

State Corporation Commission 2007 Fiscal Impact Statement

1. **Bill Number** SB1416

House of Origin Introduced Substitute Engrossed

Second House In Committee Substitute Enrolled

2. **Patron** Norment

3. **Committee** House Commerce and Labor

4. **Title** Electric utilities.

5. **Summary/Purpose: Electric utilities.** Advances the scheduled expiration of the capped rate period from December 31, 2010, to December 31, 2008, establishes a new mechanism for regulating the rates of investor-owned electric utilities, and ends the ability of most consumers to shop for electric generation service. The ratemaking procedure requires the State Corporation Commission (SCC) to review each utility's rates, terms, and conditions using a 12-month test period ending December 31, 2008 (for utilities other than Dominion) and the two successive 12-month test periods ending December 31, 2009 (for Dominion). Thereafter, the reviews will cover the two successive 12-month test periods. In these biennial reviews the SCC will determine fair rates of return on common equity for the utility's generation and distribution services, using any methodology it finds consistent with the public interest. However, the return shall not be set: (i) lower than the average of the returns on common equity reported to the Securities and Exchange Commission for the three most recent annual periods by a peer group of a majority of the other vertically-integrated investor-owned electric utilities in the southeastern United States with a Moody's bond rating of at least Baa or (ii) higher than 300 basis points above that average. The SCC may increase or decrease the rate of return by a Performance Incentive of up to 50 basis points based on the generating plant performance, customer service, operations and efficiency of a utility. If the combined rate of return on common equity earned is no more than one half of one percent above or below this rate of return, the return shall not be considered either excessive or insufficient. Each utility may seek rate adjustment clauses to recover (i) costs for transmission services provided by PJM Interconnection under applicable rates, terms and conditions approved by the Federal Energy Regulatory Commission (FERC) and costs of FERC-approved demand response programs; (ii) deferred environmental and reliability costs authorized under prior capped rate rules; (iii) costs of providing incentives for the utility to design and operate fair and effective demand-management, conservation, energy efficiency, and load management programs; (iv) costs of participation in the new renewable energy portfolio standard program; and (v) costs of projects that the Commission finds to be necessary to comply with state or federal environmental laws or regulations applicable to generation facilities used to serve the utility's native load obligations, which costs may include the enhanced rate of return for new base load generation if the project would reduce the need for construction of new generation facilities by enabling the continued operation of existing generation facilities. A utility may also apply a rate adjustment clause for recovery from customers of the costs of (i) a coal-fired generation facility that utilizes Virginia coal and is located in the coalfield region of the Commonwealth, (ii) one or more other generation facilities, or (iii) one or more major unit modifications of generation facilities, to meet the utility's projected native load obligations. The utility may recover an

enhanced rate of return on common equity associated with the project of between 200 and 300 basis points, as determined by the Commission, on projects and facilities other than simple-cycle combustion turbine facilities. This enhanced rate of return is applied during the first half of the life of the project. The Commission's final order on any petition filed for any of the rate adjustment clauses shall be entered within a specified period after the filing of the petition, and any rate increase required by the clause shall go into effect within 60 days or upon the end of capped rates, whichever is later. The Commission is required to consider petitions for rate adjustment clauses on a stand-alone basis, without regard to the other costs or revenues of the utility. Costs incurred prior to the filing of a petition for a rate adjustment clause, or during the petition's consideration, that relate to recover of the deferred environmental and reliability costs or to new generation facilities and projects (other than those using simple-cycle combustion turbines) will be deferred until the later of Commission's final order or the implementation of any rate adjustment clauses. This deferral provision does not affect the rights of parties with respect to FERC proceeding regarding Dominion's proposed deferral of its costs of joining PJM. If the Commission determines in a biennial review that a utility underearned by at least 50 basis points on its generation and distribution services, excluding provisions for new generation facilities, the Commission is required to increase the utility's rates to a level necessary to provide the opportunity to fully recover the costs of providing the utility's services and to earn such fair rate of return. The most recent 12-month test period will be used in determining the amount of the rate increase. If the Commission determines in a biennial review that a utility earned more than 50 basis points above a fair combined rate of return on its generation and distribution services, excluding provisions for new generation facilities, the Commission is required to direct that 60 percent of such overearnings be credited to customers' bills. In addition, if the Commission determines that (i) the utility's earnings exceed this limit for two consecutive biennial review periods, the Commission shall also order reductions to the utility's rates, provided that rates may not be reduced to levels below what would provide the utility with the opportunity to fully recover its costs and to earn a fair combined rate of return on its generation and distribution services, excluding provisions for new generation facilities and (ii) the utility's total aggregate regulated rates, following a biennial review, would exceed the annual increases in CPI, when compared to the utility's rates as determined in the biennial review for a base period (either the utility's first test period or the most recent test period for which credits are applied to customers' bills), the Commission shall direct, unless such action would not be in the public interest, that any or all of such overearnings be credited to customers' bills, in lieu of any rate reduction or other crediting. An electric utility that demonstrates that it has a reasonable expectation of achieving 12 percent of its base year electric energy sales from renewable energy sources during calendar year 2022 may participate in a renewable energy portfolio standard program. Under the program, a participating utility that meets specified percentage goals for sales of renewable energy is eligible for a Performance Incentive that increases the fair combined rate of return on common equity for the utility by a 50 basis points through the third succeeding biennial review if it continues to meet the RPS Goals. It is also entitled to an enhanced rate of return on the costs associated with the construction of renewable energy generation facilities used to provide the renewable energy. With regard to the ability of customers to purchase generation services from competing providers, the measure provides that after the capped rate period ends, only customers whose annual demand exceeds five megawatts will be permitted to shop. However, two or more individual nonresidential retail customers may aggregate their demand for the purpose of meeting the 5 megawatt threshold if the Commission finds that neither their incumbent electric utility nor its retail customers will be adversely affected and that the demand of the customers who are allowed to buy power from competitors will not exceed one percent of

