

Subgroup 4 Final Report:

FINANCIAL CONSIDERATIONS

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Attachment 1

1. Preamble

The focus topics for Subgroup #4 - Financial considerations outlined in SCC Staff's August 3, 2007 communication included the following: regulatory/market incentives for utilities and market providers, customer incentives and rebates, utility revenue decoupling, public benefits funds and carve out for existing participants. Staff also requested that each of the subgroups develop a list of actions or programs categorized by those that may occur immediately, in the short term, mid-term, and long-term as well as those having zero or minimal costs to those reflecting higher costs to implement.

This report is designed to be a fairly accurate portrayal of the Subgroup's discussions and joint findings on the topics outlined above, but should not be considered to be a consensus document. A concerted effort was made to prepare a report which will be helpful to Staff as they draft their report for the General Assembly. Staff is advised that individual organization positions are better reflected in their official comments filed in Case No. PUE-2007-00049.

2. Review of SCC authority with respect to cost recovery and implementation of energy efficiency programs

Attachment 1 to this report includes the relevant sections of the Virginia Code and SCC regulations which bear upon the SCC's existing authority with respect to Cost Recovery and financial impacts of EE/DSM programs implemented in Virginia. Following study and discussion among Working Group 4 participants, and without attempting a legal analysis, we offer the following observations and suggestions.

1. The SCC should provide guidance on its authority under existing law over conservation, efficiency and demand side/load management (EE/DSM) programs which could be implemented by electric utilities pursuant to SCC approval or direction. The SCC should also state its position with respect to programs which should be implemented by it, by other state or local governing bodies, or by other entities which are generally associated with providing products in open and competitive markets. Most importantly, the Commission should provide direction and guidance on how it expects to carry out its authority and responsibilities with respect to full cost recovery and other regulatory treatment of EE/DSM programs consistent with current statutes. Such guidance will provide important information to utilities, consumers and stakeholders, as well as to the legislature and other policy making bodies.

2. The SCC's basic authority over rates of public utilities including the "power to fix and order substituted therefore such rate or rates, tolls, charges or schedules as shall be just and reasonable" was established by the Virginia Legislature in 1919 and codified at 56-235. In 1976 the legislature enacted an amendment to such section providing as follows:

"56-235.1 Conservation of energy and capital resources

It shall be the duty of the Commission to investigate from time to time the acts, practices, rates or charges of public utilities so as to determine whether such acts, practices, rates or charges are reasonably calculated to promote the maximum effective conservation and use of energy and capital resources used by public utilities in rendering utility service.

Where the Commission finds that the public interest would be served, it may order any public utility to eliminate, alter or adopt a substitute or any act, practice, rate or charge which is not reasonably calculated to promote the maximum effective conservation and use of energy and

capital resources used by public utilities in providing utility service and it may further provide for the dissemination of information to the public, either through the Commission staff or through a public utility, in order to promote public understanding and cooperation in achieving effective conservation of such resources; provided, however, that nothing in this section shall be construed to authorize the adoption of any rate or charge which is clearly not cost-based or which is in the nature of a penalty for otherwise permissible use of utility services."

While the language of this section is very broad in terms of the Commission's ability to act with respect to conservation measures of electric utilities, it does not appear that the SCC has construed its authority pursuant to such section nor has any reviewing court. The statutory language appears to confirm that the Commission may have authority to act on its own initiative to require adoption by utilities of measures to promote maximum effective conservation. It would be constructive and useful for the Commission to provide utilities and the public guidance with respect to this question.

In 1977, the Legislature enacted an amendment now codified as 56-235.2. This section concerns just and reasonable rates generally. However, subsection A thereof specifically allows recovery of costs incurred by a utility for "advertisements either required by law or rule or regulation or for advertisements which solely promote the public interest, conservation or more efficient use of energy".

Section 56-235 was further amended in 1996 by a provision now codified as section 56-235-6. This section authorizes utilities to seek and the Commission to approve, or approve with modifications, such measures as the Commission may find to be in the public interest, "a performance-based rate-making methodology for any public utility engaged in the business of furnishing *** electricity service (for the purpose of this section an "electric utility") ***." Such rate-making methodology "shall mean a method of establishing rates and charges that are in the public interest, and that departs in whole or in part from the cost-of-service methodology set forth in 56-235.2."

While the language of this section would appear broad enough to cover performance-based conservation or load management measures, no specific mention is made of such measures in the statutory text, nor is there any apparent intention expressed to depart from the provisions of section 56-235-1 with respect to conservation measures. The SCC's authority under 235.6 appears to be triggered by an application of the utility in question which elects to submit proposals which would depart from traditional cost-of-service methodology. It would be useful for the SCC to provide guidance with respect to the significance of this provision to EE/DSM programs.

3. The SCC has general authority to receive, review and approve, modify or reject particular proposals by individual utilities, including those involving new rate schedules and new services.
4. Utilities may present their own proposals, consistent with state statutes and any applicable SCC direction or guidance, for such programs, whether on a customer class-wide or pilot basis.
5. Discussion of other current statutory provisions or SCC rules appear below in connection with particular subjects.

Comment on Basic Concepts

1. There is wide agreement that a utility should be able to fully recover its costs, including return of and on capital costs and operating costs consistent with current law, through properly designed rate schedules.
2. With respect to cost recovery, costs associated with SCC approved or legislatively mandated EE/DSM programs should be considered on an equal footing with the costs of building, operating and maintaining new supply side options. This may include incentive rates.
3. Under current law, after the termination of rate caps at the end of 2008, a utility will have the right to file for and seek approval for full and contemporaneous recovery of all costs related to SCC approved or legislatively mandated EE/DSM programs based on the test year 2007 levels of those costs. In addition, utilities may seek and the SCC may award lost revenues and/or any other incentives deemed appropriate.
4. The Commission should review its existing general authority, to determine and report on whether and under what terms the Commission, as part of its review and approval of a proposed EE/DSM program, will provide for full contemporaneous cost recovery or whether any periodic under-recovery of costs may be deferred and amortized, along with allowance of appropriate carrying costs on such deferrals, for subsequent recovery in rates.
5. Since the costs associated with general rate case filings are large, there is agreement that it would be useful for the SCC to issue rules or guidance as to the nature of EE/DSM programs which, if any, are considered to be pre-approved in general, and which types of programs are encouraged and the cost recovery policies it intends to follow consistent with current law.

3. Rate Structure and Rate Design Issues

Definitions

For the purpose of these comments, a utility's rate structure is defined as the totality of how customers are billed for utility services and includes rate schedules, charges, fees, rebates and other incentives, allowances, or penalties as contained in the utility's tariff. Rate design refers to the specific fixed and variable charges used to determine customer bills for each rate schedule.

Virginia Base Rate Procedures

There is general consensus that good rate structures and proper rate design are crucial to providing utility customers clear and appropriate price signals. Indeed, in its March 27, 1992 Order in Case No. PUE900070, the SCC stated:

Rate design is also a powerful tool which can be used to achieve optimal CLM [conservation and load management] objectives. As Staff indicated, it is important to establish appropriate price signal to promote energy efficiency.

A large number of rate design objectives must be balanced in setting rates, and the Virginia Supreme Court has sustained the Commission's determination that "non-cost factors may be considered by the Commission in setting rates for various classes of service...to accomplish legitimate regulatory objectives." *Secretary of Defense v. C & P Telephone*, 217 Va. 149, 152 (1976).

Clearly then, we have the discretion to consider the impact of rate design on CLM. Rates can reflect costs or drive costs. Example of the latter would include mandatory time of use rates and summer/winter differentials. In designing rates, utilities should consider costs and cost allocation in terms of the market signals sent by the rates.

We thus encourage utilities to pursue innovative rate design and continue to improve costing methodologies.¹

While the SCC recognizes the importance of rate design, the Commission's current rate procedures present a strong disincentive to making changes in existing utility base rate structures and designs. Although utilities may introduce new experimental, voluntary rates outside of a rate case, changes to existing rates must be made in the context of an expedited or general rate case. Thus, utilities typically wait until additional revenue is sought in a rate case before proposing rate structure or design modifications. Until recently, rate design changes were actually prohibited in expedited rate cases.

