January 6, 1999

BY FAX TO 371-0169

Mr. Arlen K. Bolstad
Division of Legislative Services
General Assembly Building
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910 Capitol Street
Richmond, Virginia 23219

Dear Arlen:

The Commission staff submits the following comments and suggested revisions to the four drafts, identified below, which you and your staff have prepared recently.

STRUCTURE AND TRANSITION DRAFT SUPPLEMENT, 12/31/98, 2:55 P.M.

1. It was the Commission staff's understanding that when the Drafting Committee, in its meeting on December 29, 1998, adopted the concept of a "rate ceiling" or a "rate cap," these terms meant that rates could not go above that level, but that the Commission would retain its currently-existing authority to reduce rates, after an appropriate investigation, if it found such reduction was necessary to achieve just and reasonable levels. Such action could be taken on the Commission's own initiative or upon request from other parties, including the utility.

Two aspects of the draft need to be modified to incorporate these decisions.

First, it should be made clear that the concept of "capped rates" includes the points made above.

Second, § 56-579.1.B at the bottom page 1 lists two reasons for which rates might be increased under a "cap"-- to recover fuel costs, and to deal with emergency conditions. This itemization could be misconstrued to suggest that these are the only two reasons why rates might be changed, and then only to increase them, contrary to the Committee's December 29 decisions.

2. Various clarifying language in other sections of the draft should be added, as shown below. For example, the draft states that the capped rate applies to default or last resort service; however, the capped rate goes into effect 1/1/01, while these services would not go into effect until customer choice. We understood the Committee to have intended that the ceiling apply to present utility customers before customer choice begins, and to last resort or default service customers after customer choice begins. Our proposed changes below attempt to record this understanding.

3. Section 56-592.A and B, dealing with non-bypassable wires charges and early payment of stranded costs, essentially duplicates language found in § 56-591.A and C of the December 31 Stranded Costs draft, and the former passage should be deleted, since the latter is clearer, with the changes to that section we will suggest below.

We would suggest rewriting § 56-579.1, subsections A and B, as follows, with our changes shown in bold italics and strike-throughs:

§ 56-579.1 Rate caps.

A. The Commission shall establish ***just and reasonable ceilings on electric*** ~~**capped**~~ rates, effective January 1, 2001 and, unless extended as provided hereafter, expiring on January 1, 2005, for each service territory ~~**of every**~~ ***served by an incumbent electric utility as of the date of customer choice***, as follows:

1. A capped rate shall be established for bundled ***electric service, which shall include, at a minimum,*** transmission, distribution and generation services***. Such rate shall be*** applicable to ***all customers prior to the date of customer choice, and thereafter, to those customers*** receiving (i) default service, or (ii) supplier of last resort service.

2. A capped rate for electric generation services, only, shall also be established for the purpose of ~~**effecting**~~ ***facilitating*** customer choice for those retail customers authorized and opting to purchase generation services from a supplier other than the incumbent utility during this period, and any extensions thereof.

3. In establishing such capped rates, the Commission shall use a rate method that promotes the public interest, and may establish different rates, terms and conditions for different classes of customers.

B. Such capped rates shall not be increased during the period established in § 56-579.1.A, above, or any extension thereof, except for increases due to (i) utilities' recovery of fuel costs pursuant to § 56-249.6, and (ii) emergency conditions as provided in § 56-245. However, the Commission may, during such period, or any extension thereof, decrease said rates if it finds, after notice and opportunity for hearing, that such decrease is necessary to produce just and reasonable rates.

~~**B. The Commission may adjust such capped rates in connection with (i) utilities' recovery of fuel costs pursuant to § 6-249.6, and (ii) emergency conditions as provided in § 56-245.**~~

On page 2, line 10, the phrase "per kWh-based" should be deleted. This phrase would be inconsistent with our suggestion in the draft language above requiring the Commission to select a rate method that promotes the public interest, etc.

Your draft also notes that the term "effective competition" should be defined. We suggest:

> "Effective competition" means a market in which no individual seller is able to influence significantly the price of service as a result of (1) the number of sellers of the service, (2) the size of each seller's share of the market, (3) the ability of sellers to enter and exit the market, and (4) the price and availability of reasonable substitutes for the service.

STRANDED COSTS DRAFT, 12/31/98, 3:07 P.M.

1. This draft, in stating in § 56-591 that the Commission "shall...determine for each incumbent electric utility the just and reasonable net stranded costs...." suggests that such determination will be a one-time matter, never to be re-examined. While it might be possible, though difficult, to determine the

costs incurred by a utility prior to a certain date in a single proceeding, the question of whether such costs are stranded is one which should be analyzed on a periodic basis.

The reason for this re-appraisal is that the market's valuation of any asset, group of assets or costs will change over time, and the issue of whether a cost is stranded or not depends on a comparison of the market value of the asset with its cost. We thus suggest that the following sentence be inserted at the end of the sentence on line 11, subsection A, of § 56-591:

> The Commission may adjust such determination from time to time in order to reflect changes in the market values associated with such assets and obligations.

