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COMMONWEALTH of VIRGINIA

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November 1, 2008

The Honorable Thomas K. Norment, Jr., Chairman
Commission on Electric Utility Regulation
and
Members of the Commission on Electric Utility Regulation

Re: Report Pursuant to Enactment Clause 6 of Chapters 888 and 933 of the 2007 Acts of the General Assembly

Dear Senator Norment and Commission Members:

The Office of the Attorney General submits herewith its second report to the Commission on Electric Utility Regulation pursuant to Enactment Clause 6 of Chapters 888 and 933 of the 2007 Acts of the General Assembly. As directed by the enactment clause, the report identifies issues that may impede implementation of the 2007 law regulating electric utilities in Virginia. Where appropriate, we offer suggestions for amendment to address issues identified.

The Office of the Attorney General welcomes the opportunity to continue to work with the Commission on Electric Utility Regulation and the General Assembly on this matter of great importance to the people of the Commonwealth.

Very truly yours,

For: Maureen Riley Matsen
Deputy Attorney General

cc: The Honorable Mark C. Christie
The Honorable Judith Williams Jagdmann
The Honorable James C. Dimitri

Commonwealth of Virginia
Office of the Attorney General

Report to the Commission on Electric Utility Regulation of the Virginia General Assembly

Pursuant to Enactment Clause 6 of Chapters 888 and 933 of the 2007 Acts of the General Assembly Concerning Electric Utility Regulation

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I. Introduction

In 2007, the General Assembly adopted comprehensive legislation amending the Virginia Electric Utility Restructuring Act, and related provisions of Title 56 of the Code of Virginia, to re-regulate the rates of the Commonwealth's electric utilities and establish goals for the generation of electricity from renewable sources. Enactment clause 6 of Chapters 888 and 933 of the 2007 Acts of the General Assembly (Senate Bill 1416 and House Bill 3068, (hereinafter "the Act")), directs the Office of the Attorney General, in consultation with the State Corporation Commission ("SCC" or "Commission"), to submit reports to the Commission on Electric Utility Regulation (formerly the Commission on Electric Utility Restructuring) on or before November 1, 2007, and again on or before November 1, 2008, that identify and recommend appropriate corrective legislation to address any issues that may impede the implementation of the provisions of the Act.

This second Report reflects this Office's review and analysis of the Act and concerns expressed to us by the SCC. There remain provisions of the Act that will be implemented for the first time in future proceedings before the Commission. However, adjudication of several cases that were pending when the 2007 Report was submitted offers experience with actual implementation that assists in the identification of issues in need of legislative correction. The primary recommendation of this second Report arises from issues brought into focus in two Commission proceedings concluded earlier this year. This year's Report also identifies again those issues addressed in the 2007 Report that continue to have the potential to impede the implementation of the provisions of the Act. One issue addressed last year concerned potential ramifications for one utility of the elimination of default service upon the expiration of capped rates on December 31, 2008. A recent Commission order has confirmed the previously stated concern and this issue is highlighted again in this year's Report.

The suggestions herein are not intended to foreclose interpretation of the statutory provisions. Accordingly, this Report does not attempt to identify and analyze every provision of the Act susceptible to differing interpretations.[1] Rather it presents modest proposals for clarification and simplification.

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[1] As anticipated, various legal arguments have already been advanced over competing interpretations of certain provisions of the Act, and the SCC has resolved such issues in the course of its proceedings. In Appalachian Power's 2007 fuel factor application, Case No PUE-2007-00067, there was legal argument that the 2007 amendments to § 56-249.6 D 1 did not require that utilities retain 25% of margins from "off-system sales" until the commencement of the biennial review cases in 2011. The Commission ruled that the change became effective with fuel factor cases filed after July 1, 2007. In Dominion Virginia Power's application for approval of its proposed coal generation facility in Southwest Virginia, Case No. PUE-2007-00066, the Commission had to interpret the enhanced rate of return provision of § 56-585.1 A 6. The statute authorizes a return on

II. Issues that May Impede Implementation of Provisions of the Act

A. § 56-585.1 A.2.b – Electric utility peer group for determining return on equity floor.

One of the central features of the Act is the mechanism in § 56-585.1 A that provides a floor for the authorized rate of return on common equity ("ROE") to be used in setting a utility's electric rates. The floor is derived from the average of actual earned ROEs reported to the Securities and Exchange Commission by not less than a majority of other investor-owned electric utilities in the peer group of the utility. The Commission selects the appropriate peer group to use for this purpose, pursuant to subdivision 2 b. It provides:

> [A]n investor-owned electric utility shall be deemed part of such peer group if (i) its principal operations are conducted in the southeastern United States east of the Mississippi River in either the states of West Virginia or Kentucky or in those states south of Virginia, excluding the state of Tennessee, (ii) it is a vertically-integrated electric utility providing generation, transmission and distribution services whose facilities and operations are subject to state public utility regulation in the state where its principal operations are conducted, (iii) it had a long-term bond rating assigned by Moody's Investors Service of at least Baa at the end of the most recent test period subject to such biennial review, and (iv) it is not an affiliate of the utility subject to such biennial review.

