

Legislative Transition Task Force of the Virginia Electric Utility Restructuring Act  
November 19, 2002, Richmond

The Legislative Transition Task Force was established in 1999 to work collaboratively with the State Corporation Commission in conjunction with the phase-in of retail competition within the Commonwealth. A report presented to the Task Force indicates that the Act's cap on electricity rates is generating substantial savings for residential customers of Dominion Virginia Power.

Effect of Rate Cap on Dominion Customers

Christine Chmura of Chmura Economics and Analytics (CEA) presented the Task Force with the results of a study of capped rate savings commissioned by Dominion Virginia Power (DVP). In August 1998, a rate case settlement froze DVP's retail rates through March 2002. With the enactment of the Virginia Electric Utility Restructuring Act in 1999, the cap on retail rates was extended from 2002 until July 2007. CEA's report concludes that the Act's cap on base rates, when compared to the base rates that would likely have been in effect had the caps not been imposed, has produced total savings for DVP's residential customers of between \$780 million and \$871 million over the period 1998 through 2007.

The estimated savings consist of three elements:

- \$285.6 million for period 1998-2001 from SCC-imposed rate case cap settlement,
- \$302.7 million to \$393.7 million, depending on the revenue forecast used, predicted for the 2002-2007 capped rate period under the Restructuring Act, and
- \$192 million from DVP's inability to obtain rate relief to cover extraordinary expenses, primarily environmental project expenditures, during 2002-2007.

Assuming the average residential consumer uses 1,000 kWh per month, average savings per residential customer ranged from \$429 to \$480 from 1998 through 2007, which equates to an average annual savings of \$45 to \$50 over the entire period. The report also states that, through the multiplier effect, savings from the rate caps will generate between \$132 million and \$148 million in additional economic activity in Virginia.

The study assumes that base residential rates would have risen between 7.9 and 9.2 percent between 2001 and 2007 had the rate cap not been imposed. This assumption is based on a model developed by CEA that attempts to take into account the factors that the SCC confronts when approving rate changes.

Consumer Advisory Board Recommendations

Chairman Bill Lukhard presented the Consumer Advisory Board's recommendations. The Board endorsed the following actions:

- Amend the Restructuring Act to allow shopping customers who return to the incumbent utility the option to select market-based pricing, in order to avoid minimum stay requirements.
- Direct the SCC to convene an Energy Management Work Group.
- Work with the Department of Mines, Minerals and Energy (DMME) to define a program of consumer education in energy management and energy efficiency that is designed to reduce the cost of electricity to Virginia consumers and reduce the risk of power shortages and extreme price swings at times of peak demand.
- Oppose any proposals to allow incumbent electric utilities to legally separate their generation business from their transmission and distribution business.
- Request DMME to prepare a report on building codes relating to energy management and energy efficiency, and addressing the authority to establish unique requirements for state-owned facilities.
- Amend the Restructuring Act and the natural gas deregulation statutes to have the SCC develop models, with both opt-in and opt-out provisions, for use in pilot programs for municipal aggregation, by January 1, 2004.
- Assessing each residential account in the Commonwealth with a charge of 3 cents per month, to generate revenue for the Home Energy Assistance Fund.
- Amend the Restructuring Act to extend the term of the Task Force to at least July 1, 2008.

Members of the Task Force who have an interest in pursuing any of these proposals were asked to contact the Chair of the Consumer Advisory Board.

#### Status of RTO Membership

American Electric Power (AEP) and Dominion Virginia Power (DVP) briefed the Task Force on the status of their attempts to join the PJM regional transmission organization (RTO). The Restructuring Act required incumbent electric utilities to transfer ownership or control of transmission assets to a SCC-approved RTO by January 1, 2001. Both utilities have applied for membership in the PJM Interconnection, which is now responsible for the operation and control of the bulk electric power system throughout major portions of five Mid-Atlantic states and the District of Columbia.

