

**POST-CAPPED RATE PERIOD SUBCOMMITTEE OF THE
COMMISSION ON ELECTRIC UTILITY RESTRUCTURING**

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September 28, 2006

A. Authorization for Subcommittee - Senate Bill 711

Senate Bill 711 (2006):

1. Directed the Restructuring Commission to:

"Evaluate and assess the implications of the scheduled expiration of the capped rates established pursuant to § 56-582."

2. Authorized the Restructuring Commission to:

"Establish one or more subcommittees, composed of its membership, persons with expertise in the matters under consideration by the Commission, or both . . . for any purpose within the scope of the duties prescribed to the Commission by this section."

B. Resolution for Study of Generation Service After Rate Caps Expire

- Adopted by Restructuring Commission on February 6, 2006.
- Concludes that the Restructuring Commission should conduct a two-year study of the provision of electric generation service in the Commonwealth following the termination of the rate cap period on December 31, 2010.
- The Restructuring Commission (or a subcommittee thereof) may examine, "among such other issues as it deems relevant:"
 - (i) How the State Corporation Commission should implement and monitor default service, and
 - (ii) Measures to mitigate price volatility that may be present at times in wholesale markets.

C. History of Capped Rates/ Default Service

1999 -- Senate Bill 1269: Virginia Electric Utility Restructuring Act

- Capped rates until July 1, 2007.
- During the capped-rate period, the SCC may adjust these rates to reflect changes in fuel costs, taxes, or utilities' financial distress beyond their control.
- Default service is for customers who are unable or unwilling to switch to alternative generation suppliers, or who switch to competing suppliers that fail to perform.
- Default service rates for an incumbent that is designated to be a default service provider would be rates which are fairly compensatory to the utility and which reflect any cost of energy prudently procured, including energy procured from the competitive market.
- SCC was authorized to impose conditions on its approval of an incumbent utility's functional separation plan, providing that its generation assets or their equivalent are made available for electric service during the capped rate period and periods it is a default service provider.

2001 -- Senate Bill 1420

- New mechanism for establishing the rates for default service after the capped rate period.
- SCC shall have no authority to regulate, on a cost-of-service basis or other basis, the price at which generation assets or their equivalent are made available for default service purposes.

2004 -- Senate Bill 651

- Extended the rate cap period from July 1, 2007, to December 31, 2010.
- Changed the method for adjusting capped rates, depending on the utility.
- Changed the method for determining default service rates for a distributor/default service provider that constructs a coal plant in Southwest Virginia.

2006 -- Senate Bill 262 -- Amendments proposed by Governor Kaine

- Required Dominion to apply for annual fuel factor adjustments to its electricity rates commencing July 1, 2007.
- Allowed SCC to require that 40% of any increase in fuel tariffs approved for the 12-month period beginning July 1, 2007, be deferred and recovered during the period from July 1, 2008, through December 31, 2010.

D. Current Statutory Framework for "Provision of Electric Generation Service Following Termination of the Rate Cap Period"

1. Capped Rate Period: Expires December 31, 2010

2. Rates Adjustments During Capped Rate Period

- In addition to adjustment for changes in taxes and for economic distress, varies by utility:

Dominion -- No fuel factor cases in 2005 or 2006. Annual adjustments to fuel factor commencing July 1, 2007 (with no true-up for any over-recovery or under-recovery of fuel costs incurred prior to July 1, 2007), with potential recovery of up to 40% of the 2007 increase to be deferred over 2008-2010.

AEP -- Possible increases from annual fuel factor adjustments, annual single-issue rate cases for reliability and environmental costs, full rate case before 2007, and full rate case after 2007.

Cooperatives

- If a member of ODEC, under § 56-582 B (v), recovery of fuel costs is through the wholesale power cost adjustment clause of their tariff.
 - Fuel portion of the WPCA flows through monthly.
- If not member of ODEC, under § 56-582 B (iv), adjustments allowed for all costs of purchased wholesale power.
 - Senate Bill 942 (2000): Allowed capped rates to be adjusted to reflect discounts to match the cost of providing distribution services.
- Two full rate cases permitted (before and after July 1, 2007).
- Single-issue annual rate cases for increased environmental and reliability costs.

Allegheny

1. Fuel Factor: Under the MOA, Allegheny agreed to fix its fuel factor at the 2000 level and thereafter to terminate the fuel factor.

2004 amendments to § 56-582 B state that any adjustments to the fuel factor by an incumbent electric utility that transferred all of its generation assets to an affiliate "shall be effective only on and after July 1, 2007."

- Does the amendment to the Act allow Allegheny to file a fuel factor case after 2007 for its purchased power -- even though the utility agreed to permanently terminate the fuel factor mechanism in its 2000 MOA?

MOA (paragraph 4): "During the rate cap period, pricing of the 367 MW [the amount of Virginia base load transferred to its affiliate] will be based on the Virginia unbundled frozen generation rate."

- If Allegheny can file for an increase in its fuel factor after 2007, can Allegheny pass on to its customers the market price for all of the power it purchase, or only costs to purchase power in excess of the 367 MW transferred to its affiliate?

