



CONSUMER ADVOCATE DIVISION
STATE OF WEST VIRGINIA
PUBLIC SERVICE COMMISSION

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May 13, 1997

The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U.S. House of Representatives
Washington, D.C. 20515

RE: Response to Your Letter of April 10, 1997, Concerning Electric Restructuring

Dear Congressman Dingell:

In response to your letter of April 10, 1997, concerning a number of issues related to electric restructuring and deregulation, attached please find the questions posed in that letter and the responses of the Consumer Advocate Division based on information from West Virginia. Our office has previously provided related information to Commerce Committee Chairman Bliley. A copy of our responses to the Chairman is included as Attachment A hereto. As a preface to our responses, I would like to provide you with the same general overview of the electric utility industry in West Virginia which I gave to Chairman Bliley.

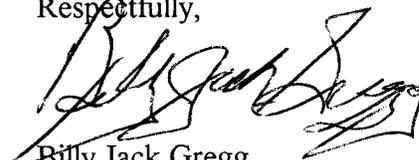
There are presently 14,000 megawatts (MW) of generation capacity operating in West Virginia, annually generating approximately 80 billion kilowatt-hours of electricity and \$160 million in state business and occupation tax revenue. West Virginia is the leading electricity exporting state in the nation, shipping approximately 70% of annual electricity production out of state. Two of the largest electric holding companies in the nation, American Electric Power (AEP) and Allegheny

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Power, serve over 90% of the electric customers in West Virginia. Not only do West Virginians enjoy some of the lowest electric rates in the nation, there is very little disparity in electric rates among companies operating in West Virginia. Residential rates range from 5.5¢ to 7¢ per kilowatt-hour, while industrial customers enjoy rates from 3¢ to 5¢ per kilowatt-hour. Finally, West Virginia electric utilities are not burdened with stranded costs. All of the utilities in West Virginia have negative stranded costs, that is, the generation assets are worth more on the open market than on the utilities' books. On a net basis, the state as a whole has negative stranded costs of approximately \$1 billion.

As can be seen, West Virginia has done very well under the existing system of utility regulation. The overriding concern of the Consumer Advocate Division in the current debate on electric restructuring and deregulation is that West Virginia not lose the benefits it currently enjoys. I appreciate the opportunity to provide this information to the Committee, and would be happy to answer any additional questions you might have.

Respectfully,



Billy Jack Gregg
Director

**Response of the Consumer Advocate Division
of the Public Service Commission of West Virginia
to Questions Posed in the April 10, 1997 Letter
from U.S. Representative John D. Dingell**

1. How has the increased competition in wholesale electric markets affected consumers in your State to date?

Response: Since West Virginia has historically been the largest exporter of electric energy, the increased access to wholesale markets has not appreciably impacted the level of sales made outside the State. One local distribution utility, West Virginia Power, has used the advent of transmission access to look for wholesale suppliers of electricity other than its former full requirements supplier, American Electric Power.

2. What role has your office played in any state proceedings on retail competition?

Response: The West Virginia Public Service Commission initiated a general investigation proceeding concerning electric restructuring on December 12, 1996. The West Virginia Consumer Advocate Division (WVCAD) submitted comments and testimony in that proceeding (See Attachments B and C). The Order of the Public Service Commission of May 9, 1997, creating a Task Force to study this issue is appended as Attachment D.

What position has your office taken on the issue of whether or not retail competition would benefit consumers?

Response: As stated in its comments to the Public Service Commission, the WVCAD does not believe that retail competition will benefit consumers in West Virginia. Because West Virginia is already a low cost state, the advent of retail competition may actually harm consumers in West Virginia if the regional market price of electricity is higher than the current regulated price. Moreover, the advent of retail competition and mandatory federal legislation may eliminate an economic development advantage currently possessed by the State, namely, low electric rates.

What position has your office taken on the issue of whether or not federal legislation mandating adoption of retail competition by a date certain, or any other type of federal legislation, is needed?

Response: The WVCAD, like the National Association of Regulatory Utility Commissioners (NARUC) and the National Association of State Utility Consumer Advocates (NASUCA) supports federal legislation that is permissive, i.e., allows states to adopt retail wheeling if they so desire and provides incentives to do so, but opposes federal legislation which would mandate a particular course of action by a particular date. Each state has been largely responsible for the situation in which it currently finds itself in regards to prices for electricity, and each state should be primarily responsible for fashioning a solution appropriate for that state. The WVCAD would not oppose federal legislation which provided incentives for adoption of retail wheeling, but which did not mandate retail wheeling. Arguments that federal mandates are necessary to prevent any state being disadvantaged, and to prevent dislocations in the market, are belied by the fact that states with retail wheeling are currently operating next to states which are totally regulated or are

in the midst of a transition to competition. Once again, the laboratory afforded by our federal system should allow decisions to be made on the basis of experience rather than conjecture.

Do you believe there are substantial differences among the various states' consumer advocates, and why or why not?

