COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, NOVEMBER 23, 2015

APPLICATION OF

VIRGINIA ELECTRIC AND POWER COMPANY

CASE NO. PUE-2015-00027

For a 2015 biennial review of the rates, terms and conditions for the provision of generation, distribution and transmission services pursuant to § 56-585.1 A of the Code of Virginia

FINAL ORDER

On March 31, 2015, Virginia Electric and Power Company d/b/a Dominion Virginia Power ("Dominion" or "Company") filed an Application with the State Corporation Commission ("Commission") for a biennial review of the Company's rates, terms and conditions for the provision of generation, distribution and transmission services pursuant to § 56-585.1 A of the Code of Virginia ("Code") and the Commission's Rules Governing Utility Rate Applications and Annual Informational Filings, 20 VAC 5-201-10 *et seq.* ("Rate Case Rules"). Pursuant to Code § 56-585.1 A 8, "[t]he Commission's final order regarding such biennial review shall be entered not more than eight months after the date of filing, and any revisions in rates or credits so ordered shall take effect not more than 60 days after the date of the order."

On April 10, 2015, the Commission issued an Order for Notice and Hearing that, among other things, established a procedural schedule for this case and directed Dominion to provide public notice of this matter.

The following parties filed notices of participation: Office of the Attorney General's Division of Consumer Counsel ("Consumer Counsel"); Department of the Navy on behalf of all Federal Executive Agencies ("FEA"); Apartment and Office Building Association of

Metropolitan Washington ("AOBA"); The Kroger Co.; MeadWestvaco Corporation; and the Virginia Committee for Fair Utility Rates ("Committee").

The Commission held a public evidentiary hearing on September 9, 10, 11, and 14, 2015. The Commission received testimony from witnesses on behalf of participants in the case and admitted over 50 exhibits. The Commission also received written comments from the public in this case; no public witnesses appeared to testify at the hearing.

On October 23, 2015, the following participants filed post-hearing briefs: Dominion; AOBA; FEA; Committee; Consumer Counsel; and the Commission's Staff ("Staff").

NOW THE COMMISSION, upon consideration of this matter, is of the opinion and finds as follows.

"EARNED" RETURN

This is Dominion's third biennial review under § 56-585.1 A and covers the 2013-2014 historical two-year period. In this proceeding, the Commission is required to determine whether the Company "has, during the test period or periods under review, considered as a whole, earned . . . more than 70 basis points below [or above] a fair combined rate of return on its generation and distribution services, as determined in subdivision 2 . . . ."[1] The fair combined rate of return on common equity ("ROE") for purposes of the instant 2013-2014 biennial review period is 10.00%, which was determined by the Commission in Dominion's second biennial review.[2] This results in a ±70 basis points earnings band under the statute of 9.30% - 10.70%.

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[1] Code § 56-585.1 A 8 a, b.

[2] *Application of Virginia Electric and Power Company, For a 2013 biennial review of the rates, terms and conditions for the provision of generation, distribution, and transmission services pursuant to § 56-585.1 A of the Code of Virginia*, Case No. PUE-2013-00020, 2013 S.C.C. Ann. Rept. 371, Final Order (Nov. 26, 2013) ("*VEPCO 2013 Biennial Review*"). A utility's fair ROE as determined in a biennial review shall be applied to that utility's subsequent biennial review. *Application of Virginia Electric and Power Company, For a 2011 biennial review of the rates, terms, and conditions for the provision of generation, distribution, and transmission services pursuant to § 56-585.1 A of the Code of Virginia*, Case No. PUE-2011-00027, 2011 S.C.C. Ann. Rept. 456, 465, Final Order

In order to determine Dominion's earned return for 2013-2014, the Commission must make determinations on specific earnings adjustments related thereto. As explained in prior biennial review orders, Code § 56-585.1 "in no manner requires the Commission to include unreasonable items in determining the earned return thereunder," and, thus, "such determination is not simply a calculation of entries as booked by the utility during the biennial period."[3] Rather, the earned return under this regulatory statute must represent a utility's reasonable earned return, on a regulatory basis, for the biennial period. Thus, "to calculate earned return (which is generally net income divided by common equity), the Commission must determine the Company's reasonable revenues, expenses, and rate base for the historical biennium," and this, "by necessity, requires the Commission to rule on regulatory earnings adjustments proposed by both the utility and other participants in the case."[4]

The Commission has necessarily applied this process in prior biennial reviews, wherein the Commission made specific regulatory accounting adjustments in order to determine the utility's reasonable revenues, expenses, and rate base for the historical two-year period.[5] Those biennial reviews included more than 100 such regulatory adjustments – some contested, some

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(Nov. 30, 2011) ("*VEPCO 2011 Biennial Review*"), *aff'd sub nom. Virginia Elec. and Power Co. v. State Corp. Comm'n*, 284 Va. 726, 744, 735 S.E.2d 684, 693 (2012) ("*VEPCO v. SCC*"). In 2013, the General Assembly codified this principle into § 56-585.1 A 8 as follows: "The fair combined rate of return on common equity determined pursuant to subdivision 2 in such biennial review shall apply, for purposes of reviewing the utility's earnings on its rates for generation and distribution services, to the entire two successive 12-month test periods ending December 31 immediately preceding the year of the utility's subsequent biennial review filing under subdivision 3." 2013 Va. Acts ch. 2.

[3] *Application of Appalachian Power Company, For a 2014 biennial review of the rates, terms and conditions for the provision of generation, distribution and transmission services pursuant to § 56-585.1 A of the Code of Virginia*, Case No. PUE-2014-00026, 2014 S.C.C. Ann. Rept. 392, 393 Final Order (Nov. 26, 2014) ("*APCo 2014 Biennial Review*) (citation omitted).

[4] *Id.*

[5] *See VEPCO 2011 Biennial Review; VEPCO 2013 Biennial Review; APCo 2014 Biennial Review.*

not – that were proposed by the utility or other participants in the case. This is a required step in determining earned return under the statute.

In this manner, the "biennial review is not a summation of previously-approved or booked items but, rather, is a review of the utility's actual performance during the prior biennium."[6] Consequently, as explained by the Supreme Court of Virginia, in order to determine earned return under this statute, the Commission must perform a "retrospective review" of the utility's "performance during the two successive 12-month periods immediately prior to such review[]."[7] The General Assembly amended Code § 56-585.1 in 2012, 2013, 2014, and 2015, but did not amend the process that the Commission has consistently employed for implementing the statutory directive to determine earned return for the historical biennium.

In sum, the Commission must rule on 2013-2014 earnings adjustments for regulatory accounting purposes and to determine earned return under the statute. Accordingly, the Commission makes the findings listed below, which we conclude are reasonable and supported by evidence in the record.[8]

New Regulatory Accounting Adjustments Proposed by Dominion

The Company proposed several new regulatory accounting adjustments for purposes of the instant biennial review.[9] Except as may otherwise be discussed in this Order, the

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[6] *APCo 2014 Biennial Review*, 2014 S.C.C. Ann. Rept. at 393.

[7] *VEPCO v. SCC*, 284 Va. at 730, 736, 735 S.E.2d at 685, 688. The order appealed from and affirmed in this Supreme Court case was the first order under § 56-585.1 in which the Commission made specific earnings adjustments, over the objection of the utility, which were necessary to determine the reasonable earned return for the historical two-year period.