After this statute was applied in two SCC proceedings that concluded earlier this year it became clear that similarly situated utilities could have

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equity incentive of 2.00% for a "carbon capture compatible, clean-coal powered" generation facility and a 1.00% incentive for a "conventional coal or combined-cycle combustion turbine" facility. On its face, the statute left a gap for a clean coal facility that is not carbon capture compatible, which arguably would result in no incentive return. The Commission applied the statute to mean that "clean-coal" and "conventional coal" are not mutually exclusive, and awarded a 1.00% return on equity incentive. In both cases the Attorney General's Division of Consumer Counsel supported the interpretation of the statutes adopted by the SCC.

materially different ROE floors as a result of the provision concerning principal operations and affiliate exclusion. The Office believes this is an unintended consequence in the implementation of this critical provision of the Act.

Virginia Electric and Power Company d/b/a Dominion Virginia Power and Appalachian Power Company each filed applications with the Commission in July 2007 for approval of proposed new coal-fired generation facilities.[2] In order to determine the amount of the rate adjustment clause for recovery of costs associated with each project, if the application were to be approved,[3] the respective applicant utilities and other participants in each proceeding applied § 56-585.1 A.2.b. to determine the statutory peer group and ultimately arrive at an ROE floor. In both cases there was agreement on the universe of peer utilities that met the requirements of the statute for inclusion in the peer group.[4]

The peer group for Appalachian Power did not include Dominion Virginia Power, but the peer group for Dominion did include Appalachian. The reason for this is the statute's language, "principal operations are conducted in the southeastern United States east of the Mississippi River in either the states of West Virginia or Kentucky or in those states south of Virginia . . . ." Appalachian

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[2] Application of Virginia Electric and Power Company, For a certificate to construct an electric generation facility in Wise County, Virginia, and for approval of a rate adjustment clause under §§ 56-585.1, 56-580 D, and 56-46.1 of the Code of Virginia, Case No. PUE-2007-00066, Final Order, March 31, 2008; Application of Appalachian Power Company, For a rate adjustment clause pursuant to § 56-585.1 A 6 of the Code of Virginia, Case No. PUE-2007-00068, Final Order, April 14, 2008.

[3] The Commission approved the Dominion Virginia Power application and denied the Appalachian Power application.

[4] There was, however, a contested issue over which of the utilities in the peer group should be selected by the Commission if it used less than all, but a majority. The average returns of this majority would establish the ROE floor pursuant to § 56-585.1 A.

has operations in both Virginia and West Virginia, with the majority of its operations in West Virginia. Thus, its principal operations are conducted in West Virginia and the company meets the statutory requirement to be included in the peer group. Dominion has operations in both Virginia and North Carolina, but the vast majority of operations are in Virginia. Dominion's principal operations are therefore not conducted in West Virginia, Kentucky, or states south of Virginia, and for this reason it is excluded from any peer group.

In addition, one utility, Kentucky Power, was included in Dominion's peer group but excluded from Appalachian's peer group. This resulted from Kentucky Power being an AEP operating company and an affiliate of Appalachian Power. The statute requires that affiliates of the applicant utility be excluded from the peer group even if they meet all other statutory criteria for inclusion. Dominion has no such affiliates.

The result of these factors described above was that the peer group average ROE, after the required exclusion of the four utilities with two highest and two lowest returns and before any further winnowing by the Commission to select a majority, was 11.8% for Appalachian and 11.4% for Dominion.[5] This difference of 40 basis points is significant, especially for two utilities that would generally have similar risk profiles and be competing in the same financial markets for capital. In these two cases the established ROE was to be applied to specific generation assets each valued at more than one billion dollars. The

[5] Pursuant to a stipulation, the ROE approved in the Dominion case was 11.12% (before applying a required 1.00% incentive adder) based on a majority consisting of eight utilities. The SCC denied Appalachian's application so no ROE was approved in that case.

approved ROEs for Virginia utilities will take on even greater prominence in the "going in" 2009 rate cases and subsequent biennial rate review proceedings. There, the peer group methodology will establish ROEs applied to the entirety of a utility's regulated rate base and will be an even more significant factor in setting the rates charged to customers.

