

THE COMMISSION ON ELECTRIC UTILITY RESTRUCTURING

**STATUS REPORT: THE DEVELOPMENT OF A
COMPETITIVE RETAIL
MARKET FOR ELECTRIC GENERATION**

**Presentation of
Howard M. Spinner**

**Director, Division of Economics and Finance
Virginia State Corporation Commission**

**Friday, January 6, 2006
Senate Room A, General Assembly Building**

KEY POINTS

- Virginia is administratively prepared for retail electric service competition
- Market conditions currently prevent voluntary customer participation
- Market wholesale electric prices are currently very high relative to cost-based rates paid by most Virginians.
- After rate caps, PJM wholesale prices will greatly influence retail prices in Virginia
- PJM prices are determined by a combination of market forces, federal regulation and PJM Market Monitoring
- Due to a lack of access to relevant data, the VA SCC is unable to fully assess the performance of PJM administered wholesale electricity markets.

Introduction

- Each September 1st the Virginia State Corporation Commission is required by the Virginia Electric Utility Restructuring Act to submit a status report on the development of a competitive retail market for electric service in Virginia to the Commission on Electric Utility Restructuring and the Governor.
- In the past the Report contained three parts; (1) a status report on the development of wholesale and retail electric markets around the country, (2) status of retail access and competition here in Virginia, and (3) recommendations (by the SCC as well as other stakeholders) to facilitate effective competition in the Commonwealth.
- This year's Report was submitted on time and consisted of three parts. This year, Part III did not contain any specific SCC recommendations.
- The Report's Part III did provide a section labeled "SCC Assessment" in which the SCC noted "some ominous new industry features and trends."

PART II

STATUS OF RETAIL ACCESS AND COMPETITION IN THE COMMONWEALTH

Transition to Full Retail Access

- **Virginia Utility Restructuring Act (“The Act”)**
- **As of January 1, 2004 - All electricity customers (approx. 3.2 million) of Virginia’s investor-owned utilities and electric cooperatives are eligible to switch to a Competitive Service Provider (“CSP”)**
- **About 29,800 customers in the southwestern part of the Commonwealth served by Kentucky Utilities d/b/a in Virginia as Old Dominion Power Company and approximately 7,700 customers served by Powell Valley Electric Cooperative are exempted from participating in retail access**

Suppliers/Aggregators

- **The Commission is responsible for licensing suppliers and aggregators interested in participating in retail access programs in Virginia. A list of suppliers with licenses at the time of the Report is on page 6 of PART II.**
- **The following six CSPs are now fully registered with Dominion Virginia Power (“DVP”):**
 - **Dominion Retail**
 - **PEPCO Energy Services (“PES”)**
 - **Washington Gas Energy Services (“WGES”)**
 - **ECONergy Energy Co.**
 - **Commerce Energy**
 - **WPS Energy Services**

- **The following seven aggregators are currently fully registered with DVP:**
 - **Advantage Energy**
 - **Buckeye Energy Brokers, INC.**
 - **EnergyWindow, INC.**
 - **Independent Energy Consultants, INC.**
 - **American PowerNet Management**
 - **WPS Energy Services**
 - **ECONergy Energy Co.**

Marketing

- **The only marketing activity that has taken place in any retail access program is in DVP's service territory.**
- **A single marketer, PES, continues to provide "Renewable Power" to residential customers in Northern Virginia. PES's offer is 51% renewable energy offered at a premium above DVP'S price-to-compare.**

Customer Participation

- **Approximately 3.2 million customers in Virginia currently have the right to choose an alternative CSP**
- **As of December 15, 2005, about 1490 residential and 20 commercial customers are enrolled with PES**

Wires Charge

- **DVP and APCO waived wires charges for 2005 and 2006.**
- **All but three of the electric cooperatives had a wires charge in 2005. Staff is awaiting data for 2006.**
- **Delmarva and Potomac Edison effectively waived their right to a wires charge in previous settlements.**
- **The methodology for determining market prices remains the same as last year. The process looks at the forward prices for electric power traded in the wholesale market.**

