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July 16, 2002

Mr. Howard M. Spinner
Virginia State Corporation Commission
Division of Energy Regulation
Tyler Building
1300 E. Main Street
Richmond, VA 23219
Via email: hspinner@scc.state.va.us

Dear Mr. Spinner:

The National Energy Marketers Association (NEM) hereby responds to your June 10, 2002, letter requesting comments to, "assist the Commission in developing a comprehensive review of methods that may be considered to calculate projected market prices and resulting wires charges." NEM submits that the wires charges as currently calculated and implemented are a significant barrier to entry in the Virginia market.

The National Energy Marketers Association (NEM) is a national, non-profit trade association representing wholesale and retail marketers of energy, telecom and financial-related products, services, information and related technologies throughout the United States, Canada and the U.K. NEM's Membership includes wholesale and retail suppliers of electricity and natural gas, independent power producers, suppliers of distributed generation, energy brokers, power traders, and electronic trading exchanges, advanced metering and load management firms, billing and information technology providers, credit, risk management and financial services firms, software developers, clean coal technology firms as well as energy-related telecom, broadband and internet companies.

This regionally diverse, broad-based coalition of energy, financial services and technology firms has come together under NEM's auspices to forge consensus and to help resolve as many issues as possible that would delay competition. NEM members urge lawmakers and regulators to implement:

- Laws and regulations that open markets for natural gas, electricity and related products, services, information and technology in a competitively neutral fashion;
- Rates, tariffs, taxes and operating procedures that unbundle competitive services from monopoly services and encourage true competition on the basis of price, quality of service and provision of value-added services;
- Competitively neutral standards of conduct that protect all market participants;
- Accounting and disclosure standards to promote the proper valuation of energy assets, equity securities and forward energy contracts, including derivatives; and
- Policies that encourage investments in new technologies, including the integration of energy, telecommunications and Internet services to lower the cost of energy and related services.

I. Wires Charges Should Not Be Assessed Absent a Determination of Net Stranded Costs

NEM submits that the language in Section 56-584 of the Restructuring Act should be the initial starting place in examining the wires charges. This Section of the Act provides that,

Just and reasonable net stranded costs, to the extent that they exceed zero value in total for the incumbent electric utility, shall be recoverable by each incumbent electric utility provided each incumbent electric utility shall only recover its just and reasonable net stranded costs through either capped rates as provided in § 56-582 or wires charges as provided in § 56-583.

NEM submits that this section raises a number of issues that are not resolved by the current wires charge methodology. As a general matter, there has not yet been a proceeding in which a determination was made as to whether any of the electric utilities, in fact, has "net stranded costs." Utilization of the term "net stranded costs," requires a determination of whether or not the utilities have any stranded costs and whether those costs are offset by any stranded benefits. It also implies a utility obligation to productively manage and mitigate net stranded costs. Until and unless a determination of whether the electric utilities in fact, have net stranded costs, and that the electric utilities have properly managed and mitigated any such costs, it is wholly inappropriate to assess wires charges against any customers. It is also necessary to definitively establish the

amount of net stranded costs so that a date certain is established by which net stranded costs are deemed fully recovered and the need for wires charges is eliminated. Competitive market participants and the consumers they wish to serve must be given a clear indication of the term of stranded cost recovery so they can form adequate and rational business plans with respect to the Virginia market. NEM urges that imposition of wires charges be suspended until a determination is made that the electric utilities do in fact have net stranded costs.

Section 56-595(C) of the Restructuring Act charges the Legislative Transition Task Force with the responsibility to, "monitor, with the assistance of the Commission, the Office of the Attorney General, incumbent electric utilities, suppliers, and retail customers, whether the recovery of stranded costs, as provided in § 56-584, has resulted or is likely to result in the overrecovery or underrecovery of just and reasonable net stranded costs." NEM submits that a Commission inquiry into whether the utilities, in fact, have net stranded costs is an integral element in its ability to provide assistance to the Task Force on this matter. NEM recognizes that the Commission has adopted Rule 20 VAC 5-202-40(B)(6) providing that,

If the Legislative Transition Task Force adopts a resolution requesting the commission's assistance with monitoring the recovery of net stranded costs pursuant to § 56-595 C of the Act, then the following information shall be provided to the commission: (1) fair market value of each generation and transmission asset functionally unbundled, transferred or sold to a third party or affiliate and (ii) a list of all long-term power contracts functionally unbundled, transferred or sold to a third party or affiliate. Information furnished shall include the length and anticipated expiration date of each contract, annual cash payments for power, and the market value of each power contract for each year of its remaining life.

NEM submits that there is no language in Section 56-595 that requires the Commission to wait to request the information described in the rules pending the adoption of a Task Force resolution on the subject.

Furthermore, notwithstanding Rule 20 VAC 5-202-40(B)(6), the 2002 Report of the Legislative Transition Task Force addressed the provision of information about the fair market value of generation assets and long-term power contracts and reports that, "[t]he Task Force revisited the issue at its December 21, 2001, meeting, and unanimously

agreed to inform the Commission that it would want the information for use in monitoring utilities' recovery of stranded costs."¹ Accordingly, it is clearly appropriate for the Commission to request such information pursuant to an inquiry into net stranded costs and resultant wires charges.

Additionally, while recognizing that stranded cost recovery is a valid concern for the utilities, NEM urges that a competitively neutral means of collecting net stranded costs should be instituted. NEM recommends that any costs that are unavoidable because utilities must incur such costs to perform Provider of Last Related (POLR)-related services should be recovered through adjustments to the rates charged for POLR-related services. Any costs or lost revenues not connected with the utilities' provision of POLR-related services and/or fully bundled sales service should be added to distribution rates in a competitively neutral fashion.

