The Honorable Clifton A. Woodrum, Vice Chairman
The Honorable Richard J. Holland
The Honorable Thomas K. Norment
The Honorable John C. Watkins
The Honorable Kenneth R. Plum
The Honorable Jerrauld C. Jones

January 5, 1999

Re: Supplemental comments on December 26, 1998 (11:12 a.m.) draft language and initial comments on December 31, 1998 (2:55 p.m.) draft language reflecting outcomes from Drafting Group's meetings of December 17 and 29, 1998.

Gentlemen:

On December 30, 1998, I provided preliminary comments on behalf of AEP on the Structure and Transition Decision Tree outcomes from the Drafting Group's December 17 meeting. Based upon establishment of a January 5, 1999 due date for written comments at the end of the December 29 drafting session, AEP wishes to offer supplemental comments on the December 26, 1998 Structure and Transition draft legislative language, as well as initial comments on the December 31, 1998 drafts of legislative language on Stranded Costs, Structure and Transition Supplement, and Consumer, Environment and Education, which reflect outcomes and activities of the December 29, 1998 Drafting Group's meeting.

As I indicated in my December 30, 1998 letter, and consistent with AEP's recommendations since the beginning of this debate, we support as a core concept, a model consisting of a modest, yet clearly defined, transition period during which all customers have choice. During this transition period, a capped generation service component would offer reasonable protection for customers that elect not to exercise choice, and, coupled with a competitive transition charge (CTC) for customers that do exercise choice during the transition period, permit utilities the opportunity to prepare for competition and recover regulatory assets and what we referred to as "transition period costs" in our draft legislation. This treatment would allow utilities to deal with any "stranded costs." We are proposing that this transition period should now begin January 1, 2001, the same time that the regional transmission entities would be in place, and extend until January 1, 2004.

Under AEP's model, at the end of the transition period, the capped rates and the CTCs would expire and all customers would obtain their generation service from the market at market-based rates. Transmission and distribution services would continue to be regulated services with rates established by the FERC and SCC, respectively.

The comments set out in this letter and my December 30, 1998 letter are consistent with this model and the Drafting Group should consider the benefits of adopting this simplified yet practical and balanced approach to customer choice. We firmly believe that extensive legislative direction and continued legislative oversight are necessary for achieving an orderly transition to a restructured electric utility industry and would diminish neither flexibility nor effective consumer protection.

Although we recognize that these are first drafts, our greatest general concern with the proposed drafts as they now provide is the lack of legislative direction provided to the SCC on key issues. For example, the drafts give the SCC little, if any, indication of the Legislature's intentions regarding the purposes of such things as a code of conduct, capped rates, and nonbypassable wire charges. In contrast, and as indicated in my December 30, 1998 letter, on the subject of ISOs (RTEs) -- a subject that by its very multi-state nature is least susceptible to oversight by the SCC given the jurisdiction of the FERC -- the drafts set forth lengthy and explicit requirements. While we understand the need for flexibility, it appears to us that the legislation as drafted is a prescription for interminable litigation at the SCC and in the courts on a variety of subjects including stranded cost recovery. With these general thoughts in mind, our more specific comments to remedy these deficiencies follow:

I. §56-591 (12/31 draft, pp. 1-2):

The draft provides that the SCC shall determine each incumbent utility's net stranded costs (definition needed); identifies the categories of assets and obligations to be considered in determining net stranded costs; provides for recovery of stranded costs through a nonbypassable wires charge; and empowers the Commission to establish a reasonable recovery period on a utility-by-utility basis.

Comments:

As indicated in my initial oral statements at the December 29 drafting group meeting, the Decision Tree -- and unfortunately, this draft – do not include several of the fundamental components of AEP's method of resolving the stranded cost issue, which we continue to believe are necessary for a reasonable, fair and balanced resolution of this issue.

The absence of any reference in AEP's proposed legislation to complex and cumbersome procedures related to a determination of a stranded cost value is not an oversight – but represents a clear benefit of the Company's proposal. AEP encourages that the simplified revenue neutral themes inherent in its proposal be reconsidered by the Drafting Group.

As indicated in the draft, a legislatively prescribed definition of just and reasonable net stranded costs is needed. Consistent with expressions of several members of the drafting group, it is absolutely necessary that the definition provide that net stranded costs cannot be less than zero so that it is clear that the Commission cannot lawfully consider payments to customers by incumbent utilities.

The AEP model treats all utilities the same with respect to the opportunity and timeframe for recovery of stranded costs, in an attempt to introduce competition fairly across the Commonwealth without putting any participant at a competitive disadvantage. Should the utility-by-utility approach contained in the current draft be found to be preferable, each incumbent utility should be required to make a filing with the SCC clearly identifying the regulatory assets and/or any stranded costs it seeks to recover, and to propose a plan for recovery. Legislative intent should be clearly expressed that any disparate treatment of the recovery of such items, through a utility-by-utility approach, must be done in a manner which is fully consistent with achieving maximum benefits for Virginia from workable and effective competition.

