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## Annual Survey of Virginia Law: Public Utility Law

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## PUBLIC UTILITY LAW

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This article reviews the significant developments in the area of public utility law between January 1996 and August 1997. The first section covers legislative changes affecting electric, gas, telephone, and other public utilities; the second section reviews administrative action taken by the Virginia State Corporation Commission; and the third section addresses judicial action applied to the regulation of public utilities. The purposes of this article are to provide Virginia public utility practitioners an overview of the recent developments in public utility law and to explain the impact these developments have upon public utilities operating in Virginia. This article, however, does not discuss or review all new developments related to Virginia public utility law.

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## I. FEDERAL LEGISLATIVE DEVELOPMENTS

### A. *Proposed Electric Industry Restructuring Bills*

There has been considerable debate in the 105th Congress concerning the adoption of legislation that would make sweeping changes to the provision of electric service. Specifically, the debate has focused upon whether and how the nation should adopt a plan of "retail choice" for electric customers. Retail choice, as the term implies, would grant retail electric consumers the right to select their electric generation supplier and to have assured access to that supplier. Senator Dale Bumpers (D-AK) and Representatives Daniel Schaefer (R-CO), Edward Markey (D-MA), and Thomas DeLay (R-TX) have all introduced bills intended to give customers retail choice.<sup>1</sup>

Significantly, the initial momentum for changing the electric industry by federal legislation may be slowing. Indeed, it is unlikely that Congress will enact "retail choice" legislation before the conclusion of the current Congress that ends September 1998. Senate Majority Leader Trent Lott (R-MS) said in mid-May that deregulation was unlikely in 1997 and that it could take years.<sup>2</sup> In part, the slow-down can be attributed to considerable ongoing debate among stakeholders. Also, issues

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1. Senator Bumpers introduced S. 237, "a bill to provide for retail competition among electric energy suppliers for the benefit and protection of consumers, and for other purposes," on January 30, 1997. Rep. Schaefer introduced H. Res. 655, "a bill to give all American electricity consumers the right to choose among competitive providers of electricity, in order to secure lower electricity rates, higher quality services, and a more robust U.S. economy, and for other purposes," on February 10, 1997. Rep. Markey introduced H. Res. 1960, "a bill to modernize the Public Utility Holding Company Act of 1935, the Federal Power Act, the Fair Packaging and Labeling Act, and the Public Utility Regulatory Policies Act of 1978 to promote competition in the electric power industry, and for other purposes," on June 19, 1997. Rep. DeLay introduced H. Res. 1230, "a bill to give all American electricity consumers the right to choose among competitive providers of electricity in order to secure lower electricity rates, higher quality services, and a more robust U.S. economy, and for other purposes," on April 8, 1997. Bumpers' bill would give retail consumers the ability to choose their electricity providers by 2003, while Schaefer's bill would mandate competition by Dec. 15, 2000, and DeLay's bill calls for a deadline of the end of 1998. See Annie Tin, *High-Voltage Debate Rights on Utilities Deregulation*, CONG. Q., Mar. 3, 1997.

2. See Joseph F. Schuler, *Peggy Welsh Winds Up: NARUC's New Exec Wants PUCs to Network with Congress*, PUB. UTIL. FORT., July 15, 1997, at 26, 28.

relating to the uncertainty, reliability, and the magnitude of costs associated with deregulating the electric industry (i.e., stranded costs) are beginning to be better understood.<sup>3</sup>

The winds of change in Congress relating to the electric industry may eventually result in the repeal or revision of two laws that some say prevent states from pursuing their own ideas for introducing competition. First, there is a move afoot to repeal or revise the Public Utility Holding Company Act of 1935 (PUHCA).<sup>4</sup> PUHCA was designed to rectify a "lack of effective public regulation"<sup>5</sup> that created "abuses . . . injurious to investors, consumers, and the general public."<sup>6</sup> As such, PUHCA is regarded as a federal consumer protection statute for ratepayers. Critics, however, claim the law hampers the ability of major investor-owned utilities to compete in a free market.<sup>7</sup>

Second, the Public Utility Regulatory Policies Act of 1978 (PURPA)<sup>8</sup> may be targeted for reform. Congress designed PURPA, in part, to promote the development of cogeneration and alternative sources of electric generation such as solar, wind, biomass, and indigenous fuels.<sup>9</sup> It thus included a mandatory purchase provision in PURPA (i.e., § 210 of PURPA) that requires electric utilities to purchase electricity from cogeneration and the alternative sources of electric generation.<sup>10</sup> Proponents of PURPA reform argue that the statute has been overtaken by events—principally by the quest for a more competitive marketplace in electric power generation.<sup>11</sup> Critics of PURPA also complain that the statute has

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3. For a discussion of how such issues are likely to impact the speed of deregulation in the electric industry, see Edward L. Flippen, *Why Electric Deregulation in the U.S. Will Stall*, 4 EUR. FIN. SERVICES L. 137 (1997).

4. 15 U.S.C. §§ 79 to 79z-6 (as amended). For example, Markey's bill, H. Res. 1960, among other things, revises PUHCA to make that statute inapplicable in competitive markets. Bumper's bill, 237, goes further and repeals PUHCA. Indeed, on June 5, 1997, the Senate Banking Committee approved Senate bill S. 621, which is sponsored by Senator Alfonse D'Amato (R-NY), and would repeal PUHCA. The House has no equivalent of S. 621.

5. 15 U.S.C. § 79a(b)(5) (1994).

6. 15 U.S.C. § 79a(c) (1994).

7. See Tin, *supra* note 1.

8. 16 U.S.C. §§ 2601-45 (1994).

9. See *Federal Energy Regulatory Comm'n v. Mississippi*, 456 U.S. 742, 750 (1982).

10. See 16 U.S.C. § 824a-3 (1994).

11. See H.R. 338, 105th Cong. (1997) (Section 2 provides in part, "the Congress

inordinately boosted consumer costs.<sup>12</sup> Representative Cliff Stearns (R-FL) introduced H. Res. 338, the Ratepayer Protection Act, to prospectively repeal § 210 of PURPA.<sup>13</sup> Markey's bill, H. Res. 1960, however, would render § 210 of PURPA inapplicable in competitive markets.<sup>14</sup>

## B. Telecommunications Act of 1996

On February 8, 1996, President Clinton signed the Telecommunications Act of 1996 (the Telecom Act), the first major overhaul of telecommunications law in almost sixty-two years. The Telecom Act, which took nearly a decade to come to fruition,<sup>15</sup> is intended "to promote competition and reduce regulation in order to secure lower prices and higher quality service for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies."<sup>16</sup>

The Telecom Act has the potential to change the way we work, live, and learn. It will impact telephone service (local and long distance), cable programming, as well as other video services, broadcast services, and services provided to schools. The Telecom Act requires existing local exchange carriers (LECs) to allow interconnecting service providers access to local networks in order to provide competing local telephone service.<sup>17</sup> The Telecom Act directs incumbent LECs to negotiate purchase and interconnection agreements with new entrants.<sup>18</sup> Parties may arrive at an agreement as to the terms for providing interconnection services either by negotiation or arbitration.<sup>19</sup> If negotiating parties cannot reach agreement after 135 days, either party may petition the appropriate state regulatory commission

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finds that—(1) implementation of Section 210 of the Public Utility Regulatory Policies Act of 1978 (16 U.S.C. 824a-3) resulted in many consumers paying excessive rates for electricity.”)

12. *See id.*

13. *See* 16 U.S.C. § 824a-3. Sterns' bill would force utilities to honor QF (qualifying facilities) contracts entered into prior to January 7, 1997.

14. *See* H. Res. 1960, § 101.

15. *See* Tin, *supra* note 1.

16. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, 56 (codified as amended in scattered sections of 47 U.S.C.).

17. *See* 47 U.S.C.A. § 251(c)(2) (West Supp. 1998).

18. *See id.* § 252.

19. *See id.* § 252(a)(b).

(for example, the Virginia State Corporation Commission) to conduct a binding arbitration of the disputed issues.<sup>20</sup> A state commission must “resolve each issue set forth in the petition [for arbitration] . . . not later than [nine] months after the date” of the initial request.<sup>21</sup>

Section 252 of the Telecom Act prescribes the arbitration procedure to be followed by new entrants seeking interconnection with incumbent LECs. Parties who arrive at either an arbitrated or negotiated agreement must submit such agreement to the state commission for approval or rejection. The state commission can approve the agreement either by express ratification or by inaction. In other words, an agreement would be deemed approved if the commission fails to approve the arbitrated agreement within thirty days after submission.<sup>22</sup> The Act provides for federal district court review as the exclusive remedy of any aggrieved party after the commission approval process.<sup>23</sup>

The U.S. Court of Appeals for the Eighth Circuit overturned several parts of the rules adopted by the FCC to implement the local competition provisions of the Telecom Act.<sup>24</sup> The Eighth Circuit found that the FCC lacked authority under the interconnection provision (i.e., § 251) of the Telecom Act to issue rules governing the pricing of local loop services offered by incumbent local telephone companies to new entrants seeking to compete in the incumbents’ markets.<sup>25</sup> Opinions on the implications of the Eighth Circuit’s decision for new competitive local exchange

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20. See *id.* § 252(b).

21. *Id.* § 252(b)(4)(C).

22. See *id.* §§ 252(e)(1), (4).

23. See *id.* § 252 (e)(6).

24. See *Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997) (overruling in part Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, First Report and Order, 61 Fed. Reg. 47284 (1996)).

25. See *id.*

carriers are mixed.<sup>26</sup> It is unlikely, however, that the Eighth Circuit's decision would materially change state pricing policies.

The Telecom Act permits Regional Bell Operating Companies (RBOCs) to offer interLATA services originating outside their local region immediately after the date of enactment.<sup>27</sup> InterLATA services, however, that terminate within the RBOC's region and allow the called party to determine the interLATA carrier are considered in-region services and are subject to the several in-region service requirements of the Telecom Act.<sup>28</sup> RBOCs may provide interLATA services originating in any of their in-region states *if* the FCC approves such service.<sup>29</sup> To obtain FCC approval, the RBOC must demonstrate that facilities-based competition exists<sup>30</sup> for their local services based upon a fourteen-point competitive checklist specified in the Telecom Act.<sup>31</sup>

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26. See, e.g., *Appeals Court Overturns Key Parts of FCC Interconnection Order*, COMM. DAILY, July 21, 1997; *Eighth Circuit's Rebuke of FCC Pricing Rules Expected, but Outcome Not as Clear*, COMM. BUS. & FIN., Aug. 4, 1997.

27. See 47 U.S.C.A. § 271(b)(2) (West Supp. 1998).

28. See *id.* § 271(b)(1).

29. See *id.*

30. See *id.* § 271(c)(1)(A).

31. See *id.* § 271(c)(1)(B). The fourteen-point competitive checklist for RBOC entry into in-region long distance services is:

1. Reasonably priced interconnection equal in quality to what is offered to any other carriers.
2. Access to network elements on unbundled basis.
3. Access to poles, ducts, and rights-of-way.
4. Unbundled local loop transmission from central office to customer's premises.
5. Unbundled local transport from trunk side of wireline LEC switch.
6. Unbundled local switching.
7. Access to 911 and directory assistance.
8. White Pages directory listing for other carriers' customers.
9. Nondiscriminatory access to telephone numbers.
10. Access to databases and associated signaling needed for call routing.
11. Number portability.
12. Local dialing parity.
13. Reciprocal compensation arrangement.
14. Resale.