In addition to formal rules limiting rate structure changes, other practical factors restrain changes in rate design. Even within general or expedited rates cases it is simply easier, and less controversial, to implement across the board rate increases to existing rate structures rather than change those rate structures. Since rate design changes can have different effects upon customers within the same rate class, there is an ongoing concern about customer impact and potential opposition to rate design changes on that basis. Consequently, as long as the existing rate structure recovers revenue requirements adequately, there is little immediate incentive to revise rate design to provide better price signals.

It should be noted that the SCC has generally not imposed rate design mandates on utilities. For example, in its Final Order dated July 18, 2006, in Case No. PUE-2006-00003, *Ex Parte: In the matter of considering § 1252 of the Energy Policy Act of 2005*, the SCC rejected implementation of a new federal standard that would have required utilities to offer time-of-use rates.

Position for Consideration by SCC Staff

Customers receive most of the information they use to make decisions about energy use through rates and monthly bills. Many consumers will respond to the information contained in rates. However, if the price for energy consumption remains unchanged in spite of changing costs, customers do not have the information, or the incentive, to reduce usage or change their usage pattern. The SCC should review its policies and procedures related to changes in utilities' rate structures and rate design and consider establishing a limited, expedited, and revenue neutral regulatory procedure under which changes can be made to rate structures or rate designs outside of a full general rate case. Such a limited rate proceeding should be available so that rates and rate structures can be reviewed and modified more frequently and more efficiently to assure that customers receive appropriate price signals.

Pros

- A separate, limited rate procedure would provide a framework to focus on rate design as it relates to energy conservation and load management.
- Better price signals would aid efforts to encourage purchases of energy efficient products and appliances and would reinforce any other market incentives.
- Unless underlying prices to consumers are accurate, layering other incentives into the rate structure could be wasteful or counterproductive.
- Changes in rate design may be a more efficient and effective way to mitigate certain issues related to energy conservation, such as revenue erosion, than other options.
- A limited rate proceeding would encourage utilities to propose beneficial rate modifications sooner than they would if they have to wait for a full rate case proceeding.

¹ *Ex Parte: In re, Investigation of Conservation and Load Management Programs.*, Case No. PUE900070, 1992 S.C.C. Ann. Rept. at 264-265.

This pro could be mitigated when utilities begin making their biennial filings, during which they could propose rate design changes, under procedures subject to Commission interpretation.

- Major rate design changes could be implemented gradually through a series of limited rate proceedings rather than through one large shift during a full rate case, thus mitigating customer impact.
- A limited rate proceeding would be less costly than a full rate case.
- Interested parties could fully participate in such proceedings.

Cons

- Even if the rate design changes proposed in a limited rate procedure are revenue neutral, certain customers could experience large rate increases.
- A rate proposal that is revenue neutral on a class basis may have broader revenue effects that would not be fully captured in a limited rate design proceeding.
- Rate design changes may have a negative impact on customers, such as low-income families and renters, with limited ability to respond to price signals.
- Some customers may have limited ability to participate in such proceedings.

Virginia Fuel Recovery

The recovery of fuel expenses by utilities in Virginia is set forth in Section 56-249.6 of the Code of Virginia. Typically, the recovery of fuel expenses through a rate charged to customers is addressed in annual fuel proceedings conducted by the Commission for each utility. In such proceedings, a fuel factor is determined on a projected basis and is charged to customers over a twelve month period. Fuel factor revenue is then compared to actual fuel expenses to identify if there has been an over-recovery or under-recovery of fuel expenses actually incurred. The over-recovery or under-recovery, if any, is deferred for future recovery or credit to ratepayers through a prior period portion of the fuel factor. Both the current period portion of the fuel factor and the prior period portion of the fuel factor are priced at an average amount per kWh consumed for all customers. Under this approach, utilities recover the actual fuel costs incurred but do not make any profit or return on fuel.

The electric cooperatives in Virginia adjust their fuel charges monthly and are considering moving to semi-annual adjustments covering winter and summer periods.

Position for Consideration by SCC Staff

As stated earlier in the section on base rate recovery, customers receive most of the information they use to make decisions about energy use through rates and monthly bills. Consumers will respond to the information contained in rates, including the portion of rates that provides utilities with recovery of fuel expenses. Currently, such recovery is through an average charge per kWh which is the same for all classes of customers. There are no differences in recovery based on differences in service characteristics, such as service voltage differences or line losses and the energy generated to account for such line losses. Also, as load changes over time and as generation responds to meet that load, a utility's fuel cost is changing such that the average fuel rate does not represent the appropriate price signal or charge at a given point in time even though it represents the appropriate charge over the course of the entire year. If the price for energy consumption remains unchanged in spite of changing costs, customers do not have the information, or the incentive, to reduce usage or change their usage pattern. The Commission should consider revising the fuel cost recovery mechanism and the allocation of such costs to the customer classes while continuing the policy of providing the utility with recovery of its actual fuel costs. Examples of how this can be accomplished include the development of voltage

differentiated fuel factor rates or by time of use rates which include a differentiated fuel component.

Pros

- Better price signals would aid efforts to encourage purchases of energy efficient products and appliances and would reinforce any other market incentives.
- Unless underlying prices to consumers are accurate, layering other incentives into the rate structure could be wasteful or counterproductive.
- Changes in rate design for fuel recovery may be a more efficient and effective way to mitigate certain issues related to energy conservation, such as revenue erosion, than other options.

Cons

- Certain customers could experience large rate increases.
- There may be a negative impact on customers, such as low-income families and renters, with limited ability to respond to price signals.

Revenue Decoupling

Revenue decoupling was viewed by the working group as another form of rate design that could be considered. Revenue decoupling is defined as a ratemaking methodology that separates utility revenues from volume of sales. Revenue decoupling may be enacted to address a variety of issues such as lost sales due to utility energy efficiency programs. Lost revenue recovery may be needed to pay for infrastructure in times of decreasing sales.

Virginia recognized the problems addressed by revenue decoupling in 2007 when amending its regulatory standards for electric utilities. For example, the law provides, as part of the State Corporation Commission's 2009 reviews of investor-owned utility rates, terms, and conditions, that the Commission shall authorize to increase a utility's rates if it finds that the utility's combined rate of return on common equity is more than 50 basis points below the authorized combined rate of return. Conversely, if the Commission finds that the combined rate of return on common equity is more than 50 basis points.

Additionally, the law provides that eligible investor-owned utilities may, after termination of capped rates, petition the Commission for approval of a rate adjustment to recover the projected and actual costs of providing incentives for effective demand-management, conservation, energy efficiency, and load management programs. These adjustments would, through subsequent biennial reviews, be incorporated into rates.

Virginia law provides that the utility may retain 25% of the margins from the off-system sales and return 75% of such margins to customers through the fuel clause. The Commission, after application, notice and opportunity for hearing may require that a smaller percentage of margins be returned to customers if clear and convincing evidence is provided that it is in the public interest to do so. The portion of margins retained by the Company is an incentive for the Company to maximize such sales in today's complex energy markets, is not to be considered in the biennial review of utility earnings, and would not be returned to customers or counted against any under-earnings in future rate adjustments.² Therefore, the portion of this revenue retained by

² Section 56-249.6.D.1 of the *Code of Virginia* provides that 100% of fuel factor costs incurred in producing the off-system sales are returned to customers through an adjustment to fuel factor expenses. The total

the utility this revenue would not be considered when the Commission determines whether a utility has over or under-earned by more than 50 basis points. Under this arrangement, if energy efficiency and demand-management actions permit additional off system sales to be made, then both customers and the Company would benefit. Given the projected increased demand for power in Virginia and the anticipated continued power deficit situation despite the proposed plans to build additional generation, it is not expected that the Virginia utilities will be able to make significant levels of off system sales anytime soon.

