

REPORT OF THE
JOINT SUBCOMMITTEE STUDYING

**RESTRUCTURING OF THE
ELECTRIC UTILITY INDUSTRY**

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

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**Report of the
Joint Subcommittee Studying
Restructuring of the Electric Utility Industry
To
The Governor and the
General Assembly of Virginia
Richmond, Virginia
1998**

TO: The Honorable James S. Gilmore, III, Governor
and
The General Assembly of Virginia

I. INTRODUCTION

Overview.

Senate Joint Resolution 259 of 1997 (Appendix A) continued the General Assembly's examination of electric utility industry restructuring. The study was initially begun pursuant to Senate Joint Resolution 118 of 1996 to determine whether restructuring the retail electricity market is feasible and in the public interest. Retail restructuring, as envisioned by its principal proponents, would permit industrial, commercial and residential electricity customers to purchase electric generation services from the providers of their choosing, leaving regulated local distribution of electricity.

Members appointed.

The following General Assembly members who served on the SJR 118 subcommittee were reappointed to serve on the SJR 259 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, Watkins of Midlothian, Plum of Reston, and J.C. Jones of Norfolk, appointed by the Speaker of the House. Senator Reasor chaired the joint subcommittee, and Delegate Woodrum served as its vice-chairman.

Work of the subcommittee in 1997.

A key provision in SJR 259 requested the Virginia State Corporation Commission (SCC) to develop a restructuring plan for Virginia to be presented to the joint subcommittee in November 1997. In preparing to receive that report, the joint subcommittee (i) examined restructuring developments at the federal level

and in other states, (ii) reviewed technical constraints on retail competition, (iii) received reports and recommendations from public utilities, electric cooperatives, large industrial customers, consumer and environmental groups, and other individuals and organizations with a stake in the outcome of this debate, and (iv) examined restructuring's likely impact on state and local tax revenues.

Activities in other states.

The joint subcommittee learned that virtually every state is studying this issue. While no restructuring plan is fully operational at this time, California will begin retail competition in April 1998. Other states, such as New Hampshire and Pennsylvania, are in the process of conducting or evaluating retail competition pilot programs in which percentages of customer classes are permitted to purchase their electrical generation from sources other than their local public utilities. By the end of 1997 over a dozen states had adopted some form of restructuring plan, either through legislation or through regulations adopted by state public service commissions.

Federal activities.

Federal restructuring activities continued to be a significant part of the joint subcommittee's discussion in 1997. The Energy and Natural Resources Subcommittee of the House Commerce Committee included Richmond in its tour of U.S. cities in which public hearings were held on electric utility restructuring. An April 1997 public hearing was convened at the Henrico County Government Center by the subcommittee's chairman, Congressman Dan Schaefer of Colorado, and Congressman Tom Bliley, the Commerce Committee's chairman—both of whom advocate retail competition.

Senator Jack Reesor, the joint subcommittee's chairman, appeared before this congressional subcommittee in August (as part of a panel of state representatives from California, Idaho, New Hampshire, New Mexico and Virginia). Senator Reesor expressed his view that the states were capable of developing restructuring plans and urged the subcommittee to focus its attention on removing federal statutory and regulatory barriers to restructuring, rather than on imposing federal control over the retail distribution and sale of electricity.

State and Local Taxation.

An emerging issue in the restructuring debate is the potential impact of retail competition on state and local tax revenues generated by taxation of electric utilities' gross receipts. The principal problem is the questionable constitutionality of levying gross receipts taxes on out-of-state generation providers. In a comparable context, the U.S. Supreme Court has disapproved state taxation of out-of-state

companies' mail order sales where the companies' sole presence in the taxing state is marketing activities.

The largest component of an electric bill is the generation component. Thus, losing the ability to assess gross receipts tax on out-of-state generation sales could have an adverse impact on tax revenues to the general fund and localities. The state's General Fund currently receives approximately \$95 million from gross receipts taxes paid by Virginia's electric utilities; localities receive about \$27 million in gross receipts taxes imposed on electric utilities through local license taxes.

A secondary taxation concern is the potential reduction in tax revenues tied to locality taxation of utility assets (at property tax rates) if electric utilities' installations or operating centers are idled due to the forces of competition and their property assessments for local tax purposes reduced proportionately.

The joint subcommittee appointed a twelve-member task force to look at restructuring tax issues. The task force, led by Delegate (now Senator) John Watkins, included representatives from the Department of Taxation, the Virginia State Corporation Commission, the Office of the Attorney General, the Virginia Municipal League, the Virginia Chamber of Commerce, the Virginia Association of Counties, investor-owned utilities, electric cooperatives, and independent power producers. The taxation task force was appointed in March 1997 and met several times during the year to develop a plan for maintaining taxation of electric utility activity on a revenue neutral basis without changing the proportions of taxes currently paid by customer classes.

Task force members addressed the out-of-state generation provider issue by endorsing a "declining block" end-user tax in combination with a corporate net income tax. Under such a plan, generation companies' locations would no longer be of concern; electric energy would be taxed at the point of consumption. This would not constitute a new tax since the gross receipts taxes paid by electric utilities are currently embedded in customers' utility rates. Additionally, companies engaged in the generation of electricity within Virginia would pay Virginia corporate income taxes if their activities in Virginia would otherwise require them to pay Virginia state income taxes. The distribution of electricity would not be subject to taxation under this proposal. Taken as a whole, the combination of the consumption tax and corporate net income tax was viewed as the mechanism most likely to succeed in keeping post-restructuring state and local utility tax revenues at their current levels.

SCC Report to the joint subcommittee; stakeholder responses.

The joint subcommittee's November 7 meeting featured the SCC's presentation of its suggested restructuring plan for Virginia. The multi-phased

model contained a study phase from 1998 to 2001 in which rate experiments, pilot programs and independent system operator (ISO) and regional power exchange (RPX) formation would take place. Phase II (2000 to 2002) called for a decision-making period in which both regulatory and legislative review of the results of Phase I would determine whether to proceed beyond that point. In the third phase (2002-2005), restructuring could commence, to be concluded by 2005.

Stakeholder responses to the SCC plan ranged from general endorsement to broad reservations. The American Association of Retired Persons (AARP) and the Virginia Citizens Consumer Council (VCCC) supported the SCC's deliberative approach to restructuring, while others, including representatives of electric cooperatives and Virginia's natural gas industry, expressed concern about the absence of SCC direction on stranded costs formulas and stranded cost mitigation. The Southern Environmental Law Center, a Charlottesville-based environmental organization, said that the SCC's plan identified some of the environmental problems posed by restructuring, but failed to identify or propose specific solutions to them.