The Office knows of no rationale to support a situation where Appalachian is included in the peer group of Dominion, while Dominion is excluded from the peer group of Appalachian. With respect to the affiliate issue, we understood the 2007 legislation's intent in excluding affiliates from a utility's peer group was to eliminate any possibility that the corporate parent could somehow influence earnings among the affiliated utilities in a way that would affect the resulting ROE floor for the applicant utility. With experience gained in applying the statute, we believe that concern is outweighed by the anomalous and unreasonable result it produces in practice. Affiliated utilities are under the jurisdiction of other states' utility regulatory commissions. That regulation should provide sufficient assurance that a corporate parent cannot manipulate earnings among its affiliated utilities, and is unlikely to be able to impact the peer group ROE that way.

Inclusion of out-of-state affiliates is preferable to excluding them from the peer group of all Virginia utilities because it provides the Commission with a wider range of utilities from which to select a majority. The Commission would have the ability to eliminate an affiliate in selecting a majority if it found it appropriate to do so. Conversely, excluding Virginia utilities from the peer group

of all other utilities subject to the Act would be appropriate to preserve the peer group as a collection of comparable utilities in the region, but which are outside of Virginia and are not subject to SCC regulation.

The following amendment to subdivision 2 b § 56-585.1 A would accomplish this objective and correct what appears to be an unintended consequence that could impede implementation of the Act. Out-of-state affiliates of Virginia utilities (that otherwise meet the peer group standards) would be included in the peer group for each Virginia electric utility, including the affiliated Virginia utility. But no Virginia utility would be included in the peer group of any other Virginia utility. This would result in the same "base" ROE peer group for each Virginia utility and the SCC would still retain the discretion to select a majority from the eligible peer group as may be appropriate in each situation.

> § 56-585.1. Generation, distribution, and transmission rates after capped rates terminate or expire.
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> . . . .
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> A.2.b. . . . For purposes of this subdivision, an investor-owned electric utility shall be deemed part of such peer group if (i) its principal operations are conducted in the southeastern United States east of the Mississippi River in either the states of West Virginia or Kentucky or in those states south of Virginia, excluding the state of Tennessee, (ii) it is a vertically-integrated electric utility providing generation, transmission and distribution services whose facilities and operations are subject to state public utility regulation in the state where its principal operations are conducted, (iii) it had a long-term bond rating assigned by Moody's Investors Service of at least Baa at the end of the most recent test period subject to such biennial review, and (iv) it is not ~~an affiliate of the utility subject to such biennial review~~ *a Virginia incumbent electric utility*.

If this peer group criteria had been in place for the referenced Appalachian and Dominion proceedings, each utility would have had a 10-member peer group which produced an ROE floor of 11.6%, before any further refinement of the group by the Commission.

B. § 56-585 - Elimination of default service obligation upon the expiration or termination of capped rates.

This issue was raised in the 2007 Report and there has been a significant development in the interim. The Act amended § 56-585 concerning default service to provide that default service shall expire upon the expiration or termination of capped rates. This provision was added to § 56-585 because, with the re-regulation of generation, there will be regulated rates, and thus availability of default service – as that term had been used in the 1999 Restructuring Act – will no longer be necessary. However, the elimination of default service obligations for all Virginia utilities has had consequences contrary to a separate express provision of the Act.

In 2000, The Potomac Edison Company d/b/a Allegheny Power was permitted to divest its generation assets subject to an Order of the SCC ensuring protection of consumers from the risks of the utility's decision to divest. The Order incorporated an agreement, a Memorandum of Understanding, or "MOU," offered by the company to price its generation in accordance with prescribed formulae that would insulate customers from potentially higher unregulated market rates *during such time as the utility had default service obligations.* Thus, without a default service obligation, an argument has been made, and accepted

by the Commission, that the divestiture agreement – and the related SCC Order – will be inoperative.[6] However, the fifth enactment clause of the 2007 Act explicitly provides that nothing in the Act shall be deemed to modify or impair the terms, unless otherwise modified by an order of the SCC, of any order of the Commission approving the divestiture of a utility's generation assets that was entered pursuant to § 56-590.