These provisions were enacted in 2007 and therefore have not been implemented or evaluated. Any new efforts on electric rate decoupling may need to be deferred until Virginia has the opportunity to evaluate the effect of these new measures. At this point, a minimum policy requirement would be to remove any disincentives associated with a utility implementing conservation and DSM programs including but not limited to the recognition of the possibility that lost revenue associated with the reduction in sales due to such programs may detrimentally impact the recovery of the utility's fixed costs.

4. Incentives for Customers

Promotional Allowances

In an Order dated March 27, 1992, in Case No. PUE900070, the Virginia State Corporation Commission adopted the current Rules Governing Utility Promotional Allowances. The review and revision of promotional allowance rules was part of a broader investigation related to energy conservation and load management programs. The current promotional allowance rules supersede and were derived from an earlier set of rules, which were aimed at restricting utility activities designed to build load through programs such as appliances sales and special rate discounts. (See Case No. 18796, Final Order dated April 15, 1970.) Changes to the earlier 1970 rules were made specifically to permit promotional allowances for cost effective conservation and load management programs while maintaining restrictions on most other promotional allowances. Left essentially unchanged from the 1970 rules were a series of very strict standards related to promotional allowances.

Position for Consideration by SCC Staff

In the fifteen years since the Commission last reviewed and revised its promotional allowance rules, there has been an increase in the variety and range of energy conservation and load management programs that could be developed and offered by utilities. Potential programs include rebates, special rates or other incentives offered to all customers or to selected customer groups. Consequently, the current promotional allowance program standards may be too restrictive, or otherwise function as a perceived regulatory barrier to viable programs offerings. Of particular concern are certain promotional allowance program standards, listed under 20VAC5-303-40, including:

1. Any utility offering a promotional allowance program shall adhere to the following standards:
 - a. The promotional allowance program shall not vary the rates, charges and schedules of the tariff under which service is rendered to the customer.

annual margins after fuel factor is split 25% to the utility and 75% to the customer. Net losses from off-system sales cannot be charged to customers. This provides an incentive to the utility to maximize cost-effective off-system sales.

b. A utility may not, directly or indirectly, offer or grant to a customer any form of promotional allowance except as is uniformly and contemporaneously extended to all customers in the same reasonably defined class.

Further, the current rules provide little guidance as to types of programs that may be acceptable within the rules without requiring prior regulatory approval. Given these circumstances, the Commission should consider reviewing and updating the current promotional allowance rules to reflect changes occurring since 1992.

Pros

- Revisions would clarify what energy conservation and efficiency promotional allowances are permitted.
- Revised rules would reduce costs for proposing promotional allowances programs.

Cons

- Revisions are not needed because the promotional allowance rules provide for a waiver of the rules under 20VAC5-303-50.
- Strict program standards should be maintained to prevent discriminatory programs.

5. Incentives for Utilities

Definition

- A policy requirement, subject to a just and reasonable standard, to provide for the timely recovery of all prudently incurred costs and an appropriate return, related to or caused by the implementation of conservation, DSM, load management and energy efficiency programs (“conservation and DSM”) such that utilities will have the incentive to undertake these activities while removing any disincentives associated with a utility implementing such programs.

Prevalence

- Since 1995, the Indiana URC has been allowed to approve incentives “for earnings from prudent investments in both supply-side and demand-side resources.” The incentive mechanism may take one of three forms: a share of the net benefit attributable to a demand-side management program, a greater than normal ROE for DSM expenditures or adjustments to the utility’s ROE based upon DSM program performance.
- A Kansas statute authorizes electric utilities to earn a premium on investments of up to 200 basis points over otherwise allowed ROE. This is for renewable generation, conservation, or energy efficiency.
- A Montana statute authorizes the PUC to approve ROE premiums of up to 200 basis points for capitalized DR program expenditures.
- On April 28, 2004, the Nevada PUC adopted revised integrated resource planning rules to allow for a 5 percent ROE premium for energy efficiency investments that are deemed “critical.”
- Wisconsin allows utilities to earn the same ROR on capitalized DR expenditures as it would earn on generating assets in rate base.

- In North Carolina, the 2007 session of the General Assembly added §62-133.8 to the North Carolina General Statutes titled "Cost recovery for demand side management and energy efficiency measures". §62-133.8(d) allows the Commission to approve an annual rider to recover all reasonable and prudent costs incurred for adoption and implementation of new demand-side management and new energy efficiency measures. Recoverable costs include all capital costs, including cost of capital and depreciation expenses, administrative costs, implementation costs, incentive payments to program participants, and operating costs. The new law goes on to allow electric public utilities to capitalize all or a portion of those costs to the extent that those costs are intended to produce future benefits. Other incentives may also be approved for electric utilities to adopt and implement new demand-side management and energy efficiency measures including rewards based on the sharing of savings achieved by the demand-side management and energy efficiency measures, rewards based on capitalization of a percentage of avoided costs achieved by demand-side management and energy efficiency measures and any other incentives that the Commission determines to be appropriate.
- In Maryland, the Public Service Commission ("Commission") authorized Pepco and Delmarva to implement and recover the costs of their CFL Programs and those portions of the Residential Awareness Campaign necessary to support the programs over a five-year period, with interest expense on unrecovered amounts set at each utility's rate of return. A surcharge is to be set annually based upon the budgeted and actual expenditures through annual filings, subject to Commission approval. Also, in February 2007, the Commission approved BGE's request to create a regulatory asset for costs associated with the Demand Response Pilot Program, estimated by the Company to be \$1 million.
- In New Jersey, there are financial incentives to utilities to encourage and promote cost-effective investment in DSM initiatives. Included in these incentives are mechanisms which permit utilities to earn financial returns equivalent to or, in recognition of the potential positive impact on society, greater than, the returns provided on utility owned supply side projects. A deferred accounting mechanism can be used to provide for recovery of actual program costs plus incentives and it also addresses disincentives. The deferred accounting treatment recognizes that fixed cost revenue erosion associated with implementing programs can be detrimental to a utility and provides for its recovery.

The basis for the opportunity to earn an incentive is to be through one of the following formats either a shared savings approach or a standard price offer. Under the standard price offer approach. A utility makes an offer in lieu of Shared Savings Programs with the offer determined under the following formula:

- Avoided Energy Costs plus Avoided Capacity Costs, minus Fixed Cost Revenue Erosion, times 0.5 (which can be adjusted by the Board from time to time)
- An appropriate discount below the formula that may be applied to reflect the anticipated benefits which would result from a competitive bid.
- In 2001, the Hawaii PUC promulgated guidelines that permitted Hawaiian Electric Company, Hawaiian Electric Light Company, and Maui Electric Company to retain 10 percent of after-tax DR savings. (Note that HECO subsequently entered into an agreement that eliminated such incentives if they would cause the company to exceed its allowed ROE.)

Virginia Statutory Framework

The following incentives are provided to utilities for energy efficiency and demand-management programs. Capital investments are included and accounted for in rate base and then depreciated. The cost, including a rate of return on rate base, is recovered through rates. Prudent expenses are recovered through rates with no incentive.

Revisions to the law in 2007 provide new incentives for energy efficiency and demand-management through three mechanisms, two direct and one indirect. The primary incentive is full cost recovery and removal of barriers to cost recovery treatment which equal to that of supply side options.

Incentives are directly provided for as follows:

Section 56-585.1.A.5.b of the *Code of Virginia* provides for timely and current recovery of projected and actual costs of providing incentives for the design and operation of fair and equitable demand-management, conservation, energy efficiency, and load-management programs. After the expiration or termination of capped rates, utilities may, no more than once in any 12-month period, petition the State Corporation Commission for a rate adjustment clause to recover these costs. The Commission is to approve the rate adjustment clause if it finds such recovery is in the public interest and the need is demonstrated with reasonable certainty. The Commission is to allow the recovery of all such costs it finds are reasonable.

Section 56-585.1.A.4 of the Code of Virginia provides that costs charged to utilities that are associated with FERC-approved demand response programs administered by the regional transmission entity shall be deemed reasonable and prudent and recoverable on a timely and current basis. After the expiration or termination of capped rates, utilities may, no more than once in any 12-month period, petition the State Corporation Commission and the Commission shall approve a rate adjustment clause to recover these costs.