Response: There are substantial differences among the various consumer advocates on the issue of retail competition. The differences are primarily dependent upon whether or not a particular state currently has a relatively high or low cost of electricity. Those states with high costs generally favor ending the existing system of regulation and adoption of retail competition. The biggest concern of consumer advocates in high cost states centers around recovery by utilities of stranded costs. States with low electricity costs have obviously benefited under the existing system and oppose retail competition or favor a "go-slow" approach. The biggest concern of consumer advocates in low-cost states centers around retention of the benefits of the existing system and recovery of negative stranded costs for ratepayers in the event that retail competition becomes a reality.

3. Some proponents of federal legislation mandating that states adopt retail competition by a date certain argue that substantial numbers of large industrial customers recently have negotiated favorable rates with their public utility commissions. Such proponents have further argued that residential and small commercial consumers lack bargaining power to achieve similar rate reductions. Finally, these proponents argue that federal legislation is essential to ensure that smaller consumers are not economically disadvantaged relative to large industrial customers.

a. Please indicate whether or not you agree with the three premises outlined above.

Response: The CAD does not agree with the three premises in the question. Industrial customers will inevitably achieve more beneficial rates than residential and small commercial customers regardless of the degree of regulation, due to the significant market power of large industrial customers.

b. In particular, please indicate whether you have reason to believe that large industrial customers are being favored in rate negotiations before public utility commissions relative to smaller commercial and residential customers. What type of state statutory direction generally governs such rate determinations? Historically, how have states balanced the interests of different customer classes? Is this changing?

Response: West Virginia Code §24-1-1(a)(4) requires the Commission to establish rates based "...primarily on the cost of providing these services." The Commission has wide latitude, not only in determining the cost of service for each customer class, but also in applying criteria other than cost in making rate determinations. Certain large customers, whose economic viability was of significant concern to the State, have received rate discounts.

c. What position has your office taken in recent rate proceedings concerning

large industrial customers' requests for rate reductions?

Response: The WVCAD's position on rate reductions or increases in any particular proceeding depends upon the evidence presented in the proceeding. The WVCAD has both supported and opposed rate reduction requests by large industrial customers, depending on the circumstances.

d. In general, have consumer electricity prices in your State been rising, holding steady, or falling, and why?

Response: Electricity prices in West Virginia have held steady in absolute terms over the last decade, and have fallen in real (inflation adjusted) terms. Customers of the major electric utilities serving the northern portion of the State experienced an absolute increase of 8% to 14% in electric rates during the period 1992-1996 because of (1) the cost of compliance with the federal Clean Air Act Amendments of 1990, and (2) the cost of purchases of capacity from independent power producers pursuant to the Public Utility Regulatory Policy Act of 1978 (PURPA). Charts showing the change in electric rates over the last ten years in West Virginia are appended as Attachment E.

4. What are the most difficult issues to resolve in connection with utilities' stranded costs? To the extent your State has adopted, or is considering adopting retail competition, has there been an attempt to distinguish between costs which were prudently incurred and those which were not? If Congress were to enact legislation mandating that states adopt retail competition by a date certain, what, if any, provisions relating to stranded costs should be included? Is securitization a useful tool, and how would it affect different interests?

Response: The recent Resource Data International study¹ of stranded costs has confirmed that West Virginia as a whole has negative stranded costs. The WVCAD has taken the position that in the event of retail competition, it will attempt to capture these negative stranded costs for the benefit of ratepayers. One of the most difficult issues related to stranded costs concerns the availability of information from utilities regarding items that serve to mitigate the amount of stranded costs. It is not in the utilities' interests to come forward with information regarding tax-timing differences which have benefited utilities in the past, assets that may be below market value, or other "stranded benefits" that serve to offset the levels of stranded costs claimed by utilities.

If Congress were to enact retail competition legislation, the treatment of stranded costs should be left to the states. Those states that wish to force 100% recovery of stranded costs from ratepayers should be allowed to do so, and should not be allowed to hide behind a federal mandate. Similarly, those states that wish to deny recovery of some or all stranded costs should not be preempted. The WVCAD has taken the position that stranded costs, or negative stranded costs, should be shared between ratepayers and shareholders.

¹Power Markets in the U.S., Resource Data International (1996)

5. Some proponents of retail competition hold the view that all electricity resources should be sold at market prices and that state authority to regulate retail rates should be eliminated. Could such a policy result in rate increases for customers that currently receive the benefit of such low-cost resources? In a restructured electric utility industry, who should receive the benefits of these low-cost resources -- utility ratepayers, utility shareholders, or simply the highest bidder?

Response: Customers who are currently served from relatively low-cost generating resources will definitely experience rate increases if all generating resources are sold at market prices. The WVCAD believes that the states should be free to distribute the windfall gains from the sale of low-cost generating resources to the native ratepayers who have heretofore supported the investment in those generating resources.

6. Recently there has been increased discussion of the need for Congress to enact “reciprocity” requirements barring retail sales of power by parties located in states which have not adopted retail competition to parties in states which have adopted retail competition?

a. Do you have a position on this issue?

