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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| **Existing Regulatory Mechanisms and Programs** | **Description** | **Primary Performance Areas Impacted** | **Current Mechanism Design** | **Comparison to Best Practice** |
| **Rate Reviews (typically biennial)** | Forward-looking | * Affordability
* Cost-efficient utility investments and operations
 | Virginia currently employs a two-year rate case cycle, after recently transitioning from a three-year cycle. Virginia has an **earnings sharing mechanism** in place for its investor-owned utilities. VA Code § 56-585.1 A 9 b requires earnings sharing for Dominion and APCo and requires refunds of base generation and distribution revenues to customers if authorized ROE is exceeded. For Dominion, 85% of earnings above authorized ROE are returned to customers, up to 150 basis points above ROE. If overearnings exceed 150 basis points above ROE, 100% of earnings are returned to customers. For APCo, 100% of overearnings above 100 bps threshold are returned to customers, but there is no sharing until 100 bps is reached.  | Multi-Year Rate PlansIn general, the two-year rate cycle may result in a high administrative burden. Frequent rate cases may also undermine **affordability** and **cost containment** goals by reducing regulatory lag (i.e., the time between when a utility incurs a cost and the time when it recovers that cost via rates). VA could consider authorizing the use of **multi-year rate plans (MRPs)**. MRPs with a longer term length (e.g. 3-5 years) may provide benefits over the two-year rate case structure currently in place. Numerous jurisdictions around the world have seen success in transitioning to an MRP structure. A well-designed MRP can create a strong cost-containment incentive for the utility, while also reducing the expenses associated with frequent rate cases. The magnitude of these benefits will depend on the specific design of the MRP, such as term length, the design of a **revenue cap** and an **attrition relief mechanism (ARM),** the design of an **earnings sharing mechanism (ESM)**, and the prevalence of cost trackers. Limiting the use of cost trackers as part an MRP can prevent undermining cost-containment incentives that the MRP creates (see more discussion on cost trackers below). U.S. utility MRPs generally include a **revenue cap** and an **ARM,** which serves as a mechanism for adjusting base rates during the MRP term. An index-based ARM, informed by external cost drivers, can create a stronger cost-containment incentive than tying allowed revenues to the utility’s own spending forecasts. Generally, under a **revenue cap**, if a utility manages to achieve savings in the costs recovered by base rates, it can benefit financially from those savings for longer than it would be able to under traditional cost-of-service regulation (COSR) — creating an incentive for it to seek cost-savings opportunities. MRPs can also be designed to include safeguards, such as **ESMs** and **off-ramps**, which provide guardrails throughout the multi-year plan term and can allow for appropriate adjustments when necessary (e.g. excessive overearnings, or a credit-rating downgrade). 16 states currently have active MRPs. Jurisdictions with MRPs that have externally-indexed ARMs include **Hawaii**, **Massachusetts,** and **Alberta, Canada**.Earnings Sharing MechanismsThe current earnings sharing requirements for Virginia’s utilities offer some protection to ratepayers from utility overearnings. However, ESMs should be structured with two objectives in mind: 1) to act as a safeguard if utilities earnings significantly exceed authorized ROE and 2) when paired with an MRP with a revenue cap, ensuring that the MRP’s cost containment incentive is not overly diluted by requiring sharing of overearnings with customers. ESM deadbands are often used to preserve a MRP’s cost containment incentive while still protecting customers from exceedingly high earnings. However, without a revenue cap, it is unclear whether a higher ROE is the result of a utility containing costs or just increasing sales, and thus the use of a deadband may not be as effective. Other jurisdictions with ESMs include **Hawaii**, **Massachusetts**, and **Vermont**. Management AuditsVirginia’s ratepayers may also benefit from more frequent **management audits** of the investor-owned utilities, regardless of whether an MRP structure is in place. Audits can unearth significant cost saving opportunities. For example, a 2020 management audit in **Hawaii** revealed $25 million of annual capital and operational cost reductions that translated into immediate bill savings. For MRPs, management audits can ensure going-in rates and ARM design accurately reflect the potential for **cost efficiencies**.Electric Revenue DecouplingVirginia does not currently have electric **revenue decoupling** in place, which is another missed opportunity