Incentives are provided for indirectly as follows:

Section 56-585.1.A of the *Code of Virginia* provides that the Commission may increase or decrease the formula-based combined rate of return by plus or minus 100 basis points based on the generating plant performance, customer service, and operating efficiency of a utility, as compared to nationally recognized standards. The operating efficiency of a utility's energy efficiency and demand-management programs may be one factor when considering the operational efficiency adjustment.

During the 2007 Legislative session, the House and Senate agreed on HJR686 directing the Commission on Electric Utility Restructuring (CEUR) to review and evaluate a voluntary program to encourage the production of electricity from renewable resources, based primarily on the program currently in place in North Carolina entitled NC GreenPower. The CEUR, at its Sept. 19, 2007 meeting established a sub-committee of the full Commission, to be chaired by Delegate Plum to hold meetings and develop a report on the matter. That sub-committee will hold its first meeting on October 3, 2007 to hear from representatives of NC GreenPower and other stakeholders. This activity is clearly germane to issues related to recovery, most specifically, the issue of voluntary contributions as a form of implementing a public benefits fund concept, and the effectiveness of administration of various programs through an independent third party administrator.

Methodology

- **Capitalization Business Model** - Utilities are paid for undertaking energy efficiency activities by capitalizing and earning a return on energy efficiency costs. The shareholder incentive is based on a capitalization policy (i.e., deferral accounting treatment).
- **Shared savings** - Utilities are paid a share of the net benefits for undertaking energy efficiency efforts. The shareholder incentive is based on a defined share of net benefits measured by an agreed cost-benefit measure. A cost recovery mechanism and way to address the throughput issue may also be used.

- **Performance-Based Ratemaking** - Through a long-lived Performance-Based Regulation (PBR) plan, the utility shares savings arising from implementation of energy efficiency. PBR mechanisms—tailored to energy efficiency issues—could include multi-year versions of the conventional regulatory incentives.
- **Energy Services** – Energy Efficiency services sold directly to retail customers on a fee-for-service basis, either through the Public Utility or an affiliate.
- **Tariff Rider** – A tariff rider for energy efficiency allows for a periodic rate adjustment to account for the differences between planned costs (included in rates) and actual costs.
- **System Benefits Charge** – A separate charge added to customer bills to collect funds for energy efficiency programs providing a stable stream of funds
- **Bonus Return** - To encourage energy efficiency investments over supply investments, regulators can authorize a return on investment that is slightly higher for energy efficiency investments or offer a bonus return on equity investment for superior performance.
- **Capitalization of a Percentage of Avoided Costs** - Energy efficiency is treated as a resource. The resource is valued at some percentage of the cost of avoided capacity and energy. The portion of avoided cost is deferred, amortized over time and recovered through rates or a rider with a return.
- **Capitalization Business Model – Participant Fund (analogous to SCC Staff’s Idea)**
 In contrast to the Capitalization Business Model, there may be programs related to conservation that are not undertaken by utilities but are undertaken directly by utility customers. To provide access to capital for customers desiring to undertake activities that will conserve energy, a Participant Fund could be established. Funding for these customers could be provided from utilities, collections from a public benefit fund ("PBF"), or some combination of both. Initially, the sources from a PBF may be very limited and utility sources may be relied upon. Customers decide to “participate” in EE/DSM after they have conducted their own decision analysis based on resource costs and a marginal cost-based rate design from the utility. Following their individual evaluation of these costs and benefits, customers then choosing to access the Participant Fund will use those funds to finance the installation of material and equipment to achieve a reduction in their consumption.
 - If utilities provide a portion of the funding for the Participant Fund, those contributions could be treated as a regulatory asset in that such contributions would be deferred and guaranteed recovery in the future with a return on the unamortized balance (comparable to rate base treatment for assets). The direct recovery of the funds, including the return, would be through charges on the electric bills to those specific customers accessing (borrowing from) the Participant Fund. Those same participating customers while seeing a charge on their bill as a “participant” to recover the amortized cost of repaying the Participant Fund would also receive the direct bill savings resulting from participation in EE/DSM and the reduction in energy consumption that results.
 - The Participant Fund would replenish itself as participating customers repay the fund on their monthly bills providing an on-going source of funds for other customers to participate in EE/DSM.
 - Finally, there would be no rate impact upon non-participants resulting from some allocation of the recovery of utility’s contributions to the Participant Fund. However,

such customers would experience the benefit that reductions in demand have on the need for future generation capacity and its associated cost.

Pros

- Makes investments in EE and DSM as financially attractive as traditional supply-side investments
- Promotes investment in all cost-effective EE and DSM programs.
- Utilities are financially motivated to design efficient cost effective programs.
- Both Utilities and Commissions agree that there is a need for incentives to provide a bonus to stimulate DSM, to get utility management to focus on DSM, and to overcome the lost revenue problem.
- In some areas of the country capitalizing energy efficiency is the only way to deal with transitional rate effects and can provide a match over time between the costs and benefits of the efficiency investments.

Cons

- A utility may be rewarded for spending money on a program that has not proven to produce the desired result.
- Many programs have failed to achieve the significant electricity savings and high degree of participation needed to make DSM the true equal of new generating units and other supply-side options in meeting customer energy needs.
- Incentives could distort rates unnecessarily as utilities are already under some obligation to invest in cost-effective efficiency measures as a means of minimizing rates whether or not they are as profitable for shareholders as new generating plants.
- There are features in the legislation which can provide incentives thereby negating the need for additional incentives.
- Some efficiency programs can meet short term rate-oriented cost-effectiveness tests if costs are capitalized. However, if the choice is made to capitalize, the regulator still has to decide the appropriate amortization period for program costs.
- Some argue that capitalizing energy efficiency is too costly and that rate effects from expensing are modest.

Position for Consideration by SCC Staff

- There should be full and timely cost recovery of, and an appropriate return on, capital investment in rate base along with full and timely recovery of expenses to implement and operate conservation and DSM programs.
- Expenses allowable for recovery should include but not be limited to operations and maintenance expenses, general and administrative expenses and advertising, promotional and education expenses. In addition, if funding of a non-utility third party administrator or public benefit fund is determined by policy and regulation to be collected

as part of a utility's cost of service, then such expense should be granted full recovery based on actual payments to the administrator or fund.

- Incentive treatment for the recovery of expenses (excluding non-utility third party administration or public benefit funds) is an appropriate policy to implement for utilities seeking to undertake conservation and DSM programs. An incentive based policy would establish the up front understanding that cost associated with programs approved by the Commission for implementation would be fully recovered. Among such incentive treatment options may be an approach that provides for deferred accounting treatment of prudent and reasonable expenses for Commission-approved programs. As an incentive, such expenses that have been incurred could have an appropriate carrying charge applied to the unamortized balance of the deferred account.
- Investments in conservation and DSM and investments in generation supply should be treated on a comparable basis in terms of the opportunity to earn a fair return consistent with current statutory provisions for establishing general rate of return on a utility's rate base. Section 56-585.1.A.6 of the Code of Virginia provides for basis points to be added to the utility's general rate of return to provide for an enhanced rate of return on common equity for specific types of generation facilities. A similar incentive for investment in rate base for conservation and DSM programs should be applied and would provide comparable treatment for recovery from supply side and demand side options

Virginia Energy Plan Assessment

A preliminary analysis completed for the Virginia Energy Plan looked at studies of achievable, cost-effective electrical efficiency in other states to estimate the potential in Virginia. Based on this analysis, the Plan concludes that the goal of reducing electric use by 10% of 2006 consumption by 2022 can be cost-effectively achieved. The Plan also recognizes that actions are needed for both energy efficiency and demand management. Some measures will provide for both results, while other measures only result in efficiency or demand management savings.

