

**COMMENTS OF THE SOUTHERN ENVIRONMENTAL LAW CENTER  
TO THE STRUCTURE AND TRANSITION TASK FORCE  
OF THE SJR 91 JOINT SUBCOMMITTEE**

**June 10, 1998**

The Structure and Transition Task Force has requested comments on three issues: 1) determining which electricity services will be competitive services following restructuring; 2) market power; and 3) suppliers of last resort and default providers.

The Southern Environmental Law Center (SELC) is a regional environmental advocacy organization headquartered in Charlottesville. We support allowing consumers to choose their electricity supplier, as long as a power system is maintained that provides adequate consumer and environmental protection, and otherwise protects the public interest.

SELC appreciates the opportunity to respond to the Task Force's questions concerning restructuring the electric utility industry in Virginia.

**I. Competitive Services**

It is important to clarify the first issue raised by the Task Force. Of particular importance, the term "competitive services" should not be considered to be synonymous with "unregulated services," since all electric services will continue to be regulated to some degree following restructuring. For example, allowing retail customers to choose their electricity supplier requires introducing greater competition to the generation segment of

the electric industry. However, environmental and consumer regulations will govern the conduct of suppliers competing for retail customers. Thus, we interpret the term "competitive services" as meaning those services which restructuring does not assign to a monopoly service provider.

Although restructuring will open the generation system to competition, there is widespread agreement that transmission and distribution functions should continue to be provided by monopoly service providers, since, among other things, the economic and environmental cost of building and maintaining a second set of wires is prohibitive.

Beyond these elements of a restructured electric industry, there is substantial debate regarding whether generation-related ancillary services such as reserve margins and spinning reserves and distribution-related services such as metering and billing should be "competitive services". SELC generally believes that these additional services should be opened to greater competition, typically through bidding rather than bilateral contracts, subject to adequate regulation to ensure reliability and consumer protection.

Energy efficiency and renewable energy research, development, and deployment are, arguably, electricity services. Although the provision of these services should not be limited to a single service provider, the public policy goals of promoting energy efficiency and renewable

resources will not be achieved by market forces in a system that provides customer choice. Therefore, special steps must be taken to achieve these goals. Of primary importance, funding for these clean energy resources should be provided through a public benefits charge assessed upon all users of the retail electric system and administered by an independent board. Although a form of market intervention, to the greatest extent practicable, this fund should be allocated using a competitive bidding process.

## **II. Market Power**

SELC believes that it is possible to allow consumers to choose their electricity supplier while maintaining a power system that provides adequate consumer and environmental protection, and otherwise protects the public interest. The potential benefits of a competitive power system will not be realized, however, unless there is open competition among electric power suppliers on a level playing field. Any system biased in favor of existing generation, particularly as a result of market power, promotes environmental degradation.

SELC agrees with the Attorney General's recent comments to the joint subcommittee that market power is the ability to control prices or to exclude competition. Moreover, as SCC staff noted, market power tends to arise in the electric industry when there are "import constraints" (i.e., when a transmission system in a particular service area has limited or no excess capacity) or when one entity owns "must run"

generation units which must be operated to ensure adequate, reliable power flow. There are many ways in which market power can be used to thwart the evolution of a competitive market, such as utility manipulation of their control of transmission facilities to advantage their own generation, concentration of control of generation markets, and subsidization of non-regulated commercial ventures with monopoly business lines.

SELC supports the Attorney General's recommendation that the SCC closely study market power issues. In addition, although we do not purport to have a comprehensive answer to market power issues, we know that five steps, in particular, will be essential to preventing market power and anti-competitive behavior.

**A. The independent governance and operation of the transmission system must be established.**

Independent governance and operation of the transmission system is fundamental to the creation of a competitive market. The system should be governed by a publicly accountable board of directors, consisting of representatives of wholesale market participants, all customer classes, and environmental interests. The rules of operation should be determined by the governing board, not by the current owners of the transmission lines. Ongoing operation must be free from the influence of entities with an interest in the competitive generation market.

The most efficient Independent System Operator (ISO) will likely cover a geographic region that expands beyond

Virginia, and require cooperation among several states. Until this is formed, there is a pressing need for Virginia to be proactive in establishing the rules by which it believes the monopoly transmission system should be governed and operated. In the absence of state action, these rules will be determined in FERC proceedings by monopoly utilities guided by minimal federal criteria established by the FERC, and Virginia will lose its ability to influence the formation of this critical component of a competitive market.

Given the immediate need to act and the likelihood that coordination on a regional basis cannot be easily accomplished in the near term, one of the first actions the Task Force should recommend is the formation of a working group which is, in essence, a prototype governing board of a Virginia ISO. This group should be charged with the responsibility for deciding the rules by which the transmission grid in the state will be governed and operated. The Task Force should recommend that utilities be required to file for FERC approval a proposal for an ISO consistent with the rules established by the prototype board, as a condition of unbundling utility rates or granting other changes to the ratemaking process requested by utilities.

