

REPORT OF THE  
JOINT SUBCOMMITTEE STUDYING

**RESTRUCTURING OF THE  
ELECTRIC UTILITY INDUSTRY**

TO THE GOVERNOR AND  
THE GENERAL ASSEMBLY OF VIRGINIA

**SENATE DOCUMENT NO.**

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**Report of the  
Joint Subcommittee Studying  
Restructuring of the Electric Utility Industry  
To  
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General Assembly of Virginia  
Richmond, Virginia  
1997**

TO: The Honorable George F. Allen, Governor  
and  
The General Assembly of Virginia

**I. INTRODUCTION**

Senate Joint Resolution 118 of 1996 (*Appendix A*) established a joint subcommittee to study the potential for electric utility industry restructuring within the Commonwealth. Virginia thus joined more than 40 other states and the District of Columbia in asking whether deregulating the retail electricity market is appropriate and in the public interest. Responding to intense nationwide interest in this issue, legislators and public utility regulators are addressing an important question: whether electricity customers should be permitted to choose electric companies with the same ease telephone customers select their long distance carriers.

Those favoring a deregulated retail market believe that electricity customers are best served by an open market that includes the traditional players (such as investor-owned utilities and electric cooperatives) plus a cadre of new entrants that include independent power producers and power marketers. Competition proponents assert that conventional delivery through franchised service territories is expensive and inefficient. However, others contend that in Virginia, electric service is reliable and moderately priced. What is not broken, they say, does not require repair.

A handful of states, including New Hampshire, Pennsylvania and California, have enacted retail competition legislation establishing pilot and other experimental programs permitting retail customer choice. The key question before this joint subcommittee was whether Virginia should join these states in laying the statutory groundwork for business, residential and industrial customer choice in a deregulated retail electricity market.

The following General Assembly members served on the joint subcommittee: Senators Reasor of Bluefield, Holland of Windsor, and Norment of Williamsburg, appointed by the Senate Committee on Privileges and Elections; and Delegates Woodrum of Roanoke, Plum of Reston, J.C. Jones of Norfolk and Watkins of Midlothian appointed by the Speaker of the House. Senator Reasor chaired the joint subcommittee, and Delegate Woodrum served as its vice-chairman.

The joint subcommittee convened four meetings between the 1996 and 1997 Sessions of the General Assembly, three at the Capitol in Richmond and one in Charlottesville. It devoted its meetings to learning about restructuring by providing a forum for electricity market stakeholders. To that end, representatives of investor-owned utilities, electrical cooperatives, independent power producers, and municipal power system operators, together with representatives of business, industrial, and residential electric power customers; natural gas distribution companies; and environmental and consumer groups all appeared before the joint subcommittee to share their views on retail competition and other facets of electric industry restructuring.

Members of the Virginia State Corporation Commission's (SCC) staff also appeared before the joint subcommittee to summarize their conclusions and recommendations to the SCC's commissioners concerning electric utility restructuring. The report followed an extensive study of restructuring by the staff of the Energy Regulation and Economics & Finance sections within the SCC's Public Utilities division. The report observed that retail competition has gained the most momentum in California and in Northeastern states where electric rates are highest. Virginia's electricity market is stable, reliable and moderately priced, the report further noted and then concluded that Virginia's electricity customers would benefit most from a go-slow approach to restructuring with the SCC monitoring and analyzing retail competition programs in other states.

One meeting was held in Charlottesville in conjunction with an SCC-sponsored forum on restructuring. In addition to learning about recent SCC orders related to restructuring, the joint subcommittee also received testimony about the entry of regulated electric utilities into unregulated business activities. Owners and operators of heating, air conditioning and ventilation (HVAC) companies appeared before the joint subcommittee to protest the anticipated entry of a Virginia electric utility (through an affiliated company) into the heating and cooling equipment service contract and warranty repair market. The Air Conditioning Contractors of America (ACCA) and other HVAC industry representatives believe the utility's market power, coupled with direct access to a sizable customer base (generated by its regulated activities), poses an anti-competitive threat to HVAC companies, most of which are small businesses.

The SJR 118 joint subcommittee held its final meeting immediately prior to the 1997 Session to discuss draft legislation continuing the study in 1997. The joint

subcommittee approved and the 1997 Session enacted Senate Joint Resolution 259 (*Appendix B*), which (i) continues the joint subcommittee's examination of retail competition and (ii) requests the Virginia State Corporation Commission staff to provide to the joint subcommittee by November 7, 1997, its draft of a working restructuring model, which may include experiments and pilot programs. The resolution also directs the joint subcommittee to consider the effects of electric utility restructuring on small business and residential consumers, and on the environment.

The joint subcommittee also met during the 1997 Session to (i) review proposed amendments to Senate Joint Resolution 259 and (ii) anticipating SJR 259's passage, to establish a special task force to examine restructuring's potential impact on state and local tax revenues.

