# Structure and Transition Task Force

## Introduction

The Virginia, Maryland & Delaware Association of Electric Cooperatives ("VMD Association" representing, in Virginia, A&N Electric Cooperative, BARC Electric Cooperative, Community Electric Cooperative, Craig-Botetourt Electric Cooperative, Mecklenburg Electric Cooperative, Northern Neck Electric Cooperative, Inc., Northern Virginia Electric Cooperative, Powell Valley Electric Cooperative, Prince George Electric Cooperative, Rappahannock Electric Cooperative, Shenandoah Valley Electric Cooperative and Southside Electric Cooperative, Inc.) and Old Dominion Electric Cooperative ("Old Dominion") (collectively, the "Cooperatives"), join in submitting these comments on the "Structural" issues under consideration by the Structure and Transition Task Force of the SJR 91 Subcommittee on Restructuring the Electric Utility Industry.

As is the case with cooperatives generally, each of the cooperatives listed above is owned by its member/consumers and is operated on a not-for-profit basis. As not-for-profit entities operated on a cooperative basis, the cooperatives are exempt from federal income taxation pursuant to Internal Revenue Code Section 501(c)(12), as long as they receive at least 85% of their revenues from their members and continue to subscribe to cooperative principles. All of a cooperative's costs and expenses are recovered through its charges to its members, and any surplus revenues are returned to its members on a periodic basis.

Each of the Cooperatives depend on transmission facilities owned by others to move power to serve their load. In addition, while Old Dominion owns substantial interests in major generating assets, it still must buy, and also may sell, additional power at wholesale. Accordingly, all of the Cooperatives are vitally interested in the development of an ISO and an RPX that will serve mainland Virginia.

## Issues

### Describe the purchase of generated electricity in a competitive market.

- RPX
- Bilateral contracts

The Cooperatives believe that a properly structured, mandatory RPX is necessary for the development of a legitimate, competitive market for generated electricity, but that not all sales need be made through the RPX. Old Dominion is the wholesale power supplier to its member distribution cooperatives, including nine in mainland Virginia. If the wholesale sale of power between Old Dominion and its member cooperatives was conducted through an RPX (with payments for generation funneled through the RPX), under the current tax code those payments would be regarded as non-member revenue. This would likely put Old Dominion's tax-exempt status in jeopardy. If nonmember revenue exceeds 15% of a cooperative's total revenue, the cooperative would lose its tax-exempt status and its cost of providing power to its members would increase substantially. Accordingly, the Cooperatives also support the use of bilateral contracts, outside of the RPX, for the sale of generated electricity. The RPX should be mandatory in the sense that all uncommitted capacity should be sold through the RPX.

The coordination of operations between the ISO and the RPX is an essential aspect of how the purchase of generated electricity will be accomplished in a competitive market. Daily sales schedules proposed by the RPX should be submitted to the ISO for review. The ISO should have the ability to require schedule adjustments for efficiency and for reliability purposes. Further, generation resources should be callable by the ISO and any uncommitted generation resources should also be dispatchable by the ISO for reliability.

Market power issues should be addressed before the RPX is fully functioning. Vertically integrated utilities should be required to resolve market power issues before being permitted to make sales through the RPX at market rates.

- effect on customers currently served by coops or municipal distributors

Until such time as any existing, above-market bilateral contracts expire, some cooperatives and municipal distributors may be adversely affected by development of an RPX. The existing contracts will preclude these entities from taking advantage of the competitive market; however, they presumably would be subject to the additional costs of developing and administering the RPX and the ISO. After the expiration of their contracts, distribution cooperatives and municipal distributors may still have limited capability to access new markets, but will be able to seek competitively priced power through the RPX.

- distinction between FERC/Commonwealth oversight

Once market power issues are resolved, market forces, rather than governmental oversight, should regulate the RPX and other vehicles for the competitive purchase of generated electricity. The regulatory agencies may have a governance role through a seat on a regulatory advisory board or the board of directors of the RPX.

**What duties are imposed on generators of electricity as a result of competition?**

- divestiture

The Cooperatives do not favor mandatory divestiture and oppose permissive authorization of a proposed divestiture in a constrained market unless the sale price is at or below book value. The divestiture of generation assets in a constrained market may lead to higher prices. The Cooperatives recommend that divestiture not be permitted in a constrained market and that the price of generated electricity be limited to the cost of service until the constraints are relieved.

- relations among affiliates

The Cooperatives continue to be not-for-profit, member-owned, federal tax-exempt organizations. The activities of the Cooperatives, particularly their financial activities, are scrutinized by the State Corporation Commission, the Internal Revenue Service, the Rural Utilities Service, other lenders, rating agencies and the member/consumers elected to the cooperative's board of directors. With this level of scrutiny, and with a business motivation to best serve the member/consumers without focusing on profitability, the Cooperatives do not believe that an expansive or strict code of affiliate conduct is appropriate for them. Most important of all, the legislature should not expand the state's regulatory authority into previously unregulated businesses because the business happens to be undertaken by a formerly regulated utility. Regulation of affiliate conduct should be narrowly tailored so as not to impede competition.

- reliability
- voltage stability
- generation reserves

Regarding reliability, voltage stability and generation reserves, the Cooperatives believe that the load serving entity should be responsible for each of these matters, pursuant to the directions of the ISO. The Cooperatives believe that, at least initially, regulatory agencies should have oversight authority over reliability at the generation and transmission level (probably FERC) and at the distribution level (the SCC). In addition, long-term standards need to be established, which standards should be administered by an independent entity (whether it be FERC, NERC (or its successor), the Department of Energy or another entity). The authority to address problems in these areas should rest with the ISO.