to address issues that stem from utilities’ **throughput** **incentive**. When variable rates are used to recover costs that are fixed in the short term, a utility can increase its revenues by selling more energy without a corresponding increase in its costs. This creates a powerful incentive to grow sales and oppose measures that reduce energy usage. Revenue decoupling can make a utility neutral towards sales volumes, thereby removing the disincentive against energy efficiency programs. Revenue decoupling calculates the difference between a utility’s approved revenues and the revenues it has actually collected from customers, and then performs a true-up via a rate rider (i.e., a refund if there was overcollection or a surcharge if there was undercollection). The function of revenue decoupling is to eliminate the throughput incentive by truing up the utility’s fixed-cost recovery to match its approved level – no more, no less. Removing the throughput incentive means that customers do not overpay for use of the utility’s existing assets when usage increases, and that the utility does not fail to recover its prudently incurred costs for those assets when usage decreases. It also eliminates the profit opportunity that increased energy sales represents, and thus reduces the utility’s financial incentive to oppose energy efficiency measures and third-party and customer-owned distributed generation. Revenue decoupling thus benefits the utility, customers, and society. 18 states and Washington, DC currently have electric revenue decoupling, including **Massachusetts**, **New York**, and **California** – states that also consistenly rank among the best performing on ACEEE’s energy efficiency scorecard. Capex-Opex EqualizationA number of **capex-opex equalization** strategies may also incentivize Virgnia’s utilities to seek **cost efficiencies**. Capex-opex equalization policies are designed to reduce or eliminate capex bias. For example, opex capitalization involves amortizing a category of opex and allowing a utility to earn a return on it over time. **Maryland** and **New Jersey,** for instance, allow capitalization of energy efficiency spending. Each state permits expenditures associated with energy efficiency programs to be amortized over a five and ten-year period, respectively, enabling utilities to evaluate efficiency investments on a level playing field relative to other investments.While opex capitalization is typically restricted to a particular project or activity, **totex ratemaking** takes a comprehensive view of capex bias seeks to eliminate the distinction between capex and opex for ratemaking purposes. Pooling capex and opex to form total expenditures – or totex – and then using a predetermined capitalization rate to divide totex into two categories called fast money and slow money. Fast money functions like opex in traditional ratemaking (i.e., as a pass-through), whereas slow money functions like capex (i.e., it is added to rate base, amortized, and earns a return for utility investors). Since the capitalization rate applies equally to all controllable expenditures, the utility can no longer grow its rate base by substituting capex for opex during the MRP. Recent research indicates that totex ratemaking is in fact compatible with US accounting standards. The **United Kingdom** currently uses totex ratemaking, along with other strategies, to encourage utility cost control. |
| Backward-looking (w/ earnings adjustments)  |
| **ROE Determinations** |  | * Affordability
* Cost-efficient utility investments and operations
 | Until recently, the SCC was prohibited from lowering authorized ROE for Virginia’s investor-owned utilities below the average of a peer group of vertically integrated utilities operating in the Southeast. It is our understanding that the restrictions on setting ROE based on a peer group of utilitlies have been removed. (See Clean VA’s regulatory assessment template on Affordability for more information). | While the use of peer benchmarking is often used as a data point in setting a utility’s authorized ROE, the restriction on setting ROE below a peer group average can be problematic since striving to be at or above an average raises the average, costing customers more. It could also reinforce suboptimal practices employed by peer jurisdictions. Moreover, regulators should take care to make sure the specific regulatory framework in which a utility operates and its corresponding risks are considered when setting an appropriate ROE, which should be a primary driver of an ROE determination. The recent elimination of the restrictions on setting ROE below peer averages should help to remove limitations that may have worked against **affordability** and **cost-efficiency** goals. Setting ROE should be informed by any PBR mechanisms that are ultimately implemented, given that several of the principal factors that ordinarily contribute to the determination of an