## II. VIRGINIA LEGISLATIVE DEVELOPMENTS

### A. Generally Applicable Statutes

In 1996, the General Assembly amended Virginia Code section 56-77 to grant the Virginia State Corporation Commission (the Commission) authority to exempt a public service company from the Affiliates Act.<sup>32</sup> In general, section 56-77(A) requires prior Commission approval of contracts between a public service company and its affiliate relating to the provision of goods and services.<sup>33</sup> The statute requires public service companies to file copies of any such agreements or arrangements with the Commission regardless of the dollar amount involved.<sup>34</sup> The 1996 legislation grants the Commission authority to exempt a public service company from all or any part of the requirements imposed by subsection A of section 56-77 if the Commission determines that such an exemption is in the public interest.<sup>35</sup> The Commission may grant such an exemption either on its own motion or upon petition by a public service company.<sup>36</sup> In addition to the exemptions for individual public service companies, the statute authorizes the Commission to adopt rules implementing exemptions from all or any part of the requirements.<sup>37</sup> The Commission may also revoke any exemptions granted under this provision if it determines that such action is in the public interest.<sup>38</sup> The 1996 amendments also provide that, not-

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32. See VA. CODE ANN. § 56-77(B) (Cum. Supp. 1997).

33. See *id.* § 56-77(A) (Cum. Supp. 1997).

34. See *id.*

35. See *id.* § 56-77(B).

36. See *id.* The Commission exercised its new authority in Application of Virginia Natural Gas, Inc., Case No. PUA960082, 1997 WL 282173 (April 3, 1997). In that case, the State Corporation Commission granted the request of Virginia Natural Gas for an exemption from certain requirements of the Affiliates Act by authorizing the company to enter into certain business transactions with its affiliates, including Consolidated Natural Gas Company (CNG) and several CNG affiliates without prior filing and approval by the Commission. See *id.* at \*1. The transactions exempt from prior filing and approval are business transactions that are not anticipated in any calendar year to affect VNG's jurisdictional revenue requirements by more than \$100,000 per affiliate. See *id.*

37. See VA. CODE ANN. § 56-77(B) (Cum. Supp. 1997).

38. See *id.*



withstanding the provisions of section 56-481.2,<sup>39</sup> the Commission may, after giving notice and an opportunity for hearing, require certificated local exchange telephone companies to meet the Affiliates Act requirements.<sup>40</sup>

### B. *Acquisition of Foreign Utility Companies*

The 1997 General Assembly enacted Virginia Code section 56-46.3 to clarify the Commission's authority to approve the application of an affiliate of a Virginia public service company to acquire or invest in a foreign utility company.<sup>41</sup> The statute clearly permits the Commission, in approving such applications, to impose any terms or limitations that it deems necessary to protect the public interest from any adverse effects attributable to a proposed investment in or acquisition of a foreign utility company.<sup>42</sup>

The General Assembly acted after the Commission, pursuant to § 33(a)(2) of PUHCA,<sup>43</sup> approved the request of Richmond-based Dominion Resources, Inc. (DRI) to certify to the Securities and Exchange Commission (SEC) that the Commission has the authority and resources to protect ratepayers subject to its jurisdiction and that it intends to exercise its authority upon DRI's acquisition of East Midlands PLC, an electric distribution company in the United Kingdom.<sup>44</sup> Virginia Code section 56-46.3 permits the Commission to certify to the SEC that it has the authority and resources to protect ratepayers of a public

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39. *Id.* § 56-481.2 (Repl. Vol. 1995) (authorizing the Commission to approve an alternative form of regulation for incumbent local exchange telephone carriers that would, in effect, exempt them from the Affiliates Act).

40. *See id.* § 56-77(C). Virginia Code section 56-481.2 relates to the rates, charges and regulations for local exchange telephone services provided by new entrants. *See id.* § 56-481.2 (Repl. Vol. 1995).

41. *See id.* § 56-46.3 (Cum. Supp. 1997).

42. *See id.* § 56-46.3(B) (Cum. Supp. 1997).

43. 15 U.S.C. § 79z-5b(a)(2) (1994).

44. PUHCA § 33(a)(2) provides that certain exemptions afforded a foreign utility company under PUHCA are not applicable unless every state commission that has jurisdiction over the retail electric or gas rates of a public utility company that is affiliated with a foreign utility company, otherwise exempted under § 33(a)(1) of PUHCA, has certified to the SEC that state commission has authority and the resources to protect ratepayers subject to its jurisdiction and that it intends to exercise such authority. *See* VA. CODE ANN. § 56-46.3(A) (Cum. Supp. 1997) (explaining PUHCA exceptions to foreign utility company exemptions).

service company subject to its jurisdiction whose affiliate intends to acquire a foreign utility company if the affiliate seeking the Commission's certification and the affiliated public service company furnish a written statement accepting all the terms, conditions, and limitations that the Commission may choose to impose.<sup>45</sup>

*C. Exemptions to the Rule Against Multiple Rate Increases Within Any Twelve-Month Period*

In 1997, the General Assembly amended Virginia Code section 56-235.4 to accomplish significant modifications to the prohibition of multiple rate increases within any twelve-month period. Prior to the amendments, section 56-235.4 limited increases in the regulated operating revenues of a public utility pursuant to Article I of Chapter 9 or Chapters 10, 16, or 19 of Title 56, to no more than once within any twelve-month period.<sup>46</sup> The 1997 amendments, however, provide that this limitation shall not apply to: (i) increases in regulated operating revenues that result from new rate schedules for expansion, reduction, or termination of existing services; (ii) increases in regulated operating revenues resulting from the initiation, modification, or termination of experimental rates under section 56-234; or (iii) the increases in regulated operating revenues resulting from making an experimental program permanent.<sup>47</sup>

The General Assembly also amended section 56-235.4 to provide, notwithstanding the prohibition against multiple rate increases in a twelve-month period, that a telephone company may apply to the Commission for permission to pass any changes approved by the Commission in carrier access charges to its customers as part of its rates.<sup>48</sup> The General Assembly enacted this amendment in recognition of changes within the telecommunications industry and, in particular, the anticipated reductions in carrier access charges which will make telephone services more competitive.<sup>49</sup>

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45. See *id.* § 56-46.3(B) (Cum. Supp. 1997).

46. See *id.* § 56-235.4(A) (Repl. Vol. 1995).

47. See *id.* § 56-235.4(A)(iii)-(v) (Cum. Supp. 1997).

48. See *id.* § 56-235.4(A) (Cum. Supp. 1997).

49. On May 7, 1997, the FCC adopted changes to its system of interstate access

#### D. *Electric Utilities*

##### 1. Treatment of Stranded Costs Resulting from the Departure of a Federal Government Facility from an Electric Utility System

The 1996 General Assembly specifically enacted Virginia Code section 56-235.7 to address the recovery of stranded costs<sup>50</sup> that result from the departure of federal governmental facilities from the electric systems of Virginia electric utilities. The new section grants the Commission limited jurisdiction over the rates and charges for service to any federal governmental facility that is a retail customer of any electric utility prior to January 1, 1996, and which ceases, in whole or in part, to be a retail customer of that electric utility after January 1, 1996.<sup>51</sup> Those rates and charges are subject to Commission jurisdiction solely to determine the proper rate, if any, that the federal government must pay the electric utility for any and all costs stranded due to the cessation of such retail service.<sup>52</sup> The Commission's jurisdiction, however, does not arise unless and until the effective date of any federal action that allows such federal facilities to purchase electricity from a supplier other than the public service company now providing electric service to such federal facility.<sup>53</sup>

##### 2. Determination of Stranded Costs

The 1996 General Assembly modified Virginia Code section 25-233 to broaden the Commission's authority to approve

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charges to make them commensurate with the pro-competitive deregulatory framework established by the Telecommunications Act. *See* First Report and Order, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers Transport Rate Structure and Pricing, Usage of the Public Switched Network by Information Service and Internet Access Providers, 7 Communications Reg. (P.F.) 1209 (May 16, 1997).

50. Stranded costs are the non-economic generating assets of electric utilities (i.e., generation assets valued below their book value because of their high capital and/or operating costs).

51. *See* VA. CODE ANN. § 56.235.7 (Cum. Supp. 1997).

52. *See id.*

53. *See id.*

the condemnation of property owned by corporations that possess the power of eminent domain.<sup>54</sup> In addition to corporations, section 25-233 now requires an authority created under the provisions of Chapter 54 of Title 15.2 of the Virginia Code to obtain approval from the Commission before taking, by condemnation proceedings, property belonging to any other corporation possessing the power of eminent domain.<sup>55</sup>

In recognition of the potential effects of the move towards retail electric competition, the General Assembly granted the Commission new power, if it approves a condemnation, to determine "whether any payment for stranded investment is appropriate and, if so, the amount of such payment and any conditions thereof."<sup>56</sup> Such determination is to be used in any condemnation proceeding.<sup>57</sup>

### 3. Alternative Regulation of Electric Utilities

In 1996, the General Assembly amended Virginia Code section 56-235.2, which sets forth the standard for determining just and reasonable rates for electric service, to permit Commission approval of alternative forms of regulation for electric companies. Specifically, the General Assembly enacted Chapter 156 of the Acts of Assembly to provide that an electric utility may apply for or, on the Commission's own motion the Commission may approve, an alternative form of regulation different from the traditional "rate base/rate of return" form of regulation.<sup>58</sup> This section provides that alternatives to the traditional "rate base/rate of return" form of regulation may include, but are not limited to, the use of price regulation, ranges of authorized returns, categories of service, price indexing, or other alternative forms of regulation.<sup>59</sup>

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54. See VA. CODE ANN. § 25-233 (Repl. Vol. 1997).

55. The amended Chapter 54, VA. CODE ANN. §§ 15.2-5400 to -5431 (Repl. Vol. 1997), became effective December 1, 1997. The previous Chapter 39 of Title 15.1 was applicable until that date. See *id.* (Editor's note).

56. *Id.*

57. See *id.*

58. See VA. CODE ANN. § 56-235.2(B) (Cum. Supp. 1997).

59. See *id.*

Significantly, the amendment does not allow an electric utility to withdraw its application after Commission approval even if the Commission modifies the utility's application. A similar amendment permitting alternative regulation of gas utilities, Virginia Code section 56-235.6(C), allows a gas utility to withdraw its application if the Commission approves the gas utility's application with modifications.<sup>60</sup> The General Assembly also amended section 56-235.2 to allow the Commission to approve special rates, contracts, or incentives (i.e., "economic development rates") to individual customers or classes of customers when it finds such measures are in the public interest.<sup>61</sup> This section provides that such special charges shall not be limited by the rule against multiple increases within a twelve-month period.<sup>62</sup>

In approving economic development rates or other alternative regulatory plans under these new provisions, the Commission must ensure that such action "(i) protects the public interest, (ii) will not unreasonably prejudice or disadvantage any customer or class of customers, and (iii) will not jeopardize the continuation of reliable electric service."<sup>63</sup> Further, the General Assembly requires the Commission to issue guidelines for special rates, adopted pursuant to the economic development ratemaking methodology, to ensure that other customers do not bear increased rates as a result of such special rates.<sup>64</sup>

#### 4. Electric Industry Restructuring

The 1997 General Assembly also approved S.J. Res. 259, which continues the Joint Subcommittee's examination of the restructuring of the electric utility industry. The resolution requires the Commission Staff to provide the joint subcommittee, by November 7, 1997, the staff's draft of

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60. *See id.* § 56-235.6(C) (Cum. Supp. 1997).

61. *See id.*

62. *See id.* § 56-235.2(A)(2) (Cum. Supp. 1997) (stating that section 56-235.4, which governs multiple rate increases in twelve month periods, shall not limit such special charges).

63. *Id.* § 56-235.2(C) (Cum. Supp. 1997).

64. *See id.* § 56-235.2(D) (Cum. Supp. 1997).

