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CLEAN VIRGINIA

**Virginia Energy performance-based
regulation stakeholder process
(SCC case: PUR-2024-00152)**

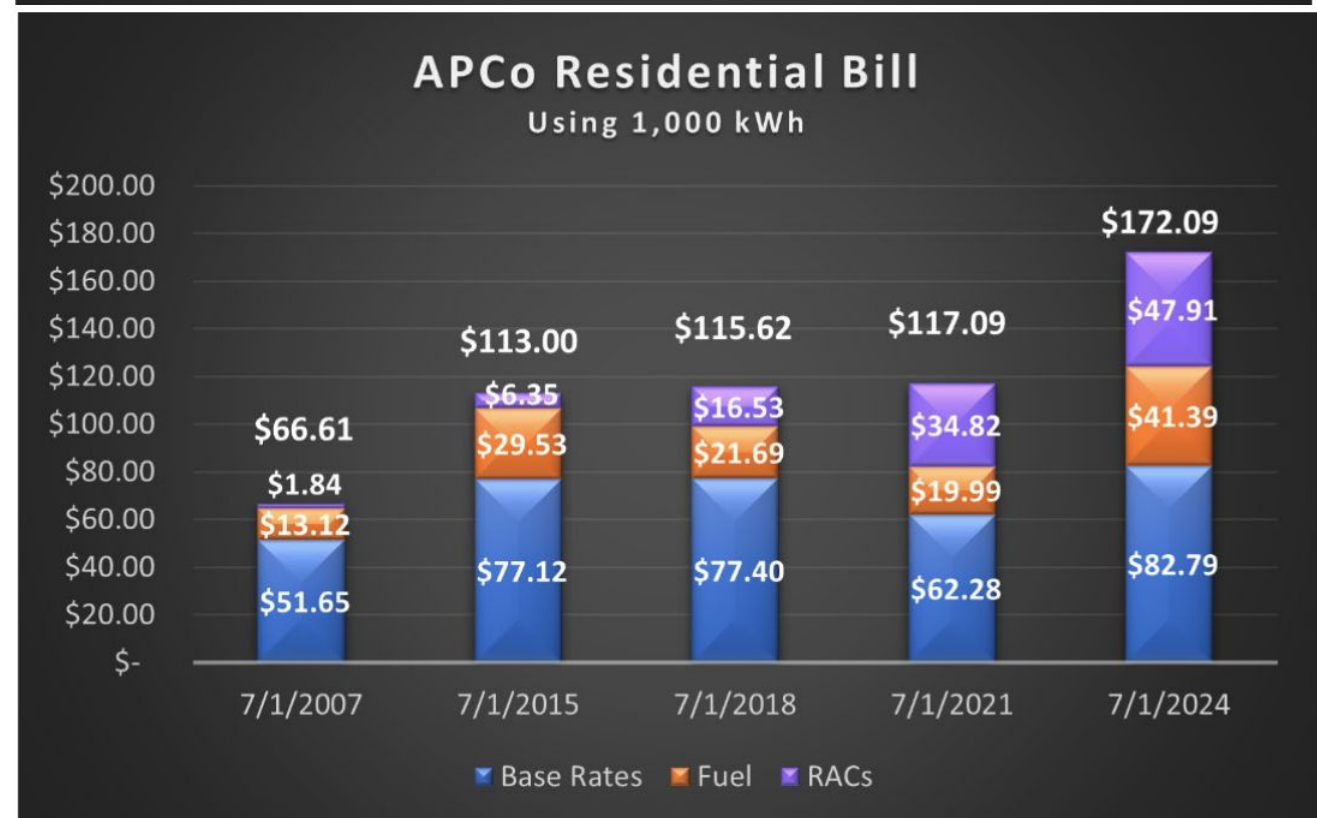
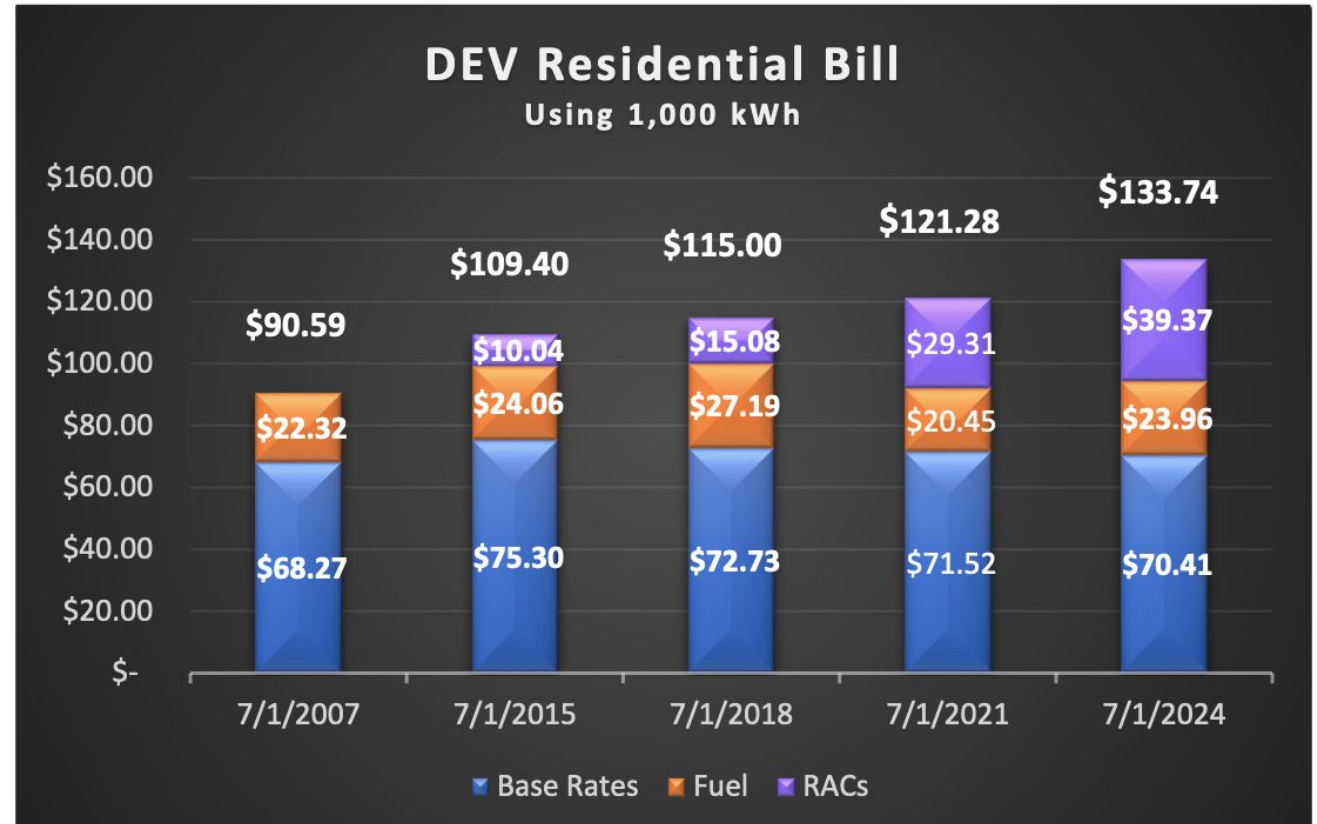
The 2023 changes normalized Virginia ratemaking.