utility’s ROE can be affected by a PBR framework. PBR mechanisms that affect the magnitude, certainty, stability and/or risk associated with expected MRP revenue can directly and/or indirectly affect the conventional determination of allowed ROE. These include the ARM formula components, interim MRP revenue attrition mechanisms, supplementary capital recovery mechanisms, earnings sharing provisions, cost tracker provisions, PIMs (including provision of expected revenue, opportunities for supplemental revenue, and possible penalties), and any off-ramp provisions.For example, a fixed ARM revenue formula, in conjunction with reconciliation of collected revenue through decoupling, produces a known, stable, multi-year revenue stream which is insulated from several characteristic industry risks and uncertainties (e.g., economic cycles, commercial building occupancy, demographic trends, weather extremes). A PBR framework can include provisions for attrition of revenue throughout the MRP and may include specific provisions for supplemental recovery for certain capital expenditures. These elements directly affect (a) the magnitude and certainty of expected revenue streams considered in discounted cash flow analysis methods and scenarios, (b) the certainty and expected variance in expected revenue streams considered in capital asset pricing model analysis and scenarios, (c) assessment of financial risk premiums in comparisons to debt securities, and (d) the selection of proxy utilities for direct comparisons and baseline statistics.Commissions in several jurisdictions have made adjustments to allowed ROE associated with PBR frameworks and/or specific mechanisms. For example, the **Hawaii** PUC adjusted allowed ROE for the HECO Companies downward by 0.25% specifically for the reduction in company risk associated with implementing its decoupling mechanism. The **Minnesota** PUC established a 9.25% ROE for Xcel Energy in its last rate case, nearly 100 basis points lower than the company’s request for a 10.2% ROE, in part due to the company’s multi-year rate plan framework. And the **Illinois** Commerce Commission lowered ROE for both ComEd and Ameren because of the role of the MRP in reducing risk for the utilities.  |
| **Rate Adjustment Clauses (i.e., trackers)** | RACs overall (general assessment of the use of RACs) | * Affordability
* Cost-efficient utility investments and operations
* Electricity decarbonization
 | Virginia’s investor-owned utilities recover a significant portion of their expenses through Rate Adjustment Clauses (RAC). RACs allow utilities to recovery expenses through trackers, rather than through base rates. RACs provide guaranteed revenue, as opposed to recovery through base rates, which traditionally occurs after a project is placed into service. Today, roughly 50% of utility costs are recovered through RACs. As of [July 2024](https://www.scc.virginia.gov/media/sccvirginiagov-home/regulated-industries/utility-regulation/energy-regulation/2024-veur.pdf), RACs accounted for almost 30% of an average residential bill for a Dominion customer, and 28% for APCo. Another 18% and 24% accounted for fuel costs for Dominion and APCo residential bills, respectively. FACs represent the largest increase in proportion of customers’ bills in recent years between FACs, fuel costs, and base rates. Virginia does not currently **have fuel-cost sharing** in place.  | Cost TrackersThe large proportion of RACs in Virginia creates several obstacles to improving **affordability** outcomes. Cost trackers can erode a utility’s incentive to make **cost-efficient spending decisions**, and when applied to capital costs, they can exacerbate the perverse incentive to overinvest in capital assets. While there may be some benefits to using cost trackers, when cost trackers are adopted in conjunction with MRPs, they should primarily be used for cost categories outside of utility control (e.g. taxes, social benefit program costs) in order to preserve an MRP’s cost containment incentives.One reason for cost trackers eroding utilities’ cost control incentives is that they reduce regulatory lag (i.e., the time between when a utility incurs a cost and the time when it recovers that cost via rates) since they adjust rates regularly to recover costs rather than just when rates are reset during a rate case. A second reason is that they tend to result in less regulatory scrutiny. This is because the prudence reviews regulators conduct in periodic cost-tracker proceedings tend to be less rigorous than those conducted in rate cases. Finally, cost trackers are often designed in ways that virtually guarantee cost recovery, which reduces utilities’ incentive to limit costs. In order to maintain cost containment incentives, Virginia could follow several cost tracker principles:1. When a new cost tracker is proposed, carefully consider the incentives it is likely to create (particularly if it is a capital cost tracker).