**Describe the transmission of electricity in a competitive market.**

- ISO formation

The Cooperatives support the formation of an ISO covering the largest area that can reasonably be included, and open and fair participation in the development and governance of whatever ISO is formed. If a given ISO is to be an effective mechanism that will be fair to all stakeholders and beneficial to all of Virginia's ratepayers, it is essential that all stakeholders be fairly represented, not only in the formation process, but also in the ultimate structure and governance of the ISO. In particular, Virginia's cooperatives, as transmission dependent utilities, must have both influence and authority in the formation and governance of any ISO that pertains to them. The ISO should have an independent board of directors, the majority of whom have no interest in the entities that operate under the direction of the ISO. If the ISO evolves into an Independent Transmission Company ("ITC"), it must own the entire transmission system, not just pieces of it.

The Cooperatives support mandatory participation in the ISO and direct operational control of all transmission facilities by the ISO. The ISO should be the sole provider of transmission services, operate the OASIS, determine Available Transmission Capacity ("ATC"), be the scheduling agent and serve as security coordinator. The ISO should have the ability to penalize power suppliers that fail to deliver to the ISO the capacity needed to support their contracted load. The Cooperatives believe it to be essential that transmission services and facilities administered under an ISO be provided on a regulated cost of service basis, applying traditional ratemaking methodologies to produce a blended rate for transmission that does not pass inappropriate or unnecessary costs on to the ratepayers. Finally, the ISO should provide a vehicle for joint transmission planning if no other regional group exists to perform that function.

- bilateral contracts

Other than existing bilateral contracts, there should be no bilateral contracts within an ISO. All transmission will be arranged through and be controlled by the ISO. However, if the ISO was structured such that it extended down to the distribution level and distribution revenues were funneled through the ISO, a distribution cooperative's tax-exempt status could be adversely affected. As discussed above, if nonmember revenue exceeds 15% of a cooperative's total revenue, the cooperative would lose its tax-exempt status and its costs would increase substantially. Accordingly, the Cooperatives recommend that the authority of the ISO not extend to the distribution level.

- distinction between FERC/Commonwealth oversight

The ISO will be reviewed, approved and regulated by FERC. The SCC should have a voice in governance of the ISO through a seat on the board of directors or a suitably empowered advisory board.

**What duties are imposed on transmitters of electricity as a result of competition?**

- import capacity

The Cooperatives believe that to the extent the import capacity of the transmission system in a given control area is constrained, there is a potential for market distortion if costs, particularly variable costs, are not kept in check. Therefore, the rates for power from generation facilities within a constrained control area should be limited to cost of service until such time as the constraint is relieved.

- oversight of operations and rates

The ISO should have authority to direct transmission system planning and construction. The ISO will have authority over operation of the transmission system, subject to FERC's general oversight and ratemaking authority.

**Describe the distribution of electricity in a competitive market.**

- treatment of coops and municipal
- oversight of operations and rates

The distribution of electricity in a competitive market should continue to be conducted much as it is now, with the current local utilities retaining the obligation to provide distribution service in certificated distribution service territories. Oversight of operations and rates for distribution cooperatives and investor-owned utilities will continue to be within the SCC's jurisdiction.

**What duties are imposed on distributors of electricity as a result of competition?**

- metering and billing

Regarding billing and metering functions, the Cooperatives believe that billing and metering should be provided by the entity providing distribution service. Unlike generation, transmission and distribution will continue to be regulated by federal and state authorities. Even in a restructured generation market, certificated, exclusive service territories will be maintained for distribution service, and the distribution service provider will have an obligation to serve everyone in its certificated territory. The Cooperatives believe that along with a duty to serve should come a right to bill for that service, and also believe that control of metering is an essential aspect of operating a distribution system. Providing for competition in metering and billing is not an essential component of restructuring. Inefficient duplication of efforts and services could create an unnecessary gap between the distributor and the customer, which could cause confusion and have a negative impact on service quality.

- collection/dispersal of stranded costs or benefits

- maintenance

The distribution service provider is likely to be responsible for the collection and dispersal of stranded costs and benefits, particularly to the extent such costs and benefits are reconciled by way of line charges. The distribution service provider also should take responsibility for maintenance of the distribution system.

- default providers

The distribution service provider should serve as the default supplier. In a competitive retail electric market, customers will have the ability to choose their retail electric supplier. The choice could be an alternative electric supplier or the incumbent electric utility. The customers classified as being served by the default supplier should be only those customers that have not made a choice regarding their retail electric supplier.

- "providers of last resort"

The distribution service provider should also serve as the supplier of last resort. For serving as the supplier of last resort for customers otherwise unable to secure service because of payment problems, the distribution service provider should receive reimbursement through charges collected from all retail power suppliers. If called upon to serve as the supplier of last resort for customers whose power supplier has failed to deliver as scheduled, the distribution service provider should have the authority to charge a premium to the power supplier and perhaps the customer. The SCC should be given authority to create a certification program for power suppliers in order to evaluate and monitor their financial viability and their ability to perform. This will help assure that power is available to consumers when they need it and that funds are available to cover liabilities and penalties for any failures to perform. Customers should be liable for the costs of emergency replacement power only as a last resort. Also, in the event power is unavailable and the ISO calls for load reduction, the customer whose supplier has failed should be subject to disconnection before other customers (presuming individual disconnection becomes technically feasible).