

Electricity Deregulation in Virginia

Irene E. Leech

Over the past 30 years state and federal governments have backed off from strict regulation of a number of sectors that influence our daily lives. In the 1970s and 1980s, telephone service was deregulated and new companies were allowed to compete with Ma Bell. With a lot of attention and often contentious dialogue, the airline industry was deregulated in the 1980s. Recently, the wave of deregulation has moved into electricity, and the process is both intriguing and contentious. Although most people refer to it as deregulation, technically, what is happening is restructuring because only the generation portion of the industry will be deregulated. Transmission and delivery of electricity will continue to be regulated.

Why Restructure?

Historically, the Virginia State Corporation Commission (SCC) has watched over companies producing electricity in Virginia. The companies providing local power had to get approval from SCC before changing the rates they charged consumers. The rate increases had to be based on new investments or cost increases companies could not avoid. The idea has been to let the company be a single source of electricity, a monopoly, since it made no sense to have more than one company stringing lines and maintaining rights of way. This approach, presumably, kept costs down and protected consumers from any exploitation by what were clearly large and powerful local or regional companies.

But the rules of the game are changing as new technology is reducing some of the energy production costs and eliminating large size as a necessary condition to keeping production costs low. Small companies are talking about entering the marketplace just to help provide power at peak usage periods and in the process, provide consumers with alternative sources of electricity. Others are marketing "green power"—power generated from renewable resources.

Three parts to Energy Services

- 1. Generation/Supply:** The production of electricity at a power plant fueled by various raw energy sources (nuclear, coal, oil, natural gas, hydro, etc.).
- 2. Transmission:** The movement of electricity or natural gas from the generation facility (power plant/wellhead) to the local distribution company.
- 3. Distribution:** The delivery of electricity or natural gas directly to a home or business. The local distribution company . . . is responsible for maintaining the equipment [poles, lines, pipelines] to distribute the energy as well as delivering it to consumers.

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With deregulation of the generation portion of electricity, competition would be boosted and consumers' cost of electricity might be reduced in much the same way that the break-up of Ma Bell reduced long distance phone costs. Consumers will now be able to choose the electricity generation provider they want, just as they select their long distance telephone service. The big question is, "Will the

hoped for competition really reduce consumers' electricity costs?"

Crucial Virginia decision makers apparently thought the answer will be "yes," and Virginia was among the first states to take action on the opportunity to restructure/deregulate. The SCC began studying restructuring in March 1995, and the General Assembly began its study in 1996. By July 1999,

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the Virginia Electric Utility Restructuring Act (the Act) was enacted (Chapter 23, Title 56, Code of Virginia).

The Act laid out a plan to deregulate only the generation portion of electricity. Companies that currently generate and distribute the electricity will continue to distribute it and will maintain the lines and other distribution equipment. The SCC will continue to regulate charges for the distribution portion of electric service. There will be no new competition for distribution, leaving a monopoly at the local level with the SCC overseeing rates and performance of the local companies whose names are familiar in every Virginia community.

Existing electric companies, having made large and long-term investments in generation plants based on the assumption that they would always be providing electricity to a certain geographic area, were immediately concerned. They wanted to be sure their investments were not ignored. If too many consumers decide to buy their electricity from new suppliers, existing companies might not be able to pay the debts on their generating plants. These debts are called “stranded costs.”

The Virginia General Assembly reacted to the concerns of the existing companies. The Act ensures that the power companies are protected from stranded costs. The rates charged consumers are to stay the same through 2007, and companies can use any revenue earned above their costs to cover the stranded costs. Also, if customers decide to select another generating company before 2007, they will have to pay a “wires charge” to their old generation company to help cover the stranded costs. Finally, the Act allows generating companies a one-time rate increase if fuel or tax cost increases justify such an increase during the transition period ending in 2007.

What will Virginia electricity consumers get from all this? Customers may benefit from the assurance that their rates will not rise significantly during the transition to a competitive market. In the longer run, the consumer’s total cost per kilowatt hour, generation plus distribution, may decrease if the competition drives generating costs down. Some consumers may feel better about their energy use if they are able to contract with suppliers of more environmentally friendly green power. Possible negatives are that consumers could pay more, especially while the marketplace beyond Virginia continues to adjust to restructuring. Consumers may also lose the sense of security and comfort they have from the service from generation plants they know.