(i) a working model most appropriate for the Commonwealth of Virginia for the future structure of the electric utility industry to provide reliable, competitive electricity and meet the demands of a changing industry by protecting environmental quality, (ii) any statutory or regulatory changes considered appropriate under such model, and (iii) the appropriate timetable and transition for the model to be implemented.<sup>65</sup>

The joint resolution also requires the Commission Staff to work in a collaborative fashion with industry representatives, including electricity suppliers, consumers of electricity in the Commonwealth, and other parties of interest, in conducting its analysis and preparing its recommendations.<sup>66</sup>

## 5. Electric Distribution Cooperatives

In 1997, the General Assembly amended Virginia Code section 56-217 to remove the prohibition against distribution cooperatives paying more than a six percent dividend on stock and annual interest on membership capital.<sup>67</sup> Among other things, this amendment allows distribution cooperatives to issue preferred stock at market rates.

## E. Gas Utilities

In 1996, the General Assembly enacted Virginia Code section 56-235.6. This statute permits the Commission to authorize, either upon the application of a gas company or upon the Commission's own motion, any gas utility to implement an optional form of rate regulation under which the cost-of-service ratemaking methodology, set forth in section 56-235.2, may be replaced with a performance-based ratemaking methodology.<sup>68</sup> This statute prevents Commission authorization of such performance-based ratemaking methodology until after such notice and opportunity for hearing as the Commission may pre-

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65. S.J. Res. 259, Va. Gen. Assembly, (Reg. Sess. 1997).

66. *See id.*

67. *See* VA. CODE ANN. § 56-217(l) (Cum. Supp. 1997).

68. *See id.* § 56-235.6(A) (Cum. Supp. 1997) (Editor's note).

scribe.<sup>69</sup> Under section 56-235.6(B), Commission approval of such performance-based ratemaking should be based on a finding that the methodology

(i) preserves adequate service to all classes of customers, including transportation-only customers; (ii) does not unreasonably prejudice or disadvantage any class of gas utility customers; (iii) provides incentives for improved performance by the gas utility in the conduct of its public duties; (iv) results in rates that are not excessive; and (v) is in the public interest.<sup>70</sup>

Further, the statute provides that performance-based forms of regulation may include

the use of revenue indexing, price indexing, ranges of authorized return, gas cost indexing and innovative utilization of utility-related assets and activities (such as off-system sales of excess gas supplies, release of upstream pipeline capacity and performance of billing services for other gas suppliers) in ways that benefit both the gas utility and its customers.<sup>71</sup>

The performance-based methodology may also "include a mechanism for automatic annual adjustments to revenues or prices to reflect changes in any index adopted for the implementation of such performance-based form of regulation."<sup>72</sup>

Under Virginia Code section 56-235.6(C), a gas utility that applies for implementation of a performance-based form of regulation may "withdraw its application and continue to be regulated under the form of regulation that existed immediately prior to the filing of the application"<sup>73</sup> if the Commission approves the application with modifications.<sup>74</sup> Conversely, after notice and opportunity for hearing, the Commission may modify, revoke, or authorize a gas utility to discontinue a performance-

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69. *See id.*

70. *Id.* § 56-235.6(B) (Cum. Supp. 1997).

71. *Id.*

72. *Id.*

73. *Id.* § 56-235.6(C) (Cum. Supp. 1997).

74. *See id.*

based form of regulation previously implemented under section 56-235.6.<sup>75</sup> The Commission may only do so

if it finds that (i) gas service to one or more classes of customers has deteriorated, or will deteriorate, to the point that the public interest will not be served by continuation of the performance-based form of regulation; (ii) any class of gas utility customer is being unreasonably prejudiced or disadvantaged by the performance-based form of regulation; (iii) the performance-based form of regulation does not, or will not, provide reasonable incentives for improved performance by a gas utility in the conduct of its public duties (which determination may include, but not be limited to, consideration of whether rates are inadequate to recover gas utility cost of service); (iv) the performance-based form of regulation is resulting in rates that are excessive compared to a gas utility's cost of service; (v) the terms ordered by the Commission in connection with approval of a gas utility's implementation of a performance-based form of regulation have been violated; or (vi) the performance-based form of regulation is no longer in the public interest.<sup>76</sup>

Virginia Code section 56-235.6(D) provides that the Commission shall use the annual review process established in section 56-234.2 (i.e., the Annual Informational Filing, or AIF, process) to monitor each performance-based form of regulation that it approves.<sup>77</sup> Under this provision, the Commission may "make any annual prospective adjustments to revenues or prices necessary to reflect increases or decreases in any index adopted for the implementation of such performance-based form of regulation."<sup>78</sup>

In 1997, the General Assembly also amended Virginia Code section 56-265.1 of the Utility Facilities Act to broaden the exemption for companies providing natural or manufactured gas to commercial and industrial customers. Chapters 105 and 148, two identical provisions of the Act of the General Assembly, expanded the exemption from the definition of public utility

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75. *See id.*

76. *Id.*

77. *See id.* § 56-235.6(D) (Cum. Supp. 1997).

78. *Id.*



provided in section 56-265.1(b)(4). It now excludes from regulation

any company, or [its] affiliate . . . , making a first or direct sale, or ancillary transmission or delivery service, of natural or manufactured gas to fewer than thirty-five commercial or industrial customers, which are not themselves 'public utilities' as defined in [that] chapter, for use solely by such purchasing customers at facilities which are not located in [the certificated territory of another public utility.]<sup>79</sup>

Prior to this amendment, only companies providing sales or transmission or delivery service of natural or manufactured gas to fewer than ten commercial industrial customers were exempted.<sup>80</sup>

#### F. *Telegraph and Telephone Companies*

In 1996, the General Assembly rewrote Virginia Code section 56-241.1 to require every telephone company that offers a dial tone line or substantially equivalent local service to offer its customers at least one offering that consists of "a single dial tone line, including associated usage, for the purpose of two-way voice communications within a local calling area at a flat rate."<sup>81</sup> A telephone company is exempted from this requirement if there was no telephone company offering dial tone line or substantially equivalent local service at a flat rate in the local calling area on January 1, 1979.<sup>82</sup>

In 1997, the General Assembly also modified Virginia Code section 56-458, which relates to the right of telephone and telegraph companies to construct, maintain, and operate their lines parallel to any railroads and to occupy and use public parks, roads, turnpikes, streets, avenues, and alleys in any other counties of the Commonwealth.<sup>83</sup> As modified, section 56-458 provides that charges, including franchise, permit, and inspection fees, charged by

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79. *Id.* § 56-265.1(b)(4) (Cum. Supp. 1997).

80. *See id.*

81. *Id.* § 56-241.1 (Cum. Supp. 1997).

82. *See id.*

83. *See id.* § 56-458(B) (Cum. Supp. 1997).

(i) a county, city or town in connection with a franchise, lease or right to use the public right-of-way or easement which is a part of or adjacent to any road, highway, bridge, turnpike, street, avenue, or alley, or (ii) the Commonwealth Transportation Board in connection with a permit for such occupation and use shall not exceed the amount or rate charged pursuant to, or any in-kind services or physical assets provided by, ordinances, permits, agreements, or franchises [that were] in effect as of February 1, 1997.<sup>84</sup>

Further, except as provided in the statute, local governments and the Commonwealth Transportation Board are prohibited from requiring telephone and telegraph companies to provide in-kind services or physical assets as a condition of consent to a franchise, lease, or right to use public property, or in lieu of any fees.<sup>85</sup> Significantly, the amendments of Chapters 474 and 515 of the Acts of Assembly, which became effective March 18, 1997, expire on July 1, 1998.<sup>86</sup>

The 1997 General Assembly also amended Virginia Code section 56-462 which relates to the rights of franchises to occupy the parks and streets of municipal corporations. The General Assembly amended this provision by adding subsection B, a provision identical to section 56-458(B).<sup>87</sup> As with section 56-458, the addition of the new restrictions on the charges for fees expires on July 1, 1998.<sup>88</sup>

In 1996, the General Assembly enacted an anti-slamming<sup>89</sup> provision to prohibit changes in a customer's long-distance service carrier without prior authorization of the customer. Specifically, Virginia Code section 56-479.1 provides that

[n]o telephone company shall cause the long distance carrier designation of any telephone customer to be changed following such customer's initial selection thereof when establishing or reestablishing telephone service, without having first

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84. *Id.*

85. *See id.*

86. *See id.* § 56-458 note (Cum. Supp. 1997).

87. *See id.* § 56-462(B) note (Cum. Supp. 1997).

88. *See id.* § 56-462 note (Cum. Supp. 1997).

89. Slamming occurs when a long-distance carrier substitutes its services for that of a customer's preferred long-distance carrier without that customer's consent.

received a statement from the long distance carrier that such carrier has received a letter of agency or letter of authorization or an electronic authorization by use of an 800 number or an oral authorization verified by an independent third party, or any other means of authorization that is approved by the Federal Communications Commission.<sup>90</sup>

### III. ADMINISTRATIVE ACTIONS

#### *A. Electric Utility Restructuring: Qualifying Facilities and Independent Power Producers*

There has been a renewed focus on the contracts between qualifying facilities (QFs) and independent power producers (IPPs) on the one hand and investor-owned electric utilities on the other. This focus stems from the current debate over the restructuring of the electric utility industry and the potential for stranded costs resulting from such restructuring. Of the three major investor-owned utilities in Virginia, Virginia Power is the most exposed in terms of stranded costs because of its large portfolio of QF and IPP contracts. Currently, nineteen percent of Virginia Power's installed and purchased power capacity is QF or IPP capacity.<sup>91</sup> Such capacity, frequently referred to as non-utility generator (NUG) capacity, is an issue because NUG contracts would be the source of most of Virginia Power's stranded costs if the provision of the retail electric service should become subject to extensive competition. Such contracts could not be fully recovered from customers in a competitive market because, in most cases, the NUG contracts require the payment of capacity and energy charges that are greater than what is currently expected in a competitive market. Those costs (to the extent that they are above market), therefore, could not be recovered in sales at competitive market prices.

Virginia Power presently has contracts with a total of sixty-two NUGs (including three that provide energy only) having an

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90. VA. CODE ANN. § 56-479.1 (Cum. Supp. 1997).

91. See STATE CORP. COMM'N, STAFF REPORT ON THE RESTRUCTURING OF THE ELEC. IND., Case No. PUE950089, 164 (Vol. 1, 1996).

aggregate, summer-dependable capacity and on December 31, 1996, a capacity of 3,509.5 megawatts.<sup>92</sup> Virginia Power also has contracts with three more NUGs in North Carolina for a total expected summer capacity of 15 megawatts, although the North Carolina NUGs have not yet achieved commercial operations.<sup>93</sup> Given this weight of NUG contracts with rates above market prices, Virginia Power has undertaken efforts to mitigate NUG contract costs.

In Case No. PUE960117, the Virginia Power sought to limit the term of Schedule 19 capacity purchases to five years.<sup>94</sup> In another case, Case No. PUE960090, the company requested that the Commission approve the implementation of a QF monitoring program to aid in determining and assuring compliance with QF requirements under PURPA.<sup>95</sup> On June 13, 1997, the Commission granted Virginia Power authority to implement that monitoring program.<sup>96</sup> As described in Virginia Power's application, the program could apply to all QFs that have power purchase contracts with Virginia Power. Such QFs would be required to file information sufficient to determine continued compliance with the QF requirements of PURPA. Under the Company's proposal, each QF would submit operational data to the Company by March 1 each year. The data would be for the previous calendar year to be evaluated by the Company to determine whether the QF remained in compliance with the applicable federal regulations.<sup>97</sup> The Company could also request additional information from a QF, as needed, to complete its compliance evaluation.<sup>98</sup> Virginia Power would notify the Commission of any QFs that have not maintained those require-

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92. See Commonwealth *ex rel.* State Corp. Comm'n *Ex parte*: Investigation of Electric Utility, Industry Restructuring—Virginia Electric and Power Co., Case No. PUE960296, Testimony of Larry W. Ellis (Mar. 28, 1997) at 28.

