Virginia Regulatory Assessment Template

**Instructions:**

* Select one (1) “performance area” or outcome from the following set to evaluate how existing regulatory mechanisms in Virginia support (incentivize) the achievement of that outcome or disincentivize the achievement of the outcome. Consider this question for each regulatory mechanism identified in the template, and for the overall performance of Virginia’s utility regulatory structure to support (or hinder) that outcome (performance area).
* Each stakeholder should complete worksheets for at least two performance areas of their choosing. Additional (more than two) performance areas can be evaluated in additional worksheets, at your discretion.

**Reference Key:** Performance Areas from *House Joint Resolution No. 30 / Senate Joint Resolution No. 47*

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| --- | --- |
| Reliability and resiliency | Affordability for customers |
| Emergency response and safety | Cost-efficient utility investments and operations |
| Peak demand reductions | Maximization of available federal funding |
| Cyber and physical security of the grid | Savings maximization from energy efficiency and exceedance of statutorily required savings levels |
| Annual and monthly generation and resource needs in addition to hourly generation and resource needs on the 10 hottest and coldest days of the year | DER integration and speed of interconnection |
| Customer service | Beneficial electrification |
| Environmental justice and equity | Electricity decarbonization |

**Regulatory Assessment**

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| **Outcome** | What regulatory *outcome* or *performance area* does this assessment consider? | | **Peak demand reductions + Savings maximization from energy efficiency and exceedance of statutorily required savings levels**  Performance based regulation can help to further align the financial incentives of investor-owned utilities  with public interest goals, including achievement of peak demand reduction and increasing energy efficiency savings. | | |
| **Do the existing regulatory mechanisms and programs sufficiently support the outcome?** | | | | | |
| **Key** |  | | | | |
| **+** | **Yes** | The mechanism or program **incents achievement** of this outcome. | | | |
| **0** | **No Impact** | The mechanism or program **does not seem to impact the achievement** of this outcome. | | | |
| **-** | **No** | The mechanism or program **disincentivizes the achievement** of this outcome. | | | |
| **Existing Regulatory Mechanisms and Programs** | **Description** | **Mechanism or Program’s Effect on Outcome** | | | **Issues for Attention** |
| **Score (+/0/-)** | | **Discussion** |
| **Rate Reviews (typically biennial)** | Rates are reset every two years. | **-** | | The biennial rate review itself does not significantly impact a utility’s incentive to support peak demand reductions and energy efficiency. However, the lack of a decoupling mechanism in between rate cases creates a disincentive for the utilities to invest in and support energy efficiency.  Under the current biennial rate review structure, rates are set to enable the utility to recover its revenue requirements for a two year period. All else being equal, once rates are set, the actual revenues collected will fluctuate with sales. Energy efficiency reduces electricity sales and therefore will reduce utility revenues between rate cases (this is often referred to as “lost revenues”). The lack of decoupling has less of an impact on incentives to support programs that only target reductions in peak demand like demand response. These programs tend to result in minimal lost revenues because they aim to shift the timing of energy sales, not reduce overall energy sales.  The frequency of rate cases also reduces regulatory lag, (i.e., the time between rate cases) which can serve as an incentive for cost efficiencies. Once rates are set, if a utility can control costs, its earnings are higher. Conversely, if utility costs increase above revenues, profits will fall. Under the current two-year rate period, there is little incentive for the utility to control costs because if it overspends it only has to wait a year until rates are reset. This means there is little incentive for the utility to consider utilizing demand-side resources like targeted demand response and energy efficiency to avoid more costly distribution system upgrades since | An MRP with a longer stay-out period (i.e., 3-5 years) combined with a revenue decoupling mechanism would help support additional peak demand reductions and energy efficiency savings in several ways.  A decoupling mechanism would remove the utility’s distinctive to support energy efficiency by allowing for the recovery of lost revenues.  An MRP with a longer stay-out period could create an incentive for the utility to seek out operational efficiencies and consider lower-cost alternative to traditional distribution investments like non-wires alternatives. The level of this incentive will also depend on how much of the earnings a utility is allowed to keep above its allowed rate of return. |
| Forward-looking | **0** | | This mechanism does not impact utility incentives for peak demand reductions or achievement of energy efficiency savings. |  |
| Backward-looking (w/ earnings adjustments) | **0** | | The earning test measures earnings of utility over a 13-month historic period. | Within the current framework the earnings tests have little impact on incentives for peak demand reduction and energy efficiency. However, it will be important to revisit these if an MRP framework is developed. |
| **ROE Determinations** |  | **-** | | The ROE determination could create a disincentive to the utilities to support peak demand and energy efficiency.  When a utility’s ROE is higher than its cost of equity (i.e., cost of borrowing) it can disincentivize investments in non-capital investments (customer-facing energy efficiency and demand response program). This is because when a utility’s ROE is greater than the cost of borrowing, utilities have a financial incentive to maximize their capital expenditures in order to increase rate base and hereby increase profits. This creates a capital bias where it is more profitable for a utility to increase capital spending instead of pursing energy efficiency and demand response. |  |
