

## **PART I**

# **STATUS OF COMPETITION IN THE COMMONWEALTH**

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## INTRODUCTION

In this section of the State Corporation Commission's ("Commission" or "SCC") report to the Governor and to the Legislative Transition Task Force ("LTTF"), we provide an update regarding activities in Virginia related to competition in the electric market. Since § 56-596 of the Virginia Electric Utility Restructuring Act ("Restructuring Act" or "Act") directs us to file a report each September 1<sup>st</sup>, the section on the status of competition in the Commonwealth can be used to provide a history of the transition to competition. Each year we will prepare a chronology that will detail the progress of competition and activities of interest during the past twelve months.

During the past year much has been accomplished. In particular, functional unbundling cases were completed for each electric utility and over 1.45 million electric customers in Virginia gained the right to choose an alternative supplier of electricity. Approximately 750,000 more customers will be gaining the right to choose on the due date of this report, September 1, 2002.

It has been disappointing, however, that competitive service providers have not made offers of attractively priced energy options. As in many other states that offer retail access, competitive activity has dwindled in Virginia during the past twelve months. There were more customers using a competitive provider during last year's pilot programs than there are today.

The following pages provide an overview of the transition from pilot programs to full retail access; the process used to develop wires charges and a price-to-compare; the status of our consumer education program; and details on a diverse list of activities and investigations devoted to the development of a competitive market.

## **COMPETITIVE ACTIVITY**

The following section provides a review of the competitive activity in Virginia's electric market starting with the three pilot programs that received Commission approval and then describing the beginning of the transition to full retail access. In addition to supplying details on the number of customers who switched energy providers, there will also be discussions of the licensing of suppliers and aggregators, marketing activity, and customer complaints.

### **Pilot Programs**

Three local distribution companies ("LDCs") conducted electric retail access pilot programs in Virginia. Dominion Virginia Power's ("DVP") electric retail choice pilot program began in May 2000 and American Electric Power – Virginia's ("AEP-VA") pilot program began in the fall of 2000. Both programs ended on December 31, 2001. Rappahannock Electric Cooperative's ("REC") pilot program began in January 2001, and continues until the Cooperative implements full retail access, scheduled for January 2003. Full retail access began in AEP-VA's service territory on January 1, 2002. DVP began its phase-in to full retail choice by initially offering choice in its northern Virginia area on January 1, 2002. Although the pilot programs ended in DVP's service area, customers who chose a competitive service provider ("CSP") during the pilot who were not in DVP's Phase I service area were able to continue receiving service from the CSP in accordance with the CSP contract. Further, customers in central Virginia who volunteered to participate in the pilot program but did not choose a CSP were allowed to continue to shop even though those customers are in Phase II of DVP's retail access program scheduled to begin on September 1, 2002.

Four CSPs actively participated in DVP's pilot program. Dominion Retail, an affiliate of DVP, enrolled the largest number of customers during the pilot and continued to serve over 19,000 residential customers beyond the end of the pilot program and into the first few months of retail access. Dominion Energy Direct Sales ("DEDS"), another DVP affiliate, enrolled over 2,000 commercial and industrial customers during the pilot program. DEDS did not apply to convert its pilot license to participate in the full retail access program because Dominion Retail expanded its customers base to include commercial and industrial customers. Instead, DEDS requested and was allowed to continue to serve its customers into 2002 through the duration of each customer's contract. By mid-May 2002, both Dominion affiliates elected to discontinue service and returned all of their customers to DVP. Washington Gas Energy Services ("WGES") also participated in the early stages of DVP's pilot program offering customers an opportunity to save on their electric bills during the winter season only. The WGES contracts with approximately 5,900 residential and commercial customers expired in May 2001, and those customers were returned to DVP capped rates.

The three CSPs just mentioned offered customers a rate for energy that was less than DVP's rate, giving customers an opportunity to save some on their electricity bills. The fourth CSP to solicit and enroll customers in DVP's pilot program was AEP Retail Energy. AEP Retail Energy offered DVP's pilot volunteers a guaranteed price of 5.3¢ per kWh for all electricity used through December 2001. This price was higher than DVP's 5.117¢ per kWh price-to-compare for 2001. This offer was for 100% renewable energy featuring waste wood from timber operations or wood processing plants. AEP Retail's offer was available to the first 1,000 customers that enrolled. When this CSP was close to reaching its limit, it withdrew its

offer and discontinued taking enrollments. Thereafter, AEP Retail dropped its customers as their contracts expired at the end of the pilot program.

No CSPs participated in the AEP or REC pilot programs. Consequently, the customers of AEP-VA and REC did not have the opportunity to shop during the pilot programs. Although these companies did not have the chance to put their pilot program systems and processes into operation, the exercise of preparing for the pilot programs may nevertheless provide a foundation for a smoother transition to full retail access.

### **Transition to Full Retail Access (Phase-In)**

The Commission order in Case No. PUE-2000-00740 established the phase-in schedule for all investor-owned utilities and cooperatives and directed them to submit quarterly reports regarding the status of efforts to implement the phase-in of retail choice. Six such reports have been submitted to the Commission staff ("Staff") as of July 2002, and a brief summary of the current status follows.

Allegheny Power ("AP"),<sup>1</sup> AEP-VA and Delmarva Power & Light ("Delmarva") implemented full customer choice within their respective Virginia service territories on January 1, 2002. In December 2001, these three LDCs were granted approval of unbundled rates and associated tariffs that became effective on January 1, 2002. Price-to-compare information was provided along with a revised bill format to inform and assist each customer in evaluating options. All of these LDCs have completed adjustments to their computer and business systems and are ready to conduct electronic data interchange ("EDI") tests with CSPs, a topic discussed later in this report. To date, no CSP has registered with any of these LDCs to provide service within their respective Virginia territories except for two CSPs that recently began the

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<sup>1</sup> Doing business in Virginia as the Potomac Edison Company ("PE").

registration process with Delmarva. The LDCs are prepared to accommodate customer choice when CSPs offer service within the companies' service areas.

DVP implemented customer choice for one-third of its statewide commercial and industrial load and a third of its residential customers, primarily within its northern Virginia territory, on January 1, 2002. DVP will provide retail access to another third of its customers, including residential customers in central Virginia, by September 1, 2002. DVP will phase-in its remaining customers by January 1, 2003.

Similar to AEP-VA, AP and Delmarva, DVP was granted approval of its unbundled rates and associated tariffs effective January 2002. Price-to-compare information was provided along with a revised bill format. Similar information will be presented to eligible customers within each phase of implementation.

DVP has completed adjustments to its EDI systems and has successfully completed testing with seven CSPs. To date, eleven CSPs (including two aggregators) have initiated discussions or are in various stages of registering with DVP to provide service within DVP's Virginia territory. Only three CSPs have actually served customers since implementing full retail access. Two of those were the DVP affiliates mentioned above that were carry-overs from the pilot program. The one CSP that had an offer in DVP's service territory this year, Pepco Energy Services ("PES"), withdrew its offer in May but continues to serve about 2,500 customers. All CSPs that have served customers either in DVP's pilot program or under full access have been affiliates of an electric or natural gas utility.

The Commission Order in PUE-2000-00740 permitted the electric cooperatives ("Cooperatives") and Kentucky Utilities ("KU")<sup>2</sup> to phase-in implementation of retail access at

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<sup>2</sup> Doing business in Virginia as Old Dominion Power Company ("ODP").

their own pace as long as it is completed by January 1, 2004. The distribution cooperatives have announced plans to develop the necessary business processes and systems to accommodate retail access by the dates shown below:

Northern Virginia	implement 7/1/02
Rappahannock	implement 1/1/03
Community	implement 4/1/03
Shenandoah Valley	implement 4/1/03
A&N	implement 7/1/03
Northern.Neck	implement 7/1/03
Prince George	implement 7/1/03
BARC	implement 1/1/04
Central Virginia	implement 1/1/04
Craig-Botetourt	implement 1/1/04
Mecklenburg	implement 1/1/04
Southside	implement 1/1/04

These Cooperatives will continue to work collectively to address transition issues and take advantage of synergies. The SCC issued its order in Case No. PUE-2002-00086 on June 18, 2002, approving Northern Virginia Electric Cooperative's ("NOVEC") tariffs and terms and conditions amended per Staff's recommendations. NOVEC's initiation of retail choice was conditioned upon the timely receipt of its wire charge allocation agreements with its generation affiliate, Old Dominion Electric Cooperative ("ODEC"), and its revised tariffs. The agreements and tariffs were filed with the Commission on July 12, 2002. REC submitted on August 2, 2002, its plan and associated tariffs to permit implementation January 1, 2003. Meanwhile, both of these Cooperatives are well toward the goal of having the necessary EDI systems in place. It is expected that NOVEC and REC will provide the basic model to be followed by the remaining Cooperatives.

KU has formed a project team to explore and identify the processes necessary to implement the transition to retail access by January 1, 2004. Realizing the potential costs to revise and build system options in its small Virginia service area and the unlikely event of



Kentucky requiring retail access in the near future, KU entered discussions with Staff to explore the possibility of reducing some of its implementation costs. On June 12, 2002, KU submitted a request for waiver of certain Rules Governing Retail Access To Competitive Energy. Specifically, KU requested a waiver of rules governing the exchange of data by electronic means in accordance with EDI standards, as developed by the Virginia Electronic Data Transfer Working Group.<sup>3</sup> The Commission issued an order on July 19, 2002, docketing this issue as Case No. PUE-2002-00323 and inviting comments on KU's request. Staff and two other parties filed comments; an order will be issued soon.

All of the LDCs referenced above continue to participate actively with various working groups assisting Staff to develop and propose rules regarding transition issues such as minimum stay provisions, competitive metering, supplier consolidated billing, and aggregation.

### **Suppliers/Aggregators**

The Commission is responsible under §§ 56-587 and 56-588 for licensing suppliers and aggregators interested in participating in the retail access programs in Virginia. The Staff has established a streamlined mechanism for processing license applications. Staff has an internal deadline of 45 days from the receipt of a complete application to the issuance of a license. Thus far, that deadline has been met for all applications. To date, the Commission has issued a total of twenty-one licenses to electric and natural gas CSPs and aggregators interested in participating in full retail access. A list of suppliers can be found on the following page. To facilitate the prompt processing of license requests, the SCC website provides access to the licensing requirements and contains a sample license application form.

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<sup>3</sup> The VAEDT will be discussed later in this report.

In order to participate in an LDC's retail choice program, a CSP must also complete a registration process with the utility. EDI testing between the CSP and the utility is required as part of the registration process. The testing must be completed before a supplier can begin enrolling customers.

**Applications for Competitive Service Provider/Aggregator  
Licensure (August 1, 2002)**

Company Name	<b>LDC Programs</b>		<b>Customer Class(es)</b>	<b>Services Provided</b>
	DVP=Dominion Virginia Power AEP-VA=AEP Virginia REC=Rappahannock Elec. Coop. (pilot) WGL=Washington Gas CGV=Columbia Gas of VA			
Pepco Energy Services	Statewide		R, C, I	Natural gas, electric and aggregation (E&G)
Dominion Retail, Inc.	Statewide		R, C,I	Natural gas, electric and aggregation (E&G)
Washington Gas Energy Svcs	Statewide		R, C, I	Electric & natural gas
EnergyWindow, Inc.	Statewide		R, C, I	Aggregation (E&G)
Allegheny Energy Supply Co.	Statewide		R, C, I	Electric
The New Power Company	Statewide		R, C	Natural gas and aggregation (E&G)
Amerada Hess Corporation	WGL, CGV, DVP, AEP-VA, REC		C, I	Electric, natural gas and aggregation (E&G)
Energy Svcs Mgmt Va LLC, d/b/a Virginia Energy Consortium	Statewide		C	Aggregation (E)
AEP Retail Energy	Statewide		R, C, I	Electric, natural gas and aggregation (E&G)
Bollinger Energy Corporation	Statewide		C, I	Natural gas
Tiger Natural Gas, Inc.	Statewide		R, C, I	Natural gas
NOVEC Energy Solutions, Inc	Statewide		R, C, I	Electric, natural gas and aggregation (E&G)
BGE Commercial Bldg Systems Inc	WGL		C, I	Natural gas
Old Mill Power Company	Statewide		R, C, I	Electric, natural gas and aggregation (E&G)
Metromedia Energy, Inc.	WGL		C, I	Natural gas
Cook Inlet Power, LP	Statewide		C, I	Electric
ACN Energy, Inc.	WGL		R	Natural gas
AOBA Alliance, Inc.	VP, AEP-VA, WGL, CGV		C	Aggregation (E&G)
Energy Consultants, Inc	Statewide		R,C	Aggregation (E)
AES NewEnergy, Inc.	Statewide		C,I	Electric and aggregation (E&G)
Select Energy, Inc.	Statewide		C,I	Electric and natural gas

Two CSPs, Dominion Retail and PES, are fully registered with DVP and ready to do business. Energy Consultants and EnergyWindow are the only two aggregators fully registered with DVP. The following five CSPs and aggregators are at various stages in the registration process with DVP:

- AES NewEnergy, Inc. (Recently acquired by Constellation Energy)
- Cook Inlet Power, LP
- Old Mill Power
- The New Power Company (Although it recently notified the SCC that it will not be making offers due to bankruptcy)
- Washington Gas Energy Services

AEP-VA and AP have each had at least one CSP inquire about their choice programs, but no CSP is registered with either at this time. Old Mill Power and WGES have pending registrations with Delmarva and WGES has begun EDI testing.

### **Marketing**

Similar to what was observed during the pilot programs, the only marketing activity that has taken place in the retail access programs is in DVP's service territory. Customers who chose Dominion Retail as their supplier during the pilot were able to continue service with Dominion Retail until the contracts expired in May 2002.

When retail access opened in January of this year, Pepco Energy Services made a "green power" offer to DVP's residential customers in Northern Virginia. Although PES's marketing material was not explicit regarding the generation source, Staff contacted the company and learned that the renewable generation source was biomass, landfill gas from a landfill in central Virginia. PES had two renewable offers available. One offer consisted of 100% renewable energy while the other was for a slightly lower-priced mix consisting of 51%

renewable energy. The Company indicated that most, if not all, customers chose the lower priced offer. Both offers were at a premium above DVP's price-to-compare.

Since full retail access began, PES's renewable energy offer is the only offer residential customers have received. Around 2,000 customers enrolled with PES before expiration of its offer in mid-January. PES renewed its offer in March, but discontinued marketing its offer in May. To date, about 2,500 residential and 24 commercial customers are enrolled with PES. There are no industrial customers using a competitive service provider.