93. See *id.*

94. See Application of Virginia Elec. & Power Co., Case No. PUE960117 (July 31, 1996). The Commission recently acted on Virginia Power's application, but a full discussion of the order is not possible here. See Application of Virginia Elec. & Power Co., Case No. PUE960117, Order Approving Application, 1998 WL 67091 (Jan. 21, 1998).

95. See Application of Virginia Elec. & Power Co., Case No. PUE960090, Final Order, 1997 WL 43871 (June 13, 1997) at \*1.

96. See *id.* at \*3.

97. See *id.* at \*1.

98. See *id.*

ments. Further, based on its evaluation of the QF data, Virginia Power could initiate a proceeding at the Federal Energy Regulatory Commission (FERC) pursuant to 18 C.F.R. § 292.207(d), for a determination of a particular project's QF compliance. In approving Virginia Power's QF monitoring program, the Commission noted that the United States Court of Appeals for the Ninth Circuit has found in a similar case that PURPA permits states to devise QF monitoring programs as long as those programs do not impose any undue burdens on the QF.<sup>99</sup> The Commission also noted that the State of California has implemented such a program.<sup>100</sup>

The Commission further explained that, pursuant to the Constitution of Virginia, Article IX, section 2, and Virginia Code sections 12.1-12, 56-35, and 56-235, the Commission has the authority and duty to establish just and reasonable rates for Virginia Power. To do so, the Commission stated that it must monitor the costs that are recovered through the electric rates paid by Virginia Power's ratepayers. The Commission also noted its vital interest in precluding Virginia Power from recovering, in its cost of service, payments to entities that are not entitled to receive them.<sup>101</sup> Recognizing that the determination of a facility's status may only be made by the FERC, the Commission nevertheless noted that when a project falls out of compliance with qualifying requirements, payments to that facility may, depending on the circumstances, be modified, suspended, or terminated.<sup>102</sup>

In order not to impose an undue burden on any particular QF, the Commission exempted QFs that supply three megawatts or less of contract capacity from the application of the monitoring program. Further, the Commission's order provides that any company with a contract capacity of three megawatts or more may apply to the Commission for exemption from the monitoring program. Conversely, Virginia Power may apply to the Commission to include any particular QF of less than three megawatts in the program. Further, in approving

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99. See *id.* at \*2 (citing *Independent Energy Producers Ass'n v. California Pub. Util. Comm'n*, 36 F.3d 848, 859 (9th Cir. 1994)).

100. See *id.*

101. See *id.*

102. See *id.*

the program, the Commission cautioned Virginia Power that the information collected is to be used only for the purpose of evaluating the continuing QF status of the various projects. The Commission warned that if this data is misused in any way, it would consider sanctions and would entertain requests for modification or termination of the program.<sup>103</sup>

The Commission further ordered that, on or before July 1 of each year, Virginia Power shall collect, and each QF having a contract capacity of three megawatts or more shall supply, the data that each QF includes or would include on the FERC Form 556 for each project. Information must be based on the project's actual operating experience from the prior calendar year. Additionally, QFs must report any change to the information previously supplied that significantly affects its continuing status as a QF within thirty days of a change in circumstance. QFs may apply for confidential treatment of the information supplied to Virginia Power.<sup>104</sup>

Finally, on or before October 1 of each year, Virginia Power is directed to file a report with the Commission's Division of Energy Regulation detailing findings of its monitoring program and specifically identifying to the Commission whether each project continues to comply with the qualifying requirements for QF status.<sup>105</sup> Virginia Power shall also inform the Division of Energy Regulation of any QF that fails to provide the specified information. The Division then may recommend action to be taken by the Commission.<sup>106</sup>

Also in 1996, by Final Order issued in Case No. PUE960092, the Commission granted Virginia Power a Certificate of Public Convenience and Necessity to purchase a 250 megawatt gas-fired combined cycle cogeneration facility in Richmond, Virginia, and other related properties from Richmond Power Enterprise, L.P. (RPE).<sup>107</sup> By that same Final Order, the Commission waived its bidding rules for purchases of capacity as to the

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103. *See id.* at \*3.

104. *See id.*

105. *See id.*

106. *See id.*

107. *See* Application of Virginia Elec. & Power Co., Case No. PUE960092, Final Order, 1996 WL 755271 (Nov. 18, 1996) at \*3 & n.1.

contract and granted Virginia Power authority to enter into a purchase power contract with RPE and Enron Power Marketing, Inc. (EPMI).<sup>108</sup>

Virginia Power had applied for such authorization to acquire the facilities and to enter into the purchase power contract after entering into a settlement with RPE of disputed issues arising from a twenty-five-year Power Purchase and Operating Agreement (PPOA) which was entered into on June 13, 1987. Pursuant to the PPOA, Virginia Power purchased the entire electrical capacity and energy output from the facility. To settle their disputes, the parties agreed that Virginia Power would purchase the facility and that the PPOA would be amended. The amended PPOA would reduce capacity payments, shorten the term of the agreement, and provide for certain sales of capacity and energy by RPE's assignee, EPMI, to Virginia Power from sources outside Virginia Power's service territory, rather than from the facility.<sup>109</sup> In its application, Virginia Power stated that implementation of the proposed arrangement would, over the life of the amended PPOA, save the Company and its ratepayers \$63 million on a net present value basis.<sup>110</sup> The Commission's Order also approved transfer of the RPE facility to Virginia Power under Chapter 5 of Title 56 of the Code of Virginia, the Utilities Transfers Act.<sup>111</sup>

## B. *Applications for Alternative Regulation of Electric Utilities*

### 1. Virginia Electric and Power Company

On March 24, 1997, Virginia Power filed an application for approval of an alternative form of regulation.<sup>112</sup> Virginia Power's proposal is a phased transition to retail competition in the electric utility market as follows:

(a) the Company's base rates would be frozen at their present level through December 31, 2002;

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108. *See id.* at \*3.

109. *See id.* at \*1.

110. *See id.*

111. *See id.* at \*3.

112. Application of Virginia Elec. & Power Co., Case No. PUE960296, Order for Notice and Hearing (April 30, 1997) at 1.

(b) during that period, a portion of the Company's earnings would be applied to the recovery of regulatory assets and, under certain circumstances, costs associated with NUG purchase power contracts that would likely be unrecoverable after the transition from regulation to competition (transition costs); and

(c) after the end of this period, if retail electric competition should be authorized, recovery of transition costs (principally costs associated with NUG contracts and nuclear decommissioning costs) would continue for specified periods through the use of a Transition Costs Charge.<sup>113</sup>

On March 28, 1997, the Commission Staff filed its report in Case No. PUE960036, a docket relating to Virginia Power's 1995 Annual Informational Filing. The Staff concluded that Virginia Power "is clearly in an overearnings position on both a per books earnings test basis and on a fully adjusted basis."<sup>114</sup> In addition, the Staff observed that Virginia Power has significant regulatory assets recorded on its books and "may have potentially large levels of strandable costs in the form of uneconomic NUG power contracts."<sup>115</sup> The Commission has consolidated Case No. PUE960036 (the 1995 Annual Informational Filing docket) and Case No. PUE960296 (*Ex parte*: Investigation of Electric Industry Restructuring—Virginia Electric and Power Company) under Case No. PUE960296.<sup>116</sup> In the consolidated docket, the Commission will consider, among other things, Virginia Power's 1995 AIF results and the Company's proposed alternative regulatory plan.<sup>117</sup> The Commission also will consider whether the public interest requires the restructuring or redesign of any of the Company's rates (for example, the reduction or elimination of any inter-class subsidies that might exist and whether the public interest requires the Company to offer rates for unbundled services).<sup>118</sup> The Commission also stated that it would consider whether the public interest requires the

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113. *See id.* at 2.

114. STATE CORP. COMM'N, STAFF REPORT ON THE VIRGINIA ELEC. POWER CO. ANNUAL INFORMATIONAL FILING, Case No. PUE960036, 48 (1997).

115. *Id.* at 49.

116. *See* Application of Virginia Elec. & Power Co., Case Nos. PUE960036 and PUE960296, Order for Notice and Hearing (April 30, 1997) [hereinafter Order for Notice and Hearing].

117. *See id.*

118. *See id.*



continuation, quantification, or elimination of the Company's fuel factor and other deferred accounting mechanisms.<sup>119</sup>

Virginia Power's plan was filed pursuant to Virginia Code section 56-235.2(C), as amended by the 1996 General Assembly, to permit electric utilities to apply for an alternative form of regulation. Virginia Code section 56-235.2(C) requires the Commission, prior to approving an alternative form of regulation, to "ensure that such action (i) protects the public interest, (ii) will not unreasonably prejudice or disadvantage any customer or class of customers, and (iii) will not jeopardize the continuation of reliable electric service."<sup>120</sup> Further, the Commission may approve or reject the plan filed by Virginia Power, or it may make such alteration to the plan as necessary to meet the requirements of the statute, or it may adopt its own plan in this proceeding.<sup>121</sup>

In an unusual admonition, the Commission stated in its Order for Notice and Hearing that:

It is the responsibility of both Virginia Power and non-utility generators to seek to reduce significantly the magnitude of any uneconomic costs. The Commission encourages the development of proposals to reduce or eliminate both current and potential rate impacts of such costs. We direct the Company and all non-utility generators that have contracts with the Company to work together to develop such proposals.<sup>122</sup>

The Commission scheduled a public hearing on the consolidated docket for February 16, 1998.<sup>123</sup>

## 2. Appalachian Power Company

On November 12, 1996, the Commission entered an order establishing Case No. PUE960301, *Ex parte*: Investigation of electric utility industry restructuring—Appalachian Power Com-

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119. *See id.*

120. VA. CODE ANN. § 56-235.2(C) (Cum. Supp. 1997).

121. *See id.* § 56-235.2(B) (Cum. Supp. 1997).

122. Order for Notice and Hearing, *supra* note 117, at 4.

123. *See id.* at 5.

pany.<sup>124</sup> In that order, the Commission directed Appalachian Power Company (APCO) to file on or before March 31, 1997, a number of studies, reports, and recommendations concerning both its cost of service and the possible restructuring of the electric utility industry. The Commission also asked for illustrative tariffs reflecting rates for unbundled services and class costs of service studies.<sup>125</sup> Further, the Commission directed that if APCO desired to file a plan for alternative regulation, such filing was to be made in this docket. The Commission required any such plan to include all schedules, adjustments, and data required for a general rate case,<sup>126</sup> as specified in the Commission's rules governing utility rate increase applications and annual informational filings adopted in Case No. PUE850022.<sup>127</sup> The Commission also asked APCO to use a 1996 calendar year as the test period for its general rate case data.

APCO filed its application for approval of an alternative regulatory plan and for a general increase in electric rates on June 13, 1997. APCO sought a general revenue increase of \$30,488,249 in base rates annually, an increase of approximately 4.8% over current annual revenues.<sup>128</sup> APCO's proposal included tariffs to implement its general rate increase that would become effective July 13, 1997.<sup>129</sup> APCO filed its plan pursuant to new Virginia Code section 56-235.2(B).<sup>130</sup>

Under APCO's plan, the Company would institute a moratorium period during which no changes would be made to the proposed total base revenue levels prior to January 1, 2001.<sup>131</sup> The plan includes a freeze on the Company's 1.482 cents per

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124. Commonwealth *ex rel.* State Corp. Comm'n *Ex parte*: Investigation of Electric Utility Industry Restructuring—Appalachian Power Co., Case No. PUE960301, 1996 WL 755308 (Nov. 12, 1996).

