

Commission on Electric Utility Restructuring
November 23, 2004, Richmond

The Commission on Electric Utility Restructuring met on November 23 to receive reports required to be prepared by the Office of the Attorney General and State Corporation Commission (SCC). The Commission also received updates on the status of the applications of Virginia's two largest investor-owned electric utilities to join the PJM Interconnection regional transmission organization.

Status of Restructuring

Section 56-596 of the Virginia Code requires the SCC, by September 1 of each year, to report to the Commission and the Governor on the status of competition in the Commonwealth, the status of the development of regional competitive markets, and its recommendations to facilitate effective competition as soon as practical.

Dr. Ken Rose of the Institute of Public Utilities at Michigan State University provided a performance review of electric power markets that gave an overview of electric utility restructuring activity across the nation and summarized regional wholesale prices and retail activity in nine states. Sixteen states and the District of Columbia allow retail access. Of the states that had enacted restructuring legislation in the 1990s, two (Oklahoma and West Virginia) have delayed access; two (Oregon and Nevada) have limited access to large customers; two (Arkansas and New Mexico) have repealed retail access laws; California has suspended retail choice; and Montana has extended its residential transition period.

In jurisdictions where retail choice is permitted, relatively few customers are switching to an alternative supplier. Over two-thirds (43 of 63) of the distribution companies in these jurisdictions had less than one percent of their customers choosing an alternative supplier. Seven companies had over 20 percent of customers that have switched providers; of these, three are in Ohio, where nearly 95 percent of the residential switching results from the state's municipal opt-out aggregation program. The other four areas where switching rates exceeded 20 percent (Duquesne Light's Pennsylvania territory, Orange & Rockland's New York territory, and CPL's and WTU's territories in Texas) were relatively higher priced areas. No low-cost areas had significant residential customer migration.

In the 19 states and the District of Columbia where data is available, the percentage of total load that has migrated to competing suppliers is significantly greater than the percentage of residential load that has switched. Seven jurisdictions (Texas, Maine, D.C., Montana, Illinois, Massachusetts, and New York) have over 20 percent of the total state load served by competitive suppliers, which indicates that large customers are better able to find suppliers. The large percentage of load switching in Texas (45 percent) was attributed to its law's feature that put larger customers in the competitive market with no price guarantee, making them subject to market based rates.

As with residential customer switching levels, there is a high correlation between higher priced areas and switching levels. Five of the seven jurisdictions where total load switching exceeded 20 percent were in higher priced areas. The correlation between power prices and natural gas prices is remarkable. While power price spikes in the past were associated with increased air conditioning usage in summer months, recently, power prices are peaking in winter in tandem with natural gas price spikes driven by increased demand during cold spells. In addition to higher natural gas prices, factors providing price pressures on electric power in the short- to intermediate-term include the failure of the merchant power business to recover, increasing demand from a recovering economy, higher capital costs for competitive services, investments in generation and transmission systems, pressure on lower-cost supply prices in regions where higher-priced loads become available, and market power exercised during peak hours and seasons. In response to Senator Watkin's concern that the report focused on trends over the next five years, next year's report will address long term trends.

Howard Spinner, Director of the SCC's Division of Economics and Finance, presented the portion of the 2004 edition of the report that addresses the status of retail access and competition for electric generation services in Virginia. Since January 1, 2004, all 3.1 million customers of investor-owned utilities and electric cooperatives, excluding the customers of Kentucky Utilities (which is exempted by statute from provisions of the Restructuring Act) and Powell Valley Electric Cooperative (which is exempt from state jurisdiction) have had the legal right to switch to a competitive service provider (CSP). Five such providers are fully registered to compete in the service territory of Dominion Virginia Power (DVP). However, as has been the case in prior years, the ability to switch to a CSP is limited in practice by the absence of competitors doing business. As of November 16, 2004, about 1,780 residential customers and 20 commercial customers in Virginia were being served by one CSP (Pepco Energy Services) that sells "green power" in Northern Virginia at a price higher than DVP's price-to-compare.

The lack of competitive activity was attributed to the price-to-compare for Virginia's largest utilities. In 2004, DVP's residential price-to-compare was 4.3 cents/kWh, and Appalachian Power's residential price-to-compare was 3.2 cents/kWh. A CSP needs to offer to sell power at a lower price than the incumbent utility's price-to-compare in order to attract customers, which is difficult when the average wholesale price of power is rising as natural gas prices increase.

Mr. Spinner reported that two power plants have been completed within the past year. Since 1998, 11 generation facilities have been completed in Virginia. Another five projects have been issued certificates, but are not yet under construction. The Commission was also briefed on the status of three pilot programs sponsored by DVP, which to date have not attracted participants, and the proposed rules governing exemptions to minimum stay requirements and wires charges.

