

May 18, 1998

The Honorable Clifton A. Woodrum
Member, Virginia House of Delegates
P.O. Box 1371
Roanoke, VA 24007

The Honorable Thomas K. Norment, Jr.
Member, Senate of Virginia
P.O. Box 1697
Williamsburg, VA 23187-1697

Dear Delegate Woodrum and Senator Norment:

The Staff of the SCC has reviewed the issues list associated with the "Structure and Transition Task Force" and is providing input as requested. We first note that many of the issues span several task forces and some redundancy is unavoidable as the issues lists are fleshed out. While most of the questions detailed herein may be implicit in the questions posed in your draft document distributed on May 7, 1998, we believe there is value in developing specific and pointed questions in order to focus clearly on some critical details. It is with this perspective that we offer the following comments and questions.

As we consider the introduction of more competition into Virginia's electric industry, there are a number of basic questions that must be asked. For example:

- What services are candidates for competition?
- What can be done to encourage the competitive provision of those services?
- What are the issues associated with establishing an ISO/RPX? and;
- When and under what conditions can the provision of specific services be deregulated?

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With regard to those services that are candidates for a competitive environment, the dialogue in Virginia has been focused primarily on electricity generation. Some states, however, are pursuing the competitive provision of specific services that are more related to distribution than to generation. For example, metering, meter reading, and customer billing are often considered to be potentially competitive services. Generation related ancillary services such as reserve margins, spinning reserves, and voltage support are often mentioned as candidates for the competitive market. With this in mind, a focus on the following issues is necessary:

- Should Virginia consider the competitive provision of distribution related services in our efforts to accommodate the transition to a more competitive market?
- If, for example, metering is deemed to be a competitive service, what are the implications of the fact that some of our utilities are installing a significant number of new meters under a regulatory regime?
- What action should be taken to ensure that all potentially competitive providers have equal access to consumers in terms of providing distribution related competitive services?
- With regard to generation related ancillary services, what responsibility should Virginia have relative to the pursuit of the competitive provision of these services? If the provision of such services has monopoly characteristics and requires the classification of specific units as "must-run" during specific periods, how should the output of these units be priced and who is responsible for establishing these prices?

With regard to encouraging competition in our electric utility industry, we must identify what pro-active efforts are appropriate to incentivize the competitive provision of specific services. We must also focus on removing obstacles to competition, especially those that may provide incumbent utilities with unearned advantages. Some areas of specific concern include:

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- How can the market power associated with existing generation be mitigated in order to facilitate a truly competitive environment? Should divestiture be given consideration? If so, should it be mandated? Should it be voluntary? What should be the treatment of sales proceeds? What kinds of protections are necessary for investors and/or consumers in the event of divestiture?
- Are existing generation sites candidate sites for new generation and does the ownership of those sites by incumbent utilities have anti-competitive implications for potential providers of incremental generation?
- Do existing generators have a competitive advantage from an environmental perspective, i.e., the ownership of SO₂ allowances and the ability to generate the NO_x offsets necessary to build generation in non-attainment areas?
- Should the incumbent utility be viewed as the supplier of last resort or would such an approach provide a guaranteed market share for the incumbent utility for an indefinite period? Should the provision of default service be competitively procured? Should all or certain competitive providers be required or allowed to serve a portion of those customers that do not select an alternative supplier?
- If new generation is required over the short-term, how should incremental capacity be provided and by whom? What are the competitive implications if incumbent utilities provide incremental generation needed for reliability purposes? Are existing market power concerns exacerbated?
- What are the implications if incumbent utilities sign long-term contracts with existing customers before competitors have access to such customers?

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Turning to ISOs and RPXs, many states have concluded that the creation of these entities is necessary to accommodate the development of a competitive generation market. In fact, the Staff of the SCC concurred with this conclusion in its restructuring report issued on November 7, 1997. The formation of ISOs and RPXs, however, requires that we focus on a number of specific issues. For example:

- How can/should the public interest of Virginia affect the formation of a specific ISO/RPX? What review/approval process should the Commonwealth exercise in the formation of such entities? What should be the criteria for approval?
- Can/should Virginia exercise any control over the ISO/RPX after their formation or should the Commonwealth rely on the FERC to protect our public interest?
- Once the ISO and RPX are formed, the ISO will presumably be responsible for transmission enhancements. What role, if any, should the state play in the approval of new transmission facilities? If the RPX is responsible for generation reliability, should the Commonwealth play any role in that area or should the FERC be relied upon to ensure that the competitive market provides for reliable generation?
- It is generally agreed that there must be some separation between generation and transmission to prevent the abuse of vertical market power. Are there any vertical market power concerns that might also require a similar separation between generation and distribution?

Another critical issue that must be addressed relative to establishing a competitive market relates to the deregulation of generation. "Deregulation" must be defined in clear and concise terms and the criteria for deregulating what has been perceived as a monopoly service for many years must be rigorously established. As an example, Section 56-235.5:F of the Code of Virginia addresses this issue from the perspective of the telephone industry. This statute states: *"The Commission may determine telephone services of any telephone company to be competitive when it finds competition or the potential for competition in the*

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market place is or can be an effective regulator of the price of those services. In determining whether competition effectively regulates the prices of services, the Commission may consider: (i) the ease of market entry, (ii) the presence of other providers reasonably meeting the needs of consumers, and (iii) other factors the Commission considers relevant...."

It may be necessary to establish similar criteria for the electric utility industry. Establishing a date certain for deregulating generation prior to the development of a competitive environment could result in the creation of unregulated monopolies.

There are also a number of other issues that require attention as we focus on the development of a more competitive market structure and the transition to that structure. For example:

- What, if any, regulatory oversight of competitive retail providers is necessary? While this issue may be fully developed by the "Consumer Protection Task Force," it has implications for market structure as well.
- Does existing Virginia law adequately address issues associated with mergers/acquisitions?
- What, if any, environmental consideration should affect the structure of an evolving competitive market in the Commonwealth?

Finally as the issues detailed herein are considered, decisions must be made as to what forum is most appropriate for their resolution – legislative or regulatory? These decisions will have a tremendous impact on the nature and scope of any restructuring legislation that is introduced.

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Thank you for this opportunity to provide input. We will be happy to provide additional information or respond to any questions you might have.

Sincerely,

William F. Stephens

C: Chairman Clinton Miller
Commissioner Theodore V. Morrison, Jr.
Commissioner Hullahen Williams Moore