125. *See id.* at \*1.

126. *See id.* at \*2.

127. Commonwealth *ex rel.* State Corp. Comm'n *Ex parte*: In the matter of adopting certain amendments to the Rules Governing Utility Rate Increase Applications, Case No. PUE850022, Final Order, 1985 WL 24799 (Aug. 21, 1985).

128. *See* Commonwealth *ex rel.* State Corp. Comm'n *Ex parte*: Investigation of electric utility industry restructuring—Appalachian Power Co., Case No. PUE960301, Order for Notice and Hearing.

129. *See id.* at 2.

130. *See id.*

131. *See id.* at 2-3.

kWh fuel factor for the same period as its base rate moratorium, a sharing of earnings above certain levels between the Company and its customers, and acceleration of the recovery of certain regulatory assets.<sup>132</sup> The plan also includes a proposal to include significant revenue shifts among the Company's customer classes with the effect that customer rates could change significantly from year to year.<sup>133</sup>

By its Order for Notice and Hearing issued July 10, 1997, the Commission suspended, pursuant to Virginia Code section 56-238, APCO's rates, charges, and tariff provisions relating to its general rate application, which APCO proposed to implement on July 13, 1997.<sup>134</sup> Suspension of APCO's rates, charges, and tariff provisions continued through November 10, 1997. The Commission also scheduled a public hearing on APCO's application for May 19, 1998.<sup>135</sup> In suspending APCO's rates for 150 days, the Commission noted that it must "consider the state of APCO's current earnings, the reasonableness of its current services, rates, rate design and rate structures, as well as the Company's economic position in a more competitive marketplace, toward which the electric utility industry seems to be evolving."<sup>136</sup> APCO's application for approval of its Plan requires the Commission to address the costs and benefits inherent in this evolution.<sup>137</sup>

### C. Territorial Issues

On May 9, 1996, the Commission approved Virginia Power's sale and transfer of certain public service property to the City of Manassas.<sup>138</sup> The Commission also amended Virginia Power's Certificate of Public Convenience and Necessity to reflect the reduction in the Company's territory as a result of the transfer.<sup>139</sup> The parties' joint application reflected an agree-

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132. *See id.* at 3.

133. *See id.*

134. *See id.*

135. *See id.* at 6.

136. *Id.*

137. *See id.* at 5.

138. *See Application of Virginia Elec. & Power Co.*, Case No. PUA950046, Order Granting Authority, 1996 WL 339623 (May 9, 1996) at \*2.

139. *See id.*

ment for Virginia Power to sell and convey to Manassas, subject to Commission approval, certain substation facilities located at an IBM plant. The IBM facilities are located in an area annexed by Manassas in 1988. At that time, Virginia Power sold and transferred its electric distribution facilities in the annexed area to Manassas, but the Company retained the right to serve the property owned by IBM and its successors within the annexed areas.<sup>140</sup> After the acquisition by Manassas, the facilities would be used to continue to provide electric service to the IBM property, then occupied by Loral, Inc. Under the terms of the parties' agreement, Virginia Power would relinquish its rights to provide retail service to the IBM property. Virginia Power would, however, through an agreement with the Virginia Municipal Electric Association No. 1 (VMEA), establish a new resale delivery point at this location for the City, a VMEA member municipality, pursuant to the terms of Virginia Power's agreement with VMEA.<sup>141</sup>

Significantly, while the original cost of the Virginia Power facilities was only \$740,525, the sale price was \$1,400,000.<sup>142</sup> The parties established this price based on the so called "South Carolina method" of valuation of utility facilities.<sup>143</sup> The Commission approved this method, prescribed by law in South Carolina and previously used by Virginia Power.<sup>144</sup> In approving the transaction, the Commission noted that in *Application of Virginia Electric and Power Co.*, Case No. PUA920031, the South Carolina method was used when the City of Franklin purchased Virginia Power's electric distribution facilities in an area annexed by Franklin.<sup>145</sup> The Commission also noted that the proposed Virginia Power-Manassas transaction would neither impair nor jeopardize adequate service at just and reasonable rates.<sup>146</sup> Therefore, pursuant to Virginia Code sections 56-89 and 56-90, the Commission granted Virginia Power authority

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140. See *id.* at \*1.

141. See *id.*

142. See *id.*

143. See *id.*

144. See *id.*

145. See *id.*

146. See *id.* at \*2.

to sell and convey the IBM substation facilities at a price of \$1,400,000 to the City of Manassas.<sup>147</sup>

*D. Virginia Electric and Power Company/Dominion Resources, Inc.*

On July 10, 1997, the Commission issued an order closing the book on its investigation of Virginia Power's relationship with its parent, Dominion Resources, Inc. (DRI).<sup>148</sup> The Commission's scrutiny of such relationship began in 1986 when the Commission addressed the public service implications of the reorganization of Virginia Power into a holding company structure.<sup>149</sup> Among other things, the 1986 Order emphasized that the Virginia Power board of directors was to remain responsible for the proper management of the utility.<sup>150</sup>

After a public spat between the respective boards of directors of Virginia Power and DRI, the Commission entered its Order Establishing Investigation and Rule to Show Cause in Case No. PUE940040, on June 17, 1994.<sup>151</sup> The June 1994 Order initiated a Commission investigation into the current operations of Virginia Power and all affiliate arrangements and contracts between Virginia Power and DRI. In the June 1994 Order, the Commission also required DRI to show cause why it should not be found to have violated the Commission's 1986 Order, which concluded the Commission's investigation of the reorganization of Virginia Power into a holding company structure.<sup>152</sup> The June 1994 Order further directed DRI and Virginia Power to provide prior written notice of any proposed change in the board or management of Virginia Power to the Commission.<sup>153</sup> Subsequently, by Order entered August 24, 1994,<sup>154</sup> the Com-

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147. *See id.*

148. *See Commonwealth ex rel. State Corp. Comm'n Ex parte: In re Investigation of Dominion Resources, Inc. and Virginia Elec. & Power Co.*, Case Nos. PUE830060, PUE960037, PUE940040 and PUE940051, 1997 WL 537356 (July 10, 1997).

149. *See id.* at \*1.

150. *See id.*

151. *See Commonwealth ex rel. State Corp. Comm'n v. Dominion Resources, Inc.*, Case No. PUE940040, 1994 WL 379785 (June 17, 1994).

152. *See id.* at \*3-4.

153. *See id.* at \*4.

154. *Commonwealth ex rel. State Corp. Comm'n v. Dominion Resources, Inc. and*

mission transferred from Case No. PUE940040 to a new case, Case No. PUE940051, all issues that did not “involve inquiries of a judicial nature into past conduct for the purpose of determining and penalizing failures to observe [Commission] orders, regulations or other applicable law, or judicial actions necessary to maintain the status quo during the pendency of the case.”<sup>155</sup> Specifically, the Commission did not transfer into Case No. PUE940051 the “show cause” aspects of Case No. PUE940040. Those aspects of Case No. PUE940040 were directed at determining whether the 1986 Order had been violated and whether certain conditions should be imposed on DRI and Virginia Power during the pendency of the case.<sup>156</sup>

On May 24, 1996, after Staff filed its reports in Case No. PUE940051, the Commission issued an order requiring Virginia Power’s board to adopt conflict of interest standards and to report its progress in that regard to the Commission Staff quarterly, beginning June 29, 1996.<sup>157</sup> The Commission also required Virginia Power to file an independent certified audit of affiliate transactions with its annual report of affiliate transactions.<sup>158</sup> The Commission further directed Virginia Power and the Commission Staff to address in the utility’s 1995 annual informational filing the extent to which Virginia Power paid for duplicate executive services it received from DRI.<sup>159</sup> Finally, the Commission continued this matter to July 12, 1997.<sup>160</sup>

The Commission noted in the May 1996 Order that DRI implemented conflict of interest standards for the DRI board of directors in response to the Staff reports.<sup>161</sup> For example, DRI modified its conflict of interest guidelines to require its direc-

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Virginia Elec. & Power Co., Case Nos. PUE940040 and PUE940051, 1994 WL 514073 (Aug. 24, 1994).

155. *Id.* at \*5.

156. *See id.*

157. Commonwealth *ex rel.* State Corp. Comm’n *Ex parte, in Re*, Investigation of Dominion Resources, Inc. and Virginia Elec. & Power Co., Case No. PUE940051, Order Directing Action and Continuing Proceeding, 1996 WL 339466 (May 24, 1996) at \*3-4.

158. *See id.* at \*4.

159. *See id.*

160. *See id.*

161. *See id.* at \*2.

tors to disclose any material transactions with any wholly owned subsidiary of DRI in which they have an interest, as well as such transactions with DRI.<sup>162</sup> The Commission further noted that it was of the "firm opinion that the absence of conflicts of interest within the DRI and Virginia Power boards is critical if Virginia Power is to maintain its independent management, which we continue to find essential for the protection of the public interest."<sup>163</sup> The Commission reserved judgment on whether the modifications taken by the DRI board afforded adequate protection to Virginia Power. The Commission, however, directed Virginia Power to adopt appropriate conflict of interest standards for its board of directors without delay.<sup>164</sup>

Thus, on July 10, 1997, the Commission issued an order closing Case Nos. PUE940040 and PUE940051.<sup>165</sup> The Commission based its decision on the changes adopted by Virginia Power and the "relative harmony" of the past year.<sup>166</sup> The Commission further ordered that Virginia Power and DRI are no longer required to provide the Commission twenty-one days prior written notice of any proposed change to the board or management of Virginia Power.<sup>167</sup>

## E. Gas Utilities

### 1. Rate Cases

By Order entered on May 27, 1997, the Commission approved a rate increase of approximately \$130,000 for United Cities Gas Company (UCGC).<sup>168</sup> The increase was substantially less than what UCGC requested in its application. UCGC sought a general increase in annual revenues of approximately \$810,000.<sup>169</sup>

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162. *See id.*

163. *Id.*

164. *See id.*

165. *See Commonwealth ex rel. State Corp. Comm'n v. Dominion Resources, Inc., and Virginia Elec. & Power Co.*, Case Nos. PUE830060, PUE960037, PUE940040 and PUE940051, 1997 WL 537356 (July 10, 1997) at \*3.

166. *Id.* at \*2.

167. *See id.*

168. *Application of United Cities Gas Co.*, Case No. PUE950008, 1997 WL 362682, (May 27, 1997) at \*1.

169. *See id.*

The Hearing Examiner assigned to the case determined that there were three principal issues accounting for most of the difference between the additional revenues sought by UCGC and that recommended by the Staff. The three issues include: (i) the methodology for allocating corporate and division costs among the states served by the Company based on the number of meters (not the number of individual customers); (ii) accumulated depreciation of a corporate and division plant in Tennessee, which is allocated to Virginia; and (iii) the disparity in the rate of return on common equity recommended by Staff and UCGC.<sup>170</sup> The Examiner found for the Staff on the first two issues, and on the third issue recommended a range on rate of return slightly higher than that recommended by the Staff.<sup>171</sup>

The Commission approved the Hearing Examiner's findings and recommendations with certain modifications. The Commission declined to accept the Examiner's recommended treatment of UCGC's interest expense for an automobile leasing arrangement with an affiliate.<sup>172</sup> While UCGC had calculated its interest based on the original cost, the Staff had argued that interest expense should be calculated based on a declining balance of a net book value of the vehicles. The Commission adopted the Staff's methodology.<sup>173</sup> In so doing, the Commission noted the fact that the arrangement between the Company and its affiliate had been approved by the Commission and is a separate matter from whether the affiliate charges should be allowed for ratemaking purposes.<sup>174</sup> Moreover, the Commission stated, "in seeking to include affiliate charges in rates, the company bears the burden of proving that the costs were reasonable."<sup>175</sup> In this case, the Commission found that the record showed no attempt by UCGC to demonstrate that the costs associated with the leasing arrangement were reasonable.<sup>176</sup> For example, the Commission noted there was no evidence that the affiliate charges were less than what had been charged by

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170. *See id.*

171. *See id.*

172. *See id.* at \*2.