Thus, as we stated in our prior Report, the intent of the General Assembly, as expressed in the subsequent enactment clause, should be clear. The 2007 Report noted that the technical conflict could be eliminated in a manner that reconciles the Act's provision to the stated intent of the enactment clause with the following amendment:

> § 56-585. Default service.
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> A. The Commission shall, after notice and opportunity for hearing, (i) determine the components of default service and (ii) establish one or more programs making such services available to retail customers requiring them during the availability throughout the Commonwealth of customer choice for all retail customers as established pursuant to § 56-577. For purposes of this chapter, "default service" means service made available under this section to retail customers who (i) do not affirmatively select a supplier, (ii) are unable to obtain service from an alternative supplier, or (iii) have contracted with an alternative supplier who fails to perform. Availability of default service shall expire upon the expiration or termination of capped rates *except as to any incumbent electric utility that divested its generation assets with approval of the Commission pursuant to §56-590 prior to January 1, 2002*.

[6] Delmarva Power and Light also divested its generation subject to a similar agreement and Commission Order. Delmarva has since transferred its Virginia service territory to A&N Electric Cooperative, with SCC approval, and therefore this issue is moot as to Delmarva.

No amendment was made in 2008 and Allegheny now has a pending case at the Commission where this legal issue has been litigated.[7] The Office's Division of Consumer Counsel advocated positions that would preserve the rate protections in the MOU beyond the expiration of statutory default service. However, in an Order dated July 18, 2008, the SCC found that, as a matter of law, both "capped rates" and "default service" as used in the MOU have been abolished by statute and are no longer in effect after December 31, 2008. Accordingly, the Commission ruled that the continuing ratemaking provisions of Allegheny's agreement expire on December 31, 2008 along with the expiration of default service. While this is a final Commission ruling on the legal issue of the life of the MOU, the case remains active pending a Final Order to establish a rate and resolve other matters concerning how Allegheny will serve its customers in the future. It should also be noted that ongoing discussions among the parties to the case could potentially resolve the issue of the termination of the MOU, in which event this issue concerning default service in § 56-585 would become moot.

C. § 56-585.1 A.2, A.8, and A.9 – Combined rates of return on both generation and distribution services.

This issue was raised in the 2007 Report. There are provisions of § 56-585.1 in subdivisions A.2.g., A.8(i), (ii), and (iii), and A.9 that speak of a

[7] Application of the Potomac Edison Company d/b/a Allegheny Power, For an increase in its electric rates pursuant to Va. Code §§ 56-249.6 and 56-582 and, alternatively, request to modify Memorandum of Understanding and Order in Case No. PUE-2000-00280, Case No. PUE-2008-00033.

"combined rate of return on both its generation and distribution services . . . ." These provisions are preceded in subdivisions A.8 and A.9 by the clause "considered as a whole." It is unclear what, if anything, "on both" requires. It is fair to conclude that "considered as a whole" and "combined rate of return" mean that the earnings at issue should be considered on a bundled basis, regardless of the unbundled earnings for generation and distribution considered separately. There is no reason to believe that "on both" was intended to change that logical result. However, the language could be used to support an argument that a determination of the requisite earnings be made separately for generation and distribution, and that rate increases (or credits, or decreases) are ordered *only* if earnings from both generation and distribution – considered separately – are *each* below (or above) the authorized rate of return. At the very least, the "on both" language is surplusage that creates uncertainty. For clarity, "both" should be stricken from these provisions.

The following amendments to subdivisions 2, 8, and 9 of § 56-585.1 A would accomplish this clarification:

> § 56-585.1. Generation, distribution, and transmission rates after capped rates terminate or expire.
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> . . . .
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> A.2.g. If the combined rate of return on common equity earned by ~~*both*~~ the generation, and distribution services is no more than 50 basis points above or below the return as so determined, such combined return shall not be considered either excessive or insufficient, respectively.
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> . . . .

A.8. If the Commission determines as a result of such biennial review that:

(i) The utility has, during the test period or periods under review, considered as a whole, earned more than 50 basis points below a fair combined rate of return on ~~*both*~~ its generation and distribution services, as determined in subdivision 2, without regard to any return on common equity or other matters determined with respect to facilities described in subdivision 6, the Commission shall order increases to the utility's rates necessary to provide the opportunity to fully recover the costs of providing the utility's services and to earn not less than such fair combined rate of return, using the most recently ended 12-month test period as the basis for determining the amount of the rate increase necessary. . . . ;

