred basis. Such contract shall contain terms and conditions, specified in rules and regulations promulgated by the Commission to implement the provisions of this subsection, that fully compensate the incumbent electric utility for such wires charge, including reasonable compensation for the time value of money.

E. 1. Notwithstanding the provisions of subsection D of § 56-582 and subsection C of § 56-585, and effective July 1, 2004, and subject further to the availability of capped rate service under § 56-582, (i) individual customers within the industrial and commercial rate classes of incumbent electric utilities, subject to such demand criteria as may be established by the Commission, and (ii) aggregated customers of incumbent electric utilities in all rate classes, subject to such demand criteria as may be established by the Commission, may elect, upon giving prior notice to such utilities, to purchase retail electric energy from licensed suppliers thereof without the obligation to pay wires charges to any such utilities as otherwise provided under this section.

2. Any such customers (i) making such election and (ii) thereafter exercising that election by obtaining retail electric energy from suppliers without paying wires charges to their incumbent electric utilities, as authorized herein, shall not be entitled to purchase retail electric energy from their incumbent electric utilities thereafter at the capped rates established under § 56-582, for the duration of the capped rate period expiring on July 1, 2007.

3. Customers making and exercising such election may thereafter, however, purchase retail electric energy from their incumbent electric utilities at market-based rates for generation capacity and energy. Such rates shall be determined and approved by the Commission after notice and opportunity for hearing. The methodology established by the Commission for determining such rates shall be consistent with the goals of (i) promoting the development of effective competition and economic development within the Commonwealth as provided in subsection A of § 56-596, and (ii) ensuring that neither incumbent utilities nor retail customers that do not choose to obtain electric energy from alternate suppliers are adversely affected.

4. The Commission shall promulgate such rules and regulations as may be necessary to implement the provisions of this subsection.

#

04 - 0397840 01/12/2004 2:00 PM CNorwood

SENATE BILL NO. _____ HOUSE BILL NO. _____

A BILL to amend and reenact § 56-589 of the Code of Virginia, relating to electric utility restructuring; municipal and state aggregation.

Be it enacted by the General Assembly of Virginia:

1. That § 56-589 of the Code of Virginia is amended and reenacted as follows:

§ 56-589. Municipal and state aggregation.

A. Counties, cities, and towns (hereafter municipalities) and other political subdivisions of the Commonwealth may, at their election and upon authorization by majority votes of their governing bodies, aggregate electrical energy and demand requirements for the purpose of negotiating the purchase of electrical energy requirements from any licensed supplier within this Commonwealth, as follows:

1. Any municipality or other political subdivision of the Commonwealth may aggregate the electric energy load of residential, commercial, and industrial retail customers within its boundaries on ~~a voluntary,~~ an opt-in or opt-out basis ~~in which each such customer must affirmatively select such municipality or other political subdivision as its aggregator. The municipality or other political subdivision may not earn a profit but must recover the actual costs incurred in such aggregation~~.

2. Any municipality or other political subdivision of the Commonwealth may aggregate the electric energy load of its governmental buildings, facilities, and any other governmental operations requiring the consumption of electric energy. Aggregation pursuant to this subdivision shall not require licensure pursuant to § 56-588.

3. Two or more municipalities or other political subdivisions within this Commonwealth may aggregate the electric energy load of their governmental buildings, facilities, and any other governmental operations requiring the consumption of electric energy. Aggregation pursuant to this subdivision shall not require licensure pursuant to § 56-588 when such municipalities or

other political subdivisions are acting jointly to negotiate or arrange for themselves agreements for their energy needs directly with licensed suppliers or aggregators.

Nothing in this subsection shall prohibit the Commission's development and implementation of pilot programs for opt-in, opt-out, or any other type of municipal aggregation, as provided in § 56-577.

B. The Commonwealth, at its election, may aggregate the electric energy load of its governmental buildings, facilities, and any other government operations requiring the consumption of electric energy for the purpose of negotiating the purchase of electricity from any licensed supplier within this Commonwealth. Aggregation pursuant to this subsection shall not require licensure pursuant to § 56-588.

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

Introduction

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

Summary

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

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

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

Background on Stranded Cost

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

Definition and Quantification of Stranded Cost

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

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

APCo

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

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

DVP

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

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

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

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

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

Before the Commission on Electric Utility Restructuring
Of the Virginia General Assembly

Comments of

Michael Swider
Strategic Energy LLC

24 November 2003

Richmond, Virginia

Mr. Chairman and members of the Commission, I want to thank you for the opportunity today to comment on the recommendations in the State Corporation Commission's ("SCC") Stranded Cost Report. My name is Michael Swider and I am employed by Strategic Energy, LLC as Manager of Regulatory Affairs for the Mid-Atlantic region.

Strategic Energy, LLC ("Strategic") is an active competitive retail electricity supplier in eight states, and is currently serving more than 27,000 customers, with an aggregate peak load of over 3,300 MW.

Strategic participated in the SCC's stranded cost proceeding that produced the Stranded Cost Report of July 1, 2003. As stated by Mr. Howard Spinner of the SCC's staff before this Commission on November 19, 2003, Strategic Energy, like other competitive retail suppliers[1], supports the Staff's recommendations in the report. Staff's recommendation to use the "asset valuation methodology" to quantify net stranded costs, if carried out, will provide clarity to consumers and competitive suppliers, and hopefully avoid extensive re-visitation of stranded costs after the transition period. Other than selling the assets, an asset valuation model is the best methodology to obtain a realistic picture of stranded costs. Less sophisticated methodologies that not consider such important assets as fuel arbitrage, transmission arbitrage, capacity optionality and site expansion value will consistently undervalue a portfolio of physical assets.

Accurately quantifying net stranded costs now would benefit retail competition in Virginia. In the current environment, one of the most significant barriers to entry is the ability of the utility to collect a "wires charge" from retail access customers. Not only does the wires charge create a "margin squeeze" between existing and competitive rates,

[1] Constellation NewEnergy, Washington Gas Energy Services, Pepco Energy Services

it creates uncertainty. Even if wholesale market prices were to fall intra-year, so that it would be possible to offer savings to consumers despite the wires charge, the variable nature of the wires charge adds considerable risk to entering into a long-term retail contract. Customer savings in the current year can evaporate if the wires charge were to increase in the following year. If quantifiable stranded costs can be fully recovered before the end of transition period in 2007 there is an opportunity to accelerate retail competition. By not attempting to quantify net stranded costs in the present, there may exist additional uncertainty that stranded costs be revisited in the future. For example, an over-collection of stranded costs could lead to later refunds, or allow an incumbent to excessively reduce its fixed costs to obtain a considerable competitive advantage.

Strategic Energy and the other competitive suppliers urge the Commission to adopt the recommendations in the SCC's Stranded Cost Report, and initiate a proceeding to quantify stranded cost recovery.

Thank You,

Michael Swider
Strategic Energy LLC
1350 I Street, NW
Washington, DC 20005

VCCC
VIRGINIA
CITIZENS CONSUMER COUNCIL

Virginia Citizens Consumer Council

Stranded Costs

November 24, 2003

- Most states dealt with these at the outset.
- Stakeholders have discussed issues repeatedly to no conclusion.
- Citizens, who do not understand this process, fail to understand why we have allowed our largest utility to make unprecedented income but still are raising rates in January and insisting that stranded costs exist.
- If the EURC wants to assure that these are monitored as the law requires, it has to find the political will to direct that the SCC analyze the costs and give the SCC the backing to get the job done. The SCC cannot succeed in the current environment without specific EURC direction as to which strategy to use.
- IF the EURC wants this done, it should direct the SCC to use the methodology they believe is most fair and not allow parties to influence the method.

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COMMENTS OF
VIRGINIA INDEPENDENT POWER PRODUCERS, INC.
COMMITTEE ON ELECTRIC UTILITY RESTRUCTURING
RE: STRANDED COSTS, METHODS AND CALCULATIONS
NOVEMBER 24, 2003

August Wallmeyer, Executive Director

Introduction

In these comments, Virginia Independent Power Producers, Inc. ("VIPP") addresses: (1) Staff's April 28, 2003 "Accounting Perspective" Proposal; (2) the proposed VCFUR approach distributed at the April 29, 2003 Working Group Meeting; (3) the clarified Virginia Power approach distributed on April 24, 2003; and (4) VIPP's recommendations for legislative or administrative action, pursuant to paragraph 9 of the January 27, 2003 Resolution of the Legislative Transition Task Force (the "LTTF Resolution").

VIPP asserts that the **Staff and VCFUR proposals are inconsistent with the basic approach to stranded costs recovery adopted by the Legislature in the Virginia Electric Utility Restructuring Act (the "Act")** and, if adopted, would add an unnecessary element of complexity to the Work Group's effort to be responsive to the LTTF. *See* ACT, § 56-595.C(iii).

The appropriate approach to monitoring stranded cost recovery is to compare (i) the cost-based generation component of capped rates to (ii) the generation-related revenues (including wires charge revenues) that would have been received based on competitive market prices throughout the transition period (on the assumption that all customers of the incumbent utility either switched to another supplier or received default service from the incumbent utility at market-based rates).[1] This determination of potential stranded costs would be a useful indicator of whether under- or over-recoveries may occur in the future. Moreover, since actual stranded costs cannot be determined until after 2007, this is the only reasonable methodology to present to the LTTF.

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[1] If (i) is greater than (ii) there is an over-recovery; and *vice versa*.

Staff's "Accounting Perspective" Proposal

- Staff's proposed method would "indicate annual recoveries of stranded costs throughout the transition period [using] an accounting approach based on an earnings test mechanism." According to comments made at the April 22 Work Group meeting, Staff would perform the calculation of "excess" earnings on an annual basis between now and 2007 and would include in the calculation excess earnings from the transmission and distribution components of embedded cost rates.

- **Staff's proposal to use "excess earnings" to measure stranded cost recoveries is flatly inconsistent with the LTTF Resolution and the Act.** Paragraph 1 of the LTTF Resolution makes it clear that the definitions, methodology and calculations to be made under Paragraphs 2 and 3 of the Resolution must be "consistent with the Act." The Act is bereft of even an indirect reference to an earnings test as the basis for determining stranded cost recoveries. **Said differently, there is absolutely no linkage whatever, expressed or implied, in the Act between stranded cost recovery and a utility's earnings.** Staff's proposal to forge such a linkage would establish a far-reaching new policy for the Commonwealth. In so doing, Staff would be usurping territory that is the exclusive province of the General Assembly.

- The Staff Proposal would create a scheme of incentives directly at odds with the intent of the General Assembly. In formulating capped rates, the General Assembly intended to provide incumbent utilities with an incentive to reduce future stranded costs by engaging in cost cutting and stranded cost mitigation. Perversely, the Staff Proposal would now penalize utilities for doing exactly that. For example, under the Staff's "earnings test" proposal, an incumbent utility that cut $10 million in expenses would now be found to have $10 million more in "excess earnings" and would be penalized for cutting its costs.

- While the Staff Proposal would use the Annual Informational Filing ("AIF") as its starting point for the determination of "excess earnings," it is certain that **AIFs would not be**

acceptable to all parties as properly representing the incumbent utility's revenue requirement. Experience shows that the AIF is only the first step in a series of discussions, akin to a rate case, about the extent to which book earnings should be adjusted to incorporate "rate making" adjustments. In addition to requiring resolution of these issues, the Staff Proposal would require reaching consensus as to an appropriate rate of return for each year of the transition period. In effect, the Staff Proposal would require the incumbent utility and the Staff to engage in complex annual rate cases—hardly the result anticipated by the General Assembly when it **deregulated** generation.

The Proposed VCFUR Approach

- Like Staff's Proposal, the proposed VCFUR method would calculate stranded cost recoveries during the transition period. In so doing, the VCFUR method suffers from the same infirmities as the Staff Proposal. Thus, **the VCFUR method would also be contrary to the Act and would improperly reinstitute annual rate cases to determine so-called excess earnings.**

- The VCFUR proposal, however, would go far beyond the Staff Proposal and would repeat the mistakes of other regulatory jurisdictions by attempting to project both generation market prices and the embedded cost-based prices for generation for every year of the approximately thirty-year time horizon constituting the remaining life of current generation assets.

- Although VCFUR's written comments attempt to convey the impression that the basic elements of the VCFUR proposal are required by the Act, this is not the case. Section 56-595.C(iii) provides that members of the LTTF shall monitor whether the recovery of stranded costs, as provided in § 56-584, has resulted or is likely to result in the over-recovery or under-recovery of just and reasonable net stranded costs. VCFUR's written comments attempt to stretch and contort this language into a precise mathematical formula, stating that the "LTTF *must* determine and compare two amounts: first, the amount that has been, or will be, available for recovery of just and reasonable net stranded costs, and second, the amount

of just and reasonable net stranded costs." VIPP disagrees. VCFUR's interpretation is simply not correct or required.

- First, although VCFUR would pretend otherwise,[2] **nowhere does the Act even mention the term "net" revenues and nowhere does it contemplate the rate case-type calculation that VCFUR says is absolutely "required."** Second, contrary to VCFUR's contention, the incredibly complex projection of future stranded costs that constitutes the second component of their proposal is not required either. VIPP believes that Section 56-595.C(iii)'s mandate to the LTTF to report on whether stranded costs are likely to be over- or under-recovered could and should be satisfied by using a far simpler method, such as the one proposed by Virginia Power to calculate potential stranded costs during the transition period.

- As thoroughly discussed in VIPP's initial comments to the stranded costs working group, **the type of market price and embedded cost projections that VCFUR recommends would be unreliable and subjective in the extreme.**

The Clarified Virginia Power Approach

- The Virginia Power approach would require a utility to calculate and report to the LTTF, for each year of the transition period, (1) whether there was an over- or under-recovery of stranded costs collected through the wires charges from switching customers and, if so, the amount thereof; (2) the company's actual "above-market" or "potential" stranded cost exposure under capped rates; (3) the amounts it has expended from funds available under capped rates to mitigate potential stranded costs; and (4) additional expenditures that increase such costs during the transition period. Referring to items (2) and (3) of the Virginia Power approach, one can devise a fairly uncomplicated method of monitoring stranded costs.