With the 2007 Re-Regulation Act, and through subsequent laws, Virginia established an unusual framework that limited basic Commission authorities critical in regulating utility monopolies.

- The Commission had restrictions on setting a fair ROE, a problem that persists even after the 2023 reforms.
 - For the 2023 rate case, the Commission could not freely set the ROE for DEV.
- The Commission had arbitrary restrictions on its ability to decrease rates.
 - Accounting restrictions.
 - Direct restrictions such as a \$50 million limit on rate reductions in the 2021 rate case.

Current rate structure in Virginia

1. Base rates: Established in biennial rate cases.
2. Riders: Wide variety of costs eligible for rider treatment (Rate Adjustment Clauses or RACs).
3. Fuel factor.



Regulation of investor-owned utility monopolies

Under the regulatory compact where investor-owned utilities are granted exclusive monopoly rights to serve a specific territory, “regulation serves as an administrative replacement for the market in determining whether costs are efficient” (Karl McDermott).

Averch-Johnson effect: when the fair rate of return is set above the market cost of capital, “the regulated firm will use an inefficiently high capital/labor ratio for its level of output. That is, the firm’s output could be produced more cheaply with less capital and more labor” (Kenneth Train).

The most important tools the regulator has to create market-like incentives for efficient spending and counteract the AJ effect are:

1. Regulatory lag
2. Prudency reviews:
 - a. Cost disallowance of imprudent costs.
 - b. Review of proposed investments in CPCN proceedings.
3. Setting a fair ROE

Regulatory lag and “incentive regulation”

Regulatory lag: period between the moment when a utility’s costs change and the moment when there is a commensurate change in its rates.