(ii) The utility has, during the test period or test periods under review, considered as a whole, earned more than 50 basis points above a fair combined rate of return on ~~*both*~~ its generation and distribution services, as determined in subdivision 2, without regard to any return on common equity or other matters determined with respect to facilities described in subdivision 6, the Commission shall, subject to the provisions of subdivision 9, direct that 60 percent of the amount of such earnings that were more than 50 basis points above such fair combined rate of return for the test period or periods under review, considered as a whole, shall be credited to customers' bills. . . . ; or

(iii) Such biennial review is the second consecutive biennial review in which the utility has, during the test period or test periods under review, considered as a whole, earned more than 50 basis points above a fair combined rate of return on ~~*both*~~ its generation and distribution services, as determined in subdivision 2, without regard to any return on common equity or other matter determined with respect to facilities described in subdivision 6, the Commission shall, subject to the provisions of subdivision 9 and in addition to the actions authorized in clause (ii) of this subdivision, also order reductions to the utility's rates it finds appropriate. However, the Commission may not order such rate reduction unless it finds that the resulting rates will provide the utility with the opportunity to fully recover its costs of providing its services and to earn not less than a fair combined rate of return on ~~*both*~~ its generation and distribution services, as determined in subdivision 2, without regard to any return on common equity or other matters determined with respect to facilities described in subdivision 6, using the most recently ended 12-month test period as the basis for determining the

> permissibility of any rate reduction under the standards of this sentence, and the amount thereof.
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> . . . .
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> A.9. If, as a result of a biennial review required under this subsection and conducted with respect to any test period or periods under review ending later than December 31, 2010 (or, if the Commission has elected to stagger its biennial reviews of utilities as provided in subdivision 1, under review ending later than December 31, 2010, for a Phase I Utility, or December 31, 2011, for a Phase II Utility), the Commission finds, with respect to such test period or periods considered as a whole, that (i) any utility has, during the test period or periods under review, considered as a whole, earned more than 50 basis points above a fair combined rate of return on ~~*both*~~ its generation and distribution services, as determined in subdivision 2, without regard to any return on common equity or other matters determined with respect to facilities described in subdivision 6, . . .

D. § 56-585.1 A.2.e - In setting the return on equity within the peer group range, the SCC shall strive to maintain costs of retail electric energy that are cost competitive with costs of retail electric energy provided by the other peer group investor-owned electric utilities.

This issue was raised in the 20007 report. This provision gives the SCC an additional tool to help ensure that the retail cost of electricity charged to consumers by Virginia's utilities does not become excessive as compared to the rates charged by other utilities in the region.[8] However, instead of referring to "rates" – which the Commission sets – it refers to "costs." The reference to the "costs of retail electric energy" is intended to refer to the amount paid by consumers. In the utility ratemaking context, those "costs" properly are referred

[8] The laws governing utility ratemaking typically prevent a regulatory agency from considering factors external to the subject utility's own costs. Section 56-585.1 A.2.e appears to be a legally permissible variation of the usual ratemaking approach, provided the Commission does not employ it to set rates so low as to result in an unconstitutional regulatory taking.

to as rates. The use of the term costs instead invites confusion and impossibility of performance. The Commission has no practical means of ascertaining the "costs" of utilities outside its jurisdiction. The following amendment would correct the problem:

> § 56-585.1 A.2.e. In addition to other considerations, in setting the return on equity within the range allowed by this section, the Commission shall strive to maintain ~~*costs of*~~ *rates for* retail electric energy that are ~~*cost*~~ competitive with ~~*costs of*~~ *rates for* retail electric energy provided by the other peer group investor-owned electric utilities.

E. §§ 56-585.1 A.3, 56-585.1 A.4, 56-585.1 A.5 and 56-585.1 A.7 - Stand-alone rate adjustment clauses.

This issue was raised in the 2007 Report. These provisions establish, and set forth procedures for the recovery of certain costs through, annual "rate adjustment clauses." Utilities may not petition for approval of such clauses more than once in any 12-month period. The SCC must consider these petitions on a "stand-alone basis without regard to other costs, revenues, investments, or earnings of the utility." Section 56-585.1 A.3 directs that, once implemented, any rate adjustment clauses pursuant to subdivision 4 or 5, or those related to facilities utilizing simple-cycle combustion turbines described in subdivision 6, are to be combined with the utility's costs, revenues, and investments in the next biennial review *only if* the SCC *first* determines in the biennial review that rates should be revised or credits be applied to customers' bills.