[8] The Commission further notes, as it has previously, that "[a]lthough the Rate Case Rules cannot supplant statutory requirements or mandate an unreasonable earned return, we find good cause to grant any waivers that might be found necessary to implement the earnings adjustments required herein in order to determine the reasonable earned return under the statute." *APCo 2014 Biennial Review*, 2014 S.C.C. Ann. Rept. at 393, n.9.

[9] *See, e.g.*, Ex. 7 (Stevens Direct) at 14-15; Ex. 47 (Stevens Revised Rebuttal) at Schedule 16.

Commission finds that Dominion's proposed new regulatory earnings adjustments are reasonable for purposes of determining the Company's earned return for the 2013-2014 biennium.[10]

Cost of Capital

In Dominion's prior biennial review, the Commission made a regulatory earnings adjustment to the Company's 2012 cost of capital related to its cost of equity (*i.e.*, regarding the percentage of equity in its capital structure). Based on the record in the instant case, the Commission will not make an adjustment to cost of capital in this proceeding to determine earned return but, rather, will use the percentage of common equity in Dominion's actual capital structures for 2013 and 2014.

Statutory Accounting for North Anna 3

Code § 56-585.1 A 6 includes numerous requirements attendant to new generation facilities. This section, among other things, allows Dominion to recover certain costs incurred for nuclear and off-shore wind facilities that have yet to be requested, approved, and/or constructed.

For purposes of new nuclear facilities, Code § 56-585.1 A 6 states in part as follows:

> Thirty percent of all costs of such a facility utilizing *nuclear power* that the utility incurred between July 1, 2007, and December 31, 2013, and *all* of such costs incurred after December 31, 2013, may be deferred by the utility and recovered through a rate adjustment clause under this subdivision at such time as the Commission provides in an order approving such a rate adjustment clause. The remaining 70 percent of *all* costs of such a facility that the utility incurred between July 1, 2007, and December 31, 2013, shall not be deferred for recovery through a rate adjustment clause under this subdivision; *however, such remaining 70 percent of all costs shall be recovered ratably through existing base rates as determined by the Commission in the test periods under review in the utility's next biennial review filed after July 1, 2014.* (Emphases added.)

[10] Likewise, unless otherwise ordered herein, the uncontested regulatory accounting adjustments proposed by Dominion or Staff are approved for purposes of this biennial review.

Pursuant to this language, to determine earned return in this biennial review Dominion recorded $320.1 million of new nuclear facility costs. Specifically, these costs are related to the potential construction of a third nuclear reactor at Dominion's North Anna Power Station ("North Anna 3").[11]

Staff testified that $58.6 million of this amount relates to site separation activities and assets that are currently in-service for (*i.e.*, currently being used for) the two existing nuclear reactors at the North Anna Power Station.[12] While these assets may currently be in service for North Anna 1 and 2, it is uncontested that these site separation costs were only incurred in order "to physically separate the future potential North Anna Unit 3 [construction] site from the existing [operating] facility (Units 1 and 2)."[13] Indeed, no participant contests the fact that these site separation costs were only required due to the potential construction of North Anna 3. As quoted above, Code § 56-585.1 A 6 specifically directs the Commission to recognize in this biennial review 70% of "all costs" of North Anna 3. The term "all costs" is clear. There is no ambiguity in the statutory directive we are bound to follow. Thus, for purposes of the biennial review accounting required herein, we find that the statute requires inclusion of the North Anna 3 site separation costs.

In addition, Dominion also included – as part of "all costs" of North Anna 3 – a return (*i.e.*, financing costs) incurred in 2014 on the unamortized balance of the allotted 70% of new nuclear costs that must be recognized in this biennial review. Again, as with the North Anna 3 site separation costs, the biennial review accounting required for this matter is governed by the

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[11] *See, e.g.*, Ex. 47 (Stevens Rebuttal) at 4; Ex. 27 (Myers Direct) at 24-25.

[12] *See, e.g.*, Ex. 27 (Myers Direct) at 27-32.

[13] *Id.* at 27, Appendix D at 41 (Dominion Interrogatory Response No. 23-317).

above statute. That is, Code § 56-585.1 A 6 is explicitly limited to costs "incurred between July 1, 2007, and December 31, 2013." Accordingly, we reject – for purposes of the biennial review as required by statute for this proceeding – Dominion's proposed financing costs for North Anna 3 that the Company incurred *after* December 31, 2013. This finding increases the Company's biennial review earnings by approximately $10.4 million.[14]

EPA Environmental Compliance Costs – Coal Ash Ponds

On December 19, 2014, the United States Environmental Protection Agency ("EPA") announced its Coal Combustion Residual Rule ("CCR Rule"), which requires certain environmental clean-up and closure of coal ash ponds.[15] On April 17, 2015, EPA's CCR Rule was published in the Federal Register.[16] After the CCR Rule was published in the Federal Register, Dominion recorded – effective May 1, 2015 – Asset Retirement Obligation ("ARO") liabilities on its books related to the CCR Rule.[17] These ARO liabilities were based on Dominion's analysis of the environmental compliance costs from the CCR Rule, totaled $325 million, and are related to Dominion's following generation facilities: Clover; Mt. Storm; Chesterfield; Virginia City; Yorktown; Bremo; Possum Point; and Chesapeake.[18]

Dominion explained that it recorded this $325 million of ARO liabilities *after* publication of the CCR Rule in the Federal Register because the legal obligations under the CCR Rule are not triggered until such publication.[19] Indeed, no participant contested the fact that the proper

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[14] *See, e.g.*, Ex. 27 (Myers Supplemental) at 5-8; Ex. 30; Tr. 439-40; Staff's Post-Hearing Brief, Appendix B at 3.

[15] *See, e.g.*, Ex. 27 (Myers Direct) at 11.

[16] *See, e.g.*, *id.* at 13.

[17] *Id.* at 13-14

[18] *See, e.g.*, *id* at 15.

[19] *See, e.g.*, Dominion's Post-Hearing Brief at 31.

time to book a liability connected to an EPA rule is after it is published in the Federal Register, which is the consensus of the Edison Electric Institute accounting committee and the accounting community as a whole.[20] As a further example, Dominion acknowledged that it has not yet recorded a liability for EPA's announced rule on the Clean Power Plan[21] because such rule has not yet been published in the Federal Register.[22]

The Commission finds that for regulatory accounting purposes and to determine the Company's statutory earnings for 2013-2014 in this biennial review, Dominion's $325 million of ARO liabilities recorded in 2015 for the CCR Rule are outside of this two-year biennial review earnings period and should not be treated as an expense for purposes of the 2013-2014 biennium. The ARO liabilities attendant to the CCR Rule were properly reflected in 2015 after publication of such obligations in the Federal Register.[23] These are not 2013 or 2014 costs and, thus, should not be included in determining earned return in the instant biennial review.

In addition to the $325 million of 2015 CCR-related ARO liabilities recorded by Dominion effective May 1, 2015, the Company also recorded on its books a contingent liability (and associated period expense) on December 30, 2014, involving a subset – *i.e.*, $121 million of the $325 million – of these costs.[24] Specifically, on December 30, 2014, Dominion sent a

[20] *See, e.g.*, Staff's Post-Hearing Brief at 7; Dominion's Post-Hearing Brief at 31 n.77.

[21] *Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Utility Generating Units*, 79 Fed. Reg. 34830 (proposed June 18, 2014) (to be codified at 40 C.F.R. pt. 60) ("CPP Rule").

