SJR 91 JOINT SUBCOMMITTEE ON RESTRUCTURING THE ELECTRIC UTILITY INDUSTRY

STRUCTURE AND TRANSITION TASK FORCE
June 10, 1998

Introduction

By memorandum dated May 29, 1998, the Staff of the SJR Joint Subcommittee requested comments on the following three critical issues:

- Determining which electricity services will be competitive services following restructuring.
- Market power (particularly that related to transmission constraints).
- Suppliers of last resort and default providers.

The Virginia, Maryland & Delaware Association of Electric Cooperatives ("VMD Association" representing, in Virginia, A&N Electric Cooperative, BARC Electric Cooperative, Community Electric Cooperative, Craig-Botetourt Electric Cooperative, Mecklenburg Electric Cooperative, Northern Neck Electric Cooperative, Inc., Northern Virginia Electric Cooperative, Powell Valley Electric Cooperative, Prince George Electric Cooperative, Rappahannock Electric Cooperative, Shenandoah Valley Electric Cooperative and Southside Electric Cooperative, Inc.) and Old Dominion Electric Cooperative ("Old Dominion") (collectively, the "Cooperatives") join in submitting comments on these issues.

1. Competitive Services Following Restructuring

First and foremost, the restructuring effort and any restructuring legislation must focus on introducing competition in the generation function. The creation of a broad-based, functioning and truly competitive market for retail generation service is the centerpiece of the restructuring process. Absent an operating competitive retail market, discussion of other competitive services is pointless. Establishing an effective and efficient retail generation market is the linchpin for the development of other competitive electricity services.

Of course, establishing the groundwork for development of an effective, competitive retail electricity market is also the most difficult aspect of restructuring. Before regulatory controls on the provision of retail electric service can be slackened or lifted, a number of substantial and significant issues must be addressed. In the Cooperative's view, development of a truly independent Independent System Operator and a properly functioning Regional Power Exchange are essential to the development of competitive retail generation service. However, neither of these entities can be developed and implemented until certain issues are addressed.

As will be discussed in greater detail later herein, foremost among the challenging issues is the existence of market power. If any market participant can wield unreasonable market power, the market will likely be distorted and not mature into a truly competitive market. Transmission system constraints serve to enhance market power in a given control area. A constrained transmission system can enhance a market participant's market power because generators outside the constrained control area may not be able to sell into that area and generators within the constrained area will have what is essentially a captive, monopoly market. Before the development, approval and implementation of either an ISO or an RPX to serve a given region, transmission constraints within that region must be alleviated, or appropriate price controls must remain in place until the constraints are removed.

Several parties have suggested that there be competition and customer choice in billing and metering. However, the Cooperatives maintain that legislating competition in metering and billing is not an essential component of restructuring. The Cooperatives continue to believe that billing should be provided by the entity providing distribution service. Unlike generation, transmission and distribution will continue to be regulated by federal and state authorities. Even in a restructured generation market, exclusive, certificated service territories will be maintained for distribution service. The distribution service provider will have an obligation to provide distribution service to everyone in its certificated territory, and may be obligated to assure that generation is available. The Cooperatives believe that control of metering is an essential aspect of operating a distribution system and that along with the duty to serve should come the right to bill for the services rendered.

Competition in billing and metering may lead to an inefficient duplication of efforts and would create an unnecessary gap between the distributor and the customer, which could create confusion and have a negative impact on service quality. The restructuring plan should not mandate competition or customer choice in billing services (an area not previously subject to specific regulation) nor create competition in metering.

Another electricity-related services that may see greater competition following restructuring is load management services. A fledgling competitive market for load management services has already emerged. Numerous entities are offering customers energy audit and electricity consumption management services, presumably in preparation to offer retail generation supply when retail competition becomes a reality.

2. Market Power/Transmission Constraints

If the electric industry is to be restructured, the restructuring must be such that no market participant is able to exert significant market power influences on the availability or pricing of electricity. In light of the traditional industry structure and organization and the physical characteristics of electricity, the restructuring process must include measures to effectively alleviate factors that could engender anti-competitive practices. Large, vertically integrated utilities, such as Virginia Power, generally own and operate the transmission system and the majority of the generation resources within their control area. In addition, transmission constraints and voltage support requirements often restrict power transfer capability into and within a given control area. The combination of concentrated ownership and control of generation and transmission facilities within a control area and limited import capability can provide a vertically integrated utility with significant market power.

