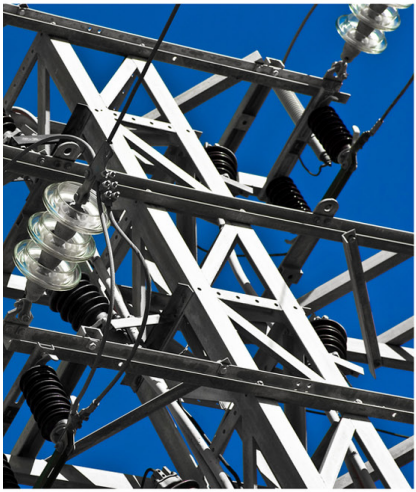
2016 Summary Update

VEPGA

Virginia Energy Purchasing Governmental Association

Elected Official's Guide to

Ensuring Fair Regulation for Electricity



Introduction

Since 2007, the Virginia General Assembly has been enacting legislation that significantly impacts how much over 2.2 million Dominion Virginia Power customers and 500,000 Appalachian customers pay for electricity. It is vital that elected officials understand these legislative actions, as they likely will result in ratepayers paying hundreds of millions of dollars each year in excessive rates through 2022.

This legislation takes away the power of the Virginia State Corporation Commission (SCC) to ensure that electric rates are fair to both the utility's shareholders and its customers. Consequently, Virginia consumers are paying inflated electricity rates that are far above what is necessary to maintain reliable electric service and a healthy electric utility industry.

Virginia's Electric Utility Rate Regulation: 2007 - 2014

In 2007, the General Assembly ended a relatively brief experiment allowing customers to choose their supplier of electric generation services. Rather than return to the traditional form of regulation that existed prior to this experiment, however, the General Assembly created a unique form of regulation that largely incorporated proposals advanced by Dominion. The Dominion-backed legislation ("2007 Legislation") passed the General Assembly with some modifications. (The legislation is now codified, in significant part, in §§ 56-585.1, 56-585.2, and 56-585.3 of the Code of Virginia.)

The 2007 Legislation largely supplanted traditional rate-setting principles with a process that substantially limits the SCC's authority to set just and reasonable rates. For example:

- The 2007 Legislation introduced the concept of "biennial reviews" that restrict the SCC's ability to both evaluate and address excessive utility earnings. The SCC is permitted to reduce

"base" (non-rider, non-fuel) rates only if the SCC determines that the utility's earnings have exceeded previously specified levels during two consecutive biennial periods (i.e., a four-year period).

- The 2007 Legislation authorized electric utilities to recover costs for new facilities outside base rates through rate adjustment clauses, or RACs. In evaluating a utility's request to implement a RAC, the SCC may not consider the level of utility earnings in base rates. As a result, the SCC must allow RAC rates to increase even though base rates already are producing excessive earnings.

- The SCC must grant utility requests to earn bonus rates of return on equity (i.e., higher profits) on investments in certain generating plants, even though utilities, as state-created monopolies, already have a legal duty to provide adequate generation.

Amendments enacted subsequent to the 2007 Legislation made matters even worse for Dominion's ratepayers. In 2013 and 2014, the General Assembly mandated significantly accelerated recovery from ratepayers of certain types of costs, thereby directly affecting the outcome of Dominion's 2013 and 2015 biennial reviews:

- In 2013, Dominion was permitted to accelerate recovery of costs associated with a rare earthquake, severe weather events, and the retirement of certain generation assets. This accelerated recovery lowered Dominion's earnings to a level that precluded SCC action following its 2013 biennial review. Although the SCC determined that Dominion's base rates, going forward were producing **$280 million in excess annual revenues** (i.e., revenues in excess of its annual costs plus a fair rate of return), the SCC was unable to order customer refunds and direct Dominion to reduce its base rates.

- In 2014, Dominion was permitted to accelerate recovery of development costs for a potential new nuclear unit. This legislative action once again significantly reduced Dominion's level of

earnings for the purposes of the biennial review. Despite the fact that Dominion was continuing to over-earn on the order of $280 million per year, this accelerated cost recovery, in conjunction with the constraints of the biennial review process, meant that the SCC could merely order a relatively small refund following the conclusion of its 2015 biennial review. Because there had been no finding of over-earnings in the 2013 biennial review, the SCC could not order Dominion to reduce its base rates.

Virginia's Electric Utility Rate Regulation: 2015

In 2015 the General Assembly enacted Senate Bill 1349 ("SB 1349"). SB 1349 effectively freezes base rates at their respective current levels for Dominion through 2022 and for Appalachian through 2020. SB 1349 also eliminated three biennial rate reviews for Dominion and two for Appalachian, thereby eliminating the potential for the SCC to direct customer refunds of excessive earnings or reductions to base rates in those reviews.

According to SCC Commissioner Dimitri, for the period from 2016 through 2022, fixing Dominion's base rates at current levels has the potential to produce earnings over and above Dominion's cost of service, including a fair rate of return, **by over $1 billion**. From 2015 through 2020, Appalachian's ratepayers may pay up to **$500 million** more than they otherwise would have paid under traditional regulation, based on a 2014 SCC staff assessment that the company was over-earning approximately $83 million per year.

Significantly, SB 1349 imposed no limits on the ability of either utility to seek increased rates via RACs. As a result, customers can expect their bills to rise, even with SB 1349's base-rate freeze, because the utility can seek new RACs and because Virginia law does not require that RAC cost recovery be offset by savings elsewhere. For example, between 2016 and the end of 2019, fixing Dominion's base rates at current levels will provide it with over $243 million from its customers for capacity costs that it will not incur, because its supply contracts with certain third-party generators will expire and not be renewed. Under traditional regulation, that savings would have been used to offset other costs, such as the $348 million that Dominion expects to collect through the RAC for its new Greensville County generating capacity. Because SB 1349 does not permit this type of offset, however, Dominion unfairly gets to collect $348 million in new capacity costs for the Greensville plant while still collecting an additional $243 million in old capacity costs that have vanished.

Assessment of Legislation

When compared to traditional utility regulation, the 2007 Legislation and subsequent amendments grant excessive benefits to utilities and impose excessive burdens on their customers. It seems likely that the legislation's electric utility supporters understood the impact of these complex legislative changes but that state legislators, who generally are not experts in utility regulation, did not.

These legislative actions have had – and will continue to have – a significant negative impact on ratepayers. Restoring to the SCC its power to set just and reasonable electric utility rates will help restore the balance between utility shareholder and customers interests, and ensure that customers no longer pay rates that are far above what is necessary to maintain reliable electric service and a healthy electric utility industry.

This Summary Guide is sponsored by VEPGA.
A more extensive Guide is available on its website listed below.

Virginia Energy Purchasing Governmental Association
an association of more than 170 local governmental entities
that assists its members in matters affecting the provision of
electricity service

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