[22] Tr. 713. While at the time of the hearing the CPP Rule had not yet been published, the CPP Rule was published on October 23, 2015. *Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Utility Generating Units*, 80 Fed. Reg. 64,662, Final Rule (Oct. 23, 2015). *See also* Staff's Post-Hearing Brief at 7, n.13.

[23] *See, e.g.*, Dominion's Post-Hearing Brief at 31, n.77; Staff's Post-Hearing Brief at 7. It is not before us on this record, and we do not rule herein, on the question of whether it is appropriate to book regulatory compliance costs for a new regulation after it is published in the Federal Register if such rule is the subject of pending litigation. Nor do we need to rule for purposes of the instant biennial review on how such costs should be booked, or in which period, or as a regulatory asset.

[24] *See, e.g.*, Ex. 47 (Stevens Rebuttal) at 4-5, 21-22; Ex. 27 (Myers Direct) at 10-11.

settlement offer to the Southern Environmental Law Center offering to settle potential litigation by closing the coal ash ponds at Bremo, Possum Point, and Chesapeake, which the Company believed would be required in any event upon publication of the CCR Rule in the Federal Register.[25] In this regard, Dominion explained that it offered to settle the threat of litigation (no lawsuit had yet been filed) because "[t]hese were costs that we were going to have to incur, in any event."[26] Dominion estimated that the environmental compliance costs under the CCR Rule for Bremo, Possum Point, and Chesapeake would be $121 million, and the Company recorded this amount effective upon transmittal of the settlement offer according to Generally Accepted Accounting Principles ("GAAP").[27] The Company's settlement offer was subsequently rejected.[28]

Dominion seeks to include this $121 million in calculating its 2014 earnings, even though it is part of the 2015 ARO liability of $325 million.[29] The Commission finds that this $121 million should not be treated differently than the rest of the 2015 ARO liability of $325 million for purposes of determining earned return for 2013-2014 in this biennial review. After Dominion chose to transmit its settlement offer on December 30, 2014, it properly recorded the $121 million as a contingent liability under GAAP. It is uncontested, however, that "GAAP accounting does not dictate treatment of costs for regulatory accounting purposes" in

[25] *See, e.g.*, Ex. 27 (Myers Direct) at 11-12; Ex. 47 (Stevens Rebuttal) at 21-22; Dominion's Post-Hearing Brief at 18-19; Staff's Post-Hearing Brief at 6-7.

[26] Tr. 587.

[27] *See, e.g.*, Ex. 27 (Myers Direct) at 12-13, n.11; Ex. 47 (Stevens Rebuttal) at 21-22; Dominion's Post-Hearing Brief at 19-20; Staff's Post-Hearing Brief at 8.

[28] *See, e.g.*, Ex. 47 (Stevens Rebuttal) at 24; Ex. 27 (Myers Direct) at 11, 17; Committee's Post-Hearing Brief at 8; Consumer Counsel's Post-Hearing Brief at 13-14.

[29] The Virginia jurisdictional portion of the $121 million is $95.5 million. Ex. 27 (Myers Direct) at 11.

determining earned return in a biennial review.[30] Rather, to determine the reasonable earned return for the biennium, the Commission starts with GAAP and makes limited regulatory adjustments when it finds reasonable justification therefor; this principle is also uncontested.[31]

In this regard, Dominion acknowledges that when it recorded the 2015 ARO liability after publication of the CCR Rule in the Federal Register, the portions of such $325 million attributed to Bremo, Possum Point, and Chesapeake replaced the $121 million contingent liability it recorded in 2014.[32] In response to discovery, the Company further explained that when it "establishes additional AROs for the ash ponds at Possum Point, Chesapeake and Bremo pursuant to the CCR rules, it will reverse the existing liability established in December 2014...."[33] This is because, as discussed by Dominion (and uncontested by the other participants), the 2015 ARO liability for the CCR Rule "takes precedence" over the discretionary 2014 contingent liability created by the Company.[34]

In addition, Dominion incurred no costs in 2014 associated with closing the coal ash facilities.[35] The Company was not required by law to offer to settle a potential lawsuit that had not yet been filed as of December 30, 2014 (thereby creating a contingent liability), nor did Dominion's December 30, 2014, offer reduce its environmental compliance liability created by

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[30] *APCo 2014 Biennial Review*, 2014 S.C.C. Ann. Rept. at 397, n.50.

[31] *See, e.g.*, Tr. 467; Ex. 27 (Myers Direct) at 7; Staff's Post-Hearing Brief at 8; Consumer Counsel's Post-Hearing Brief at 15.

[32] *See, e.g.*, Ex. 47 (Stevens Rebuttal) at 25-26; Dominion's Post-Hearing Brief at 31-32; Ex. 27 (Myers Direct) at 13.

[33] Ex. 14 (Smith) at 39-40; Attachment LA-4 at 128.

[34] *See, e.g.*, Tr. 704; Staff's Post-Hearing Brief at 14; Consumer Counsel's Post-Hearing Brief at 17-18.

[35] *See, e.g.*, Consumer Counsel's Post-Hearing Brief at 15-16; Staff's Post-Hearing Brief at 7, 14-15.

the CCR Rule in 2015 for Bremo, Possum Point, and Chesapeake.[36] Moreover, Dominion acknowledges that the 2015 ARO liability under the CCR Rule "superseded the liability" created by the 2014 settlement offer.[37]

In sum, Dominion's 2013-2014 expenses should not reflect the ARO liabilities of $325 million that were booked in 2015 to recognize environmental compliance costs resulting from the 2015 publication of the CCR Rule in the Federal Register. The Commission further concludes that for regulatory accounting purposes and to determine the Company's earned return in this biennial review, this finding includes the $121 million of environmental compliance costs attributable to Bremo, Possum Point, and Chesapeake, which Dominion previously created as a contingent liability. This $121 million has been properly superseded and replaced as part of the $325 million of environmental compliance costs booked in 2015 as part of the 2015 ARO liabilities and, as with the rest of such liabilities, should not be reflected in Dominion's earnings for the 2013-2014 biennium. This finding increases the Company's biennial review earnings by approximately $96.3 million.[38]

Micron, Inc., and Manassas, Virginia

Micron operates a semiconductor facility located within the service territory of the municipal electric utility operated by the municipality of Manassas, Virginia.[39] Micron was served by the Manassas municipal electric utility until September 2014, at which time Micron

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[36] *See, e.g.*, Committee's Post-Hearing Brief at 10; Consumer Counsel's Post-Hearing Brief at 14.

[37] Dominion's Post-Hearing Brief at 31.

[38] Staff's Post-Hearing Brief, Appendix B at 2.

[39] *See, e.g.*, Dominion's Post-Hearing Brief at 101.

became a retail customer of Dominion.[40] This arrangement was effectuated in accordance with Code § 56-265.4:1, which provides in part:

> No public utility shall extend its electric public utility service, or construct, enlarge or acquire, by lease or otherwise, any electric utility facilities, in territory served exclusively by a municipal corporation or other governmental body on June 26, 1964, *unless such municipal corporation or other governmental body shall consent by such an agreement*. (Emphasis added.)

Accordingly, pursuant to this statute, Manassas and Dominion entered into one or more agreements that allowed Dominion to become the retail service provider for Micron.[41] The Commission finds that Dominion's costs and revenues associated with serving Micron under Code § 56-265.4:1 should not be included in determining the Company's earned return in this biennial review.