- VIPP believes that this refreshingly down-to-earth approach would be acceptable under § 56-595.C(iii). First, unlike the Staff and VCFUR methods, the Virginia Power approach is

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[2] *See* Fourth Bullet, April 22 VCFUR handout. Following a discussion of *net stranded costs* as set forth in § 56-584 in Bullet Three, VCFUR argues in Bullet Four that it necessarily follows ("Thus") that the amount that will be available for recovery of net stranded costs is the "*net revenue* collected from wires charges and capped rates."

consistent with the Act. Second, the Virginia Power method is eminently practical and would fulfill the requirements of § 56-595.C(iii) because it would provide a basis for an analysis of whether stranded costs are likely to be over- or under-recovered in the future.

- Finally, the disclosure of amounts expended for stranded cost mitigation and additional expenditures during the transition period would be valuable. One of the Act's central goals is to ensure that Virginia's utilities would be ready to meet the challenge of retail competition. An evaluation of stranded cost mitigation and additional potential stranded cost exposure would enable the LTTF to consider whether this goal is being met.

VIPP's Recommendations for Appropriate Legislative or Administrative Action

- The stranded cost provisions of the Act were carefully crafted to achieve a balance among competing interests. In that balance lies Virginia's unique solution to the stranded cost issue. The General Assembly recognized the need for rate structures that would create an opportunity for the Commonwealth's incumbent utilities to recover just and reasonable net stranded costs and at the same time would ensure their financial stability as they approached the era of retail competition. **The key concept underlying the Act's stranded cost provisions is that stranded costs are not be administratively determined and recovered on a dollar-for-dollar basis through discrete rate mechanisms, as in other jurisdictions. Unfortunately, and in direct conflict with the Act, the Staff and VCFUR monitoring proposals veer dangerously in this direction.**

- VIPP is extremely concerned that the **Staff and VCFUR proposals, if adopted by the Work Group and the LTTF, would put the Commonwealth back on a path leading to annual rate cases, intrusive re-regulation of utilities, and a hurried retreat from the Act's restructuring goals. This would be extremely unfortunate.** The implementation of the Act's well-considered framework for competition is in its early stages, and competition has just begun.

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Dominion Virginia Power's Objections to Quantification of Stranded Costs

Quantification is contrary to the Restructuring Act

The Act provides for recovery of "just and reasonable" stranded costs and allows incumbent utilities an opportunity (but no guarantee) to do so via the revenues from capped rates and wires charges over a definite transition period. This approach (which was negotiated and agreed upon by the majority of stakeholders) deliberately avoided quantification of stranded cost exposure, but rather provided utilities with an incentive to mitigate these costs and enhance efficiency during the transition period in order to bring their generation costs in line with market prices by the end of the capped rate period. The Act clearly deregulates generation and to proceed with quantification of stranded costs would be in conflict with that principle. Substantial amendments would have to be made to the Act to give the SCC authority and direction necessary to carry out a quantitative procedure. Attached is a listing of the numerous issues that should be addressed in legislation in order for a quantitative methodology to be applied.

Quantification of stranded costs is not practical

In order to quantify stranded cost exposure and the extent of its collection, energy prices must be forecasted over an extended period of years (usually the life of the generating asset – itself an uncertainty) in order to estimate the difference between the revenue from that asset in the competitive market and what would have been received if traditional cost of service ratemaking had remained in place. The track record shows that past efforts at long-term forecasts of energy prices have proven to be dismal failures. Furthermore this approach would entail a series of annual rate cases to establish what the regulated rate (including reasonable earnings) would have been. In states where quantification was attempted, the wisdom of the Virginia Act has been confirmed. The quantification process has proved to be protracted, ponderous, highly contentious, subject to great uncertainty and even litigation. For an example of this, please see attached description of the PP&L stranded cost case before the Pennsylvania PUC.

Quantification would disrupt the implementation of the Act and deny benefits to consumers

The capped rates put in place by the Act are estimated to save DVP customers $871 million by mid-2007. The methods proposed by the SCC for quantification represent a clear return to out-moded cost of service ratemaking with its expectation that rates would be adjusted in response to the results. Such an approach, if implemented would very likely eliminate these savings. Moreover quantification and all that it entails would inject a level of uncertainty into the restructuring process that would disrupt the considerable strides that DVP is making in efficiency improvements and mitigation of the causes of stranded costs.

Efforts to quantify stranded costs will cause financial uncertainty for Virginia's utilities

The electric industry is experiencing a period of great uncertainty, due in part to unsettled energy policies at the federal level. The capped rate and stranded cost treatment in the Virginia Restructuring Act provides a much-needed level of financial certainty for incumbent utilities. Just as the capped rate provides a safe harbor for customers, it also provides a known revenue stream for utilities. This is important to insure the financial stability that allows utilities to continue to make the investments needed to provide reliable service. Opening a protracted procedure to quantify stranded cost will inject great uncertainty into the ability of utilities to plan and budget for the future. Moreover it will send a signal to the financial community that Virginia's utilities are exposed to a substantial financial risk. Efforts to quantify stranded costs would threaten the financial viability of Virginia's utilities and impair their ability to effectively plan and maintain an adequate infrastructure.

Monitoring for overrecovery and underrecovery, consistent with The Act, does not require quantification:

The Act, at 56-595 (iii) directs the CEUR to monitor whether the recovery of stranded costs as provided in 56-584 "has resulted or is likely to result in the overrecovery or underrecovery of just and reasonable net stranded costs;" This section refers to the use of capped rates and wires charges, as provided elsewhere in the Act to recover stranded costs. Incumbent utilities and private power producers have proposed a method, consistent with the Act, that compares the stranded cost revenues collected annually with that which would have been collected had the SCC's forecasted market price been realized. At the end of the capped rate period, this would enable a determination of whether the amount of stranded cost revenue, to which each utility would be entitled under the Act, had been overrecovered or underrecovered. This approach uses actual historical data and requires no amendment of the Act to define stranded costs or to prescribe a monitoring methodology. It does not interfere with capped rates and the customer savings expected to accrue from them and is not in conflict with the Act's principle of deregulation of generation. Furthermore, operation under the capped (frozen) rates will continue to drive efficiency improvements and stranded cost mitigation as intended.

2004 SESSION

INTRODUCED

040399428

HOUSE BILL NO. 265

Offered January 14, 2004
Prefiled January 8, 2004

A BILL to amend and reenact §§ 30-205, 56-582, 56-583, and 56-584 of the Code of Virginia, relating to the Virginia Electric Utility Restructuring Act; stranded costs.

Patron—Morgan

Referred to Committee on Commerce and Labor

Be it enacted by the General Assembly of Virginia:

1. That §§ 30-205, 56-582, 56-583, and 56-584 of the Code of Virginia are amended and reenacted as follows:

§ 30-205. (Expires July 1, 2008) Powers and duties of the Commission.

The Commission shall have the following powers and duties:

1. Monitor the work of the State Corporation Commission in implementing Chapter 23 (§ 56-576 et seq.) of Title 56, receiving such reports as the Commission may be required to make pursuant thereto, including reviews, analyses, and impact on consumers of electric utility restructuring programs in other states;

2. Determine whether, and on what basis, incumbent electric utilities should be permitted to discount capped generation rates established pursuant to § 56-582;

3. Monitor~~, after the commencement of customer choice and with the assistance of~~ the *implementation by the* State Corporation Commission ~~and the Office of Attorney General, the incumbent electric utilities, suppliers, and retail customers, whether the recovery of stranded costs, as provided in~~ *of the provisions of* § 56-584, ~~has resulted or is likely to result in~~ *regarding* the ~~overrecovery or underrecovery~~ *determination* of *the amount of each incumbent electric utility's* just and reasonable net stranded costs *and such utility's recovery of such costs through capped rates as provided in § 56-582 and wires charges as provided in § 56-583*;

4. Examine (i) utility worker protection during the transition to retail competition, (ii) generation, transmission and distribution systems reliability concerns, and (iii) energy assistance programs for low-income households;

5. Establish one or more subcommittees of its membership, to meet at the direction of the chairman of the Commission, for any purpose within the scope of the duties prescribed to the Commission by this section; and

6. Report annually to the General Assembly and the Governor on the progress of each stage of the phase-in of retail competition and offer such recommendations as may be appropriate for legislative and administrative consideration in order to maintain the Commonwealth's position as a low-cost electricity market and ensure that residential customers and small business customers benefit from competition.

§ 56-582. Rate caps.

A. The Commission shall establish capped rates, effective January 1, 2001, and expiring on July 1, 2007, for each service territory of every incumbent utility as follows:

1. Capped rates shall be established for customers purchasing bundled electric transmission, distribution and generation services from an incumbent electric utility.

2. Capped rates for electric generation services, only, shall also be established for the purpose of effecting customer choice for those retail customers authorized under this chapter to purchase generation services from a supplier other than the incumbent utility during this period.

3. The capped rates established under this section shall be the rates in effect for each incumbent utility as of the effective date of this chapter, or rates subsequently placed into effect pursuant to a rate application filed by an incumbent electric utility with the Commission prior to January 1, 2001, and subsequently approved by the Commission, and made by an incumbent electric utility that is not currently bound by a rate case settlement adopted by the Commission that extends in its application beyond January 1, 2002. If such rate application is filed, the rates proposed therein shall go into effect on January 1, 2001, but such rates shall be interim in nature and subject to refund until such time as the Commission has completed its investigation of such application. Any amount of the rates found excessive by the Commission shall be subject to refund with interest, as may be ordered by the Commission. The Commission shall act upon such applications prior to commencement of the period of transition to customer choice. Such rate application and the Commission's approval shall give due consideration, on a forward-looking basis, to the justness and reasonableness of rates to be effective for a period of time ending as late as July 1, 2007. The capped rates established under this section, which

include rates, tariffs, electric service contracts, and rate programs (including experimental rates, regardless of whether they otherwise would expire), shall be such rates, tariffs, contracts, and programs of each incumbent electric utility, provided that experimental rates and rate programs may be closed to new customers upon application to the Commission. Such capped rates shall also include rates for new services where, subsequent to January 1, 2001, rate applications for any such rates are filed by incumbent electric utilities with the Commission and are thereafter approved by the Commission. In establishing such rates for new services, the Commission may use any rate method that promotes the public interest and that is fairly compensatory to any utilities requesting such rates.

B. The Commission may adjust such capped rates in connection with the following: (i) utilities' recovery of fuel costs pursuant to § 56-249.6, (ii) any changes in the taxation by the Commonwealth of incumbent electric utility revenues, (iii) any financial distress of the utility beyond its control, (iv) with respect to cooperatives that were not members of a power supply cooperative on January 1, 1999, and as long as they do not become members, their cost of purchased wholesale power and discounts from capped rates to match the cost of providing distribution services, ~~and~~ (v) with respect to cooperatives that were members of a power supply cooperative on January 1, 1999, their recovery of fuel costs, through the wholesale power cost adjustment clauses of their tariffs pursuant to § 56-231.33, *and (vi) any rate adjustments authorized pursuant to § 56-584 with respect to any incumbent electric utility that has collected its just and reasonable net stranded costs.* Notwithstanding the provisions of § 56-249.6, the Commission may authorize tariffs that include incentives designed to encourage an incumbent electric utility to reduce its fuel costs by permitting retention of a portion of cost savings resulting from fuel cost reductions or by other methods determined by the Commission to be fair and reasonable to the utility and its customers.

C. A utility may petition the Commission to terminate the capped rates to all customers any time after January 1, 2004, and such capped rates may be terminated upon the Commission finding of an effectively competitive market for generation services within the service territory of that utility. If the capped rates are continued after January 1, 2004, an incumbent electric utility which is not, as of the effective date of this chapter, bound by a rate case settlement adopted by the Commission that extends in its application beyond January 1, 2002, may petition the Commission for approval of a one-time change in the nongeneration components of such rates.

D. Until the expiration or termination of capped rates as provided in this section, the incumbent electric utility, consistent with the functional separation plan implemented under § 56-590, shall make electric service available at capped rates established under this section to any customer in the incumbent electric utility's service territory, including any customer that, until the expiration or termination of capped rates, requests such service after a period of utilizing service from another supplier.

E. During the period when capped rates are in effect for an incumbent electric utility, such utility may file with the Commission a plan describing the method used by such utility to assure full funding of its nuclear decommissioning obligation and specifying the amount of the revenues collected under either the capped rates, as provided in this section, or the wires charges, as provided in § 56-583, that are dedicated to funding such nuclear decommissioning obligation under the plan. The Commission shall approve the plan upon a finding that the plan is not contrary to the public interest.

§ 56-583. Wires charges.

A. To provide the opportunity for competition and consistent with § 56-584, the Commission shall calculate wires charges for each incumbent electric utility, effective upon the commencement of customer choice, which shall be the excess, if any, of the incumbent electric utility's capped unbundled rates for generation over the projected market prices for generation, as determined by the Commission; however, where there is such excess, the sum of such wires charges, the unbundled charge for transmission and ancillary services, the applicable distribution rates established by the Commission and the above projected market prices for generation shall not exceed the capped rates established under § 56-582 A 1 applicable to such incumbent electric utility. The Commission shall adjust such wires charges not more frequently than annually and shall seek to coordinate adjustments of wires charges with any adjustments of capped rates pursuant to § 56-582. No wires charge shall be less than zero. The projected market prices for generation, when determined under this subsection, shall be adjusted for any projected cost of transmission, transmission line losses, and ancillary services subject to the jurisdiction of the Federal Energy Regulatory Commission which the incumbent electric utility (i) must incur to sell its generation and (ii) cannot otherwise recover in rates subject to state or federal jurisdiction.

