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STATE CORPORATION COMMISSION

January 29, 2018

The Honorable J. Chapman Petersen
Virginia State Senate
Pocahontas Building, Room E517
900 E. Main Street
Richmond, Virginia 23219

BY HAND

Dear Senator Petersen:

In response to your request, the Staff of the State Corporation Commission has prepared the enclosed bill analysis. Please contact me at 371-9608 if the Commission can be of further assistance.

Sincerely,

John F. Dudley
Counsel to the Commission

Enclosure

C: The Honorable George L. Barker
The Honorable Amanda F. Chase
The Honorable R. Creigh Deeds
The Honorable Adam P. Ebbin
The Honorable Emmett W. Hanger, Jr.
The Honorable T. Montgomery "Monty" Mason
The Honorable Jeremy S. McPike
The Honorable William M. Stanley, Jr.
The Honorable David R. Suetterlein
The Honorable Scott A. Surovell
The Honorable Jennifer T. Wexton

SCC Analysis of SB 966 and SB 967[1] (as introduced)

I. Treatment of Future Earnings, Refunds, and Base Rate Changes

Q: In general, how can the likely effect of SB 966 and SB 967 on ratepayers be summarized?

As explained in greater detail within this document, the key impacts on ratepayers can be summarized as follows:

a. There will be no opportunity to consider base-rate reductions or refunds to customers for at least six years, and then only if the utility over-earns for two consecutive three-year periods, effectively extending the current base-rate freeze further into the future.

b. There may be only a partial return of the reduction in federal income taxes currently being collected in base rates.

c. The provision in current law that allows utilities to keep more than 30% of their excess earnings is continued.

d. The legislation allows the utilities to keep future excess earnings (i.e. customer overpayments) and, rather than return them to customers, use them for capital projects chosen by the utility. In addition, the utilities can charge customers for these same projects in base rates.

e. The legislation deems certain capital projects to be "in the public interest," thus impacting the SCC's authority to evaluate whether such projects are cost-effective or whether there are alternatives available at lower costs to customers. This provision could potentially result in billions of dollars of additional costs that will be charged to customers in higher rates.

f. An amount that appears to represent the customers' portion of prior period excess earnings is returned to customers, but the amount has not been examined in a formal proceeding to determine its accuracy.

Q: Under SB 966 and SB 967, will the SCC have the authority to conduct base rate reviews, order refunds to customers and/or reduce base rates if either Apco or Dominion are over-earning?

These bills resume base rate review proceedings on a three-year (triennial) basis with the first rate review for Apco in 2020 and Dominion in 2021. The bills permit refunds or rate

[1]For economy of analysis, this document focuses primarily on SB 966 and SB 967, which are the most comprehensive bills. Additional features of the other bills will be identified at the end regarding SB 955 and SB 965.

reductions on a limited basis but only if the utilities over-earns over six years (two consecutive Triennial Reviews).

Q: Under SB 966 and SB 967, when is the earliest that customers could receive refunds if the Commission determines in future Triennial Reviews that an electric utility has over-earned?

Customers could receive refunds (under limited circumstances detailed below) only after the conclusion of a second consecutive Triennial Review (6 years) in which a utility over-earns. <u>The earliest date that Apco customers could receive refunds would be in 2024. The earliest date that Dominion customers could receive refunds would be in 2025.</u>

Q: Under SB 966 and SB 967, can base rates be reduced if the Commission determines in a future Triennial Review that an electric utility has over-earned?

Base rates can be reduced only after the utility over-earns in <u>two</u> consecutive Triennial Reviews (6 years). <u>The earliest date that Apco customers' rates could be reduced would be in 2024. The earliest date that Dominion customers' rates could be reduced would be in 2025.</u>

Q: Do SB 966 and SB 967 impose any limits on customers actually receiving either a refund (customers' 70% share of over-earnings) or receiving a rate reduction?

Yes. The legislation requires that utility spending on distribution grid transformation projects and renewable generation during two consecutive Triennial Review Periods (6 years) reduce, on a dollar for dollar basis, or cancel out refunds otherwise due to customers. <u>Rates cannot be reduced if utility spending on these projects during this period is greater than customer refunds that would otherwise result from over-earnings.</u> Further, it keeps existing provisions in law allowing the electric utilities to keep 30% of over-earnings, i.e. earnings that exceed the fair rate of return determined by the SCC plus 70 basis points.