The Virginia Energy Plan estimated that, based on all retail sales in Virginia, utilities would have to invest from \$100 to \$120 million per year on average for energy efficiency and demand management programs. This would have to be matched by consumer investments of between \$180 and \$200 million per year. These investments would result in a net savings (after utility and consumer costs) of between \$15 and \$50 million per year on average between 2008 and 2022.³

6. Public Benefits Fund

This issue proved to be the most controversial for Subgroup 4 and therefore may need targeted study by SCC Staff. Individual organization filed comments should be referenced to gain an appreciation for member's views on this topic as this text does not represent a consensus opinion.

³ Analysis for the Virginia Energy Plan assumed that the cost of energy efficiency measures equals 3 cents per lifetime kilowatt hour saved, based on cost estimates from the National Action Plan for Energy Efficiency and American Council for an Energy Efficient Economy. Energy efficiency measures were assumed to have a 4-year payback and a 12-year life on average. The analysis for the Plan assumed that 25% of the savings would accrue without public incentives, and that the remaining savings would require a 50% incentive level. This incentive level is based upon experience of electric efficiency programs in other states. Savings are projected using Virginia 2005 electric costs adjusted based on the Energy Information Administration's projection of future electric costs. Savings total to an average of \$50 million per year if it is assumed that the full retail cost of electricity is saved. If the amount of savings is reduced to account for continued recovery of distribution system costs, then savings are reduced to an average of \$15 million per year.

Definition

- Public Benefit Funds (PBF) are referred to by many names, including system benefit funds, system benefit charges and public goods funds.
- A PBF is a collection of money by utilities from customers to foster energy efficiency and conservation goals established in the state.
- Most commonly, utilities are used as conduits to collect the money from their customers and then pass it on to the state or their specified agency to fund Energy Efficiency (EE) programs. However, a PBF may also be used to collect funds for utility operated programs.

Prevalence

- In an April 2004 American Council for an Energy-Efficient Economy (ACEEE) conducted a study entitled "*Five Years In: An examination of the First Half-Decade of Public Benefits Energy Efficiency Policies*" (by Martin Kushler, Dan York, and Patti White; Report Number U041). The report identified approximately 20 states that either required or encouraged PBF EE programs in their legislation or regulatory orders. Eighteen of those states currently have such programs in operation. The 18 states consisted of Arizona, California, Connecticut, Illinois, Maine, Massachusetts, Michigan, Montana, Nevada, New Hampshire, New Jersey, New York, Ohio, Oregon, Rhode Island, Texas, Vermont, and Wisconsin.
- Most of these states with EE PBF are currently under some form of a restructured regulatory environment. Another common thread is that these are mostly relatively high-utility price states (with noted exceptions being Michigan and Ohio) with tight supply-demand situations.
- The study also identified other states where PBF were also used for renewables, low income customer weatherization (a specific type of EE), and uncollectible accounts receivable.

Methodology

- The most common PBF approach is for the utility to charge customers a non-bypassable per KWH charge on the electric distribution rates. Twelve of the eighteen states used this method of collection. The remaining six states used some other approach, such as embedding the charge in base rates, or charging some type of flat monthly fee.
- The PBF is generally collected from all customer classes. In some instances, certain customer classes seek to be exempted from the fee. Industrial customers are often capable of achieving this exemption. Industrial customers often use the rationale that they should be able to opt-out of the PBF on the basis that they have individually implemented sufficient EE measures regarding their own operations such that they should not be required to fund other competitors or other customer classes.
- Issues related to competitive impact may be mitigated through placing caps on the monthly kWh used by any single customer that would be subject to the PBF fee.
- Another consideration in Virginia is that rates for certain customers (the Commonwealth, local governments, the federal government) are not subject to the jurisdiction of the SCC but instead are set based on contracts between utilities and these non-jurisdictional customers.

Funding Levels

- The magnitude of the funding levels for the 18 states identified in the ACEEE study ranged from .03 to 3 mills per kWh. The median value was just over 1.1 mills per kWh.
- Total funding in Virginia would be subject to the amount of the fee and whether the fee covered all jurisdictional and non-jurisdictional consumers. If it is assumed that 10 percent of total electric consumption is from non-jurisdictional customers, then a PBF fee

of 1 mill per kWh would result in collections of approximately \$100 million based on 2006 jurisdictional customer consumption.

Pros

- Limits conflicts of interest of utilities (impact of reduced sales on earnings)
- Lower administrative costs (avoids duplication of utility administrative efforts)
- Consistency in branding among state residents
- Economies of scale (for statewide efforts)
- Utilities do not have to increase their work force to support utility-sponsored programs
- Ease of administration
- Flexible programs can be designed to target specific goals.
- Can facilitate wide involvement in establishing and operating programs.

Cons

- If used alone, eliminates the ability for utilities to receive supply-side treatment for demand-side programs (i.e., earning a return on and of investments)
- Utilities collect and pass on the fee to agencies to fund EE programs
- Depending upon the agency selected, may require a refocus of existing agencies mission and activities since energy efficiency may not necessarily be a part of these agencies core mission
- Agency regulations may limit flexibility of programs.
- Risk of funding programs that are not cost effective.
- Fund raids - funds being diverted from the public benefit fund to other governmental programs. This can be a serious concern that should be safeguarded through the careful legislation.
- Does not take advantage of utility relationship with their customers
- Can separate the responsibility for performance and operational control (Utilities could be held responsible for the goals with no control over the administration)
- 'One-size-fits-all' programs may not be best for customers across entire state.

Potential PBF Funding Process

If Virginia adopts policy to have utilities collect money to finance a Public Benefits Fund, a mechanism similar to the Electric Utility Consumption Tax (Code of Virginia §58.1-2900) should be given strong consideration by the Commission. The structure of the consumption tax assigns the tax revenues proportionately to the State consumption tax (similar to a gross receipts or sales tax), Special regulatory tax (to fund the operation of the State Corporation Commission), and Local consumption tax (similar to a Business, Professional, and Occupational License tax). The tax rates are divided into usage blocks so that the rates decline as usage increases. The current tax rates and monthly usage blocks are: \$0.00155 per kWh for usage of 2,500 kWh or less; \$0.00099 per kWh for consumption between 2,501 to not more than 50,000 kWh; and \$0.00075 per kWh for all consumption in excess of 50,000 kWh. This mechanism has several benefits and relatively few negatives.

Pros

- The process has been used since 2000 and would require little if any additional computer programming by utilities.
- The consumption tax already appears on electric statements and would therefore not require additional space or redesign of billing statements.
- The Department of Taxation already receives and redistributes consumption tax revenues based on the Code requirements. Adding a fourth distribution category, or

directing more money to the special regulatory fund which can then be used for public benefits, should require only minimal administrative changes.

- Consumers who wish to avoid the tax can minimize its impact by reducing their consumption, thus helping to achieve the stated goal of reducing consumption by 10%.
- Due to the tax's block design, tax rates can be created that, if desired, limit the amount paid by larger commercial and industrial customers.

Cons

- The PBF dollars would essentially be "hidden" within the overall consumption tax.
- As conservation and efficiency efforts are implemented electricity consumption should decrease, resulting in reduced tax revenues and fewer dollars with which to fund programs supported by the PBF.
- The Electric Utility Consumption Tax does not apply to sales of electricity to non-jurisdictional customers.

Position for Consideration by SCC Staff

- The Commission and the stakeholders should consider whether energy conservation goals are best achieved through the public benefits fund or the utility sponsored EE program mechanisms or a combination of both.
- If the utilities are going to be held accountable for the energy consumption goals then they are best served by programs that are under their control. If the public benefit fund is used then the utilities should not be held accountable for the energy consumption reductions, since they will only have limited control over the implementation of the programs.
- PBF's can be utilized effectively for efforts that are universal to all the utilities and are not utility-specific, such as general EE education for consumers. This is a good example of a program that lends itself to the public benefits fund, as impacts cannot be as easily measured as other energy efficiency programs.
- Utility-specific sponsored programs are preferable for EE efforts that are tailored to each state utility's service territory, and unique circumstances of the utility such as demand control programs.
- PBF's require oversight for program funding and spending. Regardless of which approach is taken or if it is a combination of the two – PBF and utility sponsored programs - such programs need to be cost-effective and provide for lasting reduction impacts. The programs should be subject to measurement and verification and be periodically monitored for cost effectiveness.
- Utilities, by hiring outside contractors to implement their EE programs, can limit their workforce investment.
- The financial disincentive to promote reduced consumption by customers can be addressed by providing appropriate cost recovery to place EE investments on equal footing with supply side investments in the form of cost recovery of program costs, net lost revenues (i.e., fixed costs) between rate cases and a financial return.
- Using third-party administration (which often accompanies PBF's) is an option to consider. Such an arrangement should come with proper measurement, verification and oversight.
- It may be appropriate to have the PBF be subject to a "sunset provision" and a blocked tier structure or other capping mechanism to address the competitive issues raised by industrial customers.

