

State Corporation Commission 2007 Fiscal Impact Statement

1. Bill Number HB3068

House of Origin	<input type="checkbox"/> Introduced	<input checked="" type="checkbox"/> Substitute	<input type="checkbox"/> Engrossed
Second House	<input checked="" type="checkbox"/> In Committee	<input type="checkbox"/> Substitute	<input type="checkbox"/> Enrolled

2. Patron Hogan

3. Committee Senate Commerce and Labor

4. Title Virginia Electric Utility Restructuring Act.

5. Summary/Purpose: Virginia Electric Utility Restructuring Act. Changes the State Corporation Commission's authority to review electric utility rates from annually to biennially. Relaxes the requirements on adjustments allowed to be made in rate requests before the Commission for all utilities. Provision prohibiting speculative adjustments is stricken. Provides the Commission authority to approve a performance-based rate-making methodology for electric utilities; current statute applies only to gas utilities. Repeals the State Corporation Commission's authority to consider a utility's overall cost of service when reviewing the need for an increase in its fuel adjustment clause. Instead costs that are recoverable through the fuel rate adjustment clause will be considered on a stand-alone basis without regard to the other costs, revenues, investments or earnings.

After the capped rate period ends, only (i) customers whose annual demand exceeds five megawatts, and (ii) two or more nonresidential retail customers that petition the Commission and receive authority to aggregate their demands to meet the five megawatt limitation, will be permitted to purchase electricity from a competing provider of generation services. The ability of large customers to purchase electric power from a licensed competitive supplier is subject to the condition that they cannot thereafter purchase electricity from their incumbent utility without giving five years' notice, unless it demonstrates that the supplier failed to perform and that such customer is unable to obtain service from an alternative supplier. If a customer receives an exemption from the five-year minimum stay requirement, the cost of its power during the exemption period will be the market-based costs of the utility generation plus various mark-ups including the fair rate of return defined by § 56-585.1, discussed below.

The State Corporation Commission's authority to take certain actions to expand transmission capacity is repealed. The bill removes the prohibition against the filing for eminent domain for construction or enlargement of generation facilities. It specifically provides that an electric utility may offer metering options. Adds a requirement that the State Corporation Commission find that any facility constructed and operated by a utility whose rates are regulated pursuant to § 56-585.1 of the Code of Virginia, are required by the public convenience and necessity. The expiration of capped rates is moved up from December 31, 2010 to December 31, 2008.

The bill requires the State Corporation Commission (SCC) to conduct biennial reviews, subject to notice and opportunity for hearing, of the rates terms and conditions of investor-owned electric utilities. It sets the following parameters for setting a fair rate of return: (i) no less than the average returns on equity reported to the Securities and Exchange Commission of a peer group of nine companies (the specific companies may be chosen by the SCC based on guidelines

provided in the statute) for the previous three years; and (ii) no higher than the national average earned returns, of vertically integrated, regulated electric utilities granted during the most recent 12 months plus 200 basis points. The return calculated according such parameters may be increased or decreased based on the operations of the utility, as compared to national standards, by 50 basis points. If a utility's earnings are within 50 basis points of such return, it shall be considered neither excessive nor insufficient. Costs for transmission services provided by PJM Interconnection and approved by the Federal Energy Regulatory Commission (FERC) and costs of FERC-approved demand response programs administered by PJM, are deemed reasonable and prudent and the SCC shall approve recovery of such costs through a rate adjustment clause. Such rate approval will be made on a stand-alone basis, without consideration of the overall earnings of the electric utility. The SCC must issue its final order within three months of an application.

Utilities may also obtain, after the capped rate period, rate adjustment clauses that: (i) provide incentives for the utility to design and operate various programs including, demand-side management, conservation, energy efficiency and load management programs, which shall be approved if the program is in the public interest and the cost of providing the incentives is demonstrated with reasonable certainty; (ii) provide for projected and actual costs of participation in a renewable energy portfolio standard program provided such costs result in rates that are just reasonable and in the public interest; (iii) provide for projected and actual costs of projects necessary to comply with environmental laws and regulations, including an enhanced return in some instances. The SCC must issue its final order within eight months of an application. The provision of the Virginia Electric Utility Restructuring Act stating that the development of a coal-fueled generation facility in Southwest Virginia is in the public interest remains unchanged. The cost recovery afforded such a facility, i.e. cost recovery via a rate adjustment clause, is amended to apply to other generation facilities (simple-cycle combustion turbines are limited to those constructed after the capped rate period), and major unit modifications of generation facilities and provides that the utility has the right to recover the costs of the facility through its rates, including allowance for funds used during construction plus a fair rate of return, through a rate adjustment clause. As an incentive to undertake such projects, all projects, except simple-cycle combustion turbines, shall include the cost of an enhanced rate of return on the utility's investment for the construction period and the first year of commercial operation. The enhanced rate of return will be no less than 50 basis points and no more than 400 basis points. The SCC must issue its final order within nine months of an application. Each adjustment clause shall be considered on a stand alone basis, without regard to a utility's overall earnings. All costs incurred relative to a specific adjustment clause are to be deferred for future recovery prior the implementation of such a factor. New adjustment clause factors must be effective within 60 days of a final order of the SCC. Based on the results of the SCC's biennial reviews: (i) if earnings are more than 50 basis points below the combined fair rate of return, rates shall be increased to provide earnings of the fair rate of return; however, such increase will be limited to the CPI plus 200 basis points, unless the SCC finds rates are just and reasonable; (ii) if earnings are more than 50 basis points above the fair combined rate of return 60% of such excess shall be returned to ratepayers over a 24-month period; however, if the SCC finds that rates during the review period increased more than the CPI-U, then, if in the public interest, the SCC can require that all earnings more than 50 basis points above the fair rate of return be refunded back to customers; (iii) if earnings are more than 50 basis points above the fair combined rate of return for two consecutive biennial review periods considered as a whole the Commission shall order rate reductions in addition to refunds only if such reductions will continue to allow the utility to earn 50 basis points above a fair combined rate of return. The SCC final order in biennial proceedings