Proponents for restructuring, including the Alliance for Lower Electricity Rates Today (ALERT) and the Committee for Fair Utility Rates, criticized the plan for moving too slowly toward competition. They also rejected the SCC notion of restricting competitive sales to those made through exclusive regional power exchanges. They urged the alternative availability of direct, bilateral contracts between power suppliers and customers, contending that exclusive pools could have the effect of encouraging power suppliers to engage in market price manipulation—thereby capturing large profits on all dispatched plants.

The heaviest criticism of the SCC plan came from an organization representing apartment and office building owners in Northern Virginia and metropolitan Washington, D.C. The Apartment and Office Building Association of Metropolitan Washington (AOBA) told the subcommittee that the plan was deficient in its failure to (i) specifically address a stranded costs recovery formula, (ii) advocate pilot programs large enough to make data generated by such pilots meaningful, and (iii) include electric consumers in the planning and development of ISOs and RPXs.

Final Pre-Session Meeting.

At the joint subcommittee's December meeting prior to the legislative session, its members endorsed a resolution continuing the study in 1998 for the purpose of developing a comprehensive restructuring plan for Virginia. Included in the resolution were proposed "sense of the General Assembly" statements encouraging SCC initiatives such as retail competition pilot programs. The resolution also declared that net stranded costs should be recovered.

Additionally, Senator Reasor, the subcommittee's chairman, told the subcommittee members that he intended to introduce a comprehensive restructuring bill in the 1998 Session, but would not seek the subcommittee's endorsement of the measure. He also suggested that all restructuring-related bills introduced in the 1998 Session be introduced solely for the purpose of consideration in a "carry over" status by the joint subcommittee in 1998—this included restructuring bills addressing state and local taxation.

Legislative activity in the 1998 Session.

Several restructuring bills were introduced in the 1998 Session, including two comprehensive restructuring bills introduced by joint subcommittee members Senator Reasor and Delegate Plum (SB 688 and HB 1172, respectively). Additionally, Senator Watkins introduced two bills and two resolutions addressing state and local taxation issues: SB 619, SB 620, SJR 45 and SJR 46. And, Senator Reasor introduced SJR 91 continuing the joint subcommittee's work in 1998.

Senate Bill 688 (the Reasor bill) prescribed a five-year, phased transition to full retail competition in the electric utility industry, with preliminary activities beginning in 2000 and retail competition fully phased in by 2004. State and local taxation bills introduced by Senator Watkins included SB 619, which eliminates electric utilities' obligation to pay state gross receipts taxes, the SCC special assessment tax, and locality gross receipts taxes. Substituted for these taxes in the bill was a declining block consumption tax paid by residential, commercial, and industrial users of electric power. A companion bill (SB 620) made electric utilities' income from generation services subject to Virginia's corporate income tax. All three bills (SB 688, SB 619, and SB 620) were carried over to the 1999 Session in the Senate Committee on Commerce and Labor. They were referred to this restructuring subcommittee for review in 1998.

Senator Watkins also introduced SJR 46 which would, via constitutional amendment, effectively authorize the SCC to assess the real and tangible property of all sellers of electricity for the purpose of creating tax assessment parity between public service companies (currently assessed by the SCC) and independent power producers (IPPs), whose real and tangible property is assessed by localities. SJR 46 was carried over to the 1999 Session in the Senate Committee on Commerce and Labor; it was also referred to this joint subcommittee for review in 1998.

Bills passed in the 1998 Session.

The General Assembly approved SJR 91, continuing the joint subcommittee's activities in 1998, and directing the joint subcommittee to develop a comprehensive restructuring proposal for Virginia's electricity market. The resolution also

expresses the sense of the General Assembly that Virginia's electric utilities should recover "legitimate stranded costs."

Also approved was SJR 45 (introduced by Senator Watkins) memorializing Congress to carefully consider the state and local tax revenue impact of any federal restructuring legislation. The resolution also requests a federal grant of authority to state and local governments to continue imposing and collecting taxes from all generators of electricity selling electricity within their respective jurisdictions, without regard to the corporate location of such businesses.

The General Assembly also approved HB 1172 (introduced by Delegate Plum) which established a broad outline for Virginia's transition to retail competition in the sale of electricity. HB 1172's provisions (i) establish 2001 as a target deadline for establishing ISOs and RPXs for the dispatch and sale of generation, (ii) begin the transition to retail competition in 2002, and (iii) establish 2004 as the target date for the completion of transition to retail competition.

HB 1172, signed by the Governor on April 15, 1998, does require additional legislation and regulatory activity before retail competition comes to Virginia. However, the bill signals the commencement of significant restructuring activity in Virginia as the Commonwealth enters the next century. HB 1172, along with SJR 91, will guide the joint subcommittee's activities in 1998.

II. POLICY OVERVIEW

Retail competition in the sale of electricity would eliminate the exclusive service territory structure through which Virginia's electric utilities currently market and deliver power. Most restructuring models under consideration deregulate electrical generation, leaving transmission and distribution regulated by federal and state utility regulatory agencies. Virtually every state is examining retail competition and, to date, over a dozen states have adopted various retail competition plans. At the federal level, several bills mandating retail competition are pending before the House and Senate.

Retail competition, as typically proposed, would permit the competitive sale of electric generation at the retail level, releasing electricity customers—industrial, commercial, and residential customers alike—from their local public service companies to purchase generation in a nationwide electricity market. Virginia's industries, businesses and residents currently buy their power from investor-owned utilities like AEP Virginia, Potomac Edison and Virginia Power; electric cooperatives; municipal power suppliers; and public power authorities, such as the TVA. According to the SCC, Virginians enjoy electricity rates well below the national average. Recent statistics show that Virginia's residential customers pay, on average, seven cents per kilowatt hour; commercial customers pay five cents; and industrial customers pay about four cents per kilowatt hour. By way of

comparison in New Hampshire (a state engaged in restructuring) power customers pay an average of 13 cents per kilowatt hour for residential use, 11 cents for commercial, and eight cents for industrial.

ALERT and other restructuring proponents contend that restructuring will lower the price of electricity for everyone—by up to 17 percent, according to one source—while critics say the benefits of retail competition would be enjoyed by a narrow class of large industrial customers, leaving open the possibility of rising electricity prices for others. Aside from price, there is considerable debate about the interstate transmission system's capacity to handle the increased load flows anticipated in a competitive market. And, SCC staff have repeatedly urged the joint subcommittee to focus on the overall reliability of the Commonwealth's electricity delivery system in competitive market, including its capacity to ensure sufficient generation reserves over the long run.

Several broad policy questions have emerged from this discussion. First, some electric utilities fear capital investment losses if retail competition produces market rates below regulated rates; generation facilities and equipment may decline in value. These economic losses are referred to as "stranded costs," and a vigorously debated question is whether a utility's customers should help reimburse the utility for these losses during a transition to retail competition. A related question: how should such transition costs be calculated?