2. Consider ways to encourage cost-efficiency in areas where cost trackers may weaken cost-containment incentives (e.g., through a comprehensive shared savings mechanism or stricter transparency requirements).
3. Consider what level of review or criteria should be used to ensure investments recovered via cost trackers are delivering expected benefits to customers.
4. Regularly reconsider existing cost trackers (e.g., as part of an annual review) and discontinue any that are determined to not be serving the public interest.
5. Assess the cumulative impact of all cost trackers on the utility’s overall business risk, and account for any risk reduction when setting the utility’s allowed ROE.

In Virginia, because the SCC cannot consider base rate earnings when setting RACs, it is not allowed to reduce RAC charges if it finds that the utility’s base rates are too high. Additionally, the large list of allowed RAC trackers in Virginia may substantially lower the utilities’ financial risks; as a result, utilities’ may be earning higher ROEs than their risk profiles justify. Overall, the prevalent use of RACs in Virginia may undermine the implementation of PBR from a **cost efficiency** perspective. Fuel Cost SharingVirginia does not currently have **fuel cost sharing** in place, which is a missed opportunity to deliver customer savings. Fuel cost sharing includes policy mechanisms that share the risk of fuel cost volatility between customers and the utility, creating an incentive for utilities to seek out **cost efficiencies**. A fuel cost sharing approach differs from the current approach used in Virginia, which allows utilities to pass 100% of fuel costs through to customers via an RAC. **Missouri, Wyoming,** **Washington**, and **Montana** are a few states where customers are currently benefiting from fuel cost sharing policies. |
| Fuel Cost Recovery |
| Demand response program costs |
| RPS compliance costs |
| Broadband capacity extension |
| Low-income programs (lost revenue recovery) |
| Capital projects (e.g. combined cycle gas projects, offshore wind, solar, distribution system undergrounding, distribution grid transformation, nuclear life extension, etc.) |
| **Performance adjustments and measurement** | ROE adjustment mechanisms | * Affordability
* Cost-efficient utility investments and operations
* Reliability and resiliency
* Electricity decarbonization
* DER integration
* Peak demand reductions
 | The SCC currently has the authority to adjust base ROE by up to ±50 bps based on performance related to reliability, generating plant performance, customer service, and operating efficiency of a utility.   | Virginia may be missing an opportunity to deliver significant customer savings and **affordability** gains by not considering more robust ROE adjustment mechanisms (i.e., performance incentive mechanisms, or “PIMs”). The statutory limit of ±50 bps to ROE adjustment based on performance may limit the potential impact on the ability of the SCC to incentivize improved performance against the standards and protocols that will be approved by the SCC. Moreover, the authority to adjust base ROE is limited to a narrow set of four performance categories (reliability, generating plant performance, customer service, and operating efficiency), constrains the SCC’s ability to create PIMs that would deliver benefits relative to the broader set of performance areas included in HJR No. 30 / SJR No. 47.States that have implemented robust portfolios of performance metrics and incentives related to some of the other performance areas included in HJR No. 30/ SJR No.47 – such as **beneficial electrification, DER interconnection and utilization, electricity decarbonization, environmental justice**, among others – include **Hawaii, New York, Minnesota, Illinois,** and **Colorado.** In Hawaii, the PUC determined that it was appropriate to implement a portfolio of PIMs whose cumulative value totaled up to ±200bps as part of its comprehensive PBR framework. |
| Performance mechanisms (e.g., metrics, scorecards, PIMS), in Case No. PUR-2023-00210  | * Reliability and resiliency
* Electricity decarbonization
* DER integration
* Peak demand reductions
* Operating efficiency
* Affordability