The primary intent of these clauses is to provide utilities with the opportunity for more timely recovery of costs between biennial reviews of their

base rates. Accomplishing that purpose does not require that, once implemented, consideration of the costs and revenues captured by rate adjustment clauses in biennial reviews be conditioned on the limited circumstances currently provided by the Act. As a practical matter, implementation would be simplified if they are included with the utility's other costs and revenues and considered in the utility's subsequent biennial review from the outset of that process. We have been unable to identify any meaningful advantage to the current "two-step" process. That result can be accomplished with the following amendment:

> § 56-585.1 A.3. Each such utility shall make a biennial filing by March 31 of every other year, beginning in 2011, consisting of the schedules contained in the Commission's rules governing utility rate increase applications (20 VAC 5-200-30); however, if the Commission elects to stagger the dates of the biennial reviews of utilities as provided in subdivision 1, then Phase I utilities shall commence biennial filings in 2011 and Phase II utilities shall commence biennial filings in 2012. Such filing shall encompass the two successive 12-month test periods ending December 31 immediately preceding the year in which such proceeding is conducted, and in every such case the filing for each year shall be identified separately and shall be segregated from any other year encompassed by the filing. ~~*If the Commission determines that rates should be revised or credits be applied to customers' bills pursuant to subdivision 8 or 9, a*~~*Any* rate adjustment clauses previously implemented pursuant to subdivision 4 or 5, or those related to facilities utilizing simple-cycle combustion turbines described in subdivision 6, shall be combined with the utility's costs, revenues and investments until the amounts that are the subject of such rate adjustment clauses are fully recovered. ~~*The Commission shall combine such clauses with the utility's costs, revenues and investments only after it makes its initial determination with regard to necessary rate revisions or credits to customers' bills, and the amounts thereof, but a*~~*After* such clauses are combined as herein specified, they shall thereafter be considered part of the utility's costs, revenues, and investments for the purposes of future biennial review proceedings. By the same date, each such utility

shall also file its plan for its projected generation and transmission requirements to serve its native load for the next 10 years, including how the utility will obtain such resources, the capital requirements for providing such resources, and the anticipated sources of funding for such resources.

F. § 56-585.1 A.5.b - Recovery of costs for demand-side management, conservation, energy efficiency and load management programs.

This issue was raised in the 2007 Report. Section 56-585.1 A.5.b provides a rate adjustment clause for costs associated with conservation efforts. The existing language "Projected and actual costs of providing incentives for the utility to design and operate . . ." is confusing. The language appears to authorize recovery of only the costs of providing incentives and not the actual costs of the programs themselves. Assuming the intent was to authorize recovery of the costs of the program, the amendment suggested below would make that clear. It would also change the phrase "demand-management" to the term of art used in the industry, "demand-*side* management," to be clear that no other reference is intended.

> § 56-585.1 A.5.b. Projected and actual costs ~~*of providing incentives*~~ for the utility to design and operate fair and effective demand-*side* management, conservation, energy efficiency, and load management programs, *including incentives to undertake such programs*. The Commission shall approve such a petition if it finds that the program is in the public interest and that the need for the incentives is demonstrated with reasonable certainty; provided that the Commission shall allow the recovery of such costs as it finds are reasonable;

G. § 56-585.1 A.5.a., b., c., and d. - Commission authority to determine the duration or amortization period for rate adjustment clauses.

This issue was raised in the 2007 Report. These provisions establish and set forth procedures for the recovery of certain costs through annual "rate adjustment clauses." Beneath § 56-585.1 A.5.d, it states "[t]he Commission shall have the authority to determine the duration or amortization period for any adjustment clause approved under this subdivision." While it is logical that this should apply to each of the clauses of A.5, it could be interpreted to apply to only A.5.d. For clarity and to ensure proper implementation by the SCC, we believe it should be explicit that the Commission's authority to determine the duration and amortization periods applies to each clause under subdivision A.5. The amendment suggested below would make that clear.

> § 56-585.1 A.5. A utility may at any time, after the expiration or termination of capped rates, but not more than once in any 12-month period, petition the Commission for approval of one or more rate adjustment clauses for the timely and current recovery from customers of the following costs:
>
> a. Incremental costs described in clause (vi) of subsection B of § 56-582 incurred between July 1, 2004, and the expiration or termination of capped rates, if such utility is, as of July 1, 2007, deferring such costs consistent with an order of the Commission entered under clause (vi) of subsection B of § 56-582. The Commission shall approve such a petition allowing the recovery of such costs that comply with the requirements of clause (vi) of subsection B of § 56-582;
>
> b. Projected and actual costs of providing incentives for the utility to design and operate fair and effective demand-management, conservation, energy efficiency, and load management programs. The Commission shall approve such a petition if it finds that the program is in the public interest and that the need for the incentives is demonstrated with reasonable certainty; provided that the