Code § 56-585.1 A requires the Commission to conduct biennial reviews for each "investor-owned incumbent electric utility." For purposes of this section, an "incumbent electric utility" is defined as an "electric utility [that] supplie[s] electric energy to retail customers located in an exclusive territory established by the Commission."[42] Micron is not located in Dominion's exclusive territory established by the Commission.

The General Assembly has created a clear distinction between an electric utility that serves a retail customer: (1) within its exclusive territory established by the Commission; or (2) within the territory served by a municipal corporation or other governmental body. If an electric utility seeks to serve a retail customer by expanding its exclusive service territory,

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[40] *Id.*

[41] *Id.*

[42] Code § 56-576.

Commission approval is required.[43] If an electric utility seeks to serve a customer located within the territory of a municipal electric utility, approval is required by the municipality – not the Commission – under Code § 56-265.4:1. Moreover, an electric utility has the obligation (and the right) to serve jurisdictional retail customers located within its exclusive territory established by the Commission, and the utility must provide such service under the specific rates, terms and conditions required by the Commission. Conversely, an electric utility has no obligation (or right) to serve a retail customer within the territory of a municipal electric utility, and any obligation undertaken by the electric utility therefor is governed by consensual contract between the municipality and electric utility under Code § 56-265.4:1.

In this manner, the General Assembly has not conferred upon the Commission jurisdiction over arrangements between municipalities and electric utilities under Code § 56-265.4:1. Thus, Dominion understandably did not seek the Commission's authority to serve a customer of a municipal utility, necessarily located outside of Dominion's territory, because the statute does not grant the Commission authority over such transaction. Under this statutory scheme, Micron has no ability to seek regulatory relief from the Commission regarding its electric utility service arrangement. Indeed, Manassas has not disposed of its right to serve Micron absent its agreement with Dominion, and Micron ultimately remains under the jurisdiction of the municipal electric utility in whose exclusive service territory it remains located.

Accordingly, the Commission finds that Micron is not a Virginia jurisdictional customer of Dominion for purposes of the Commission's determination of the utility's earned return in this

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[43] Code § 56-265.3 A.

biennial review.[44] This finding increases the Company's biennial review earnings by approximately $5.4 million.[45]

Property Tax Functionalization and Jurisdictionalization

The Company's earned return in this biennial review shall be modified to reflect the regulatory accounting adjustments proposed by Staff, and agreed to in principle by the Company, regarding the proper functionalization and jurisdictionalization of property taxes.[46] This finding increases the Company's biennial review earnings by approximately $568,000.[47]

Lobbying Expenses

The Commission finds that Staff's proposed regulatory accounting adjustments for industry dues – which remove the amount of such dues that Dominion was unable to establish were not related to lobbying expenses – are reasonable for purposes of determining earned return in this biennial review.[48] This finding increases the Company's biennial review earnings by approximately $114,000.[49]

Cash Working Capital

The Commission finds that Staff's proposed regulatory accounting adjustments to cash working capital (*i.e.*, the amount of investor-supplied funds used to sustain ongoing operations of

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[44] The Commission notes that Dominion also serves governmental and military customers that are non-jurisdictional for these and other purposes. *See, e.g.*, Ex. 52 (Haynes Rebuttal) at 16; Staff's Post-Hearing Brief at 26.

[45] Staff's Post-Hearing Brief, Appendix B at 3. Accordingly, Micron shall also not be included in Dominion's cost of service for purposes of determining cost recovery in its rate adjustment clauses ("RACs"). *See, e.g.*, Ex. 24 (Grant) at 22.

[46] *See, e.g.*, Staff's Post-Hearing Brief, Appendix B at 4; Dominion's Post-Hearing Brief at 45.

[47] Ex. 27 (Myers Supplemental) at Statement III. Company Witness Stevens' rebuttal testimony further revised the Company's regulatory accounting adjustments to property taxes. Ex. 47 (Stevens Revised Rebuttal), Schedule 4 at 14-18, Schedule 6 at 20-24.

[48] *See, e.g.*, Ex. 25 (Ellis Direct) at 9-10.

[49] Ex. 27 (Myers Supplemental) at Statement III.

the utility) related to (i) the earnings test results ordered herein, and (ii) balances for offshore wind costs incurred from July 1, 2007 through December 2013,[50] are reasonable for purposes of determining earned return in this biennial review.[51] This finding increases the Company's biennial review earnings by approximately $3.5 million.[52] .

Test Period Earnings and Earned Return

Based on our findings in this case, Dominion earned, on average, an ROE of approximately 10.89% during the 2013-2014 biennial review period. As noted above, the fair rate of return for purposes of this proceeding is 10.00%. Thus, for the 2013-2014 biennial period under review, Dominion had excess earnings and, pursuant to Code § 56-585.1 A 8, three results must now occur:

(1) Dominion retains 70 basis points of excess earnings over 10.00% (*i.e.*, 10.00% to 10.70%), which is approximately $103.9 million;

(2) Dominion also retains 30% of excess earnings above 10.70%, which is approximately $8.5 million; and

(3) The remaining 70% of excess earnings above 10.70%, which is approximately $19.7 million, shall be credited to customers' bills.

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[50] For the reasons discussed above regarding North Anna 3 financing costs, the Commission likewise rejects – for purposes of biennial review accounting required by this statute – Dominion's proposed financing costs incurred in 2014 for the unamortized balance of 70% of offshore wind costs recognized in this biennial review pursuant to Code § 56-585.1 A 6. *See, e.g.,* Staff's Post-Hearing Brief at 32-34. In addition, the Commission finds that it is reasonable, for determining earned return in this biennial review, not to include a return on balances associated with 30% of the offshore wind costs that remain deferred on Dominion's books pending potential recovery thereof through a future RAC. *Id.*

[51] *See, e.g., id.*

[52] *Id.,* Appendix B at 4.

CREDITS TO CUSTOMERS' BILLS

Section 56-585.1 A 8 of the Code directs in part as follows:

> (b) ... Any such credits shall be amortized over a period of six to 12 months, as determined at the discretion of the Commission, following the effective date of the Commission's order, and shall be allocated among customer classes such that the relationship between the specific customer class rates of return to the overall target rate of return will have the same relationship as the last approved allocation of revenues used to design base rates;
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> . . .
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> [A]ny revisions in rates or credits so ordered shall take effect not more than 60 days after the date of the order.

We find that such credits to customers' bills, which must total not less than $19.7 million, shall: (1) be amortized over a period of six (6) months; (2) be based on each customer's usage during calendar years 2013 and 2014; and (3) begin to take effect within sixty (60) days after the date of this Final Order.

In addition, such credits "shall be allocated among customer classes such that the relationship between the specific customer class rates of return to the overall target rate of return will have the same relationship as the last approved allocation of revenues used to design base rates."[53] In this regard, the Company shall allocate the credits among customer classes using the results from Dominion's 2013 Biennial Review, in which the Commission reduced base rates to account for three discontinued demand-side management programs.[54]

TERMS AND CONDITIONS AND CLASS COST ALLOCATIONS

Dominion proposed clarifying revisions to its Terms and Conditions of Service as contained in Filing Schedule 41. No participant objected to these clarifications. The

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[53] Code § 56-585.1 A 8 b.