Restructuring Began

The moves to a competitive market have started. In the fall of 2000, Virginia Power offered a pilot choice program to

consumers in the Richmond metropolitan area. Three different energy providers made offers. Only those customers who signed up for an alternative generating company the very first month of the program got a full year’s worth of savings, which averaged about \$150 (SCC presentation). Some customers accepted an offer in the fall that was only good until May. When the company did not renew the offer, customers had to return to Virginia Power, which had higher rates than the competitive provider had been charging. Because American Electric Power’s (AEP) and Rappahannock Electric Cooperative’s pilot programs did not draw any competitive providers, consumers who signed up never had a chance to choose generation from an alternative provider.

Thus, the new program appears to be off to a rocky start. Many observers concluded that the pilot programs were not very successful. Alternative electricity providers told the SCC that only a few customers were involved in the pilot programs and the companies new to the area did not have enough buyers to be able to keep per unit costs low and make a profit. The SCC analyzed the situation and decided they were obligated to continue to develop the program to move toward competitive generating markets.

What Did California Teach Us?

Meanwhile, on the national level, California experienced a disastrous transition to a restructured market. Several factors have been blamed. The California law required that California electric companies put their generation plants into companies totally separate from the distribution companies. California law also prohibited distribution companies from entering into long-term contracts to purchase electricity. Thus, all energy purchases were made on the volatile short-term cash market. The law also capped the rates for consumers, leaving the distribution companies no way to pass on to consumers higher costs of providing electricity. Then natural gas prices went sky high. Some of the distribution companies went bankrupt and shut down, and rolling blackouts occurred during 2000. The state of California took on high long-term costs to keep the system going. Nearby states also had problems. Luckily, the summer of 2001 was relatively mild, and with consumers practicing conservation, the worst fears about blackouts and disruptions of service were not realized. However, in March 2002, the price freezes ended for residential consumers using Pacific Gas and Electric (PG&E), Southern California Edison (Edison), and San Diego Gas and Electric (SDG&E) (Calif. Public Util. Comm.). California’s residential customers will likely pay for these mistakes through higher energy rates and taxes for many years.

The events in California and the challenges that California and other states are experiencing as they move to a restructured market for electricity generation are very visible and widely observed. Some states, including North Carolina, decided either to stop or to slow their state's move to deregulation. In Virginia, however, existing and aspiring electric companies were confident that the legislators who drafted Virginia's law had protected them from the problems California had experienced, so they encouraged legislators to resist attempts to slow Virginia's deregulation process.

By the end of 2001, the SCC had to make decisions about how existing Virginia electric companies would separate their generation from their distribution. The companies asked to put generation and distribution in legally separate companies. Consumer advocates and representatives of electricity users opposed this action. They knew that when the companies were legally separate, the state would be permanently giving up the ability to regulate the generation plants. (According to Federal regulations, only the Federal Energy Regulatory Commission (FERC) could regulate electricity generation once it was legally separated from the distribution portion of the electric service.) Thus, if something were to go wrong (as it did in California), the SCC may have trouble forging a solution to the problem.

Consumer advocates believe that legal separation should not occur until a competitive market is active, a number of other necessary changes have occurred, and the kinks are worked out. The SCC decided that legal separation should not occur at this time.

Restructuring Time Table

Officially, consumer choice began on January 1, 2002 (Table 1). Consumer choice is being phased in, beginning with AEP-Virginia customers in southwestern Virginia and Virginia Power customers in northern Virginia. However, in spite of other companies being able to come into Virginia, none had done so by spring 2002. Electric cooperative customers will be the last to join the program by January 1, 2004.

A competitive market for electricity is going to require that more generating plants and more transmission lines be built in Virginia. Currently, the state has over 30 applications to build new generating plants (SCC). Most of

Table 1. When choice begins by electric company

Date choice begins	Company
January 1, 2002	AEP-Virginia (Appalachian Power)
	Allegheny Power (Potomac Edison)
	Delmarva Power and Light (Conectiv)
	Dominion Virginia Power—residential customers in northern Virginia and 1/3 non-residential customers
September 1, 2002	Dominion Virginia Power residential customers in Central and Western Virginia and second 1/3 non-residential customers
January 1, 2003	Dominion Virginia Power residential customers in Hampton Roads and last 1/3 non-residential customers
By January 1, 2004	All electric cooperatives
	Kentucky Utilities (Old Dominion Power)

Source: Virginia Energy Choice at www.yesvachoice.com

the new plants will use natural gas, and most companies indicate they will operate these plants only when peak amounts of power are needed. There is no guarantee that all these plants will be built, and there is no guarantee they will sell the power in Virginia or that their cost will be competitive. But a growing economy is likely to require more electricity and natural gas is a cleaner and more environmentally friendly source of fuel than coal. Relatively small and high tech turbines may make production for peak usage periods feasible and cost effective. If that happens, these turbines may provide necessary reserve capacity.

