

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**

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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 design and monitoring.
- VA SCC cannot assure Virginians that the PJM market is competitive and that monopoly pricing power is effectively mitigated, because there is no independent monitoring of the PJM market and the VA SCC has historically had great difficulty obtaining data necessary to make our own determination.

Introduction

- Each September 1st the Virginia State Corporation Commission submits, pursuant to 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.
- The Report contained three parts; (1) a status report on the development of wholesale and retail electric markets around the country, [Dr. Rose will report to you next] (2) the 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.
- Utility Specific Review
- The Report's Part III provides a section labeled "SCC Assessment" in which the SCC updated "some ominous new industry features and trends" that were mentioned last year.
- I would like to add one new trend.

PART II

STATUS OF RETAIL ACCESS AND COMPETITION IN THE COMMONWEALTH

Transition to Full Retail Access

- **Virginia Electric 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 found 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, Inc.**
 - **WPS Energy Services**

- **The following six aggregators are currently fully registered with DVP:**
 - **American PowerNet Management, LP**
 - **Independent Energy Consultants, Inc.**
 - **WPS Energy Services**
 - **City of Fairfax, VA**
 - **Intel-Audits, Inc.**
 - **New Era Energy, Inc.**

Marketing

- **Limited retail marketing activity has taken place within the service territories of DVP and Delmarva.**
- **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 11, 2006, about 1,324 residential and 17 commercial customers of DVP are enrolled with PES**
- **Another supplier, WGES, acquired 4 large customers from Delmarva within the past few months.**

Wires Charge

- **DVP waived wires charges for 2005, 2006, and, it appears, will do so in 2007. APCO waived such charges all three years.**
- **All but three of the electric cooperatives had a wires charge in 2005, and all waived such charge for 2006 and 2007.**
- **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.**

2006 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	3.7 ¢/kWh	3.2 ¢/kWh

Data for 2007, to be released in December 2006, is expected to show similar results for DVP and 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 (Tenaska-Buckingham seeking reissuance)
- **Projects cancelled prior to receiving certificates:**
 - 7 Totaling 5,430 MW
- **Projects withdrawn after receiving certificates:**
 - 1 Totaling 680 MW
- **Project applications pending certificates:**
 - 1 Totaling 39 MW (Highland New Wind Development)

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”)**
- **To date, 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 only one has been licensed, City of Fairfax, VA.**

§ 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 provisions of the Restructuring Act. These 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.**
- **To date, the market has not been conducive to utilize either provision.**

Utility Specific Review

- **Dominion Virginia Power**
 - **Fuel Factor Filing expected in Spring '07**
 - **North Anna**
 - **500 KV line in Northern Virginia**
- **AEP Virginia**
 - **Surcharge effective 12/1/06 for E&R costs**
 - **Pending Rate case (\$198.5 M), interim rates in effect**
 - **Pending Fuel Factor (\$38.7 M), 1/1/07 if appr.**

Utility Specific Review

- **Delmarva Power**
 - **22,000 customers on Eastern Shore**
 - **Requested approx 50% increase**
 - **Granted approx 25% increase**
 - **Controversy regarding application of year 2000 MOA**
 - **Is it all just fuel prices or is the structure of the restructured marketplace responsible for the many rate increases seen around the country?**

Utility Specific Review

- **Potomac Edison (APS)**
 - The VA SCC adopted a “similar” MOA
 - The MOA entitled customers to certain financial benefits associated with APS generating units
 - Subsequent legislation has made that entitlement subject to dispute
- **Old Dominion Power Company (KU)**
 - Parent has withdrawn from RTO MISO
- **Virginia’s Electric Cooperatives / Munis**
 - Some signing contracts for cost based rates and/or longer terms

Federal Review

- **Allocation of bulk transmission costs among PJM Zones**
- **National Interest Electric Corridors - EPACT 2005**

Review of Part III

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

(1) Single Price Auction

- 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.
- Regardless of whether fuel prices or PJM's single price auction are driving rates higher, the ability to mitigate financially adverse impacts on consumers crucially depends on the corporate structural relationship between generation and consumers.

(2) Historical Wholesale Prices

- 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 is complicated by changes in PJM's geographic "footprint" over time.
- Fuel-price adjusted LMPs – PJM changing this calculation
- Recent results of the termination of capped rates within other restructured states reinforce the SCC's concern of potentially significant rate increases in 2011.

(2) Historical Wholesale Prices

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

[APRIL – MARCH, \$/MWH]

(3) Actual Impacts on Customers

- 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.
- The plight of the Eastalco aluminum smelter near Frederick, Maryland. Resulted in plant shutdown.
- Staff of the SCC have been monitoring resulting retail default prices in areas such as Maryland, Texas, and Illinois, as these states end or approach the end of their transition periods and capped rates.