2005 Price-To-Compare

The methodology leads to calculations of the Price-to-Compare (the price the CSP has to beat to 'win' customers)

	<u>Residential</u>	<u>Industrial</u>
DVP	6.1 ¢/kWh	4.2 ¢/kWh
AEP	3.4 ¢/kWh	2.9 ¢/kWh

Data for 2006, released on December 22, 2005, shows similar results for DVP and a slight increase for AEP.

Plant Construction Activity

- **Plants completed since 1998:**
 - 11 Totaling 4,150 MW
- **Plants currently under construction:**
 - None
- **Projects with certificates but not yet under construction:**
 - 5 Totaling 3,185 MW
- **Projects cancelled prior to receiving certificates:**
 - 7 Totaling 5,430 MW
- **Projects withdrawn after receiving certificates:**
 - 1 Totaling 680 MW

DVP'S Retail Access Pilot Programs

- **March 19, 2003 - DVP filed an application requesting approval of 3 retail access pilot programs to begin in 2004.**
- **The three proposed pilot programs are:**
 - **Municipal Aggregation Pilot**
 - **Competitive Bid Supply Service (“CBS”)**
 - **Commercial and Industrial Pilot (“C&I”)**
- **No competitors have submitted bids in the CBS Pilot.**

With Respect to the Other Two Pilots:

- **No CSPs have enrolled any commercial and industrial customers.**
- **Several municipalities have expressed interest in participating in the Municipal Aggregation Pilot but none have applied for a license at this time.**

§ 56-577 C requires the SCC to report on the status of pilots by November of each year through 2006. The Commission considers the September 1 Report as responsive to that requirement.

Proposed Rules Governing Exemptions to Minimum Stay Requirements and Wires Charges

- **June 16, 2004 – The Commission initiated a proceeding to establish rules and certain market-based pricing methodologies to implement two new provisions of the Restructuring Act. These new statutory provisions relate to the minimum stay requirements adopted by the Commission pursuant to § 56-577 E of the Restructuring Act, and wires charges imposed pursuant to § 56-583 of The Act.**
- **January 5, 2006 – The Commission issued an Order in Case PUE-2004-00068 establishing the regulations to implement these two provisions of the Act and deferring determination of the incremental cost and margin components of the market—based price until the market is conducive to such competitive offers.**

Review of Parts I and III

- Dr. Rose provided his analysis in Part I.
- Based on that work as well as the current situation in Virginia as set forth in Part II, the VA SCC identified six features/trends in Part III of this year's Report
- The SCC concluded Part III by stating the implications of these features/trends for consumers when capped rates end.

New Industry Feature/Trend (1)

- The nature of the single price auction as practiced in PJM means that retail prices based on wholesale market results may reflect higher marginal costs (actually, the offer price of the last unit required to meet load) for any period under consideration, as compared to the actual average cost of power charged or potentially charged under regulatory regimes where customers are served from a diverse fleet of generating resources.