**B. Reserve capacity must be bid.**

It is critical for market power reasons that the right to provide reserve capacity be put out to bid, rather than simply given to existing utilities by designating some of

their existing generators "must run" units for reliability purposes. The cost of maintaining an adequate reserve margin should be borne by users of the transmission grid.

**C. There must be clear separation of the monopoly functions of the power system from the competitive generation market.**

Preventing the abuse of market power will also require clear separation of the monopoly functions of the power system --transmission and distribution -- from the competitive generation market. The best way to accomplish this is through the divestiture of generation from distribution assets, and by turning over operational control of transmission to the ISO as described above. The move toward customer choice in Virginia should be designed to provide utilities with strong incentives to do this. Such incentives might include rigorous reporting requirements for utilities owning both generation and transmission and distribution assets, or strict rules barring transactions between affiliated generation and transmission and distribution companies. If it is determined that utilities should be allowed to recover some portion of stranded costs from consumers, the right to recovery should be conditioned on the utility's willingness to divest and to take other steps necessary to achieve a competitive market.

Although competition can be good for consumers, we know for certain that competitors hate it and will do whatever is legally within their means to eliminate it. Thus, although divestiture is important, once companies divest they will immediately begin efforts to reacquire market power. In

other words, the mitigation of market power is an ongoing rather than one-time event. It will require permanent monitoring and enforcement mechanisms to ensure reasonably competitive markets. Although the responsibility to enforce market power protections might reside with the FERC, the Justice Department, and the Attorney General's Office, the ISO must serve an ongoing policing function. This function should encompass monitoring trades and the collection of information necessary to successful enforcement of market power protections, and the responsibility to alert the appropriate enforcement authority when market power problems arise.

**D. There must be comparable environmental standards for all generation sources.**

Although this issue hopefully will be explored more fully by the task force on environmental and consumer issues, the federal Clean Air Act's exemption of power plants built or under construction prior to 1977 from meeting the stricter environmental standards that must be met by today's plants, gives these older plants an economic advantage and poses a significant barrier to achieving a competitive market.

Several states are considering strategies to prohibit electricity sales from generators or utility systems that do not meet emission standards currently required of new sources. As it studies restructuring, Virginia should acknowledge the competitive and environmental problems caused by disparate emission standards for old and new

sources, and consider options for addressing this problem at the state level.

SELC believes that the problem of pollution transport makes federal legislation the most effective way to address the competitive and environmental problems caused by the current disparity in emission standards. Since the resolution of this issue will impact Virginia's ability to develop a competitive electric power market, however, Virginia should insist on appropriate action at the federal level to remove the current disparities in emission standards between generation sources as part of any plan to allow customers to choose electricity suppliers in the state.

**E. If recovery of any portion of stranded investment is allowed, such recovery should not be allowed to subsidize the ongoing operation of uneconomic plants.**

Although there is a separate task force on stranded cost issues, it is important to note in the context of discussing market power that allowing stranded cost recovery, and the manner in which stranded costs are calculated and recovered, can create a significant impediment to achieving an open and competitive electric power market. Consequently, whether to allow stranded cost recovery must be carefully considered, and any decision to allow the recovery of such costs must be structured so that it does not enhance the market power of monopoly utilities.



### **III. Suppliers of Last Resort and Default Providers**

It is widely recognized that distribution systems will continue to be regulated following restructuring. Among other things, the entities providing these services should be charged with the responsibility of maintaining our current expectations of universal service. Regulation of the distribution utility must ensure the existence of a provider of last resort for those customers unable to choose (or, perhaps more accurately, those customers unable to be chosen by) an alternative provider, as well as a default provider for those customers unwilling to choose a provider. Moreover, a system must be in place to ensure that these services are provided at affordable rates.

One alternative for providers of last resort would be to subject all power suppliers wishing to participate in Virginia's market to licensing conditions which ensure that all customers have access to reliable and affordable electricity. In addition to licensing requirements and proper regulation of the distribution system to ensure access, a system that allows customer choice must also include programs that ensure electricity remains affordable to the most vulnerable customers. Such programs include weatherization and other energy efficiency programs which will reduce the energy bills for low income customers, and other rate protection programs. These programs can be financed through a public benefits charge imposed on all users of the distribution system.

With regard to default providers, it is instructive to note that in California, the first state to implement full-scale retail competition, the vast majority of customers (including over 99% of residential customers) have not chosen an alternate electricity supplier. This cannot be attributed solely to customer loyalty or satisfaction with incumbent utilities. Many customers are confused or apathetic about the choices retail competition offers. As a result, the competitive market will be severely distorted if customers who do not affirmatively choose a power supplier automatically remain with their existing utility. To address this potential market power problem, default providers should be subject to competitive bidding and randomly assigned.