Commission shall allow the recovery of such costs as it finds are reasonable;

c. Projected and actual costs of participation in a renewable energy portfolio standard program pursuant to § 56-585.2 that are not recoverable under subdivision 6. The Commission shall approve such a petition allowing the recovery of such costs as are provided for in a program approved pursuant to § 56-585.2; and

d. Projected and actual 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. The Commission shall approve such a petition if it finds that such costs are necessary to comply with such environmental laws or regulations. If the Commission determines it would be just, reasonable, and in the public interest, the Commission may include the enhanced rate of return on common equity prescribed in subdivision 6 in a rate adjustment clause approved hereunder for a project whose purpose is to reduce the need for construction of new generation facilities by enabling the continued operation of existing generation facilities. In the event the Commission includes such enhanced return in such rate adjustment clause, the project that is the subject of such clause shall be treated as a facility described in subdivision 6 for the purposes of this section.

The Commission shall have the authority to determine the duration or amortization period for any adjustment clause approved under ~~*this*~~ subdivision*s 5 a through 5 d*.

H. § 56-585.1 A.7 and A.8 - Deadlines for SCC final orders.

This issue was raised in the 2007 Report and is supplemented in this Report by experience from the past year. Section 56-585.1 A.7 prescribes deadlines of three months, eight months, and nine months from filing, respectively, for the Commission to enter final orders on petitions for rate adjustment clauses filed pursuant to subdivisions A.4 (certain transmission related costs), A.5 (costs for environmental compliance, conservation and energy

efficiency programs, or renewable energy portfolio standard programs), and A.6 (costs for new generation facilities or major unit modifications). In addition, § 56-585.1 A.8 requires a final order within nine months from the end of the test period, in a biennial rate review, which is six months after filing.

As a practical matter, these statutory deadlines may limit the level of participation that can be afforded to the parties involved in these proceedings. The SCC typically provides for public notice of rate filings and allows time for case participants to retain consultants, conduct discovery, and pre-file testimony before a public hearing. Following a hearing, legal briefs are often required after a transcript of the hearing becomes available. The statutory deadlines likely will require curtailing the time allotted for some of this traditional practice, or revision of the practice altogether. However, as noted in the 2007 Report, given the Commission's authority to adopt its own rules of practice, it would have been premature to assume a need for a legislative remedy last year, and that continues to be the case at this time.

Two proceedings conducted over the past twelve months under § 56-585.1 A.6 provided practical experience with the nine-month statutory deadline for processing applications for rate adjustment clauses for new generation facilities.[9] Those cases were handled in a timely manner, although the evidentiary hearings were before the SCC commissioners as opposed to what might otherwise have been proceedings conducted by a hearing examiner. Pursuant to § 56-585.1 E, the Commission is directed to promulgate rules and

[9] The Appalachian Power and Dominion Virginia Power cases described in Part II. A. above.

regulations as may be necessary to implement the provisions of § 56-585.1. This rulemaking opportunity should allow the SCC to adopt procedures for adjudication of the filings subject to statutory deadlines in a manner that optimizes the time allotted to the case participants and to the Commission. There is a pending proceeding for revising the rules governing applications to construct and operate generation facilities.[10] In addition, the Commission is in the process of revising its rules governing rate case applications.[11] Both of these rulemaking proceedings are largely to accommodate new requirements of the 2007 Act. The results of these rulemakings, and the outcome of subsequent cases in which the new rules are applied, may reveal necessary changes to the statutory deadlines in the future.

I. § 56-585.1 A.8 - Actions taken in biennial review.

This issue was raised in the 2007 Report. The term "such biennial review" in the opening clause of § 56-585.1 A.8 was the result of that text originally following the biennial review section of the Act (subdivision A.3 of § 56-585.1). Because subdivision A.8 is now separated from the biennial review provisions of the § 56-585.1 by five subdivisions, the language is no longer helpful. A corrective amendment follows:

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[10] Commonwealth ex rel. State Corporation Commission, Ex Parte: In the matter of revising the rules of the State Corporation Commission governing applications to construct and operate electric generating facilities, Case No. PUE-2008-00066,

[11] Commonwealth ex rel. State Corporation Commission, Ex Parte: In the matter of revising the rules of the State Corporation Commission governing utility rate increase applications pursuant to Chapter 933 of the 2007 Acts of Assembly, Case No. PUE-2008-00001.