[54] *See, e.g.*, Ex. 24 (Grant) at 30, Attachment MGG-9. The adjusted net operating income analysis prepared by Company Witness Haynes shall be used for this purpose. *See, e.g.*, Dominion's Post-Hearing Brief at 110, n.401; Ex. 52 (Haynes Rebuttal) at 19-20; Ex. 52C (Haynes Rebuttal), Schedule 5.

Commission approves such changes to the Terms and Conditions of Service, which shall become effective within sixty (60) days after the date of this Final Order.[55]

Next, both AOBA and the Committee express concerns regarding Dominion's 2014 class cost of service study. AOBA states that the "Commission should take particular note of the rather dramatic downward movement shown in the unitized rate of return for its Schedule GS-4 service," that GS-1 and GS-2 "are now the only classes with above system average rates of return," and that the Special Contract class has a negative rate of return that is costing other customer classes "approximately $4.45 million" per year.[56] The Committee, however, asserts that the Commission "should not rely upon [Dominion's] class cost of service study," because it "is not reflective of normal operations reasonably expected to occur going forward."[57] In this regard, the Commission clarifies that it need not, and does not, make a finding in the instant proceeding on the reasonableness of Dominion's 2014 class cost of service study.

<u>SENATE BILL 1349</u>

Earnings Review

During its 2015 Regular Session, the General Assembly of Virginia enacted Senate Bill 1349, which was signed by the Governor and then became effective on July 1, 2015.[58] Senate Bill 1349, among other things, suspends Dominion's next biennial review until 2022 and states that "no adjustment to an investor-owned incumbent electric utility's existing tariff rates ...

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[55] *See, e.g.*, Dominion's Post-Hearing Brief at 110.

[56] AOBA Post-Hearing Brief at 8-9.

[57] Committee Post-Hearing Brief at 25-27.

[58] 2015 Va. Acts ch. 6 (approved February 24, 2015; effective July 1, 2015) (codified in part as Code § 56-585.1:1 A).

shall be made" until the conclusion of that next biennial review, "except as may be provided pursuant to § 56-245 or 56-249.6 or subdivisions A 4, 5, or 6 of § 56-585.1."[59]

For purposes of the instant biennial review, Senate Bill 1349 further states as follows:

> Notwithstanding the provisions of §§ 56-249.6 and 56-585.1: ... Any biennial review of the rates, terms, and conditions for any service of a Phase II Utility occurring in 2015 during the Transitional Rate Period shall be *solely a review of the utility's earnings* on its rates for generation and distribution services for the two 12-month test periods ending December 31, 2014, *and a determination of whether any credits to customers are due* for such test periods pursuant to subdivision A 8 b of § 56-585.1.[60]

Consistent with this language, and as set forth in this Final Order, the Commission has (1) reviewed the utility's earnings for 2013-2014, and (2) made a determination of whether any credits to customers are due.

Fair Rate of Return on Common Equity

The fair ROE determined in Dominion's prior biennial review has been applied in this proceeding, in accordance with § 56-585.1 A 8.[61] Senate Bill 1349 directs that the fair ROE to

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[59] Senate Bill 1349 (Code § 56-585.1:1 A) also provides in part as follows:

> Notwithstanding the provisions of §§ 56-249.6 and 56-585.1: ... After the conclusion of the Transitional Rate Period, biennial reviews shall resume for a Phase II Utility [(*i.e.*, Dominion)], as defined in § 56-585.1, in 2022, with the first such proceeding utilizing the two successive 12-month test periods beginning January 1, 2020, and ending December 31, 2021. Consistent with this provision, (i) no biennial review filings shall be made by an investor-owned incumbent electric utility in the years 2016 through 2019, inclusive, and (ii) no adjustment to an investor-owned incumbent electric utility's existing tariff rates, including any rates adopted pursuant to § 56-235.2, shall be made between the beginning of the Transitional Rate Period and the conclusion of the first biennial review after the conclusion of the Transitional Rate Period, except as may be provided pursuant to § 56-245 or 56-249.6 or subdivisions A 4, 5, or 6 of § 56-585.1.

[60] Code § 56-585.1:1 A (emphasis added).

[61] Code § 56-585.1 A 8 states in relevant part as follows: "The fair combined rate of return on common equity determined pursuant to subdivision 2 in such biennial review shall apply, for purposes of reviewing the utility's earnings on its rates for generation and distribution services, to the entire two successive 12-month test periods ending December 31 immediately preceding the year of the utility's subsequent biennial review filing under subdivision 3." 2013 Va. Acts ch. 2.

be used in Dominion's next biennial review – which will be in 2022 (for 2020-2021) – shall be determined in an ROE proceeding commencing in 2019. As a result, unlike in prior biennial reviews, the Commission will not determine herein the fair ROE that will be used for purposes of Dominion's next biennial review.[62]

Code § 56-585.1 A 3

Since the Commission has found that credits are due in this biennial review, the normal operation of Code § 56-585.1 A 3 would: (1) require the Commission to "combine" certain RACs with the utility's costs, revenues, and investments "until the amounts that are the subject of such [RACs] are fully recovered;" and (2) direct that after such RACs are combined, they "shall thereafter be considered part of the utility's costs, revenues, and investments for the purposes of future biennial review proceedings."

The Commission has previously implemented Code § 56-585.1 A 3's requirement to combine RACs with base rates until the amounts that are the subject of such RACs are fully recovered. This has necessarily required adjustments to Dominion's existing tariff rates.[63] As noted above, however, Senate Bill 1349 precludes "adjustment[s] to ... existing tariff rates" at this time "except as may be provided pursuant to § 56-245 or 56-249.6 or subdivisions A 4, 5, or 6 of § 56-585.1." Code § 56-585.1 A 3 is not listed as one of these express exceptions. Accordingly, Senate Bill 1349 has stayed the operation of Code § 56-585.1 A 3 at this time.

[62] As quoted above, Senate Bill 1349 explicitly states that the instant biennial review is "solely a review of the utility's earnings ... and a determination of whether any credits to customers are due." Thus, the Commission is not determining ROE herein for any purpose, including for RACs. We also make no ruling herein on whether the Commission has the authority to determine ROE in currently pending RAC proceedings.

[63] *VEPCO 2011 Biennial Review*, 2011 S.C.C. Ann. Rept. at 465-66. *VEPCO 2013 Biennial Review*, 2013 S.C.C. Ann. Rept. at 377.

2016 Rate Year Adjustments

Dominion provided testimony to support its position that it will have a revenue deficiency for the 2016 rate year; *i.e.*, if base rates were not prohibited from being adjusted herein per statute, the Company asserts that it would need an annual base rate increase of approximately $6.2 million in order to earn its desired ROE of 10.75%.[64] In response thereto, Consumer Counsel and Staff submitted evidence to support the position that Dominion will not have a revenue deficiency in 2016 but, rather, will have a revenue sufficiency that would require a base rate decrease if otherwise permitted by Virginia statute. Specifically, Consumer Counsel's evidence projects that Dominion will earn approximately $229 million more than its reasonable cost of service (including a fair rate of return) in 2016,[65] and Staff's calculations conclude that Dominion's 2016 revenues will exceed its costs (including a fair rate of return) by $299 million.[66]

Senate Bill 1349 explicitly states that the instant biennial review is "solely a review of the utility's earnings ... and a determination of whether any credits to customers are due." This statutory provision prohibits the Commission from making – *in this biennial review* – specific findings regarding rate year adjustments, ROE, and a specific revenue sufficiency or deficiency

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[64] *See, e.g.*, Ex. 47 (Stevens Revised Rebuttal), Schedule 7 at 1. Dominion filed a motion on February 27, 2015, requesting a waiver of certain filing requirements contained in the Commission's Rate Case Rules. In support of such motion, the Company cited Senate Bill 1349, which did not take effect until July 1, 2015. The Commission denied Dominion's motion on March 13, 2015, noting as follows:

> [T]he Motion and subsequent pleadings reflect varying views on the impact of Senate Bill 1349 for purposes of receiving information in this proceeding. ... Any specific questions or issues regarding the use of such information in this proceeding will be addressed as such questions arise during the course of the proceeding, not prior to the filing of the Application....

