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Comments to Virginia Energy re: Performance-Based Regulation

The utility profit model is infamous for its "perverse incentives" – the incentive to maximize capital expenditures and therefore return on investment (ROI), regardless of whether such expenditures are in the public interest. Chesapeake Climate Action Network (CCAN) believes that well-regulated, financially healthy monopoly utilities are critical to advancing an affordable clean energy transition, but that new regulatory models are needed to align profit models with the public interest.

CCAN represents some 35,000 members in Virginia, united behind our mission to advance global warming solutions in the Commonwealth. It is fundamental to our mission to ensure that utilities have the right incentives to effectively lead a clean energy transition. The current regulatory model does not incentivize efficient integration of modern tools to assist with this transition, including distributed energy resources (DER) and grid modernization initiatives such as advanced reconductoring and grid-enhancing technologies (GETs).

To more effectively put these modern tools to work in an affordable, clean energy transition, CCAN advocates for the following policies falling under the "performance-based regulation" (PBR) umbrella term:

1) Revenue decoupling,
2) Multi-year rate plans,
3) Capex-Opex equalization,
4) Performance metrics,
5) Performance incentive mechanisms.

Revenue decoupling

A revenue decoupling mechanism (RDM) compares a utility's allowed revenue to its actual revenue, and then adjusts rates to make them match (usually through a refund rate adjustment clause). When allowable revenue for fixed costs is predetermined, this allows utilities to pursue grid modernization efforts and encourage energy efficiency program efficacy by removing the existing incentive to sell more electricity, called the "throughput incentive." Given that both Dominion Energy and Appalachian Power have

repeatedly not met year-by-year energy efficiency targets pursuant to the Energy Efficiency Resource Standard (EERS), removing existing disincentives for energy efficiency is essential.

Multi-year rate plans (MYRPs)

Currently, utilities are subject to rate reviews every two years. The rate reviews themselves take many months to litigate, meaning utilities are more or less always reviewing the impact of recent rate cases or preparing for the next. This inhibits investment in programs that may take longer to return profit; for example, an initial investment in grid-enhancing technologies may reduce profit in the short-term but begin to return profit on a longer time horizon. Overall, MYRPs provide more predictable pricing over a longer period, encourage cost containment measures by the utility, and can lead to lower overall prices and less sudden price changes for ratepayers. Maine provides a successful example of MYRPs that resulted in lower costs for consumers while meeting or exceeding performance targets.

Capex-Opex equalization

Currently, utilities are biased towards capital expenditures (Capex) over operating expenditures (Opex), given the guaranteed rate-of-return that they receive on the former. However, building new infrastructure through Capex is not the only mechanism to meet demand. Utilities now have sophisticated tools to manage demand that incur operating costs, such as adoption of Virtual Power Plants or certain GETs. PBR reform should consider placing capex and opex on a level playing field by imposing equal rates of return on investment for both expenditure classes, thereby eliminating the capex bias. This is sometimes referred to as "totex ratemaking."

Performance metrics

Currently, much utility data is considered proprietary. This makes it difficult for intervenors, advocacy organizations, and lawmakers to accurately assess a utility's performance on measures of interest, structure litigation at the State Corporation Commission (SCC), or develop state-level legislation to encourage better performance. Collecting metrics on quantifiable measures of performance – such as energy efficiency deployment and program efficacy, energy intensity and usage, reliability, integration of DER, demand-side management integration – and displaying it publicly can increase effective stakeholder engagement in utility planning processes, SCC dockets, and facilitate development of better utility legislation.

Performance incentive mechanisms

Performance incentive mechanisms (PIMs) are necessary complements to revenue decoupling mechanisms (RDMs) and performance metrics. Through RDMs, regulators can remove the throughput incentive. Through performance metrics, regulators and other stakeholders can ensure information symmetry and be better partners in ratemaking processes and legislation. But while perverse incentives and utility opacity have been addressed, it is then necessary to incentivize desired behavior by explicitly tying revenue to performance.

Fuel-cost sharing mechanisms split some portion of fuel costs between shareholders and ratepayers. This helps incentivize utilities to pursue affordable energy contracts, operate plants efficiently, and overall keep fuel costs low. The byproduct of implementing fuel-cost sharing mechanisms is often greater investment in clean energy resources, which have no fuel costs, which would support utilities efforts to meet Virginia Clean Economy Act build targets and Renewable Portfolio Standard (RPS) year-by-year benchmarks. RPS compliance is also associated with lower costs for ratepayers, as deficiency payments are passed off to customers.

The Commission should also consider other PIMs tied to performance on measures consistent with state climate goals, with the existing Energy Efficiency Resource Standard as one example. Beneficial electrification, which can involve significant short-term investment but yield greater long-term savings and efficiency, is one measure that may require specific PIMs to support.