(4) Industry Consolidation

- 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. Duke/Cinergy completed.
- Basic economic theory indicates that, other things equal, increasing industry concentration will diminish competition and raise prices.
- Two recently proposed mergers not completed:
 - Exelon/Public Service Electric and Gas (NJ)
 - Constellation (MD)/Florida Power & Light

(5) FERC Actions

- **The Federal Energy Regulatory Commission has allowed 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.**

(5) FERC Actions

- **PJM filed its RPM (Reliability Pricing Model) on August 31, 2005**
 - **In Settlement proceeding at FERC – Settlement is opposed by the VA SCC because it will raise costs with certainty but is not certain to increase supply.**
 - **The contested settlement is before FERC and litigation or appellate review may reasonably be expected of any final FERC Order**

(6) Market Monitoring

- 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 an external market monitor and the difficulty of and delays in getting information from the PJM MMU.

(6) Market Monitoring

- OPSI (Organization of PJM States, Inc) work group recommendation endorsed unanimously by OPSI:

The OPSI Board should pass an appropriate resolution stating its support for the principle that the PJM MMU should be independent of PJM management and should make information, recommendations and market analyses available to OPSI members on an independent basis. An appropriate organizational structural change should be implemented to ensure the independence of the PJM MMU.

- FERC “Attachment M” proceeding.
 - OPSI and others take this argument to the FERC, without success

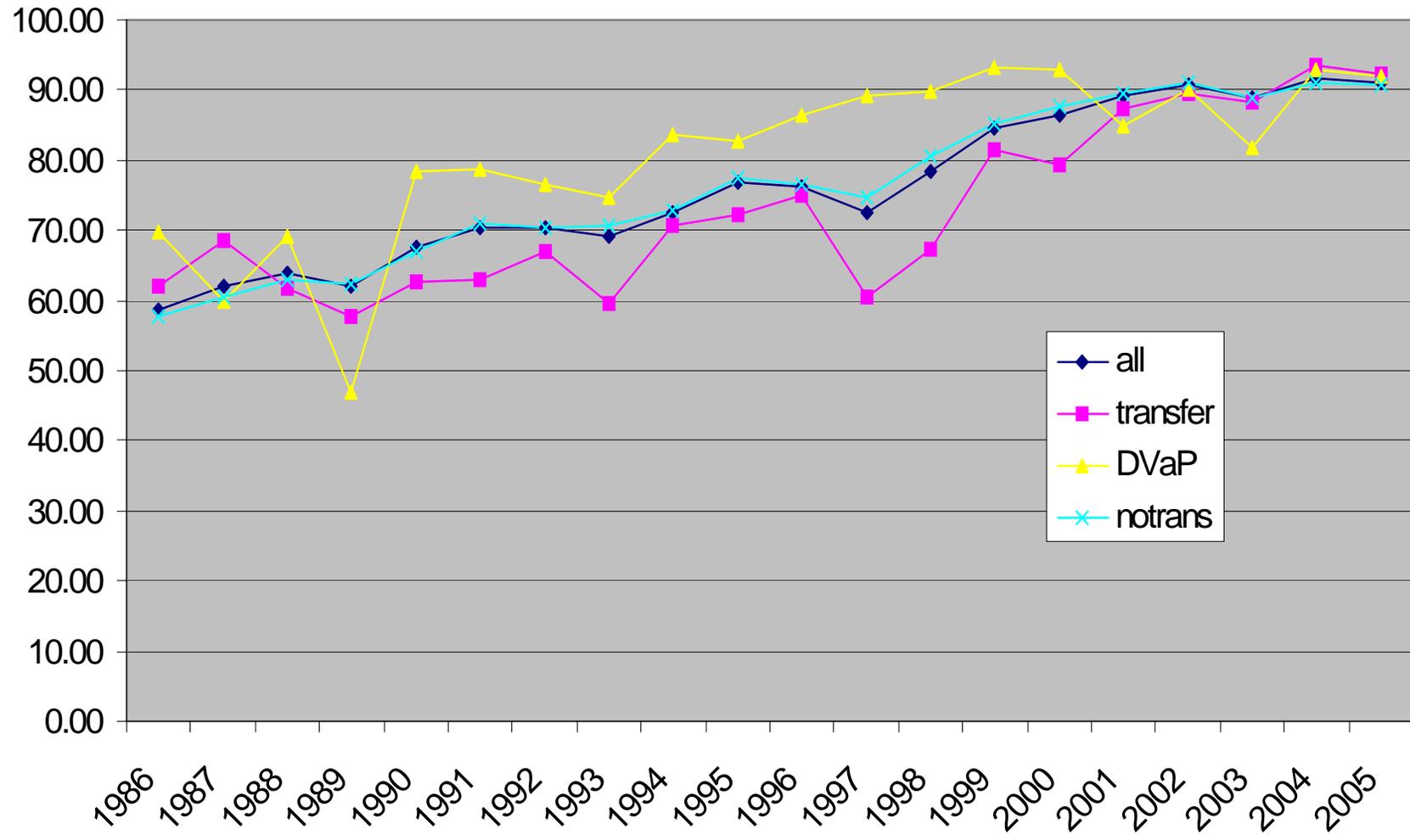
New Trend (7) Restructuring Cost/Benefit Studies