Q: If customers' refund money is reduced by distribution grid transformation and renewable generation projects ("Projects"), are the Projects considered paid in full?

No, under the legislation if the utility has spent money on Projects, customer refunds will be reduced by that amount and base rates will recover the same amount with interest and profit margin.

For example, suppose the SCC determines after two Triennial Reviews that customers are owed a refund of $100 million. Assume further, that during the six year period of the Triennial Review, an electric utility spends $100 million on distribution grid transformation investment. As a result, customer refunds are offset by this utility spending (customers would not receive any refunds). Then, customers will pay the full $100 million for these distribution grid transformation projects, plus interest and a profit margin, through base rates. Effectively, customers are more than $200 million out of pocket ($100 million lost refund + $100 million paid through base rates + interest/profit margin) for these $100 million of new distribution grid transformation projects.

Q: How do SB 966 and SB 967 provide for recovery of costs associated with renewable generation and distribution grid transformation projects that exceed customer refunds?

The costs of these projects that exceed customer refund amounts can be charged to customers through RACs (rate riders) in which the utility is guaranteed dollar-for-dollar recovery including a profit margin.

Using the example above, if the customer refund amount remains at $100 million but the utility investment is actually $300 million, then (i) the customers still receive no refund, (ii) $100 million is collected through base rates, and (iii) the $200 million above the customer refund amount can be collected through a RAC. Effectively, customers are more than $400 million out of pocket ($100 million lost refund + $100 million paid through base rates + $200 million paid through a RAC + interest/profit margin) for $300 million of new distribution grid transformation projects.

II. Federal Tax Cut and Biomass Cost Treatment

Q: How do SB 966 and SB 967 address the recent federal tax cut and resulting tax savings?

For Dominion, the legislation provides for rates to be reduced effective July 1, 2018, by $125 million (reflecting the estimated base rate tax savings plus the discontinuance of the Biomass RAC). This will result in a base rate reduction of less than $125 million. For example, if the annual revenue requirement of the Biomass unit is $25 million, then the net decrease to base rates on July 1, 2018, will be $100 million ($125 million rate reduction *minus* $25 million Biomass unit annual revenue requirement).

Dominion's reduction is interim and as of April 1, 2019, the tax rate reduction will be trued-up back to July 1, 2018. Since the federal tax rate cut was effective January 1, 2018, this bill may allow Dominion to keep any tax rate savings actually realized between January 1, 2018 and June 30, 2018.

Apco is required to reflect the reduction in federal tax expense in its rates as of April 1, 2019. Similar to Dominion, Apco may potentially keep the tax rate savings actually realized between January 1, 2018 and March 31, 2019.

Q: Do SB 966 and SB 967 eliminate Dominion's cost recovery for its Biomass units?

No. The legislation discontinues Dominion's recovery of its current RAC (rate rider) for Biomass costs which will lower customer bills. However, SB 966 and SB 967 do not require Dominion to write-off the costs of the Biomass units. Rather, Dominion will eliminate the rider charge and shift the cost recovery to base rates where it will sit and absorb future over-earnings.

III. <u>Costs for Identified Projects</u>

Q: How do SB 966 and SB 967 address renewable generation?

The legislation increases the amount of utility-owned solar generation currently declared in statute to be in the public interest from 500 MW to 4000 MW. Additionally, 16 MW of off-shore wind generation together with on-shore wind generation (no MWs specified) is declared to be in the public interest.

Q: Do SB 966 and SB 967 impact the SCC's traditional authority to determine whether certain Dominion and Apco renewable generation projects are needed, whether their costs are "reasonable and prudent," and whether there are cheaper alternatives available?

Yes, SB 966 and SB 967 include provisions stating that these projects are deemed to be "in the public interest." These provisions impact the Commission's authority to evaluate whether such projects are cost-effective or whether there are alternatives available at lower costs to customers. This could potentially result in billions of dollars of additional costs that must be borne by customers in higher rates.

Q: How do SB 966 and SB 967 address the costs of undergrounding distribution lines?

