

Commonwealth of Virginia
State Corporation Commission

**Report to the Commission on Electric Utility Restructuring
of the Virginia General Assembly**

And the Governor of the Commonwealth of Virginia



**Status Report: The Development of a Competitive Retail Market for
Electric Generation within the Commonwealth of Virginia**

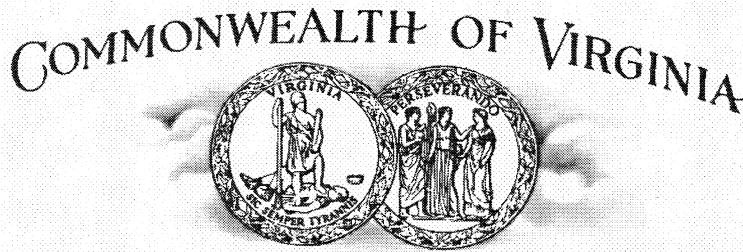
Pursuant to Section 56-596 of the Code of Virginia

September 1, 2006

MARK C. CHRISTIE
CHAIRMAN

THEODORE V. MORRISON, JR.
COMMISSIONER

JUDITH WILLIAMS JAGDMANN
COMMISSIONER



JOEL H. PECK
CLERK OF THE COMMISSION
P.O. BOX 1197
RICHMOND, VIRGINIA 23218-1197

STATE CORPORATION COMMISSION

September 1, 2006

TO: The Honorable Timothy Kaine
Governor, Commonwealth of Virginia

The Honorable Thomas K. Norment, Jr.
Member, Senate of Virginia
Chairman, Commission On Electric Utility Restructuring
and
Members of the Commission On Electric Utility Restructuring

The State Corporation Commission is pleased to transmit its report regarding the advancement of competition in Virginia as required by Section 56-596 of the Virginia Electric Utility Restructuring Act.

This report, required annually by September 1, provides information on the status of competition in the Commonwealth, the status of the development of regional competitive markets, and the Commission's recommendations to facilitate effective competition as soon as practical.

Respectfully submitted,

Mark C. Christie
Commission Chairman

Theodore V. Morrison, Jr.
Commissioner

Judith Williams Jagdmann
Commissioner

TABLE OF CONTENTS

EXECUTIVE SUMMARY AND OVERVIEW

GLOSSARY OF ACRONYMS

PART I: STATUS OF THE DEVELOPMENT OF REGIONAL
COMPETITIVE MARKETS: PERFORMANCE REVIEW OF
ELECTRIC POWER MARKETS

PART II: STATUS OF RETAIL ACCESS AND COMPETITION IN THE
COMMONWEALTH

PART III: RECOMMENDATIONS TO FACILITATE EFFECTIVE
COMPETITION IN THE COMMONWEALTH

Executive Summary and Overview

Over seven years have passed since the Virginia General Assembly passed the Virginia Electric Utility Restructuring Act (“Restructuring Act” or “Act”)¹, and only a few years remain to the end of the transition period in 2010 as set forth in the Act. Section 56-596 of the Act requires the Virginia State Corporation Commission (“SCC”) to report to the Commission on Electric Utility Restructuring (“CEUR”) and the Governor by September 1 of each year on the status of competition in the Commonwealth, the status of the development of regional competitive markets and the SCC’s recommendations to facilitate effective competition in the Commonwealth as soon as practicable. This section of the statute also requires the SCC to report any recommendations of actions to be taken by the General Assembly, electric utilities, suppliers, generators, distributors, and regional transmission entities that the SCC considers to be in the public interest.

Since the Restructuring Act was enacted into law in 1999, electric utility customers in Virginia have been insulated, to some degree, from changes in electric charges that would otherwise apply in the absence of the base rate caps which are an integral component of Virginia’s restructuring program. The presence of those base rate caps, which will remain in place through 2010, has kept retail prices for most Virginia consumers from increasing precipitously despite escalating prices for electricity in wholesale markets. While these retail rate caps will remain in place through 2010, we note that through various provisions of the Restructuring Act, Virginia’s electric utilities will have several legally permissible avenues to increase rates between now and the end

¹ Virginia Electric Utility Restructuring Act, Chapter 23 (§ 56-576 et seq.) of Title 56 of the Code of Virginia.

of 2010. For example, Dominion Virginia Power is authorized to seek yearly changes in rates for fuel costs beginning in 2007, and other Virginia electric utilities, including Appalachian Power and electric co-operatives, may seek rate increases for environmental, reliability, and fuel costs, and two general rate increases, before 2011. Appalachian has already twice applied to this Commission for increases in base rates and Delmarva Power was recently granted a 25% overall rate increase. The Act's ability to protect Virginia's homes and businesses from increases in the market-based price of electricity via the Act's capped base rate mechanism is limited. More Virginia retail customers could see precipitous increases in their electric bills as utilities apply for permitted increases for base and fuel charges prior to the expiration of capped rates on January 1, 2011.