## **II. OVERVIEW**

The principal issue before the joint subcommittee was whether conventional methods of delivering electricity to residential and business customers in the Commonwealth through franchised public utilities should be shelved in favor of a deregulated, competitive market. The intense debate over electric industry restructuring on state and federal levels originated in federal energy initiatives, with the current round prompted largely by the federal Energy Policy Act of 1992 (EPACT).

Building on the Public Utilities Regulatory Policy Act of 1978 (PURPA), EPACT authorized nonutility generators (producers of electricity having no transmission facilities or distribution systems) to sell electrical power in the wholesale market at unregulated market rates. PURPA had required utilities to purchase power from nonutility generators, but at rates that reflected costs utilities would avoid by purchasing power rather than generating it. PURPA and EPACT together mandate nonutility generator access to public utilities' transmission networks to facilitate wholesale power sales. Moreover, utility charges for such access must be reasonable and nondiscriminatory.

In 1996 and 1997, congressional public utility activity shifted from wholesale to retail electrical power sales. Several bills were introduced that would preempt state law on this issue, mandating customer choice nationwide. The federal bills also address numerous ancillary issues such as generation facility emissions, utility use of renewable energy sources, and utility recovery of stranded investments and nuclear plant decommissioning costs. The "Electric Consumers Protection Act of 1997" (S. 237) is typical of such federal legislation. No consensus on restructuring has yet developed, however, in the House Commerce or Senate Energy and Natural Resources committees considering these bills.

Retail competition is also under legislative consideration by many of Virginia's sister states. Nearly all states are studying the issue, and several states, including New Hampshire, California and Pennsylvania, have enacted legislation authorizing retail competition on some level. In New Hampshire, for example, a 1995 retail choice pilot program will give way to full implementation for all customer classes in 1998. California's retail competition initiative is also scheduled for full implementation in 1998.

The joint subcommittee noted that retail deregulation raises practical and policy considerations in three distinct categories: (i) the opportunities and challenges presented by "unbundling" electrical generation from transmission and distribution; (ii) the potential for "stranded" utility assets; and (iii) competitive and regulatory parity between utilities and nonutility generators in the emerging deregulated market. An overarching issue is whether regulatory responses to these issues should be enacted state by state, or in comprehensive federal legislation.

### **III. PERSPECTIVES: POWER PRODUCERS AND SUPPLIERS**

#### **A. INVESTOR-OWNED UTILITIES**

Investor-owned utilities represent the current model for electric power delivery throughout the U.S., exclusive of public power sources such as the Tennessee Valley Authority (TVA). Electricity is delivered through franchised service territories in which utilities are obligated to furnish retail electric service to all consumers and businesses in those territories at regulated rates. In exchange for the obligation to serve, utilities obtain the sole right to provide electric service in these areas, to the exclusion of any other potential provider. Representatives of investor-owned utilities, including the Edison Electric Institute (EEI), a trade association representing such utilities, appeared before the joint subcommittee to present their views on restructuring. Virginia's EEI members include Virginia Power; American Electric Power; Virginia (AEP Virginia); and Potomac Edison (an Allegheny Power operating unit).

Virginia Power (with retail electricity sales centered in the Commonwealth) favors a state-based approach to the restructuring process, preferring the Virginia State Corporation Commission to Congress as the principal forum for Virginia's restructuring debate (*Appendix C*). According to Virginia Power, the current pressure for retail deregulation exerted by large industrial customers is premature and unnecessary because electric service in Virginia is reliable and reasonably priced.

Virginia Power urged the joint subcommittee to consider carefully the potential impact of retail competition, including system reliability, parity among

competing suppliers, the possibility of cross-subsidization and cost-shifting among consumer classes, and the potential for stranded investments. The company expressed considerable concern about retail competition's potential to leave electric utilities with stranded investments, i.e., service and facility investment costs incurred and likely recoverable in a regulated structure that may not be recouped in a fully competitive market.

Allegheny Power, on the other hand, expressed support for 50-state uniformity and a preference for regional or national guidelines. Allegheny, with an interstate service territory, advocates a deregulated, market-priced environment for electrical generation in which electrical transmission and distribution would continue to be regulated (*Appendix D*). AEP Virginia, a subsidiary of American Electric Power, however, supports state-originated retail competition initiatives, but emphasized the need for assured equal access to interstate markets, or some form of state market reciprocity (*Appendix E*).

AEP Virginia favors retail customer choice for generation services. It believes that fair and efficient competition, with customer access to a large body of generating companies and resources, can best be accomplished by the creation of independent system operators (ISOs). ISOs would assume independent operating control, but not ownership, of the transmission systems of utilities within large regions of the country. Transmission pricing would be simplified and cost based. In effect, an ISO would define the boundaries of a regional market for generation services.