B. Customers that choose suppliers of electric energy, other than the incumbent electric utility, or are subject to and receiving default service, prior to the expiration of the period for capped rates, as provided for in § 56-582, shall pay a wires charge determined pursuant to subsection A based upon actual usage of electricity distributed by the incumbent electric utility to the customer (i) during the period from the time the customer chooses a supplier of electric energy other than the incumbent electric utility or (ii) during the period from the time the customer is subject to and receives default service until capped rates expire or are terminated, as provided in § 56-582, *or are eliminated as provided in*

§ 56-584.

C. The Commission shall permit any customer, at its option, to pay the wires charges owed to an incumbent electric utility on an accelerated or deferred basis upon a finding that such method is not (i) prejudicial to the incumbent electric utility or its ratepayers or (ii) inconsistent with the development of effective competition, provided that all deferred wires charges shall be paid in full by July 1, 2007.

D. A supplier of retail electric energy may pay any or all of the wires charge owed by any customer to an incumbent electric utility. The supplier may not only pay such wires charge on behalf of any customer, but also contract with any customer to finance such payments. Further, on request of a supplier, the incumbent electric utility shall enter into a contract allowing such supplier to pay such wires charge on an accelerated or deferred basis. Such contract shall contain terms and conditions, specified in rules and regulations promulgated by the Commission to implement the provisions of this subsection, that fully compensate the incumbent electric utility for such wires charge, including reasonable compensation for the time value of money.

§ 56-584. Stranded costs.

A. Just and reasonable net stranded costs, to the extent that they exceed zero value in total for the incumbent electric utility, shall be recoverable by each incumbent electric utility provided each incumbent electric utility shall only recover its just and reasonable net stranded costs through either capped rates as provided in § 56-582 or wires charges as provided in § 56-583.

B. The Commission shall calculate the amount of each incumbent electric utility's just and reasonable net stranded costs as follows:

1. An incumbent electric utility's just and reasonable net stranded costs means the net loss in the economic value of the utility that is attributable to prudently incurred, verifiable and nonmitigable electric generation-related assets that become unrecoverable due to restructuring and retail competition.

2. The Commission, after notice and opportunity for hearing, shall conduct proceedings in which it shall calculate the amount of each incumbent electric utility's just and reasonable net stranded costs as of January 1, 2002. Such calculation shall be made based on actual information available on such date as such information shall be updated to reflect actual changes to such information and changes that may be reasonably anticipated.

3. In proceedings under this subsection, the Commission shall calculate the amount of each incumbent electric utility's just and reasonable net stranded costs by determining the amount, if any, by which (i) the booked value of all of the utility's generation-related assets, including but not limited to company-owned, operated, or leased generation assets, the value of Commission authorized regulatory assets, and the value of purchased power contracts, exceeds (ii) the value of the utility's generation-related assets, including but not limited to company-owned, operated, or leased generation assets, the value of Commission authorized regulatory assets, and the value of purchased power contracts, over the life of the assets, based on the net present value cash flows that reasonably would be expected to be generated from such assets in a competitive market, using reasonable estimates of market prices for the applicable future periods, and adjusted for anticipated operations and maintenance costs.

4. If the Commission determines that the amount calculated under clause (ii) of subdivision 3 exceeds the amount calculated under clause (i) of subdivision 3 for an incumbent electric utility, then such utility shall be deemed to have no just and reasonable net stranded costs.

C. The Commission, in a proceeding under subsection B or in a separate proceeding after notice and an opportunity for a hearing, shall conduct proceedings to calculate the amount that each incumbent electric utility has collected for the recovery of just and reasonable net stranded costs through capped rates as provided in § 56-582 and wires charges as provided in § 56-583. Such proceedings shall be conducted annually, or less frequently if the Commission deems it appropriate, prior to the expiration of the capped rate period pursuant to § 56-582. In such proceedings, the Commission shall determine the amount that an incumbent electric utility has collected through capped rates for the recovery of just and reasonable net stranded costs by subtracting (i) the actual cost to the utility of providing service, which shall include mitigation costs, plus a fair return, from (ii) the utility's actual revenues from the provision of capped rate service. The Commission shall determine the utility's fair return on its prudently incurred investment by application of the principles of Chapter 10 (§ 56-232 et seq.) of this title and applicable regulations. The utility's actual cost of providing service shall be determined based upon earnings test information filed by the utility under the Commission's applicable rate case regulations and annual informational filing requirements.

D. In connection with any proceeding under subsection C, the Commission shall compare the amount that the incumbent electric utility has collected for the recovery of just and reasonable net stranded costs to the amount of the utility's just and reasonable net stranded costs.

E. If the Commission determines that an incumbent electric utility has no just and reasonable net stranded costs, or that the amount the incumbent electric utility has collected or is reasonably expected to collect, for the recovery of just and reasonable net stranded costs through capped rates and wires

charges exceeds the utility's just and reasonable net stranded costs, then the Commission is authorized, in connection with a proceeding under subsection C or in a separate proceeding after notice and an opportunity for a hearing, to (i) eliminate the utility's authority to collect wires charges and (ii) reduce the utility's capped rates to an amount that reflects the utility's actual cost of providing service plus a fair return on its prudently incurred investment. In establishing the utility's capped rates for the balance of the capped rate period, the Commission shall conduct a proceeding pursuant to Chapter 10 (§ 56-232 et seq.) of this title and applicable regulations. In lieu of reducing a utility's capped rates, the Commission may allow the capped rates to remain in effect at then-current levels, subject to refund, until the Commission may determine that the capped rates should be reduced and a refund be made.

F. If an incumbent electric utility determines that its collections through capped rates as provided in § 56-582 and wires charges as provided in § 56-583 will not permit it to recover its just and reasonable net stranded costs during the balance of the capped rate period, the utility may request the Commission to approve an increase in its capped rates, as part of a proceeding under subsection C. Consideration of a request for such an increase in capped rates shall be conducted pursuant to Chapter 10 (§ 56-232 et seq.) of this title and the Commission's then-current rate case rules.

G. By December 1 of each year, the Commission shall report to the Commission on Electric Utility Restructuring on the amount of each incumbent electric utility's just and reasonable net stranded costs and the amount of such costs that have been recovered through capped rates and wires charges. This report shall include a summary of actions taken by the Commission pursuant to this section and any recommendations for action to be taken by the General Assembly regarding the recovery of just and reasonable net stranded costs.

H. To the extent not preempted by federal law, the establishment by the Commission of wires charges for any distribution cooperative shall be conditioned upon such cooperative entering into binding commitments by which it will pay to any power supply cooperative of which such distribution cooperative is or was a member, as compensation for such power supply cooperative's stranded costs, all or part of the proceeds of such wires charges, as determined by the Commission.

COMMONWEALTH of VIRGINIA

Office of the Attorney General
Richmond 23219

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January 12, 2004

Commission on Electric Utility Restructuring
The Honorable Thomas K. Norment Jr., Chairman
The Honorable Allen W. Dudley
The Honorable Terry G. Kilgore
The Honorable Harry J. Parrish
The Honorable Kenneth R. Plum
The Honorable Richard L. Saslaw
The Honorable James M. Scott
The Honorable Kenneth W. Stolle
The Honorable Robert Tata
The Honorable John Watkins

Re: Stranded Costs

Dear Senator Norment:

At the November 24, 2003, meeting of the Commission on Electric Utility Restructuring ("EURC") it was requested that the Office of the Attorney General ("Office" or "Attorney General") present to the EURC a stranded cost methodology proposal that could be considered as a compromise alternative to the competing proposals advanced by Dominion Virginia Power ("DVP") and the State Corporation Commission ("SCC") Staff. (A methodology very similar to SCC Staff's was also presented by the Virginia and Old Dominion Committees for Fair Utility Rates.)

The Attorney General participated in the stranded costs proceeding convened by the SCC in response to the EURC Resolution of January 27, 2003. The EURC Resolution sought to obtain consensus recommendations on the definition of "stranded costs" and "just and reasonable net stranded costs," the proper method of quantifying potential stranded costs, and the current status of recovery of stranded costs by Virginia's electric utilities, including whether such recovery has resulted in or is likely to result in the over-recovery or under-recovery of just and reasonable net stranded costs.

Our Office offered to the Work Group a definition for "stranded costs,"[1] however, we did not propose a specific methodology for valuing stranded costs and measuring their recovery. In our filed comments we noted various advantages and disadvantages of the two competing proposals of DVP and SCC Staff. (See Summaries of Comments, SCC July 1, 2003 Stranded Cost Report at 10-11, 17-18.)

DVP proposed a methodology that focuses on the extent to which the annual projected market prices used to develop wires charges were in fact accurate. It does not address a utility's current generation costs or earnings. (See Stranded Cost Report at 7-8.)

The SCC Staff and the Virginia Committees proposed an Asset Valuation Approach that compares the expected net present value cash flows from generation assets under both regulated and unregulated market environments. (See Stranded Cost Report at 15, 31-33.)

SCC Staff also proposed an alternative "Accounting Approach". This approach would employ existing Annual Informational Filings that utilities currently file with the SCC. It would include an "earnings test" mechanism that could serve to show the amount a utility has earned over its cost of service, assuming an agreed upon rate of return. It would also include a comparison of a utility's cost of service for generation to the prevailing market price for generation.

The Attorney General believes that use of the Accounting Approach as a stand-alone method would be appropriate as a practical compromise approach. The most controversial aspect of this approach will likely be the determination of the appropriate return on equity percentage. To avoid a protracted proceeding on this issue, the Office believes that this data should be presented to the EURC in several scenarios using various returns on equity. The Office would be pleased to prepare such presentations working with the SCC Staff.

Very truly yours,

Judith Williams Jagdmann
Deputy Attorney General

[1] The Attorney General's proposed definition (applicable to both "stranded costs" and "just and reasonable net stranded costs") was: Stranded costs are a utility's lost revenues arising from prudently incurred, verifiable and non-mitigable electric generation-related costs that become unrecoverable due to restructuring and retail competition.

COMMISSION ON ELECTRIC UTILITY RESTRUCTURING

RESOLUTION

WHEREAS, section 56-584 of the Virginia Electric Utility Restructuring Act (the "Act") provides:

> Just and reasonable net stranded costs, to the extent that they exceed zero value in total for the incumbent electric utility, shall be recoverable by each incumbent electric utility provided each incumbent electric utility shall only recover its just and reasonable net stranded costs through either capped rates as provided in § 56-582 or wires charges as provided in § 56-583; and

WHEREAS, subdivision (3) of § 30-205 of the Code of Virginia provides that the members of the Commission on Electric Utility Restructuring shall:

> Monitor, after the commencement of customer choice and with the assistance of the State Corporation Commission and the Office of the Attorney General, the incumbent electric utilities, suppliers, and retail customers, whether the recovery of stranded costs, as provided in § 56-584, has resulted or is likely to result in the overrecovery or underrecovery of just and reasonable net stranded costs; and

WHEREAS, this Commission adopted a resolution on January 27, 2003, ("the Stranded Costs Resolution") requesting the State Corporation Commission ("SCC") to convene a work group of stakeholders to develop consensus recommendations for a definition of "stranded costs" and "just and reasonable net stranded costs," and for a methodology to monitor the recovery of a utility's just and reasonable net stranded costs; and

WHEREAS, the Stranded Costs Resolution also requested that, in the absence of consensus among work group members, the State Corporation Commission include in its reports any recommendations of the SCC and other work group members and an analysis by SCC staff of those recommendations; and

WHEREAS, the SCC convened four meetings of the work group for discussion of the issues presented in the Stranded Costs Resolution; and

WHEREAS, during the course of the work group discussions, the SCC, the Virginia Committee for Fair Utility Rates, and the utilities each proposed a methodology for monitoring stranded cost recovery; and

WHEREAS, as the work group progressed, SCC staff also proposed an accounting approach as an alternative to the methodology proposed by the stakeholders; and

WHEREAS, the work group was unable to reach consensus on the proposed definitions or methodologies for monitoring stranded cost recovery; and

WHEREAS, the SCC submitted on July 1, 2003, its first report to this Commission on the progress of the work group; and

WHEREAS, in its report, the SCC requested additional direction from this Commission on the appropriate methodology for monitoring stranded cost recovery; and

WHEREAS, this Commission received the report from the SCC at its meeting held November 19, 2003; and

WHEREAS, this Commission received comments from members of the work group on the SCC report and proposed methodologies at its meeting held November 24, 2003; and

WHEREAS, at that November 24 meeting, this Commission requested the Division of Consumer Counsel of the Office of Attorney General to amplify on its recommendations for the monitoring of stranded costs; and

WHEREAS, the Division of Consumer Counsel has recommended that the Division make an annual report to this Commission in the manner specified below as a means of assisting with such monitoring of stranded costs; and

WHEREAS, this recommendation reflects a fair balancing of the concerns of all stakeholders while preserving the spirit of the Restructuring Act; now therefore be it

RESOLVED, that the Commission on Electric Utility Restructuring hereby requests the Division of Consumer Counsel of the Office of Attorney General:

1. On or before September 1, 2004, and annually thereafter, to report to the Commission on Electric Utility Restructuring (i) the cost of service of each incumbent electric utility's generation; and (ii) the market prices for generation as calculated for wires charge purposes immediately prior to said reporting date; provided, however, that the first such report is requested to cover the period beginning July 1, 1999 and ending December 31, 2003.

2. In determining generation cost of service, to take into account factors such as the incumbent electric utility's applicable Annual Informational Filing to the SCC, any adjustments to such Filing made by the SCC, example ranges of returns on common equity, and such other factors as the Division deems Relevant.

3. In determining market prices for generation, to take into account market prices as determined by the SCC and such other factors as the Division may deem relevant.

4. To continue to make such reports for each incumbent electric utility until the capped rates for such utility expire or are terminated pursuant to the provisions of § 56-582.

Adopted by the Commission on Electric Utility Restructuring on _____, 2004.

A true copy:_____

Title:_____

WIRES CHARGES

Proposed by:

Old Mill Power Company
103 Shale Place
Charlottesville, VA 22902-6402
Michel A. (Mitch) King, President
Voice: 1-434-979-WATT(9288)
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§ 56-583. Wires charges.