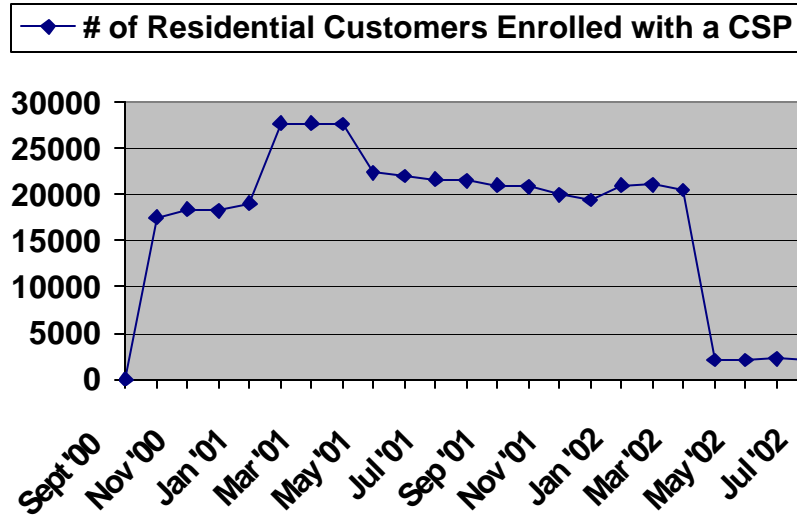
### **Customer Issues**

The Staff receives many calls from customers regarding utility issues. The calls can be divided into the following four categories: complaints, inquiries, requests for a supplier list, and allegations of slamming. Not all of the complaints received are related to retail choice. Common complaints due to the introduction of choice are about marketing practices (telemarketing and door-to-door solicitation), billing, and cancellation fees. A small number of complaints have been about the length of time it takes to become enrolled with a supplier.

By mid-January 2002, the Staff had received approximately 20 consumer complaints regarding techniques used by telemarketing representatives of PES. Specifically, the representatives were alleged to have 1) told consumers they had to switch to PES; 2) aggressively solicited consumers' DVP account numbers; and 3) enrolled consumers without authorization. Staff requested that PES provide information regarding these complaints. When the Staff met with representatives of PES in late January to discuss ways the CSP could improve its marketing campaign, PES's offer was no longer available to new customers. The CSP was receptive to the Staff's concerns, and when it began telemarketing again in March, it had revised its script and hired a different telemarketing firm. The Commission did not receive complaints about the second campaign.

## Customer Participation

The following graph shows DVP's residential customer switching activity from the start of the pilot program until now.



### Notes:

- Phase I of DVP's pilot program began May 2000, however, energy flow from CSPs was not permitted until September 1, 2000, to allow DVP time to comply with the Retail Access Pilot Rules and conduct EDI testing with registered CSPs.
- Phase II of DVP's pilot program began January 1, 2001. Enrollments for Phase II customers began in December 2000.
- Enrollments increased between February 2001 and March 2001 when WGES enrolled approximately 5000 residential pilot customers.
- WGES's customers' contracts ended with their May 2001 meter read dates.
- AEP Retail enrolled customers between November 2000 and the end of April 2001. AEP Retail's customers' contracts ended at the end of DVP's pilot, December 31, 2001. A few customers continued to receive service from AEP Retail until their January meter read dates.
- Although the pilot ended in December 2001, Dominion Retail continued to serve customers who enrolled during the pilot program through mid-May 2002.
- Pepco Energy Services began serving retail access customers in January 2002 and is currently the only active CSP.

The table below contains the number of eligible customers and the number of switches to a CSP, as of August 16, 2002, for DVP's retail access program. The information is shown for each class of customer.

**Dominion Virginia Power –**  
Phase I (includes Central Virginia Pilot Volunteers)

**Data below is as of August 16, 2002:**

<b>Class</b>	<b># of Customers Eligible to Choose</b>	<b># of Customers Currently Served by a CSP</b>
Residential	690,000	2,560
Church	900	0
GS-1 <30 KW	51,000	23
GS-2 30-500 KW	10,400	1
	<b>Total Annual MWH Allowed in Phase I</b>	<b>Total Annual MWH for Accounts Currently Served by a CSP</b>
GS-3 Secondary Voltage >500 kW	3,400,000	0
GS-4 Primary Voltage >500 KW	2,600,000	0

The following table provides the number of electric customers in other Virginia LDC territories that are currently eligible to shop for a CSP.

<b>Company</b>	<b># of Eligible Residential Customers</b>	<b># of Eligible Nonresidential Customers</b>	<b># of Customers Currently Served By a CSP</b>
<b>AEP-VA</b>	419,734	67,253	0
<b>AP</b>	74,902	12,648	0
<b>Delmarva</b>	18,872	3,364	0
<b>NOVEC</b>	97,255	6,714	0

Therefore, out of approximately 1.3 million residential customers in Virginia who currently have the right to choose an alternative source of electric energy, only about 2,500 customers have done so, or about 0.2%.

## **DEVELOPMENT OF A PRICE FOR THE ENERGY COMMODITY**

This section of the report will detail the steps involved with setting the price for energy while rate caps are in effect. Unbundled generation rates and market prices for generation are essential components of the wires charges calculations. Additionally, the generation market prices established by the Commission for each incumbent utility help competitive suppliers determine whether they can or will make competitive offers in utilities' service territories.<sup>4</sup>

The first step is the functional unbundling of rates into separate generation, transmission and distribution components as required under § 56-590 of the Restructuring Act. The next step is the calculation of the market price for generation which, when compared to the unbundled generation rate, will determine the amount of an appropriate wires charge, if any. The procedure for calculating market prices and wires charges are detailed in § 56-583 of the Act. A final important component of the pricing of energy is the determination of the price-to-compare for each incumbent electric utility. This benchmark price can then be used by consumers for comparison shopping.

### **Functional Unbundling**

Section 56-590 of the Restructuring Act required Virginia's incumbent electric utilities to file plans detailing the proposed separation of the incumbents' generation, retail transmission and distribution functions. The cases provided the companies an opportunity to file proposed retail access tariffs applicable to customers and third party suppliers. As part of these cases, the Commission also "unbundled" the companies' retail rates for purposes of establishing wires charges.

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<sup>4</sup> It should be noted, however, that if a utility's unbundled generation rate is *less* than the Commission-determined market price for generation, then the price a CSP must "beat" in order to make a competitive offer would be the unbundled generation rate, and not the market price.



Rate unbundling in these cases consisted of separating the utilities' bundled rates,<sup>5</sup> for retail electricity service into separate components to reflect distribution, transmission and generation charges. Transmission charges were also unbundled into base and ancillary services. The companies' retail access tariffs addressed and defined the operational relationship between the utilities and competitive service providers in the provision of competitive generation service in the incumbents' respective service territories. These tariffs, among other things, addressed CSP creditworthiness requirements, noncompliance and default, load forecasting and scheduling procedures, and CSP billing. Highlights of the incumbents' functional separation cases are provided below.

Dominion Virginia Power (PUE-2000-00584): Dominion Virginia Power and AEP-VA, Virginia's largest utilities, both filed plans seeking corporate separation, in which these utilities' generation assets were proposed to be transferred to affiliated generation companies not regulated by the State Corporation Commission.

Dominion Virginia Power proposed to transfer its generation assets to Dominion Generation, a generation company affiliate that intended to operate as an exempt wholesale generator subject to the exclusive jurisdiction of the Federal Energy Regulatory Commission. The Company also sought an indexed fuel factor.

A final order in the DVP proceeding, entered on December 18, 2001, found that "Virginia Power's assets should, at this time, continue in the ownership of the Company, and operate in a division functionally separate from transmission and distribution operations"

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<sup>5</sup> A bundled rate consists of one rate for electricity which was comprised of all elements of service: generation, transmission and distribution.

(Order at p. 57). Additionally, the order established unbundled rates for services, as well as fees for new services proposed by the Company as part of the transition to retail choice.

AEP-Virginia (PUE-2001-00011): As noted above, AEP-VA also proposed legal separation via the transfer of its generation assets to an affiliate not subject to Commission regulation. As part of this proceeding, however, AEP-VA entered into a stipulation with the Commission's Staff and other interested parties providing, in pertinent part, that the Company would functionally separate by divisions, and would seek the Commission's review of the corporate separation issue in the year 2002. The Company also stipulated that it would not seek to recover wires charges from any shopping customer in its service territory during calendar year 2002. The parties agreed that the Company would make no change in its fuel factor recovery mechanism or its specific fuel factor for calendar year 2002. The Commission issued an order in this proceeding on December 18, 2001, approving these stipulations. Subsequently, by order dated June 18, 2002, the Commission approved the Company's April 30, 2002, motion requesting that the Commission hold all further proceedings on the corporate separation issues in abeyance until no earlier than July 1, 2003.

Old Dominion Power Company (Kentucky Utilities) (PUE-2001-00003): KU stated in its functional separation application that, with the exception of one 500 kV transmission line extending into Virginia, all of KU's generation and transmission assets are located in Kentucky and are subject to the jurisdiction of the Kentucky Public Service Commission. The Company argued that legally and practically it cannot functionally separate its assets related to its Virginia load nor transfer them to an affiliated entity. KU suggested in its application, however, that it can achieve the goals and objectives of the Restructuring Act without functional separation.

The Commission issued its final order in this proceeding on December 19, 2001. As part of that order, the Commission approved KU's proposal to operate under the guidelines set forth by the 1999 Kentucky General Assembly in Kentucky House Bill 897 which imposes a code of conduct on the relationship between regulated entities and unregulated affiliates and establishes specific reporting requirements. However, as recommended by this Commission's Staff, when the Company enters into competitive services in Virginia, KU must file a code of conduct with the Commission outlining its plan to comply with the Virginia requirements governing affiliate and/or division relationships and to file requests for any necessary or desired waivers.

Delmarva Power & Light (PUE-2000-00086): Delmarva's functional separation was handled by the Commission in two phases. On June 29, 2000, the Commission entered an order in the first phase of this proceeding approving the transfer by Delmarva of nearly all of its out-of-state generation assets to affiliated and non-affiliated companies. The Company did retain two intermediate units located on Virginia's Eastern Shore. The transfers were approved in conjunction with Delmarva's agreement to base rate reductions, waiver of wires charges, freezing its fuel factor until 2004, and agreeing to a Rate Case Protocol that would assure that the generation component of default service rates following the expiration of capped rates is no higher than it would have been had Delmarva continued to own its existing generating assets.

In supplemental filings made in April and June 2001, Delmarva filed proposed retail access tariffs, workpapers describing the development of its unbundled rates, proposed tariff changes relating to retail choice, and a proposed electricity supplier agreement that would govern the relationship between alternative energy suppliers and Delmarva for the CSPs'

provision of competitive generation service in the Company's territory. An order addressing this second phase was entered in December 2001.

The Potomac Edison Company (PUE-2000-00280): Similar to Delmarva, Potomac Edison's functional separation was addressed in two phases. In July 2000, the Commission entered an order authorizing this Company to transfer its generating units, most of which were located out of state, to an affiliated generation company, with the exception of four small hydroelectric generating facilities located in Virginia. Significant to the Commission's approving the transfers was the Company's agreement to a substantial base rate reduction, waiver of wires charges, the elimination of its fuel factor, and the Company's commitment to provide default service (subsequent to the end of capped rate service) on a cost of service basis. The Company filed the second phase of its functional separation plan in December 2000.

By order dated December 21, 2001, the Commission unbundled the Company's monthly rates for service into unbundled components to reflect distribution, transmission and generation charges. The order also addressed the Company's proposed retail access supplier tariffs and related issues.

Electric cooperatives: The Commission reviewed functional separation applications for the following electric cooperatives: A&N (PUE-2001-00008), BARC (PUE-2001-00002), Community (PUE-2000-00746), Craig-Botetourt (PUE-2001-00009), Central Virginia (PUE-2000-00583), Mecklenburg (PUE-2001-00004), Northern Neck (PUE-2001-00006), Northern Virginia (PUE-2001-00005), Prince George (PUE-2001-00001), Rappahannock (PUE-2001-00007), Shenandoah Valley (PUE-2000-00747/00748), and Southside (PUE-2000-00749/00750). Shenandoah Valley, Southside, and Central Virginia filed rate cases to establish

capped rates effective January 1, 2002, concurrent with their functional separation plans. Commission orders concerning all of these applications were entered in December 2001.

None of the Cooperatives proposed to divest any generation assets, to create any new functionally separate entity, or to transfer any functions, services, or employees to a functionally separate entity or third party. Nor did any of the Cooperatives file retail access/supplier tariffs as part of their functional separation applications. In keeping with the Commission's order establishing retail choice phase-in schedules for Virginia's incumbent utilities (PUE-2000-00740), the Commission granted the Cooperatives waivers to delay these tariff filings. In all cases, the individual Cooperatives must file these tariffs in advance of the advent of retail access in their service area to accommodate the Commission approval process (including notice if necessary). For example, Northern Virginia Electric Cooperative filed these tariffs on July 12, 2002, in Case No. PUE-2002-00086.

### **Market Price and Wires Charge Calculations**

The Restructuring Act directs the Commission to establish wires charges for each incumbent electric utility effective upon the commencement of customer choice. In order to establish such wires charges the Commission must determine projected market prices for energy and subtract those projected market prices from each utilities' embedded generation rate. The embedded generation rate includes fuel costs as determined by the Commission pursuant to § 56-249.6.

Market Price Determination in Pilots: Our first experience with market prices and wires charges was in the three electric retail access pilots that began in September 2000 and ran through 2001. As noted earlier, AEP-VA, Rappahannock Electric Cooperative and DVP each conducted an electric retail access pilot.

In each pilot, projected market prices were based solely on historical data. Given this common thread, there were still significant differences in the methods proposed by DVP and AEP-VA to calculate projected market prices. These are briefly set forth below.

DVP's method for pilot market price determination began with a "price-out" of each participating rate class' hourly load using the "real-time" PJM<sup>6</sup> locational marginal price ("PJM LMP") at the transmission interface between PJM and the DVP bulk transmission system. The class hourly loads are produced by either load research techniques or actual metered data. Both the price and the quantity data forming the basis for this method consist strictly of historical information. At the time each pilot's market price determination was made, the latest available historical information was employed in the calculations.