- Large numbers of studies that attempt to speak to the efficacy of electric utility restructuring
- Most are commissioned by stakeholders and performed by consulting firms
- Press releases, headline impacts aimed at policymakers
- APPA has put out a study critiquing 12 of these studies

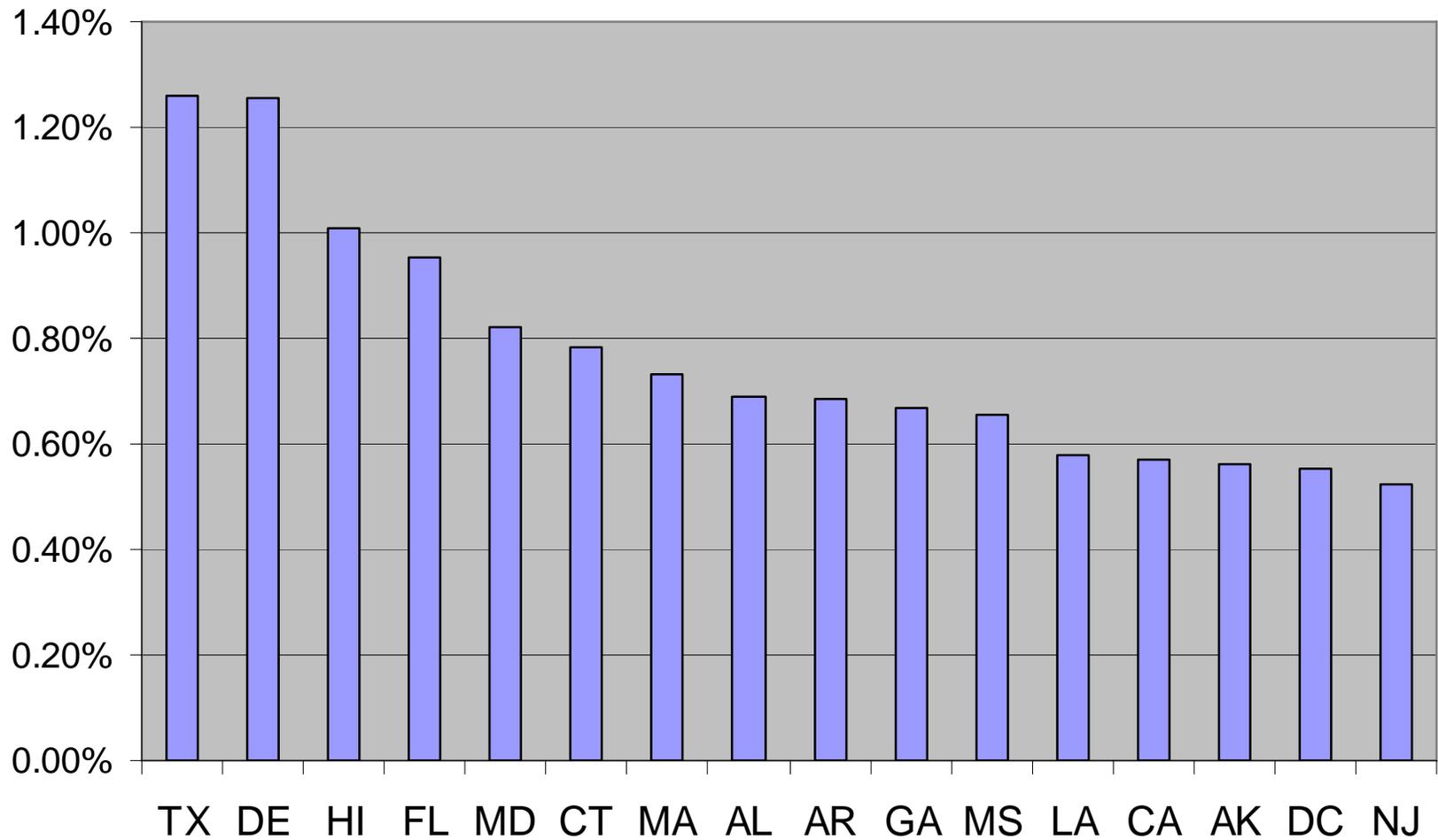
(7) Restructuring Cost/Benefit Studies

- For example, it is often claimed that restructuring and resulting competition have caused an improvement in U.S. nuclear plant performance.
- Sounds reasonable – But does an analysis of the data support such a claim?
- Plant performance has been improving since the early 1980's and in plants in both restructured and non-restructured regions...

U.S. Nuclear Capacity Factor 1986-2005



Residential Electric Cost Increases - Budget Share Basis: 2004 - 2006



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>