A. To provide the opportunity for competition and consistent with § 56-584, the Commission shall calculate wires charges for each incumbent electric utility, effective upon the commencement of customer choice, which shall be the excess, if any, of the incumbent electric utility's capped unbundled rates for generation over the projected market prices for generation, as determined by the Commission; however, where there is such excess, the sum of such wires charges, the unbundled charge for transmission and ancillary services, the applicable distribution rates established by the Commission and the above projected market prices for generation shall not exceed the capped rates established under § 56-582 A 1 applicable to such incumbent electric utility. The Commission shall adjust such wires charges not more frequently than annually and shall seek to coordinate adjustments of wires charges with any adjustments of capped rates pursuant to § 56-582. *To promote a gradual transition to full retail competition, the wires charges beginning July 1, 2004 shall be 67% of the values calculated as above and in effect on January 1, 2004, the wires charges beginning July 1, 2005.shall be 33% of the values calculated as above and in effect on January 1, 2004, and the wires charges beginning July 1, 2006 and thereafter shall be zero.*

No wires charge shall be less than zero. The projected market prices for generation, when determined under this subsection, shall be adjusted for any projected cost of transmission, transmission line losses, and ancillary services subject to the jurisdiction of the Federal Energy Regulatory Commission which the incumbent electric utility (i) must incur to sell its generation and (ii) cannot otherwise recover in rates subject to state or federal jurisdiction.

B. Customers that choose suppliers of electric energy, other than the incumbent electric utility, or are subject to and receiving default service, prior to the expiration of the period for capped rates, as provided for in § 56-582, shall pay a wires charge determined pursuant to subsection A based upon actual usage of electricity distributed by the incumbent electric utility to the customer (i) during the period from the time the customer chooses a supplier of electric energy other than the incumbent electric utility or (ii) during the period from the time the customer is subject to and receives default service until capped rates expire or are terminated, as provided in § 56-582.

C. The Commission shall permit any customer, at its option, to pay the wires charges owed to an incumbent electric utility on an accelerated or deferred basis upon a finding that such method is not (i) prejudicial to the incumbent electric utility or its ratepayers or (ii) inconsistent with the development of effective competition, provided that all deferred wires charges shall be paid in full by July 1, 2007.

D. A supplier of retail electric energy may pay any or all of the wires charge owed by any customer to an incumbent electric utility. The supplier may not only pay such wires charge on behalf of any customer, but also contract with any customer to finance such payments. Further, on request of a supplier, the incumbent electric utility shall enter into a contract allowing such supplier to pay such wires charge on an accelerated or deferred basis. Such contract shall contain terms and conditions, specified in rules and regulations promulgated by the Commission to implement the provisions of this subsection, that fully compensate the incumbent electric utility for such wires charge, including reasonable compensation for the time value of money.

RATIONALE:

The greatest single impediment to the development of a robust competitive electricity market in Virginia is the wires charge that can be imposed by each utility on customers who purchase their electricity from competitive suppliers. Unlike the situation in many other jurisdictions currently undergoing electric industry restructuring, Virginia's wire charges are particularly effective at thwarting competition for at least three reasons: 1) because they remain in full force throughout what was intended to be a transition period for the development of full retail competition; 2) because they are re-calculated annually, and therefore create a significant amount of cost uncertainty for competitive suppliers and their prospective customers of a type not normally seen in emerging markets; and 3) because they are based on wholesale prices in neighboring electricity markets in such a way that any potential "head room" for competitive suppliers, and thus any potential savings that could be passed on to consumers, created by decreasing wholesale prices in such neighboring electricity markets is quickly erased by the next year's wires charge calculations.

The proposed revision directly addresses the first defect described above by gradually phasing out the wires charges during what remains of the transition period, and thereby significantly diminishes the adverse effect of the other two defects.

If a gradual phase-out of the wires charges as described in the proposed revision is not adopted, the current legislation will continue to thwart the development of effective competition until such time as the wires charges go away for other reasons, either because the Commission on Electric Utility Restructuring determines that the utilities' stranded costs have been fully recovered, or because the current legislation authorizing such wires charges sunsets, as scheduled, on Jun 30, 2007. If the Commission wants to make sure that effective competition exists when the capped rates expire on June 30, 2007, it must take proactive steps to phase-out or eliminate the wires charges well before that date.

Virginia Power 2004 Wires Charges

Rate Schedule	Wires Charge Per kWh
1 (Residential)	$0.01803
GS-1	$0.01379
GS-2	$0.01486
GS-3	$0.00817
GS-4	$0.00681
5C (Churches)	$0.02494
1P	$0.01403
1S	$0.01399
1T	$0.01573
1W	$0.00852
5U	$0.03530
7U	$0.02560
6U	$0.00890
6TS	$0.00390
10	$0.00473
5P	$0.01919
GS-2T	$0.01268
25	$0.01804
27	$0.02595
28	$0.02592
29	$0.01367

2004 SESSION

INTRODUCED

040400428

HOUSE BILL NO. 264

Offered January 14, 2004
Prefiled January 8, 2004

A BILL to amend the Code of Virginia by adding a section numbered 56-577.1, relating to electric utility restructuring; protection of state jurisdiction.

Patron—Morgan

Referred to Committee on Commerce and Labor

Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia is amended by adding a section numbered 56-577.1 as follows:

§ 56-577.1. Protection of state jurisdiction.

Customer choice under this chapter shall be suspended until July 1, 2007, unless the Commission finds prior thereto that proceeding with customer choice and unbundling the components of rates will not result in the Commonwealth ceding its jurisdiction and authority to ensure reliable service at reasonable rates for Virginia's retail customers. Notwithstanding the provisions of §§ 56-577, 56-579, 56-585, and 56-590, or any other provision of this chapter, the Commission shall direct the immediate rebundling of incumbent electric utilities' retail electricity rates. During the period in which customer choice is suspended, and notwithstanding any other provision of this chapter, the Commission shall take such actions found necessary by the Commission, following notice to interested persons and an opportunity for a public hearing, to protect the Commonwealth's jurisdiction to ensure reliable electric service at reasonable rates. No incumbent utility's capped rates shall be changed prior to July 1, 2007, except as provided in § 56-582.

2. That an emergency exists and this act is in force from its passage.

INTRODUCED

HB264

1/27/04 8:8

Amendment to the Electric Utility restructuring Legislation (LD6926372)
Proposed by the Electric Cooperatives and Others

Amend proposed new § 56-597 by adding new subsection B (new language is italicized), as follows:

§ 56-597. Commission regulation of retail electric energy.

A. Except as otherwise provided in this chapter, the Commission shall continue to regulate, pursuant to this title, the generation, transmission, and distribution of retail electric energy in the Commonwealth by incumbent electric utilities.

*B. The Commission shall direct the immediate rebundling of the generation, distribution, and transmission components of incumbent electric utilities' retail electricity rates, and thereafter, **for so long as this section remains in effect**, the retail rates of service of incumbent electric utilities shall be bundled rates; provided that the Commission shall permit, on an experimental basis, the unbundling of the generation, distribution, and transmission components of an incumbent electric utility's retail electricity rates in order to implement any pilot program encompassing retail customer choice authorized pursuant to subsection C of § 56-577.*

040406452

HOUSE BILL NO. 59

Offered January 14, 2004

Prefiled December 8, 2003

A BILL to amend and reenact § 56-580 of the Code of Virginia, relating to electrical generating facility certificates.

Patron—Parrish

Referred to Committee on Commerce and Labor

Be it enacted by the General Assembly of Virginia:

1. That § 56-580 of the Code of Virginia is amended and reenacted as follows:

§ 56-580. Transmission and distribution of electric energy.

A. The Commission shall continue to regulate pursuant to this title the distribution of retail electric energy to retail customers in the Commonwealth and, to the extent not prohibited by federal law, the transmission of electric energy in the Commonwealth.

B. The Commission shall continue to regulate, to the extent not prohibited by federal law, the reliability, quality and maintenance by transmitters and distributors of their transmission and retail distribution systems.

C. The Commission shall develop codes of conduct governing the conduct of incumbent electric utilities and affiliates thereof when any such affiliates provide, or control any entity that provides, generation, distribution, transmission or any services made competitive pursuant to § 56-581.1, to the extent necessary to prevent impairment of competition.

D. The Commission shall permit the construction and operation of electrical generating facilities upon a finding that such generating facility and associated facilities (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. In review of a petition for a certificate to construct and operate a generating facility described in this subsection, the Commission shall give consideration to the effect of the facility and associated facilities on the environment and establish such conditions as may be desirable or necessary to minimize adverse environmental impact as provided in § 56-46.1. In order to avoid duplication of governmental activities, any valid permit or approval required for an electric generating plant and associated facilities issued or granted by a federal, state or local governmental entity charged by law with responsibility for issuing permits or approvals regulating environmental impact and mitigation of adverse environmental impact or for other specific public interest issues such as building codes, transportation plans, and public safety, whether such permit or approval is prior to or after the Commission's decision, shall be deemed to satisfy the requirements of this section with respect to all matters that (i) are governed by the permit or approval or (ii) are within the authority of, and were considered by, the governmental entity in issuing such permit or approval, and the Commission shall impose no additional conditions with respect to such matters. Nothing in this section shall affect the ability of the Commission to keep the record of a case open. Nothing in this section shall affect any right to appeal such permits or approvals in accordance with applicable law. In the case of a proposed facility located in a region that was designated as of July 1, 2001, as serious nonattainment for the one-hour ozone standard as set forth in the federal Clean Air Act, the Commission shall not issue a decision approving such proposed facility that is conditioned upon issuance of any environmental permit or approval.

E. Nothing in this section shall impair the distribution service territorial rights of incumbent electric utilities, and incumbent electric utilities shall continue to provide distribution services within their exclusive service territories as established by the Commission. Nothing in this chapter shall impair the Commission's existing authority over the provision of electric distribution services to retail customers in the Commonwealth including, but not limited to, the authority contained in Chapters 10 (§ 56-232 et seq.) and 10.1 (§ 56-265.1 et seq.) of this title.

F. Nothing in this chapter shall impair the exclusive territorial rights of an electric utility owned or operated by a municipality as of July 1, 1999, nor shall any provision of this chapter apply to any such electric utility unless (i) that municipality elects to have this chapter apply to that utility or (ii) that utility, directly or indirectly, sells, offers to sell or seeks to sell electric energy to any retail customer outside the geographic area that was served by such municipality as of July 1, 1999, except any area within the municipality that was served by an incumbent public utility as of that date but was thereafter served by an electric utility owned or operated by a municipality pursuant to the terms of a franchise agreement between the municipality and the incumbent public utility. If an electric utility owned or

operated by a municipality as of July 1, 1999, is made subject to the provisions of this chapter pursuant to clause (i) or (ii) of this subsection, then in such event the provisions of this chapter applicable to incumbent electric utilities shall also apply to any such utility, mutatis mutandis.

G. The applicability of this chapter to any investor-owned incumbent electric utility supplying electric service to retail customers on January 1, 2003, whose service territory assigned to it by the Commission is located entirely within Dickenson, Lee, Russell, Scott, and Wise Counties shall be suspended effective July 1, 2003, so long as such utility does not provide retail electric services in any other service territory in any jurisdiction to customers who have the right to receive retail electric energy from another supplier. During any such suspension period, the utility's rates shall be (i) its capped rates established pursuant to § 56-582 for the duration of the capped rate period established thereunder, and (ii) determined thereafter by the Commission on the basis of such utility's prudently incurred costs pursuant to Chapter 10 (§ 56-232 et seq.) of this title.

H. The expiration date of any certificates granted by the Commission pursuant to subsection D of this section, for which applications were filed with the Commission prior to July 1, 2002, shall be extended for an additional two years from the expiration date that otherwise would apply.

04 - 7086780 **12/16/2003 1:46 PM** **Martin G. Farber**

SENATE BILL NO. _____ HOUSE BILL NO. _____

A BILL to amend and reenact § 10.1-1322.3 of the Code of Virginia, relating to the air emissions trading program.

Be it enacted by the General Assembly of Virginia:

1. That § 10.1-1322.3 of the Code of Virginia is amended and reenacted as follows:

§ 10.1-1322.3. Emissions trading programs; emissions credits; Board to promulgate regulations.

In accordance with § 10.1-1308, the Board may promulgate regulations to provide for emissions trading programs to achieve and maintain the National Ambient Air Quality Standards established by the United States Environmental Protection Agency, under the federal Clean Air Act. The regulations shall create an air emissions banking and trading program for the Commonwealth, to the extent not prohibited by federal law, that results in net air emission reductions, creates an economic incentive for reducing air emissions, and allows for continued economic growth through a program of banking and trading credits or allowances. The regulations applicable to the electric power industry shall foster competition in the electric power industry, encourage construction of clean, new generating facilities, provide without charge new source set-asides of five percent for the first five plan years and two percent per year thereafter, and provide an initial allocation period of five years. In promulgating such regulations the Board shall consider, but not be limited to, the inclusion of provisions concerning (i) the definition and use of emissions reduction credits or allowances from mobile and stationary sources, (ii) the role of offsets in emissions trading, (iii) interstate or regional emissions trading, (iv) the mechanisms needed to facilitate emissions trading and banking, and (v) the role of emissions allocations in emissions trading. No regulations shall prohibit the direct trading of air emissions credits or allowances between private industries, provided such trades do not adversely impact air quality in Virginia.

Amendment Proposed by MDV-Solar Energy Industries Association

§ 56-594. Net energy metering provisions.

A. The Commission shall establish by regulation a program, to begin no later than July 1, 2000, which affords eligible customer-generators the opportunity to participate in net energy metering. The regulations may include, but need not be limited to, requirements for (i) retail sellers; (ii) owners and/or operators of distribution or transmission facilities; (iii) providers of default service; (iv) eligible customer-generators; or (v) any combination of the foregoing, as the Commission determines will facilitate the provision of net energy metering, provided that the Commission determines that such requirements do not adversely affect the public interest.