Since PJM LMP was recognized as a price for energy, the DVP pilot method next added a capacity value to the PJM LMP-based energy value to yield a base market price for each rate class. The base market price was adjusted (increased by about 10%) to reflect potential sales opportunities at more distant price points or market hubs. The adjustment specifically considered historical prices at the "into" Cinergy and PJM-West trading hubs.

The pilot market price determination did not include an adjustment for any expense associated with transmitting power to any of the price points used in the market price determination. Instead, the Commission ordered DVP to report actual net transmission expenses associated with pilot operations. This includes the actual expense of selling electricity into wholesale markets as offset by revenues earned by DVP in its role as bulk transmission provider of access to CSPs serving load in the DVP pilot. DVP filed the required report on May 15, 2001. The report indicated that DVP's net cost for transmission and

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<sup>6</sup> "PJM" refers to the Pennsylvania-New Jersey-Maryland Interconnection.

ancillary services for displaced pilot sales for the months October 2000 through March 2001 amounted to approximately \$0.00045 per kWh. This value is equal to approximately one-half of one mil.

After initial disagreements about the proper method for market price determination for Rappahannock Electric Cooperative's pilot, Staff and the Cooperative agreed to recommend to the Commission that projected market prices be determined based on the same method used by DVP in the DVP pilot. The rationale for this approach was that market price ought to apply on a control area specific basis. Since REC essentially resides in the DVP control area, the market price determinations for these two entities should be mutually consistent. Given this approach, valid market price differences could result from differences in displaced sales load shapes or net transmission costs. REC agreed to use DVP market price determinations and apply them to its customer classes as appropriate.

AEP-VA proposed the use of historical "into" Cinergy sales data to determine pilot market prices. The proposed method was to be based on one year of both peak and off-peak price data as reported in McGraw-Hill's Power Markets Week ("PMW"). The Company proposed the use of its internal load research information to convert PMW block prices into a value more reflective of displaced pilot sales, which is a shaped product.<sup>7</sup> Given the reach of the AEP transmission system, Staff opposed AEP-VA's use of a single price point for market price determination. Instead, Staff proposed the inclusion of information from several regional price points by choosing the maximum daily peak-hour price. The Commission ordered AEP-

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<sup>7</sup> "Shaped product" means that actual displaced sales are not a uniform block of power, i.e, the same amount every hour. Rather, displaced sales exhibit a load "shape" that is usually more expensive to serve, per kWh, than a uniform block of power.

VA to employ a method that chose the average of the two highest daily, on-peak prices selected from five regional price points reported in PMW.<sup>8</sup>

The ordered method produced projected market prices well in excess of AEP-VA's capped generation rate. Except for outdoor lighting service, there were no wires charges.

Market Price Determination for Full Retail Access: To prepare for the beginning of customer choice on January 1, 2002, each incumbent utility hosting customer choice developed an embedded generation rate, a fuel cost and a market price to accommodate necessary calculations.<sup>9</sup> These calculations produced, where applicable, rate element specific wires charges that are currently included in incumbent utility distribution tariffs applicable to those customers taking service from a competitive service provider.

In order to facilitate a transition to customer choice which allows for some level of CSP participation in the market, it was important that the Commission make capped generation rate, market price and fuel factor determinations in advance of the start of retail choice on January 1, 2002. This would enable incumbents to make necessary calculations and carry out compliance filings before the choice date. Also, such timely determinations were intended to allow time for CSPs to formulate and implement pricing and marketing strategies required to participate in the marketplace.

The timing issues associated with the completion of necessary actions required to implement choice on January 1, 2002, were significant. For example, issues and uncertainties raised in the Dominion Virginia Power functional separation case (Case No. PUE-2000-00584)

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<sup>8</sup> The price points were "into" Cinergy, "into" TVA, "into" Comed, ECAR North, and MAIN Southern.

<sup>9</sup> Delmarva and Potomac Edison waived their right to wires charges. AEP-VA waived its right to collect wires charges for calendar year 2002. Rappahannock Electric Cooperative continued wires charges developed in its pilot into 2002, but experienced no customer switches to CSPs.



regarding an alternative fuel cost recovery method illustrated a significant timing and coordination issue that was resolved by the Commission allowing for the commencement of choice on January 1, 2002. In this matter, DVP agreed to keep its fuel factor at its 2001 level for 2002, subject to deferred accounting. This allowed for the determination of capped generation rates, which when compared to the Commission determined projected market price for generation, allowed for the calculation of wires charges in advance of January 1, 2002. Similarly, in its functional separation proceeding (Case No. PUE-2001-00011), AEP-Virginia agreed to forego wires charges for calendar year 2002.

For full retail access, the Commission determined in Case No. PUE-2001-00306 that projected market prices for generation used in wires charge calculations would be based on "forward prices"<sup>10</sup> for electric power traded in the wholesale market. This was different from the method employed in the pilots. By the time this order was issued in November 2001, the Commission had determined that forward prices were a better indicator of projected market prices and that the forward markets were functioning reasonably well.

The forward price method considers prices at two delivery/receipt points (Cinergy and PJM West) for a calendar year of data. Unlike the DVP pilot, there is no explicit inclusion for capacity value.<sup>11</sup> Price adjustments for load shaping were accomplished using methods similar to those employed in the pilots. Finally, the Commission ordered a specific method for adjusting market price to consider the cost to transport power to a distant market.

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<sup>10</sup> "Forward prices" generally refer to agreements made today for the future purchase and sale of a specified quantity of electric power at some specified location for a specified time period.

<sup>11</sup> Staff recently evaluated the appropriateness of including a capacity value in projected market price determinations for 2003.

The use of this methodology produced projected market prices well below DVP's capped generation rate. As such, wires charges are applicable to DVP customers that choose to take service from a CSP. Again, AEP-VA, Delmarva, and Potomac Edison have no wires charges for 2002. NOVEC implemented choice in July 2002 and REC will begin in January 2003. The wires charges for these two Cooperatives are to be calculated using market prices derived from forward markets.

The order referred to above also set a general schedule for making annual changes to wires charges effective at the beginning of successive calendar years. This process requires electric utility incumbents seeking to implement choice in their service territories on or after January 1<sup>st</sup> of a particular year to file a market price and fuel factor proposal with the Commission by July 1<sup>st</sup> of the preceding year. This is to allow wires charge determinations to be finalized in October, or about 3 months in advance of the date that choice begins.

Various industry advocates have offered widely differing interpretations of the setting of wires charges as defined by §56-583 A of the Restructuring Act. The Commission Staff is currently investigating potential changes in the methods of determining market prices. A work group met on July 24, 2002, to discuss possible revisions to the market price calculation, including, but not limited to, conceptual changes or use of new data sources. At the meeting, 21 people representing eight parties joined Staff. Unfortunately only one CSP was represented, AES NewEnergy. The group seemed satisfied, for the most part, with the inputs, data sources, and timing of the current market price methodology. Most of the discussion centered around whether a value for capacity should be included in the market price. It was agreed that additional meetings to discuss that issue would be worthwhile.

A subsequent meeting was held on August 12, 2002. Once again, only one CSP was represented. The representative of that CSP indicated that while including a value for capacity would provide some additional headroom, the adder would be too small to change the business strategy of a CSP to enter the Virginia energy market. In conference calls with three other CSPs, the Staff heard a similar message.

All testimonies have been filed in this year's market price/wires charge case and the hearing will be held on September 4, 2002.

**Price-to-Compare**

Once rates have been unbundled and the appropriate wires charge has been calculated, a company's price-to-compare can be determined. The price-to-compare is a cents per kilowatt hour benchmark number that can be used by a customer to evaluate offers from competitive service providers.

The price-to-compare is determined by taking the sum of the unbundled generation rate and the unbundled transmission rate and subtracting the wires charge. If a company does not have a wires charge because its embedded generation rate is less than the market price or if a company has waived its right to a wires charge, the price-to-compare is the sum of the unbundled generation and unbundled transmission rates. For the 2002 price-to-compare calculation, only DVP had a wires charge component.

The 2002 price-to compare numbers are:

Customer Class	Dominion Virginia Power	AEP Virginia	Allegheny Power	Conectiv
Residential	3.671¢/kWh	3.3¢/kWh	3.87¢/kWh	5.5965¢/kWh
Small Commercial	3.768¢/kWh	3.1¢/kWh	3.96¢/kWh	6.0615¢/kWh
Large Commercial	3.408¢/kWh	3.6¢/kWh	3.9¢/kWh	Not applicable
Small Industrial	3.291¢/kWh	3.0¢/kWh	3.55¢/kWh	5.7092¢/kWh
Large Industrial	3.045¢/kWh	2.8¢/kWh	3.34¢/kWh	5.6113¢/kWh
Churches	3.564¢/kWh	3.0¢/kWh	Not applicable	Not applicable

As can be seen, the price-to-compare differs among classes of customers. The numbers above are averages for each customer class. The actual price-to-compare for an individual customer will vary depending upon that customer's usage and rate schedule.

As mentioned in the previous section, new market price and wires charge calculations are scheduled to be completed in October for use in 2003. Soon after that time, the new price-to-compare numbers will also be available. Price-to-compare information will appear on the monthly bill of customers who have not yet chosen an alternative supplier.

## **CONSUMER EDUCATION**

The Virginia Energy Choice ("VEC") consumer education program utilized an integrated communications strategy in the first full year of activities to accomplish the single most important objective of the statewide education effort, as outlined in the education plan presented to the General Assembly: Provide information that is clear, accurate and unbiased.

The three stages of the five-year program are (1) build awareness of energy choice, (2) educate Virginians about changes in the energy market, and (3) provide information needed for consumers to shop and select an energy provider.

To ensure proper input and program oversight, the Commission Staff and its team of communications contractors have met with the Virginia Energy Choice Consumer Education Advisory Committee on an ongoing basis to share program plans and to receive input from investor-owned utilities, electric cooperatives, competitive suppliers, and consumer groups. Additionally, a web-based Extranet was set up to communicate program updates and share communication team information in a timely basis to all advisory committee members.

### **Benchmark Research**

Preliminary research conducted for the SCC showed in June 2001, that Virginians expect "lower price" and "competition" to be restructuring's advantages. Furthermore, the research indicated that positioning energy choice as empowering Virginians to make their *own* decisions about who will supply their energy in the future was a compelling and meaningful context in which to deliver the Virginia Energy Choice message. This message became the platform for the program.

### **Advertising**

The primary role of the communications program in Year 1 was to increase awareness of energy restructuring and to direct Virginians to information sources to learn more. The

strategy was to position Virginia Energy Choice as the single unbiased source for information about the changes coming to Virginia, with the primary message focusing on "consumer empowerment." Each element of the campaign, from utility bill inserts, billboards and television and radio commercials, includes the toll-free information number (1-877-YES-2004) and the website address (www.yesvachoice.com) where in-depth information is provided.

Demographically, a core target market of adult homeowners between the ages of 25-54 was identified, as well as community opinion leaders or "decision influencers," and included the important African American and Hispanic markets. The advertising was introduced to the Commonwealth in phases to correspond to the beginning of electric choice for most Virginians. Phase I advertising began in November 2001, prior to electric choice starting on January 1, 2002, in northern Virginia, southwestern Virginia and the Eastern Shore. Phase II advertising began in May 2002, prior to electric choice coming to many consumers in central and western Virginia on September 1, 2002. Phase III advertising is scheduled to start in Hampton Roads in October 2002, prior to the introduction of electric choice on January 1, 2003.

To create a consistent campaign look, a custom logo was designed and featured in all communications.



Materials were created to inform and educate, yet without



over-promising choice. The communications centerpiece was the Consumer Guide, a full-color brochure which includes important information Virginians need to know about the changes coming. The guide communicates what changes are underway and includes definitions of key terms, instructions on reading your energy bill to locate key information, as well as information and

a worksheet on comparing prices. A half million guides were printed and distributed via the call center, direct mail, newspaper insertions, and grassroots outreach. The Consumer Guide

can be requested at the program answer center and is available online in English, Spanish and for visually impaired consumers.

At Phase I launch in November 2001, the key program message of self-empowerment was delivered through a broad range of advertising vehicles, including: (a) 30-second television and 60-second radio commercials to build awareness and



establish effective exposure frequency; (b) page-dominant newspaper advertisements to provide more detailed information; (c) outdoor billboards to remind and reinforce the toll-free number and website address; and (d) selected online banner ads on high-traffic websites, with links to the VEC website.

### **Public Relations**

The public relations program extends the reach of the education program by reinforcing key messages through grassroots education and media relations and provides a level of context and detail not possible with advertising alone. By reaching key segments of the population with specifics of competition and educational information, consumers will be able to make informed decisions when they have the opportunity to choose a competitive service provider.

The public relations program includes tailored education materials, a proactive media relations program, community outreach through a grassroots program, and a Virginia Energy Choice website.

Goals for the media relations component have been to increase media coverage for the consumer education effort and widespread distribution of information through media kits, briefings, opinion-editorial pieces, and release of Energy Choice information.

To date, the program has generated more than 179 print news articles in daily and weekly newspapers. Additional coverage has been generated in television and radio

broadcasts. The coverage has been widespread throughout the state with 40 percent of the stories running in central Virginia newspapers; 24 percent of the stories running in southwestern Virginia newspapers; and, 36 percent of the coverage in northern Virginia.

The grassroots outreach effort has reached consumers through direct contact with organizations and community leaders they know and trust, and utilized their communications networks to disseminate educational information on energy choice. There are two main goals of the program: (1) enlist opinion leaders, local governments and community-based organizations to ensure that Virginians understand the changes taking place and available resources, and (2) reach audiences that may have difficulty receiving the information disseminated via the mass media or have special information needs, including: low-income senior citizens, non-English speaking, minorities, people with disabilities, residents of very rural areas, and the small business community.