In the past year, retail electric customers in neighboring states have faced precipitous electricity cost increases as applicable rate caps have expired. The controversies generated by the proposed increases have dominated utility news. This Report questions the assertion that new higher rate levels are the result of a well functioning competitive electricity market. However, whether new higher market rates are the result of robust competition or the inappropriate exercise of market power, the basic problem is that today's prevailing wholesale prices are much higher than those envisioned at the onset of industry restructuring. This means that stranded costs are much less than was assumed at the beginning of the transition. While a balancing of the equities remains state and/or utility specific, much of the controversy in Maryland and Delaware arises from the fact that customers paid stranded cost charges set by low market price expectations and now, after paying those stranded cost charges for a number of

years, must pay current higher prevailing prices that render, in hindsight, those stranded cost charges unnecessary.

The SCC offers its sixth annual Report pursuant to the requirements of the Act consisting of three parts. Part I is a description of evolving regional retail and wholesale markets prepared by Dr. Kenneth Rose, Consultant and Senior Fellow, Institute of Public Utilities at Michigan State University. Part II reports on the status of retail access and competition in the Commonwealth. Part III presents the SCC's view of the current competitive marketplace, including comments offered by stakeholders responding to an annual SCC solicitation of potential recommendations and actions to facilitate effective competition.

Part I of this Report contains detailed data and information on restructured wholesale and retail electricity markets around the United States. This year, Dr. Rose has focused on resulting prices and price trends. The economic health of these markets continues to be questionable with little effective competition evident especially for residential and small commercial consumers. Currently, states that have restructured are nearing the end of the respective transition periods with retail prices being determined by market forces. Dr. Rose reports that, in states where the generation portion of the customers' bills is being determined by the market, prices have increased more rapidly than the national average. These restructured states' price increases also exceed those in states that did not restructure. Most non-restructured states remain at prices below the current national average. Thus, the evidence suggests that to date, electricity customers have not received any discernible benefit once the rate caps have expired.

Dr. Rose also presents information regarding his evaluation of recent electricity prices within the wholesale markets. Various factors, including hot weather, natural gas prices, and customer demand, influence electricity prices. Additionally, the frequency that costly generators operate as marginal units to meet load, strongly influences hourly electricity prices.

On the basis of the extensive information submitted by Dr. Rose, the SCC concludes that, while retail access is widely available in many jurisdictions, vigorous retail competition has yet to develop especially for smaller consumers. This national result, when combined with results obtained here in the Commonwealth as detailed in Part II of this Report, continues to question the ability of retail electric competition to provide Virginians with lower prices for electric service than would have prevailed under traditional regulation of the industry.

Part II of the Report focuses on activities in Virginia related to retail access and reviews Virginia specific developments relating to wholesale electric markets and the Federal Energy Regulatory Commission's (FERC) stewardship of those wholesale markets. Almost all of Virginia now resides in the PJM Interconnection "footprint". PJM directs the operation of the regional bulk power system and administers several wholesale electricity markets including those for electric energy, generating capacity and related services. Virginia statutes that govern the regulation of public utilities in general, and the Virginia Electric Utility Restructuring Act in particular, provide the SCC with both the obligation and authority to monitor the workings of wholesale electricity markets that will impact Virginia retail electric consumers. The integration of Virginia's electric utilities into PJM provides the SCC with a unique challenge in obtaining information

from PJM and Virginia utilities required to monitor wholesale markets. Over the past year, the SCC and its staff sought to obtain data and information necessary to carry out the market monitoring that was envisioned by the General Assembly when the Act was first passed in 1999. To date, our staff's efforts to work with PJM have met with mixed results. Difficulties in obtaining vital data and information leaves the Virginia State Corporation Commission unable to warrant independently that PJM's competitive wholesale electricity markets are effectively competitive.

Part II of this Report also reviews the SCC's efforts to develop a proper infrastructure to accommodate competition and to prepare Virginians for consumer choice for generation, as directed by the Act. During the past year the SCC continued to implement the Restructuring Act, permitting about 3.2 million electricity customers in Virginia the right to choose an alternative supplier of electricity.

As we reported last year, the right to choose has still not evolved into the ability to choose. While it is clear that the SCC, the utilities and the various stakeholders have effectively enabled retail access in Virginia, there remains little competitive activity in the Commonwealth. We understand that many suppliers still perceive little economic incentive to enter the Virginia retail market. No competitive service provider is offering energy priced so that switching customers may save money. Currently, one supplier continues to serve slightly more than 1,300 residential customers and 19 small commercial customers in Dominion Virginia Power's ("Dominion" or "DVP") northern service area with an environmentally-friendly renewable power offer. This service is more expensive than DVP's price-to-compare and the number of customers taking such service has declined from last year's report. The only other supplier activity in the

Commonwealth reflects the recent selection of four large customers in Delmarva's service territory. Again, as detailed in Part I, this lack of activity is not unique to the Commonwealth; in other states currently offering retail access, few customers have the option to purchase power at a price lower than their incumbent's price-to-compare.

