

**WILLIAMS MULLEN
CHRISTIAN & DOBBINS**

ATTORNEYS & COUNSELORS AT LAW

MEMORANDUM

TO: Structure and Transition Task Force, Joint Subcommittee
c/o Arlen K. Bolstad

FROM: Ralph L. "Bill" Axselle, Jr.

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Set forth below are the preliminary comments of the Alliance for Lower Electric Rates Today in Virginia (ALERT) to the issues recently highlighted. We would comment as follows:

A. Determining which electricity services will be competitive services following restructuring.

Basic Issue: How billing, metering, ancillary and "back up" services will be handled.

Position - Competitive Services

As the electric power industry is deregulated, the natural monopoly functions of transmission and distribution will continue to be regulated in order to ensure nondiscrimination, reliability, and reasonable rates for the delivery of electricity to all consumers. All other aspects of the electric power industry which are not natural monopolies should be fully deregulated.

Electric utilities own and operate both power generators, transmission and distribution lines. Utilities have a monopoly over the electricity transmission lines because of appropriate prohibitions against the construction of multiple lines in accordance with sound economic principles. In return for granting monopoly franchises, the rates charged by utilities to transport units of electric power over those lines are strictly regulated. Under retail competition utilities must open their lines to power producers and transport this electricity to the end consumer. It is important that utilities continue to be regulated in the areas of transmission and distribution so that power lines are kept open and access to them is fairly priced.

The traditional bundled package of retail services should be "unbundled." Most services can be offered in fully competitive markets without regulatory oversight or other forms of government involvement. Services that may be unbundled are:

Basic Electric Service - Access to bundled or unbundled electric service provided by one or more suppliers should not be limited.

Ancillary Services - These services, which include spinning reserves, voltage support, compensation for losses, and black-start service, are used by grid operators or supply coordinators to support the efficient operation of the grid and to meet instantaneous change in system loads. Most, if not all, of these services can be provided competitively.

Maintenance, Back-up, and Supplemental Power Services - Each of these services - which collectively can be referred to as "back-up" services - would be provided on a fully competitive basis. Back-up power would likely be bought directly on a spot market if other contractual arrangements were not made. Buyers should be allowed to blend contracts and spot purchases to meet their needs and risk preferences.

Metering and Billing - Consumers should be allowed to competitively solicit these services or own their own metering and load control equipment and to assign and reassign responsibility for reading, operating, and/or billing from this equipment to their primary service provider.

State and Federal regulators should continue to regulate the transmission and distribution rates to ensure fair pricing and nondiscriminatory access. Outside of transmission and distribution, all consumers should have the right to purchase electric services in a competitive market.

B. Market Power

Vertical and horizontal market power can thwart the development of a competitive market for electric power. In order to ensure the unobstructed and equitable movement of power, the factors that create the potential for market power abuse must be removed. The contributors to market power can be both physical limitations (technological and generation limitations of the grid) and/or discretionary limitations (methods by which the grid is managed).

The first step in the process of developing solutions to market power is to identify the potential types of market power abuse in the Commonwealth. Secondly, a list of solutions required to mitigate these potential problems should be developed. Following the development of these lists, those options that best suit the Commonwealth can be implemented.

Obviously, these methods will include both legislative and regulatory actions. During the development of these options, careful attention needs to be paid to the potential for market power abuse during the transition period to competition. Methods for resolving market power issues when full competition is implemented may not eliminate abuses during the transition period. For example, vertically integrated companies could end up with market power when part of their operation is regulated and others operate in a competitive environment.

The following is a partial list of market power issues:

1. Transmission bottlenecks
 - Load pockets e.g. high load demand areas with restricted transmission
 - “Must run” generating units
2. Control of access to the grid
 - Potential for preferential treatment when owning both generation and transmission
3. Environmental issues—to be handled by the Consumer, Environmental and Education Task Force
4. Stranded Costs—to be handled by the Stranded Cost and Related Issues Task Force (To state the obvious, market power can create market power that can not be over come.)
5. Eminent domain
 - Any company or affiliate uses this power to control access to grid or end markets
6. Affiliate relationships
 - Cross subsidization

The following is a partial list of solutions to market power:

1. Generation divestiture
 - Appropriate regulatory safeguards for must run units
 - Divestiture neither should be mandated or prohibited
 - The State Corporation Commission should have the power to require divestiture, if deemed necessary to resolve market power or determine stranded cost.
2. Functional Divestiture
 - Functionally unbundling vertically integrated utilities
 - Codes of conduct for affiliates transaction
 - Ensure enforcement of anti-trust laws
 - Non-discriminatory pricing for all users of transmission and distribution services
3. Establishment of a broad geographic area ISO
 - Subject to FERC regulations
 - The State Corporation Commission to have authority to approve utility involvement in ISO with consideration being given, among other factors, to the affect of ISO involvement on market power.
 - Mandatory expansion of the interconnections to relieve transmission constraints.

4. Implement technical projects to eliminate physical barriers causing market power to exist
 - Regulatory environment to encourage development of merchant plants, cogeneration or other distributed generation.

The participants on this Task Force, collectively, could identify most of the market power issues facing the Commonwealth and appropriate solutions. However, a market power survey could be conducted to determine the extent to which public utilities operating in Virginia have market power. Such a study could identify the areas and types of market power and, if directed, could identify solutions to these issues.

C. Suppliers of last resort and default provider.

Basic Issue: Determining the generation suppliers of electricity customers who (i) are unable to obtain generation supply services (supplier of last resort), or (ii) do not affirmatively choose generation suppliers (default provider).

Position - Suppliers of last resort and default providers

To discuss the issues of "Suppliers of Last Resort" and "Default Providers", the terms must first be clearly defined. The supplier of last resort is the utility which will retain the obligation to serve customers who were unable to get a generation supplier or who have returned to such services because they were terminated by their non-utility supplier. The default provider will provide electric service to individuals that do not exercise their choice of a generation supplier. In a deregulated marketplace, both sets of customers will have the same electric service protections that are now available.

A process must be developed for assigning both sets of customers either together or as separate groups. The procedure should be a competitive process among the available electricity providers.

Alternatives include the following:

- Designate the distribution company as the supplier of last resort.
- Procurement of competitive bids for a default provider
- Distribute among the retail service providers those who do not or are unable to choose a provider.

Depending on which alternative is chosen, there will be certain market advantages and disadvantages that must be addressed

Note: There will be a need for backstop providers where contract suppliers fail to deliver generation supply. This occurrence is usually addressed by contract. Usually, the electric power will be purchased at the RPX, with the price difference to be made up by the supplier.

RLA

cc: W. L. Blanchfield
Lloyd J. Vye
Michael Ansell
Mr. John R. Amos
Dr. B. Lee Kindberg
Reginald N. Jones, Esquire

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