II. Projected Market Prices Must Account for the Full Energy Supply and Commercial Costs of Serving Retail Load

If the Commission makes a determination that the electric utilities do in fact have net stranded costs and if the Commission finds it is appropriate to continue to assess a wires charge despite the disjunctive provision in Section 56-584 to the contrary, the next step for consideration is reformulation of the wires charge methodology. NEM submits that the wires charge as currently instituted is a major barrier to competitive entry and should be reexamined consistent with the Commission's authority, vested in Section 56-596, to, "take into consideration, among other things, the goals of advancement of competition and economic development in the Commonwealth."

By the terms of Section 56-583, the wires charge is to be calculated as the, "excess, if any, of the incumbent electric utility's capped unbundled rates for generation over the projected market prices for generation." NEM submits that the market price for generation must be priced at retail rates for each customer class. If the market price for generation is subsidized or set artificially low, i.e., if it does not reflect the true costs of providing retail generation service, true competition on the basis of price and quality of service will not be possible. Competitive suppliers will be challenged to cover their costs

¹ 2002 Report of the Legislative Transition Task Force at page 26.

and offer products that provide value to customers. If the incumbent utility is permitted to subsidize retail energy services by passing through wholesale price signals and embedding the retail costs of energy-related services in its distribution rate, a competitive marketplace cannot occur. (See attached article). Under these circumstances fewer customers will choose competitive energy service providers, the utility's market share will be maintained, consumers will not benefit to the degree they should, and competitive markets simply won't develop. The market price for electric generation should include the fully allocated embedded costs associated with providing energy supply including the commercial costs of serving retail load including transmission charges, scheduling and control area services, and distribution system line losses, a share of pool operating expenses, risk management premiums, load shape costs, commodity acquisition and portfolio management, working capital, taxes, administrative and general expenses, the costs of metering, billing, collections, bad debt, information exchange, compliance with consumer protection regulations, and customer care.

When the Commission previously examined the subject of including retail costs in projected market prices in Case PUE010306, it noted the argument that, "such cost adjustments are needed in order to make a fair and equitable comparison of the market price and the utility's price to compare, and that the adjustments would promote competition," and that the Commission, "do[es] not disagree that allowing for 'headroom' by incorporating retail costs in market prices would fairly recognize the costs CSPs will incur to service customers, and would likely promote competition." However, the Commission rejected the method based on its view that, "it would not be revenue neutral to the incumbent utility," and that the Restructuring Act, "is designed to make the incumbent utility whole." NEM notes that there is no requirement for revenue neutrality explicitly set forth in the Restructuring Act. NEM maintains that a determination of how and how much "revenue neutrality" is required cannot or should not be made until and unless there is a reasonable level of migration to competitively provided products, services, information and technology. Only after a reasonable level of migration has in fact occurred can the Commission determine with any degree of accuracy the amount and proper allocation of additional revenues that will be needed to compute a competitively neutral means to provide a utility with "revenue neutrality."

For example, the New York Public Service Commission, in implementing a market-based retail access credit (RAC) in the NYSEG service territory found that,

A market-based RAC should be revenue neutral for NYSEG. If a customer selects retail access under the market RAC, NYSEG avoids the cost of purchasing power to service that customer. Moreover, NYSEG may actually realize savings from a market RAC. If it purchases electricity for less than the market price, and a customer selects a retail access alternative, then NYSEG may resell the electricity it has purchased at the potentially higher market price. (Cases 96-E-0891 and 01-E-0217, Order on Tariff Compliance Filings, Canceling Ordinary Tariff Filing, and Rejecting Other Requests for Relief, issued April 26, 2001, at page 16.)

This rationale is equally applicable to this Commission's computation of the projected market prices, resultant wires charges and the amount, if any, of revenue neutrality that is required. As the New York Public Service Commission further explained in the NYSEG proceeding,

When a customer begins taking generation services from an ESCO, that ESCO must incur the costs of purchasing the generation supply it will furnish to the customer. The ESCO must also incur customer care costs, such as responding to customer inquiries. If the 2 and 4 mill retail access credits are not subtracted from NYSEG's bundled rate, it will continue to recover those costs from the departing customer. But that customer also pays the ESCO for those services. As a result, without the credits, the customer selecting retail access is paying twice for the same services. Concomitantly, the utility is double-recovering -- it saves the cost of providing the services to the customer, but continues to bill the customer for them. (Cases 96-E-0891, 01-E-0001, and 01-E-0217, Order Denying Rehearing on Market-Based Retail Access Credit Issues, issued August 30, 2001, at page 18).


More recently the New York Public Service Commission explained, "it seems clear that customers who migrate to ESCOs must be able to avoid the utility's retail service costs. No market can develop if the ESCO customer must continue to pay the utility for retail service the utility no longer provides." (Case 00-M-0504, Order on Rehearing and Clarification Petitions, issued May 30, 2002, page 5). When consumers migrate to competitive providers, utilities are able to avoid retail energy supply and commercial costs of serving these customers. If projected market prices and concomitant determinations of revenues needed to maintain a utility's "revenue neutrality" do not include the fully allocated embedded costs of providing retail energy supply including the

commercial costs of serving retail load then the market price will be artificially low, the wires charge will be artificially high, and a determination of revenue neutrality will be overstated thereby increasing costs to switching customers further hampering competition. As a result, consumers will be deprived of receiving the true price benefits of selecting a competitive provider.

III. Conclusion

NEM urges the Commission to institute an inquiry into the amount of the utilities' net stranded costs. NEM also urges the Commission reexamine its assessment of projected market prices and resulting wires charges consistent with the recommendations set forth herein.

Sincerely,

A handwritten signature in blue ink, appearing to read "Craig Goodman".

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