Attachment 1

Scope of Existing SCC Authority To Implement Conservation, Energy Efficiency and Demand Side/Load Management and Allow Cost Recovery

The following represents Dominion Virginia Power regulatory staff's attempt to respond to a request by Work Group #4 to provide a summary-level review of the scope of the State Corporation Commission's ("Commission") authority to implement conservation, energy efficiency and load management programs and to provide for the recovery of the costs associated with such programs. The following information has been obtained from two sources: 1) the Virginia Administrative Code, Agency 5 – State Corporation Commission, Chapters 303 and 304, and 2) the Code of Virginia.

1) Virginia Administrative Code, Agency 5 – State Corporation Commission Chapters 303 and 304

The following rules were derived from the Commission's Order in Case No. PUE900070. Statutory authority for Chapter 303 comes from §§ [56-235.1](#) and [56-235.2](#) of the Code of Virginia. Statutory authority for Chapter 304 comes from §§ [56-234](#), [56-235.1](#), [56-235.2](#), [56-247](#) and [56-249](#) of the Code of Virginia. Chapter 303 became effective on March 27, 1992. Chapter 304 became effective on June 28, 1993.

CHAPTER 303

RULES GOVERNING UTILITY PROMOTIONAL ALLOWANCES

20VAC5-303-10. Purpose.

The purpose of these rules is to establish the conditions under which electric and gas utilities operating in Virginia may propose to recover reasonable costs associated with promotional allowances to customers. Any utility proposing a promotional allowance program shall demonstrate that such program is reasonably calculated to promote the maximum effective conservation and use of energy and capital resources in providing energy services. Promotional allowance programs shall be cost justified using appropriate cost/benefit methodologies.

20VAC5-303-20. Promotional allowances prohibited for ratemaking.

Except as provided for under 20VAC5-303-30, no electric or gas utility shall give or offer to give any payment, subsidy or allowance, directly or indirectly, or through a third party, to influence the installation, sale, purchase, or use of any appliance or equipment. No electric utility shall give or offer to give any monetary or other allowance or credits based on anticipated revenues for the installation of underground service. Schedules of charges for underground service based on revenue-cost ratios or cost differentials shall be filed with the Commission.

20VAC5-303-30. Permitted activities.

1. Unless otherwise specifically prohibited in writing by the Commission, the following activities are not prohibited by these rules:

- a. Advertising by a utility in its own name, consistent with [§56-235.2](#) of the Code of Virginia.
- b. Joint advertising with others, if the utility is prominently identified as a sponsor of the advertisement consistent with [§56-235.2](#) of the Code of Virginia.
- c. Financing the purchase of appliances by utilities so long as the interest rate or carrying charge to the purchaser is not less than the interest rate paid by the utility for short term debt.
- d. Merchandising of appliances or equipment by utilities.
- e. Inspection and adjustment of appliances by utilities. Repairs and other maintenance to appliances and equipment if charges are at cost, or above.
- f. Donation or lending of appliances by utilities to schools for instructional purposes.
- g. Technical assistance offered to customers by employees of utilities.
- h. Incentives to full time employees of utilities.

2. Promotional allowance programs designed to achieve energy conservation, load reduction, or improved energy efficiency are permitted under these rules, subject to the prior approval of the Commission. Any promotional allowance program proposed under this chapter shall comply with the standards contained in 20VAC5-303-40.

20VAC5-303-40. Promotional allowance program standards.

- 1. Any utility offering a promotional allowance program shall adhere to the following standards:
 - a. The promotional allowance program shall not vary the rates, charges and schedules of the tariff under which service is rendered to the customer.
 - b. A utility may not, directly or indirectly, offer or grant to a customer any form of promotional allowance except as is uniformly and contemporaneously extended to all customers in the same reasonably defined class.
 - c. Any utility promotional allowance program should be designed in such a manner so as to minimize the potential for placing private businesses at an undue competitive disadvantage.
 - d. To the extent applicable, any appliances or equipment promoted by a utility under a promotional allowance program shall have energy efficiency ratings which meet or exceed current federal standards as contained in the National Appliance Energy Conservation Act (Public Law 100-12), or any subsequent amendments thereof. The Commission may, at its discretion, impose other standards for appliances or equipment promoted under a utility promotional allowance program.
 - e. Any utility proposing a promotional allowance program that would have a significant effect on the sales levels of an alternative energy supplier shall consider the effect of the program on that supplier, and demonstrate that the program serves the overall public interest.

20VAC5-303-50. Waivers.

A utility may file for exemptions from any or all of these rules. In making its decision regarding exemptions, the Commission will consider the size of the utility's operations in Virginia, the

requirements of other regulatory bodies having jurisdiction over the utility, and the specific Virginia statutory authority under which the utility operates.

20VAC5-303-60. Commission authority.

Notwithstanding any of the provisions of this chapter, the Commission may authorize an otherwise prohibited promotional allowance program if the Commission finds that it is in the public interest.

Nothing in the provisions of this chapter shall preclude the Commission from investigating, formally or informally, a utility promotional activity and, if it determines the activity to be adverse to the public interest, modifying or eliminating the activity.

Statutory Authority: §§[56-235.1](#) and [56-235.2](#) of the Code of Virginia.

Historical Notes: Derived from Case No. PUE900070 §VI, eff. March 27, 1992.

CHAPTER 304

RULES GOVERNING COST/BENEFIT MEASURES REQUIRED FOR DEMAND-SIDE MANAGEMENT PROGRAMS

20VAC5-304-10. Purpose.

The purpose of these rules is to establish the cost/benefit measures which utilities operating in Virginia must conduct to determine whether a proposed demand-side management ("DSM") program is cost effective and in the public interest.

20VAC5-304-20. Cost/benefit measures.

Utility applicants shall analyze a proposed program from a multi-perspective approach using, at a minimum, the Participants Test, the Utility Cost Test, the Ratepayer Impact Measure Test, and the Total Resource Cost Test. Utilities may file for approval of programs individually or as a package. However, any application which includes a package of DSM programs shall also provide an analysis of the cost/benefit of each program individually.

20VAC5-304-30. Minimum guidelines for data input and modeling assumptions.

Minimum guidelines to provide direction to electric and natural gas utilities in developing applications for approval of DSM programs are as follows:

1. That the assumptions used in developing projected input data and the models used in the integrated resource planning process should be identified and well-documented. Utility-specific data should be used whenever possible (e.g., unit performance data, end-use load research data, market research data, etc.). In cases where utility-specific data are not available, the assumptions must be clearly defined;
2. That historic data, if available, should be assessed in developing projected data. Significant departures from historic trends should be explained;
3. That each projected data series should represent the Company's most current forecast;
4. That computer modeling techniques should be used in the development of an integrated resource plan;

5. That estimates of the capital and O&M (operation and maintenance) costs of supply-side options should include realistic projections of the costs of compliance with all promulgated environmental regulations or enacted legislation from which environmental regulations will be promulgated;
6. That each assumption and/or projected data series should be consistent with all other assumptions and/or projections. Consistency of data should be maintained between all models used within the integrated resource planning process; and
7. That alternative projections to determine sensitivity to input assumptions should be developed. These alternative projections should be used to perform cost/benefit analysis. Waiver of strict adherence to these guidelines for small utilities or those in unusual circumstances may be granted by order of the Commission.

20VAC5-304-40. Pilot or experimental programs.