B. For the purpose of this section:

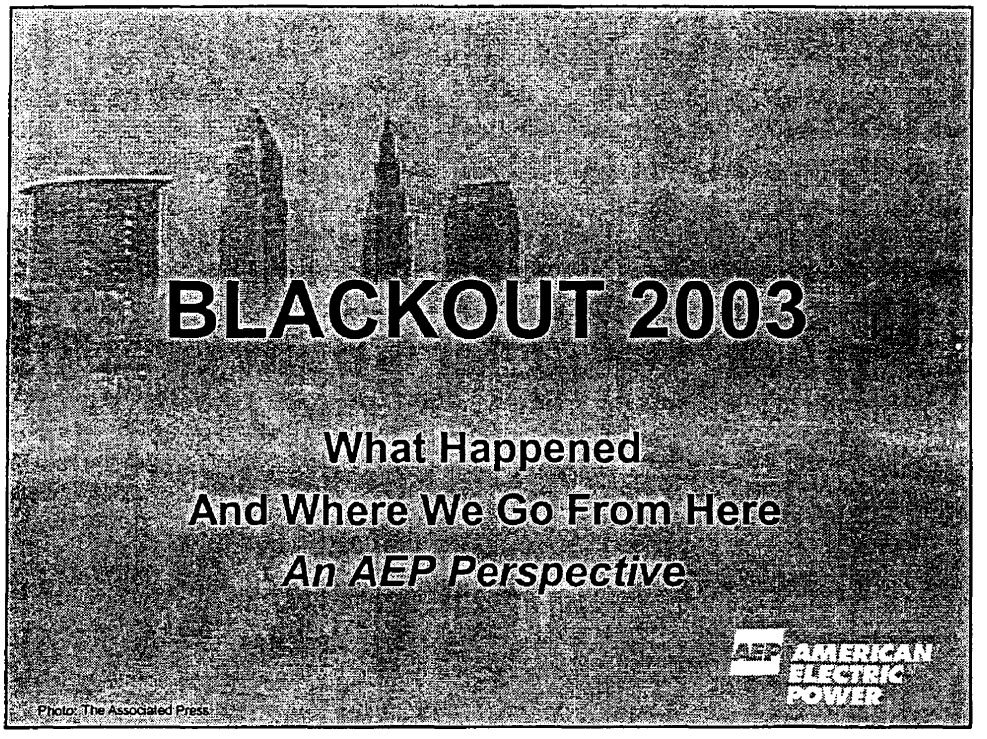
"Eligible customer-generator" means a customer that owns and operates an electrical generating facility that (i) has a capacity of not more than ten kilowatts for residential customers and ~~twenty-five~~ 500 kilowatts for nonresidential customers; (ii) uses as its total source of fuel solar, wind, or hydro energy; (iii) is located on the customer's premises; (iv) is interconnected and operated in parallel with an electric company's transmission and distribution facilities; and (v) is intended primarily to offset all or part of the customer's own electricity requirements.

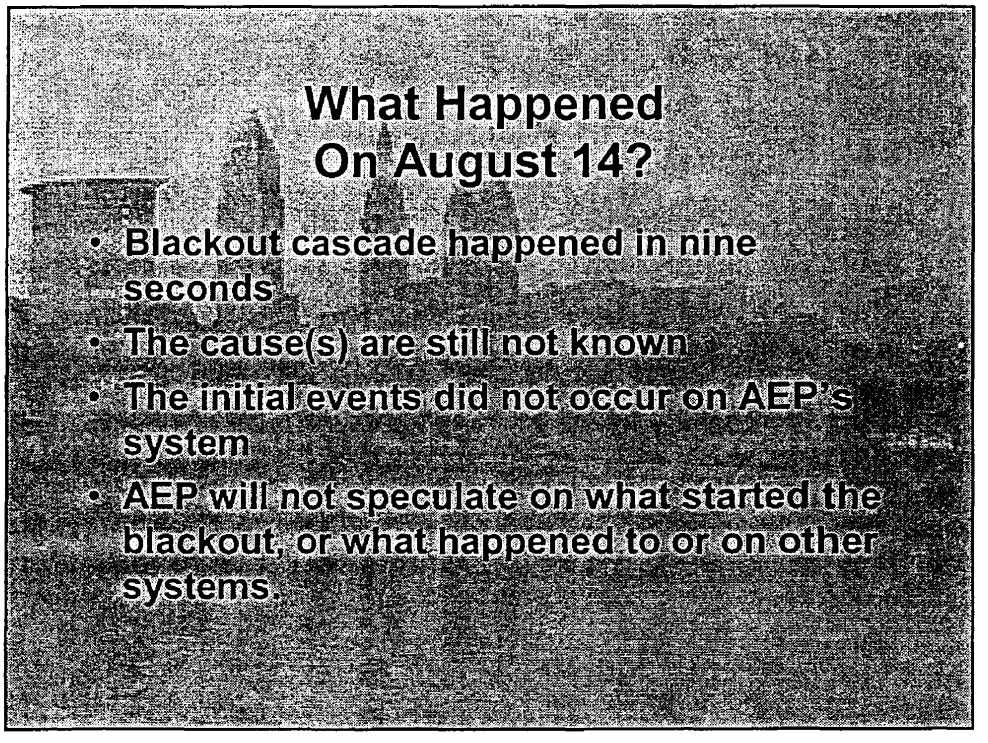
"Net energy metering" means measuring the difference, over the net metering period, between (i) electricity supplied to an eligible customer-generator from the electric grid and (ii) the electricity generated and fed back to the electric grid by the eligible customer-generator.

"Net metering period" means the twelve-month period following the date of final interconnection of the eligible customer-generator's system with an electric service provider, and each twelve-month period thereafter.

C. The Commission's regulations shall ensure that the metering equipment installed for net metering shall be capable of measuring the flow of electricity in two directions, and shall allocate fairly the cost of such equipment and any necessary interconnection. An eligible customer-generator's solar, wind or hydro electrical generating system shall meet all applicable safety and performance standards established by the National Electrical Code, the Institute of Electrical and Electronics Engineers, and accredited testing laboratories such as Underwriters Laboratories. Beyond the requirements set forth in this section, a customer-generator whose solar, wind or hydro electrical generating system meets those standards and rules shall bear the reasonable cost, if any, as determined by the Commission, to (i) install additional controls, (ii) perform or pay for additional tests, or (iii) purchase additional liability insurance.

D. The Commission shall establish minimum requirements for contracts to be entered into by the parties to net metering arrangements. Such requirements shall protect the customer-generator against discrimination by virtue of its status as a customer-generator. Where electricity generated by the customer-generator over the net metering period exceeds the electricity consumed by the customer-generator, the customer-generator shall not be compensated for the excess electricity unless the entity contracting to receive such electric energy and the customer-generator enter into a power purchase agreement for such excess electricity. The net metering standard contract or tariff shall be available to eligible customer-generators on a first-come, first-served basis in each electric distribution company's Virginia service area until the rated generating capacity owned and operated by eligible customer-generators in the state reaches 0.1 percent of each electric distribution company's adjusted Virginia peak-load forecast for the previous year.

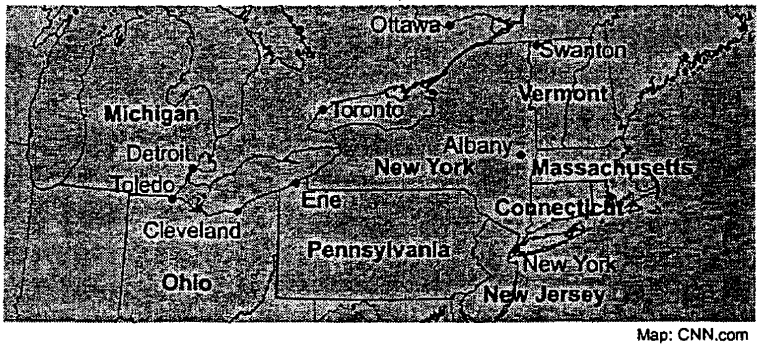

BLACKOUT 2003
What Happened
And Where We Go From Here
An AEP Perspective
AEP AMERICAN ELECTRIC POWER
Photo: The Associated Press


What Happened
On August 14?
• Blackout cascade happened in nine seconds
• The cause(s) are still not known
• The initial events did not occur on AEP's system
• AEP will not speculate on what started the blackout, or what happened to or on other systems

Summary: What Happened at AEP On August 14?

- The AEP system held
- AEP's protective systems automatically performed as designed to isolate the AEP grid
- AEP operators performed and communicated as they should
- Load and generation stayed in balance

Where Was The Blackout?



Map: CNN.com

What Can AEP Say?

- AEP first detected possible problems on interconnection lines with FirstEnergy prior to the blackout
- AEP immediately contacted FirstEnergy and our reliability coordinator, PJM
- When power flows on AEP lines exceeded safe levels, automatic protective devices began "opening" or tripping off lines

What Can AEP Say?

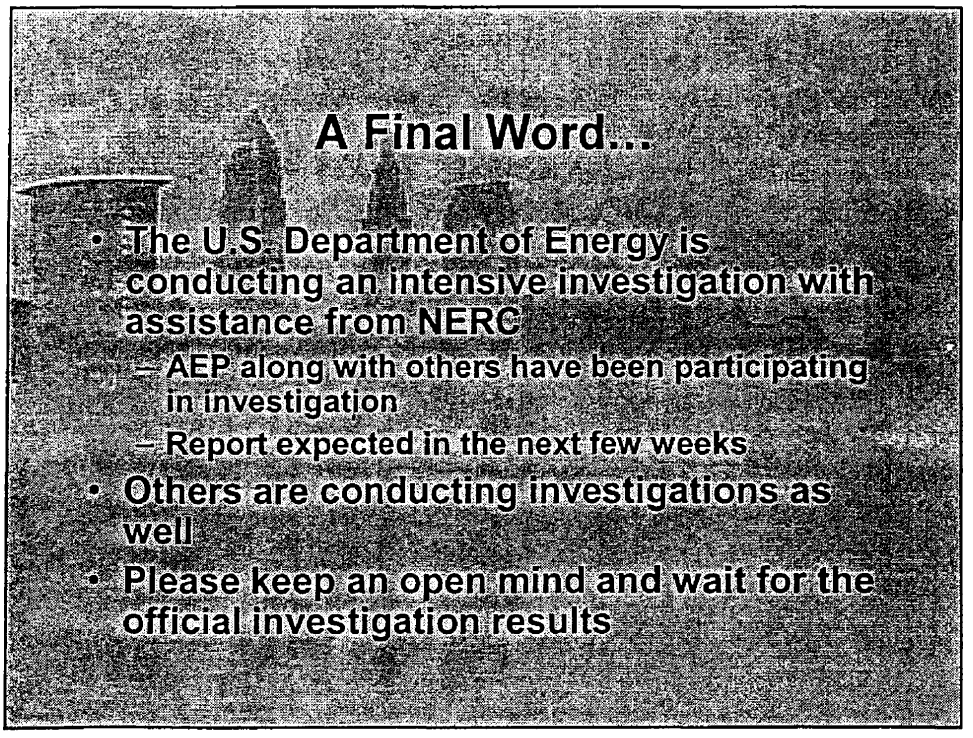
- Cascading outages avoided across AEP and possibly far beyond
  - AEP helped sustain other systems
  - Public safety issues were avoided
- Some systems held and others did not
  - We can't speculate about performance of other systems

Relevant Transmission Issues

- U.S. transmission grid is not being used the way it was originally intended
- Built for native load – local customers of local companies
- Now being used for extensive wholesale transactions across wide regions
- Ours is not a "Third World Grid"

What Will Facilitate Grid Improvements?

- Regulatory certainty
  - Cost recovery
  - Siting
- Coordinated communications among entities overseeing the grid
- Mandatory transmission reliability standards
- Consensus on use of grid
  - Balance between markets and reliability – but tipped toward reliability
  - No reliability, no markets
- Resolution of state/federal jurisdiction issues without putting utilities in the middle


A Final Word...
• The U.S. Department of Energy is conducting an intensive investigation with assistance from NERC
– AEP along with others have been participating in investigation
– Report expected in the next few weeks
• Others are conducting investigations as well
• Please keep an open mind and wait for the official investigation results

Status of the Virginia Energy Choice Consumer Education Program
Commission on Electric Utility Restructuring
November 19, 2003

The "quiet" period for the Virginia Energy Choice consumer education program continues with limited resources focused on maintaining a website, the toll-free information line, and completing education grants.

- **Website** – The VEC website (www.vaenergychoice.org) is routinely updated as electric cooperatives implement choice. The number of visits to the site declined in the first quarter of 2003 when awareness advertising ended. At the time, the site averaged over 12,000 visits per month. However, the number of visitors has leveled out since then. The site now receives between 8,000 and 10,000 visits per month.
- **Information Line** – The call volume on the toll-free information line (1-877-YES-2004) also declined in the first quarter of 2003. In January, the call center served almost 1,000 customers. By June, the average monthly call volume on an automated system leveled out to about 500 customers and has stayed at that volume through October. Approximately four percent of the callers request a call back from the SCC. Most have additional questions about energy choice or their energy bills.
- **Grant Program** – Eight of 12 consumer education projects funded with Virginia Energy Choice grants were completed between July 1, 2002 and October 31, 2003. Two grant projects have reported progress, but have not submitted final invoices for reimbursement. Two grant projects report no progress and have received no funding.
- **Electronic Newsletter** – The sixth edition of the "The Source," an electronic newsletter, was distributed in September. The newsletter highlighted several of the consumer education grant projects and the Dominion Virginia Power pilot programs. Several hundred consumers have signed up to receive the newsletter. In addition, several hundred community-based organizations that have been contacted by VEC in the past two years receive the newsletter.
- **Virginia Energy Fair** – The Virginia Energy Choice program was one of the state and local government groups sponsoring the Virginia Energy Fair on October 10-11 at the Science Museum of Virginia in Richmond. The theme of the program was energy conservation and education. VEC was involved in the project prior to the curtailment.
- **Education Advisory Committee** – The committee that provides advice and guidance to the consumer education program is scheduled to meet in Richmond on January 14, 2004 to receive a status report on energy choice and begin planning for the possible resumption of campaign activities after July 1, 2004.

