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Mr. William F. Stephens
Virginia State Corporation Commission
Division of Energy Regulation
Tyler Building
1300 E. Main Street
Richmond, VA 23219
Via email: sestes@scc.state.va.us

Dear Mr. Stephens:

The National Energy Marketers Association (NEM) hereby responds to your June 10, 2002, letter requesting comments on the competitive provision of default service in Virginia.

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.

NEM appreciates this opportunity to respond to the questions framed in your letter.

1. What is your current thinking relative to having default service provided by a non-incumbent?

NEM supports the competitive provision of default service. NEM has developed, "*National Guidelines for Designing and Pricing Default Energy and Related Services*" (a copy of which is attached hereto and incorporated by reference). As discussed in NEM's Guidelines, state economic regulation of the true distribution monopoly function reduces costs to society by eliminating duplication and by regulating monopoly profits. Accordingly, limiting regulation to the natural monopoly function, while permitting robust competition for all other functions, products, services, information and technology, should maximize benefits of innovation, reduce prices and provide higher quality service, while minimizing the economic distortions inherent in monopoly economics. The public interest is not served by charging monopoly prices for competitive services. Additionally, as regulated utilities fully unbundle energy supply and service functions, the provider-of-last-resort function can be provided by qualified suppliers and the obligation to serve can be modified into an obligation to connect and deliver.

It is not necessary for the utility to act as the default service provider because marketers have the ability and experience to supply these services to customers. Marketers have long been involved in developing and aggregating generation, and providing utilities with energy as a commodity. Indeed, in many cases marketers have supplied utilities with energy and related services on an outsourced basis for years, enabling those utilities to provide energy supply services. Neither is it necessary to establish the utilities as default service providers in order to allow those utilities the opportunity to compete for customers, or customers the opportunity to choose a familiar entity as their energy service provider. In a competitive environment utilities can form competitive subsidiaries and customers can affirmatively choose those subsidiaries as their suppliers. However, in a market that has opened to competition, an assumption that customers who have not selected a competitive supplier have made an affirmative decision to receive service from the utility is unwarranted. Retaining the utility as the default provider of energy supply services long-term in a restructured environment will have a negative impact on the development of competitive markets.

2. What is your current interest in providing default service to retail customers in Virginia?

Various NEM members intend to serve customers in the Virginia market, including residential, commercial, and industrial customer segments in all of the utilities' service territories.

3. What do you view as technical, regulatory or legal impediments to the competitive provision of default service?

A. Competitive Provision of Default Service

As an initial matter, NEM submits that the tantamount consideration, as set forth in Section 56-585(A) of the Code, is to, "determine the components of default service," and "establish one or more programs making such services available to retail customers." (emphasis added). The Commission's proper structuring and pricing of retail default service will be key to establishing a competitive electric market in Virginia.

i. Components of Default Service Price

In those markets where default service pricing reflects the true costs of providing retail services rather than hiding these costs in distribution rates, markets will develop quickly, while markets that have subsidized or artificially low default service prices relative to retail costs will develop much more slowly.

All suppliers providing generation service to customers at retail, including default service and competitive suppliers, incur costs to do so in addition to the wholesale cost of the energy commodity. These costs include: 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. Default service pricing mechanisms that hide the true costs of providing retail energy services, showing instead the wholesale power costs alone as the "price to compare," do not benefit default service customers, who are getting a false price signal and are still paying the other costs to provide generation service in the distribution component of the bill. They do, however, penalize customers who switch to competitive suppliers since those customers are paying for the retail costs of energy supply services twice. They also have a devastating effect on the competitive market, since competitive suppliers are unable to compete effectively on the basis of price with the subsidized default service option. Furthermore, default service pricing mechanisms must allow prices to change over time in response to wholesale market conditions to better reflect real competitive markets, provide more accurate price signals, and help level the competitive retail playing field.

ii. Structure of Default Service

NEM submits that Section 56-585(B)(2) of the Code properly permits competitive bidding for different suppliers of, "one or more components of such services, in one or more regions of the Commonwealth, to one or more classes of customers." The costs to provide default service vary by customer group. As permitted and recognized by the Code, properly designed default service prices should reflect these real price differences to encourage competition for all customer classes.

iii. Retail Default Service

NEM strongly urges this Commission not to interpret competitive provision of default service to mean competitive wholesale provision of supply to utilities for their retail customers. Section 56-585(A) defines "default service" as, "service made available under this section to retail customers." The specific inclusion of the words "to retail customers" in the Code means that competitive suppliers are to provide default service directly to retail customers, not on a wholesale basis to the utility as an intermediary.

If this Commission determines that "competitive bidding processes" under Section 56-585(B)(2) encompasses competitive selection for wholesale contracts to meet the needs of retail customers, NEM submits that such a system will not contribute to the ultimate development of a competitive retail market because customers will be unaware of the competitive suppliers serving their supply needs. The competitive suppliers will have no direct conduit with customers and will not be able to establish themselves in customers' perception of reliable, low cost suppliers. Customers will not be receiving default service on a truly competitive basis because the utility will still be acting as an intermediary point of contact for supply. In the long term, competitive suppliers must be able to render default service at the retail level. If the Commission determines that a wholesale bidding option should be selected on an interim basis, any resulting default service retail price should include not only the fully embedded energy supply and commercial costs of serving retail load but also any bid costs associated with procurement of supply.

B. Utility Provision of Default Service

If the Commission decides to designate a utility as a provider of default service, a significant obstacle for the market is the requirement set forth in Section 56-585(C)(1) that, "the rates for default service provided by a distributor shall equal the capped rates established pursuant to subdivision A 2 of § 56-582," until the expiration or termination of capped rates. As has already been evidenced, the capped rates instituted for the utilities have stifled competition in the state. Similarly, establishment of default service rates based on capped rates will not foster the development of the competitive market.

Furthermore, Section 56-585(C)(1) provides that, "[a]fter the expiration or termination of such capped rates, the rates for default services shall be based upon competitive market prices for electric generation services." NEM submits that if the default service price is only based on the price for electric generation service, it will be an artificially low, subsidized price. The utility default service price must include the fully allocated embedded costs of energy supply including the commercial costs of serving retail load as discussed in Section 3(A)(i) above.

4. 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.

NEM supports the use of a competitive bidding process to solicit the provision of default service. No one market participant should be granted an unfair competitive advantage in the provision of default service to customers. State-mandated selection or non-competitive transfers of customers at subsidized energy prices should be avoided. The opportunity to serve default service customers through a competitive process provides a public service in a manner that does not impose barriers to meaningful competition or distort the operation of competitive price signals.

5. What specific actions can/should the Commission or the legislature take to enhance the competitive provision of default service?

In order to enhance the competitive provision of default service, the Commission and legislature must ensure that default service is properly priced and structured in conformance with NEM's comments set forth above.

NEM appreciates this opportunity to comment on the implementation of competitively rendered default service in Virginia and reiterates our commitment to working with the Commission and the other stakeholders to devise fair and effective ways to implement competitive restructuring in the state.

Sincerely,



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