must be issued within 8 months of the end of the test period, or five months after the review is filed with the SCC.

The SCC shall regulate a utility on a stand-alone basis, without regard any entity to which it may be affiliated, specifically when considering federal and state income tax costs. Utilities may file for rate increases pursuant to § 56-245 or the SCC rate case rules, except the rate of return shall be determined per § 56-585.1. Investor-owned electric utilities may apply to the SCC to participate in a renewable energy portfolio standard (RPS) program and the SCC shall approve such application if the utility shows it will likely achieve 12% of base year electric energy sales by 2022. The legislation provides for an increase in the fair rate of return as an incentive whenever the utility meets an RPS goal. The specific RPS goals are defined by the legislation. The legislation states that it is in the public interest for utilities to achieve RPS goals. The SCC shall not require any cooperative to reflect changes in wholesale power costs which occurred during the capped rate period, other than during a general rate proceeding. Cooperatives may change its base rates by vote of its Board of Directors, without SCC review and approval, provided any cumulative increase or decrease, excluding fuel provisions, does not exceed five percent over a three year period. Revised tariffs are to be filed with the SCC.

Section 56-581.1 of the Code of Virginia is repealed. The SCC shall establish a proceeding to relating to energy conservation to establish goals, develop a plan, determine the entity to deploy and administer such a plan, and provide costs estimates of attaining the established goals. The SCC is to report to the Governor and the Commission on Electric Utility Restructuring.

The Department of Taxation shall conduct an analysis of the potential implications of changes to the system of taxation resulting from this law.

This legislation does not modify or impair the terms of any SCC orders approving the divestiture of generation assets.

6. Fiscal impact estimates are: Not available and cannot be determined at this time. See Item # 8.

7. Budget amendment necessary: No.

8. Fiscal implications: There will likely be a fiscal impact on the State Corporation Commission because electric reviews will be limited to a short time period each year. This concentrated work load may result in the need for hiring consultants to assist staff during the limited review period. The legislation will have implications on revenues collected by electric utilities and the bills paid by electric consumers. Such impacts cannot be quantified; however, most major cost increases incurred by electric utilities will be recovered via adjustment clauses without regard to the overall earnings position of the company with no limitation on the number or frequency of such increases.

9. Specific agency or political subdivisions affected: State Corporation Commission;
Virginia Department of Taxation

10. Technical amendment necessary: None noted, but see Item # 11.

11. Other comments:

§ 56-585.1 A:

(1) Generally, this section provides for utilities to increase rates for a host of reasons via adjustment clauses on a stand alone, single issue, basis ignoring current earnings levels. Rates can increase, regardless of a utility's earning levels. It is unclear whether these increases will be noticed and opportunity for hearing provided. Notice and opportunity for hearing provided for by § 56-585.1 A. appears only to apply to biennial reviews.

(2) Subdivision 9 provides that in a biennial review the Commission may order refunds of all distribution and generation earnings more than 50 basis points above the fair return if a test based on a comparison of *total aggregate regulated rates* at specific points in time exceeds the increase in CPI-U. The parameter is unclear.

(3) The specific requirement stating that Commission is not precluded from reviewing the prudence of costs during proceedings conducted pursuant to this section (except FERC approved costs) has been eliminated. Specific language in subdivisions requiring Commission approval of specific costs and the limited time allowed for Commission investigations brings into question the effectiveness of prudence reviews.

(4) § 56-56-585.1 A 2. sets a ceiling on returns set by the Commission of "average *earned* returns...*granted* during the most recent 12 months, plus 200 basis points" (emphasis added). Consideration should be given to striking either "earned" or "granted" to clarify this legislative constraint.

Date: 02/09/07 / sdl

cc: Secretary of Commerce and Trade