 | In case PUR-2023-00210, the SCC staff have filed proposed draft regulations to implement a selection of 11 “scorecard” metrics (similar to PIMs, but different in a few key ways discussed to the right)to be used in biennial review proceedings to determine an ROE incentive in 2027 and beyond. The proposed rules are awaiting a final order from the SCC prior to being adopted.In the same proceeding, the SCC staff have proposed to implement a set of reporting metrics which would be reported by utilities for informational purposes only (i.e., no financial incentive would be determined based on the information provided against these metrics). All PIMs and reporting metrics in this proceeding are limited to the outcomes of reliability, generating plant performance, customer service, operating efficiencyThere is also currently a performance incentive mechanism (penalty only) in place for failure to achieve the RPS targets.  | Though the ROE adjustment mechanisms (i.e., performance incentive mechanisms) are not yet in place, RMI’s comments in this section are a reflection of our understanding of where the PUR-2023-00210 process currently stands, and the decisions and filings the SCC has made in that proceeding to date.Based on RMI’s interpretation of the SCC staff’s August 2024 report, SCC’s October 2024 order, and the SCC staff’s March 2025 draft proposed rules,the SCC will employ an implementation approach for the ROE adjustment mechanisms (referred to as “scorecard metrics” in the proceeding) that differs from industry best practice implementation of PIMs in two key ways: * Virginia’s scorecard metrics do not have prescribed targets (referred to as “benchmarks in the proceeding) and incentive values.
* The incentive earned by the utility for its performance will be determined in a non-formulaic manner at the time when utility performance data is reported, presumably reflecting on the utility’s performance against the portfolio of all 11 scorecard metrics.

To elaborate on these differences, it appears that benchmarks for scorecard metrics will be set, retrospectively, and by the utility. In the proposed rules submitted by SCC Staff, a utility will file its performance against 11 scorecard metrics for a historical benchmark period at the same time that it would also submit an industry benchmark for comparison to its own performance (in other words, a target). The drawback of this approach is that it might allow gaming. For example, the utility could selectively submit data from the industry that would make its own performance against all 11 scorecard metrics look superior to increase the likelihood of receiving the maximum possible reward of +50bps.The effect of utility gaming could lead to a potential negative impact on **affordability** for ratepayers, particularly if the utility’s performance is not providing equal or higher benefits that the monetary value of the incentive. In addition to gaming risk, industry best practice is to establish clear targets for a PIM prior to the period of performance (i.e., the period of time in which the utility’s performance will be measured and compared against the target) so that the utility knows the standard by which it will be measured against during a forthcoming period of performance, and can plan its resources accordingly to try to improve its performance to meet the desired targets. RMI is aware of no other jurisdictions for utilities to lack clarity on the target or benchmark for which its performance will be compared prior to the performance period. To the second key difference, the incentive value for each scorecard metric will remain unprescribed until after the period of performance. This approach is based on precedent of ROE adjustment mechanisms in Virginia prior to 2015. To RMI’s understanding, the incentive values associated with a utility’s performance against a scorecard metric established in PUR-2023-00210 will be left to the SCC discretion after the period of performance. Industry best practice is to pre-determine an incentive amount for achieving a preset target for each metric. This gives the utility helpful information in advance of the period of performance to inform how cost-efficient allocation of resources during the performance period to prioritize achieving a certain target in order to earn a known reward or avoid a penalty. For example, a utility who knows the performance target and incentive value for a PIM can evaluate the cost of achieving the target to earn the reward. It can decide to not attempt to achieve the target in cases where the cost of achieving the PIM’s target are larger than the reward. Ambiguity about how incentive value will be assigned across the eleven scorecard metrics may impede the performance area of **cost-efficient utility investment and operations** resource and effort across the areas measured by scorecard metrics.The SCC staff proposed a set of additional metrics that will be tracked and reported for informational purposes only (commonly referred to in industry as reporting metrics). The reporting metrics that will be included in Schedule 49 were informed by a narrow focus on the four outcomes of **reliability**, **generating plant performance**, **customer service**, and **operating** **efficiency**, as defined in the authorizing statutue. However, several of the reporting metrics proposed by the SCC staff also support a few key performance areas, such as **decarbonization**, **emissions, DER integration, peak demand reductions, and cost-efficient utility investment & operations.