Figure 1
PJM 2004 Supply Curve

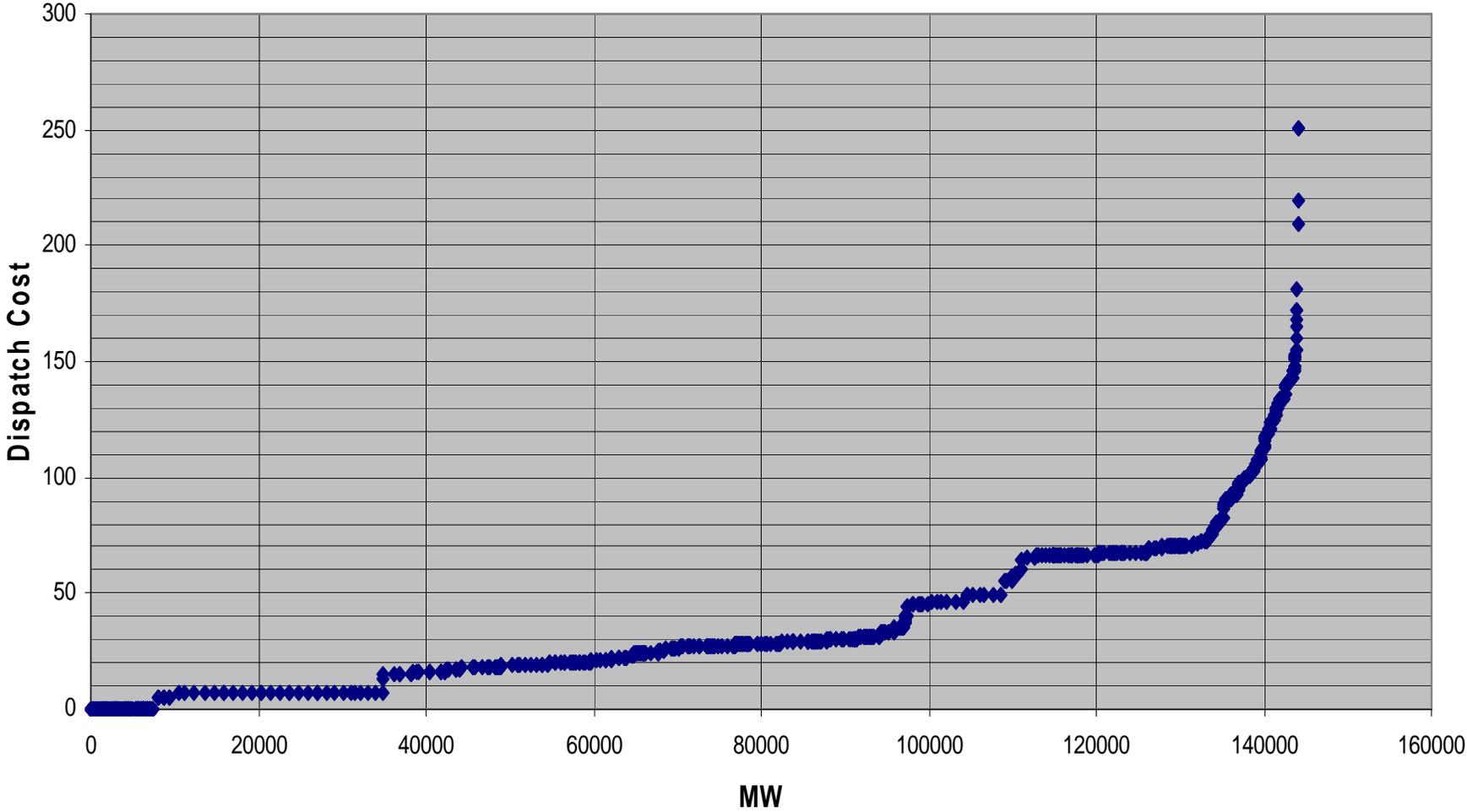
