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The Stranded Costs Working Group
Virginia Corporation Commission
Tyler Building, 1300 E. Main St.
Richmond, Virginia 23219

Washington Gas Energy Services (WGES) appreciates the opportunity to respond to the two stranded costs methods as presented to the Stranded Costs Working Group. Although this task was not fully addressed during pre-restructuring it is not too late to tackle it now. We thank the Commission for facilitating this process.

Model 1

The proposal as proffered by Dominion Virginia Power (revised version) is summarized as follows:

> The methodology for calculating "just and reasonable net stranded costs" requires a utility to determine (1) whether there is over- or under-recovery of stranded costs collected through the wires charges from switching customers, and (2) the amounts it has expended from funds available under capped rates to mitigate potential stranded costs, less any additional expenditures that negatively impact such costs.
>
> Under (1), a company can compare the revenue actually collected annually from customers via the wires charges based on projected market prices to the revenue that would have resulted had wires charges been based on the actual market prices experienced during that year. If the revenue collected through the wires charges was greater than the revenue that would have resulted had the actual market price been correctly predicted, the wires charges were set too high, resulting in an over-recovery for that year. If the contrary is the case then there is under-recovery.
>
> In any event, whether the above two measures produce an over- or under-recovery of a utility's total stranded costs cannot be finally determined until after July 1, 2007.

Model 1 Deficiencies

1. Failure to Compute Stranded Costs

WGES sees little merit to Proposal 1 because it would fail to meet the fundamental task of computing and quantifying stranded costs in the first instance.

2. Omission of Stranded Costs from Capped Rates

The model is also unworkable because it seeks to deal with stranded costs only through wires charges that are payable by customers who select competitive electricity suppliers. It would omit the recognition of stranded costs recovered or to be recovered through capped rates. By inference, the absence of customer switching would preclude the need to determine over/under collection of stranded costs. This is a fatal flaw.

The Restructuring Act contemplates recovery of stranded costs from both capped rates and wires charges, and the determination of over/under-recovery of stranded costs should come from both. The Act in Section 56-584 stipulates that "...each incumbent electric utility shall only recover its just and reasonable net stranded costs through either capped rates as provided in section 56-582 or wires charges as provided in Section 56-583...." (emphasis supplied).

Therefore, stranded costs are embedded and are recovered in capped rates, where there is no switching. Stranded costs are only unbundled for customers that choose competitive suppliers, a hallmark of a nonbypassable surcharge. Customers who purchase a premium product such as renewable energy from a competitive supplier have not switched. They still pay stranded costs through capped rates and not wires charges.

3. False Premise of Revenue-based Stranded Costs

The premise that stranded costs are only to be based on revenues collected from wires charges is false. Such revenues are transition charges that flow from a pre-determined amount of stranded costs for each incumbent utility at the start of restructuring in 2000 to July 1, 2007. In this case, we are dealing with the determination of stranded costs post- restructuring implementation. Stranded costs represent unmitigated lost value of generation related assets brought about by electricity restructuring. The process is based on asset valuation, analysis or other determinant basis. Therefore, stranded costs are a cost-based not revenue-based determination. Besides, it would be impractical to determine the real over/under recovery of stranded costs without first establishing the underlying total amount of stranded costs. Proposal 1 fails to satisfy this precept.

4. Potential Stranded Costs Deficiency

The model is further deficient because it purports to deal with expenditures to mitigate potential stranded costs and not actual stranded costs. The Restructuring Act does not contemplate the recovery of strandable costs. Instead, it speaks of the recovery of just and reasonable net stranded costs. The former is prospective and speculative in nature and the latter is inclusive of mitigation of known stranded costs identified ahead of time.

5. Failure to Meet Monitoring Obligation under the Restructuring Act

The model as proposed would not permit stakeholders or the Legislative Transition Task Force to discharge their obligation under the Restructuring Act Section 56-595 that reads as follows:

> (C) (iii) (A)fter the commencement of customer choice, monitor, with the assistance of the Commission, the Office of the Attorney General, incumbent electric utilities, suppliers, and customers, whether the recovery of stranded costs, as provided in Section 56-584, has resulted or is likely to result in the overrecovery or underrecovery of just and reasonable net stranded costs.

Proposal 2 as Summarized by Staff

The main framework is:

To calculate just and reasonable net stranded costs compare asset values based on net present value cash flows that arise from remaining in a regulated market (cost plus a fair return) to the net present value cash flows that arise in a competitive market (over the life of the assets). From this amount subtract recoveries via capped rates (to the extent capped rates exceed actual costs including a fair return) and wires charges to determine the over- or under-recovery of just and reasonable net stranded costs.

1. Model 2 would Compute Stranded Costs as Intended

The fundamental basis of Model 2 is the calculation of stranded costs based on generation related asset valuation and the recovery of transition charges through capped rates or wires charges. It is a balanced approach that seeks to establish stranded costs first, set a recovery schedule and determine the over- or under-recovery of just and reasonable net stranded costs, at least annually, until the expiration of the transition period on July 1, 2007. The final recoverable amount for stranded costs should be known by June 30, 2007. And by July 1, 2007 and thereafter, there would be no opportunity to collect stranded costs through capped rates or wires charges by an incumbent utility company.

2. Opportunity to Terminate Capped Rates after January 1, 2004

The Act in Section 56-582 allows for a utility to end capped rates by petition or Commission action. The relevant portion reads as follows:

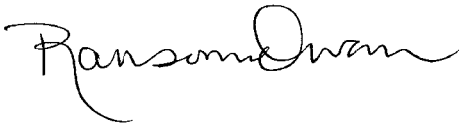
> (C) A utility may petition the Commission to terminate the capped rates to all customers any time after January 1, 2004, and such capped rates may be terminated upon the Commission finding of an effectively competitive market for generation services within the service territory of that utility....

Since the model would permit the calculation of total stranded costs for each incumbent utility and set a revenue recovery schedule, it would be easy to know the pace of recovery and the expiration of such costs. Therefore, it is quite conceivable to recover stranded costs on an accelerated basis through either capped rates with no switching or through wires charges under robust competition.

Under the two scenarios capped rates and wires charges could cease after January 1, 2004. The proposed Model 2 at least would allow for such a determination to be affirmatively made.

We recognize the issues of potential model complexity, data intensiveness and model assumptions. However, these are not demerits of model 2 but rather the inherent nature of establishing total stranded costs. Stranded costs calculations have been accomplished in other jurisdictions that have restructured including New York, Massachusetts, Pennsylvania and Rhode Island, to mention a few. It is not too late for each utility in Virginia to provide a stranded cost recovery plan. Such a plan should identify mitigation strategies, net out stranded costs collected from 2000 to December 2003, establish an annual recovery schedule from January 2004 to July 1, 2007 (with year-end adjustments) and identify potential early termination of capped rates. Model 2 would make that possible.

Respectfully submitted,



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