Effective partnerships have been formed with statewide and local organizations that are helping to educate their members and constituents. As outlined in the following chart, a total of 276 organizations have committed to distribute 48,440 Consumer Guides. Several local governments have published VEC information in their respective newsletters, including: Arlington County (93,048 copies); Prince William County (105,000 copies); Lynchburg (40,000 copies); and Culpeper (16,000 copies). Additionally, organizations have committed to distribute newsletter articles, information sheets (in English and Spanish) and add a VEC link and/or VEC information to their websites. As part of the grassroots effort, VEC partnered with several statewide organizations to deliver more than 107,000 consumer guides accompanied by a letter from SCC Chairman Clinton Miller. Participating organizations included the Virginia Farm Bureau, the Virginia chapter of the National Federation of Independent Businesses and

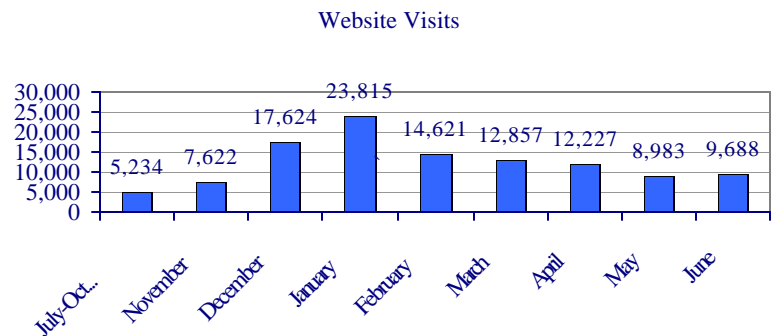


the Virginia Retail Merchants Association. The Virginia Retirement System also distributed VEC information to more than 405,000 individuals.

**Summary of Grassroots Outreach Activity by Category of Organization as of 7/01/02**

Populations Represented	Total number of materials organizations have committed to distribute (through mailings, emails, presentations and events)				Website info
	Consumer Guides <i>Number of Orgs Participating</i>	Newsletter Articles <i>Number of Orgs Participating</i>	Two-Pagers <i>Number of Orgs Participating</i>	Spanish Two-Pagers <i>Number of Orgs Participating</i>	Added VEC link/info to website
<b>Seniors</b>	<b>18,348</b> <i>66 orgs</i>	<b>332,440</b> <i>41 orgs</i>	<b>11,935</b> <i>47 orgs</i>	<b>4,761</b> <i>27 orgs</i>	<b>23</b>
<b>African Americans</b>	<b>9,330</b> <i>60 orgs</i>	<b>144,350</b> <i>27 orgs</i>	<b>16,235</b> <i>39 orgs</i>	<b>2,060</b> <i>13 orgs</i>	<b>15</b>
<b>Low-Income</b>	<b>11,991</b> <i>53 orgs</i>	<b>150,175</b> <i>28 orgs</i>	<b>11,823</b> <i>45 orgs</i>	<b>5,126</b> <i>36 orgs</i>	<b>19</b>
<b>Non-English Speaking</b>	<b>9,597</b> <i>48 orgs</i>	<b>111,825</b> <i>15 orgs</i>	<b>17,867</b> <i>38 orgs</i>	<b>6,355</b> <i>38 orgs</i>	<b>16</b>
<b>Disabled</b>	<b>4,996</b> <i>48 orgs</i>	<b>135,270</b> <i>20 orgs</i>	<b>14,344</b> <i>24 orgs</i>	<b>3,246</b> <i>17 orgs</i>	<b>17</b>
<b>Small Business</b>	<b>6,805</b> <i>33 orgs</i>	<b>149,470</b> <i>35 orgs</i>	<b>2,125</b> <i>8 orgs</i>	<b>700</b> <i>2 orgs</i>	<b>18</b>

The Virginia Energy Choice website has extensive information on the changes coming to the energy market; it is also accessible to the visually impaired. To date, more than 103,000 visits have been made to the website. The chart shows monthly traffic to the site.

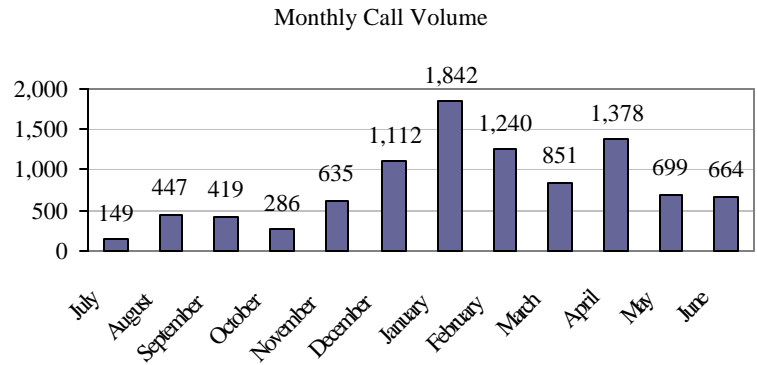


Source: Web Trends

Approximately 25,000 visitors are unique, first time visitors, with an average of eight page views per visitor indicating that new consumers are coming to the website each month and accessing the needed information.

**Call Center**

To provide ongoing one-on-one phone support to answer inquiries regarding the program, 15 customer service representatives were trained to answer frequently asked questions about energy

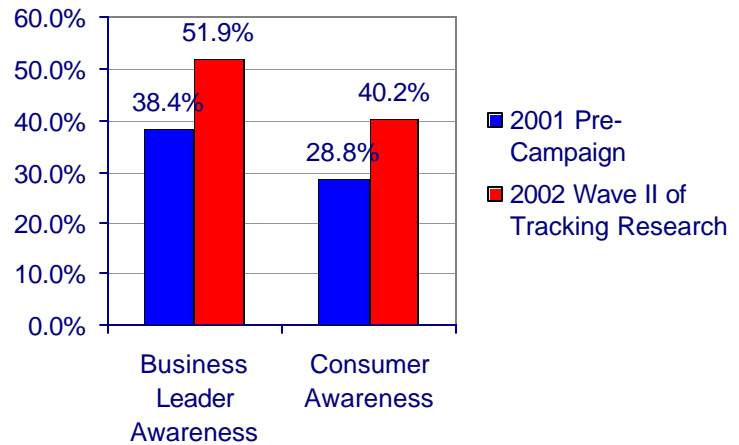


Source: 1to1 Contact Centers

restructuring in Virginia, under the supervision of the SCC. The toll-free information line is staffed from 8 a.m. to 9 p.m. Monday through Friday and 8 a.m. to noon on Saturday. The call center also responds to Virginia Energy Choice inquiries by e-mails and fulfills daily requests for consumer education materials. Most commonly asked questions are related to general information about choice and timing as well as how to get a Consumer Guide. Since July 2001, the call center has fielded over 10,000 inquiries.

**Follow-Up Research**

In January, 2002, follow-up research, conducted after 12 weeks of advertising activity, indicated progress in building awareness of Virginia Energy Choice.



Source: The Center for Research & Public Policy, fielded January 14-24, 2002.

Consumer awareness rose from 28.8% to 40.2% (an increase of 39.6%); business leader awareness rose from 38.4% to 51.9% (an increase of 35%).

Awareness among Hispanics and seniors also increased significantly, up 10 percentage points to 30% and from 22.5% to 45.8%, respectively. However, awareness among African

Americans was virtually unchanged from the 21.7% benchmark. This lack of movement could be attributed to the fact that advertising only impacted Phase I areas, where only 12% of the population is African American, vs. 27% and 31% respectively for Phases II and III of the state.

The research also showed that Virginians have a lot to learn about energy restructuring, not surprising given the early stage of the program. Education levels did show some encouraging signs, as the majority of Virginians have good understanding of six of ten measured knowledge points. While the majority of Virginians still support energy choice, the level of support among consumers declined slightly; business leader support increased. Overall, interest in choice remained high at 71.9 percent.

### **Next Steps**

While the program, as launched in Phase I areas of the state, has been effective at building consumer awareness, a scaled back advertising effort will start in the Phases II and III areas due to the slow development of actual competition. Cable television has been eliminated from the plan and overall broadcasting and newspaper advertising levels have been reduced for Phase II and III areas. However, grassroots efforts have been maintained. This approach allows us to maintain a voice for the campaign and maximize overall efficiency of the program. Given the significant reduction in Year 2 advertising spending, the frequency at which consumer expectation messages are received by Virginians will be affected accordingly; lower levels of advertising are expected to take longer to impact the target audience.

These outlined reductions will reduce the spending allocations of the overall consumer education program budget by more than 30 percent in Year 2. The investment in grassroots

activities is maintained with a focus to strengthen our efforts among African Americans, Hispanics and other specialized audiences.

	<b>Year 1</b>	<b>Year 2</b>
	(April 2001 – June 2002)	(July 2002 – June 2003)
Advertising	\$3.74 million (44%)	\$1.86 million (32%)
Grassroots Outreach	\$1.23 million (14%)	\$1.1 million (19%)
Public Relations	\$670,000 (8%)	\$380,000 (6%)
Contract Services	\$2.88 million (34%)	\$1.75 million (30%)
Media Contingency		\$740,000 (13%)
<b>Total</b>	<b>\$8.52 million</b>	<b>\$5.83 million</b>

A media contingency fund has been set up to purchase additional advertising if competitive activity strengthens in this fiscal year. These funds will be used only if needed to ensure people are aware and understand how to choose. In the event that the contingency funds are used, the overall advertising weights will still be lower than in Year 1 of the program. In Year 1, the entire advertising budget was utilized to reach 50 percent of the state. In Year 2, the advertising budget will reach 100 percent of the state.

Future information from research surveys, call center data, advisory committee input and web inquiries will be used to measure not only increases in awareness and knowledge, but also to monitor ongoing consumer attitudes toward energy restructuring. Consumers still want and need information, and the program should continue to provide them with the access points through which they can easily gain that information. The toll-free number and website continue to be critical elements to highlight in all communications. As the five-year program progresses beyond Year 2, advertising activity will continue to be adjusted depending upon

market development, while grassroots and media relations efforts will remain important tools in extending the reach of the education program. As ongoing effectiveness is evaluated and market development is monitored, considerable knowledge from the program will be used to adapt the most effective communications strategies over the longer term.

## **DEVELOPMENT OF A COMPETITIVE STRUCTURE**

This section will detail several activities that have been undertaken with the goal of creating the framework within which effective competition may develop. While these activities cannot, in and of themselves, assure that competition will flourish, there is no doubt that a competitive market will require both rules to guide behavior and systems to control business operations. In addition, the continuing development of our energy infrastructure, including power plants, transmission lines and natural gas pipelines, is an essential element of future energy reliability. Finally, properly functioning regional transmission organizations are recognized as a necessity for an effective competitive wholesale market, which is a precursor to an effective retail market.

### **Rules Governing Retail Access**

The Restructuring Act directed the SCC to establish a transition schedule for retail access and promulgate regulations to guide the transition implementation. The Commission Staff invited representatives of interested parties to participate in a work group to assist the Staff in developing proposed rules for the start of retail access. The work group met on numerous occasions to share perspectives and experiences gained through Virginia's pilot programs and information regarding rules adopted by neighboring states and national efforts regarding uniform business practices.<sup>12</sup>

Comments were received on Staff's proposed rules and its report and a hearing was held on May 10, 2001. Subsequently, the work group reconvened the next day and resolved several of the outstanding issues with further revisions to the proposed rules. Additional comments

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<sup>12</sup> The rules were to be developed for both a competitive electricity market and a competitive natural gas market. Our focus in this report is the electricity market.

were filed on May 21, 2001. The Commission considered the proposed rules and the comments with these objectives in mind: (1) afford reasonable customer protections, (2) ensure equitable treatment of market participants, and (3) promote the advancement of competition in the Commonwealth.

On June 19, 2001, the SCC issued an order in Case No. PUE-2001-00013 adopting its Rules Governing Retail Access to Competitive Energy Services ("Retail Access Rules" or "Rules") to be effective on August 1, 2001.<sup>13</sup> The Retail Access Rules currently consist of 12 sections in Chapter 312 (20 VAC 5-312-10 et seq.) of Title 20 of the Virginia Administrative Code and pertain to various relationships among the local distribution companies ("LDCs"), competitive service providers and retail customers.

These Rules govern (1) the relationships between LDCs and affiliated competitive service providers to prevent discriminatory or anti-competitive behavior; (2) the CSP application process for licensure by the SCC; (3) the process for CSP registration with the LDC; (4) the development, maintenance, and distribution of mass lists and other customer information to CSPs; (5) CSP dissemination of clear and accurate marketing materials to consumers, and minimum customer service contract provisions; (6) the process, responsibilities and rights of a customer, the LDC and a CSP in switching a customer's provider of electricity or natural gas supply service; (7) the provision of billing service options and the establishment of minimum bill information standards and consumer protections; (8) the reasonableness and non-discriminatory application of LDC load profiling activities; (9) the establishment of

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<sup>13</sup> The Retail Access Rules are available at the SCC's website at: <http://www/state/va/us/scc/division/restruct/main/rules/teirrules.htm>.

dispute resolution procedures between customers and CSPs and between CSPs and the LDC; and (10) the provision of access to interval meter data.<sup>14</sup>

The future electricity market may have many CSPs offering choices for energy supply, aggregation, billing or metering services. A CSP may occupy one or more of the following roles related to those services: Energy Service Provider, Meter Service Provider, Meter Data Management Agent, or Billing Agent. As the future electricity market matures, other roles may also evolve. Depending on the marketplace, customers may be able to receive service from more than one CSP per meter point or consumption point (multiple meters acting as one). The marketplace may allow an on-peak/off-peak market, base load/load following market or other combinations. Other potential agents, such as a Market Data Clearinghouse, may serve as an intermediary point of contact among various market participants.

The precise structure of the future marketplace is unknown and uncertain at the present time. The Commission's Staff will monitor and evaluate the continued development of the energy marketplace, including our experiences in Virginia, and recommend further adjustments to such Rules, if necessary. Responses to Staff's recent questionnaire regarding facilitation of effective competition in Virginia indicate that most market participants believe the current Retail Access Rules are: (1) consistent with other state requirements, (2) reasonable to balance the concerns and needs of market participants, and (3) conducive to promoting a competitive energy marketplace.

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<sup>14</sup> As previously discussed, this Commission permitted the Cooperatives and Kentucky Utilities Company to phase-in implementation of open access by January 1, 2004, in its Final Order in Case No. PUE-2000-00740. As a result, these LDCs will stagger implementation over the next 16 months and comply with the Retail Access Rules upon implementation, unless granted a waiver for certain provisions.