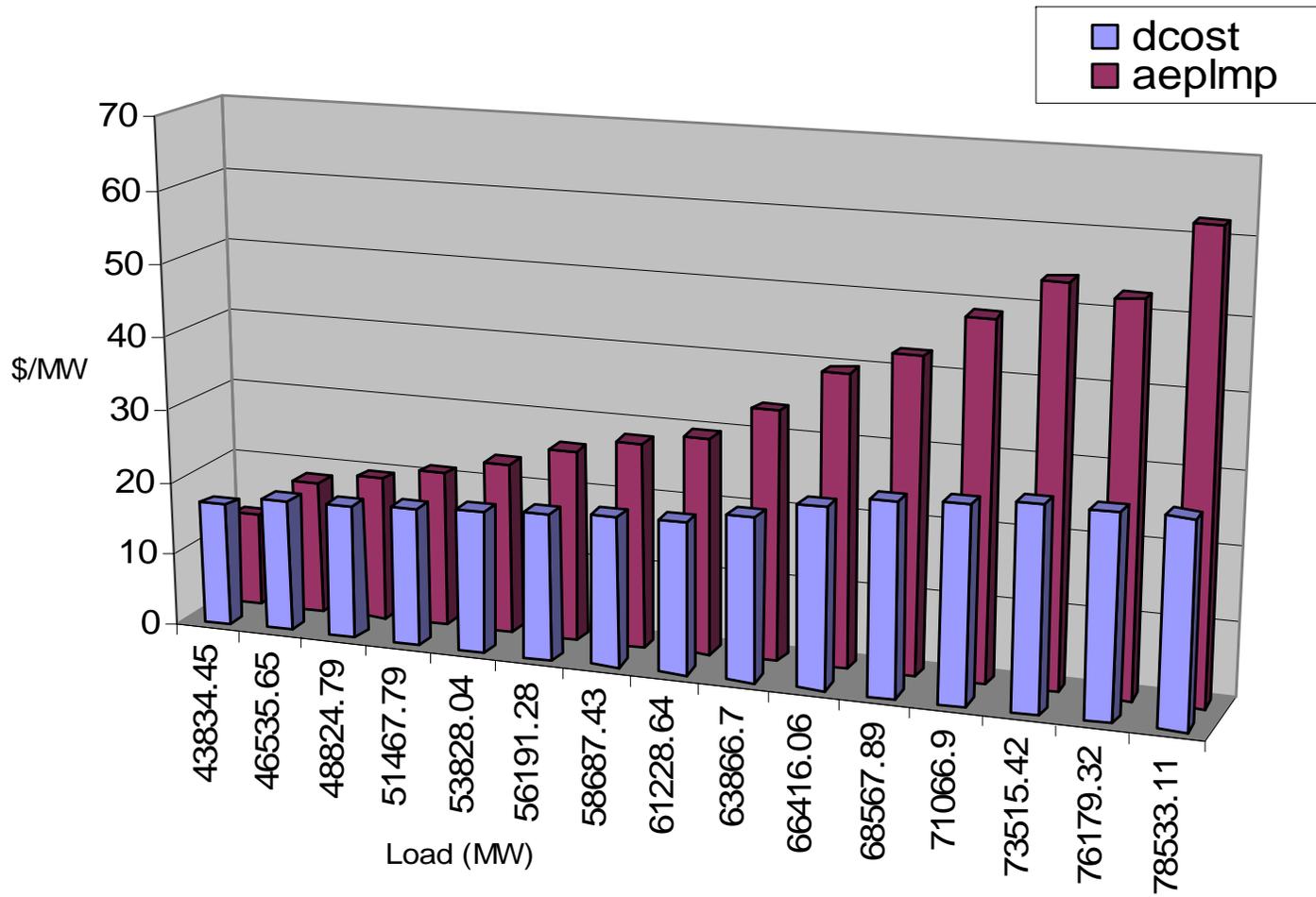