| **Rate Adjustment Clauses (i.e., trackers)** | RACs overall (general assessment of the use of RACs) | **-** | | RACs benefit the utility by allowing the utility to recover costs more quickly but disincentivize cost containment incentives and undermine affordability.  The ability to recover capital costs through RACs increases utility capital bias through infrastructure investments over energy efficiency and demand response. | Tracking mechanisms should only be used for a very limited set of costs that are outside of a utility’s control and strategic investments. |
| Fuel Cost Recovery | **0** | | The fuel cost recovery approach does not have a direct impact on this outcome. | . |
| Purchased power | **0** | | The recovery of purchased power does not have a direct impact on this outcome. |  |
| Demand response program costs | **+** | | The ability for utilities to recover costs associated with demand response does not necessarily create an incentive for utilities, the ability for utilities to recover costs on an ongoing basis is more beneficial than if the costs were recovered in base rates. |  |
| RPS compliance costs | **0** | | The recovery of RPS compliance costs does not have a direct impact on this outcome. |  |
| Broadband capacity extension | **0** | | The recovery of broadband capacity extension costs does not have a direct impact on this outcome. |  |
| Low-income programs (lost revenue recovery) | **0** | | The recovery of low-income programs does not have a direct impact on this outcome. |  |
| Capital projects (e.g., combined cycle gas projects, offshore wind, solar, distribution system undergrounding, distribution grid transformation, nuclear life extension, etc.) |  | | (Same as RACs above) | (Same as RACs above) |
| **Other trackers** (user choice to select additional trackers used in Virginia rate making for attention) |  |  | |  |  |
|  |  | |  |  |
| **Transmission cost recovery (FERC formula rates)** |  | **0** | | Transmission cost recover does not have a direct impact on this outcome. |  |
| **Performance adjustments and measurement** | ROE adjustment mechanisms |  | |  |  |
| Energy efficiency savings target (ROE adder applied to DSM operating expenses) | **+** | | Va. Code § 56-585.1 provides that a utility that meets its energy efficiency savings targets shall earn a return on the operating costs associated with the program. Further, if the utility exceeds its savings target, the utility can earn an additional 20 basis points for each additional 0.1% in annual savings beyond the target.  The ability for utilities to receive a financial benefit for the achievement of energy efficiency savings creates an incentive to the utility to pursue these savings. | The ability to earn a return on energy efficiency costs helps to offset the utility’s throughput incentive (aka lost revenues) and capital bias.  However, the design of the incentive mechanism could be improved to support meeting savings targets more cost-efficiently. Due to the fact the financial reward is calculated based on the utility’s energy efficiency program costs (operating expenses), this framework might reward greater program spending, rather than rewarding the utility for implementing the most cost-effective energy efficiency measures. |
| Performance mechanisms (e.g., metrics, scorecards, PIMS), including Case No. PUR-2023-00210 (Separate SCC PBR Case) | **+** | | PIMs can help to align a utility’s financial incentives with the achievement of peak demand reductions and energy efficiency savings. | PIMs should be implemented in Virginia alongside incentives to control the costs associated with meeting the PIM targets. In addition, the total value of potential PIM rewards plus the utility’s base ROE should not be excessive, or the utility will have a stronger incentive to expand its rate base. |
| **Other ratemaking and regulatory features** | IRPs | **-** | | IRPs that include reasonable and ambitious assumptions for energy efficiency facilitate adoption and encourage deployment. It also allows stakeholders to weigh low-cost energy efficiency programs with other alternatives. | In the most recent planning documents, utilities have modeled energy efficiency programs at the bare minimum. This hinders the ability to understand the full potential of this resource. |
| Certificates of Public Need and Necessity (CPCN) | **0** | | CPCN do not have a direct impact on this outcome. |  |
| Rate design (including universal service fee) | **0** | | Rate design does not have a direct impact on this outcome. |  |
| Pilot programs |  | |  |  |
|  | Limits to third party-owned generation | **0** | | Third party generation does not have a direct impact on this outcome. |  |

Overall Assessment

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| --- | --- | --- |
| **Overall, does the existing regulatory framework support achievement of the identified outcome?** | | **Discussion** |
| **+ (YES)** incents achievement |  |  |
| **0 (NO IMPACT)** |  |  |
| **- (NO)** disincentivizes achievement | **-** | Overall the current regulatory framework creates a disincentive for utilities to invest in energy efficiency and achieve reductions in peak demand.  While Va. Code § 56-585.1 provides an incentive for utilities that meet their energy efficiency savings targets, it is likely not sufficient to outweigh the current disincentives related to lost revenues and capital bias.  Without decoupling the utility has a disincentive to promote energy efficiency because it has the potential to creates lost revenues to the utility in between rate cases due to lower electricity sales that lead to lower revenues.  In addition, the existing framework creates incentives for utilities to invest in capital infrastructure over demand-side resources through ROEs that are likely higher than the cost of borrowing and the use of cost trackers. |