Order Denying Motion at 2.

[65] *See, e.g.*, Ex. 14 (Smith) at 25.

[66] *See, e.g.*, Ex. 27 (Myers Supplemental) at 12.

for the 2016 rate year. The Commission is not barred, however, outside of this proceeding, from its other regulatory responsibilities, including the collection of such financial information and records from Dominion as may be necessary to fulfill the Commission's several reporting obligations under Title 56 of the Code. For example, during the Transitional Rate Period, information related to Dominion's costs and revenues is relevant to our reporting duties and will be of value to the General Assembly.

In addition, Senate Bill 1349 itself requires the Commission to report by December 1st of each year on the costs of implementing the federal Clean Power Plan carbon control regulations, the costs of which may be substantial. As the Commission has previously noted, it remains unclear as we enter the Transitional Rate Period whether the bulk of these regulatory environmental compliance costs will be borne by Dominion through frozen base rates or by ratepayers through RACs.[67] Reporting on information addressing Dominion's base rate costs and revenues during the Transitional Rate Period would be valuable information for the General Assembly as it considers issues associated with the costs of the federal Clean Power Plan regulations.

NORTH ANNA 3 COSTS

Consumer Counsel raises concerns regarding the growing costs of development of the North Anna 3 nuclear power station.[68] Consumer Counsel notes that these rapidly mounting costs are being incurred without Dominion having applied for, much less having received, a

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[67] *Petition of Virginia Electric and Power Company, For approval to implement new demand-side management programs and for approval of two updated rate adjustment clauses pursuant to § 56-585.1 A 5 of the Code of Virginia*, Case No. PUE-2014-00071, Doc. Con. Cen. No. 150420228, Final Order at 6-7 (Apr. 24, 2015); *Application of Virginia Electric and Power Company, For approval and certification for the proposed Remington Solar Facility pursuant to §§ 56-46.1 and 56-580 D of the Code of Virginia, and for approval of a rate adjustment clause pursuant to § 56-585.1 A 6 of the Code of Virginia*, Case No. PUE-2015-00006, Doc. Con. Cen. No. 151030161, Final Order at 5, n.7 (Oct. 20, 2015)

[68] *See, e.g.*, Ex. 17 (Norwood) at 6-7; Consumer Counsel's Post-Hearing Brief at 35-38.

Certificate of Public Convenience and Necessity ("CPCN") or RAC for such facility. The Commission has, in the past, explained that Dominion is incurring its North Anna 3 costs purely at its stockholders' risk and should have no expectation of future recovery from customers without an approved CPCN and/or RAC.[69]

Given that this is not a CPCN or RAC application, it is not before us in this proceeding to rule on the recoverability of North Anna 3 costs (except for over $300 million of such costs incurred between July 1, 2007, and December 31, 2013, which the statute directs the Commission to recognize in this biennial review as discussed elsewhere in this Final Order).[70] As Consumer Counsel points out, even beyond those North Anna 3 costs made recoverable from ratepayers in the instant case through the operation of Code § 56-585.1 A 6, North Anna 3 development costs continue to grow significantly. Consumer Counsel also notes that Dominion's capital cost estimate for North Anna 3 has increased by more than 55% since 2011.[71] The evidence demonstrates that Dominion has incurred over $500 million in North Anna 3 development costs to date, that such costs will reach almost $5 billion by 2020, and that the full build-out costs are currently projected at $20 billion.[72]

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[69] *See, e.g., Commonwealth of Virginia, ex rel., State Corporation Commission, In re: Virginia Electric and Power Company's Integrated Resource Plan filing pursuant to Va. Code § 56-597 et seq.*, Case No. PUE-2011-00092, Doc. Con. Cen. No. 120320147, Order on Certified Question at 3-4 (Mar. 19, 2012) ("[W]e note that the reasonableness and prudence of any actual or projected expenditures toward one or more specific demand- or supply-side resource option is not at issue in an [Integrated Resource Plan ("IRP")] proceeding. *Dominion acknowledged that actual expenditures incurred toward any specific resource option that has not been approved by this Commission in an applicable formal proceeding are incurred solely at the risk of Dominion's stockholders.* Further, as the Commission indicated in its 2010 Order in the Company's prior IRP proceeding (Case No. PUE-2009-00096), finding that an IRP is reasonable and in the public interest under § 56-599 E of the Code in no manner represents – and should not be characterized as representing – explicit or implicit approval for construction or cost recovery of any specific resource option contained in the IRP.") (emphasis added).

[70] *See* Code § 56-585.1 A 6.

[71] *See, e.g.*, Consumer Counsel's Post-Hearing Brief at 36.

[72] *See, e.g., id.* at 35-36; Ex. 17 (Norwood) at 6; Tr. at 323-28, 345-46, 633-34.

Consumer Counsel does not urge the Commission to order Dominion to stop development of North Anna 3 at this time, nor does Consumer Counsel ask Dominion to stop development.[73] Rather, Consumer Counsel urges us to initiate a separate proceeding of some type, to review the Company's planned expenditures for North Anna 3.[74] In this regard, Consumer Counsel notes that Dominion "projects it will have spent approximately $2 billion in development of North Anna 3 before it intends to ask the Commission for approval to construct the project."[75]

We re-emphasize herein what we have explained in the past, that Dominion should have no expectation or assumption that this Commission will necessarily grant recovery of costs that Dominion chooses to incur without a CPCN. In addition, Consumer Counsel has also raised issues regarding this matter in Dominion's pending IRP proceeding (Case No. PUE-2015-00035), which will be addressed in the Commission's order in that proceeding.

Accordingly, IT IS ORDERED THAT:

(1) The Company's Application is granted in part and denied in part as set forth in this Final Order.

(2) The Company shall comply with the directives set forth in this Final Order.

(3) The Company shall bear all costs incurred in effecting the credits to customers' bills set forth in this Final Order.

(4) The Company shall forthwith file revised terms and conditions of service and supporting workpapers with the Clerk of the Commission and with the Commission's Divisions

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[73] Tr. at 63, 355-56; Consumer Counsel's Post-Hearing Brief at 38.

[74] *See, e.g.*, Consumer Counsel's Post-Hearing Brief at 38-43.

[75] *Id.* at 36 (*citing* Tr. 636).

of Energy Regulation and Utility Accounting and Finance, as necessary to comply with the directives set forth in this Final Order. The credits required herein shall begin to take effect within sixty (60) days after the date of this Final Order. The Clerk of the Commission shall retain such filing for public inspection in person and on the Commission's website: http://www.scc.virginia.gov/case.

(5) Within sixty (60) days of completing the credits to customers' bills ordered herein, the Company shall file with the Commission's Divisions of Energy Regulation and Utility Accounting and Finance a report verifying that all credits have been completed. The report shall also provide the cost incurred by the Company in effecting such credits.