Taxation issues are also a part of this debate. The transition to retail competition could significantly reduce the \$90 million in gross receipts taxes the Commonwealth currently receives from electric utilities. The reason: possible constitutional barriers to imposing this tax on out-of-state suppliers of electricity. One idea considered by the joint subcommittee is switching from a gross receipts tax to a corporate net income tax, in combination with a end-user consumption tax. The consumption tax would not be a new tax since gross receipts taxes are currently embedded in electric rates established by the SCC.

Consumer protection is also part of the discussion. Representatives of consumer, low-income, and senior citizen groups told the SJR 259 joint subcommittee that low-income residential consumers and senior citizens are most at risk in any restructuring scenario. Unlike business and industrial customers, these electricity customers lack the market power to negotiate cheaper rates; they are unlikely sales prospects for power marketers. Advocates for these groups recommend that any restructuring bill contain adequate provision for "suppliers of last resort" to ensure service to these customer groups.

Virginia's largest industrial and commercial customers are retail competition's principal advocates. Acting through ALERT and the Virginia Committee for Fair Utility Rates (an organization representing Virginia Power's largest industrial and commercial customers), these large customers have proposed

that retail competition be fully phased in by the year 2001. In contrast, the SCC's utility staff supports a more deliberate approach. As will be discussed later in this report, in November 1997 the SCC staff outlined for the joint subcommittee a five-year phased plan for transition to retail competition. The plan would include extensive analysis, including retail competition pilot programs, during the first three years comprising phase one. If phase one results support a transition to retail competition, Virginia's electric utilities would then file retail competition plans with the SCC to begin the final transitional phases.

Practical questions also persist in this debate. First, what will a "live" retail competition market look like, and will it furnish electricity to retail customers at just and reasonable rates? While California is poised to *begin* full-scale retail competition in April 1998, there is no place for Virginia's legislators and regulators to look for information and assurance about such a system's success in operation. Second, in replacing franchised service territories with two-tier service separating deregulated generation and transmission from regulated distribution systems, how will the General Assembly and the SCC ensure adequate generation and generation reserves? The issue is particularly pressing if generation is furnished through ISOs and RPXs regulated by the Federal Energy Regulatory Commission.

Also, to the extent that the allure of retail competition to large industrial and commercial customers is the hope of direct, bilateral contracting between such customers and electric generation suppliers, can a bilateral contract option be engrafted to the central dispatch and sale architecture of independent system operators and regional power exchanges?

All of these complex issues were before the joint subcommittee as it began its second year of activities.

III. WORK OF THE JOINT SUBCOMMITTEE

The joint subcommittee examined legislative activity in states such as New Hampshire and Pennsylvania where restructuring bills have passed and restructuring pilots are underway. The subcommittee also investigated federal restructuring activities and the technological reliability of restructured delivery systems.

A. ACTIVITIES IN OTHER STATES.

Nearly every state is looking at electric utility restructuring, and thus far, over a dozen have enacted retail competition legislation or adopted restructuring regulatory plans. In 1996, legislatures in New Hampshire, Rhode Island, California and Pennsylvania passed bills authorizing retail competition. In 1997,

legislatures in Oklahoma, Montana, Maine, Illinois and Nevada enacted retail competition laws.

William Spratley, a utilities market analyst and publisher of The Leap Letter (a restructuring newsletter), noted in remarks to the joint subcommittee that the scope and details of the restructuring bills enacted to date vary widely (Appendix B). Some states, like New Hampshire and Pennsylvania, have initial pilot programs in their legislation (in which a percentage of electricity customers may shop for their electric supplier), followed by phase-in periods to a date in which retail competition is available to all customers statewide. However, a New Hampshire public service commission representative describing the New Hampshire restructuring experience to date told the joint subcommittee that, while recent survey results showed that the pilots were popular with power customers, the pilots were expected to indicate very little about likely price trends in a restructured market.

California addressed restructuring's commencement in that state by simply establishing January 1, 1998, as a start date for all customers in every class—later revising that to April 1, 1998, to allow for the completion of its power exchange. Oklahoma's 1997 bill directs its public service commission to develop a retail competition plan. Furthermore, the Oklahoma bill conditions any such plan on the development of an acceptable strategy for dealing with restructuring's potential impact on state and local tax revenues from electric utility taxation.

A critical variable in all of the legislation under consideration, as well as that approved to date, is the treatment of stranded costs. In California, for example, that state's public utility commission will determine stranded costs related to generation assets, and will permit recovery through severance fees paid to incumbent electric utilities (those currently furnishing service in regulated markets) by departing customers, and through "competitive transition charges" (CTCs) paid by utilities' remaining customers. CTCs will end for most customers in 2001. In New Hampshire, on the other hand, "interim recovery charges" will be allowed for up to two years, but no entry or exit fees will be paid by customers leaving or returning to incumbent utilities. Pennsylvania's public utility commission will determine just and reasonable stranded costs through nonbypassable CTCs. Since stranded costs will not be realized, if at all, except in competitive markets, many states require periodic stranded costs "true ups," or recalculations to determine the extent to which actual market prices have prompted actual losses related to generation assets.

Market structure and market power of incumbent utilities are addressed in some states' legislation. In Montana, that state's public service commission is required to order vertically integrated electric utilities to functionally separate supply, transmission, and distribution. However, it may not order or prohibit divestiture. In contrast, Maine requires investor-owned utilities to divest all

generation assets and generation-related business on or before March 1, 2000. Pennsylvania's legislation, on the other hand, stipulates that the Pennsylvania Public Utility Commission may permit, but cannot require, divestiture or other corporate reorganization of its incumbent electric utilities.

Another critical variable is the matter of customer protection—particularly the protection of residential and small business customers. The most significant concern is eliminating the potential for consumer fraud or misrepresentations. Virtually all states with legislation on the books have included provisions requiring all generation suppliers to register with state public service commissions. Some states, such as Pennsylvania, require these suppliers to post bonds or furnish other security; others, like Maine and Montana, require proof of financial security and responsibility. Other requirements include the obligation of public utilities (under the supervision of state utility regulators) to educate consumers about the meaning and implication of customer choice in a restructured market.

B. FEDERAL ACTIVITIES.

The momentum for legislative study on the state level is unquestionably driven by the strong possibility of federal legislation preempting state authority over electric competition. Federal intervention in the interstate electricity market began in 1978, when Congress passed the Public Utilities Regulatory Policies Act (PURPA) requiring public utilities to purchase power from independent power producers if the latter could produce it as cheaply as the former. And, a federal electric utility policy favoring open markets was declared in earnest with the passage in 1992 of the National Energy Policy Act (EPACT). EPACT and a consequent Federal Energy Regulatory Commission order (FERC Order 888) opened the transmission system to independent power producers for wholesale power sales. EPACT did not, however, permit FERC to implement retail competition, leaving that issue to the states.