These bills provide for recovery through rates of costs to underground distribution lines back to September 1, 2016. Some costs incurred as of this date have been previously disallowed by the Commission. Previously, Dominion has proposed to spend $2 billion ($6 billion including interest and profit margin over the life of these projects) to underground approximately 20% of the overhead distribution tap lines. All customers will pay these costs through a RAC while resulting savings will increase base rate earnings. Additionally, all customers will pay for undergrounding costs, regardless of whether lines providing service in their vicinities are undergrounded or not. These provisions impact the Commission's authority to evaluate whether such projects are cost-effective or whether there are alternatives available at lower costs to customers. This could potentially result in billions of dollars of additional costs that must be borne by customers in higher rates.

V. <u>Return on Equity</u>

Q: How do SB 966 and SB967 address the determination of the ROE (utility profit margin)?

Under current law, the SCC is required to establish ROEs in 2018 for Apco and in 2019 for Dominion. Subsequently, SB 966 and SB 967 provide that the SCC can only establish the utilities' ROEs once every three years during their Triennial Review proceedings. These ROEs will be applicable to both base rates and RACs. Currently, the SCC may determine annually the ROEs to be used in RAC cases.

VI. <u>Demand Side Management/ Energy Efficiency</u>

Q: How will the bills' Demand-Side Management (Energy Efficiency) provisions affect rates?

To date, the Commission has approved 122 gas and electric DSM programs (initial or renewed). These bills effectively eliminate the Ratepayer Impact Measure (RIM) cost-benefit test. The RIM test measures the cost that virtually all customers are required to pay for a DSM program that mainly benefits a small fraction of customers. DSM RAC rates are likely to increase because more programs will be approved that benefit the utility and participants while shifting costs to non-participants.

VII. <u>Refunds for Past Period Excess Earnings</u>

Q: Do SB 966 and SB 967 provide for an immediate refund to Dominion customers?

Yes. SB 966 and SB 967 provide Dominion customers a one-time refund of $133 million. This amount appears to be based on earnings information provided by Dominion to the SCC during the Transitional Rate Period for 2015/2016. This information was reported subsequently by the SCC to the Commission on Electric Utility Regulation. However, the SCC did not conduct an audit or investigation of the financial information provided by Dominion. If a case including an audit of the information had been conducted, then any SCC-determined refund amount may have differed from the $133 million proposed for refund in these bills.

VIII. Other Provisions

Q: Does SB 966 provide for any new reporting requirements?

Yes, SB 966 requires the SCC to submit an annual report to the Governor and General Assembly by December 1 of each year addressing several topics within the scope of this bill, including utility integration of renewables, grid hardening, and the need for additional generation during periods of peak demand.

Q: Does SB 967 contain any additional undergrounding provisions?

Yes, SB 967 contains an amendment to address obligations between an electric utility and cable operators in conjunction with an electric utility moving distribution facilities underground.

IX. SB 955 and SB 965

Q: Under SB 955, will the SCC have the authority to conduct base rate reviews, order refunds to customers and/or reduce base rates if either Apco or Dominion are over-earning?

Yes, SB 955 resumes base rate review proceedings on a two-year (biennial) basis with the first rate review for Apco in 2018 and for Dominion in 2019. The bill also provides that the SCC shall review the earnings of each utility during the Transitional Rate Period (2014 – 2017 for Apco and 2015 – 2018 for Dominion). After such reviews, the SCC may order adjustments to rates or credits to customers, as warranted.

The earliest that refunds or rate changes would occur for Apco is in 2019 and for Dominion in 2020.

Q: Does SB 965 provide for an immediate refund to Apco customers?

Yes. SB 965 provides Apco customers a $10 million one-time reduction to the costs recovered through the fuel factor.

Q: Does SB 965 provide for the SCC to conduct a new pilot program?

Yes, SB 965 directs the SCC to conduct a five-year pilot program for Apco and Dominion regarding the deployment of electric power storage batteries (up to 10 MW of storage capacity for Apco and up to 30 MW for Dominion). The cost of the pilot programs will be recovered through base rates. The SCC is required to adopt rules or guidelines governing this pilot by December 1, 2018.