DVP has applied to join PJM under a plan whereby its service territory would be designated as PJM South. DVP would cede operational control of its transmission lines to PJM, but would continue to own these assets. DVP's Director of Electric Market Policy told the Task Force that PJM offers several advantages, including the approval by the Federal Energy Regulatory Commission (FERC) of its RTO structure and the fact that all major electric utilities serving Virginia will be members of the same RTO. DVP's schedule provides that its plan for joining PJM will be filed with FERC and state regulators in December 2002; a transmission tariff that eliminates rate pancaking will be in place by February 2003; federal and state regulators will issue their approvals by June 2003; and the integration of DVP into PJM's system will be completed by October 2003.

Because AEP's decision to join PJM as a part of the PJM West zone preceded DVP's election to join PJM, AEP is scheduled to finalize its RTO membership sooner. AEP expects to make its

state filings in December, to turn over transmission service and reliability functions to PJM by February 2003, and to be integrated into PJM energy markets by May 2003.

Several members expressed concerns regarding the possible reduction in SCC oversight that may ensue if these incumbent utilities join PJM. The PJM structure, which complies with the standard market design model being considered by FERC, cedes control over the dispatch of generation to the RTO. In addition, some long-term resource adequacy planning will be overseen by the RTO. One member commented that the Restructuring Act contemplated RTO oversight of transmission, but not generation, services.

Greg White of Old Dominion Electric Cooperative raised concerns with PJM's locational marginal pricing rules. These rules provide that when generation is dispatched in transmission-constrained areas, the price for all of the power will be the cost of the last-dispatched, highest-priced power. Under the current system, as more expensive power is dispatched, its cost is blended with that of all of the power. Fixed transmission rights can in theory be purchased as a hedge against the congestion costs associated with the locational marginal pricing rules. However, in practice they have not been adequate. While the rules may theoretically provide an incentive for the construction of new low-cost generation and transmission assets to reduce congestion, the long periods needed for approval and construction of power lines and other facilities have forced customers to pay higher costs.

#### Recent Restructuring Activities

SCC spokespersons brought the Task Force up to date on recent Commission activities in implementing the provisions of the Restructuring Act. Working groups have been convened to address issues relating to competitive metering and billing and aggregation. The Commission is preparing comments to the FERC's controversial proposed rules on standard market design, which are due by January 10, 2003. The Commission is expected to issue an order in the near future regarding the components of default service. Under amendments to the Restructuring Act adopted in 2001, parties other than the incumbent electric utility may be designated as default service providers.

The Commission has approved several applications to construct new generation facilities. In addition, the Commission and the Department of Environmental Quality have entered into a memorandum of agreement regarding the agencies' respective duties in reviewing the environmental impacts of power plant applications. A final agreement between the agencies, executed in August, implements the General Assembly's intent in enacting Senate Bill 554 during the 2002 Session.

#### Stranded Cost Recovery

The Restructuring Act provides that after the commencement of customer choice, members of the Task Force shall monitor, with the assistance of the SCC, the Office of the Attorney General, incumbent electric utilities, suppliers, and retail customers, 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. Just and reasonable net stranded costs are recoverable

by incumbent electric utilities through either capped rates or wires charges. Customers choosing to purchase generation from a nonincumbent must pay a nonbypassable wires charge as a surrogate for the stranded cost recovery that an incumbent would recover from nonshopping customers.

Under the regulatory compact theory, any departure from a regulated, cost-of-service environment must allow a utility to recover prudent costs that were incurred while it was regulated and that are rendered uneconomic because of restructuring. When generation is deregulated, the market price for generation could drop below the rate a given utility is receiving in the current, regulated market. Consequently, the utility's generation assets could lose some of their pre-restructuring book value. Primary sources of potential stranded costs include generation asset devaluation and potential losses associated with above-market purchased power contracts.

The Restructuring Act neither defines stranded costs nor provides any formula or statutory framework for their calculation. In order to monitor the progress incumbent utilities are making toward their recovery of stranded costs, the SCC has observed that the amount of stranded costs will need to be determined, and some part of the wires charges and capped rates will need to be allocated to their recovery. Since there was no determination of reasonable net stranded costs going into the transition (nor any statutory structure for their calculation, thereafter), this may be a challenging task. The Task Force will be considering alternative versions of a resolution requesting the SCC to convene a working group to develop a definition of "stranded costs" and to develop recommendations relating to the determination of whether the Restructuring Act's stranded cost recovery mechanisms are likely to result in the overrecovery or underrecovery of just and reasonable net stranded costs.

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