VIRGINIA ACTS OF ASSEMBLY -- 2004 SESSION

CHAPTER 827

An Act to amend and reenact §§ 56-249.6, 56-577, 56-580, 56-582, 56-583, 56-585, 56-589, and 56-594 of the Code of Virginia, relating to the Electric Utility Restructuring Act.

[S 651]

Approved April 14, 2004

Be it enacted by the General Assembly of Virginia:

1. That §§ 56-249.6, 56-577, 56-580, 56-582, 56-583, 56-585, 56-589, and 56-594 of the Code of Virginia are amended and reenacted as follows:

§ 56-249.6. Recovery of fuel and purchased power costs.

A. 1. Each electric utility ~~which~~ *that* purchases fuel for the generation of electricity *or purchases power and that was not, as of July 1, 1999, bound by a rate case settlement adopted by the Commission that extended in its application beyond January 1, 2002,* shall submit to the Commission its estimate of fuel costs, including the cost of purchased power, for the ~~twelve~~ *12*-month period beginning on the date prescribed by the Commission. Upon investigation of such estimates and hearings in accordance with law, the Commission shall direct each company to place in effect tariff provisions designed to recover the fuel costs determined by the Commission to be appropriate for that period, adjusted for any over-recovery or under-recovery of fuel costs previously incurred.

2. The Commission shall continuously review fuel costs and if it finds that ~~the~~ *any* utility *described in subdivision A 1* is in an over-recovery position by more than five percent, or likely to be so, it may reduce the fuel cost tariffs to correct the over-recovery.

B. All fuel costs recovery tariff provisions in effect on January 1, 2004, for any electric utility that purchases fuel for the generation of electricity and that was, as of July 1, 1999, bound by a rate case settlement adopted by the Commission that extended in its application beyond January 1, 2002, shall remain in effect until the earlier of (i) July 1, 2007; (ii) the termination of capped rates pursuant to the provisions of subsection C of § 56-582; or (iii) the establishment of tariff provisions under subsection C. Any such utility shall continue to report to the Commission annually its actual fuel costs, including the cost of purchased power until July 1, 2007.

C. Unless capped rates are terminated pursuant to the provisions of subsection C of § 56-582 prior to July 1, 2007, the Commission shall direct each electric utility described in subsection B to submit to the Commission its estimate of fuel costs, including the cost of purchased power, for the 42-month period beginning July 1, 2007, and ending December 31, 2010. Upon investigation of such estimate and hearing in accordance with law, the Commission shall direct each such utility to place in effect tariff provisions designed to recover the fuel costs determined by the Commission to be appropriate for such period, without adjustment for any over-recovery or under-recovery of fuel costs previously incurred. Such tariff provisions shall remain in effect until the capped rates for such utility expire or are terminated pursuant to the provisions of § 56-582.

D. 1. In proceedings under subsections A and C, the Commission may, to the extent deemed appropriate, offset against fuel costs and purchased power costs to be recovered ~~hereunder~~ the revenues attributable to sales of power pursuant to interconnection agreements with neighboring electric utilities.

2. In proceedings under subsections A and C, the Commission shall disallow recovery of any fuel costs that it finds without just cause to be the result of failure of the utility to make every reasonable effort to minimize fuel costs or any decision of the utility resulting in unreasonable fuel costs, giving due regard to reliability of service and the need to maintain reliable sources of supply, economical generation mix, generating experience of comparable facilities, and minimization of the total cost of providing service.

3. The Commission is authorized to promulgate, in accordance with the provisions of this section, all rules and regulations necessary to allow the recovery by electric utilities of all of their prudently incurred fuel costs *under subsections A and C,* including the cost of purchased power, as precisely and promptly as possible, with no over-recovery or under-recovery, *except as provided in subsection C,* in a manner that will tend to assure public confidence and minimize abrupt changes in charges to consumers.

The Commission may, however, dispense with the procedures set forth above for any electric utility if it finds, after notice and hearing, that the electric utility's fuel costs can be reasonably recovered through the rates and charges investigated and established in accordance with other sections of this chapter.

§ 56-577. Schedule for transition to retail competition; Commission authority; exemptions; pilot programs.

A. The transition to retail competition for the purchase and sale of electric energy shall be implemented as follows:

1. Each incumbent electric utility owning, operating, controlling, or having an entitlement to transmission capacity shall join or establish a regional transmission entity, which entity may be an independent system operator, to which such utility shall transfer the management and control of its transmission system, subject to the provisions of § 56-579.

2. On and after January 1, 2002, retail customers of electric energy within the Commonwealth shall be permitted to purchase energy from any supplier of electric energy licensed to sell retail electric energy within the Commonwealth during and after the period of transition to retail competition, subject to the following:

a. The Commission shall separately establish for each utility a phase-in schedule for customers by class, and by percentages of class, to ensure that by January 1, 2004, all retail customers of each utility are permitted to purchase electric energy from any supplier of electric energy licensed to sell retail electric energy within the Commonwealth.

b. The Commission shall also ensure that residential and small business retail customers are permitted to select suppliers in proportions at least equal to that of other customer classes permitted to select suppliers during the period of transition to retail competition.

3. On and after January 1, 2002, the generation of electric energy shall no longer be subject to regulation under this title, except as specified in this chapter.

4. On and after January 1, 2004, all retail customers of electric energy within the Commonwealth, regardless of customer class, shall be permitted to purchase electric energy from any supplier of electric energy licensed to sell retail electric energy within the Commonwealth.

B. The Commission may delay or accelerate the implementation of any of the provisions of this section, subject to the following:

1. Any such delay or acceleration shall be based on considerations of reliability, safety, communications or market power; and

2. Any such delay shall be limited to the period of time required to resolve the issues necessitating the delay, but in no event shall any such delay extend the implementation of customer choice for all customers beyond January 1, 2005.

The Commission shall, within a reasonable time, report to the General Assembly, or any legislative entity monitoring the restructuring of Virginia's electric industry, any such delays and the reasons therefor.

C. The Commission may conduct pilot programs encompassing retail customer choice of electricity energy suppliers for each incumbent electric utility that has not transferred functional control of its transmission facilities to a regional transmission entity prior to January 1, 2003. Upon application of an incumbent electric utility, the Commission may establish opt-in and opt-out municipal aggregation pilots and any other pilot programs the Commission deems to be in the public interest, and the Commission shall report to the ~~Legislative Transition Task Force~~ *Commission on Electric Utility Restructuring* on the status of such pilots by November of each year through 2006.

D. The Commission shall promulgate such rules and regulations as may be necessary to implement the provisions of this section.

E. *1.* By January 1, 2002, the Commission shall promulgate regulations establishing whether and, if so, for what minimum periods, customers who request service from an incumbent electric utility pursuant to subsection D of § 56-582 or a default service provider, after a period of receiving service from other suppliers of electric energy, shall be required to use such service from such incumbent electric utility or default service provider, as determined to be in the public interest by the Commission.

2. Subject to (i) the availability of capped rate service under § 56-582, and (ii) the transfer of the management and control of an incumbent electric utility's transmission assets to a regional transmission entity after approval of such transfer by the Commission under § 56-579, retail customers of such utility (a) purchasing such energy from licensed suppliers and (b) otherwise subject to minimum stay periods prescribed by the Commission pursuant to subdivision 1, shall nevertheless be exempt from any such minimum stay obligations by agreeing to purchase electric energy at the market-based costs of such utility or default providers after a period of obtaining electric energy from another supplier. Such costs shall include (i) the actual expenses of procuring such electric energy from the market, (ii) additional administrative and transaction costs associated with procuring such energy, including, but not limited to, costs of transmission line losses, and ancillary services, and (iii) a reasonable margin. The methodology of ascertaining such costs shall be determined and approved by the Commission after notice and opportunity for hearing and after review of any plan filed by such utility to procure electric energy to serve such customers. The methodology established by the Commission for determining such costs shall be consistent with the goals of (a) promoting the development of effective competition and economic development within the Commonwealth as provided in subsection A of § 56-596, and (b) ensuring that neither incumbent utilities nor retail customers that do not choose to obtain electric energy from alternate suppliers are adversely affected.

3. Notwithstanding the provisions of subsection D of § 56-582 and subdivision C 1 of § 56-585, however, any such customers exempted from any applicable minimum stay periods as provided in subdivision 2 shall not be entitled to purchase retail electric energy thereafter from their incumbent

electric utilities, or from any distributor required to provide default service under subdivision B 3 of § 56-585, at the capped rates established under § 56-582, unless such customers agree to satisfy any minimum stay period then applicable while obtaining retail electric energy at capped rates.

4. The Commission shall promulgate such rules and regulations as may be necessary to implement the provisions of this subsection, which rules and regulations shall include provisions specifying the commencement date of such minimum stay exemption program.

§ 56-580. Transmission and distribution of electric energy.

A. The Commission shall continue to regulate pursuant to this title the distribution of retail electric energy to retail customers in the Commonwealth and, to the extent not prohibited by federal law, the transmission of electric energy in the Commonwealth.

B. The Commission shall continue to regulate, to the extent not prohibited by federal law, the reliability, quality and maintenance by transmitters and distributors of their transmission and retail distribution systems.

C. The Commission shall develop codes of conduct governing the conduct of incumbent electric utilities and affiliates thereof when any such affiliates provide, or control any entity that provides, generation, distribution, transmission or any services made competitive pursuant to § 56-581.1, to the extent necessary to prevent impairment of competition.

D. The Commission shall permit the construction and operation of electrical generating facilities upon a finding that such generating facility and associated facilities (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. In review of a petition for a certificate to construct and operate a generating facility described in this subsection, the Commission shall give consideration to the effect of the facility and associated facilities on the environment and establish such conditions as may be desirable or necessary to minimize adverse environmental impact as provided in § 56-46.1. In order to avoid duplication of governmental activities, any valid permit or approval required for an electric generating plant and associated facilities issued or granted by a federal, state or local governmental entity charged by law with responsibility for issuing permits or approvals regulating environmental impact and mitigation of adverse environmental impact or for other specific public interest issues such as building codes, transportation plans, and public safety, whether such permit or approval is prior to or after the Commission's decision, shall be deemed to satisfy the requirements of this section with respect to all matters that (i) are governed by the permit or approval or (ii) are within the authority of, and were considered by, the governmental entity in issuing such permit or approval, and the Commission shall impose no additional conditions with respect to such matters. Nothing in this section shall affect the ability of the Commission to keep the record of a case open. Nothing in this section shall affect any right to appeal such permits or approvals in accordance with applicable law. In the case of a proposed facility located in a region that was designated as of July 1, 2001, as serious nonattainment for the one-hour ozone standard as set forth in the federal Clean Air Act, the Commission shall not issue a decision approving such proposed facility that is conditioned upon issuance of any environmental permit or approval.

E. Nothing in this section shall impair the distribution service territorial rights of incumbent electric utilities, and incumbent electric utilities shall continue to provide distribution services within their exclusive service territories as established by the Commission. Nothing in this chapter shall impair the Commission's existing authority over the provision of electric distribution services to retail customers in the Commonwealth including, but not limited to, the authority contained in Chapters 10 (§ 56-232 et seq.) and 10.1 (§ 56-265.1 et seq.) of this title.

F. Nothing in this chapter shall impair the exclusive territorial rights of an electric utility owned or operated by a municipality as of July 1, 1999, nor shall any provision of this chapter apply to any such electric utility unless (i) that municipality elects to have this chapter apply to that utility or (ii) that utility, directly or indirectly, sells, offers to sell or seeks to sell electric energy to any retail customer outside the geographic area that was served by such municipality as of July 1, 1999, except any area within the municipality that was served by an incumbent public utility as of that date but was thereafter served by an electric utility owned or operated by a municipality pursuant to the terms of a franchise agreement between the municipality and the incumbent public utility. If an electric utility owned or operated by a municipality as of July 1, 1999, is made subject to the provisions of this chapter pursuant to clause (i) or (ii) of this subsection, then in such event the provisions of this chapter applicable to incumbent electric utilities shall also apply to any such utility, mutatis mutandis.

G. The applicability of this chapter to any investor-owned incumbent electric utility supplying electric service to retail customers on January 1, 2003, whose service territory assigned to it by the Commission is located entirely within Dickenson, Lee, Russell, Scott, and Wise Counties shall be suspended effective July 1, 2003, so long as such utility does not provide retail electric services in any other service territory in any jurisdiction to customers who have the right to receive retail electric energy from another supplier. During any such suspension period, the utility's rates shall be (i) its capped rates established pursuant to § 56-582 for the duration of the capped rate period established thereunder, and (ii) determined thereafter by the Commission on the basis of such utility's prudently incurred costs

pursuant to Chapter 10 (§ 56-232 et seq.) of this title.

H. The expiration date of any certificates granted by the Commission pursuant to subsection D, for which applications were filed with the Commission prior to July 1, 2002, shall be extended for an additional two years from the expiration date that otherwise would apply.

§ 56-582. Rate caps.

A. The Commission shall establish capped rates, effective January 1, 2001, ~~and expiring on July 1, 2007,~~ for each service territory of every incumbent utility as follows:

1. Capped rates shall be established for customers purchasing bundled electric transmission, distribution and generation services from an incumbent electric utility.

2. Capped rates for electric generation services, only, shall also be established for the purpose of effecting customer choice for those retail customers authorized under this chapter to purchase generation services from a supplier other than the incumbent utility during this period.