(6) This case is dismissed.

DIMITRI, Commissioner, concurring in part and dissenting in part:

I concur in the earnings test findings as set forth in this Final Order, except as noted below. In addition, I would establish herein a fair rate of return on common equity for the Company's next biennial period (2015-2016), and would direct implementation of the rate combination provisions of Code § 56-585.1 A 3, since I conclude that the provisions of Senate Bill 1349 that fix the Company's base rates for at least the next seven years – and which take the base rate setting function away from the Commission – violate the plain language of Article IX, Section 2, of the Constitution of Virginia.

Senate Bill 1349 (which was passed in 2015 by the General Assembly and signed by the Governor) fixes the Company's base rates at the current level and prohibits the Commission from conducting further biennial reviews for Dominion until 2022.[76] Since biennial reviews under

[76] This legislation also prohibits the Commission from conducting further biennial reviews for Appalachian Power Company until 2020.

Code § 56-585.1 have been presumed to be the only legislatively-sanctioned basis for setting or lowering customers' base rates, Senate Bill 1349 has foreclosed all avenues for reasonable base rate reductions, if warranted, by the Commission. As explained by Dominion in this proceeding, unless the Company seeks an emergency rate increase, Senate Bill 1349 fixes Dominion's base rates until at least 2023.[77]

For its authority and duties, the Commission looks to the law, which includes both the Code and Constitution of Virginia. Article IX, Section 2, of the Constitution of Virginia provides in pertinent part as follows:

> Subject to such criteria and other requirements as may be prescribed by law, the Commission *shall have the power and be charged with the duty of regulating the rates*, charges, and services *and*, except as may be otherwise authorized by this Constitution or by general law, the *facilities of* railroad, telephone, gas, and *electric companies*. (Emphasis added.)

The italicized language grants the Commission the power and the duty to regulate (i) rates, and (ii) facilities. The Commission's constitutional grant of authority as to rates is explicitly "[s]ubject to such criteria and other requirements as may be prescribed by law." As discussed by Professor A.E. Dick Howard in his Commentaries on the Constitution of Virginia, although this language gives the General Assembly wide latitude to determine the standards that must be used by the Commission in regulating rates, the Constitution grants the Commission jurisdiction "that the General Assembly may not take away."[78]

Of particular relevance here, Professor Howard further explains as follows: "[T]he Assembly may not itself fix the rates of a particular company. Nor would it seem that the Legislature could take this function away from the [Commission] and confer it upon some other

[77] Dominion's Post-Hearing Brief at 99.

[78] 2 A.E. Dick Howard, *Commentaries on the Constitution of Virginia* 980 (1974).

agency or body."[79] Thus, there is a distinction, or a line, between the establishment of legislative criteria and requirements for rate regulation, versus the reservation in the Constitution of rate setting power and duty in the Commission. The location of this line, between establishing criteria or requirements and actually setting rates, may be subject to differing views.[80] Senate Bill 1349, however, does not fall in a grey area. It does not establish criteria that the Commission must apply in regulating Dominion's base rates. Rather, it unequivocally fixes those rates and takes the base rate setting function away from the Commission. This is a legislative prohibition, rather than a requirement. Thus, Senate Bill 1349 is a prohibition on the Commission's exercise of its constitutional authority to regulate rates. There is no basis in the Constitution for legislation to nullify the Commission's grant of jurisdiction in this regard.[81]

Rate regulation traditionally has been accomplished through a process that reviews a utility's cost structure and allows into base rates the prudently incurred costs of operation, such

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[79] *Id.* at 983.

[80] Examples of where the General Assembly has established "criteria and other requirements" include Code § 56-235.2 (traditional standards for setting base rates), § 56-249.6 (recovery of fuel costs incurred by electric utilities), and § 56-585.1 (the instant biennial review process).

[81] In addition, the Constitution's grant of authority to the Commission to regulate "rates" stands in sharp contrast to the grant of authority to regulate "facilities." Specifically, unlike rate regulation, the General Assembly can remove the Commission's regulation of "facilities" by statute. This is because the Constitution grants the Commission the power to regulate facilities "except as may be otherwise authorized by this Constitution or by general law." Va. Const. Art. IX, § 2. When it comes to rate regulation, however, there is no "except as may be otherwise authorized" provision, and the General Assembly is not constitutionally empowered to shift the setting of rates to a body other than the Commission. *See, e.g.,* 2 A.E. Dick Howard, *Commentaries on the Constitution of Virginia* 983 (1974). While, as Professor Howard notes, the Supreme Court of Virginia has addressed relevant provisions of Article IX, Section 2, *see, e.g., Commonwealth v. Virginia Elec. & Power Co.*, 214 Va. 457, 201 S.E.2d 771 (1974) ("*VEPCo*"), this precedent left unresolved the current scenario of rates fixed by legislation. In *VEPCo*, the Court addressed the Commission's authority only in the context of utility rates *offered and charged to governmental entities as consumers*, who were already excluded by statute at the time of the adoption of the Constitution. Because *VEPCo* did not involve the fixing of rates by legislation, the Court did not have to reach the constitutional limitation on the authority to do so. In this regard, the Court in *VEPCo* declined to address Commissioner Catterall's recognition that "[i]n short, the General Assembly cannot itself fix the rates." *Application of Virginia Electric and Power Company, For a declaratory judgment*, Case No. 19176, 1972 S.C.C. Ann. Rept. 304, 308, Order (Dec. 12, 1972) (Shannon, concurring), *rev'd sub. nom.*, *VEPCo*. To determine that Article IX, § 2 gives the General Assembly unfettered authority to set rates itself and legislate away the Commission's rate-setting authority would render portions of Article IX, § 2 superfluous.

as employee costs, depreciation of assets used to provide service (such as generation facilities) and taxes, coupled with a reasonable return, or profit (determined based on market rates of equity, cost of debt and similar funding sources), on its investments – generation plants, distribution facilities, office buildings, etc. Absent imprudent action by the utility, if costs of providing service go up, base rates are adjusted upward, and if costs go down base rates are reduced to reflect that fact.[82]

For decades Virginia law protected customers from monopoly pricing and excessive rates while allowing utilities to recover their prudently incurred costs plus a reasonable return on investment through statutes such as Code § 56-235.2, which required the Commission to establish rates that provided the utility with revenues "not in excess" of the utility's "actual costs" plus a "fair return."[83] This allowed the Commission to consider both upward and downward adjustments to rates, which it did based on a fully developed record that analyzed the utility's costs and financing and gave all interested parties, including the utility, an opportunity to present evidence on costs, revenues and a fair return and legal argument.

In 2007, the General Assembly passed Code § 56-585.1, which largely supplanted the fundamental principles of § 56-235.2 identified above and instituted the biennial review process, placing newly crafted limitations on the Commission's authority to regulate the rates of investor-owned electric utilities (*i.e.*, Dominion and Appalachian Power Company). Code

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[82] The basic reason that rates are regulated in this manner – protecting the utility financially to maintain a reliable electric system and earn a fair return, and protecting customers by charging no more than the utility's costs plus a reasonable return – is because the utility is a state-created public utility monopoly and electricity is a necessity. *See, e.g.*, Evans B. Brasfield, Regulation of Electric Utilities by the State Corporation Commission, 14 Wm. & Mary L. Rev. 589, 589-93 (1973); Michael J. Ileo and David C. Parcell, Economic Objectives of Regulation – The Trend in Virginia, 14 Wm. & Mary L. Rev. 547, 547-50 (1973).

