

**Report of the Commission on Electric Utility Regulation on  
Proposals Relating to the Regulation of Municipal Electric Utilities:  
Senate Bill 1396 and Senate Joint Resolution 300  
October 9, 2015**

**I. Introduction**

Code § 30-205 grants the Commission on Electric Utility Regulation (the Commission) the following powers and duties:

1. Monitor the work of the State Corporation Commission (SCC) in implementing Chapter 23 (§ 56-576 et seq.) of Title 56, receiving such reports as the Commission may be required to make pursuant thereto, including reviews, analyses, and impact on consumers of electric utility regulation in other states;
2. Examine generation, transmission and distribution systems reliability concerns;
3. Establish one or more subcommittees, composed of its membership, persons with expertise in the matters under consideration by the Commission, or both, to meet at the direction of the chairman of the Commission, for any purpose within the scope of the duties prescribed to the Commission by this section, provided that such persons who are not members of the Commission shall serve without compensation but shall be entitled to be reimbursed from funds appropriated or otherwise available to the Commission for reasonable and necessary expenses incurred in the performance of their duties; and
4. Report annually to the General Assembly and the Governor with such recommendations as may be appropriate for legislative and administrative consideration in order to maintain reliable service in the Commonwealth while preserving the Commonwealth's position as a low-cost electricity market.

Senator Thomas K. Norment, Jr., chairs the Commission and Delegate Jackson H. Miller serves as its vice-chair.

By letters dated March 10, 2015, and May 6, 2015, Susan Clarke Schaar, Clerk of the Senate, advised the chair that the subject matter contained in two items of legislation from the 2015 Session - Senate Bill 1396 and Senate Joint Resolution 300 - had been referred by a standing committee of the General Assembly to the Commission and requested that the chair of the referring committee and the patron of the measure be provided a report thereon by November 1, 2015.

Both Senate Bill 1396 and Senate Joint Resolution 300 involve issues relating to the regulation of municipal electric utilities in the Commonwealth. This report, which is provided by the Commission pursuant to Ms. Schaar's requests, addresses both items of legislation because the issues they raise are integrally related.

## **II. Legislative Proposals**

### **A. Senate Bill 1396**

Senator William M. Stanley introduced Senate Bill 1396 by request. The bill was referred to the Committee on Local Government, which on January 27, 2015, voted unanimously to pass the bill by with a letter.

The bill comprises two enactments. The first enactment consists of "Section 1 bill," or uncodified measure, stating:

That, notwithstanding any other provision of law, general or special, the city council for the City of Danville and the city council for the City of Martinsville may exercise the authority granted pursuant to this section. The city may, by ordinance adopted by an affirmative vote of two-thirds of all of its members, (i) abolish all or part of its utilities or (ii) sell all or part of its utilities, including all of its related assets, or transfer the functions thereof, to an investor-owned utility, a merchant utility service provider, or a cooperative regulated by the State Corporation Commission if it is found to be in the public interest.

The second enactment of Senate Bill 1396 directs that a study be conducted as follows:

That, due to the growing disruptions in the electric utility markets and their impact on consumers and localities, the Commission on Electric Utility Regulation, the State Corporation Commission, and the Attorney General of the Commonwealth of Virginia shall report to the House and Senate Committees on Commerce and Labor by November 22, 2015, on tax practices, return on investment practices, purchase power practices, regional congestion pricing practices, and general municipal utility efficiencies that have led to higher costs for some municipal electric utility and natural gas consumers compared with average statewide consumers.

### **B. Senate Joint Resolution 300**

Senator Stanley was also the patron of Senate Joint Resolution 300, which he introduced upon receiving unanimous consent of the Senate on January 20, 2015. Unanimous consent was required because the deadline for introducing legislation creating a study was January 14, 2015. The resolution was referred to the Committee on Rules, which passed the bill by with letter, by voice vote, on January 27, 2015. The resolution had been reviewed by the Manufacturing Development Commission at its meeting on January 13, 2015.

Senate Joint Resolution 300 recites that the SCC has not expressly been provided the authority to regulate the rates, charges, and services of electric utilities operated by municipal corporations. It further recites that the issue of whether the General Assembly is authorized under the Constitution of Virginia to direct the SCC to regulate the rates, charges, and services of electric utilities operated by municipal corporations has not been resolved.

The resolution directs the Commission to study whether the SCC should have the authority to regulate the rates of municipal electric utilities. The resolution directs the Commission in conducting the study to determine whether SCC regulation or review of such rates would be

permitted under the Constitution of Virginia; if so, whether the General Assembly should direct the SCC to regulate such rates; and if not, whether the Constitution of Virginia should be amended to permit SCC regulation of such rates.