## **B. INDEPENDENT POWER PRODUCERS**

Nonutility generating companies, also known as independent power producers (IPPs), with more than \$3.7 billion in generating facilities in Virginia advocate the swiftest possible route to retail competition. The Virginia Independent Power Producers, an IPP trade association, reported that approximately 60 percent of Virginia's new generating capacity within the past 10 years has been provided by IPPs. IPPs view federal support and endorsement of full, nationwide retail competition as inevitable, and assert that a competitive market will be more financially beneficial to Virginians than the current regulated system (*Appendix F*).

## **C. ELECTRICAL COOPERATIVES**

Virginia's electric cooperatives favor a go-slow approach to electric market restructuring. The co-ops were represented before the joint subcommittee by the Virginia, Maryland and Delaware Association of Electric Cooperatives. With distribution facilities in Virginia's less densely populated areas, the co-ops expressed concern about the fate of their residential customers if co-op industrial customers (representing less than two percent of their customer base, but over 22

percent of their electrical sales) leave the co-op system. Furthermore, they contend that stranded costs resulting from retail competition should be borne by those who choose to leave their current supplier, and not by the remaining customers such as the small business and residential customers who comprise 98 percent of their customer base (*Appendix G*).

#### **D. MUNICIPAL POWER SUPPLIERS**

A number of Virginia's municipalities purchase electrical power from public utilities for resale to municipal residents. The cities of Harrisonburg and Blackstone are typical of localities with municipal power supply systems. Their power system managers appeared before the joint subcommittee to express concern about the potential impact of retail competition on municipal power suppliers who rely on electric utilities' reserve generation capacity--a capacity that could easily be eliminated in a highly competitive retail environment.

Without utility generating reserves, municipal power systems could find it increasingly difficult to purchase affordable power for their customers. The Harrisonburg and Blackstone power system managers also expressed concern that their larger business customers could potentially abandon them for better deals from remote generators, leaving municipalities with the problem of recovering the cost of distribution system improvements made for the benefit of business customers. Thus, stranded costs were seen as a potential problem for municipal power suppliers as well.

### **IV. SCC STAFF REPORT ON RETAIL COMPETITION**

The Virginia State Corporation Commission's public utility staff prepared a report in 1996 on utility restructuring for the SCC commissioners, and summarized their findings about retail competition for the joint subcommittee (*Appendices H, I and J*). The reasons for national interest in retail competition, the staff said, include the development of low-cost, natural gas-fired units, an excess of base-load capacity resulting in low cost power availability in the spot market, and sharp regional price differences. Federal energy regulatory policies have contributed as well, they said, citing Federal Energy Regulatory Commission (FERC) Order 888, which requires electric utilities to offer transmission services for the transport of electricity. Members of Congress have also added momentum by introducing retail competition bills, including a measure calling for retail customer choice by the year 2000.

SCC staff recommended a measured, incremental approach to retail competition in Virginia since residential electric rates in the Commonwealth are, on average, the 27th lowest in the U.S., while industrial customers are currently paying the 15th lowest rates. Consequently, Virginia is unlike states such as

California and New York where utility rates are high, and thus the SCC staff sees no immediate need to begin retail competition--on an experimental basis or otherwise. However, the staff has recommended that the SCC monitor retail competition experiments in other states to help answer some of the following questions: (i) Will all customers benefit from retail competition? (ii) Will price volatility be acceptable to all customers? (iii) What will become of the excess capacity currently driving the market toward retail competition? (iv) How should retail competition be structured to minimize stranded costs and benefits?

SCC staff concluded that Virginia's electric utilities are furnishing reliable service at moderate prices, and that there is little to gain by rushing into retail restructuring. The staff did, however, recommend to the Commission several steps Virginia could take in the meantime, including the following: (i) prices for all utility services should be "unbundled" (separated into their component parts of generation, transmission and distribution) for informational purposes, and "real time" pricing should be explored; (ii) reserve margins for utilities should be scrutinized and studied; (iii) utilities should seek to renegotiate high-cost contracts with nonutility generators; (iv) an updated and thorough cost of services study should be completed for each public utility; and (v) conservation and load management programs should be reviewed. An SCC order dated November 12, 1996, incorporated these recommendations in directives to Virginia's electric companies and electric cooperatives (*Appendix K*).

## **V. ELECTRICITY CUSTOMERS' VIEW OF RETAIL COMPETITION**

Energy customers appeared before the joint subcommittee to express their views about electrical market restructuring and retail competition. The Alliance for Lower Electricity Rates Today (ALERT), a coalition of industrial, business and residential customers, favors moving forward expeditiously to retail competition. ALERT representatives advocated doing more in Virginia than merely monitoring retail competition activities in other states, and asserted that retail competition will result in significant electric customer savings (*Appendix L*).