2. Full Rate Cases During Capped Rate Period: 2004 amendments allowing incumbents other than Dominion to seek rate adjustments before and after 2007 states, "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."

- The order approving divestiture does not authorize the utility to file for changes in its rates - Does this provision apply to Allegheny?
- The MOA references pricing the 367 MW during the rate cap period. Would Allegheny be authorized to file a general rate case to determine the price for any purchases of power in the market in excess of the 367 MW?

3. Single-issue rate cases for environmental and reliability costs.

Delmarva

1. Fuel Factor

- MOA: Fuel Index Procedure will be utilized in establishing fuel rates on and after January 1, 2004, and shall remain operative until such time as Delmarva is no longer designated as a provider of default service.
- SCC order of June 19, 2006: Fuel Index Procedure governed the setting of the fuel factor. Delmarva's fuel factor set at 5.6185 cents/kWh (increase of 2.5486 cents over the current fuel factor of 3.0699 cents).
 - § 56-582 B: Any adjustments to the fuel factor of a utility bound by an order approving transfer of all generation assets to an affiliate shall be effective only on and after July 1, 2007. Does this apply to Delmarva?

2. Full Rate Cases During Capped Rate Period

- Subsection C of § 56-582 was amended to give incumbent utilities other than Dominion the ability to seek one full rate case, to adjust capped rates, prior to 2007, and a second rate case after July 1, 2007.
 - Does this have any effect on the MOA, which says that Delmarva's fixed embedded production rates shall not change until capped rates are terminated by the Commission or by operation of law?

3. Single-issue rate cases for environmental and reliability costs

3. Rate-Setting Methodology After Expiration of Capped Rates

§ 56-585 - Default service is for 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 are to be determined by the SCC.

a. Designation of Default Service Providers

- SCC may periodically conduct competitive bidding processes and designate providers
- SCC may require a distributor to provide components of such services
- Cooperatives shall be default service providers in its certificated service territory

b. Rates for Default Service

- During capped rate period, rates for default service = capped rates.
- After capped rate period, default service rates are to be based upon competitive market prices.
- Plans to procure generation for default service shall be approved if the procurement of capacity and energy under such plan is adequately based upon prices of capacity and energy in competitive regional electricity markets.
- If there is no approved plan, rates shall be based upon prices for generation capacity and energy in competitive regional electricity markets.
- Factors in determining if a regional electricity market is one where competition effectively regulates the price of electricity:
 - the liquidity and price transparency of such markets,
 - whether competition is an effective regulator of prices in such markets,
 - the wholesale or retail nature of such markets, as appropriate,
 - the reasonable accessibility of such markets to the regional transmission entity to which the distributor belongs, and
 - such other factors it finds relevant.
- If no regional electricity markets where competition is an effective regulator of rates, then SCC default service rates to approximate those likely to be produced in a competitive regional electricity market.
 - Proxy generation rates shall take into account the same factors used in determining whether a regional electricity market is competitive.
- Exception: § 56-585 G - distributor that constructs a coal powered generation facility in Southwest Virginia, which can recover costs of the facility plus a fair rate of return.
- A distribution electric cooperative's rates for such default services shall be based upon the distribution electric cooperative's prudently incurred cost after the capped rate period.

c. Other Considerations

- § 56-595 D: Commission shall take into consideration the need of default service customers for rate stability and for protection from unreasonable rate fluctuations.

d. Effect of Divestiture of Generation Assets

- § 56-590 as amended in 2001 states that the SCC cannot regulate, on a cost-of-service basis or other basis, the price at which generation assets or their equivalent are made available for default service purposes.

Allegheny

MOA: Company will contract for generation sufficient to meet its default service obligations "at rates set in accordance with the current Act or as the Act may be changed or modified until the Company's obligation to provide default service terminates."

- When the MOA was executed, the Act provided rates for default service were to be set at rates which are fairly compensatory to the utility and which reflect any cost of energy prudently procured.
 - Does the provision in the MOA (rates set in accordance with the current Act "or as the Act may be changed or modified") mean Allegheny's default service rates will be based on market rates?

MOA: After capped rates, pricing of 367 MW will be based on then current generation costs of the portion of the existing system dedicated to serve retail Virginia load.

- Is the MOA's requirement for cost-of-service rates superseded by the Act's amendments that say SCC can't base default service rates based on cost of service and that market rates are to be used?
- If the MOA's requirement for cost-of-service rates survives the subsequent amendments to the Act, does the requirement apply only to 367 MW of the load? How will any excess load be priced - based on market?

Delmarva

- MOA Fuel Index Procedure "shall remain operative until such time as Delmarva is no longer designated as a provider of default service."
- MOA's Rate Case Protocol that applies to Default Service Rates after the end of capped rates.
 - Do changes to the provisions of the Act regarding the pricing of default service apply to Delmarva, which contractually bound itself to having default service rates set based on cost of service pursuant to the Rate Case Protocol?
- MOA provides (p. 8) that default service rates will be determined in accordance with the provisions of the Rate Case Protocol if Delmarva's capped rates "terminate by operation of law on July 1, 2007."
 - What is the effect of the 2004 extension of capped rates beyond July 1, 2007?