173. *See id.*

174. *See id.*

175. *Id.* (footnote omitted).

176. *See id.*



an unaffiliated entity or that the arrangement was less costly than if UCGC had purchased the vehicles.<sup>177</sup> Nevertheless, the Commission declined to disallow all of these affiliate costs. Rather, it adopted the Staff's recommendation that an adjustment to calculate interest expense based on a declining balance of the net book value of the vehicles was reasonable and appropriate. This adjustment resulted in a disallowance of approximately \$58,000.<sup>178</sup>

The Commission also declined to adopt the Examiner's findings with respect to a rate base adjustment for the over- or under-recovery of gas costs.<sup>179</sup> UCGC had recorded an adjusted journal general entry of approximately \$4.3 million to reflect the proper level of purchased gas expense for Virginia.<sup>180</sup> The Staff requested that UCGC reconcile the \$4.3 million figure on an invoice-by-invoice basis.<sup>181</sup> UCGC initially provided a response that provided support for only \$4.1 million.<sup>182</sup> Subsequently, UCGC revised its response to provide support for an adjustment of \$4.3 million.<sup>183</sup> With respect to questions concerning the discrepancy between the \$4.1 million and the \$4.3 million, UCGC provided no reasonable explanation, claiming only that "the reason(s) for the difference in the two numbers is unknown."<sup>184</sup> The Commission found that UCGC, despite being given several opportunities to reconcile the difference between the \$4.1 million and the \$4.3 million figures and to support the \$4.3 million, had failed to do so and, therefore, UCGC did not carry its burden of proof with respect to the \$4.3 million.<sup>185</sup> Because the Staff stated it could trace the \$4.1 million to each gas invoice for every month involved, the Commission held that the \$4.1 million figure should be used to calculate the appropriate adjustment to deferred gas costs included in the rate base.<sup>186</sup>

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177. *See id.* at \*2.

178. *See id.*

179. *See id.* at \*3.

180. *See id.*

181. *See id.*

182. *See id.*

183. *See id.*

184. *Id.* (quoting Transcript at 123).

185. *See id.*

186. *See id.*

Consistent with its findings, the Commission held that UCGC required additional gross annual revenues to have an opportunity to earn a return on equity in the range of 10.50%–11.50%.<sup>187</sup> The Commission, therefore, ordered UCGC to implement the approved rates and to issue refunds, with interest, to customers who paid UCGC's originally proposed rates on an interim basis.<sup>188</sup>

## 2. Certification of Underground Natural Gas Storage Facility

On July 25, 1997, Hearing Examiner Deborah V. Ellenberg issued her report recommending that the Commission approve Virginia Gas Pipeline Company's application for a certificate of public convenience and necessity for the first salt cavern underground natural gas storage facility in Virginia.<sup>189</sup> Virginia Gas Pipeline Company (VGPC) filed an application for a certificate of public convenience and necessity under the Utility Facilities Act<sup>190</sup> to develop, construct, and operate an underground natural gas storage facility in the Town of Saltville in Smith and Washington Counties, Virginia.<sup>191</sup> VGPC proposed a certificated area of approximately 2,037 acres. The proposed project encompassed existing salt caverns previously used for salt production, proposed future caverns, six miles of eight-inch pipeline to connect the storage facility to a pipeline owned and operated by East Tennessee Natural Gas Company, and a future right-of-way for a second pipeline when necessary.<sup>192</sup>

The storage capacity of the facility would be 650,000 MMBtu, of which 450,000 MMBtu would represent working gas and 200,000 MMBtu would be injected gas to serve as a cushion or

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187. *See id.* at \*4.

188. *See id.*

189. *See* Application of Virginia Gas Pipeline Co., Case No. PUE960093, Report of Deborah V. Ellenberg, Hearing Examiner (July 25, 1997). The Commission issued a final order in the case September 17, 1997 adopting most of the Hearing Examiner's recommendations. *See* Application of Virginia Gas Pipeline Co., Case No. PUE960093, Final Order, 1997 WL 652498 (Sept. 17, 1997) at \*3. A full discussion of the Final Order in this article is not possible.

190. VA. CODE ANN. §§ 56-265.1-9 (Repl. Vol. 1995 & Cum. Supp. 1997).

191. *See* Application of Virginia Gas Pipeline Co., Case No. PUE960093, Report of Deborah V. Ellenberg, Hearing Examiner (July 25, 1997) at 1.

192. *See id.* at 2 (citation omitted).

base. The Company proposed to offer three firm storage services: (i) a ten-day withdrawal service; (ii) a sixty-day withdrawal service; and (iii) a ninety-day withdrawal service.<sup>193</sup> Further, interruptible service would be available under Rate Schedule ISS, and customers would be able to transfer capacity rights from services available under Rate Schedule FSS.<sup>194</sup>

The two issues in the controversy between VGPC and the Commission Staff during the hearing involved VGPC's request that the certificated area include the proposed right-of-way for the future pipeline connecting the storage facilities to East Tennessee Natural Gas's facilities to handle anticipated load growth and the proper treatment of an acquisition adjustment.<sup>195</sup> In addressing the need for the facility, the Examiner noted that the Commission had previously issued a certificate under Virginia Code section 56-265.2 authorizing the construction and operation of the first underground natural gas storage facility in Virginia to an affiliate of VGPC.<sup>196</sup> The Examiner determined that the criteria for establishing the public convenience and necessity in that case also applied to VGPC. The criteria required: (i) the applicant to show that there is a need for the additional service within the time frame contemplated by the application; (ii) that there are no suitable alternatives to the proposed construction; and (iii) that the facility's estimated cost, choice of technology, construction plans, and proposed manner of carrying out the project are reasonable.<sup>197</sup> Further, when the applicant is a newly formed public service company, it is also necessary to determine if the proposed rates are just and reasonable before a certificate to provide service can be granted.<sup>198</sup> After evaluating the record in VGPC's case, the Examiner determined that "[a]pproval of the Company's proposed natural gas storage facility and pipeline is justified by the public convenience and necessity."<sup>199</sup> Specifically, the Examiner found that underground storage is a "crucial component" to the management of fluctuating load and gas supply in local

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193. *See id.*

194. *See id.*

195. *See id.* at 6.

196. *See id.*

197. *See id.*

198. *See id.* at 6-7.

199. *Id.* at 15.

distribution.<sup>200</sup> Distribution companies can use such storage to supplement supply during peak periods and times when upstream suppliers are facing capacity constraints. In addition, this storage could “enable distribution companies to take advantage of seasonal fluctuations in the price of natural gas,” thereby obtaining cost savings that will ultimately be passed on to ratepayers.<sup>201</sup> She also determined that there were no alternatives that could provide the same or substantially similar service to that contained in VGPC’s proposal.<sup>202</sup>

One of the more critical issues addressed by the Examiner was an acquisition adjustment proposed by VGPC. This adjustment was the result of the withdrawal of Tenneco Energy, an original investor, from the project.<sup>203</sup> Tenneco had previously agreed to participate in the development of the proposed project as a fifty percent, non-operating, equity owner.<sup>204</sup> In February, 1996, Virginia Gas agreed to purchase Tenneco Energy’s interest in the project for \$2,225,000. At that time, Tenneco Energy had accumulated \$1,049,000 in equity in the project.<sup>205</sup> Thus, it appeared that the purchase of Tenneco Energy’s interest exceeded Tenneco Energy’s actual cost by \$1,176,000.<sup>206</sup> VGPC capitalized the excess and charged it to engineering/supervision.<sup>207</sup> Staff recommended eliminating an acquisition adjustment of \$825,364, resulting from VGPC’s acquisition of Tenneco Energy’s interest in the Project, from the Company’s rate base.<sup>208</sup>

The Examiner agreed with the Staff and rejected the acquisition adjustment stating that “the record does not support the purchase price [of Tenneco Energy’s interest] or a finding of net benefit to the ratepayer, both of which must be clearly established before such an extraordinary adjustment should be made.”<sup>209</sup> In rejecting VGPC’s acquisition adjustment, the Ex-

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200. *Id.* at 7

201. *Id.*

202. *See id.*

203. *See id.* at 9.

204. *See id.*

205. *See id.*

206. *See id.* (citation omitted)

207. *See id.*

208. *See id.* at 10.

209. *Id.* at 14.

aminer relied on Commission precedent, noting that "an acquisition adjustment is made only in extraordinary circumstances."<sup>210</sup>

With respect to VGPC's request for certification of a future right-of-way to serve expected future load growth, the Hearing Examiner determined that the record did not support granting approval of VGPC's request.<sup>211</sup> The Hearing Examiner explained, "[t]he need has not been established and Commission precedent reveals a reluctance to approve contingent facilities."<sup>212</sup> The State Corporation Commission issued a final order September 17, 1997, but a full discussion of the order is not possible in this article.<sup>213</sup>

### 3. Capacity Release and Off-System Sales Experiment

On May 15, 1995, Commonwealth Gas Services, Inc., (CGS) applied to revise its rates and tariffs.<sup>214</sup> The application included proposals to implement, on a two-year experimental basis, incentive-based mechanisms to share revenues resulting from capacity release and off-system sales with customers.<sup>215</sup> The proceeding to address CGS's application was bifurcated into Phase I and Phase II by agreement of the participating parties. Phase I considered CGS's proposed tariff provisions, and Phase II considered the incentive mechanisms. The Examiner issued his report on March 12, 1996, addressing the issues pertaining to Phase I. On April 24, 1996, the Commission issued an order remanding Phase II of the proceeding to the Hearing Examiner for further consideration of CGS's off-system

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210. *Id.* at 10.

211. *See id.* at 15.

212. *Id.*

213. *See* Application of Virginia Gas Pipeline Co., Case No. PUE960093, Final Order, 1997 WL 652498 (Sept. 17, 1997).

214. Application of Commonwealth Gas Servs., Inc., Case No. PUE950033, Report of Howard P. Anderson, Jr., Hearing Examiner (Mar. 20, 1997), at 1. Two subsequent orders have come from the Commission in this case, neither of which can be fully discussed in this article. *See* Application of Commonwealth Gas Servs., Inc., Case No. PUE950033A, Order Granting Partial Reconsideration, 1997 WL 793182 (Nov. 4, 1997); Application of Commonwealth Gas Servs., Inc., Case No. PUE950033, Order on Incentive-Based Mechanisms, 1997 WL 715702 (Oct. 14, 1997).