- “Primary incentive mechanism included in regulation that should increase utility efficiency incentives in a manner similar to competitive markets (efficiency leads to increased profitability)” (David E. Dismukes).
- Riders decrease regulatory lag incentives by guaranteeing recovery of incurred costs.
- Virginia’s biennial reviews allow very little time between the moment the utility incurs a cost and the moment it is reflected in rates.
- A Berkeley National Laboratory study concluded that “cost containment incentives depend on the frequency of rate cases” (Mark Lowry).
- The longer regulatory lag of well designed multi-year rate plans (MRP) could be a tool for incentivizing efficient decisions around capital investments.

Regulatory lag and “incentive regulation” – riders

Best practice theory indicates that **riders should be limited to unpredictable costs that are outside of a utility’s management control.**

The use of riders in Virginia is disproportionately high compared with other states.

Allowing almost every cost to be updated yearly through riders is a remarkable departure from market-like incentives for efficiency.

Riders **substantially** reduce risk for utilities. This lower risk should be reflected in a substantially lower ROE.

Guidance

Five-year capital summary

	Dominion Energy Virginia	Dominion Energy South Carolina	Contracted Energy	Corporate & Other	Total ³
2025 – 2029 capital plan (\$B)	\$35.5	\$5.9	\$1.2	\$0.6	\$43.2
Primary drivers	<ul style="list-style-type: none"> Economic growth Zero-carbon generation Grid transformation Generation reliability Transmission and distribution resiliency 	<ul style="list-style-type: none"> Economic growth Grid transformation Electric generation 	<ul style="list-style-type: none"> Maintenance, environmental and fuel for Millstone 	<ul style="list-style-type: none"> Information technology and other 	
5-yr utility rate base CAGR YE’24 – YE’29	9.0%	6.6%—5.1% <i>(without and with CCR¹)</i>	—	—	7.8%—7.5% <i>(without and with CCR)</i>
% rider eligible²	75%	15%	—	—	64%



Note: Figures include impact of 50% non-controlling equity partner funding 50% of CVOW project costs ¹ 20-year amortization of rate base associated with the Capital Cost Rider (CCR) ² For DESC, represents growth capital under the Natural Gas Rate Stabilization Act ³ Total investment base CAGR reflects regulated rate base at DEV and DESC, plus approximate net book value of CE and non-rate base DEV ringfenced solar

Prudency reviews

- Disallowance of cost recovery for imprudently incurred costs.
- Review of proposed investments in Certificate of Public Convenience and Necessity (CPCN) proceedings.

Powerful tool to create cost-containment incentives. However, it has several limitations:

1. Information and resource asymmetry between the utility and the regulator.
2. Weak tools available to assess utility selection of resources.
 - a. Weak planning processes.
 - b. Weak competitive procurement requirements.
 - c. Limitations on third-party owned projects.

Conclusion

- Frequent rate cases and a wide range of costs eligible for rider treatment reduce incentives to control costs. Possible alternatives include:
 - Evaluating the benefits of longer multi-year rate plans.
 - Reevaluating the types of costs that merit rider treatment.
 - Ensuring ratepayers benefit from reduced capital costs.
- As regulatory lag disappears, the system relies more heavily on prudency reviews to incentivize efficiency. Steps to strengthen prudency reviews include:
 - Ensuring sufficient resources for the regulator.
 - Improving the planning process.
 - Improving and expanding competitive procurement solicitations.
 - Allowing more third-party owned projects to be selected.

Mark Lowry

Pacific Economics Group

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What is a Multiyear Rate Plan (MRP)?

Key Components

- Rate case moratorium (e.g., 3-5 year rate case cycle)
- Between rate cases, an attrition relief mechanism (ARM) provides automatic rate relief for financial attrition using *predetermined formulas that aren't linked (like a cost tracker or formula rate) to the utility's contemporaneous cost growth.*
 - >>> Stronger utility cost containment incentives, streamlined regulation
- Large, volatile expenses (e.g., energy) get tracker treatment
- Performance incentive mechanisms (PIMs) for “blue-sky” reliability

Optional Bells and Whistles

- Additional metrics and PIMs [e.g., for demand-side management and customer service quality]
- Targeted incentives for underused practices [e.g., cost trackers, management fees, & pilot programs for these practices (e.g. DSM)]
- Revenue decoupling
- Integrated resource and delivery system planning

Do MRPs Improve Utility Performance?