In particular, transmission limitations can eliminate much of the generation competition from meaningful participation in a given market. When a limited interface has low or zero Available Transmission Capacity ("ATC"), any generation owner that must transmit through that interface may be unable to make deals over that interface. The absence of adequate import capability will effectively bar generation suppliers outside of a given control area from competing within that control area. Firm and non-firm capacity purchases, as well as the non-firm economy markets, are adversely affected by transmission limitations. The Structure and Transition Task Force must consider existing transmission constraints in Virginia in determining what manner of restructuring would best serve Virginia.

In Virginia, the Cooperatives place substantial reliance on the Virginia Power transmission system. Virginia Power is interconnected to Carolina Power and Light, Allegheny Power System, American Electric Power and the Pennsylvania-New Jersey-Maryland ("PJM") Interconnection. Due to the availability of lower cost, coal-fired capacity in the west, which is less expensive than sources of generation in the eastern region, the prevailing power flows on Virginia Power's system (and systems in the area to the north of Virginia Power) are from the west to the east. Efforts to displace more expensive generation in the east with less expensive, coal generation in the west result in heavy west-to-east flows on the transmission system. There is adequate transmission capability to deliver power within the Virginia Power system but import capability, particularly from the west (given the high levels of west-to-east base transfers presently on the system), is limited. In recent years, it has been difficult or impossible to arrange firm base transfers on many occasions.

When the import capacity of the transmission system in a given control area is constrained, significant market power influences may be exerted. Further, there is a potential for market distortion if costs, particularly variable costs, are not kept in check. In the Virginia Power system, major improvements are necessary to increase import capability and dilute Virginia Power's market power. The Cooperatives believe that current transmission constraints on the Virginia Power system must be addressed in the process of developing a restructuring plan for Virginia and that the rates for power from generation facilities within such a constrained control area should be limited to cost of service until such time as constraints are relieved.

3. Suppliers of Last Resort and Default Providers

The "supplier of last resort" is the supplier for customers otherwise unable to secure service because of payment problems and the supplier for customers whose power supplier has failed to deliver as scheduled. The Cooperatives believe that the distribution service provider should serve as the supplier of last resort. For serving as the supplier for customers otherwise unable to secure service because of payment problems, the supplier of last resort should receive reimbursement through charges collected from all retail power suppliers. If called upon to serve as the back-up supplier for customers whose power supplier has failed to deliver as scheduled, the supplier of last resort should have the authority to charge a premium to the power supplier or, if necessary, to the customer. Customers should be liable for the costs of emergency replacement power only as a last resort. Also, in the event power is unavailable and the system operator calls for load reduction, the customer whose supplier has failed should be subject to disconnection before other customers (presuming individual disconnection becomes technically feasible).

The SCC should be given authority to create a certification program for power suppliers in order to evaluate and monitor their financial viability and their ability to perform. This will help assure that power is available to consumers when they need it and that funds are available to cover liabilities and penalties for any failures to perform.

In a competitive retail electric market, customers will have the opportunity to choose their retail electric supplier. Regardless of this opportunity, some customers will simply refuse to make a choice. Default service will be available to those customers that do not make a choice regarding their retail electric supplier. The distribution service provider also should serve as the default provider. However, any restructuring plan adopted for Virginia should recognize that customers might *make a choice* to remain with their incumbent electric provider. Unlike their investor-owned brethren, most of the Cooperatives will not create elaborate marketing structures and strategies to sign-up their existing customers under the umbrella of a newly organized and creatively named retail sales division. The Cooperatives want their member/consumers to continue to buy power from the

cooperative and hope (as well as expect) that most of their member/consumers will want the same. The Cooperatives' member/consumers should not be classified as default customers simply because they did not choose an "alternative electric supplier." A choice to remain with the incumbent electric utility is equally valid as a choice to switch to an alternative electric supplier. Loyal customers choosing to remain with their incumbent supplier should be distinguished from customers not making a choice. Only those customers that have not made any choice regarding their retail electric supplier should be classified as receiving default service from the default provider.