### **III. Work of the Commission**

The Commission received a briefing from staff and testimony from Senator Stanley and other interested parties on SB 1396 and SJR 300 at its meeting on July 13, 2015. Persons speaking in favor of the legislation included, in addition to Senator Stanley, Brett A. Vassey of the Virginia Manufacturers Association, Connie Nyholm of Virginia International Raceway, and Donnie Stevens of DVF Foods. Persons speaking against the legislation included Thomas A. Dick of the Municipal Electrical Power Association of Virginia (MEPAV); Roger C. Wiley, Esq., representing MEPAV; Brian O'Dell, General Manager, Harrisonburg Electric Commission; and W. Scott Johnson, Esq., representing American Municipal Power (AMP). C. Meade Browder Jr., Senior Assistant Attorney General, also addressed the Commission with regard to constitutional issues. Information regarding testimony and materials provided may be accessed through the Commission's website at <http://dls.virginia.gov/commissions/eur.htm?x=mtg>.

### **IV. Overview of Virginia's Municipal Electric Utilities**

Virginia is served by three categories of electric utilities. The three investor-owned electric utilities - Dominion Virginia Power, Appalachian Power Company, and Old Dominion Power (a subsidiary of Kentucky Utilities) - serve 78.4 percent of Virginia's population. Virginia's electric distribution cooperatives, of which there are approximately a dozen, serve 17.1 percent of the population. The 16 municipal electric utilities in Virginia serve 4.5 percent of the Commonwealth's population. The term "municipal electric utilities" is technically a misnomer. As used in this report, the term includes publicly-owned utilities that are not operated by a city or town. Of the 16 publicly-owned electric utilities, 14 are operated by localities, one is operated by a state agency (Virginia Tech), and one is operated by an authority (BVU Authority).

Virginia's municipal electric utilities serve approximately 163,200 residential customers. These utilities are ranked by number of residential customers, per the Office of the Attorney General's July 2014 rate survey, in the following table:

<u>Operator</u>	<u>Residential Customers</u>
Danville	46,000
Harrisonburg	20,100
Bristol (BVU)	16,400
Manassas	15,300
Salem	13,400
Martinsville	7,900

Radford	7,300
Front Royal	7,300
Bedford	6,500
Virginia Tech	6,300
Franklin	5,600
Culpeper	4,900
Richlands	2,600
Blackstone	2,000
Elkton	1,100
Wakefield	500

Virginia's investor-owned electric utilities and electric distribution cooperatives are subject to regulation by the SCC. The SCC has no role in regulating the rates and service of the municipal electric utilities.

The municipal electric utilities typically generate less than five percent of the power they provide to customers, and buy their power at wholesale from one of a handful of sources. Five municipals (Danville, Martinsville, Bedford, Front Royal, and Richlands) purchase power as members of AMP. AMP is a membership-based nonprofit wholesale power supplier and services provider based in Ohio. Its members, which comprises over 100 municipal electric systems in eight states, purchase shares in generation projects undertaken by AMP.

Of the other municipal electric utilities, seven (Blackstone, Culpeper, Elkton, Franklin, Harrisonburg, Manassas, and Wakefield) purchase power from Dominion; three (Radford, Salem, and Virginia Tech) purchase power from APCO; and one (Bristol-based BVU Authority) obtains power from the Tennessee Valley Authority. Wholesale purchases of electricity by municipal electric utilities are subject to regulation by the Federal Energy Regulatory Commission (FERC). FERC has exclusive jurisdiction over the "sale of electric energy at wholesale in interstate commerce" under provisions of the Federal Power Act. 16 U.S.C. § 824(b).

In an article published in 1980 by the University of Virginia's Institute of Government, Michael F. Digby, Professor in the Department of Political Science and Public Administration at Georgia College, traced the development of municipal electric systems from their origin in the late nineteenth century for the provision of streetlighting. For example, Danville began providing electric services in 1886. As the value of electricity for other uses became apparent, many cities extended their services to private customers. In most areas with municipal electric systems, private suppliers were unavailable. When private suppliers became available, many of the municipal electric systems were shut down or sold. Those that have remained in operation have done so for practical reasons that include low-cost hydroelectric plants and the existence of well-run and firmly-established public utility departments. Municipal Electric Utility Systems in Virginia, University of Virginia News Letter (vol. 57, no. 4 at 13).