Utilities must seek Commission approval of pilot or experimental programs that involve rates or promotional allowances, but other limited pilot or experimental programs may be conducted without prior Commission approval. Utilities shall file reports with the Commission's Division of Economics and Finance that identify any pilot or experimental program at least 30 days prior to its implementation. Periodic reports shall also be filed at least semi-annually with the Commission's Division of Economics and Finance identifying all DSM pilot or experimental programs and the status of such programs.

Statutory Authority: §§[56-234](#), [56-235.1](#), [56-235.2](#), [56-247](#) and [56-249](#) of the Code of Virginia.
Historical Notes: Derived from Case No. PUE900070 §1, eff. June 28, 1993.

2a) Enactment Clause from House Bill 3068 approved on April 4, 2007

Be it enacted by the General Assembly of Virginia:

3. That it is in the public interest, and is consistent with the energy policy goals in § 67-102 of the Code of Virginia, to promote cost-effective conservation of energy through fair and effective demand side management, conservation, energy efficiency, and load management programs, including consumer education. These programs may include activities by electric utilities, public or private organizations, or both electric utilities and public or private organizations. The Commonwealth shall have a stated goal of reducing the consumption of electric energy by retail customers through the implementation of such programs by the year 2022 by an amount equal to ten percent of the amount of electric energy consumed by retail customers in 2006. The State Corporation Commission shall conduct a proceeding to (i) determine whether the ten percent electric energy consumption reduction goal can be achieved cost-effectively through the operation of such programs, and if not, determine the appropriate goal for the year 2022 relative to base year of 2006, (ii) identify the mix of programs that should be implemented in the Commonwealth to cost-effectively achieve the defined electric energy consumption reduction goal by 2022, including but not limited to demand side management, conservation, energy efficiency, load management, real-time pricing, and consumer education, (iii) develop a plan for the development and implementation of recommended programs, with incentives and alternative means of compliance to achieve such goals, (iv) determine the entity or entities that could most efficiently deploy and

administer various elements of the plan, and (v) estimate the cost of attaining the energy consumption reduction goal. The Commission shall, on or before December 15, 2007, submit its findings and recommendations to the Governor and General Assembly, which shall include recommendations for any additional legislation necessary to implement the plan to meet the energy consumption reduction goal. In developing a plan to meet the goal, the Commission may consider providing for a public benefit fund and shall consider the fair and reasonable allocation by customer class of the incremental costs of meeting the goal that are recovered in accordance with subdivision A 5 b of § 56-585.1 of the Code of Virginia.

2b) The following sections from the Code of Virginia may be relevant to the implementation of conservation, energy efficiency and demand side/load management and programs and the allowance of cost recovery

§ 56-232. Public utility and schedules defined.

A. The term "public utility" as used in §§ 56-233 to 56-240 and 56-246 to 56-250:

1. Shall mean and embrace every corporation (other than a municipality), company, individual, or association of individuals or cooperative, their lessees, trustees, or receivers, appointed by any court whatsoever, that now or hereafter may own, manage or control any plant or equipment or any part of a plant or equipment within the Commonwealth for the conveyance of telephone messages or for the production, transmission, delivery, or furnishing of heat, chilled air, chilled water, light, power, or water, or sewerage facilities, either directly or indirectly, to or for the public.

2. Notwithstanding any provision of subdivision 1 of this subsection or subsection G of § 13.1-620, shall also include any governmental entity established pursuant to the laws of any other state, corporation (other than a municipality established under the laws of this Commonwealth), company, individual, or association of individuals or cooperative, their lessees, trustees, or receivers, appointed by any court whatsoever, that at any time owns, manages or controls any plant or equipment, or any part thereof, located within the Commonwealth, which plant or equipment is used in the provision of sewage treatment services to or for an authority as defined in § 15.2-5101; however, the Commission shall have no jurisdiction to regulate the rates, terms and conditions of sewage treatment services that are provided by any such public utility directly to persons pursuant to the terms of a franchise agreement between the public utility and a municipality established under the laws of this Commonwealth.

§ 56-233. Service defined.

The term "service" is used in this chapter in its broadest and most inclusive sense and includes not only the use and quality of accommodations afforded consumers or patrons, but also any product or commodity furnished by any public utility and equipment, apparatus, appliances and facilities devoted to the purposes in which such public utility is engaged and to the use and accommodation of the public.

§ 56-233.1. Public utilities purchasing practices.

Every public utility subject to the biennial review provisions of Title 56 shall use competitive bidding to the extent practicable in its purchasing and construction practices. In addition, all such public utilities shall file with the Commission and keep current a description of its purchasing and construction practices.

§ 56-234. Duty to furnish adequate service at reasonable and uniform rates.

It shall be the duty of every public utility to furnish reasonably adequate service and facilities at reasonable and just rates to any person, firm or corporation along its lines desiring same. It shall be their duty to charge uniformly therefor all persons, corporations or municipal corporations using such service under like conditions. However, no provision of law shall be deemed to preclude voluntary rate or rate design tests or experiments, or other experiments involving the use of special rates, where such experiments have been approved by order of the Commission after notice and hearing and a finding that such experiments are necessary in order to acquire information which is or may be in furtherance of the public interest. The charge for such service shall be at the lowest rate applicable for such service in accordance with schedules filed with the Commission pursuant to § 56-236. But, subject to the provisions of § 56-232.1, nothing contained herein or in § 56-481.1 shall apply to (i) schedules of rates for any telecommunications service provided to the public by virtue of any contract with, (ii) for any service provided under or relating to a contract for telecommunications services with, or (iii) contracts for service rendered by any telephone company to, the state government or any agency thereof, or by any other public utility to any municipal corporation or to the state or federal government. The provisions hereof shall not apply to or in any way affect any proceeding pending in the State Corporation Commission on or before July 1, 1950, and shall not confer on the Commission any jurisdiction not now vested in it with respect to any such proceeding.

§ 56-235.1. Conservation of energy and capital resources.

It shall be the duty of the Commission to investigate from time to time the acts, practices, rates or charges of public utilities so as to determine whether such acts, practices, rates or charges are reasonably calculated to promote the maximum effective conservation and use of energy and capital resources used by public utilities in rendering utility service. Where the Commission finds that the public interest would be served, it may order any public utility to eliminate, alter or adopt a substitute for any act, practice, rate or charge which is not reasonably calculated to promote the maximum effective conservation and use of energy and capital resources used by public utilities in providing utility service and it may further provide for the dissemination of information to the public, either through the Commission staff or through a public utility, in order to promote public understanding and cooperation in achieving effective conservation of such resources; provided, however, that nothing in this section shall be construed to authorize the adoption of any rate or charge which is clearly not cost-based or which is in the nature of a penalty for otherwise permissible use of utility services.

§ 56-235.2. All rates, tolls, etc., to be just and reasonable to jurisdictional customers; findings and conclusions to be set forth; alternative forms of regulation for electric companies.

A. Any rate, toll, charge or schedule of any public utility operating in this Commonwealth shall be considered to be just and reasonable only if: (1) the public utility has demonstrated that such rates, tolls, charges or schedules in the aggregate provide revenues not in excess of the aggregate actual costs incurred by the public utility in serving customers within the jurisdiction of the Commission, including such normalization for nonrecurring costs and annualized adjustments for future costs as the Commission finds reasonably can be predicted to occur during the rate year, and a fair return on the public utility's rate base used to serve those jurisdictional customers, which return shall be calculated in accordance with § 56-585.1 for utilities subject to such section; (1a) the investor-owned public electric utility has demonstrated that no part of such rates, tolls, charges or schedules includes costs for advertisement, except for advertisements either required by law or rule or regulation, or for advertisements which solely promote the public interest, conservation or more efficient use of energy; and (2) the public utility has demonstrated that such rates, tolls, charges or schedules contain reasonable classifications of customers. Notwithstanding § 56-234, the Commission may approve, either in the context of or apart from a rate proceeding after notice to all affected parties and hearing, special rates, contracts or incentives to individual customers or classes of customers where it finds such measures are in the public interest. Such special charges shall not be limited by the provisions of § 56-235.4. In determining costs of service, the Commission may use the test year method of estimating revenue needs. In any Commission order establishing a fair and reasonable rate of return for an investor-owned gas, telephone or electric public utility, the Commission shall set forth the findings of fact and conclusions of law upon which such order is based.