Total factor productivity (“TFP”) of US railroads and telecom utilities grew rapidly under MRPs.

PEG studied cost impact of MRPs in Berkeley Lab paper using incentive power and productivity research¹.

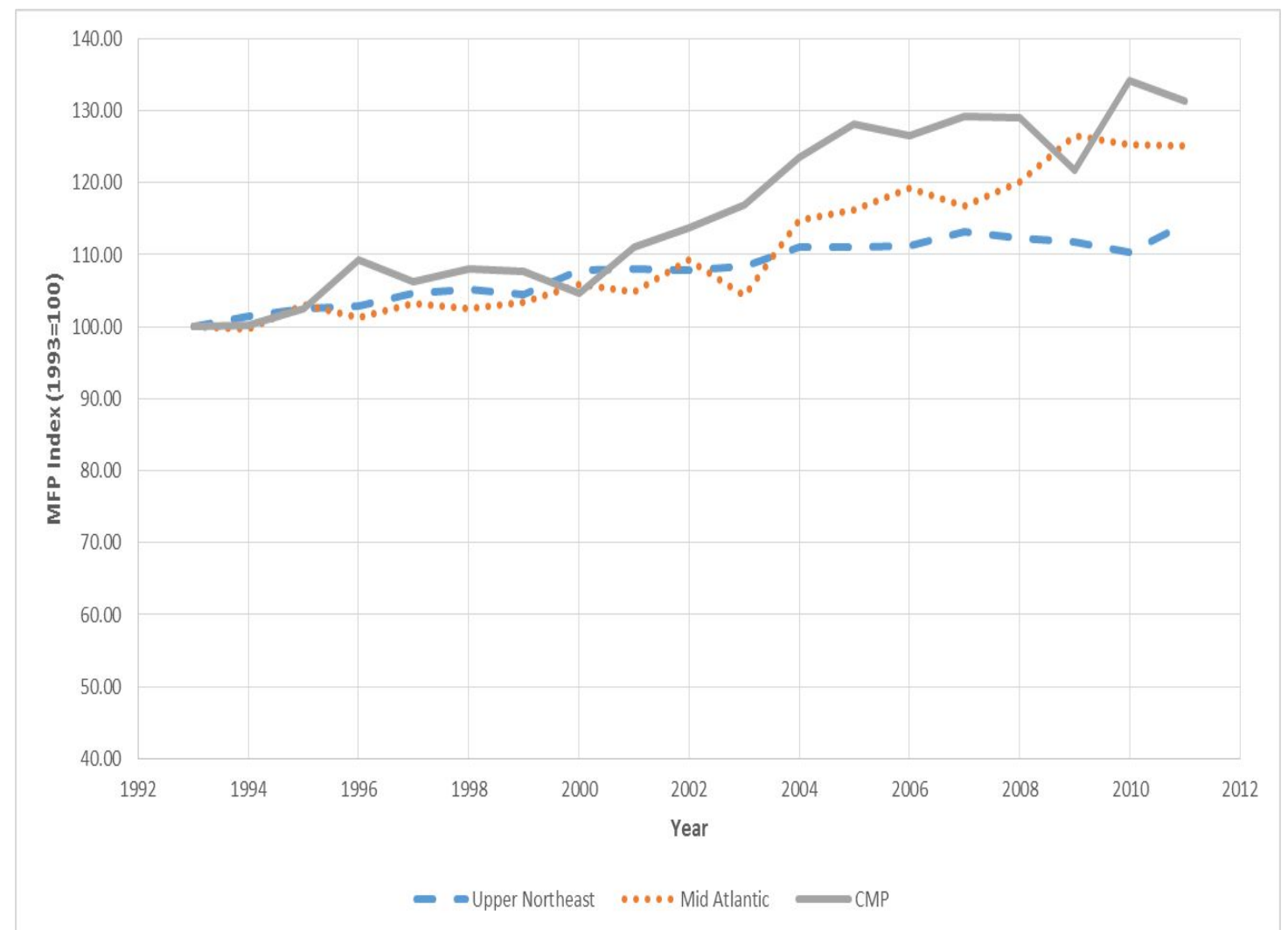
Incentive power research showed that cost containment incentives are weakened by frequent rate cases, cost trackers, and earnings sharing.

Studied *power distributor* productivity trends because vertically integrated electric utilities and “wirecos” both provide these services.

Central Maine Power achieved superior productivity growth under three consecutive MRPs.

Productivity growth of mid-Atlantic power distributors operating under infrequent rate cases was also exceptionally rapid in this era.