Part III of the Report presents comments advanced by a few stakeholders as a means of facilitating effective competition in the Commonwealth. It also includes the SCC's analysis of key industry events occurring since the issuance of last year's report. In last year's report, the State Corporation Commission described "some ominous new industry features and trends." Over this past year, those ominous industry features and trends continued. Part III includes a detailed update on the progression of those trends and how industry restructuring in Virginia has been affected by those trends. Those six trends include the import of the single price auction as practiced in PJM wholesale markets, historical wholesale prices trends, actual impacts on Virginia customers resulting from wholesale market results, industry consolidation, FERC actions, and concerns about PJM market monitoring.

As outlined in this Report, the problems that are impeding the development of retail competition in Virginia and other regional markets continue unabated. In terms of the existence of retail competition, little, if anything, has changed since last year. Although most parties still agree that a robust wholesale market under an operational and independent regional transmission organization will lead to a viable competitive retail market, experience with PJM over the past year indicates such a marketplace in the Commonwealth continues to be slow to develop. We currently have the basic rules,

systems, and procedures in place to harmonize retail access and will continue to monitor market conditions and react accordingly.

ACRONYMS

| | |
|-----------------|--|
| A&N | A&N Electric Cooperative |
| AEI | American Energy Institute |
| AEP | American Electric Power |
| AP | Allegheny Power |
| APCo | Appalachian Power Company |
| BARC | BARC Electric Cooperative |
| BGS | basic generation service |
| BHE | Bangor Hydro-electric Company |
| CBEC | Craig-Botetourt Electric Cooperative |
| CEC | Community Electric Cooperative |
| CEUR | Commission on Electric Utility Restructuring |
| CGV | Columbia Gas of Virginia |
| CSP | competitive service provider |
| CTC | competitive transition charge |
| CVEC | Central Virginia Electric Cooperative |
| DCPSC | District of Columbia Public Service Commission |
| DP&L | Delmarva Power & Light Company |
| DEPSC | Delaware Public Service Commission |
| DEQ | Virginia Department of Environmental Quality |
| DVP | Dominion Virginia Power |
| EDI | electronic data interchange |
| ESCO | energy service company |
| FERC | Federal Energy Regulatory Commission |
| FREDI | First Regional Electronic Data Interchange |
| ICAP | installed capacity market of PJM |
| ICC | Illinois Commerce Commission |
| IEEE | Institute for Electrical and Electronic Engineers |
| IURC | Indiana Utility Regulatory Commission |
| KU | Kentucky Utilities |
| kW | kilowatt |
| KPSC | Kentucky Public Service Commission |
| LDC | local distribution company |
| LMP | locational marginal price |
| MEC | Mecklenburg Electric Cooperative |
| MIPSC | Michigan Public Service Commission |
| MISO | Midwest Independent System Operator |
| MMU | Market Monitoring Unit of PJM |
| MDPSC | Maryland Public Service Commission |
| MW | megawatt |
| NAESB | North American Energy Standards Board |
| NARUC | National Association of Regulatory Utility Commissioners |

| | |
|----------------|---|
| NCUC | North Carolina Utilities Commission |
| NEM | National Energy Marketers Association |
| NERTO | New England Regional Transmission Organization |
| NJBPU | New Jersey Board of Public Utilities |
| NNEC | Northern Neck Electric Cooperative |
| NOPEC | North East Ohio Public Energy Council |
| NOPR | Notice of proposed rulemaking |
| NOVEC | Northern Virginia Electric Cooperative |
| NYISO | New York Independent System Operator |
| ODCFUR | Old Dominion Committee for Fair Utility Rates |
| ODEC | Old Dominion Electric Cooperative |
| ODP | Old Dominion Power |
| PAPUC | Pennsylvania Public Utilities Commission |
| PES | Pepco Energy Services |
| PE | Potomac Edison |
| PGEC | Prince George Electric Cooperative |
| PJM | PJM Interconnection, LLC |
| POLR | provider of last resort |
| PUCO | Public Utilities Commission of Ohio |
| PUCT | Public Utility Commission of Texas |
| REC | Rappahannock Electric Cooperative |
| REP | retail electric provider |
| ROA | retail open access |
| RTE | regional transmission entity |
| RTO | regional transmission organization |
| S&P | Standard & Poor's Ratings Service |
| SCC | Virginia State Corporation Commission |
| SERC | Southeastern Reliability Council |
| SOS | standard offer service |
| SPP | Southwest Power Pool |
| SSEC | Southside Electric Cooperative |
| SVEC | Shenandoah Valley Electric Cooperative |
| T&D | transmission and distribution |
| UBP | Uniform Business Practices |
| UCAP | unforced capacity market of PJM |
| VCCC | Virginia Citizens Consumer Council |
| VCFUR | Virginia Committee for Fair Utility Rates |
| VEC | Virginia Energy Choice |
| VEPA | Virginia Energy Providers Association |
| VIPP | Virginia Independent Power Producers |
| VMDA | Virginia, Maryland, & Delaware Association of Electric Cooperatives |
| WGES | Washington Gas Energy Services |
| WGL | Washington Gas Light |
| WVPSC | West Virginia Public Service Commission |