For ratemaking purposes, the Commission shall determine the federal and state income tax costs for investor-owned water, gas, or electric utility that is part of a publicly-traded, consolidated group as follows: (i) such utility's apportioned state income tax costs shall be calculated according to the applicable statutory rate, as if the utility had not filed a consolidated return with its affiliates, and (ii) such utility's federal income tax costs shall be calculated according to the applicable federal income tax rate and shall exclude any consolidated tax liability or benefit adjustments originating from any taxable income or loss of its affiliates.

B. The Commission shall, before approving special rates, contracts, incentives or other alternative regulatory plans under subsection A, ensure that such action (i) protects the public interest, (ii) will not unreasonably prejudice or disadvantage any customer or class of customers, and (iii) will not jeopardize the continuation of reliable electric service.

C. After notice and public hearing, the Commission shall issue guidelines for special rates adopted pursuant to subsection A that will ensure that other customers are not caused to bear increased rates as a result of such special rates.

§ 56-235.4. Prohibition of multiple rate increases within any twelve-month period; exception.

A. The regulated operating revenues of a public utility shall not be increased pursuant to Chapter 9.1 (§ 56-231.15 et seq.), 10 (§ 56-232 et seq.) or 19 (§ 56-531 et seq.) of this title more than once within any twelve-month period. This limitation shall not apply to increases in regulated operating revenues resulting from (i) increases in rates pursuant to § 56-245 or § 56-249.6, (ii) any automatic rate adjustment clause approved by the Commission, (iii) new rate schedules for service not offered under existing rate schedules or for expansion, reduction, or termination of existing services, (iv) initiation, modification or termination of experimental rates under § 56-234, or (v) the making permanent of an experimental program. Notwithstanding any other provisions of this section, a telephone company may apply to the Commission to pass on to its customers as a part of its rates any changes approved by the Commission in the carrier access charges.

B. The Commission may adopt such rules and regulations as may be necessary to carry out the provisions of this section. The Commission may specify, by rule, the time during the calendar year when application may be filed by electric utility and cooperatives, gas utilities, telephone utilities and cooperatives, and other utilities.

The Commission may by rule provide standards and procedures for expedited handling of rate increase applications, and such rules may provide that an expedited rate increase may take effect in less than twelve months after the preceding increase so long as regulated operating revenues are not increased pursuant to the provisions of subsection A of this section more than once in any calendar year.

§ 56-35. Regulation of public service companies.

The Commission shall have the power, and be charged with the duty, of supervising, regulating and controlling all public service companies doing business in this Commonwealth, in all matters relating to the performance of their public duties and their charges therefor, and of correcting abuses therein by such companies.

§ 56-36. Inspection of books and documents; special reports; rules and regulations to prevent unjust discrimination.

The Commission shall also have the right at all times to inspect the books, papers and documents of all public service companies doing business in this Commonwealth, and to require from such companies, from time to time, special reports and statements, under oath, concerning their business. It shall keep itself fully informed of the physical condition of all railroads of the Commonwealth, as to the manner in which they are operated, with reference to the security and accommodation of the public, and shall, from time to time, make and enforce such requirements, rules and regulations as may be necessary to prevent unjust or unreasonable discrimination by any public service company in favor of, or against, any person, locality, community, connecting line, or kind of traffic in the matter of car service, train or boat schedule, efficiency of transportation or otherwise, in connection with the public duties of such company.

§ 67-102. Commonwealth Energy Policy.

C. All agencies and political subdivisions of the Commonwealth, in taking discretionary action with regard to energy issues, shall recognize the elements of the Commonwealth Energy Policy and where appropriate, shall act in a manner consistent therewith.

D. The Commonwealth Energy Policy is intended to provide guidance to the agencies and political subdivisions of the Commonwealth in taking discretionary action with regard to energy issues, and shall not be construed to amend, repeal, or override any contrary provision of applicable law. The failure or refusal of any person to recognize the elements of the Commonwealth Energy Policy, to act in a manner consistent with the Commonwealth Energy Policy, or to take any other action whatsoever, shall not create any right, action, or cause of action or provide standing for any person to challenge the action of the Commonwealth or any of its agencies or political subdivisions.

During the 2007 General Assembly Session, new legislation was enacted through Senate Bill 1416 and House Bill 3068. § 56-585.1 sets forth new provisions for the regulation of generation, distribution, and transmission rates after capped rates terminate or expire. Capped rates are set to expire on December 31, 2008 unless terminated sooner by the Commission.

The following are specific provisions within § 56-585.1 that could possibly impact the implementation and the provision for cost recovery of conservation, energy efficiency and demand side/load management programs.

2009 Rate Case

§ 56-585.1 A. During the first six months of 2009, the Commission shall, after notice and opportunity for hearing, initiate proceedings to review the rates, terms and conditions for the provision of generation, distribution and transmission services of each investor-owned incumbent electric utility. Such proceedings shall be governed by the provisions of Chapter 10 (§ [56-232](#) et seq.) of this title, except as modified herein. In such proceedings the Commission shall determine fair rates of return on common equity applicable to the generation and distribution services of the utility...

Biennial Reviews Commencing in 2011

§ 56-585.1 A. ... Commencing in 2011, the Commission, after notice and opportunity for hearing, shall conduct biennial reviews of the rates, terms and conditions for the provision of generation, distribution and transmission services by each investor-owned incumbent electric utility, subject to the following provisions:

1. Rates, terms and conditions for each service shall be reviewed separately on an unbundled basis, and such reviews shall be conducted in a single, combined proceeding.

The first such review shall utilize the two successive 12-month test periods ending December 31, 2010. However, the Commission may, in its discretion, elect to stagger its biennial reviews of utilities by utilizing the two successive 12-month test periods ending December 31, 2010, for a Phase I Utility, and utilizing the two successive 12-month test periods ending December 31, 2011, for a Phase II Utility, with subsequent proceedings utilizing the two successive 12-month test periods ending December 31 immediately preceding the year in which such proceeding is conducted. For purposes of this section, a Phase I Utility is an investor-owned incumbent electric utility that was, as of July 1, 1999, not bound by a rate case settlement adopted by the Commission that extended in its application beyond January 1, 2002, and a Phase II Utility is an investor-owned incumbent electric utility that was bound by such a settlement.

Additional specific provisions that provide details on how the biennial reviews will be conducted have not been included in this document.

Rate Adjustment Clauses

§ 56-585.1 A.4. The following costs incurred by the utility shall be deemed reasonable and prudent: (i) costs for transmission services provided to the utility by the regional transmission entity of which the utility is a member, as determined under applicable rates, terms and conditions approved by the Federal Energy Regulatory Commission and (ii) costs charged to the utility that are associated with demand response programs approved by the Federal Energy Regulatory Commission and administered by the regional transmission entity of which the utility is a member. Upon petition of a utility at any time after the expiration or termination of capped rates, but not more than once in any 12-month period, the Commission shall approve a rate adjustment clause under which such costs, including, without limitation, costs for transmission service, charges for new and existing transmission facilities, administrative charges, and ancillary service charges designed to recover transmission costs, shall be recovered on a timely and current basis from customers. Retail rates to recover these costs shall be designed using the appropriate billing determinants in the retail rate schedules.

§ 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: ...

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;

Clarification of Commission Authority

§ 56-585.1.D. Nothing in this section shall preclude the Commission from determining, during any proceeding authorized or required by this section, the reasonableness or prudence of any cost incurred or projected to be incurred, by a utility in connection with the subject of the proceeding. A determination of the Commission regarding the reasonableness or prudence of any such cost shall be consistent with the Commission's authority to determine the reasonableness or prudence of costs in proceedings pursuant to the provisions of Chapter 10 (§ [56-232](#) et seq.) of this title.