the utility's peak annual load. 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 5 years' notice, with certain exceptions. Municipalities are allowed to aggregating the electric energy load of their governmental operations for the purpose of negotiating rates and terms, and conditions of service from the electric utility certificated by the Commission to serve the territory in which such operations are located. Other provisions (i) require utilities to file plans for how they will meet generation and transmission requirements to serve native load for the ensuing 10 years; (ii) authorize electric utilities to seek approval of optional performance-based regulation methodologies to the same extent as gas utilities; (iii) restore the requirement that the Commission find, before permitting the construction and operation of an electrical generating facility, that the facility is required by the public convenience and necessity; (iv) requires rates of distribution electric cooperatives to be regulated pursuant to the provisions of Chapters 9.1 and 10 of Title 56; (v) states that it does not impair the terms, unless otherwise modified by an order of the SCC, of any order approving the divestiture of generation assets; (vi) provides that an incumbent electric utility that transferred all of its generating assets to an affiliate shall, by January 1, 2009 purchase generating assets or notify the SCC of its intent in good faith to pursue the construction of generating assets to serve the base load portion of its retail native load in Virginia, and that after that date its rates, terms and conditions shall be determined in the same manner as other electric utilities; (vii) directs the SCC to conduct a proceeding to establish goals for the amount of energy and demand to be reduced by the operation of demand side management, conservation, energy efficiency, and load management programs, and develop a plan for the development and implementation of recommended programs; and (viii) directs the Department of Taxation is directed to conduct an analysis of the potential implications of the provisions of this measure on the system of taxation. Provisions of the Electric Utility Restructuring Act that exempt the generation of electric energy from regulation, prohibit public service corporations from exercising the power of eminent domain to acquire property for generation facilities, and authorize competition for metering and billing services are repealed.

6. Fiscal Impact Estimates are: Not available at this time. See Item # 8.

7. Budget amendment necessary: No.

8. Fiscal implications: The fiscal impact is not quantifiable at this time. 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 and the State Department of Taxation.

10. Technical amendment necessary: None specifically noted; but see comments at # 11.

11. Other comments:

The following comments on the legislation have been submitted by the Division of Public Utility Accounting:

(1) Lines 139-146, the proposed language prohibits off-system sales losses from flowing through the fuel factor; however, such losses are not also prohibited from inclusion in the biennial review of base rates, possibly shifting 100% of any losses to customers while sharing net profits 75/25 between customers and the utility.

§ 56-585.1 A:

(2) Generally, this section provides for utilities to increase rates for a host of reasons via adjustment clauses on a stand alone, single issue, basis without considering 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.

(3) 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.

(4) The specific requirement stating that the 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.

Date: 02/12/07 / sdl

cc: Secretary of Commerce and Trade