New generating facilities will require other changes. Virginia will need to make significant additions and changes in its electricity transmission lines. Few lines have been approved or built in recent years. Without adequate transmission capacity, new generating companies will not be able to make offers to consumers.

The deregulation of generating capacity and the possibilities of new and competitive markets may face issues unique to Virginia. For many years, Virginia consumers have paid electric prices below the national average. Rates do vary around the state and across alternative suppliers, but the rates are generally very competitive nationally (Table 2).

Table 2. Price to Compare: Annual average price for generation and transmission services

Customer Class	Dominion			
	Virginia Power	AEP-Virginia	Allegheny Power	Conectiv
	-----¢/kWh-----			
Residential	3.7	3.3	3.9	5.6
Small Commercial	3.8	3.1	4.0	6.1
Large Commercial	3.4	3.6	3.9	Not Applicable
Small Industrial	3.3	3.0	3.6	5.7
Large Industrial	3.0	2.8	3.3	5.6
Churches	3.6	3.0	Not Applicable	Not Applicable

Source: State Corporation Commission, Press Release, January 10, 2002

In addition to the generating and transmission costs shown in Table 2, customers pay a distribution cost. This distribution cost will continue to be regulated. The company that has always provided electricity to consumers in an area will continue to be their distribution company. As competition develops, consumers might get a bill from both their generation company and their distribution company with the bill from each company providing detail on fees and services provided.

Looking Ahead

Looking ahead and monitoring developments, Virginia consumers are faced with a number of questions to ask new generating companies that seek their business:

1. Is the competitor licensed by the Virginia State Corporation Commission (SCC)?
2. What are per kilowatt hour rates?
3. Are the rates fixed or do they vary depending on time of day, season, or cost of fuel?
4. What other fees are charged, including deposits and late fees?
5. Will a fee be charged for switching generating companies?
6. What is the length of the contract?
7. Will the contract automatically renew and will the consumer be notified of the renewal?
8. Will a fee be charged for canceling (especially if one has to move before the contract ends)?
9. Will the generating company send bills separate from the bills from the distribution company?
10. What special plans, such as budget billing, are available?
11. Is an incentive being offered to consumers to sign up?
12. How is the power generated, for example coal, hydro, natural gas, wind?
13. When will the new service begin?
14. How is the "price to compare" offered by the new company determined?

Beyond the specific questions dealing with new service, what issues do Virginia consumers need to be concerned about relative to the restructuring process?

- All areas of the state—including rural areas—should have competition. In Pennsylvania, which has had some success with the competitive market, rural areas still do not have a choice of suppliers. Only the more populated areas have had a choice. And the number of providers in Pennsylvania in 2001 compared to before deregulation, had dropped significantly (Levis, 2002).
- Consumers need to have appropriate information to comparison shop. Much of the needed information is provided by SCC's Energy Choice education program which is available by visiting their website at www.yesvachoice.com or by calling 1-877-YES-2004.

SCC's *Consumer Guide to Virginia Energy Choice* is available at their website. Another useful website is the U. S. Department of Energy's Energy Information Administration at <http://www.eia.doe.gov/>.

- Consumers need to be able to evaluate the offers they receive using comparable measures for comparison. Companies should quote prices for a standard unit such as cents per kilowatt hour of usage.
- The state needs to encourage existing and new energy providers to have sufficient reserves to protect consumers from blackouts at critical times.
- SCC might consider provisions to ensure that the needs of Virginians, including reserves, be met before power generated in Virginia is sold out of state. In a competitive market, firms will usually sell to the highest bidder. If Virginia companies can get higher prices selling to North Carolina customers, they will sell to North Carolina.
- The new and competitive market needs to be transparent so that people know what is happening and that companies are not taking risks that will jeopardize their ability to provide electric power at competitive rates and to meet peak requirements. This transparency should be required before state oversight and regulatory tools are eliminated.

A lot of people remember what happened when the long distance telephone market was restructured—the transition period was rough. Service was interrupted; rural areas were underserved; people did not know who to call when they had a problem. But in a few years, the problems were ironed out. New technologies became available; services were restored; and most importantly, costs for some services dropped significantly. Electric restructuring might go the same way. It is critical that consumers and competitors be patient and not expect the competitive market for electricity to develop over night. Along the way, consumers and the electricity industry will need to work together so that ultimately everyone's needs are met.

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