Total Factor Productivity Growth Of Central Maine Power and Other Northeast Power Distributors 1994-2011¹



¹Mark N. Lowry, Matt Makos, and Jeff Deason, “State Performance-Based Regulation Using Multiyear Rate Plans for U.S. Electric Utilities, Ed. L. Schwartz, 2017. Available at:

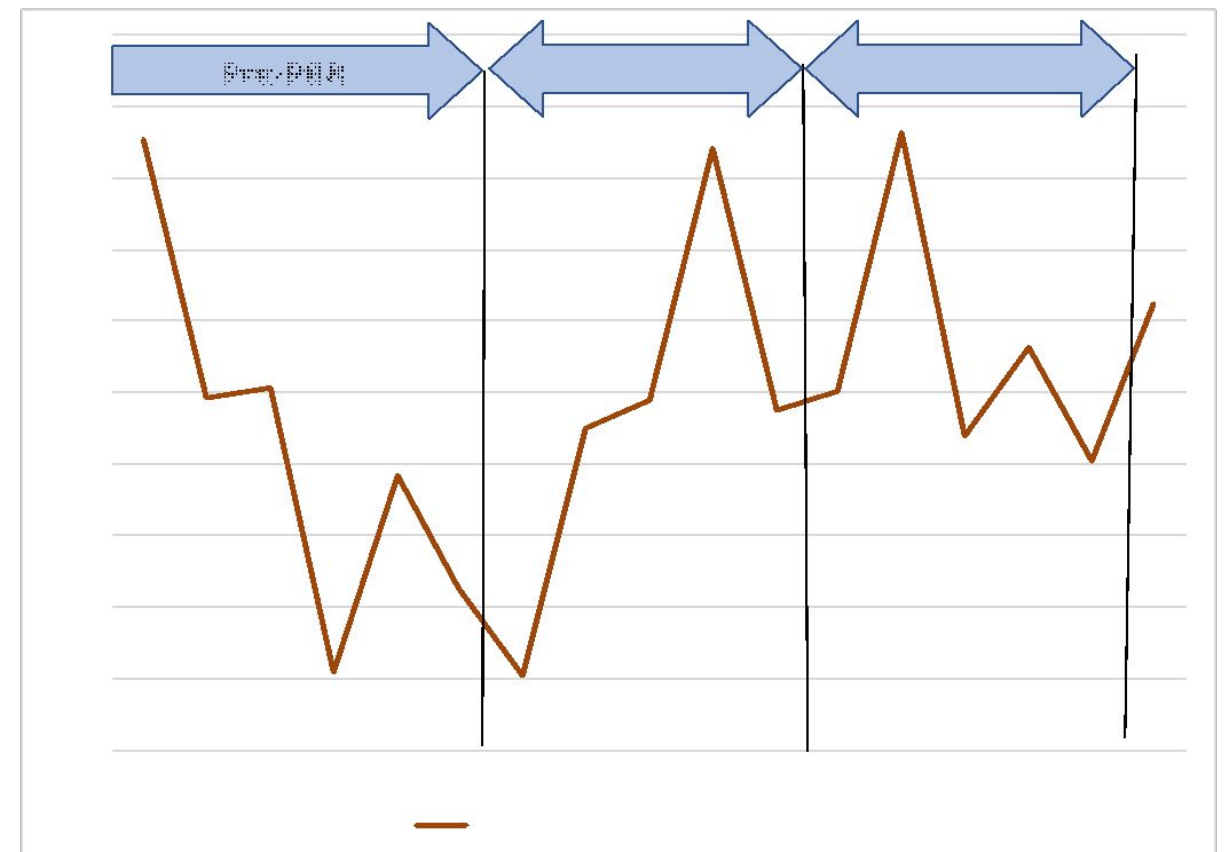
Do MRPs Improve Utility Performance? (cont'd)

Alberta's utility commission made MRPs (called PBR plans) mandatory for gas & electric power distributors after years of biennial rate cases.

Recent PEG study found that power distributor TFP growth soared under the first two plans¹

Capital productivity growth was slowed in first plan by capital cost trackers but surged in second plan when trackers were replaced by fixed capex budgets that weren't based on company forecasts.

Total Factor Productivity Growth of Alberta Power Distributors 2008-2023



¹ Lowry, Mark Newton, David Hovde, Rebecca Kavan, and Matthew Makos. "Impact of Multiyear Rate Plans on Power Distributor Productivity: Evidence from Alberta," *The Electricity Journal*, Volume 36, Issue 5, June 2023.