Future legislative or Commission decisions may also affect the developing energy marketplace. Commission orders regarding a minimum stay period (PUE-2001-00296), competitive metering (PUE-2001-00298), and supplier consolidated billing (PUE-2001-00297), were issued on May 15, 2001. These orders established work groups to assist Staff in developing and proposing recommendations governing such topics. An additional docket was established on March 18, 2002, to clarify rules regarding aggregation of competitive energy services (PUE-2002-00174). As these and other dockets progress, the Retail Access Rules will be amended as needed to incorporate future rules that may be adopted by the SCC.<sup>15</sup>

### **Minimum Stay Provisions**

Section 56-577 E of the Restructuring Act directed the SCC to promulgate regulations establishing whether customers that return to the incumbent LDC or default service provider after receiving service from a CSP should be required to remain for a minimum period of time (the minimum stay period). Staff reconvened the Retail Access Rules work group to assist in the development of proposed rules governing such a situation. The Staff's report, issued on June 26, 2001, explained the potential need for minimum stay periods. The existence of capped rates for LDCs potentially create the economic incentives for astute retail customers to seek, and CSPs to offer, electricity supply service from the competitive market during low demand periods when prices in the wholesale market are below the LDC's capped rate service, and for those customers to return to capped rate service when market demand is high and wholesale prices are expected to exceed such capped rates.

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<sup>15</sup> These Dockets and others regarding restructuring issues may be found on the SCC's website at: <http://www.state.va.us/scc/caseinfo.htm>.

The Staff stated that price-induced switching between competitive and regulated markets is economically rational and expected. However, customers that return to the LDC during high cost periods, paying only average prices, could impose significant additional fuel or power supply costs on the LDC. Upon reviewing similar provisions adopted in other states, the Staff sought to balance the concerns of the LDCs regarding the financial impact of the short-term return of customers to capped rate service during high cost periods against efforts to advance the development of a competitive market and to encourage customers to exercise their right to choose a CSP.

The SCC issued its order on October 9, 2001 in Case No. PUE-2001-00296 adopting rules regarding minimum stay periods. The Commission approved a 12-month minimum stay period upon return to the LDC for a customer with a threshold demand of 500 kW or more. The LDCs and CSPs are required to disclose this requirement to affected customers, which would be large industrial plants or commercial facilities, such as a Philip Morris, a Home Depot or a Ukrops supermarket. A provision is included in the minimum stay rules describing the requirements of an LDC wishing to request expanded applicability of a minimum stay period. Additionally, the Staff is to explore alternatives, such as market-based pricing options, to the minimum stay provision and submit a report detailing its findings by March 31, 2003.

### **Competitive Metering Provisions**

In the SCC's May 15, 2001, order starting a procedure for establishing rules and regulations for competitive metering services (Case PUE-2001-00298), the Commission directed incumbent electric utilities to submit their intended schedules for implementing competitive metering services and the Staff to submit, with input from a work group, an interim

report presenting recommendations on further procedures to develop proposed rules for such services pursuant to § 56-581.1 of the Act.

The Act directed the SCC to implement the provisions of competitive metering services for industrial and large commercial customers by January 1, 2002, and allowed such services for small commercial and residential customers as early as January 1, 2003. All but one of the investor-owned electric LDCs implementing full or phased-in retail access in the Commonwealth requested a one-year delay to begin competitive metering within their service territories or upon implementation of retail access. AEP-VA stated that it would not object to a delay and requested that the Commission not foreclose the possibility that early entrants into the competitive metering market could be accommodated under the Company's existing tariffs during 2002.

Staff again convened a work group to help determine an approach to implement competitive metering and develop proposed rules governing such a situation. In its July 16, 2001, interim report, the Staff recommended that: (1) competitive metering should initially encompass meter data availability and access choices, including access to meter data on a near real-time basis by January 1, 2003; (2) the Staff, with input from the work group, should submit a draft of proposed rules relative to meter data availability and access choices; and (3) upon implementation of the rules, the Staff and work group should continue to meet and conduct an ongoing investigation of the development of competitive metering markets and make recommendations regarding additional competitive metering market elements.

The utilities' requests to delay implementation of competitive metering until January 1, 2003, for large industrial and commercial customers and to permit early entrants under AEP-VA's approved tariffs were granted by the Commission's order on December 21, 2001. The

order directed the Staff and the work group to continue to address rules that would provide customers and CSPs with reasonable options regarding meter data availability and accessibility and submit such proposed rules by February 14, 2002. The Commission, recognizing that the issues surrounding competitive metering are complex and controversial and that little or no competitive metering activity has developed elsewhere, also directed the Staff and work group to evaluate additional elements of competitive metering services, taking into consideration the nine statutory implementation criteria set forth in § 56-581.1 E of the Act, and to submit a report with additional recommendations. The due date for the report was extended from June 30, 2002 to August 30, 2002.

The Staff submitted, on February 14, 2002, its report and proposed rules regarding competitive electricity metering services for the elements of meter data availability and accessibility.<sup>16</sup> The development of competitive metering rules presents challenges due to the lack of activity nationally and the corresponding lack of proven market structures and standardized business practices. Many states have delayed or slowed implementation efforts for competitive metering.

The Staff recognizes that the implementation of competitive metering should avoid the premature imposition of significant system development costs on incumbent utilities. Such effort and costs may prove wasteful if significant rework is required once markets for these services begin to develop and supplier interest and attention increase. Accordingly, the Staff recommended the development of proposed rules recognizing that implementation of competitive metering should be evolutionary in nature.

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<sup>16</sup> The report may be found at: [http://www.state.va.us/scc/caseinfo/pue/case/comp\\_meter.pdf](http://www.state.va.us/scc/caseinfo/pue/case/comp_meter.pdf).

The Commission is not aware of market development of competitive metering in any state where such competition is authorized. One of the most critical aspects of metering service relative to advancing competitive electricity markets is the availability and accessibility of interval meter data by customers and suppliers. Accordingly, the initially proposed competitive metering rules focus on ensuring that customers and/or suppliers have a reasonable option for obtaining advanced or interval metering service from the LDC at the incremental cost above basic metering service, including direct access to meter data. This service would permit suppliers to send improved price signals to their retail customers and would enhance the value of competitive energy management services. The Staff, with the assistance of the metering work group, is continuing its evaluation of other elements of metering services and expects to submit another report with additional recommendations by August 30, 2002.

The Commission's order of February 19, 2002, requested comments from interested parties and provided an opportunity for hearing. Comments were received from several parties with no requests for a hearing. The Commission issued an order in this case on August 19, 2002, approving rules regarding competitive electricity metering services for the elements of meter data availability and accessibility effective January 1, 2003.<sup>17</sup> The order directs the work group to continue to meet and address other elements of competitive metering services.

### **Competitive Billing Provisions**

In the SCC's May 15, 2001, order starting a proceeding for establishing rules and regulations for supplier consolidated billing services<sup>18</sup> (PUE-2001-00297), the Commission directed the Staff to submit by February 14, 2002, with input from a work group, a report

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<sup>17</sup> The adopted rules may be found at: <http://www.state.va.us/scc/caseinfo/pue/case/e010298d.pdf>.

<sup>18</sup> This is for bills sent to a customer by the generation supplier, instead of by the local electric distribution company, which now provides billing services.

presenting proposed rules relative to licensed CSPs offering consolidated billing services to LDCs and retail customers pursuant to § 56-581.1 of the Act. Subsequently, the Staff's request to delay its submission until May 24, 2002, was granted by the Commission.

During the course of the work group efforts, the Staff developed a fuller appreciation of the complexity of issues associated with CSP consolidated billing. A major issue concerns the separation of responsibilities between the CSP, which controls the issuance of the bill and the processing of customer payment, and the LDC, which controls service disconnection activities for non-payment of its regulated charges. This demands the development of proposed rules that reasonably ensure billing accuracy and timeliness, and minimize the potential for confusion and unwarranted credit action against consumers. Additionally, the Staff and the work group recognized: (1) that the issues surrounding CSP consolidated billing are complex and controversial; (2) that there has been little CSP participation to date with the work group; and (3) that little or no competitive billing service activity has developed elsewhere. This led the work group to evaluate reasonable alternatives to a comprehensive electronic data interchange requirement and to propose an alternative plan for compliance with legislation and Commission orders while the market evolves. The Staff submitted its report and proposed rules on May 24, 2002.<sup>19</sup>

As with competitive metering, Staff recognizes that the implementation of supplier consolidated billing should avoid the premature imposition of significant system development costs on incumbent utilities. Accordingly, the Staff has recommended an evolutionary approach in the development of proposed rules for supplier consolidated billing.

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<sup>19</sup> This report may be found at: [http://www.state.va.us/scc/caseinfo/pue/case/e010297\\_staff\\_5\\_24.pdf](http://www.state.va.us/scc/caseinfo/pue/case/e010297_staff_5_24.pdf).

Staff has proposed amending the Retail Access Rules to make the current LDC consolidated billing rules reciprocal in applicability to CSP consolidated billing. Additionally, Staff has proposed requiring a supplier to provide the incumbent utility and Staff with notice at least 30 days in advance of offering a consolidated billing service to allow for validation of the supplier's system testing and for establishment of satisfactory creditworthiness with respect to state and local consumption tax collections. To avoid the potential for unwarranted service disconnection due to miscommunication between the utility and the supplier, Staff also has proposed that utilities be required to issue disconnect notices directly to retail customers, separate from the supplier consolidated bill.

Work group representatives of the investor-owned electric utilities proposed that, subsequent to the Commission's adoption of final rules for supplier consolidated billing, incumbent utilities not be required to proceed with system development of standardized electronic data exchange protocols. The utilities represented that due to: 1) the significant system development cost; 2) the current uncertainty of market development and the potential for substantial future rework; and 3) limited supplier participation, a more appropriate alternative at present would be to allow incumbent utilities to work with any interested suppliers to develop a workaround to standardized electronic protocols until such time as supplier interest increases in providing this service. Suppliers offering informal comments have generally agreed with this approach at the current time and Staff supported this proposal in its report to the Commission. Comments to Staff's Report and proposed rules were submitted by June 27, 2002, with no requests for a hearing. No formal comments were filed by a CSP.

The Commission issued an order on August 21, 2002, approving rules that become effective January 1, 2003, regarding supplier consolidated billing services.<sup>20</sup> The order permits implementation of these rules through an interim EDI workaround to be replaced later with standardized business practices and EDI protocols as the volume of competitive billing increases.

### **Business Practices**

Staff was actively involved in the joint efforts undertaken by the Edison Electric Institute and the Coalition for Uniform Business Rules to develop Uniform Business Practices ("UBP") in 2000. Business practices refer to the complex infrastructure of business operations and systems that underlie the retail energy market.<sup>21</sup> Traditionally, these practices were developed on an individual state or utility basis and could be considered a barrier to the emergence of regional or national retail energy markets. One of the major objectives of this collaborative effort was to utilize the experience and expertise of a broad cross-section of market participants to provide recommended practices that would encourage innovation, competition, and opportunities to the benefit of retail energy consumers. It is generally believed that potential customer benefits from restructuring are more likely to be realized through consistency and uniformity of business practices over a wider region.

Staff continued efforts in 2001 to further UBP development by participating with efforts to converge the retail electricity and natural gas industries under one common standards board.

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<sup>20</sup> The adopted rules may be found at: <http://www.state.va.us/scc/caseinfo/pue/case/e010298b.pdf>.

<sup>21</sup> For example, regulatory policy may determine that if multiple enrollment requests to switch a customer are received by the LDC within any one billing cycle, the first request is processed to permit a customer to take service from the CSP upon the next meter read while all other requests are discarded. Business practices to process this policy might include: proof of customer authorization, determination of specific customer account elements essential to maintain continuous service, electronic medium in which to communicate such specific account data, and an automated mechanism to prevent any further switch of that account during the current billing cycle.



These efforts led to expanding the Gas Industry Standards Board ("GISB"), supported by the Federal Energy Regulatory Commission, ("FERC"), to include standards for the electricity industry. As a result, the North American Energy Standards Board ("NAESB") was created. This new organization became effective on January 1, 2002, and is structured into four quadrants to develop standards for implementing national or state energy policies for each of the four energy sectors: the wholesale and retail natural gas markets and the wholesale and retail electricity markets.

Recognizing the ongoing convergence of the natural gas and electricity businesses, NAESB ensures that its implementation standards and business practices will receive and utilize the input of all industry sectors through its open membership and balanced voting processes. Its precursor, GISB, provided many processes for group-decision making and developing standard business practices for the natural gas industry that will prove invaluable to implementing the new organization. Industry participants will realize reduced transaction costs as standardization of transactions is endorsed and implemented. NAESB has received recognition and accreditation as a standards-setting body from the American National Standards Institute, independent of policy and politics, and will build public-private partnerships with the FERC, the Department of Energy and the state commissions. NAESB's infrastructure and processes<sup>22</sup> have received endorsement from FERC Commissioners and will be instrumental to comply with FERC's desire to develop a standard market design.<sup>23</sup>

Staff participated in the development and implementation of the retail electricity and natural gas quadrants and is monitoring the urgent establishment of the wholesale electricity

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<sup>22</sup> Additional information regarding the NAESB may be found at: <http://www.naesb.org>.

<sup>23</sup> Additional information regarding FERC's standard market design and structure may be found at: [http://www.ferc.gov/Electric/RTO/Market\\_Strct.comments/smd.htm](http://www.ferc.gov/Electric/RTO/Market_Strct.comments/smd.htm).

quadrant. Staff continues to assist the evolution of these quadrants and currently serves on the Advisory Committee to NAESB.

### **Virginia Electronic Data Transfer Working Group**

The Staff has served as a facilitator for the Virginia Electronic Data Transfer ("VAEDT") Working Group since its establishment in April 1999. The VAEDT was created by the Commonwealth's electric LDCs to develop standards and guidelines for electronic data interchange ("EDI"). EDI is a means for a utility and a CSP to communicate electronically and involves the computer-to-computer exchange of business information. It includes information such as customer enrollment, usage and billing. All CSPs are required to use EDI to transact business with the utilities. A CSP may negotiate with a LDC to use some alternative to EDI on a temporary, start-up basis to provide additional time to comply with the Retail Access Rules, but should implement EDI within 180 days of an initial service offering.

In June 2000, the VAEDT filed with the Commission for informational purposes its Virginia Plan, Implementation Guidelines and Data Dictionaries, and EDI Test Plan.<sup>24</sup> The VAEDT filed revised documents with the Commission in May 2002, and continues to meet periodically to refine standards as the market evolves and experience is gained.

The Staff also participates in a regional effort to establish and maintain uniform criteria for exchanging electronic information between electric utilities and CSPs. The regional effort will make it easier for CSPs and LDCs to exchange data and operate in multiple states. The VAEDT agreed in April 2001, to support efforts of the First Regional Electronic Data Interchange ("FREDI").<sup>25</sup> Commission staffs of the eastern states of Pennsylvania, New Jersey,

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<sup>24</sup> Additional information available at: <http://www.vaedt.org>.