3. The capped rates established under this section shall be the rates in effect for each incumbent utility as of the effective date of this chapter, or rates subsequently placed into effect pursuant to a rate application filed by an incumbent electric utility with the Commission prior to January 1, 2001, and subsequently approved by the Commission, and made by an incumbent electric utility that is not currently bound by a rate case settlement adopted by the Commission that extends in its application beyond January 1, 2002. If such rate application is filed, the rates proposed therein shall go into effect on January 1, 2001, but such rates shall be interim in nature and subject to refund until such time as the Commission has completed its investigation of such application. Any amount of the rates found excessive by the Commission shall be subject to refund with interest, as may be ordered by the Commission. The Commission shall act upon such applications prior to commencement of the period of transition to customer choice. Such rate application and the Commission's approval shall give due consideration, on a forward-looking basis, to the justness and reasonableness of rates to be effective for a period of time ending as late as July 1, 2007. The capped rates established under this section, which include rates, tariffs, electric service contracts, and rate programs (including experimental rates, regardless of whether they otherwise would expire), shall be such rates, tariffs, contracts, and programs of each incumbent electric utility, provided that experimental rates and rate programs may be closed to new customers upon application to the Commission. Such capped rates shall also include rates for new services where, subsequent to January 1, 2001, rate applications for any such rates are filed by incumbent electric utilities with the Commission and are thereafter approved by the Commission. In establishing such rates for new services, the Commission may use any rate method that promotes the public interest and that is fairly compensatory to any utilities requesting such rates.

B. The Commission may adjust such capped rates in connection with the following: (i) utilities' recovery of fuel *and purchased power* costs pursuant to § 56-249.6, *and, if applicable, in accordance with the terms of any Commission order approving the divestiture of generation assets pursuant to § 56-590,* (ii) any changes in the taxation by the Commonwealth of incumbent electric utility revenues, (iii) any financial distress of the utility beyond its control, (iv) with respect to cooperatives that were not members of a power supply cooperative on January 1, 1999, and as long as they do not become members, their cost of purchased wholesale power and discounts from capped rates to match the cost of providing distribution services, ~~and~~ (v) with respect to cooperatives that were members of a power supply cooperative on January 1, 1999, their recovery of fuel costs, through the wholesale power cost adjustment clauses of their tariffs pursuant to § 56-231.33, *and (vi) with respect to incumbent electric utilities that were not, as of the effective date of this chapter, bound by a rate case settlement adopted by the Commission that extended in its application beyond January 1, 2002, the Commission shall adjust such utilities' capped rates, not more than once in any 12-month period, for the timely recovery of their incremental costs for transmission or distribution system reliability and compliance with state or federal environmental laws or regulations to the extent such costs are prudently incurred on and after July 1, 2004. Any adjustments pursuant to §§ 56-249.6 and clause (i) of this subsection by an incumbent electric utility that transferred all of its generation assets to an affiliate with the approval of the Commission pursuant to § 56-590 prior to January 1, 2002, shall be effective only on and after July 1, 2007.* Notwithstanding the provisions of § 56-249.6, the Commission may authorize tariffs that include incentives designed to encourage an incumbent electric utility to reduce its fuel costs by permitting retention of a portion of cost savings resulting from fuel cost reductions or by other methods determined by the Commission to be fair and reasonable to the utility and its customers.

C. A utility may petition the Commission to terminate the capped rates to all customers any time after January 1, 2004, and such capped rates may be terminated upon the Commission finding of an effectively competitive market for generation services within the service territory of that utility. If ~~the~~ *its* capped rates, *as established and adjusted from time to time pursuant to subsections A and B,* are continued after January 1, 2004, an incumbent electric utility ~~which~~ *that* is not, as of the effective date of this chapter, bound by a rate case settlement adopted by the Commission that extends in its application beyond January 1, 2002, may petition the Commission, *during the period January 1, 2004, through June 30, 2007,* for approval of a one-time change in ~~the nongeneration components of such~~ *its* rates, *and if the capped rates are continued after July 1, 2007, such incumbent electric utility may at*

any time after July 1, 2007, petition the Commission for approval of a one-time change in its rates. Any change in rates pursuant to this subsection by an incumbent electric utility that divested its generation assets with approval of the Commission pursuant to § 56-590 prior to January 1, 2002, shall be in accordance with the terms of any Commission order approving such divestiture. Any petition for changes to capped rates filed pursuant to this subsection shall be governed by the provisions of Chapter 10 (§ 56-232 et seq.) of this title.

D. Until the expiration or termination of capped rates as provided in this section, the incumbent electric utility, consistent with the functional separation plan implemented under § 56-590, shall make electric service available at capped rates established under this section to any customer in the incumbent electric utility's service territory, including any customer that, until the expiration or termination of capped rates, requests such service after a period of utilizing service from another supplier.

E. During the period when capped rates are in effect for an incumbent electric utility, such utility may file with the Commission a plan describing the method used by such utility to assure full funding of its nuclear decommissioning obligation and specifying the amount of the revenues collected under either the capped rates, as provided in this section, or the wires charges, as provided in § 56-583, that are dedicated to funding such nuclear decommissioning obligation under the plan. The Commission shall approve the plan upon a finding that the plan is not contrary to the public interest.

F. The capped rates established pursuant to this section shall expire on December 31, 2010, unless sooner terminated by the Commission pursuant to the provisions of subsection C.

§ 56-583. Wires charges.

A. To provide the opportunity for competition and consistent with § 56-584, the Commission shall calculate wires charges for each incumbent electric utility, effective upon the commencement of customer choice, which shall be the excess, if any, of the incumbent electric utility's capped unbundled rates for generation over the projected market prices for generation, as determined by the Commission; however, where there is such excess, the sum of such wires charges, the unbundled charge for transmission and ancillary services, the applicable distribution rates established by the Commission and the above projected market prices for generation shall not exceed the capped rates established under *subdivision A 1 of* § 56-582 ~~A 1~~ applicable to such incumbent electric utility. The Commission shall adjust such wires charges not more frequently than annually and shall seek to coordinate adjustments of wires charges with any adjustments of capped rates pursuant to § 56-582. No wires charge shall be less than zero. The projected market prices for generation, when determined under this subsection, shall be adjusted for any projected cost of transmission, transmission line losses, and ancillary services subject to the jurisdiction of the Federal Energy Regulatory Commission which the incumbent electric utility (i) must incur to sell its generation and (ii) cannot otherwise recover in rates subject to state or federal jurisdiction.

B. Customers that choose suppliers of electric energy, other than the incumbent electric utility, or are subject to and receiving default service, prior to the ~~expiration of the period for capped rates, as provided for in § 56-582,~~ *earlier of July 1, 2007, or the termination by the Commission of capped rates pursuant to the provisions of subsection C of § 56-582* shall pay a wires charge determined pursuant to subsection A based upon actual usage of electricity distributed by the incumbent electric utility to the customer (i) during the period from the time the customer chooses a supplier of electric energy other than the incumbent electric utility or (ii) during the period from the time the customer is subject to and receives default service until ~~capped rates expire or are terminated, as provided in § 56-582~~ *the earlier of July 1, 2007, or the termination by the Commission of capped rates pursuant to the provisions of subsection C of § 56-582.*

C. The Commission shall permit any customer, at its option, to pay the wires charges owed to an incumbent electric utility on an accelerated or deferred basis upon a finding that such method is not (i) prejudicial to the incumbent electric utility or its ratepayers or (ii) inconsistent with the development of effective competition, provided that all deferred wires charges shall be paid in full by July 1, 2007.

D. A supplier of retail electric energy may pay any or all of the wires charge owed by any customer to an incumbent electric utility. The supplier may not only pay such wires charge on behalf of any customer, but also contract with any customer to finance such payments. Further, on request of a supplier, the incumbent electric utility shall enter into a contract allowing such supplier to pay such wires charge on an accelerated or deferred basis. Such contract shall contain terms and conditions, specified in rules and regulations promulgated by the Commission to implement the provisions of this subsection, that fully compensate the incumbent electric utility for such wires charge, including reasonable compensation for the time value of money.

E. 1. Subject to (i) the availability of capped rate service under § 56-582, and (ii) the transfer of the management and control of an incumbent electric utility's transmission assets to a regional transmission entity after approval of such transfer by the Commission under § 56-579, (a) individual customers within the large industrial and large commercial rate classes of such incumbent electric utility, and (b) aggregated customers of such incumbent electric utility in all rate classes, subject to such aggregated demand criteria as may be established by the Commission, may elect, upon giving 60 days' prior notice to such utility, to purchase retail electric energy from licensed suppliers thereof without the obligation

to pay wires charges to any such utility that imposes a wires charge as otherwise provided under this section.

2. Notwithstanding the provisions of subsection D of § 56-582 and subdivision C 1 of § 56-585, any such customers (i) making such election and (ii) thereafter exercising that election by obtaining retail electric energy from suppliers without paying wires charges to their incumbent electric utilities, as authorized herein, shall not be entitled to purchase retail electric energy thereafter from their incumbent electric utilities, or from any distributor required to provide default service under subdivision B 3 of § 56-585 at the capped rates established under § 56-582.

3. Customers making and exercising such election may thereafter, however, purchase retail electric energy from their incumbent electric utilities at the market-based costs of such utility, upon 60 days' prior notice to such utility. Such costs shall include (i) the actual expenses of procuring such electric energy from the market, (ii) additional administrative and transaction costs associated with procuring such energy, including, but not limited to, costs of transmission, transmission line losses, and ancillary services, and (iii) a reasonable margin. The methodology of ascertaining such costs shall be determined and approved by the Commission after notice and opportunity for hearing and after review of any plan filed by such utility to procure electric energy to serve such customers. The methodology established by the Commission for determining such costs shall be consistent with the goals of (a) promoting the development of effective competition and economic development within the Commonwealth as provided in subsection A of § 56-596, and (b) ensuring that neither incumbent utilities nor retail customers that do not choose to obtain electric energy from alternate suppliers are adversely affected.

4. The Commission shall promulgate such rules and regulations as may be necessary to implement the provisions of this subsection. Such rules and regulations shall include provisions specifying the commencement date of such wires charge exemption program and enabling customers to make and exercise such election on a first-come, first-served basis in each incumbent electric utility's Virginia jurisdictional service territory until the most recent total peak billing demand of all such customers transferred to licensed suppliers in any such territory reaches, at a maximum, 1,000 MW or eight percent of such utility's prior year Virginia adjusted peak-load within the 18 months after such commencement date, and thereafter according to regulations promulgated by the Commission.

§ 56-585. Default service.

A. The Commission shall, after notice and opportunity for hearing, (i) determine the components of default service and (ii) establish one or more programs making such services available to retail customers requiring them commencing with the availability throughout the Commonwealth of customer choice for all retail customers as established pursuant to § 56-577. For purposes of this chapter, "default service" means service made available under this section to retail customers who (i) do not affirmatively select a supplier, (ii) are unable to obtain service from an alternative supplier, or (iii) have contracted with an alternative supplier who fails to perform.

B. From time to time, the Commission shall designate one or more providers of default service. In doing so, the Commission:

1. Shall take into account the characteristics and qualifications of prospective providers, including proposed rates, experience, safety, reliability, corporate structure, access to electric energy resources necessary to serve customers requiring such services, and other factors deemed necessary to ensure the reliable provision of such services, to prevent the inefficient use of such services, and to protect the public interest;

2. May periodically, as necessary, conduct competitive bidding processes under procedures established by the Commission and, upon a finding that the public interest will be served, designate one or more willing and suitable providers to provide one or more components of such services, in one or more regions of the Commonwealth, to one or more classes of customers;

3. To the extent that default service is not provided pursuant to a designation under subdivision 2, may require a distributor to provide, in a safe and reliable manner, one or more components of such services, or to form an affiliate to do so, in one or more regions of the Commonwealth, at rates determined pursuant to subsection C and for periods specified by the Commission; however, the Commission may not require a distributor, or affiliate thereof, to provide any such services outside the territory in which such distributor provides service; and

4. Notwithstanding imposition on a distributor by the Commission of the requirement provided in subdivision 3, the Commission may thereafter, upon a finding that the public interest will be served, designate through the competitive bidding process established in subdivision 2 one or more willing and suitable providers to provide one or more components of such services, in one or more regions of the Commonwealth, to one or more classes of customers.

C. If a distributor is required to provide default services pursuant to subdivision B 3, after notice and opportunity for hearing, the Commission shall periodically, for each distributor, determine the rates, terms and conditions for default services, taking into account the characteristics and qualifications set forth in subdivision B 1, as follows:

1. Until the expiration or termination of capped rates, the rates for default service provided by a distributor shall equal the capped rates established pursuant to subdivision A 2 of § 56-582. After the

expiration or termination of such capped rates, the rates for default services shall be based upon competitive market prices for electric generation services.

2. The Commission shall, after notice and opportunity for hearing, determine the rates, terms and conditions for default service by such distributor on the basis of the provisions of Chapter 10 (§ 56-232 et seq.) of this title, except that the generation-related components of such rates shall be (i) based upon a plan approved by the Commission as set forth in subdivision 3 or (ii) in the absence of an approved plan, based upon prices for generation capacity and energy in competitive regional electricity markets, *except as provided in subsection G.*

3. Prior to a distributor's provision of default service, and upon request of such distributor, the Commission shall review any plan filed by the distributor to procure electric generation services for default service. The Commission shall approve such plan if the Commission determines that the procurement of electric generation capacity and energy under such plan is adequately based upon prices of capacity and energy in competitive regional electricity markets. If the Commission determines that the plan does not adequately meet such criteria, then the Commission shall modify the plan, with the concurrence of the distributor, or reject the plan.

4. a. For purposes of this subsection, in determining whether regional electricity markets are competitive and rates for default service, the Commission shall consider (i) the liquidity and price transparency of such markets, (ii) whether competition is an effective regulator of prices in such markets, (iii) the wholesale or retail nature of such markets, as appropriate, (iv) the reasonable accessibility of such markets to the regional transmission entity to which the distributor belongs, and (v) such other factors it finds relevant. As used in this subsection, the term "competitive regional electricity market" means a market in which competition, and not statutory or regulatory price constraints, effectively regulates the price of electricity.

b. If, in establishing a distributor's default service generation rates, the Commission is unable to identify regional electricity markets where competition is an effective regulator of rates, then the Commission shall establish such distributor's default service generation rates by setting rates that would approximate those likely to be produced in a competitive regional electricity market. Such proxy generation rates shall take into account: (i) the factors set forth in subdivision C 4 a, and (ii) such additional factors as the Commission deems necessary to produce such proxy generation rates.