II. §56-592 (12/31 draft, p. 2):

This section provides as follows: "The commission shall develop appropriate mechanisms maximizing and promoting competition pursuant to this chapter, for assessing per kwh-based charges against retail customers in conjunction with allocating (i) such stranded costs as may be determined pursuant to §56-591.1, or (ii) any transition costs [should be defined] allocated to retail customers under any other provision of this chapter."

Comments:

The legislative guidance to the Commission -- that mechanisms to assess and allocate recovery of stranded costs and transition costs must be developed to maximize and promote competition -- is a positive expression of legislative intent. However, the draft correctly notes that the term transition costs is yet to be defined. AEP suggests that such definition must include any costs associated with the consumer education program to be developed under §56-589, and all other transition related programs which may be eventually required.

The draft language also falls short of providing sufficient direction to the Commission on how stranded costs and transition costs should be allocated and the resulting ¢/kwh recovery factors developed. Cross subsidiaries between customer classes continue to be a problem for AEP-VA and should not be exacerbated by how these costs are allocated. If anything, the legislation should address the need for the SCC to eliminate cross-subsidization among classes of customers.

III. §56-579.1 (12/31 draft, pp.1-2):

The draft establishes "capped rates" from January 1, 2001 through December 31, 2004, unless extended annually by the SCC upon a determination that "effective competition" does not exist within a service territory. Bundled capped rates are established for a customer receiving default or supplier of last resort service; a capped rate for generation service is also established for customers opting to purchase generation from another supplier.

Comments:

The fact that the draft provides for the possibility that rates be capped for some unknown period beyond December 31, 2004 is especially troubling for AEP. There needs to be some definitive end-date.

Only the generation service component needs to be capped. As provided for in AEP's draft legislation, the distribution-related component established by the SCC at the outset, and the transmission service component under the applicable FERC Open Access Transmission Tariff, should be subject to regulation throughout the period of capped rates and thereafter. The amount remaining once the distribution and transmission service components are initially determined equals the capped generation component for customers that elect not to choose an alternative supplier during the capped rate period. Once a customer exercises choice, the capped generation component is no longer available because the utility must have the ability to market that generation.

Contrary to the draft, there is no reason to establish a capped generation component for customers opting to purchase generation from another supplier.

In no event should the capped generation component be applicable when the incumbent utility becomes an emergency service provider (supplier of last resort). While the customer would continue to be responsible for the contract price, as explained in my December 30, 1998 letter, the non-performing supplier must be responsible for the full cost of replacement energy, including the cost of the energy, the cost incurred by others as a result of the non-performance, and the assessment of penalties as may be approved either by the SCC, to the extent not precluded by federal law, or by the FERC.

IV. §56-583 C and §56-593 C.3. (sic) (12/26 Draft, p. 7 and 12, respectively):

The Draft succinctly states that the SCC shall establish "codes of conduct". . . .

Comments:

Our preference in this area is that the code of conduct be legislated. However, if the Drafting Group is uncomfortable adopting explicit rules along the lines set out in the draft legislation previously supplied by AEP, at a minimum, there should be some indication that the legislation does not intend to preclude or even hamstring affiliates of incumbent utilities from being active participants in the competitive generation market. Any such rules should encourage competition among as many players as possible and not be designed to advantage or disadvantage any participants.

V. §56-590.1 A, B (12/31 draft, pg. 6-7)

This section directs the Commission to establish net energy metering provisions designed to, among other items, encourage private investment in renewable energy resources; and, in defining net energy metering arrangements, it requires corresponding billing or crediting of the customer-generator retail customer account by that customer's chosen supplier.

Comments:

AEP does not oppose efforts to encourage development of renewable energy, economic growth or diversification of Virginia's energy resource mix. However, we believe that renewable energy must develop through normal market forces and that any specific measures adopted to facilitate such encouragement should not interfere with market-based pricing, or provisions related to billing or payment. The provision which appears to mandate billing credits by a customer's supplier for net energy metering arrangements should be either left to market forces or, if considered by the Legislature to be an appropriate method to effectuate encouragement of renewables, handled through some form other than an intrusion into pricing or contracting in competitive energy markets.

Finally, I would note that AEP's comments on the December 21, 1998 (4:40 p.m.) draft language related to tax issues (reflecting the activities of the December 17, 1998 drafting group meeting) are being submitted in a separate letter. Those comments contain specific recommendations and technical changes which support the general goals of fairness and revenue neutrality. I would like to take this opportunity to emphasize that it is imperative that the proposed language concerning FASB 109 must be included in any tax legislation in order to prevent incumbent utilities from experiencing substantial writeoffs for financial purposes.

Thank you for this opportunity to provide comments on the draft legislation.

Sincerely,

R. Daniel Carson, Jr.

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The Honorable Harry J. Parrish
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