<sup>25</sup> Additional information available at: <http://www.firstregionalEDI.org>.

Maryland, Delaware, Ohio and Virginia plus Washington D.C. realized the numerous similarities among each state's current EDI guidelines (80-85% comparable) and of the identities of the competitive service providers active in each state and initiated a regional effort to effectuate future EDI changes simultaneously in the respective jurisdictions.

Currently, PA, NJ, MD & DE have a common set of EDI documents with the remaining jurisdictions, including Virginia, intending to conform their documents in 2002. The differences in current EDI guidelines are generally attributable to differences in policies and business rules among the participating jurisdictions. Future revisions to EDI guidelines will be reviewed, accepted and implemented by the respective state EDI work groups within each of the FREDI jurisdictions in a coordinated manner to better realize synergies within the regional energy market. This effort may potentially evolve for the regional jurisdictions to converge to the same EDI standards and perhaps develop consistent business rules to better promote a robust competitive energy market. FREDI may also provide the starting point for NAESB to develop national standards regarding electronic protocols.

### **Generation and Transmission Additions**

Within the last five years, six generating plants have been built and placed into commercial operation within the Commonwealth, adding 1,769 megawatts ("MW") to existing generation physically located in Virginia.<sup>26</sup> Construction of three additional facilities totaling 1,762 MW has been approved by the Commission and these units should be ready for operation in the latter half of 2003.<sup>27</sup> In addition, 14 other independent operators have submitted

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<sup>26</sup> These new plants are comprised of two Dominion generating stations and four independent power plants, representing 960 MW and 809 MW, respectively.

<sup>27</sup> One of the projects includes the retirement of two existing units, the conversion of two units to gas-fired operation and a new combined-cycle unit at Dominion's Possum Point Station for a net increase of 397 MW. ODEC recently received approval to construct a 465 MW combustion turbine facility.

applications for generating capacity of 9,991 MW that are pending before the SCC in various stages of the certification process. Of this amount, three projects totaling 3,370 MW have been suspended by the developers. The Staff is also aware of discussions to develop five other facilities totaling 4,510 MW.

Currently, all of the Commonwealth's incumbent utilities own, or contract for, sufficient capacity to meet the expected customer demand within their respective service territories. Traditionally, this has been accomplished with integrated resource planning by each LDC. In a regulated regime, the utility would develop its demand and energy forecast, its fuel forecast, and its forecast of needed capacity. The amount and type of additional capacity was determined using a target reserve margin (generally maintained around 12-15%) or loss-of-load-hours methodology to optimize system operation and fuel expenses with the existing system and anticipated need. Expected costs of such an investment was then attributed to base rates to recover such costs and earn a reasonable rate-of-return on the investment.

Needed capacity could be built by the LDC or procured with a bilateral agreement with another utility with available capacity. An independent generator could also build a facility but usually had to meet the need of an LDC and establish a bilateral agreement to provide power solely to that LDC.

Changes within the electricity marketplace under a competitive regime, and actions by the FERC, have caused the electric industry to explore alternatives to traditional integrated resource planning. Evolvement of RTOs to include a broader number of market participants and to cover wider service areas has changed the complexion of the future electric industry. Future capacity, generation as well as transmission, will come to fruition when market participants recognize and react to market signals such as reliability, price, customer service,

load growth and economics. Such response will include physical construction and modification as well as evolvement of contractual and financial alternatives.

The FERC issued its Notice of Proposed Rulemaking on July 31, 2002, to modify open access transmission tariffs to remedy undue discrimination in providing interstate transmission services and to assure just and reasonable rates within and among regional power markets. As part of the FERC's proposed standard market design, it proposes to establish a resource adequacy requirement for each load serving entity.

As more independent generators begin commercial operation and suppliers utilize a variety of capacity purchases to serve customer load, the traditional reserve margin loses significance. Difficulties arise in determining which supply sources and which customer loads should be included at any particular time to determine such a calculation.

Expansion of transmission facilities is also needed to accommodate expected customer demand and required energy supply. The SCC granted permission to AEP-VA to construct a 765-kV electric transmission line in southwestern Virginia. That line is pending final federal approval. Applications for several smaller transmission lines have been approved or are currently pending before the SCC. Additionally, several applications to construct natural gas pipelines to supply fuel to some of the proposed generators are also pending before the SCC. Two additional interstate pipelines to transport fuel across the Commonwealth are under consideration by Federal agencies.

The table on the following pages provides further detail.

### **Power Plant Siting Rules**

By order dated June 12, 2001, the Commission initiated a proceeding, Case No. PUE-2001-00313, to establish new filing requirements to be applicable to all entities seeking authority to construct and operate electric generating facilities in Virginia. After notice to the

**Summary of Construction Activity in Virginia  
As of July 31, 2002**

<u>Company/Facility</u>	<u>Size</u>	<u>Location</u>	<u>Docket</u>	<u>Fuel</u>	<u>C.O.D.*</u>	<u>Status</u>
<b><u>Power plants with SCC certificates that began operation within the last 5 years</u></b>						
Commonwealth Chesapeake	300 MW	Accomack County	PUE960224	3-OilCT	sum 01	8/5/98 Approved
Dominion Virginia Power	600 MW	Fauquier County	PUE980462	4-GasCT	sum 00	5/14/99 Approved
Wolf Hills Energy, LLC	250 MW	Washington County	PUE990785	5-GasCT	sum 01	5/2/00 Approved
Dominion Virginia Power	360 MW	Caroline County	PUE000009	2-GasCT	sum 01	10/10/00 Approved
Doswell Limited Partnership	171 MW	Hanover County	PUE000092	1-GasCT	sum 01	6/15/00 Approved
Allegheny Energy Supply	<u>88 MW</u>	Buchanan County	PUE010657	4-GasCT	sum 02	6/25/02 Approved
	1,769 MW					
<b><u>Power plants with SCC certificates currently under construction.</u></b>						
Virginia Power-Possum	540 MW (397 net)	Prince William County	PUE000343	convert/GasCC	sum 03	3/12/01 Approved
<b><u>Power plants with SCC certificates, but not yet under construction.</u></b>						
Tenaska Virginia Partners I, LP	900 MW	Fluvanna County	PUE010039	Gas CC	sum 03	4/19/02 Approved
Louisa Generation, LLC (ODEC)	465 MW	Louisa County	PUE010303	Gas CT	sum 03	7/17/02 Approved
<b><u>Power plants that have applied for an SCC certificate</u></b>						
CinCap-Martinsville	330 MW	Henry County	PUE010169	4-GasCT	sum 03	supplemental data
Kinder Morgan of Virginia, LLC	550 MW	Brunswick County	PUE010423	Gas CC	win 04	8/13/02, H.E. Report, pending Order
Tenaska Virginia Partners II, LP	900 MW	Buckingham County	PUE010429	Gas CC	fall 04	5/28/02 Hearing, pending HE Report
Competitive Power Ventures	520 MW	Fluvanna County	PUE010477	Gas CC	spr 04	8/8/02, H.E. Report, pending Order
Chickahominy Power, LLC	665 MW	Charles City County	PUE010659	Gas CT	fall 03	5/1//02 Hearing, pending HE Report
Duke Energy Wythe, LLC	620 MW	Wythe County	PUE010721	Gas CC	sum 04	6/25/02 Hearing, pending HE Report
Kinder Morgan VA, LLC	560 MW	Cumberland County	PUE010722	Gas CC	sum 04	12/17/02 Hearing
Marsh Run Generation, LLC	696 MW	Fauquier County	PUE-2002-00003	4-GasCT	sum 04	5/21/02 Hearing, pending HE Report
CPV Warren, LLC	520 MW	Warren County	PUE-2002-00075	2-GasCC	spr 05	7/24/02 Hearing, pending HE Report
James City Energy Park, LLC	580 MW	James City County	PUE-2002-00150	2-GasCC	1/05	9/18/02 Hearing
White Oak Power Co., LLC	680 MW	Pittsylvania County	PUE-2002-00305	4-Gas CT	sum 04	10/24/02 Hearing
Henry County Power/Cogentrix	1,100 MW	Henry County	PUE010300	Gas CC	sum 04	Suspended by Cogentrix 6/13/02
Mirant Danville, LLC	870 MW	Pittsylvania County	PUE010430	Gas CC	sum 04	Suspended by Mirant 1/31/02
Loudoun County Power/Tractebel	1,400 MW	Loudoun County	PUE010171	Gas CC	04/05	Withdrawal & Dismissed 3/27/02
Total	9,991 MW	(reduced to 6,621 MW following suspended projects)				

\*Commercial Operation Date

**Potential power plants under consideration, but have not yet filed an application with the SCC\*\***

Competitive Power Ventures	900 MW	Smyth County	Gas CC
US Data Port/Calpine	250 MW	Prince William County	Gas CC
LS Power Associates	1600 MW	Sussex County	Coal
Chippokes Energy Ctr	1060 MW	Surry County	Gas CC
Duke	<u>700 MW</u>	Isle of Wight County	Coal
Total	4,510 MW		

\*\* compiled from local news stories and DEQ air permit activity list

**Transmission lines**

AEP-VA	765 kV-90 mi	Wymoing-Jackson's Ferry	PUE970766	2004	5/31/01 Approved
DVP	2@230 kV- 4 mi	Loudoun	PUE010154	2003	6/27/02 Approved
DVP	500 kV-101 mi	Joshua Falls-Ladysmith	PUE910043	hold	DVP revised 5/02 & continued

**Regional Transmission Organization membership pending before the SCC**

DVP	PJM-South	PUE-2000-00551	
AEP-VA	PJM-West	PUE-2000-00550	
AP	PJM-West	PUE-2000-00736	Staff report 7/12/02
Conectiv	PJM-East	PUE-2001-00353	Staff report 7/12/02
KU	MISO	PUE-2000-00569	Staff report 7/24/02

**Natural gas pipelines**

DVP	20"-14 mi	Prince William County	PUE000741	2003	11/5/01 Approved
Duke Energy Patriot Extension	95 mi	Wythe to Rockingham Cty	FERC	2004	
Dominion Transmission Greenbrier	280 mi	Charleston to Rockingham	FERC	2005	
Saltville Gas Storage Co., LLC	24"-7 mi	Saltville / Chilhowie	PUE010585	2003	5/31/02 Hearing Examiner recommended approval

public and receiving comments, the Commission adopted revised filing requirements by order dated December 14, 2001, which became effective January 1, 2002.<sup>28</sup>

In its December 14<sup>th</sup> order, the Commission also initiated a new proceeding, Case No. PUE-2001-00665, to consider further amendments to the rules, as well as to consider development of expedited permitting processes for small generating facilities of 50 MW or less. The amendments as proposed by the Commission, would add rules 20 VAC 5-302-20 9 I, a provision related to fuel and fuel infrastructure, and 20 VAC 5-302-30 15, a provision related to market power. Those amendments would have expanded rules 20 VAC 5-302-20 12 a and b, related to the cumulative impact the proposed power plant and certain other pollution sources may have on air quality and water sources.

The Commission also directed Staff to convene a work group for discussion of the Commission's proposed amendments and the development of expedited permitting processes for small generating facilities of 50 MW or less. Staff was directed to file a report by April 19, 2002, with recommendations for further action by the Commission.

By January 15, 2002, 45 people expressed interested in participating in the work group. These people represented a wide range of interests, including environmental groups, citizens of the Commonwealth, state agencies, independent power producers, incumbent electric utilities, natural gas utilities, and large power users.

Staff convened its first work group meeting on February 5, 2002, at which time it was decided to suspend action on the Commission's proposed rules on environmental cumulative

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<sup>28</sup> The adopted rules may be found at: <http://www.state.va.us/scc/caseinfo/pue/e010313.htm>.



impacts in light of SB 554.<sup>29</sup> It was also agreed that those persons interested in providing comments to Staff on the remaining issues would do so by March 1, 2002.

As a result of this first meeting, Staff received comments from nine parties concerning the remaining issues. The comments were received from Dynegy Power Corp., Columbia Gas of Virginia, DVP, Columbia Gas Transmission, AEP-VA, Allegheny Energy, Virginia Energy Providers Association, Calpine Eastern Corporation, and Competitive Power Ventures. The comments focused on the issues of market power, cumulative impacts on fuel and fuel infrastructure, and the development of expedited permitting processes for units of less than 50 MW. As was agreed in the first meeting, none of the comments dealt with the environmental aspects of the Commission's proposed amendments to the filing requirements.

Staff convened a second work group meeting on March 22, 2002. At that meeting there was considerable discussion concerning the passage of SB 554 and the impact it may have on the Commission's review of environmental issues as part of its decision whether to grant an applicant a certificate of public convenience and necessity. The remainder of the second work group meeting dealt with streamlining the filing requirements for units less than 50 MW and the rules related to fuel and fuel infrastructure and market power.

Based on the work group meetings and the comments, in its April 19, 2002, report Staff proposed a set of revised filing requirements for the Commission's consideration. By May 24, 2002, the Commission had received written comments on the Staff Report as well as the Commission proposed amendments to the filing requirements.

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<sup>29</sup> On January 9, 2002, Senate Bill No. 554 ("SB 554") was introduced. The bill would modify the Commission's future role in reviewing the environmental aspect of applications to construct electric generating facilities in Virginia. SB 554 passed the Senate but was amended by the House. The Senate concurred with the House amendment. SB 554 was signed by Governor Warner on April 4, 2002, and became effective on July 1, 2002.

By order dated August 21, 2002, the Commission adopted filing requirements for applications filed on or after September 1, 2002.<sup>30</sup> The Commission noted that there was significant preference expressed in the written comments for portions of the amendments proposed by Staff, as opposed to the requirements originally proposed by the Commission. Consequently, the filing requirements adopted by the Commission were based on Staff's proposals, rather than the Commission's initial amendments.

In the August 21<sup>st</sup> order the Commission also concluded that, due to the passage of SB 554, filing requirements addressing cumulative environmental impacts are not necessary. Therefore the Commission's filing requirements do not require information related to environmental cumulative impacts.

### **Energy Infrastructure Study**

Senate Bill 684, enacted by the 2002 Session of the General Assembly, requires the SCC to convene a work group to "... study the feasibility, effectiveness, and value..." of collecting information relative to the location and operation of specified electric generating facilities, electric transmission facilities, gas transmission facilities, and gas storage facilities serving the Commonwealth. This information encompasses data relative to the electric and gas loads imposed by Virginia consumers and the dedication of facilities to the service of those loads.

