Testimony before the
Commonwealth of Virginia
Joint Subcommittee
On
Electric Restructuring

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June 3, 1998

My name is Beverly E. Jones, and I'm Vice President of External Affairs and Policy Development for Consolidated Natural Gas Company.

CNG is an integrated energy company, best known in the Commonwealth as the parent of both Virginia Natural Gas, a utility headquartered in Norfolk, and CNG Transmission, an interstate pipeline which supplies gas transmission service to gas distribution companies, electric utilities and independent power producers located in Virginia. The Commonwealth also is the headquarters for one of our newest units, CNG International.

Recently, CNG has been actively building another company that is interested in making investments in Virginia – a retail company serving residential, commercial and industrial customers with natural gas, electricity and various other energy-related products and services. At present, CNG Retail Company has almost 250,000 customers, which makes us the largest residential marketer in the country. While this may be a fleeting claim, as more states open energy supply to competition and other marketers gain momentum, we hope that the experience we have gained can assist this Subcommittee to evaluate the various issues facing the four task forces.

We are pleased to be here today, and to speak briefly about issues related to transmission constraints and market power.

Transmission Constraints

Generally, CNG believes that competition has the potential to provide market-based solutions to at least some of the limited flexibility that now characterizes transmission facilities in the Commonwealth. A competitive market has the potential to value various alternatives to constrained transmission and determine least-cost solutions. Those alternatives may include upgrading existing transmission lines, building new lines, or building new power generation in closer proximity to the load.

For example, as competition expands, a new market may develop for small generation facilities built to serve specific loads, thus reducing the need for imported power, additional transmission capacity and maybe even distribution. This type of generation is often referred to as distributed generation and includes such things as micro turbines and fuel cells, both of which are very clean and efficient sources of electricity.

While we are in the process of moving toward competition, however, the constrained nature of Virginia's transmission system does mean that marketers considering investments will be particularly concerned about whether they can get the access to the grid necessary to supply their customers. And then, even if competition is achieved, there will be a continuing need for the transmission system to be monitored to assure fair access.

Aside from market power and access concerns, transmission constraints must be addressed on an ongoing basis to assure the continued, long-term reliability of the transmission system. As communities change so will their load requirements, so some entity must have the responsibility to monitor and maintain reliability of the transmission system.

FERC anticipated all these needs in Order 888. The creation of an Independent System Operator (ISO) was intended to assure reliability, minimize market power and allow competition to flourish. CNG believes that the ISO concept makes sense, and that the ISO should have the ultimate responsibility for determining the most cost-effective solutions to transmission constraints. This assumes, however, that the ISO membership is comprised of all stakeholders including regulators, marketers, generators, transmission owners, and distribution companies.

Market Power

A quick discussion of market power translates into the practical question of whether it will be possible for companies like CNG to enter the retail electric market and have a fair opportunity to compete. The benefits of restructuring can be achieved only if the process delivers real competition, which means that there must be room for new entrants in various sectors of the unbundled electric market.

Achieving market access for players other than incumbent utilities will be a challenging and delicate task, and we recognize that some jurisdictions will be more successful than others in finding the right balance. The most important factor is to recognize early on that there is no simple formula. The challenge will be to lay out the policy goals in the legislation and then build in enough flexibility to allow policymakers to refine the details during the transition period.

At CNG, we recognize that mid-course corrections are likely during the transition phase, but we are looking carefully at the policy goals that will shape the future electric market in Virginia and other states where we have substantial assets. We are trying to decide whether there are likely to be entry barriers just too difficult for us, or other marketers, to overcome. I would like to briefly talk about a few of the areas we are thinking about, as we continue to weigh opportunities:

- **Cost-related entry barriers**.

The complexity of the electric market, and the costs associated with developing the expertise and infrastructure, are daunting to new entrants, and provide one explanation of why more competitors have not entered the retail market where unbundling already has begun. As we look at the experience of other states, however, it appears that the inherent costs of start-up may be dwarfed by the approach used to allow electric utilities to recover stranded costs.

The single biggest barrier to entry of new marketers may be the amount of potential savings to customers absorbed early by the stranded cost recovery process. There is a balance that is needed here. On one hand, the sooner these costs go away, the sooner we are likely to see a robust competitive market. On the other hand, if these costs are borne by the ratepayer over a short period of time, there isn't much savings available to customers. This would mean little margin for competitors and a real possibility that marketers will forego these high stranded cost markets.

Any recovery process needs to be structured with the potential impact on new entrants very much in mind, then monitored on an ongoing basis, to protect against unintended competitive impacts, as well as any potential for affiliates of the historic utilities to game the system.

Determining the value of generating assets, as well as just how stranded costs are to be allocated, is paramount to a healthy start to electric competition. We think that an auction of generation assets, with the utility or its affiliate empowered to participate just like other bidders, may be the best available tool for determining the future value of an asset.

Finally, I've already mentioned the need for an ISO that is truly independent. The ISO should act like UPS -- it should be indifferent to whose electricity it carries. It should only be concerned with safety and reliability. How the market prices electricity, and how financial transactions are carried out, should not be in the domain of the ISO or the utilities connected to the ISO.

- **Codes of Conduct and issues related to utilities' marketing affiliates.**

We are pleased that the Commonwealth is taking a broad look at market power issues, and that this Subcommittee and the Commission have demonstrated a willingness to undergo a comprehensive examination of market power questions. Too often, we think, Codes of Conduct are held up as a simplistic solution to more complex issues related to the changing role of incumbent utilities. And this is an issue that we can look at from both sides.

On the one hand, we do hope to compete in the towns we know best, and in cities like Norfolk where we have made considerable investments of shareholder dollars in corporate goodwill. On the other hand, as a gas system we are comfortably operating under FERC's code of conduct for pipelines, and we have a real stake in assuring that the electric utility affiliates, with whom we may be competing, are held to the same kind of requirement for arms-length relations.

These issues are indeed important but it is not enough to focus all market power concerns on the marketing affiliates of utilities. Certainly, during the transition period from regulated electricity supply to a competitive market place, care must be taken to assure that new entrants are not at a competitive disadvantage because of rules that favor affiliated marketers. Likewise, the rules must not favor new participants. Often the debate is cast to give the impression that new entrants are small, struggling companies trying to compete with large utilities. While this is true in some instances, some of these new entrants are large multinational corporations with well known names and huge assets backing their entry into electricity.

Generally, CNG supports separation of affiliate operations to the extent necessary to prohibit two situations. First, affiliate marketers should not be provided with customer information by the utility that is not also made available to unaffiliated marketers. Second, utilities should not subsidize the affiliated marketer. Seeking separation of the two entities beyond this may have the inadvertent result of raising costs for local, affiliated marketers that are not borne by new entrants.

Finally, a strong code of conduct in legislation that only addresses transactions between utilities and their affiliated marketers may miss market power abuse that could occur by marketer affiliates of nonutility energy companies. It is hard to predict how the market will evolve, which companies will be successful, or what type of affiliations may develop as the market matures. Therefore, the legislation should address market power in a general manner and require penalties to be levied against abuses of market power rather than attempt to develop detailed rules.

CNG appreciates the opportunity to provide these comments and we look forward to working with this Subcommittee as you work through all of the issues surrounding customer choice and electric utility restructuring.