

**TO:** SJR 91 Structure and Transition Taskforce

**FROM:** Jean Ann Fox, Vice President  
Virginia Citizens Consumer Council

**RE:** Response to May 29 Memorandum

**DATE:** June 10, 1998

The Virginia Citizens Consumer Council submits the following preliminary comments on the three issues scheduled for discussion by the Taskforce on June 15: Competitive services, market power and suppliers of last resort.

### **Competitive Services**

While it is arguable possible to designate some functions of the distribution and transmission electric company as potentially competitive, such as billing or meter-reading, the challenges of making the generation market effectively competitive before the deadline enacted by the General Assembly should receive first priority. We should not side-track legislative attention on defining exactly which office or service functions can be competitive. The parallel exercise of dividing up the local telephone market into Actually Competitive, Potentially Competitive, and Basic required months of regulatory wrangling and tortured definitions.

### **Market Power**

Market power is the greatest single barrier to effective competition in the electric generation market. Unless this problem is resolved, "competition" will not take the place of regulation and most customers will not benefit from restructuring the electric industry.

Types of market power include vertical integration (ownership of transmission and distribution), market share (Virginia Power controls about 80% of generation in its service area), mergers/consolidation (which eliminate potential competitors), name recognition, product tie-in, and customer information. A vertically-integrated company can exert market power by giving itself or its affiliates a better price or better service than it gives competitors.

A company with market power is able to set prices at an uncompetitive level and to force competitors out of a market. By definition, incumbent utilities who currently have 100% market share and own their transmission and distribution systems can be in a position to exercise market power. Add to that the current transmission constraints that prevent the importation of sufficient energy to provide alternative choice of suppliers, and Virginia may not be able to achieve an effectively competitive electric generation market.

**1. Competition must be effective before electricity generation is deregulated.**

Regulation is a surrogate for an effectively competitive market. Workable competition is defined as five or six independent rivals of comparable size. Competitive firms are price takers, not price-fixers. A competitive market has freedom of exit and entry. The electric generation market does not come close to meeting the Justice Department's criteria for workable competition. A deregulated monopoly can charge high prices for unreliable service. Before the General Assembly deregulates generation of electricity, it must achieve effective competition.

**2. The State Corporation Commission must have authority to order divestiture of generation plants to achieve a competitive market for generation prior to deregulation.**

"Functional unbundling" which leaves separate functions under affiliates of the same holding company is likely to be ineffective in preventing anti-competitive practices. The unbundled divisions still have an incentive to act together to maximize profit for the parent company. Divestiture or strong oversight will be necessary to achieve a competitive generation market.

**3. Regulators must guard against abuses of market power and must enforce anti-trust laws.**

Following an initial surge of new entrants, the electric market is likely to become a tight oligopoly, with a few large firms dominating the markets. Mechanisms will be necessary to permit regulators to monitor concentration levels, collect and analyze data, and take steps to correct excessive market power. The SCC will need authority to deny mergers or acquisitions that harm ratepayers, reduce competition or result in anti-competitive conditions. The SCC will need to develop rules for electric utilities and affiliated companies to conduct business.

## **Obligation to Serve**

### **1. Electric utilities must have an obligation to connect all customers to electric service providers of the customer's choosing.**

The electric distribution company should have an obligation to serve all customers in its service area as far as distribution is concerned. In other words, the utility must have a legal "duty to connect" all retail customers in its service area to energy service providers of the customers' choosing at reasonable rates and under reasonable conditions.

### **2. Utility and non-utility electric service providers must be under an obligation to participate in providing service to residual customers.**

All electric service providers should be prohibited from redlining customers (refusing to provide service in geographic areas because of their racial, ethnic or economic composition.)

The General Assembly must decide how electric service will be provided to:

Customers who have competitive choices available to them, but do not affirmatively choose a provider,

Customers who have no competitive choices available to them, and

Customers who have had their service terminated by a provider.

As a transition measure, the utility would have to provide these customers with uninterrupted basic service at regulated rates in order to ensure continuous service. In the long-run, however, all electric service providers should participate in serving these customers. Provider-of-last-resort status should not give one supplier a competitive advantage or captive market. One method is to assign these residual customers to providers in proportion to each provider's market share. This is similar to the introduction of competition in the long distance telephone market. Simply allowing the incumbent utility to retain the large proportion of residential customers who, for a variety of reasons, do not voluntarily select a new supplier, would produce a two-tier market where the customers who are considered profitable are served by the competitive "voluntary" market and customers considered less desirable are left with the incumbent.