Figure 2

PJM LMP/Dispatch Cost 4Q 2004 Unconstrained Hours



New Industry Feature/Trend (2)

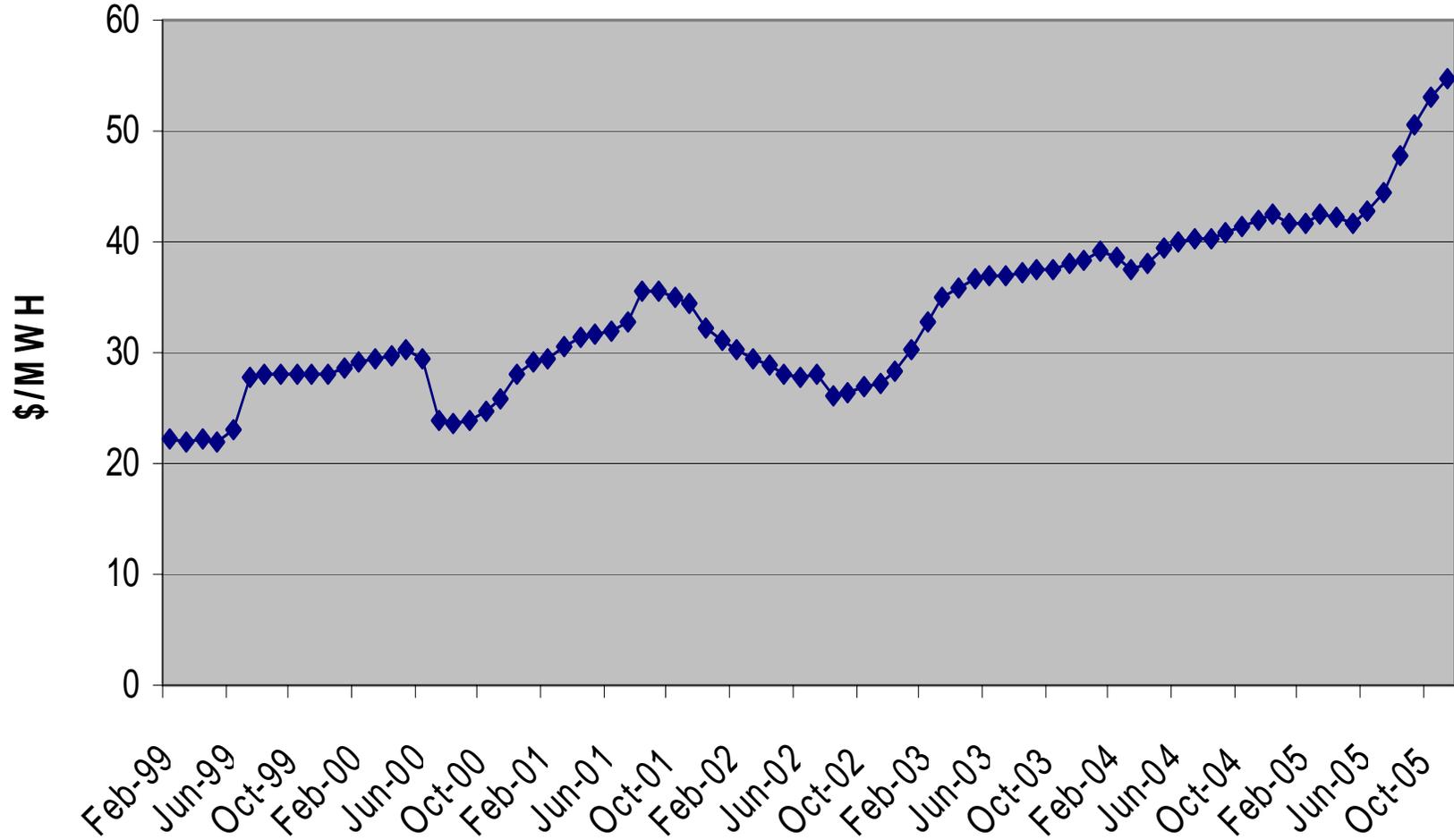
- The wholesale price histories as described in the body of this Report indicate large retail cost increases for Virginians when those wholesale prices become the basis for retail rates or prices.
- Analyst's Note: PJM price history study is complicated by changes in PJM's geographic "footprint" over time.
- Fuel-price adjusted LMPs

New Industry Feature/Trend (2)

PJM Real-Time LMP HISTORY (PJM Classic + APS)

[APRIL – MARCH, \$/MWH]

PJM Real-Time LMP: 12 Month Rolling Average



New Industry Feature/Trend (3)

- Some Virginia electric utilities (Craig Botetourt Electric Cooperative, City of Danville Municipal, City of Bristol Municipal) have already had to deal with large price increases necessitated by exposure to current and expected future wholesale market conditions.
- Staff of the SCC has been monitoring the plight of the Eastalco aluminum smelter near Frederick, Maryland. Here, the viability of a major manufacturer is in jeopardy due to an impending shift to market-based electricity costs.
- Eastalco: \$72 million difference between existing contract and “market.”