215. *See* Application of Commonwealth Gas Servs., Inc., Case No. PUE950033, Report of Howard P. Anderson, Jr., Hearing Examiner (Mar. 20, 1997), at 1.

sales and capacity release revenue sharing proposal.<sup>216</sup> The Order directed CGS to offer its incentive plans on an interim basis, subject to refund, effective January 1, 1996, and established a schedule for consideration of the plan.<sup>217</sup>

CGS's innovative off-system sales and capacity release revenue sharing proposal merits detailed discussion. Under the proposed revenue sharing mechanisms for capacity release and off-system sales, the company proposed a 65% to 35% sharing of off-system sales profits, with 65% of such profits being credited to customers through the purchase gas adjustment clause (PGA) and 35% retained by the CGS, up to an annual profit level of \$130,000.<sup>218</sup> All profits from off-system sales that exceed that amount would be split on a 50/50 basis between the company and the PGA customer.<sup>219</sup> CGS also proposed a benchmark to measure its success or failure in its capacity release program and to expose CGS to an economic risk if it performs at lower than benchmark levels.<sup>220</sup> It proposed that "the benchmark be set at the average annual revenue reached in the first two years since the beginning of operation under FERC Order 636."<sup>221</sup> CGS proposed symmetrical sharing percentages "around the capacity release benchmark, with two progressive levels of incentives."<sup>222</sup> Specifically, CGS proposed that if the annual revenue for capacity release fell between \$0.00 and \$500,000, CGS would credit to PGA customers, in addition to all of the capacity release revenue collected, an amount equal to 50% of the difference between the revenue attained and \$500,000, plus an amount equal to 35% of the \$130,000 difference between \$500,000 and \$630,000.<sup>223</sup> Further, if the annual revenue was greater than \$500,000 but less than \$600,000, CGS credit to the PGA, in addition to all of the capacity release revenue, would be 35% of the difference between actual revenue and \$630,000. But if capacity release revenue exceeded \$630,000, CGS would progressively share in a

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216. *See id.*

217. *See id.*

218. *See id.* at 7.

219. *See id.*

220. *See id.*

221. *Id.*

222. *Id.* at 8.

223. *See id.*

portion of the revenue.<sup>224</sup> For example, if the annual revenue was more than \$630,000 but less than \$760,000, CGS would retain 35% of the revenue that exceeded \$630,000. CGS would retain 50% of revenue that exceeded \$760,000.<sup>225</sup>

Hearing Examiner Howard P. Anderson, Jr., found that CGS's capacity release and off-system sales pilot incentive programs should be adopted.<sup>226</sup> The Examiner deemed CGS's proposed programs to be modest in scope and duration. He also noted that the programs were designed to be learning and growth experiences from which the Commission and CGS could develop larger, more comprehensive, and more complex programs in the future.<sup>227</sup> The Examiner also noted that because the pilot programs had been implemented on an interim basis since January of 1996, more than one-half of the potential two-year duration of the experiment had already passed by the time he rendered his report.<sup>228</sup>

In reaching his conclusions, the Hearing Examiner found that the pilot incentive program satisfied the five criteria outlined in Virginia Code section 56-235.6.<sup>229</sup> First, the Examiner found that the proposed program would preserve adequate service to all classes of customers, including transportation-only customers. In this regard, the Examiner declined to tie customer service and pipeline safety to the pilot programs. The Examiner stated, "the Company's [CGS's] pipeline safety and customer service performance can and should be monitored with the purpose of including these components in a comprehensive, future performance-based plan. I find simply that it is premature to do so at this time."<sup>230</sup> Second, the Examiner found that the proposed programs do not prejudice or disadvantage

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224. *See id.*

225. *See id.*

226. *See id.* at 15. The Examiner recommended adoption of a modified version of the Company's original proposal. *See id.* In an attempt to address concerns raised by certain industrial protestants and Commission Staff, CGS revised its initial proposal to, among other things, increase the share of its PGA customers in the revenues resulting from the program. *See id.*

227. *See id.*

228. *See id.* at 19.

229. VA. CODE ANN. § 56-235.6 (Cum. Supp. 1997).

230. Application of Commonwealth Gas Services, Inc., Case No. PUE950033, Report of Howard P. Anderson, Jr., Hearing Examiner (Mar. 20, 1997), at 16.

any customer class because all customers would share in anticipated gas cost savings.<sup>231</sup> Third, he found that “the two programs will encourage additional efforts by CGS in the areas of capacity release and off-system sales.”<sup>232</sup> In other words, he found that the Plan provided incentives for improved performance by CGS. Fourth, the Examiner found that contrary to causing excessive rates, the proposed pilot programs, through revenue sharing, would reduce gas costs to retail customers without impacting the base rates to either sales or transportation customers.<sup>233</sup> Fifth, the Examiner found that the proposed programs would serve the public interest.<sup>234</sup> He found that “experience gained by Commonwealth in the competitive gas market can and should benefit the Company [CGS] and its customers in an increasingly competitive utility field.”<sup>235</sup> Finally, he found that the proposed incentive programs would not serve as a guaranteed bonus but would put CGS at risk if results fell below a certain level.<sup>236</sup> The State Corporation Commission issued two orders in this case this fall, neither of which can be fully discussed in this article.<sup>237</sup>

## F. Telephone Utilities

### 1. Telecommunications Act and New Local Exchange Companies

As of July 28, 1997, forty-two firms had applied for certificates of public convenience and necessity to operate as local telephone exchange companies in Virginia.<sup>238</sup> As of the same date, twenty-three had been certificated, seventeen applications

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231. *See id.*

232. *Id.*

233. *See id.*

234. *See id.*

235. *Id.*

236. *Id.* at 17.

237. *See* Application of Commonwealth Gas Servs., Inc., Case No. PUE950033A, Order Granting Partial Reconsideration, 1997 WL 793182 (Nov. 4, 1997); Application of Commonwealth Gas Servs., Inc., Case No. PUE95033, Order on Incentive-Based Mechanisms, 1997 WL 715702 (Oct. 14, 1997).

238. Interview with William Irby, Manager, Rates & Costs, Virginia State Corporation Commission, Division of Communications (July 28, 1997).



were still pending, and two companies had withdrawn their applications.<sup>239</sup>

Pursuant to the Telecom Act, the Commission has held two major arbitration proceedings involving Bell Atlantic-Virginia and GTE South, Inc., the primary incumbent local exchange telephone carriers in Virginia. For new competitors interested in buying existing services of Bell Atlantic-Virginia at wholesale prices and reselling to their own retail customers, the Commission set a temporary wholesale discount of 18.5%.<sup>240</sup> For new competitors electing to provide their own operator services instead of reselling Bell Atlantic's, the wholesale discount will be at a higher rate of 21.3%.<sup>241</sup> With respect to interconnection prices, which must be cost-based and non-discriminatory, Bell Atlantic and the other parties involved in the arbitration agreed to use the interim pricing provisions set by the FCC,<sup>242</sup> as a basis for setting Bell Atlantic's rates. The Commission thus set rates based on the FCC proxy rates for using critical elements of Bell Atlantic-Virginia's network in order to complete calls.<sup>243</sup>

In the fall of 1996, the Commission established the prices competing LECs would pay to GTE-South<sup>244</sup> to either connect with GTE's network or resell GTE local services.<sup>245</sup> The Com-

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239. *Id.*

240. See Application of AT&T Communications of Virginia, Inc., Case No. PUC960100, Order Resolving Wholesale Discount for Resold Services, 1996 WL 755291 (Nov. 8, 1996) at \*2.

241. See Application of AT&T Communications of Virginia, Inc., Case No. PUC960100, Amending Order, 1996 WL 755292 (Nov. 13, 1996) at \*1.

242. See First Report and Order, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, 61 Fed. Reg. 47284 (1996) (overruling in part, *Iowa Util. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997)). The FCC's rules are contained in Appendix B of the First Report and Order and now are codified in scattered sections of Title 47, Code of Federal Regulations.

243. See Application of AT&T Communications of Virginia, Inc., Case No. PUC960100, Order Setting Proxy Prices and Resolving Interim Number Portability, 1996 WL 755290 (Nov. 8, 1996).

244. The Commission had earlier determined that GTE's service territory in South-west Virginia qualified for the exemption afforded rural telephone companies under § 3(37)(C) of the Telecommunications Act. See Commonwealth of Virginia *ex rel.* State Corp. Comm'n, *Ex parte*: In the matter of investigating GTE South, Inc.'s status as a rural telephone company pursuant to the Telecommunications Act of 1996, Case No. PUC960109, Order on Rural Status and Denying Stay, 1996 WL 692371 (Oct. 22, 1996) at \*3.

245. See Petition of AT&T Communications of Virginia, Inc., Case No. PUC960117,

mission set a temporary wholesale discount of 20.6%.<sup>246</sup> New competitors electing to provide their own operator services instead of reselling GTE's, however, would get a wholesale discount of 23.4%.<sup>247</sup> The GTE arbitration was contentious because the parties did not agree to use the pricing methodology contained in the First Report and Order and the FCC rules as guidelines for setting temporary prices. The Commission was not satisfied with the various pricing models submitted by the parties, and the Commission noted that much of the information submitted in the proceeding was not specific to the cost of GTE's Virginia operations.<sup>248</sup> The Commission therefore set temporary rates until it could establish new rates based on Virginia data.<sup>249</sup> As discussed in the next section of this article, GTE unsuccessfully sought judicial review of the Commission's orders. On the same date it issued this Pricing Order, the Commission also entered an "Order Resolving Non-Pricing Arbitration Issues and Requiring Filing of Interconnection Agreements"<sup>250</sup> as to GTE and AT&T. In the Non-Pricing Order, the Commission resolved twenty-nine issues in dispute between AT&T and GTE, ranging in complexity from whether AT&T could get access to GTE's Advanced Intelligent Network (AIN) triggers and Signaling System 7 (SS7) to whether AT&T may obtain information necessary to bill its customers from GTE, and if so how much of GTE's cost for providing the information should be borne by AT&T.<sup>251</sup>

Since the Commission issued its Pricing and Non-Pricing Orders, the Commission has initiated a proceeding to determine permanent pricing for both Bell Atlantic-Virginia and GTE Virginia.<sup>252</sup> The permanent pricing proceeding involving Bell

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Order Resolving Rates for Unbundled Network Elements and Interconnection, Wholesale Discount for Services Available for Resale, and Other Matters, 1996 WL 767555 (Dec. 11, 1996).

246. *See id.* at \*6.

247. *See id.*

248. *See Pricing Order, supra* note 275, at 3-4.

249. *See id.* at 4.

250. Petition of AT&T Communications of Virginia, Inc., Case No. PUC960117, Order Resolving Non-Pricing Arbitration Issues and Requiring Filing of Interconnection Agreement, 1997 WL 768163 (Dec. 11, 1996).

251. *See id.*

252. *See Commonwealth ex rel State Corp. Comm'n Ex parte: To Determine Prices Bell Atlantic-Virginia, Inc., is Authorized to Charge Competing Local Exchange Carri-*

Atlantic-Virginia was heard by the full Commission in June and July, 1997. A final decision is pending. On April 30, 1997, the Commission issued an order suspending the procedural schedule for the GTE permanent pricing proceeding.<sup>253</sup>

## 2. Federal District Court Review of Commission Arbitration Decisions

After the Commission issued its Pricing and Non-Pricing orders after the GTE-AT&T arbitration orders, GTE filed an action in the Eastern District of Virginia alleging that the orders violated sections 251 and 252 of the Telecommunications Act.<sup>254</sup> Specifically, GTE alleged that the Commission's arbitration decision (i) did not follow appropriate pricing standards for providing interconnection, network elements, and services; (ii) contained an expensive categorization of network elements; and (iii) contained inappropriate requirements for GTE to modify or upgrade its network for competitors.<sup>255</sup> GTE sought declaratory relief alleging that (i) the December 11, 1996, orders violate the Act; (ii) the Act requires that prices be based on GTE's cost and avoided cost; (iii) GTE is entitled to competitively neutral non-bypassable end user charges to cover GTE stranded costs; and (iv) the Commission be permanently enjoined from taking action on the December 11, 1996, orders.<sup>256</sup>

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ers in Accordance with the Telecommunications Act of 1996 and Applicable State Law, Case No. PUC970005; Commonwealth *ex rel* State Corp. Comm'n *Ex parte*: To Determine Prices GTE-South, Inc., is Authorized to Charge Competing Local Exchange Carriers in Accordance with the Telecommunications Act of 1996 and Applicable State Law, Case No. PUC970006.