In response to this legislative directive, the Staff mailed a letter on May 29, 2002, soliciting written comments from stakeholders addressing the issues related to collecting the information detailed in Senate Bill 684, giving consideration to the Commission's responsibilities under the Restructuring Act and the language in Senate Bill 684 relative to

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<sup>30</sup> The amended rules may be found at: <http://www.state.va.us/scc/caseinfo/pue/case/e010655a.pdf>.

the"...purpose of monitoring the adequacy of the energy infrastructure within the Commonwealth..." Sixteen parties provided comments.

Staff convened a meeting of interested parties on July 17, 2002. At that meeting were 34 people, not including Staff, representing twenty parties. A general discussion was held on electric and natural gas system reliability. A second meeting convened on August 7, 2002, for utilities to provide specific proposals for the collection of information necessary to track reliability. A third was convened on August 14, 2002, at which a representative from PJM presented how it manages reliability, and transmission planning.

Several comments have been submitted and are posted to the SCC's website.<sup>31</sup> A Staff review is underway of the comments we have received plus information that has been provided to other regulatory agencies and industry organizations.

### **RTE Development**

Section 56-579 of the Restructuring Act requires incumbent electric utilities to establish or join regional transmission entities ("RTEs")<sup>32</sup> as part of the transition to retail competition. This obligation is imposed on each incumbent electric utility owning, operating, controlling, or having an entitlement to transmission capacity. Section 56-579 also requires the State Corporation Commission to determine "whether to authorize transfer of ownership or control from an incumbent electric utility to a regional transmission entity." Behind this requirement was an expectation that RTEs would manage and control the transmission assets of Virginia's utilities with the objective of meeting the transmission needs of electric generation suppliers

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<sup>31</sup> Additional information is available at: [http://www.state.va.us/scc/division/eaf/comments\\_infra.htm](http://www.state.va.us/scc/division/eaf/comments_infra.htm).

<sup>32</sup> RTE and RTO (Regional Transmission Organization) are essentially synonymous terms. The former is used in the Act; the latter is the Federal Energy Regulatory Commission ("FERC") preferred acronym.

both within and outside Virginia.<sup>33</sup> Most of the parties who responded to the Staff's April 24, 2002, letter requesting input on facilitating competition in Virginia viewed the development of RTEs as either essential or very beneficial in the development of retail competition. Several respondents expressed significant concern that RTE plans were unsettled for much of Virginia.<sup>34</sup>

Three of Virginia's incumbent electric utilities, Kentucky Utilities, Allegheny Power and Delmarva, have shifted management of their transmission facilities to an RTE. Delmarva and AP are participating in PJM.<sup>35</sup> KU is participating in the MISO.<sup>36</sup> Dominion Virginia Power and AEP-VA have not yet transferred control of their transmission facilities to an RTE. Both are currently pursuing participation in PJM and are negotiating agreements governing the transfer of control. On July 31, 2002, the Federal Energy Regulatory Commission issued an order which, among a number of things, conditionally accepted DVP's and AEP's plans to join PJM. This approval is contingent upon acceptance of the final agreements with PJM and a number of other developments, which include the formation of a common market and the development of joint operational agreements between MISO and PJM.

Dominion Virginia Power and AEP-VA must also update their RTE filings with this Commission in conjunction with the Commission's review and determinations under the

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<sup>33</sup> § 56-579 A 2 d.

<sup>34</sup> Both AEP and Virginia Power participated in a prior effort to develop the Alliance RTO which ultimately failed to gain FERC approval. AEP had entered into a Memorandum of Understanding ("MOU") to join PJM West at the time of the Staff's letter soliciting comments on the status of competition. Virginia Power has since entered into a similar MOU to form "PJM South."

<sup>35</sup> Delmarva has participated in PJM since PJM's inception decades prior to passage of the Restructuring Act. Allegheny and PJM implemented the PJM West arrangements on April 1, 2002.

<sup>36</sup> "MISO" is the Midwest Independent System Operator. MISO began offering transmission service over KU's transmission facilities on February 1, 2002.

Restructuring Act. Such updates will likely be filed once final agreements have been negotiated with PJM.

Although Virginia's incumbent utilities have been involved in RTE development for several years, much remains to be done. The formation of RTEs is an extremely complex undertaking that has thus far been fraught with "starts" and "restarts." This is particularly so because the FERC continues to modify and adjust its RTE related policies in response to many factors, including proceedings it has initiated to examine significant RTE-related issues such as the interconnection of new generating facilities to the transmission system.

For example, the FERC recently issued a Notice of Proposed Rulemaking ("NOPR") to establish standard market rules and market oversight for bulk power markets. These rules would establish new requirements for RTEs and for transmission system users. The NOPR would, for example, require RTEs to establish short-term electricity markets to facilitate locational marginal pricing for transmission congestion. The rulemaking also asserts federal jurisdiction over bundled retail transmission for the first time. The NOPR raises these and several other very controversial issues for resolution. In short, the NOPR greatly complicates RTE development (not just in Virginia, but throughout the country) and will likely serve to extend the development process. The NOPR may, however, be beneficial to the development of competition in the long run, in that it seeks to facilitate the creation of short-term energy markets, create standard market rules, and establish effective market oversight.

In the meantime, the State Corporation Commission (as required by § 56-579 C) will continue to participate in key FERC proceedings concerning RTE formation and development. The Commission will also continue its work under § 56-579, generally, with respect to pending applications by incumbent utilities to transfer management and control of their transmission

assets to RTEs, consistent with the public interest and other statutory criteria established by the General Assembly. Consistent with § 56-596 A of the Restructuring Act, the Commission must also ensure that in reviewing the utilities' applications under § 56-579, the goals of advancing competition and economic development in Virginia are kept paramount. In that key respect, the competitive interstate wholesale electricity market envisioned by the FERC and the General Assembly's goal to bring competition to Virginia's retail market are at once complementary and distinct. The continuing challenge to this Commission is reconciling these objectives as it reviews incumbent utilities' applications to transfer management and control of their transmission assets to RTEs, consistent with the requirements of the Restructuring Act.

## **OTHER ACTIVITIES AND ISSUES**

### **Aggregation Investigation**

The Restructuring Act authorizes the provision of aggregation services for the Commonwealth's retail electricity customers. Section 56-576 of the Act defines aggregator, §56-588 details the licensing of aggregators, and §56-589 authorizes municipal and state aggregation. Aggregation service is the purchasing or arrangement of the purchase of electric energy for sale to two or more retail customers.

On March 18, 2002, in Case No. PUE-2002-00174, the Commission established an investigation of aggregation issues. Questions had arisen with respect to which persons or entities needed to be licensed as aggregators. For instance, it would seem reasonable that a group of residential customers could act together to market their combined electric load to competitive suppliers without having to obtain an aggregators license. Are licenses needed, however, before collective electricity purchasing programs can be offered by religious organizations, senior citizens organization, buying clubs or other groups? Other questions that needed to be addressed included whether limitations needed to be placed on the length of aggregation contracts, and whether aggregation contract cancellation rights needed further clarification.

In the Commission's aggregation investigation order the Staff was directed to convene a work group to focus on aggregation issues and to issue a report by August 1, 2002. The Staff convened a work group on May 1, 2002. The stated objectives of the meeting were to discuss various models of aggregation, examine how the Act addresses aggregation, re-examine the Commission's Retail Access Rules concerning aggregation, and to discuss possible changes to the Rules. Twenty-five persons joined the Staff to discuss these issues.

On May 22, 2002, the Staff sent a letter to the participants of the work group meeting and others who had expressed an interest in aggregation issues. In that letter Staff summarized six main issues that had been identified in the work group meeting that needed clarification. Staff asked for written input on these issues and received comments from four parties. Staff prepared and filed a report on August 1, 2002, which addressed these issues.<sup>37</sup>

In its August 1, 2002 report, the Staff reviewed the objectives of its investigation, described the efforts of the work group, and summarized the comments received in response to its May 22, 2002, letter. The two areas that created the most interest from work group participants were related to the aggregator definition and the role of potential aggregators functioning solely as marketers. Regarding the aggregator definition, the Staff recommends no change at the present. Regarding the marketing issue, the Staff recommends a minor role change.

The Staff asserts that an entity that is not involved in the transactional arrangements between a licensed competitive service provider or aggregator and its retail customers should not be required to be licensed. The Staff does not believe that marketing activities, alone, conducted on behalf of, or in conjunction with, licensed CSPs or aggregators warrant licensure of this third party. The Staff concludes that the licensed CSP is responsible for the actions of the marketer. Further, the Staff believes that the recommended marketer exclusion is consistent with the Commission's authority as defined in the Restructuring Act. Staff recommends that one Retail Access Rule be changed to require CSPs to maintain a list of entities with whom they have a marketing relationship. Such information would be helpful to the Staff with respect to investigating any complaints related to marketing practices.

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<sup>37</sup> The report may be found at: [http://www.state.va.us/scc/caseinfo/pue/case/e020174\\_staff.pdf](http://www.state.va.us/scc/caseinfo/pue/case/e020174_staff.pdf).



The Commission will review the Staff's report and the comments received in response to Staff's letter and act accordingly.

### **Distributed Generation**

Distributed generation involves moving the generation of electricity away from large central units to smaller units located closer to the point of consumption.<sup>38</sup> In accordance with §56-578 of the Restructuring Act, the Commission instructed the Staff to work with interested parties to develop proposed interconnection standards for distributed generation. The Act specifies that the interconnection standards "shall not be inconsistent with nationally recognized standards acceptable to the Commission." Staff has been monitoring the progress of the Institute for Electrical and Electronic Engineers ("IEEE"), an organization that sets electric related standards, and its efforts to set national standards for distributed generation interconnections ("IEEE-1547"). The deadline for finalizing IEEE-1547 has been extended. Once projected for completion in the summer of 2001, it is now scheduled for completion by the end of this year.

Staff is also monitoring a similar effort by the National Association of Regulatory Utility Commissioners ("NARUC") to endorse a model interconnection agreement and procedures for distributed generation. In addition, Staff is monitoring the activities of FERC in its development of interconnection procedures.

In the meantime, Staff has developed, with the assistance of interested stakeholders, a draft of proposed standards for Virginia. Several work group meetings were held and the proposal was sent out for comments. In addition, a meeting was co-hosted by the Staff and the

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<sup>38</sup> In May of 2000, the Commission issued rules governing net energy metering promulgated pursuant to § 56-594 of the Restructuring Act. The net metering rules establish interconnection guidelines and tariffs under which an electric customer may interconnect a small wind, hydro or solar generating facility to the grid. The rules may be found at: <http://www.state.va.us/scc/caseinfo/pue/case/e990788rul.pdf>.

Virginia Tech Alexandria Research Institute on May 17, 2002, at the Commission's offices. At that meeting, presentations related to distributed generation were made by the U.S. Department of Energy, the Commission Staff, and Virginia's Department of Environmental Quality.

Our Staff's efforts continue on this project.

### **Default Service Investigation**

In accordance with §56-585 of the Restructuring Act, default service will be available to retail electric customers who do not select a competitive supplier, who are unable to select a competitive supplier, or who have contracted with a competitive supplier that fails to perform.

The Commission is charged with determining the components of default service and with establishing one or more programs making it available. Default service is to be available when retail choice is available throughout the Commonwealth, or by January 1, 2004. While the Commission may require an incumbent distribution utility to provide all or a portion of default services, there is also a provision in the Restructuring Act that allows the Commission to conduct a competitive bidding process to select an alternative default service provider. A selected alternative default service provider may be authorized to supply specific components of default service, to supply one or more defined regions in the Commonwealth, and to serve one or more classes of customers.

The Commission Staff initiated a process to attempt to discover the extent of interest from potential alternative default service providers. A letter was sent on June 10, 2002, to a number of companies and organizations with the following questions:

- What is your current thinking relative to having default service provided by a non-incumbent?
- What is your current interest in providing default service to retail customers in Virginia?

- What do you view as technical, regulatory or legal impediments to the competitive provision of default service?
- Please comment on the desirability and feasibility of the Commission conducting competitive bidding processes to solicit the provision of default service. Provide specific comments relative to procedures that should be implemented to facilitate such processes. If you are a potential supplier of default service, what is your current level of interest relative to participating in such a competitive process? Specify whether your interest extends to particular classes of customers, geographic regions or a specific component(s) of default service.
- What specific actions can/should the Commission or the legislature take to enhance the competitive provision of default service?

Responses to these questions along with any other thoughts or comments were submitted by August 15, 2002, and are posted to the SCC's website.<sup>39</sup> A work group meeting has been scheduled on October 4, 2002, to initiate active discussions surrounding default service.

### **Tax Issues**

A recent generating facility purchase by Dominion Virginia Power illustrates a restructuring-related taxation issue that could cause a decline in local tax revenue.

In 2001, DVP completed the purchase of three generating facilities and terminated seven long-term power purchase contracts with non-utility generators. These transactions were the result of the Company's ongoing review of power purchase obligations created under the federal Public Utility Regulatory Policies Act of 1978 and its efforts to mitigate exposure to stranded costs. Cash payments related to the purchase of the three generating facilities exceeded \$200 million, and were assigned to the assets and liabilities acquired based upon estimated fair market values as of the date of acquisition. The acquired generating facilities were appraised at only salvage value based on an independent analysis done on behalf of

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<sup>39</sup> Submitted comments may be viewed at: <http://www.state.va.us/scc/division/eaf/comments.htm>.

Dominion Virginia Power, which indicated that operation of the facilities would be uneconomical in a competitive environment. If the assessments were based on the reduction in the reported value of the properties as stated by DVP, the property tax liability associated with these facilities would be approximately \$48,622. The Company contends that the majority of the purchase price can be attributed to the terminated power purchase contracts, resulting in a charge to operating income for the period.

The reduction in the reported value of the properties as stated by DVP would translate into a significant decline in property tax assessments and payments to local taxing authorities. For 2001, the three generating facilities and associated property were assessed a combined property tax bill of \$1,177,824 by the local taxing authorities. The SCC Staff has estimated the combined 2002 property tax liabilities associated with the acquired generating facilities at \$968,099 based on depreciated original cost values. The net result represents a decrease in taxation due to the relatively low real estate tax rates in two of the localities compared to the machinery and tools rate used when the properties were assessed locally.