** The formalization of these reporting metrics represent an important step forward in measuring and tracking data related to a broad set of critical performance areas for utilities in Virginia, and can pave the way for a more expansive set of PIMs in the future. Although the newly proposed metrics are a strong step forward, there may still be gaps in the metrics that are measured, and there is room for improvement by expanding the reporting metrics portfolio to include metrics that more holistically address the 13 performance areas of HJR No. 30/ SJR No.47. For instance, within the **customer service** category, other jurisdictions have implemented additional performance categories (e.g. abandoned call rates, first-call resolution rates, customer satisfaction, call center experience, and customer enrollment in programs), in addition to traditional metrics (e.g. average speed of answering calls to a call center). Other jurisdictions have also broadened the scope of the **affordability** metrics that are tracked to include metrics such as low and moderate-income household energy burden (i.e. bills as a percentage of household income).Reported metrics can be particularly helpful for establishing a utility performance baseline, and can be useful in the future for setting a target or benchmark when elevating a metric from something that is only reported, to a PIM. In addition, the set reporting metrics will be reviewed as part of the biennial review through utility reporting in accordance with Schedule 49. Some metrics may benefit from a more frequent reporting timeframe (e.g. quarterly updates). Moreover, we see a gap in terms of the process of publicly reporting on and providing access to performance data. It is industry best practice to make utility performance data accessible and easily interpretable to the general public. The Hawaiian Electric’s performance scorecards and metrics [website](https://www.hawaiianelectric.com/about-us/performance-scorecards-and-metrics) is an example of transparent data dashboards that could be employed, in addition to the Schedule 49 reporting process. There may also be an opportunity to develop more granular understanding of the impact of various performance categories, e.g. by analyzing performance at the census tract level.States with ROE-based PIMs include **New York**, whose IOUs have shown success with an ROE basis point incentive for achieving energy efficiency savings specifically among low and moderate-income customers. New York also employs ROE-based PIMs for demand response, light-duty vehicle emissions, transportation electrification interconnection timelines, DER utilitization, and electric peak reduction, among others. **Illinois** also has numerous PIMs informed by ROE basis point values, including peak load reduction; DER interconnection timeliness; as well as SAIDI, SAIFI, CEMI, CELID performance specifically in environmental justice communities.By implementing a portfolio of scorecard metrics and reporting metrics, Virginia has made significant progress towards supporting several of the the desired regulatory outcomes included in HJR No. 30/ SJR No.47. However, as described above, there is room to better define these mechanisms and align with industry best practice for performance mechanisms. |
| Energy efficiency savings target (ROE adder applied to DSN operating expenses) | * Electricity decarbonization
* Peak demand reductions
* Affordability
 | Virginia has a mandatory Energy Efficiency Resource Standard (EERS) in place, following the passage of the Virginia Clean Economy Act.Utilities can earn an additional 20 basis points for each additional 0.1% in annual savings beyond the statutory savings targets. The SCC also has the authority to deny new CO2-emitting generating facilities if energy savings targets are not met (Va. Code § 56-585.1 A 5 c). One PIM currently in place adjusts ROE depending on achieved energy efficiency savings. Utilities are allowed to earn a return on the operating costs associated with their energy efficiency programs, and if they exceed the mandated efficiency targets, the Commission can award an additional 20 basis points for each additional incremental 0.1 percent in annual savings. | While the SCC can reward utilities for exceeding the EERS targets, there may be opportunities to further incentivize stronger performance and to disincentize underperformance with more robust performance incentives. There remains significant untapped potential to deliver efficiency savings (see PUR-2023-00227). There may also be an opportunity for cost-effectiveness methodology reform, e.g. including health and safety non-energy benefits within cost-effectiveness tests. Examples of states with strong energy efficiency PIMs including **Massachusetts**, **New** **York**, and **Vermont**. |

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 |  |  |