[83] This statute, which reflects fundamental rate setting criteria and requirements as established by the General Assembly, is still applied by the Commission in, among other proceedings, the rate reviews and rate cases for natural gas distribution and water companies in Virginia.

§ 56-585.1, among other things, established requirements on how the Commission determines a fair return on investment and restricted the circumstances under which the Commission can decrease base rates. This statute has been applied to allow the utility to seek base rate increases if its costs increase, while allowing the Commission to reduce base rates only if the utility earns more than a fair return for two consecutive bienniums (during which time the utility might have to refund a portion of its excess revenues, but otherwise base rates remain at the same higher level). In addition, the General Assembly subsequently established specific criteria that required the Commission to include extraordinary costs, which would not have been recognized as directed in the biennial review under conventional rate setting standards, as part of Dominion's biennial reviews in 2013 and 2015; the effect thereof is to reduce the utility's regulatory earnings as calculated in the biennial review and reduce or eliminate refunds to customers and reduce or eliminate the possibility of base rate reductions on a going-forward basis.

The record in this case and other biennial review proceedings demonstrate that, when conventional rate standards are applied, there have been, and are projected to continue to be, excessive base rates that are being paid by Dominion customers. The Commission Staff estimates earnings in excess of the authorized return on equity of approximately $226 million in 2013 and $265 million in 2014, excluding extraordinary statutorily directed impairment or write-off charges.[84] The Commission, in its Final Order in the 2013 Biennial Review, which reviewed earnings for the years 2011 and 2012, determined that the Company needed $4.87 billion in annual revenues to recover its cost of service and earn a fair return, but that the Company's current rates were designed to produce approximately $5.15 billion, or about

[84] Ex. 31. Even with a large directed write-off in this case, the Commission finds that there are earnings in excess of a fair return. The Office of the Attorney General argued that without the General Assembly's requirement of the North Anna 3 write-off in this case, customers would have been due a refund of $188 million even assuming the Company's accounting adjustments. Office of the Attorney General's Post-Hearing Brief at 8.

$280 million more than necessary.[85] Under the terms of Code §§ 56-585.1 *et seq.*, the Commission has not been allowed to reset rates that are producing these revenue levels.

The trend of current rates producing revenues over cost and a fair return has been continuing. For 2015, the Commission Staff projects revenues over a fair return of $310 million, and $299 million for 2016.[86] The Office of the Attorney General stated in the current proceeding that the Company's rates are designed to produce excess revenues of $229 million, or $299 million if based upon the Commission Staff's recommended return on equity.[87] The point here is not the determination of the precise amount of earnings in excess of a fair return in a given year, but rather that the current rate levels, which the Commission has not been authorized to adjust, are designed to produce and have been producing annual excess revenues of hundreds of millions of dollars. There always will be variables that affect the amount of actual costs and revenues in a given year, but current rates are fixed at a level which is designed to overcollect from customers based on current analysis and historical results. If base rates are fixed at current levels for at least the next seven years, earnings over and above the Company's cost of service and a fair return have the potential to reach well over a billion dollars, at customer expense.[88]

The 2015 General Assembly Session took the final step ending the Commission's rate setting authority and any ability to review and, if warranted, reset the Company's base rates, with the passage of Senate Bill 1349. Under this law, major categories of rising costs can be passed along to customers, but lower costs or savings cannot. That is, for virtually any significant

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[85] *VEPCO 2013 Biennial Review*, 2013 S.C.C. Ann. Rept. 378. Tr. 456-57.

[86] Based upon Staff calculations and assumptions. Ex. 31; Tr. 428-36. Dominion disagrees with some Staff adjustments and calculated amounts of overrecovery. Dominion's Post-Hearing Brief at 94-98.

[87] Office of the Attorney General's Post-Hearing Brief at 9.

[88] Ex. 31.

infrastructure or related costs (such as new power plants, demand-side management investment, or transmission lines), separate rate increases are mandated through rider provisions in Code § 56-585.1, which effectively guarantee recovery of those costs to the utility, plus a profit and, in some cases, a rate of return bonus.[89] Conversely, Senate Bill 1349 fixes base rates (and any excess revenues currently built therein) at existing levels; base rates cannot be lowered by the Commission.

The above discussion illustrates that there is ample precedent for the General Assembly having prescribed "criteria and other requirements" that impact how the Commission may establish base rates. Indeed, there may be differing views as to the point at which particular "criteria and other requirements" become so proscriptive that they effectively remove the Commission's constitutional authority to regulate rates. For example, the limitations and directives in § 56-585.1 (discussed above) stand in stark contrast to the traditional regulatory criteria in § 56-235.2 (which required just and reasonable base rates based on the utility's actual cost of service and a fair return). Senate Bill 1349, however, requires no such analysis. Rather, Senate Bill 1349 draws a bright line for regulating base rates: The legislation has fixed the level of base rates and prohibited the Commission from reducing them under any circumstances. Again, the Constitution grants jurisdiction to the Commission "that the General Assembly may not take away," and, as a result, "the Assembly may not itself fix the rates of a particular company."[90]

For these reasons, I would find that the provisions of Senate Bill 1349 that fix the Company's base rates violate Article IX, Section 2, of the Constitution of Virginia and, thus,

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[89] *See* Code §§ 56-585.1 A 4, 5, and 6.

[90] 2 A.E. Dick Howard, *Commentaries on the Constitution of Virginia* 980, 983 (1974).

would determine a fair rate of return on common equity for the Company's next biennial period (2015-2016). In addition, having concluded that the Commission may constitutionally adjust base rates, and since the Commission has found that credits shall be applied to customers' bills in this proceeding as referenced in Code § 56-585.1 A 3, I would find that – as required by Code § 56-585.1 A 3 – the Commission must "combine" certain rate adjustment clauses with the utility's costs, revenues, and investments "until the amounts that are the subject of such rate adjustment clauses are fully recovered."[91]

* * *

As to earnings test adjustments, I disagree with my colleagues on their rejection of the Staff-proposed adjustments to the earnings test for North Anna 3 costs, which results in a significant reduction of approximately $30 million in the refund due customers in this case. The assets in question, primarily support service buildings, were constructed in June 2013 solely for the use at this time of existing units North Anna 1 and 2, and Dominion does not contest the fact that these assets are currently in use for North Anna 1 and 2, are currently accounted for on the Company's books as plant in service for Units 1 and 2, and will continue to be used for these units whether or not Unit 3 is ever built. The new facilities would not even be needed at this time for North Anna 3 but only needed to be built now for Units 1 and 2. Moreover, Dominion would be allowed to recover these costs through base rates in any case, and the effect of the Dominion accounting proposal simply acts to lower its reported earnings and reduce the amount of the refund due customers. The Staff adjustment is sound and reflects a real world, common sense application of the statutory language of Code § 56-585.1 A 6.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to all persons on the official Service List in this matter. The Service List is available from the Clerk of

[91] Code § 56-585.1 A 3.

the State Corporation Commission, c/o Document Control Center, 1300 East Main Street, First Floor, Tyler Building, Richmond, Virginia 23219. A copy shall also be sent to the Commission's Office of General Counsel and Divisions of Energy Regulation and Utility Accounting and Finance.