D. In implementing this section, the Commission shall take into consideration the need of default service customers for rate stability and for protection from unreasonable rate fluctuations.

E. On or before July 1, 2004, and annually thereafter, the Commission shall determine, after notice and opportunity for hearing, whether there is a sufficient degree of competition such that the elimination of default service for particular customers, particular classes of customers or particular geographic areas of the Commonwealth will not be contrary to the public interest. The Commission shall report its findings and recommendations concerning modification or termination of default service to the General Assembly and to the Commission on Electric Utility Restructuring, not later than December 1, 2004, and annually thereafter.

F. A distribution electric cooperative, or one or more affiliates thereof, shall have the obligation and right to be the supplier of default services in its certificated service territory. A distribution electric cooperative's rates for such default services shall be the capped rate for the duration of the capped rate period and shall be based upon the distribution electric cooperative's prudently incurred cost thereafter. Subsections B and C shall not apply to a distribution electric cooperative or its rates. Such default services, for the purposes of this subsection, shall include the supply of electric energy and all services made competitive pursuant to § 56-581.1. If a distribution electric cooperative, or one or more affiliates thereof, elects or seeks to be a default supplier of another electric utility, then the Commission shall designate the default supplier for that distribution electric cooperative, or any affiliate thereof, pursuant to subsection B.

G. To ensure a reliable and adequate supply of electricity, and to promote economic development, an investor-owned distributor that has been designated a default service provider under this section may petition the Commission for approval to construct, or cause to be constructed, a coal-fired generation facility that utilizes Virginia coal and is located in the coalfield region of the Commonwealth, as described in § 15.2-6002, to meet its native load and default service obligations, regardless of whether such facility is located within or without the distributor's service territory. The Commission shall consider any petition filed under this subsection in accordance with its competitive bidding rules promulgated pursuant to § 56-234.3, and in accordance with the provisions of this chapter. Notwithstanding the provisions of subdivision C 3 related to the price of default service, a distributor that constructs, or causes to be constructed, such facility shall have the right to recover the costs of the facility, including allowance for funds used during construction, life-cycle costs, and costs of infrastructure associated therewith, plus a fair rate of return, through its rates for default service. A distributor filing a petition for the construction of a facility under the provisions of this subsection shall file with its application a plan, or a revision to a plan previously filed, as described in subdivision C 3, that proposes default service rates to ensure such cost recovery and fair rate of return. The construction of such facility that utilizes energy resources located within the Commonwealth is in the public interest,

and in determining whether to approve such facility, the Commission shall liberally construe the provisions of this title.

§ 56-589. Municipal and state aggregation.

A. Counties, cities, and towns (hereafter municipalities) and other political subdivisions of the Commonwealth may, at their election and upon authorization by majority votes of their governing bodies, aggregate electrical energy and demand requirements for the purpose of negotiating the purchase of electrical energy requirements from any licensed supplier within this Commonwealth, as follows:

1. Any municipality or other political subdivision of the Commonwealth may aggregate the electric energy load of residential, commercial, and industrial retail customers within its boundaries on ~~a voluntary,~~ *an* opt-in *or opt-out* basis ~~in which each such customer must affirmatively select such municipality or other political subdivision as its aggregator. The municipality or other political subdivision may not earn a profit but must recover the actual costs incurred in such aggregation.~~

2. Any municipality or other political subdivision of the Commonwealth may aggregate the electric energy load of its governmental buildings, facilities, and any other governmental operations requiring the consumption of electric energy. Aggregation pursuant to this subdivision shall not require licensure pursuant to § 56-588.

3. Two or more municipalities or other political subdivisions within ~~this~~ *the* Commonwealth may aggregate the electric energy load of their governmental buildings, facilities, and any other governmental operations requiring the consumption of electric energy. Aggregation pursuant to this subdivision shall not require licensure pursuant to § 56-588 when such municipalities or other political subdivisions are acting jointly to negotiate or arrange for themselves agreements for their energy needs directly with licensed suppliers or aggregators.

Nothing in this subsection shall prohibit the Commission's development and implementation of pilot programs for opt-in, opt-out, or any other type of municipal aggregation, as provided in § 56-577.

B. The Commonwealth, at its election, may aggregate the electric energy load of its governmental buildings, facilities, and any other government operations requiring the consumption of electric energy for the purpose of negotiating the purchase of electricity from any licensed supplier within ~~this~~ *the* Commonwealth. Aggregation pursuant to this subsection shall not require licensure pursuant to § 56-588.

§ 56-594. Net energy metering provisions.

A. The Commission shall establish by regulation a program, to begin no later than July 1, 2000, which affords eligible customer-generators the opportunity to participate in net energy metering. The regulations may include, but need not be limited to, requirements for (i) retail sellers; (ii) owners and/or operators of distribution or transmission facilities; (iii) providers of default service; (iv) eligible customer-generators; or (v) any combination of the foregoing, as the Commission determines will facilitate the provision of net energy metering, provided that the Commission determines that such requirements do not adversely affect the public interest.

B. For the purpose of this section:

"Eligible customer-generator" means a customer that owns and operates an electrical generating facility that (i) has a capacity of not more than ~~ten~~ *10* kilowatts for residential customers and ~~twenty-five~~ *500* kilowatts for nonresidential customers; (ii) uses as its total source of fuel solar, wind, or hydro energy; (iii) is located on the customer's premises; (iv) is interconnected and operated in parallel with an electric company's transmission and distribution facilities; and (v) is intended primarily to offset all or part of the customer's own electricity requirements.

"Net energy metering" means measuring the difference, over the net metering period, between (i) electricity supplied to an eligible customer-generator from the electric grid and (ii) the electricity generated and fed back to the electric grid by the eligible customer-generator.

"Net metering period" means the ~~twelve~~ *12*-month period following the date of final interconnection of the eligible customer-generator's system with an electric service provider, and each ~~twelve~~ *12*-month period thereafter.

C. The Commission's regulations shall ensure that the metering equipment installed for net metering shall be capable of measuring the flow of electricity in two directions, and shall allocate fairly the cost of such equipment and any necessary interconnection. An eligible customer-generator's solar, wind or hydro electrical generating system shall meet all applicable safety and performance standards established by the National Electrical Code, the Institute of Electrical and Electronics Engineers, and accredited testing laboratories such as Underwriters Laboratories. Beyond the requirements set forth in this section, a customer-generator whose solar, wind or hydro electrical generating system meets those standards and rules shall bear the reasonable cost, if any, as determined by the Commission, to (i) install additional controls, (ii) perform or pay for additional tests, or (iii) purchase additional liability insurance.

D. The Commission shall establish minimum requirements for contracts to be entered into by the parties to net metering arrangements. Such requirements shall protect the customer-generator against discrimination by virtue of its status as a customer-generator. Where electricity generated by the customer-generator over the net metering period exceeds the electricity consumed by the customer-generator, the customer-generator shall not be compensated for the excess electricity unless the entity contracting to receive such electric energy and the customer-generator enter into a power purchase

agreement for such excess electricity. The net metering standard contract or tariff shall be available to eligible customer-generators on a first-come, first-served basis in each electric distribution company's Virginia service area until the rated generating capacity owned and operated by eligible customer-generators in the state reaches 0.1 percent of each electric distribution company's adjusted Virginia peak-load forecast for the previous year.

VIRGINIA ACTS OF ASSEMBLY -- 2004 SESSION

CHAPTER 262

An Act to amend and reenact § 56-580 of the Code of Virginia, relating to electrical generating facility certificates.

[H 59]

Approved March 31, 2004

Be it enacted by the General Assembly of Virginia:

1. That § 56-580 of the Code of Virginia is amended and reenacted as follows:

§ 56-580. Transmission and distribution of electric energy.

A. The Commission shall continue to regulate pursuant to this title the distribution of retail electric energy to retail customers in the Commonwealth and, to the extent not prohibited by federal law, the transmission of electric energy in the Commonwealth.

B. The Commission shall continue to regulate, to the extent not prohibited by federal law, the reliability, quality and maintenance by transmitters and distributors of their transmission and retail distribution systems.

C. The Commission shall develop codes of conduct governing the conduct of incumbent electric utilities and affiliates thereof when any such affiliates provide, or control any entity that provides, generation, distribution, transmission or any services made competitive pursuant to § 56-581.1, to the extent necessary to prevent impairment of competition.

D. The Commission shall permit the construction and operation of electrical generating facilities upon a finding that such generating facility and associated facilities (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. In review of a petition for a certificate to construct and operate a generating facility described in this subsection, the Commission shall give consideration to the effect of the facility and associated facilities on the environment and establish such conditions as may be desirable or necessary to minimize adverse environmental impact as provided in § 56-46.1. In order to avoid duplication of governmental activities, any valid permit or approval required for an electric generating plant and associated facilities issued or granted by a federal, state or local governmental entity charged by law with responsibility for issuing permits or approvals regulating environmental impact and mitigation of adverse environmental impact or for other specific public interest issues such as building codes, transportation plans, and public safety, whether such permit or approval is prior to or after the Commission's decision, shall be deemed to satisfy the requirements of this section with respect to all matters that (i) are governed by the permit or approval or (ii) are within the authority of, and were considered by, the governmental entity in issuing such permit or approval, and the Commission shall impose no additional conditions with respect to such matters. Nothing in this section shall affect the ability of the Commission to keep the record of a case open. Nothing in this section shall affect any right to appeal such permits or approvals in accordance with applicable law. In the case of a proposed facility located in a region that was designated as of July 1, 2001, as serious nonattainment for the one-hour ozone standard as set forth in the federal Clean Air Act, the Commission shall not issue a decision approving such proposed facility that is conditioned upon issuance of any environmental permit or approval.

E. Nothing in this section shall impair the distribution service territorial rights of incumbent electric utilities, and incumbent electric utilities shall continue to provide distribution services within their exclusive service territories as established by the Commission. Nothing in this chapter shall impair the Commission's existing authority over the provision of electric distribution services to retail customers in the Commonwealth including, but not limited to, the authority contained in Chapters 10 (§ 56-232 et seq.) and 10.1 (§ 56-265.1 et seq.) of this title.

F. Nothing in this chapter shall impair the exclusive territorial rights of an electric utility owned or operated by a municipality as of July 1, 1999, nor shall any provision of this chapter apply to any such electric utility unless (i) that municipality elects to have this chapter apply to that utility or (ii) that utility, directly or indirectly, sells, offers to sell or seeks to sell electric energy to any retail customer outside the geographic area that was served by such municipality as of July 1, 1999, except any area within the municipality that was served by an incumbent public utility as of that date but was thereafter served by an electric utility owned or operated by a municipality pursuant to the terms of a franchise agreement between the municipality and the incumbent public utility. If an electric utility owned or operated by a municipality as of July 1, 1999, is made subject to the provisions of this chapter pursuant to clause (i) or (ii) of this subsection, then in such event the provisions of this chapter applicable to incumbent electric utilities shall also apply to any such utility, mutatis mutandis.

G. The applicability of this chapter to any investor-owned incumbent electric utility supplying

electric service to retail customers on January 1, 2003, whose service territory assigned to it by the Commission is located entirely within Dickenson, Lee, Russell, Scott, and Wise Counties shall be suspended effective July 1, 2003, so long as such utility does not provide retail electric services in any other service territory in any jurisdiction to customers who have the right to receive retail electric energy from another supplier. During any such suspension period, the utility's rates shall be (i) its capped rates established pursuant to § 56-582 for the duration of the capped rate period established thereunder, and (ii) determined thereafter by the Commission on the basis of such utility's prudently incurred costs pursuant to Chapter 10 (§ 56-232 et seq.) of this title.

H. The expiration date of any certificates granted by the Commission pursuant to subsection D of this section, for which applications were filed with the Commission prior to July 1, 2002, shall be extended for an additional two years from the expiration date that otherwise would apply.

VIRGINIA ACTS OF ASSEMBLY -- 2004 SESSION

CHAPTER 334

An Act to amend and reenact § 10.1-1322.3 of the Code of Virginia, relating to the air emissions trading program.

[S 386]

Approved April 8, 2004

Be it enacted by the General Assembly of Virginia:

1. That § 10.1-1322.3 of the Code of Virginia is amended and reenacted as follows:

§ 10.1-1322.3. Emissions trading programs; emissions credits; Board to promulgate regulations.

In accordance with § 10.1-1308, the Board may promulgate regulations to provide for emissions trading programs to achieve and maintain the National Ambient Air Quality Standards established by the United States Environmental Protection Agency, under the federal Clean Air Act. The regulations shall create an air emissions banking and trading program for the Commonwealth, to the extent not prohibited by federal law, that results in net air emission reductions, creates an economic incentive for reducing air emissions, and allows for continued economic growth through a program of banking and trading credits or allowances. The regulations applicable to the electric power industry shall foster competition in the electric power industry, encourage construction of clean, new generating facilities, provide *without charge* new source set-asides of five percent for the first five plan years and two percent per year thereafter, and provide an initial allocation period of five years. In promulgating such regulations the Board shall consider, but not be limited to, the inclusion of provisions concerning (i) the definition and use of emissions reduction credits or allowances from mobile and stationary sources, (ii) the role of offsets in emissions trading, (iii) interstate or regional emissions trading, (iv) the mechanisms needed to facilitate emissions trading and banking, and (v) the role of emissions allocations in emissions trading. No regulations shall prohibit the direct trading of air emissions credits or allowances between private industries, provided such trades do not adversely impact air quality in Virginia.

2. Nothing in this act, however, shall be construed to interfere with, apply to, or affect the auction of Virginia's allocation of nitrogen oxide pollution credits set aside for new sources of electric power generation and other facilities for the years 2004 and 2005 as authorized by Chapter 1042 of the Acts of Assembly of 2003.