§ 56-585.1 A.8. If the Commission determines as a result of ~~*such* biennial review~~ *reviews conducted under subdivision A.3* that: . . . .

J. § 56-585.1 A.8(i) - Biennial review rate increases.

This issue was raised in the 2007 Report. Section 56-585.1 A.8 sets forth the provisions for increasing rates (clause (i)), crediting customer bills (clause (ii)), and decreasing rates (clause (iii)) in the biennial review process. Under 8(iii), when there have been over-earnings for two consecutive biennial reviews, in addition to credits pursuant to 8(ii), the SCC shall order rate reductions. However, there is conditional language in 8(iii) instructing that the Commission may not order rate reductions "unless it finds that the resulting rates will provide the utility with the opportunity to fully recover its costs of providing its services and to earn not less than a fair combined rate of return . . . ." It is possible a utility would have over-earned in the past, but due to rising costs or other factors a prospective rate reduction would not provide it with the opportunity to continue to recover its costs and earn a fair return.

The identical conditional language appears in Subdivision 8(i) pertaining to rate increases. However, because the inquiry engaged in for determining the appropriateness of a rate increase following a period of under-earnings is different than that for a rate decrease, the conditional language should be adjusted slightly to have an equivalent beneficial effect. For a rate increase following a period of under-earnings the relevant inquiry is not simply whether a prospective rate increase *will* provide the utility with the opportunity to continue to recover its costs and earn a fair return, but whether, due to the possibility of

falling costs or other factors, the increase is *necessary* to do so. This point is illustrated by the existing language in the first sentence of 8(i) that "the Commission shall order increases to the utility's rates necessary to provide the opportunity to fully recover the costs . . . ."

The following amendment would resolve this issue:

> § 56-585.1 A.8. If the Commission determines as a result of such biennial review that:
>
> (i) The utility has, during the test period or periods under review, considered as a whole, earned more than 50 basis points below a fair combined rate of return on both its generation and distribution services, as determined in subdivision 2, without regard to any return on common equity or other matters determined with respect to facilities described in subdivision 6, the Commission shall order increases to the utility's rates necessary to provide the opportunity to fully recover the costs of providing the utility's services and to earn not less than such fair combined rate of return, using the most recently ended 12-month test period as the basis for determining the amount of the rate increase necessary. However, the Commission may not order such rate increase unless it finds that the resulting rates ~~will~~ *are necessary to* provide the utility with the opportunity to fully recover its costs of providing its services and to earn not less than a fair combined rate of return on both its generation and distribution services, as determined in subdivision 2, without regard to any return on common equity or other matters determined with respect to facilities described in subdivision 6, using the most recently ended 12-month test period as the basis for determining the permissibility of any rate increase under the standards of this sentence, and the amount thereof; . . . .

K. § 56-592 - Consumer education programs.

In 2008, Senate Bill 596 made a number of amendments to statutory provisions in the former Restructuring Act to bring consistency with the re-

regulation changes in the 2007 Act.[12] These "housekeeping" changes in 2008 included shifting the focus of the SCC's consumer education program under §§ 56-592 and 56-592.1 from matters of retail competition and marketing of competitive suppliers to energy conservation, energy efficiency, and related matters relevant to consumers. Section 56-592.A provides for "an electric energy consumer education program" designed to provide "information to retail customers."

Amending Section 56-592.A to permit the consumer education program to target natural gas customers as well may further the goals of the program by allowing consumers to make more informed decisions regarding all of their energy consumption. A substantial overlap exists between electric and natural gas conservation and efficiency initiatives. For example, the decision to install more efficient windows or weather-stripping could impact a person's consumption of both electricity and natural gas. Because of this overlap, the Commission's consumer education program may deliver information more effectively by communicating information regarding both electric and natural gas usage. Customers are, in turn, able to make more informed decisions when they receive information in such a manner. The Commission's education program can be made more inclusive with the following amendment:

> § 56-592. Consumer education and marketing practices
>
> A. The Commission shall develop an electric <u>and natural gas</u> energy consumer education program designed to provide the following information to retail customers; . . . .

[12] 2008 Acts of Assembly Chapter 883.

III. Conclusion

Over the course of the past year we have begun to gain some experience with the 2007 Act's new approach to ratemaking for regulated electric utilities. Several implementation issues and unintended consequences have become apparent, while other potential issues have not yet been tested through implementation. The attorneys and staff of the Office of the Attorney General remain ready to assist in any way requested with regard to the issues and suggestions included herein.