Response: For very practical reasons, there is no need to adopt “reciprocity” legislation. First, many multistate utilities jointly own generating facilities in several different states. Passage of a reciprocity requirement may have the unintended consequence of prohibiting a utility serving one state with retail wheeling from importing power from its own plants in a neighboring state without retail wheeling. Secondly, such a dual market is currently operating without adverse consequences. Already in West Virginia generating plants are jointly owned by regulated and deregulated utilities, and are operated and dispatched to the advantage of customers of both entities, regardless of in which state the ultimate customers reside.

b. Which interests would benefit from a federal reciprocity requirement, which would not, and why?

Response: As stated above, it seems highly impractical for Congress to forbid a state without retail competition to sell into a state with retail competition. It would appear that the ultimate losers could be the customers in the state allowing retail competition by artificially limiting a source of electricity.

7. Does your State currently have adequate tools to protect the interests of low-income electricity consumers if Congress were to mandate retail competition by a date certain? If such legislation were enacted, do you have any recommendations as to how Congress should approach this important issue?

Response: The ability of low cost states such as West Virginia to maintain reasonable rates for low income customers will be hampered by the inevitable increases in electricity prices from the deregulation of electric generation. Continued funding of low income energy assistance programs is crucial to protect low income customers. Although West Virginia currently has in

place a 20% discount program for certain categories of welfare recipients, if Congress mandates retail competition in electricity, Congress must also establish a “universal service fund” similar to that included in the recent Telecommunications Act of 1996 in order to ensure affordable electricity rates in all parts of the country, and to all classes of consumers.

8. Do you have any concerns about reliability of service or the ability of the interstate transmission or local distribution systems to handle the transactions that would occur if retail competition became more prevalent?

Response: Electric service will become less reliable in the future as the generous capacity reserve margins for regulated utilities are eventually eroded. It is doubtful that a market-based system of electricity generation will result in the high levels of excess capacity (20% to 25% reserve margins) that have historically been used by regulated utilities. This will generally result in more cost-efficient operation, but at the same time will provide less margin for accidents and transient contingencies on the electric grid.

9. Are rural and urban consumers in different positions with respect to their relative ability to bargain for competitive electricity prices? Are all consumers similarly situated in terms of aggregation?

Response: The ability to aggregate rural customers depends upon the configuration of the transmission and distribution networks after unbundling. Rural customers may be isolated from other areas if the transmission lines used to serve their distribution areas are transferred to an Independent System Operator (ISO) and are no longer owned and operated by the distribution utility. A similar functionalization of the natural gas industry limited the ability of West Virginia to protect rural customers.

10. Some proponents of retail competition have argued in favor of federal legislation requiring states to adopt retail competition regimes which include mandatory unbundling of those services currently provided by local distribution companies. What advantages and disadvantages might this pose for consumers? Do you have any recommendations?

Response: As discussed above, the WVCAD does not believe that it is appropriate for Congress to mandate unbundling of services by local distribution companies. This issues should be decided by the states.

11. There is a wide divergence of opinion as to whether or not the Public Utility Holding Company Act of 1935 (PUHCA) should be modified or repealed. In view of the recent merger trend, PUHCA’s protections have significance for all states, whether or not they traditionally have been served by a registered holding company.

a. Do you believe PUHCA is a significant impediment to competition, at wholesale or retail level, or can “effective competition” be achieved regardless of whether Congress enacts changes to PUHCA?

Response: The WVCAD believes that PUHCA is largely irrelevant as a consumer protection device. PUHCA was passed as a title of the Federal Power Act of 1935. The intent of the law

was to protect both shareholders in utility holding companies (PUHCA) and customers of these utilities (Federal Power Act). All of the shareholder protection provisions of PUHCA have now been superseded by subsequent disclosure requirements and shareholder protection laws and regulations. Customer protections have been inherited by the Federal Power Authority (now Federal Energy Regulatory Agency). The continued existence of PUHCA only creates a jurisdictional tangle that is more often used by utilities as a refuge from effective regulation in the public interest, as shown in the Ohio Power case. The delays inherent in PUHCA requirements do create a competitive disadvantage for those few holding companies that fall within its strictures.

b. Do you believe Congress should modify or repeal PUHCA, why, and under what, if any, conditions?

Response: Repeal of PUHCA should only be allowed as part of comprehensive legislation to clarify that states may allow retail competition (see Question 2 above), or standing alone to reverse the Ohio Power decision (see Question 10.c. below).

c. Should Congress enact legislation to modify the holding in Ohio Power v. FERC, 954 F.2d 779 (D.C. Cir. 1992)?

Response: Yes. Regardless of whether retail competition legislation is passed, Congress should allow the FERC to determine whether or not affiliated contracts work to the detriment of utility ratepayers. The Court's holding in Ohio Power v. FERC forced the West Virginia ratepayers of Wheeling Power (an affiliated wholesale customer of Ohio Power) to pay \$24.7 million in excess rates.