New Industry Feature/Trend (4)

- As Dr. Rose points out in Part I, there is an increasing tendency towards oligopoly in the electric power generation sector.
- PUHCA repeal will allow further industry consolidation.
- Basic economic theory indicates that, other things equal, increasing industry concentration will diminish competition and raise prices.
- The proposed merger of Exelon and Public Service Electric and Gas would greatly increase market concentration in PJM.
- Mitigation??

New Industry Feature/Trend (5)

- The Federal Energy Regulatory Commission may soon allow more net cash flow to the generation sector, with such cash flow to be obtained from consumers via new capacity pricing constructs or relaxed market mitigation rules.
- The FERC appears to believe that raising the sector's financial returns will lead to a more robust, competitive generation sector that will benefit consumers in the longer run.

New Industry Feature/Trend (5)

- PJM filed its RPM (Reliability Pricing Model) on August 31, 2005
- In its transmittal letter, PJM asked the FERC to find that:
“PJM’s current capacity pricing model and market rules fail to assure that reliability will be maintained at the lowest reasonable cost, and as such, are unjust and unreasonable”
- New capacity construct (RPM) is expected to cost customers more than current construct

New Industry Feature/Trend (5)

- Current proceedings underway or recently completed that will:
 - (1) reduce PJM market monitor's ability to mitigate market power, and
 - (2) set cost of service based cost recovery for units that might otherwise retire but are needed for reliability
- Conn. AG (and other customer parties) recently complained to FERC that FERC's approach to competitive electricity markets in Connecticut violates the Federal Power Act.

They stated:

"The aggregate effect of the Commission's current regulatory policies in Connecticut...has moved the Commission to the point where it is now violating the Federal Power Act [FPA] by ensuring that electric consumers in Connecticut are paying the higher of either cost of service or market-based rates for electricity -- a pricing system that guarantees rates that are unjust and unreasonable."

New Industry Feature/Trend (6)

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

New Industry Feature/Trend (6)

- Besides FERC and PJM themselves, who will monitor wholesale electric power markets?
- What incentives and motivations will act on those monitors?
- What data will be collected?
- What analysis will be conducted?
- What standards will be employed?

New Industry Feature/Trend (6)

- **There Are Substantial Barriers to Effective State Level Market Monitoring**
 1. Data Access
 2. Institutional Barriers
 3. Jurisdiction
 4. Remedies
- **Sept. 2005 formation of the Organization of PJM States, Inc. (OPSI) to address these barriers.**
- **OPSI effectiveness is an open question at this time**

IMPLICATIONS

- After the end of capped rates in 2010, should Virginia's homes and businesses face electricity prices based on, set by or primarily influenced by wholesale electric prices in PJM, prices for electric service could rise precipitously in the Commonwealth.
- While post-2010 market conditions cannot be known with certainty, post rate cap prices could be significantly higher than today's capped rate levels.
- At the same time, such higher electricity prices will likely yield extraordinarily high returns to certain base load coal and nuclear fired generating resources that currently serve Apco and DVP customers.
- To the extent that base load generating units remain inside the incumbent utility, such generating units will remain subject to Virginia state jurisdiction.
- As such, it would be possible for Virginia policymakers to mitigate, in a non-confiscatory manner, potentially high retail rate levels.
- The Report is posted on the Commission website <http://www.scc.virginia.gov/caseinfo/reports.htm> or <http://www.scc.virginia.gov/division/restruct/history.htm>