The Committee for Fair Utility Rates, an association of Virginia Power's 20 largest industrial customers, told the joint subcommittee that the paramount issue is whether the Commonwealth will embrace retail competition or wait passively for Congress to enact federal legislation providing such choice. The Committee favors a structured transition to customer choice, including (i) "hands on" experience with a retail competition, (ii) study and development of rules for customer choice, and (iii) the implementation of customer choice when feasible (*Appendix M*). Hoechst Celanese, a large AEP Virginia industrial customer also expressed its desire for customer choice by the year 2000 (*Appendix N*).

The Virginia Citizens Consumer Council (VCCC) advocates residential rates that are as low as possible and that assure the reliable, safe delivery of electricity. However, a VCCC representative cautioned, residential customers are at great risk if electric utility restructuring is done poorly without safeguards and protections. The VCCC suggested that goals for a restructured electric industry should include (i) restructuring and not cost shifting among customer classes, (ii) real price benefits for consumers, including affordable electricity bills for low-income customers, (iii) retaining price regulation of transmission and distribution to avoid anticompetitive behavior, and (iv) maximum public participation (*Appendix O*).

## **VI. NATURAL GAS INDUSTRY PERSPECTIVES**

A representative of Washington Gas, a large natural gas distributor, told the subcommittee that competition will bring the benefits of greater choice and lower rates to electricity consumers in Virginia (*Appendix P*). However, he said, if electric utilities are permitted to sell natural gas to retail customers--as they are doing now--gas companies should be given a reciprocal right to sell electricity. Washington Gas believes that the SCC staff's go-slow recommendations do not go far enough; that it is not enough to merely develop unbundled prices for generation, transmission and distribution for informational purposes. It proposes that the General Assembly enable the opening of the retail electricity market, at least on a pilot basis.

## **VII. ENVIRONMENTAL IMPACT OF RESTRUCTURING**

According to the Southern Environmental Law Center, the potential environmental impacts of restructuring are significant. If the electric utility industry is deregulated improperly, a Center representative told the joint subcommittee, deregulation will increase the environmental damage caused by power production. Retail competition could, for example, create additional markets for older power plants which enjoy an economic advantage because of depreciation and relaxed environmental standards for such plants.

Exemptions in the federal Clean Air Act for older plants allow plants built prior to 1977 to emit two to ten times the level of key pollutants as similar new plants. If plants of this age are kept in service longer and run more frequently, there could be dramatic increases in air pollution, a Center representative said. The Center also advocates continued emphasis on utility investment in energy conservation and load management and expressed concern that retail competition will result in utilities focusing exclusively on short-term prices with less emphasis on energy efficiency (*Appendix Q*).

## **VIII. ANCILLARY ISSUES: ELECTRIC UTILITY COMPETITION WITH HEATING AND AIR CONDITIONING CONTRACTORS**

Representatives of the Air Conditioning Contractors of America (ACCA) appeared before the joint subcommittee to express the organization's concerns about competition from regulated electric utilities. The focal point of ACCA's concern was Virginia Power's acquisition of a subsidiary for the purpose of entering the electric appliance and equipment warranty repairs market. ACCA had formally opposed the utility's application for SCC approval of this affiliated relationship (*Appendix R*).

In 1996 the SCC approved Virginia Power's use of this subsidiary for commercial and industrial warranty service, but the application for residential service was withdrawn by Virginia Power before the SCC formally acted on it. ACCA expressed concern that the residential market entry issue was far from resolved, and that Virginia Power could take advantage of its size and a current customer base of nearly two million to compete unfairly with small HVAC companies for warranty and repair work. ACCA representatives cited Baltimore Gas & Electric's sale of nearly 40 percent of all appliances sold at retail in the Baltimore area as an example of utilities' potential market power in nonregulated areas.

## **IX. CONTINUING THE RESTRUCTURING STUDY IN 1997**

At its final meeting before the 1997 General Assembly Session, the joint subcommittee recommended continuing this legislative study on restructuring. Noting the Virginia State Corporation Commission's orders designed to develop data needed for the SCC's internal study of restructuring, the joint subcommittee concluded that continued legislative monitoring of these and other developments--including those occurring at the federal level and in other states--was warranted.

Accordingly, the joint subcommittee approved and the 1997 Session enacted Senate Joint Resolution 259 (*Appendix B*) which (i) continues the joint subcommittee's examination of retail competition and (ii) requests the Virginia State Corporation Commission staff to provide to the joint subcommittee by November 7, 1997, its draft of a working restructuring model, which may include experiments and pilot programs. The resolution also directs the joint subcommittee to consider the effects of electric utility restructuring on small business and residential consumers, and on the environment.

Respectfully submitted,

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