Several federal legislators are eager to quickly open up the retail market. Congressman Dan Schaefer of Colorado introduced H.R. 655 in 1996 which mandates full retail competition in all states by the year 2000 (Appendix C). Whether Congress has constitutional authority to mandate state implementation of retail restructuring is open to interpretation, however, following the U.S. Supreme Court's 1997 decision in Prinz v. U.S. The Prinz decision suggests that federal authority to direct state implementation of federal legislation must rest upon clear preemptive authority granted by the U.S. Constitution over the legislation's subject area—an authority not yet determined vis-à-vis the retail electricity market.

A restructuring consensus in Congress has not emerged in any event. Bills such as H.R. 655 (Schaefer's bill), H.R. 1230 (mandating full, nationwide retail competition by 1999), and others before the House Commerce Committee are in conflict with another view of restructuring in Congress, represented by S.21

pending before the Senate Energy and Natural Resources Committee. That bill presents a pro-state view emerging in the Senate empowering retail competition in the states, but without federal mandates. Consequently, while both Senate and House committees continue their work on this issue with frequent committee hearings and workshops, no agreement between the two chambers appears imminent. Adding further complication is the Clinton administration's commitment to unveiling its own federal restructuring plan.

C. RESTRUCTURING AND TRANSMISSION SYSTEM TECHNOLOGY.

The joint subcommittee also focused on restructuring and the electric power transmission system. Subcommittee members toured the Virginia Power System Operations Center to observe that utility's computerized generation, dispatching and transmission management system, and also received a presentation from an Electric Power Research Institute (EPRI) representative concerning ongoing research and development work in the field of electric transmission technology (Appendix D).

Transmission technology research is critical to restructuring, the EPRI representative emphasized, because power generation and transmissions related to wholesale power sales result in power flows in all directions across the interconnected electrical transmission network, and not just in direct lines from sellers to purchasers. Thus, generation resulting from an interstate sale of electricity from an electric utility in Montana to a distribution system in Ohio, for example, will most probably add load to adjacent transmission lines in all directions. Neighboring utilities could be required to reduce generation in order to prevent transmission line overload resulting from generation outside their control.

Wholesale power transactions, frequently uncoordinated through any centralized operations system, can potentially overload transmission lines resulting in their shutdown and—in a severe case—cascading shutdowns of adjacent lines to which power is shifted. According to EPRI's representative, at least one significant recent power outage on the West Coast may have resulted from line overloading relating to wholesale wheeling. EPRI's representative's said that while these line problems were not caused by retail competition, uncoordinated power flows resulting from numerous retail competition transactions could overwhelm the interstate transmission system.

To address these and related load-flow issues, EPRI is participating in the development of a computerized regional communications network designated as the Open Access Same-time Information System, or OASIS. OASIS, currently in testing stages, will be used by system control centers to determine accurate system status, safe networking operating limits, network overload capabilities, and the impact of power transactions in near real-time. A related system under development (the Flexible Alternating Current Transmission System, or FACTS) is

likely to replace generation control as a means of controlling power flow over transmission lines. Computerized electronic “valves” will boost power flows on specified transmission lines as a means of ensuring transmission system integrity.

EPRI’s representative also emphasized that regional power generation is essential to steady state voltage security. Large regions importing virtually all of their power, he said, would have great difficulty maintaining steady state voltage—essential to the safe and efficient operation of electrical equipment. Unstable voltage outside certain tolerances can result in damage to electrical systems and sensitive industrial equipment.

D. REPORTS RECEIVED CONCERNING SCC ACTIVITIES.

The SCC's public utilities staff reported on the work of staff-coordinated work groups examining five restructuring topics: (i) a model for a restructured industry, (ii) reliability issues from both a generation and transmission perspective, (iii) stranded costs and stranded margins associated with potential transition to a more competitive generation market, (iv) the costs and benefits associated with the introduction of more competition into the generation sector, and (v) the potential impacts of a restructured industry on the environment.

The work groups, comprised of representatives of investor-owned utilities, electric cooperatives, independent power producers, major industrial electricity customers, environmental groups, and others with a stake in this issue met extensively in 1997. The work groups were established to help the SCC continue its examination of restructuring and to prepare its recommendations for a Virginia restructuring model.

Models.

The models work group examined and critiqued legislation or models proposed or implemented in other states (including Texas, Indiana, Pennsylvania, New Hampshire and California), and members were furnished opportunities to propose and explain models of their own design. Significant models-related issues included concern about price levelization in an open retail market which could result in rate increases in regions currently served by low-cost utilities. Additionally, group members debated whether regulated local distribution companies should be required to be a generation service supplier of last resort, and whether any restructuring should be accomplished through pilot programs and transition periods.

Reliability.

The reliability group focused on reconciling customer choice with the physical realities of electrical flows—an issue highlighted in EPRI’s presentation to the joint subcommittee. This group also identified critical ancillary services such as frequency control and voltage regulation—all essential to the provision of reliable electric service in any market, but particularly so in a competitive one. Mandatory generation reserves—a feature of the current, regulated generation system—proved to be a contentious area. Transmission grid users can theoretically rely on the reserves of other generators to assure reliability, and may have little incentive to individually provide for sufficient reserves. Reserve cost-sharing in a competitive market may, however, be necessary to ensure generation reliability.

Environment.

The environmental group was unable to reach consensus about the effects of retail competition on air pollution; some members predicted that competition will cause older, high emission coal plants to be run more often, while others asserted that the mandates of the federal Clean Air Act will minimize emissions. A related issue: potential competitive disparity between new plants that must be built with expensive, pollution control technologies and those plants built prior to 1978 and subject to less stringent emissions standards. The group also addressed concerns about the impact of restructuring on the future of utilities’ current conservation and load management programs. Minimizing the construction of new generation and transmission facilities through such programs is thought by some to be at odds with the concept of retail competition, while others suggested that competition may promote energy efficiency.

Stranded Costs.

The stranded costs group confronted one of the most difficult issues presented by retail competition. Stranded costs or margins are characterized as the differences between the market value of utilities’ generation-related assets in a competitive environment and their book value. In a restructured market, older, high-cost nuclear plants, for example, may not be competitive with newer, more efficient generation units, and the nuclear units’ value may be substantially reduced as a result.

For some, such as Virginia Power, for example, long-term purchased power contracts with non-utility generators (a by-product of federal PURPA legislation) at prices currently above market represent their stranded cost exposure. These contracts have the same cost effect on a utility as undepreciated generation units. On the other hand, low-cost investor-owned utilities, such as AEP Virginia and Potomac Edison, have existing plants that are fully depreciated. These utilities may have net stranded margins or minimal stranded costs at most, the SCC staff reported.

Utility recovery of stranded costs from ratepayers was the key issue before this work group. The justification offered for this recovery is found in the concept of a "regulatory compact" said to exist between franchised public utilities and their regulators. It suggests that stranded costs are essentially sunk investments which the utilities made to fulfill their legal obligation to provide adequate service to all consumers within their service territories.