Also, in subsection A, the date on which stranded costs are to be fixed, January 1, 2002, is probably too early from the perspective of the incumbent utilities. While the phase-in to full competition will begin on that date, many customers will not have shopping rights at that time, and the incumbent's obligation to serve will still be in effect. We suggest deleting the date and substituting the term "the date of customer choice" as you do later in the same subsection.

In subsection B of § 56-591, stating that the Commission is to (1) set a recovery period for the amounts determined under subsection A, and (2) that such period shall continue until the Commission determines all stranded costs have been recovered, are inconsistent concepts. There is no reason to fix a period for recovery initially, if such period is not to end until a determination of full recovery is made at some later date. Setting such a recovery period initially is also inconsistent with the point made above, that market values of assets and costs will change over time, leading to a reappraisal of the "stranded" nature of various costs.

We suggest that the following language be substituted for present subsection B:

> The Commission shall, in specifying the amounts, terms, conditions and periods of effectiveness of any wires charges, permit each incumbent electric utility a reasonable opportunity to recover any net stranded costs determined to be recoverable under subsection A, above. After such reasonable opportunity has expired, no further stranded costs shall be recoverable.

STRUCTURE AND TRANSITION DRAFT, 12/26/98, 11:12 A.M.

56-579: Schedule for transition to competition

579(A)(2) (**equal percentage of customers):** Note that (c)(1) (authorizing SCC to allow residentials and small business to shop before other retail customers) is in conflict with (b) requiring SCC to allow equal percentages from each class to shop simultaneously; also (c)(2) is redundant of (b). Therefore, we suggest deleting (c).

579(C): Instead of "Upon the separation and deregulation of the generation function and services," substitute "Upon the implementation of competition within the generation function and services,...."

> **Reason**: the term "deregulation" is not otherwise referenced, and there will be some "regulation" in the sense of licensing.

56-581: ISOs

581(B)(2): delete the requirement that "No incumbent electric utility shall be authorized by the Commission to establish or join any ISO unless residential retail customers are represented on the ISO's governing board."

> **Reason**: The Commission fully supports the goal of residential ratepayer representation. However, this requirement may make it impossible for a utility to meet the ISO requirement. FERC has not imposed this requirement, no other ISO has this requirement and other states might not impose the same requirement. The general criteria given to the Commission with which to review ISO proposals should suffice. Alternatively consider replacing this sentence with: "***The incumbent electric utility and the Commission shall take all action possible to secure representation by residential retail customers on the ISO's governing board***."

581(C): delete the final phrase: "whenever such proceedings concern the approval or modification of any ISO of which an incumbent electric utility is or proposes to be a member."

> **Reason**: The deleted language inadvertently limits the situations in which the SCC can intervene at FERC.

56-586: Suppliers of last resort

Comment: In general, there is no reason to make statutory distinctions among last resort, default and backstop service. The boundaries between each of these categories may be fluid and hard to define. If the general concept is defined sufficiently broadly, further distinctions can be made by rules.

56-586(A): line 11: delete the phrase "during the transition to customer choice."

Reason: The Committee on December 21 decided (see 56-586(D)) that last resort or default service should be available beginning with the date of customer choice, until such time as the Legislature determines it is no longer necessary.

56-593: Divestiture, functional separation and other corporate relationships

56-593(B)(2): in line 23, "may be" should be "shall be." The "may" in conjunction with the passive tense creates some ambiguity.

56-593(E): mergers and acquisitions:

Comment: If and when the Committee selects a phrase for the concept of last resort, draft, backstop or basic service, the provider of such service should be included within the category of "covered entities," so that acquisitions of or mergers with such entities come to the Commission for approval.

CONSUMER, ENVIRONMENT & EDUCATION DRAFT, 12/31/98, 2:56 P.M.

1. Licensing of "aggregators," specified in § 56-587, can easily be combined with the licensing of "retail electric energy suppliers" found in § 56-585 of the December 26, 1998, Structure and Transition Draft. The two sections are very similar, and both are not needed.

2. In § 56-589.1, dealing with a private right of action, the two year limitation on exercising such right is tolled in

subsection C at the time "the Commission...files suit for the purpose of enforcing the provisions of subsection C of § 56-589...." The problem with this language is that the Commission, as an entity with the powers of a court of record, normally institutes and conducts its own enforcement proceedings in regard to any statutory authority it is given by the General Assembly, without resorting to the court system. Indeed, as you aware, the Virginia Constitution denies to any court but the Supreme Court the power to revoke, annul or overturn any decision of the Commission.

We would thus suggest that the language on lines 25 of page 5 be changed to read:

> Commission ***institutes a proceeding***, or any other governmental agency files suit for the purpose of enforcing the provisions of subsection C of s 56-589, the time during which such ***proceeding or*** governmental suit and all

Sincerely,

Stewart E. Farrar
Solicitor General

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