Other localities in Virginia may also be affected as a consequence of the transition to a deregulated generation market within the Commonwealth. The potential reductions in property tax values could cause a significant decline in revenues to the affected taxing jurisdictions. Additionally, many of these facilities that were previously assessed locally were taxed at the machinery and tools rate, whereas the SCC's assessments under § 58.1-2606 of the Code of Virginia require all property to be taxed at the real estate rate in the respective localities, which in most cases is substantially lower. Other methodology differences employed by the SCC in its assessment of depreciated original cost values may increase or decrease the level of property taxes that were previously assessed by the various local taxing authorities.

## **Financial Profile of Virginia's Electric Utilities**

The electric industry is very capital intensive. Therefore, it is important that electric utilities be able to raise capital on reasonable terms and at favorable rates. One factor influencing the terms and rates a company is able to obtain when raising debt capital is its credit ratings. The two major rating agencies are Moody's Investors Service ("Moody's") and Standard & Poor's Ratings Services ("S&P"). S&P assigns bond ratings ranging from "AAA" to "D", with a plus (+) or minus (-) added to show relative standing within the major categories. Moody's assigns ratings ranging from "Aaa" to "C", with a modifier of 1, 2 or 3 in each ratings category from "Aa" through 'Caa" to show relative standings within the major categories. A bond rated below "BBB-" by S&P or "Baa3" by Moody's is considered non-investment grade or a "junk bond".

Recently there has been substantial press coverage devoted to the sudden collapse of Enron Corp. and the precipitous decline in both market value and credit ratings of other well-known energy companies across America.<sup>40</sup> The financial difficulties experienced by some of these companies have had an impact in Virginia. For example, two Enron subsidiaries were licensed by the Commission to provide competitive gas service in Virginia. As a result of the financial difficulties it encountered in late 2001, Enron did not renew a license for one of the subsidiaries and agreed with our Staff to a suspension of the license of its other subsidiary. In addition, The New Power Company, a spin-off of Enron, was licensed to provide competitive natural gas, electricity and aggregation services in Virginia. Due to its recent financial difficulties and its eventual bankruptcy filing, the New Power Company has transferred all of

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<sup>40</sup> Calpine Corp. is currently rated Ba3, CMS Energy is rated B3, Mirant Corporation is rated Ba1, Dynegy Holdings is rated B1, and Reliant Resources is rated Ba3, all in junk bond status.

its existing Virginia customers back to the incumbent utilities and has agreed not to market its services in Virginia.

The impact on Virginia has not been isolated to just the loss of energy marketers. There have been numerous merchant plant developers planning to construct electric generating facilities in Virginia that have experienced cancellations or delays in their projects because of financial difficulties. For example, Mirant Corporation announced in early 2002, that it had "indefinitely deferred the construction of its electric generating facilities at the AirSide Industrial Park in Danville, Virginia."<sup>41</sup> Mirant will proceed only with the processing of environmental and regulatory approvals for the project and will actively negotiate with other entities to take over the development of the project for construction. Mirant's change in plan was prompted by a "new business plan that requires reduced capital expenditures."<sup>42</sup> In addition, Kinder Morgan Virginia, LLC, by motion filed on May 2, 2002, asked the Commission to delay the processing of its application that was pending before the Commission. In its motion Kinder Morgan stated that: "Recent events and energy market developments have resulted in delays in the timetable Kinder Morgan Virginia established for the Facility."

With the turmoil facing the energy markets it is important to highlight the financial health and well being of Virginia's regulated electric utilities. Our distribution Cooperatives continue to obtain most of their debt funding from the Rural Utilities Services<sup>43</sup> on reasonable terms and at favorable rates. Our five investor-owned electric utilities and ODEC all continue to have a senior bond rating in the "A" category by Moody's. S&P, however, has some of these utilities' senior secured bonds rated as low as "BBB".

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<sup>41</sup> Letter dated February 6, 2002, to Joel H. Peck, Clerk of the Commission.

<sup>42</sup> Id.

<sup>43</sup> Formerly the Rural Electrification Association

The lower S&P ratings can be attributed to S&P's consolidated ratings methodology that rates corporate parents on par with its legal subsidiaries. The idea is that cash is fungible and therefore can be used anywhere within the corporate family to meet debt service obligations. As a result, a strong utility owned by a weaker parent generally is rated no higher than the parent or the consolidated corporate credit quality.

The current ratings for each investor owned electric utility and ODEC are listed below. After the matrix is a brief discussion of the rating agencies' rationale for the rating assigned.

Company	Senior Secured Debt Credit Ratings	
	Moody's	Standard & Poor's
Appalachian Power	A3	BBB+
Delmarva Power	A2	A-
Kentucky Utilities	A1	BBB+
ODEC	A3	A+
Potomac Edison	A1	BBB
Virginia Power	A2	A

Appalachian Power (AEP-VA) - On May 23, 2002, S&P lowered its rating on APCO's debt to "BBB+" from "A-" based on the ratings review and subsequent downgrade of its parent, American Electric Power. The ratings review and downgrade were prompted by AEP's corporate restructuring of its regulated and unregulated lines of business. Moody's on the other hand has placed AEP on credit watch for a possible downgrade as a result of the corporate restructuring, but affirmed APCO's senior bond rating at A3. In affirming APCO's rating,

Moody's stated that it did not expect that the credit quality of APCO to change substantially after AEP's restructuring.

Delmarva Power - On February 12, 2001, S&P placed Delmarva on credit watch for a possible downgrade along with the entire Conectiv corporate family as a result of Conectiv's proposed merger with Potomac Electric Power Co. According to S&P, Delmarva's rating reflects a business profile whose strengths include a low-risk distribution business, a high percentage of residential customers, modest annual customer growth (1% per year), a strong service territory economy, and contracted energy supply. However, S&P believes these strengths are offset by provider of last resort risk and weak financial measures. Moody's, however, in May of 2002, affirmed the credit rating of Delmarva at "A2". In doing so, Moody's stated that it expected the merger to take place as planned. However, if the merger does not take place, or deviates from plans, there could be credit implications for entities other than Delmarva.

Kentucky Utilities - Kentucky Utilities, as well as its parent, LG&E Energy Corp., is on credit watch for a possible upgrade reflecting the pending acquisition of LG&E Energy's parent, Powergen PLC, by a higher rated German entity E.ON AG. According to S&P, the rating of Kentucky Utilities reflects the financial profile of its parent, LG&E, and is supported by Kentucky Utility's above-average business profile arising from low production costs, competitive rates, lack of nuclear generating assets, and sufficient base load capacity in the near term. The potential for tighter emissions standards related to nitrous oxide and higher-risk energy marketing, independent power projects, and international operations of its parent LG&E Energy are credit concerns to S&P. Moody's, on the other hand, has placed LG&E Energy on credit watch for possible upgrade but has left Kentucky Utilities' rating alone.



Potomac Edison - On April 3, 2002, S&P lowered all rated Allegheny Energy Inc. subsidiaries, which includes Potomac Edison, to "BBB+". The downgrade reflects an equalization of all Allegheny Energy Inc. subsidiaries and was reflective of Allegheny's decision to abandon the announced spin-off of its non-regulated generating subsidiary, Allegheny Energy Supply LLC, and instead to continue operating as an integrated company. More recently, S&P downgraded Allegheny Energy Inc. and its subsidiaries to "BBB", and continues to have a negative outlook on Allegheny Energy Inc. and its subsidiaries. The downgrades reflect a weakened financial profile caused by increasing leverage and a more-than-expected downturn in the wholesale power market. S&P notes that much of Allegheny's recent credit deterioration is attributable to the additional leverage associated with the cost of creating the infrastructure necessary to become a national energy player. Moody's has rated Potomac Edison's senior bonds at "A1" since May of 1995. According to Moody's, this rating reflects good cash flow and the moderate pace of deregulation in its three-state service territory. Further, although business risk has declined with the transfer of its generating assets, Potomac Edison as a transmission and distribution company may still face some turbulence as the region transitions to competition in generation. These comments notwithstanding, on August 8, 2002, Moody's placed Allegheny Energy Inc. and its subsidiaries on credit watch for a possible downgrade.

Dominion Virginia Power - As noted earlier, DVP is the only investor owned electric utility in Virginia whose ratings are not equalized with its corporate parent by S&P. Dominion Virginia Power's senior bond rating by S&P is "A" while its parent company, Dominion Resources is rated "BBB+". According to S&P, the ratings difference is attributable to DVP's adequate credit protection measures on a stand-alone basis, combined with statutory insulation

that allows S&P to view DVP's dividend payments to its parent as discretionary. According to S&P: "A significant level of regulatory insulation restrains Virginia Power from subsidizing holding company expansion into nonregulated activities, as state statute empowers the State Corporation Commission to prevent the utility from paying dividends to the parent if that action would impair the utility or if the parent would profit to the detriment of the utility's bondholders." S&P further stated that DVP's ratings reflect its "economically strong service territory, competitive rates, efficient operations, and rate stability resulting from legislative and regulatory actions concerning deregulation."<sup>44</sup>

Another S&P publication cites the Restructuring Act as an example of how Dominion Virginia Power has an opportunity to improve its financial performance. S&P states that the Act "provides several credit-enhancing features, including rate stability through July 1, 2007, ...continued fuel cost recovery via an automatic adjustment through mid-2007, and recovery of stranded costs...through capped rates or a wires charge."<sup>45</sup>

According to Moody's, Virginia Power's "A2" senior bond rating is based on a reasonably competitive position, a transition to competition through 2007 which supports credit quality, and conservative management. However, exposure to nuclear risks and ongoing restructuring charges restrain the rating.

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<sup>44</sup> Both quotes from Standard and Poor's Rating Direct Research; Summary: Virginia Electric & Power Co.; July 8, 2002.

<sup>45</sup> Standard & Poor's Ratings Direct Research; Summary: Virginia Electric & Power Co.; January 25, 2002.

**APPENDIX I-A**

**SUMMARY OF NATURAL GAS RETAIL  
ACCESS PROGRAMS IN VIRGINIA**

## **SUMMARY OF NATURAL GAS RETAIL ACCESS PROGRAMS IN VIRGINIA**

This appendix provides a brief history of the natural gas retail access programs in the Commonwealth of Virginia. Large natural gas customers in the Commonwealth have been allowed to arrange for their own supply and transportation of gas for more than ten years. But in 1997, natural gas retail access became available on a limited basis through two retail access pilot programs, one in the service territory of Washington Gas Light (“WGL”) and the other in the territory of Columbia Gas of Virginia (“CGV”).

### **WGL’s Retail Access Program**

The Commission initially approved WGL’s retail access pilot program in Case No. PUE-1997-01024 in an order dated June 18, 1998. The two-year pilot program was scheduled to begin on October 1, 1998. As approved, all of WGL’s customers were eligible to choose a CSP with up to ten percent of WGL’s customers actually allowed to switch to a CSP in the first year and up to 20 percent in the second year.

Natural gas deliveries under the program began on January 1, 1999. By October 1, 1999, one year after the effective date of the program, approximately 17,000 residential customers and 3,500 non-residential customers were receiving service from 12 CSPs. One year later those numbers had increased to approximately 38,600 residential customers and 5,100 non-residential customers.

On September 11, 2000, WGL applied for approval to end the pilot program and implement full retail access throughout its Virginia territory, including the territory of its Shenandoah Gas Division. In its proposal, WGL requested permission to phase-in retail access for all of its customers over a two-year period. The Commission approved the application with

certain modifications in its order in Case PUE-200-00474 issued on March 7, 2001.\* Among the modifications was a shortened phase-in period that allowed retail access to all WGL's non-residential customers and to 50 percent of its residential customers (approximately 150,000) effective April 1, 2001. The remaining WGL residential customers became eligible to choose a CSP effective January 1, 2002. Additionally, all Shenandoah Gas customers, both residential and non-residential, were eligible to choose a CSP effective April 1, 2001. Together, WGL and Shenandoah Gas currently have 378,647 customers eligible to shop for a CSP.

As of August 1, 2002, WGL's program had eleven active CSPs serving approximately 7,300 non-residential customers and five active CSPs serving approximately 69,000 residential customers. Cumulatively, these accounts represent approximately 20.2 percent of the natural gas customers in WGL's service territory. It is important to note, however, that WGL's unregulated affiliate, WGES, is serving approximately 70 percent of the non-residential shoppers and approximately 72 percent of residential shoppers.

### **CGV's Retail Access Program**

The Commission approved CGV's retail access pilot program in Case No. PUE-1997-00455 in an order dated September 30, 1997. The two-year program began October 1, 1997, and served as the first retail access program in the Commonwealth. As approved, the program was limited geographically to CGV customers in Prince William, Fauquier, Culpeper, and Fairfax Counties. Within that area, all of the approximately 26,500 customers were eligible to enroll and switch to a CSP. On August 24, 1999, the Commission granted an extension of the program from October 1, 1999 to October 1, 2000. A second extension was granted in Case No. PUE-2000-00284, allowing the program to continue until the Commission approved a

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\* Additional information may be found at: <http://www.state.va.us/scc/caseinfo/pue/e000474.htm>.

permanent program or October 1, 2001, whichever occurred first. On June 14, 2001, the Company requested another extension of the pilot program beyond October 1, 2001. The Commission Staff requested that CGV give serious consideration to expanding its pilot to a full retail access program for all of its customers. On January 2, 2002, CGV applied for approval of a retail supply choice program that would enable nearly all of its customers to exercise retail choice for supply beginning with the 2002-2003 heating season. The Commission issued its Order in Case PUE-2001-00587\*\* on June 28, 2002, approving CGV's retail choice plan with modifications as directed. A subsequent order extended the effective date of the retail access plan to October 1, 2002.

As of July 1, 2002, 39,203 customers were eligible to participate in CGV's program. Six CSPs are providing service to 702 non-residential customers and 9,678 residential customers, which represents approximately 24.7 percent of the eligible customer base.

### **CSP Activity**

The two natural gas retail access programs have provided useful information to utilities, CSPs, consumers, and the Commission Staff. The level of CSP activity has been considerably better in the natural gas programs than has been experienced in the electric programs, although a high level of affiliate market concentration may have distorted the actual level of competitive activity.

The New Power Company, a CSP active in both natural gas retail access programs, recently announced plans to return the natural gas customers it has been serving back to WGL and CGV by August 31, 2002. Approximately 4,500 residential customer and approximately 240 commercial customers will be affected.

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\*\* Additional information may be found at: <http://www.state.va.us/scc/caseinfo/pue/e010587.htm>.