Some work group participants advocated full recovery from ratepayers, while other suggested that these costs should be shared equally between ratepayers and utilities' shareholders. Those in the latter camp contend that shareholders have explicitly assumed the risk of potential regulatory and statutory reform within the industry. One important consensus: the difficulty of projecting stranded costs, a fact underscored by national estimates of utilities' potential stranded costs ranging from \$50 billion to over \$500 billion.

The work group favored a time-specific, non-bypassable "wires charge" as a mechanism for recovering stranded costs, if they are to be recovered at all. The group also agreed that utilities should be obligated to mitigate the extent of their stranded costs. In that vein, the California and Pennsylvania restructuring legislation offers up stranded cost "securitization" as a means of mitigation. Securitization enables low-cost debt refinancing of potentially stranded utility assets, securing that debt with legislation establishing a ratepayer-produced stranded cost recovery income stream.

IV. SCC RESTRUCTURING PLAN

A. PLAN OVERVIEW.

At its November meeting, the SCC presented its proposed restructuring plan to the joint subcommittee (Appendix E). The plan encompasses a two-phase restructuring process beginning in 1998. In Phase I (1998-2001), the rates of all electric utilities would be thoroughly examined, retail pilots would be conducted, and the SCC would pursue such key ingredients such as ISO formation. Phase II (beginning in 2002) would inaugurate actual retail competition—if the SCC and General Assembly agreed that retail competition was in the public interest—and Virginia's electric utilities would be required to file retail competition plans.

Phase I.

According to SCC staff, the Phase I rate examination is essential since these rates could be in effect for an extended period of time during a transition to competition. Virginia Power and AEP Virginia have rate/alternative regulatory plan cases currently pending before the Commission (Virginia Power's case is set for

hearing in early 1998) and Allegheny Power is expected file a rate case as early as 1998. Thus, in some respects, Phase I has already begun.

The rate reviews proposed by the SCC would (i) determine whether current rates reflect costs and (ii) undertake preparatory work for a competitive model. The review would include examination of such issues as inter-class subsidies, unbundled rates and bills, stranded costs and margins, transition and transaction costs, and consumer services.

SCC staff believes that the formation of a regional independent system operator is critical to the success of any significant level of retail access. In concept, ISOs would provide centralized generation dispatch coordination in a competitive market. The report proposes ISO formation (coordinated with other states and the federal government) during Phase I and concurrent formation of a regional power exchange to develop a spot market for electricity.

Pilot programs.

Phase I would also include retail access pilot programs and studies (lasting up to two years) to be conducted by Virginia's investor-owned utilities (such as AEP Virginia and Virginia Power) and at least two electric cooperatives. SCC staff hopes that these pilot programs will produce useful information in several areas including information technology requirements, generation supply and load matching, time-of-use metering, marketing and rate information, rules governing utility affiliates, and consumer protection.

The staff cautioned the subcommittee, however, that the pilots probably would not produce concrete information about electricity prices or reliability in a competitive market. However, SCC staff said that pilot programs would help develop information about technology requirements and consumer impacts.

Stranded costs.

A key restructuring issue is stranded costs, or possible capital losses resulting from electric utility generation asset devaluation in a competitive market. Some electric utilities are concerned that regulated rates may be the only means of ensuring sufficient rates of return on some electricity generation plants. New coal-fired plants with the latest in federally-required emissions control technology may fall into this category. Nuclear power plants as well power purchased from nonutility generators (NUGs) may be in this category as well.

The SCC's report raises many questions about stranded cost recovery, while providing no proposed formula for their calculation. These questions include ones about mitigation, equitable cost sharing between shareholders and ratepayers,

recovery periods, and allocation among customer classes—to name just a few. The staff told the joint subcommittee that its plan included no recovery formula to avoid prejudicing ongoing discussions between Virginia Power and its NUGs, with whom Virginia Power has purchase power contracts said to be currently above market—and potentially the source of stranded costs. These discussions resulted from a November 1996 SCC order directing Virginia Power to conduct negotiations with its NUGs to determine whether the contracts could be renegotiated to reduce this utility’s potential stranded cost exposure.

Phase II Features.

In Phase II (denominated the “decisional phase”), the SCC and General Assembly would jointly review the pilot program results, ISO/RPX formation progress, and retail competition in other states. They would also review reliability issues and the transaction and transition costs associated with restructuring. A cost-benefit analysis would be undertaken as part of this review to determine whether the benefits of retail competition outweigh its costs. If the review supports the development of retail competition, all electric utilities would be required to file retail competition plans.

The electric utilities’ retail competition filings would be required to detail the following:

- Generation reliability.
- ISO/RPX development.
- Likely rate impact on customer classes.
- Necessary information and metering technology.
- Market power issues.
- Necessary consumer protection measures and their implementation.
- Proposed implementation period.
- Stranded costs and margins.
- Environmental impact.

The SCC would conduct public hearings on these submissions, ensuring that each approved plan meets the above standards, and that net benefits would accrue from its adoption. If transition proceeds smoothly, the SCC could choose to accelerate the phase-in pace; if it does not, the phase-in period could be extended.

The SCC staff believes there are several possible models for competition in Virginia, including a *wholesale* competition model, and a *retail* competition model that encompasses (i) an expanded wholesale model, (ii) an ISO/RPX model and (iii) straight bilateral contracts. Essentially, the SCC’s wholesale model would encourage market pricing by basing electric utilities’ return on new capacity (where they choose to build rather than buy) on wholesale market prices and not on

traditional rate base pricing. An expanded or modified wholesale model would permit large retail power purchases by a limited number of industrial customers, the logic being that these purchases are indistinguishable in size and magnitude from the direct, wholesale purchases (from the supplier of their choice) currently made by municipal power suppliers and electric cooperatives.

The ISO/RPX model is key to the SCC's view of a functional competitive retail market. An RPX would provide dispatch logic for generation and a competitive spot market for electricity based on generation owners' bids for generation at specified times of the day. An ISO would then direct generation dispatch using RPX-developed load curves reflecting projected loads at different times of the day.

The electricity customer fits into this model by having the *equivalent* of retail access. This is accomplished—assuming the local distribution companies have appropriate information technology—by customers exercising “contracts for differences.” Straight, bilateral contracts could be accommodated within this model for a limited number of large customers. However, the SCC staff believes that the ISO/RPX model diminishes the logic or need for such transactions. Moreover, the straight bilateral contract model (one between a retail supplier and purchaser) does not, in the SCC staff's estimation, provide for effective access to competitive suppliers for many classes of customers.

Need for legislation.

The SCC plan identified two narrow areas where legislation may be needed to support retail competition's evolution. First, the SCC recommended legislation authorizing construction of “merchant plants” (essentially NUGs) in incumbent utilities' service territories to counterbalance the utilities' potential market power. The SCC also suggested legislation to address issues associated with eminent domain and merchant plant's construction and siting. SCC staff strongly recommended that this and all other legislation associated with restructuring be done without any attempt to anticipate federal legislative activity in this area. While some federal bills under consideration offer “grandfathering” to states with restructuring plans enacted prior to the federal bills' effective dates, the staff noted that such grandfathering ultimately requires conformity with the federal enactment.