The third part of the SCC's annual report is directed to identify recommendations to facilitate competition. Mr. Spinner noted that stakeholders continue to identify the lack of participation in a regional transmission organization, low capped "default" rates, and

wires charges and stranded cost issues as barriers to competition. This year's report did not identify any legislative changes or other actions to facilitate competition.

Ken Schrad, Director of the SCC's Division of Information Resources, reported on the status of the Virginia Energy Choice consumer education program. Since March 2003, the program has limited outreach activities to maintaining a website and toll-free telephone number responding to requests for printed materials. With the likelihood of minimal retail energy market activity in the next year, the outreach components of the consumer education program will remain suspended. Mr. Schrad denied that there was any pent-up public demand for information, but observed that the public may be frustrated with having the opportunity to choose but no real competition.

Stranded costs report

Deputy Attorney General Judith Jagdmann provided an overview of the issue of determining Virginia utilities' stranded costs. In 2003, the Commission requested the Division of Consumer Counsel of the Office of the Attorney General, by September 1, 2004, and annually thereafter, to report (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. The first such report covers the period beginning July 1, 1999, to December 31, 2003. In determining generation cost of service, the Division is 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 it deems relevant. In determining market prices for generation, the Division is to take into account market prices as determined by the SCC and such other factors as the Division may deem relevant.

The 2004 stranded cost report compared average annual stranded cost recoveries for 2001-2003 to potential stranded cost exposure for 2003. Scott Norwood, the consultant who prepared the report, observed that higher market prices equate to lower potential stranded costs, and that estimates of potential stranded costs are inherently uncertain, due to volatility in generation market prices and other factors.

Under the "base case" scenario (assuming a market price of 4.53 cents/kWh with a 10 percent return on equity for investor-owned utilities and 2.0 times interest earned ratio for cooperatives), the potential stranded cost exposure for 2003 (\$157.4 million) is estimated to be about half the average annual stranded cost recovery over 2001-2003 (\$350.4 million). The potential stranded cost exposure for the post-transition period, without capped rates and wires charges, remains significant if market prices fall below 4 cents/kWh.

Mr. Norwood observed that if market prices stay high, as they have for the past 18 months, significant additional mitigation of stranded costs should be achieved through the extension of capped rates beyond 2007, and there would be the potential for over-recovery of stranded costs.

Status of RTO Applications

Both Appalachian Power and DVP applied for SCC approval to transfer control of their transmission assets to the PJM Interconnection, LLC (PJM). The Restructuring Act requires Virginia electric utilities to transfer ownership or control of such assets to a regional transmission organization (RTO) by January 1, 2005, subject to approval of the SCC. On August 30, 2004, the SCC issued an order approving Appalachian's application, and on November 10 issued such an order approving DVP's application. The SCC determined that PJM represents one of the best available regional transmission entity models and is the only feasible option to satisfy the requirements of the Act. The approvals were granted with two conditions. First, except for emergency situations, customers are assured that electricity will not be curtailed in the utility's Virginia service territory because of inadequate electricity planning elsewhere on the PJM system. Second, the utilities and PJM are required to provide annual reports to assist the SCC with monitoring electricity transactions, transmission reliability, and congestion pricing in the PJM market and their respective impacts on customers. In addition, Appalachian Power is prohibited from attempting to recover administrative, congestion, or increased costs for ancillary services associated with the transfer except through a base rate case that requires SCC approval. Its customers will receive a share of the projected benefits from integration into PJM through a credit on their electric bills, which for a typical residential customer is expected to be to about \$2.40 a year.

Craig Baker of Appalachian Power addressed several issues of interest to the Commission, including the administrative charges of PJM and a regional transmission rate design under consideration at the Federal Energy Regulatory Commission. Paul Koonce of DVP asserted that its cost/ benefit analysis shows a \$250-\$450 million benefit for customers, in addition to benefits in reliability and security. DVP is seeking approval of the transfer by North Carolina's regulators.

Other Matters

At the Commission's September 8 meeting, Augie Wallmeyer agreed to act as a facilitator to assist in bringing forth legislative initiatives relating to renewable energy. He reported that the participants agreed that a cost-benefit analysis, conducted by a reputable entity with no stake in the outcome, was appropriate. He stated that there was disagreement as to how to measure health benefits, and noted that stakeholders would continue to develop a recommendation.

Future Activities

At the close of the meeting, the Restructuring Commission announced that the next meeting would be held December 20, 2004. Issues to be addressed include proposed legislation, adequacy of resources of the SCC and the Attorney General's Office to participate in proceedings at PJM, and the position of Virginia's electric cooperatives with respect to retail competition.