253. See Commonwealth *ex rel* State Corp. Comm'n. *Ex parte*: To determine prices GTE South, Inc., is Authorized to Charge Competitive Local Exchange Carriers and Wholesale Discounts for Services Available for Resale in Accordance with the Telecommunications Act of 1996 and Applicable State Law, Case No. PUC970006, Order Suspending Procedural Schedule (Apr. 30, 1997).

254. GTE South, Inc. v. Morrison, 957 F. Supp. 800 (E.D. Va. 1997). GTE sued each of the three Commissioners of the State Corporation Commission in their official capacity as Commissioners of the Commission. Also named as defendants were AT&T Communications of Virginia, Inc., MCI Telecommunications Corporation, and MCI Metro Access Transmission Services of Virginia, Inc., all of which had been participants in the arbitration proceeding.

255. See *id.* at 802.

256. See *id.* at 802-03.

Each of the defendants moved to dismiss GTE's filing pursuant to Federal Rules of Civil Procedure 12(b)(1), 12(b)(6), and 12(b)(2). The defendants contended that the court lacked subject matter jurisdiction and the case was not ripe for review until the Commission rejects or accepts an agreement between the parties. In addition, the commissioner defendants argued that the Eleventh Amendment of the United States Constitution obviates the court's jurisdiction over the commissioners.<sup>257</sup> The court found that it lacked subject matter jurisdiction and thus did not address the remaining arguments raised by the defendants.<sup>258</sup> In holding that it did not have jurisdiction, the court observed that jurisdiction depended on the court's interpretation of § 252(e)(6) of the Telecom Act and the undisputed facts as applied to that interpretation.<sup>259</sup> The defendants contended that the court lacked subject matter jurisdiction because § 252(e)(6) provides Federal District Court review only of the Commission's approval or disapproval of the final agreement, and that the Commission had not approved or rejected a final agreement because the parties had not submitted an agreement to the Commission.<sup>260</sup> GTE, however, contended that the December 11, 1996, orders are "determinations" by the Commission and, therefore, are reviewable by the district court.<sup>261</sup>

As the court noted, § 252(e)(6) provides for Federal District Court review of agreements "[i]n any case in which a State commission makes a *determination* under [section 252], any party aggrieved by such *determination* may bring an action in an appropriate Federal district court to *determine whether the agreement* or statement meets the requirements of Section 251 of this title and this section."<sup>262</sup> Construing the statute as a whole, the court found that it did not have subject matter jurisdiction under the Telecom Act over GTE's complaint.<sup>263</sup> The court added that the structure of the Telecom Act supported its determination.<sup>264</sup> The court observed that § 252 sets out a

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257. *Id.* at 803.

258. *See id.*

259. *See id.*

260. *See id.*

261. *See id.* at 804.

262. *Id.* (quoting 47 U.S.C.A. § 252(e)(6)) (West Supp. 1998) (emphasis in original).

263. *See id.*

264. *See id.*

four-stage approach to developing an interconnection agreement: (i) voluntary negotiations for the first 135 days; (ii) arbitration of the unresolved issues commencing during the 135th to 160th day and concluded by the State commission within nine months of the first interconnection agreement request; (iii) approval or rejection by the State commission; and (iv) review of State commission actions.<sup>265</sup> The Commission had not completed the third stage in the statutory procedures because the parties had not submitted a final agreement. Therefore, the Court held, the December 11, 1996, orders were not final and not subject to review.<sup>266</sup>

### 3. IntraLATA Competition

By Order dated May 9, 1997,<sup>267</sup> the Commission established requirements and conditionally approved the dialing parity plans of various local exchange telephone companies in Virginia. The telephone companies had developed dialing parity plans to comply with § 251(b)(3) of the Telecom Act which requires that all local exchange telecommunications carriers furnish dialing parity to competing providers of exchange and toll telephone services.<sup>268</sup> Pursuant to § 251(b)(3), the FCC issued its Second Report and Order and memorandum opinion<sup>269</sup> in which it established an implementation time table for local exchange carriers to provide intraLATA and interLATA dialing parity by no later than February 8, 1999.<sup>270</sup> The Second Report and Order requires LECs to provide intraLATA toll dialing parity in a state coincident with their provision of interLATA toll service within that state.<sup>271</sup> A grace period was granted, however, to

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265. See *id.*; 47 U.S.C.A. § 252(a), (b), (e) (West Supp. 1998).

266. See *GTE South*, 957 F. Supp. at 804-05.

267. Commonwealth *ex rel.* State Corp. Comm'n *Ex parte*: Implementation of IntraLATA Toll Dialing Parity pursuant to the provisions of 47 U.S.C. § 251(b)(3), Case No. PUC970009 1997 WL 362693 (May 9, 1997).

268. See 47 U.S.C.A. § 251(b)(3) (1997) (West Supp. 1998).

269. In the matter of implementation of the local competition provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, (Aug. 8, 1996) [hereinafter Second Report and Order].

270. See *id.* at ¶ 62(a).

271. See *id.* at ¶ 62(b), (c).

LECs providing interLATA toll services prior to August 8, 1997.<sup>272</sup>

The Commission adopted minimum standards and other guidelines LECs must follow in implementing intraLATA presubscription in Virginia.<sup>273</sup> Further, the Commission determined that recovery for a LEC's intraLATA equal access incremental costs should be shared proportionately among intraLATA providers on the basis of total intraLATA minutes.<sup>274</sup> The Commission, however, determined that it would allow the intraLATA market to develop for one year before a LEC may begin cost recovery.<sup>275</sup> The Commission also granted GTE and United/Centel a limited waiver for carrier notification and required those companies to provide at least thirty-days notice to carriers prior to implementing intraLATA equal access by end office to meet their proposed implementation schedules.<sup>276</sup>

Under the Commission's Guidelines, unless the Commission determines otherwise, a two-PIC method must be utilized by all LECs.<sup>277</sup> This would allow customers to presubscribe to different carriers for their intraLATA and interLATA toll calling. Further, the Guidelines require LECs to offer intraLATA toll dialing parity to carriers on a competitively neutral basis and in a non-discriminatory manner.<sup>278</sup> Among other requirements is the mandate that a LEC provide notices of thirty-days and sixty days to customers and interexchange companies, respectively, of the availability of intraLATA equal access in their exchange areas prior to implementation of dialing parity.<sup>279</sup> Further, the Guidelines provide that a LEC may provide an

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272. See *id.* at ¶ 62(c).

273. See Commonwealth *ex rel.* State Corp. Comm'n *Ex parte*: Implementation of IntraLATA Toll Dialing Parity pursuant to the provisions of 47 U.S.C. § 251(b)(3), Case No. PUC970009, 1997 WL 362693 (May 9, 1997) at Attachment 1. These guidelines are found in attachment to this order (hereinafter Guidelines).

274. See *id.* at \*2.

275. See *id.*

276. See *id.*

277. See Guidelines, *supra* note 273, ¶ 1.

278. See *id.* ¶ 10.

279. *Id.* at ¶¶ 3, 4.

intraLATA PIC freeze option to requesting customers once intraLATA equal access has been implemented.<sup>280</sup>

#### 4. GTE South, Inc., Rate Case

GTE filed what it described as a "revenue neutral" rate application with the Commission requesting authority to restructure and rebalance its rates and charges on June 29, 1995.<sup>281</sup> In its first rate application in more than a decade, GTE claimed that its rate restructuring and rebalancing proposals were necessary for the company to position itself for an impending increase in competition in the telecommunications market in Virginia.<sup>282</sup> GTE originally proposed to reduce its intrastate access charges by approximately \$16.9 million, reduce its intraLATA long-distance rates by approximately \$5.8 million, and reduce its intrastate revenues by approximately \$12.1 million by expanding its local calling areas.<sup>283</sup> GTE also proposed to increase its local exchange rates and other miscellaneous rates and charges so as to recover the \$34.8 million in lost revenues associated with its proposed reductions in access charges and intraLATA long-distance rates and expanded local calling areas.<sup>284</sup>

As the Hearing Examiner stated in his report, GTE's proposed local exchange rate increases "generated substantial and unprecedented public opposition."<sup>285</sup> Following Staff criticisms of GTE's original proposals and the public outcry over the proposed rate rebalancing, GTE revised its application in November 1995 and reduced the proposed increase in basic local rates to approximately \$21 million.<sup>286</sup> The company also scaled back

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280. *Id.* at ¶ 6.

281. *See* Application of GTE South, Inc., Case No. PUC950019, 1997 WL 595203 (Aug. 7, 1997) at \*2.

282. *See* Application of GTE South, Inc., Case No. PUC950019, Report of Glenn P. Richardson, Hearing Examiner (Mar. 14, 1997) at 1.

283. *See id.*

284. *See id.*

285. *Id.* at 1. The Examiner also described the public opposition as a "literal firestorm." *Id.* at 99.

286. *See id.* The Commission received an unprecedented number of custody letters and petitions (9,000 letters and 17,000 signatures), almost all of which opposed GTE's proposal. *See id.* at 1-2.

the proposed reductions in access charges to \$4.7 million and intraLATA long-distance rates to \$3.175 million.

The Hearing Examiner rejected GTE's attempt to have its rate case evaluated as a revenue neutral filing.<sup>287</sup> GTE argued that its plan was revenue neutral under the alternative regulatory plan already adopted by the Commission as a substitute for the traditional rate base/rate of return regulation in *Ex parte*: In the matter of investigating telephone regulatory methods pursuant to Virginia Code section 56-235.5.<sup>288</sup> GTE further argued that the numerous accounting and financial adjustments proposed by the Staff and the Attorney General, which would reduce the Company's annual operating revenues by approximately \$40-46 million, were inappropriate and should not be considered by the Commission when evaluating the application.<sup>289</sup> In rejecting GTE's request that its application be evaluated as a revenue neutral filing, the Examiner determined that GTE's filing "goes far beyond the scope" of a revenue neutral filing which is designed for revenue neutral pricing modifications for basic local exchange telephone service and discretionary services.<sup>290</sup>

The Commission agreed with the Examiner, stating: "We find that GTE's characterization of its filing is incorrect, for several reasons, and that its argument that its rates are free from examination as to their 'justness and reasonableness' and therefore may not be reduced is wrong."<sup>291</sup>

Thus, using the traditional rate review of GTE's revenue and expenses for its Virginia operation, the Commission determined that the Company's current rates are unjust and unreasonable and must be reduced by over \$27.36 million.<sup>292</sup> Further, the Commission ordered revenue reductions of approximately \$18.46 million and \$7.55 million in access and toll revenues,

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287. *Id.* at 9.

288. Case No. PUC960036, Final Order (Oct. 18, 1994).

289. See Application of GTE South, Inc., Case No. PUC950019, Report of Glenn P. Richardson, Hearing Examiner (Mar. 14, 1997) at 4.

290. *Id.* at 10.

291. Application of GTE South, Inc., Case No. PUC950019, 1997 WL 595203 (Aug. 7, 1997) at \*3.

292. See *id.* at \*2.



respectively.<sup>293</sup> The Commission, however, allowed GTE to decrease those amounts to recover costs it incurs by implementing a local calling plan proposed by Commission Staff.<sup>294</sup> Further, the Commission allowed GTE to increase monthly rates for basic local service in each rate group in the GTE Contel service territory, with some exceptions, by \$2.00.<sup>295</sup> Customers exempted from this rate increase include universal service plan customers, USS business customers in the Contel service territory and local service customers throughout GTE's southwest territory.

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293. *See id.* at n.7.

294. *See id.* at \*7.

295. *See id.* at \*6.