B. STAKEHOLDER RESPONSES.

The responses of restructuring stakeholders to the SCC plan ranged from general endorsement to strong reservations. The American Association of Retired Persons (Appendix F) and the Virginia Citizens Consumer Council (Appendix G) supported the SCC's deliberative approach to restructuring. Representatives of the

Virginia Poverty Law Center and the Virginia Council Against Poverty also voiced support for the SCC plan, although they, and VMH, Inc. (an entity furnishing energy services to low-income consumers) expressed hope that any eventual plan would provide more explicit assurances of protection for low-income residential customers. The International Brotherhood of Electrical Workers—representing electrical workers in the Commonwealth—also expressed support for the SCC plan's phased approach.

The electric cooperatives (Appendix H) took issue with the SCC plan's suggestion that transition to retail competition begin with a rate review. They believe that unbundling rates for each electric utility into their generation, transmission and distribution components should be first on the agenda. The electric cooperatives also expressed concern that the SCC proposal lacked guidance concerning stranded costs. And, while the electric cooperatives favor ISO and RPX formation, they also expressed concern about the potential market power that could be exercised by companies like Virginia Power with limited import capacity in their present transmission system (Virginia Power, for example, currently has less than 4,000 megawatts of such capacity).

Virginia's oil and gas producers (Appendix I) expressed concern about the absence of SCC direction on stranded costs formulas and mitigation. Washington Gas responded by promoting its plan for restructuring in which all energy providers (electric and natural gas, alike) could participate in a two-year retail access pilot program (1998-2000), followed by a three-year phase-in (2000-2002) to full retail customer choice. This company emphasized the importance of including the natural gas industry in the transition to electric industry restructuring, since the emergence of full-service energy companies selling both products will, in their estimation, have significant roles to play in Virginia's deregulated energy future. Washington Gas emphasized that the natural gas industry is presently gaining experience in restructuring; proposed retail pilots for Virginia's natural gas customers are pending before the SCC.

The Municipal Electric Power Association of Virginia (MEPAV), representing Virginia's localities (such as Harrisonburg and Blackstone) with municipal power supply systems, told the joint subcommittee that MEPAV supports the SCC's plan to proceed with caution to retail competition. MEPAV urged the subcommittee to ensure that any restructuring plan (i) permits no bypass of existing distribution systems, (ii) allows no existing electric utility to utilize the constraints in the capacity of its current bulk power system to exercise unregulated monopoly power in a deregulated market, and (iii) becomes effective in concert with necessary federal legislation facilitating the creation of regional independent system operators, ensuring transmission reliability, and minimizing potential market power exercise by incumbent utilities.

The Southern Environmental Law Center said it generally supported the SCC's plan, agreeing that the proposed phase-in was appropriate; that pilots programs should precede full-scale competition; and that ISOs should be used to coordinate generation. However, Center representatives told the joint subcommittee that the plan should have contained a specific date for retail competition commencement, and was deficient in omitting to suggest specific environmental protection provisions (Appendix J). The Center suggested that, at a minimum, retail customers should be provided environmental disclosures from generation suppliers concerning each supplier's fuel mix and emission rates. Additionally, the Center said, an independent non-profit entity should be established to administer funding for a program promoting greater energy efficiency and renewable technology development. Energy Consultants, Inc., a company furnishing energy utilization management technology, also addressed energy efficiency and its potential for reducing air emissions. It recommended that the SCC incorporate test programs, during any pre-restructuring evaluation phase, that would include examinations of the interrelationships between energy efficiency programs and environmental and health benefits.

Proponents of restructuring criticized the plan as moving too slowly. The Alliance for Lower Electricity Rates Today (Appendix K) and the Committee for Fair Utility Rates (representing large industrial area commercial users) (Appendix L) also challenged the plan's suggestion that competitive generation sales be limited to those coordinated by regional power exchanges. They urged the alternative availability of direct, bilateral contracts between power suppliers and customers. ALERT and the Committee argued that such exclusive pools could have the effect of encouraging suppliers to engage in market price manipulation to capture large profits on all dispatched plants.

The Apartment and Office Building Association of Metropolitan Washington criticized the plan on several fronts (Appendix M). AOBA, whose members are large commercial users of electricity, called for broader participation by electric consumers in the formation of ISOs and RPXs—a job that AOBA contended the SCC plan left principally to incumbent electric utilities. The group also criticized the SCC's failure to recommend a specific competitive model while offering model options which included—from AOBA's perspective—options leaving open the possibility that retail competition would be available to large industrial consumers (presumably, under the SCC's "expanded wholesale" model) while leaving out commercial and other classes of electricity customers.

AOBA joined other critics in noting the absence of SCC specificity in the area of stranded costs. AOBA stated emphatically that rigorous, up-front calculation of stranded costs was a hurdle that must be cleared prior to initiating significant customer choice. The group also discounted the value of any retail pilot programs *unless* the pilots were of a large enough scale to generate meaningful data. To that

end, AOBA recommended that pilots should be (i) large enough to represent a substantial portion of each utility's total service requirements (10-20 percent); (ii) implemented without participation incentives or cost subsidies; and (iii) sufficiently long in duration (at least three years) to discourage marketers from offering service at a loss to gain market share.

Virginia's largest investor-owned utilities also responded to the SCC model. Virginia Power criticized the additional study time advocated by the SCC; it urged the enactment of restructuring legislation as soon as possible (Appendix N). It questioned the practicality of conducting retail pilots given the SCC staff's belief that the pilots would produce little useful pricing information. It also stated that the report's principal shortcomings were in its failure to endorse a legislative restructuring framework in 1998, and omitting to provide a strong position on parameters for stranded cost recovery—an issue Virginia Power believes to be “the single most critical issue in the electric restructuring debate.” Deferring restructuring in Virginia while undertaking additional and extensive SCC-coordinated study may harm Virginia's utilities (and ultimately its customers) in the financial markets. This would result, Virginia Power said, from leaving uncertain the future of Virginia's electric industry.

AEP-Virginia told the joint subcommittee that it generally agreed with the SCC's staff findings. While expressing little formal opinion about the SCC's plan, this utility did, however, urge that stranded costs and other transition issues be resolved with the objective of beginning a transition period in 1999 (Appendix O). AEP-Virginia also advocated significant SCC participation in the development of one or more ISOs to serve Virginia as part of the transition to retail competition.

V. WORK OF THE TAXATION TASK FORCE

The joint subcommittee established a task force comprised of restructuring stakeholders (including investor-owned utilities, electric cooperatives, municipal-owned utilities, power marketers and independent power producers, and industrial and commercial customers) and governmental officials (such as the Virginia State Corporation Commission, the Office of the Attorney General, and the Department of Taxation), directing its members to examine the potential impact on state and local tax revenues resulting from electric restructuring.

