

**SENATE JOINT SUBCOMMITTEE
TASK FORCE ON STRANDED COSTS AND RELATED ISSUES
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May 26, 1998**

I will limit my remarks so that they do not duplicate what you have already heard from others, and I'll speak only about (1) the options for recovery of stranded costs, as may be advocated by AEP, and (2) the issue of stranded benefits.

Options for Recovery of Stranded Costs:

AEP has advocated recovery through a fixing of rates for the duration of a transition period, with utilities having the opportunity to recover stranded costs by any reasonable means available to them, within the constraint imposed by the capping of rates (i.e., through savings in costs, renegotiation of contracts, and other means). This approach may not be practical now due to the status of rate proceedings before the SCC.

Another option is a long-term true-up mechanism where full costs are compared to revenues for certain unique classes of stranded assets or liabilities (such as purchase power contracts) with the difference recoverable through a non-bypassable wires charge. These stranded "commitments" are essentially left in a regulated posture as their treatment would be subject to continuous review by the SCC. (AEP has not taken a firm corporate position on this option due to concerns that distortion of the market for generation may occur if the process is not properly administered.)

A final option is to decide upon some level of legitimate, non-mitigatable stranded costs which should be recoverable by the utility. This decision would be made upon the onset of competition, and render a dollar amount which could be securitized with recovery from customers via a non-bypassable wires charge.

Stranded Benefits:

The definition most popular in Virginia is one of negative stranded costs; i.e., to the extent that market value of assets exceeds book value, the utility would owe this to its ratepayers.

It is not a foregone conclusion that AEP will not have stranded costs; it and other Virginia utilities that have provided service at very low rates are the obvious target of the stranded benefits definition.

We disagree with it.

We urge the legislature to look at this issue in a different way -- one that recognizes (1) the reality that these assets are the property of the share owners of the Company; (2) the impracticality of a methodology which would have a low-cost utility making payments to its customers (possibly its former customers, and presumably by borrowing money to do so); and (3) the unfairness to shareholders and the utility of a dilution in value -- independent of consideration of the job they have done and the significant value they have produced for customers historically.

The stranded benefits treatment which has been suggested by some would affect low-cost utilities like AEP and is counter-intuitive. For the sake of argument, consider utility Company A. Over the years its management has made good decisions, has employed technologies successfully, has been careful and frugal in spending money. Its rates are well below the national average. As a result, under the "negative stranded cost" philosophy, its customers would not only have benefited from these low rates over the years, but they would now be entitled to a stranded benefits payment from Company A as well. Conversely, had Company A acted differently over the years, taking much different actions, its customers could have paid much higher rates, and on top of this be required to make stranded cost payments to the Company on a going forward basis.

The stranded benefits issue derives from a concern that customers of low-cost utilities should be protected from the possibility of rates unduly increasing as the result of a move to a competitive marketplace.

This is a reasonable concern, even though people could argue all day about what is likely to happen to rates in such a marketplace.

The "stranded benefit" should be defined as: the reasonable expectation of customers of low-cost utilities that their rates will remain relatively low in the future.

The proper way to deal with this "stranded benefit," we would submit, is to provide in legislation for a capping of rates (1) for a defined transition period, (2)

for those customers who do not change generation suppliers. (This, in fact, is one of the methods suggested by the SCC Staff in its report of last November 7.)

If such a cap is to act as a surrogate for cost-based regulation, it should provide for reasonable increases to account for cost increases . . . related to new environmental controls and inflation, for example.