Conceivably, restructuring could have a huge economic impact on the Commonwealth and its localities. Electric utility gross receipts taxation furnishes over \$90 million annually to the Commonwealth's general fund. Localities receive almost \$300 million annually from consumer utility taxes, real property taxes, and local gross receipts taxes paid or collected by regulated providers of electricity (Appendix P).

The work of the task force centered on two concurrent tax policy goals: (i) sustaining the current level of revenue for the Commonwealth and localities, and (ii) maintaining the current apportionment of tax burden among residential, commercial and industrial electricity customer classes. A restructured environment would allow out-of-state producers of electricity access to Virginia's customer base. Introduction of competition affects the revenue received from gross receipts taxes in two ways.

First, many analysts feel that the introduction of competition will result in significantly lower electric costs for all classes of consumers. Lower electricity prices impact negatively on a taxation method based on gross receipts unless a proportional increase in consumption accompanies these lower prices. Several different economic studies suggest that consumption increases, expressed as "elasticity factors," will result, but the task force reached no consensus on the average usage increase resulting from lower electricity prices.

The second way that competition impacts revenue collected by the Commonwealth from gross receipts taxes is that collecting this tax from providers of electricity located outside the Commonwealth may not be legally permissible. The subcommittee's extensive discussion of the "nexus" issue left the constitutional question of the Commonwealth's ability to tax out-of-state generators unresolved. A Pennsylvania public service commission representative told the task force that that state's restructuring bill imposes the gross receipts tax on all persons supplying electricity to Pennsylvania customers—in or out of state. The taxing nexus is presumably established through the bill's requirement that all suppliers register with the public service commission. However, the bill does contain a safety valve: in the event gross receipts taxes cannot be imposed on out-of-state suppliers, any consequent revenue deficit is made up through an end-user consumption tax.

The task force discussed various replacement taxation schemes, including replacing the gross receipts tax with a corporate income tax. The recommendation of the task force was to impose a tax on the income derived from the generation of electricity. Income derived from transmission and distribution would not be taxed. However, such a replacement by itself would result in a decrease in the current tax revenue collected by gross receipts tax by the Commonwealth by approximately \$66 million.

The task force explored many different variations of a consumption tax to make up the \$66 million shortfall. These approaches included (i) an *ad valorem*, or sales tax approach; (ii) a per kilowatt hour, or kWh-based, tax levied at the distribution rather than retail level; and (iii) a unique end-user tax method developed for the task force that imposed a kWh-based tax on electricity consumption using a "declining block" method. The task force ultimately endorsed the declining block method (Appendix Q).

The declining block proposal taxes electricity consumption at three tax rates, with the highest for the first 2,500 kilowatt hours consumed each month; the second and lower rate on consumption between 2,501 and 50,000 kWh, and the third and lowest rate is imposed on kilowatt hours consumed in excess of 50,001 kWh per month. The task force developed these consumption blocks for discussion purposes only; they are broad approximations of electricity consumption levels in the current residential, commercial, and industrial customer classes. This tax would not be assessed against local, state, and federal governmental entities.

The task force also discussed the potential impact of restructuring on the taxes imposed by localities on electric utilities, including real property taxes, local gross receipts taxes, the special regulatory assessment collected by the State Corporation Commission, and the local consumer utility tax. The declining block model incorporates the local gross receipts tax and the special regulatory assessment, but not the consumer utility tax.

Legislation establishing the end-user declining block scheme in combination with a corporate net income tax for electric utilities (in lieu of the gross receipts tax) was recommended by the task force for introduction in the 1998 session of the General Assembly. At the time this proposal was endorsed, it was generally understood that this legislation, if introduced in the 1998 Session, would be carried over to the 1999 legislative session, and studied by the restructuring subcommittee along with other restructuring bills carried over for consideration between the two legislative sessions.

The task force also endorsed a proposal to amend the Constitution of Virginia to allow a central state agency, as prescribed by law, to assess real estate and tangible personal property. The Constitution currently authorizes a central state agency to assess the real estate and tangible personal property of public service corporations that pay a tax based on gross receipts or gross earnings. Finally, the task force also recommended memorializing Congress to give careful consideration to the state and local taxation revenue impact of any federal restructuring legislation, prior to its enactment.

All of the task force's recommendations were reported to the joint subcommittee, and were introduced in the 1998 legislative session by Senator Watkins, the task force chairman. All were carried over and referred to the restructuring subcommittee for study, with the exception of the resolution memorializing Congress concerning state and local tax impacts of federal restructuring bills. That resolution was passed by the Senate and House.

VI. OTHER MATTERS BEFORE THE JOINT SUBCOMMITTEE

A. UTILITY ENTRY INTO UNREGULATED MARKETS.

One feature of an evolving electric utility industry is the actual or proposed entry of regulated utilities (those regulated as public service companies) into unregulated markets—directly, or through affiliates or subsidiaries. In Virginia, public service companies' activities are restricted by statute to their public service activities such as providing telecommunications and electric power generation and distribution. However, they may also engage in business activities “related and incidental” to that public service.

Since 1996, the joint subcommittee has had before it the issue of whether furnishing services usually supplied by contractors in the heating, ventilation, air conditioning, cooling and refrigeration (HVACR) trades are “related and incidental to” an electric utility’s principal public service activities. This resulted from an ongoing dispute between Virginia Power and representatives of a coalition composed principally of HVACR contractors and petroleum jobbers brought to the joint subcommittee’s attention. The coalition’s main concern is that Virginia Power would use its size and market power in entering the HVACR market to achieve market penetration sufficient to harm the livelihood of HVACR concerns and other businesses. The two parties were requested by the joint subcommittee to review and negotiate the issues before them, and to report their progress at this meeting.

Virginia Power and the coalition reported to the joint subcommittee that they had reached agreement on a statement of intent and proposed standards of conduct restricting certain Virginia Power activities during the transition to retail competition (Appendix R). Key areas include structural and operational separation of Virginia Power’s unregulated subsidiaries. The agreement also addresses issues of customer information sharing between parent and subsidiary, and the subsidiary’s use of the parent’s name or logo in marketing and sales activities.

B. IMPACT OF RESTRUCTURING ON DEMAND CONTROL.

An issue frequently raised in the restructuring debate is retail competition’s potential impact on energy conservation achieved through demand management programs. One such program approved in Virginia by the Virginia State Corporation Commission is customer use of a billing rate option called Schedule 1S. This option separates the charge for electricity into two parts: one for monthly kWh consumption, and the other for peak demand placed on the power company during the month. The option has been available to residential customers since 1978.

Energy Consultants, Inc., an energy consulting company furnishing computerized demand control equipment to approximately 2,000 residential and 30 small business and church electricity customers in Virginia, testified before the

joint subcommittee. In a residential setting, the company's equipment manages the electrical loads for heating and cooling, hot water heaters and electric clothes dryers—uses representing about 80 percent of typical residential usage. The bulk of savings comes from reductions in peak usage demand, with some customers reportedly saving up to \$600 per year. The energy consulting company noted that the Virginia Power's alternative rate plan (pending before the SCC) makes no provision for demand management involving electricity customers with small loads. The company asked for the joint subcommittee's support for demand management programs in any restructuring transition period, and thereafter. One suggestion the company had for a Virginia restructuring plan: permit demand control users to negotiate demand-based billing rates (Appendix S).

VII. PRE-SESSION AND SESSION ACTIVITIES

A. FINAL PRE-SESSION MEETING.

At the joint subcommittee's final meeting prior to the legislative session, its members endorsed a resolution continuing the study in 1998 for the purpose of developing a comprehensive restructuring plan for Virginia. Included in the resolution were proposed "sense of the General Assembly" statements concerning encouragement of SCC initiatives such as retail competition pilot programs, and the recovery of net stranded costs.

Subcommittee members were also advised that Senator Reasor intended to introduce a comprehensive restructuring plan in the 1998 Session, but did not plan to seek the subcommittee's endorsement of the plan. He suggested that all restructuring-related bills introduced in the 1998 Session be introduced solely for the purpose of consideration in a "carry over" status by the joint subcommittee, including bills addressing state and local taxation.

B. LEGISLATIVE AND SUBCOMMITTEE ACTIVITY IN THE 1998 SESSION.

Several restructuring bills were introduced in the 1998 Session, including two comprehensive restructuring bills introduced by joint subcommittee members Senator Reasor and Delegate Plum (SB 688 and HB 1172, respectively). Additionally, Senator Watkins introduced three bills addressing state and local taxation issues. And, Senator Reasor introduced SJR 91 which would continue the joint subcommittee's work in 1998.

Senate Bill 688, introduced by Senator Reasor (Appendix T), prescribed a five-year, phased transition to full retail competition in the electric utility industry with preliminary activities beginning in 2000 and retail competition fully phased in by 2004. The bill was introduced and referred to the Senate Commerce & Labor committee, where it was carried over to the 1999 Session and referred (on an

advisory basis) to the restructuring joint subcommittee continued pursuant to SJR 91.

State and local taxation bills introduced by Senator Watkins were designed to address several objectives, including electric utility tax revenue neutrality in the event of restructuring. SB 619 (Appendix U) would eliminate electric utilities' obligation to pay state gross receipts tax, the SCC special assessment tax, and locality gross receipts taxes. Substituted for these taxes in the bill was a proposed declining block consumption tax paid by residential, commercial, and industrial users of electric power. A related bill, SB 620, (Appendix V) would make certain electric utilities' income from generation services subject to the corporate net income tax.

Senator Watkins also introduced SJR 46 (Appendix W) which would effectively authorize the SCC to assess the real and tangible property of electricity producers who are not public service companies, e.g., independent power producers, thereby creating tax assessment parity between public service companies (currently assessed by the SCC), and IPPs whose real and tangible property is assessed by localities.

SB 688, SB 619, SB 620 and SJR 46 were all referred to the Senate Committee on Commerce and Labor and, at the request of their chief patrons, were carried over to the 1999 Session and referred (on an advisory basis) to the SJR 91 joint subcommittee for additional study.

C. BILLS PASSED IN THE 1998 SESSION.

The General Assembly passed SJR 91 (introduced by Senator Reasor), continuing the joint subcommittee's activities in 1998 and directing the joint subcommittee to develop a comprehensive restructuring proposal for Virginia's electricity market (Appendix X). It directs the joint subcommittee to review, in detail, the restructuring legislative proposals it has received to date, as well as such other proposals as it may receive. Significantly, the resolution also expresses the sense of the General Assembly that Virginia's electric utilities should recover "legitimate stranded costs" (as such costs may be defined by the General Assembly) in the event of restructuring. The resolution also increases the size of the joint subcommittee from seven to 11, and provides funding for technical assistance.

Also passed was SJR 45 (introduced by Senator Watkins) which memorialized Congress to carefully consider the effect on tax revenue for the Commonwealth and its localities prior to enacting any federal electric industry restructuring legislation (Appendix Y). The resolution also requests federal authorization for state and local governments to continue imposing and collecting taxes from generators of electricity, even if such generators are not physically located within that state.

The General Assembly also approved HB 1172 (introduced by Delegate Plum) which established a schedule for Virginia's transition to retail competition in the sale of electricity (Appendix Z). In a special meeting of the SJR 259 joint subcommittee convened on February 5, 1998, the subcommittee approved by a vote of 5-2 a redraft of HB 1172 which formed the foundation for the bill finally approved by the House and Senate. As passed by the General Assembly, HB 1172's provisions (i) establish 2001 as a target deadline for establishing ISOs and RPXs for the dispatch and sale of generation, (ii) begin the transition to retail competition in 2002, and (iii) establish 2004 as the target date for the completion of transition to retail competition.

HB 1172 addresses the critical stranded costs issue, stating that "[J]ust and reasonable net stranded costs shall be recoverable and appropriate consumer safeguards related to stranded costs and considering stranded benefits shall be implemented." Its provisions are declared to have no effect on pending cases before the Virginia State Corporation Commission (SCC). Finally, the bill provides that restructuring's direction will come from the General Assembly with regulatory implementation by the SCC. The Governor signed the bill on April 15, 1998.

D. ANTICIPATED LEGISLATIVE AND REGULATORY ACTIVITY FOLLOWING THE 1998 SESSION.

HB 1172, along with SJR 91, will serve as the foundation for the joint subcommittee's activities in 1998, which are expected to culminate in comprehensive restructuring. Meanwhile, important regulatory activities are also occurring. The SCC has entered a 1998 restructuring-related order directing Virginia Power and AEP-Virginia to develop retail access pilot programs in their service territories. Proposed programs must be filed with the SCC by August 1, 1998. The order also encourages other electric companies and electric cooperatives to develop pilot programs in their service territories as well.

The SCC has also entered 1998 orders concerning the development of regional ISOs and RPXs. The order directs all investor-owned utility companies to file, by April 15, 1998, reports of current and future activities concerning ISO and RPX development.

With the passage of SJ 91 and HB 1172 in the 1998 Session, this joint subcommittee will begin its third year of work, focusing on the development of a comprehensive restructuring plan for the Commonwealth. The joint subcommittee anticipates a series of joint subcommittee meetings to address the specific policy questions restructuring raises, including stranded costs, market power, transition dates, and consumer protection. The subcommittee will report its work—slated to include a comprehensive restructuring bill—to the Governor and the 1999 Session of the General Assembly.

Respectfully submitted,

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