At the time of its publication in 1980, Professor Digby observed that interviews with local officials involved in the administration of publicly owned utilities in Virginia revealed that

ratemaking criteria are seldom set out explicitly by the local governing body or electric commission. He observed that the retail rates for most of Virginia's municipal electric systems are set to equal, or be slightly under, the rates of the private firms from which the electricity is purchased. Professor Digby concludes that his analysis shows that "citizens of cities with public power benefit from lower electricity rates and often from lower property tax rates" and "the net incomes of the municipal electric systems can provide a major contribution to the city treasuries." He concludes that his analysis leads to a "mixed evaluation of the relative merits of public ownership" due to the falling generating capacity of public systems and the decline of net income from electricity systems as a potential revenue source. *Id.* at 16.

## **V. Rates**

Advocates of SB 1366 and SJR 300 advised the Commission that their support of the legislation was based in substantial part on concerns that the rates charged by municipal electric utilities were not competitive with the rates of other types of Virginia utilities. Staff compiled tables ranking the commercial and industrial rates of Virginia's investor-owned, distribution cooperative, and municipal electric utilities as of January 1, 2015. These tables, and the Office of the Attorney General's table with rates of residential customers of the utilities as of July 1, 2014, are on the Commission's website at <http://dls.virginia.gov/commissions/eur.htm?x=mtg>.

The table for residential customers shows the amount of a bill based on a hypothetical customer with monthly usage of 1,000 kWh. Of the 10 most expensive utilities, 8 are distribution cooperatives and 2 (Culpeper and Danville) are municipal utilities. Of the 10 least expensive utilities, 8 are municipal utilities, one is a distribution cooperative, and one (KU) is an investor-owned utility.

For a hypothetical customer in the commercial class with 40 kW demand and consumption of 10,000 kWh, five of the 10 most expensive utilities are distribution cooperatives, and five (Culpeper, Wakefield, Danville, Radford, and Elkton) are municipal utilities. Of the 10 least expensive utilities, four are distribution cooperatives, three are municipal utilities (Harrisonburg, Front Royal, and Richlands), and three are investor-owned-utilities.

Tables were prepared for industrial customers at two usage levels. For the first, with a hypothetical customer in the industrial class with 1,000 kW demand and consumption of 400,000 kWh, seven of the 10 most expensive utilities are distribution cooperatives and three (Danville, Radford, and Bristol) are municipal electric utilities. Of the 10 least expensive utilities, five are municipal electric utilities, two are distribution cooperatives, and three are investor-owned utilities. The second level of industrial usage was for a larger hypothetical customer with the same demand (1,000 kW) but with consumption of 650,000 kWh. Of the 10 most expensive utilities, the distribution is the same as with the smaller industrial users: seven are distribution cooperatives and three (Danville, Radford, and Bristol) are municipal utilities. Of the 10 least expensive utilities, six are municipal utilities, one is a distribution cooperative, and three are investor-owned utilities. Seven of the 16 municipals did not have industrial customers in either of these two levels of usage.

The Code of Virginia does not establish standards to be followed by local governing bodies in setting the rates of their municipal electric utilities. Subsection A of Code § 15.2-2109

authorizes any locality to "(i) acquire or otherwise obtain control of or (ii) establish, maintain, operate, extend and enlarge: . . . electric plants . . . and other public utilities within or outside the limits of the locality."

In an opinion regarding water and sewer connections, the Attorney General stated that where there are no standards provided to determine the charges that may be assessed by a municipal utility (in this case for water and sewer connections), "an implicit general requirement of reasonableness which is present in all such provisions of law" will govern. 1975-1976 Op Atty Gen Va 423 (1976).

Though it does not deal with rates for electric service, the Attorney General has further opined in an analogous situation relating to the standard of reasonableness in computing the charges in a contract for fire protection:

It is my view that the charge imposed under § 27-2.1 should bear a reasonable relationship to the actual cost of the service rendered. A charge bearing absolutely no relationship to the actual cost incurred would be an absurdity. It is well settled that such a statutory construction is to be avoided. . . . Although the statute vests sole discretion in the locality, it neither expressly nor impliedly grants the locality the right to charge a rate unreasonably disproportionate to the services to be performed or the cost incurred. 1981-1982 Op Atty Gen Va 68 (1981).

The Code of Virginia provides more detail regarding standards for rates for municipal water and sewer utilities. Code § 15.2-2143 requires fees for water utility service to be fair and reasonable. Code § 15.2-2119 requires fees for sewer utility service to be practicable, equitable, and uniform.

The ratemaking procedures and standards utilized by the municipal utilities include conducting cost of service studies, which is used in allocating costs to various classes of customers. Utility budgets usually involve transfers or payments in lieu of taxes to the local government's general fund, which effectively reduces the locality's property and machinery and tools taxes. The utility's budget is debated and acted upon, after public notice and public hearings, as part of the locality's local budgeting process.

Danville's city charter addresses ratemaking requirements at § 2-19, as follows:

A. The council shall have the power to establish, impose and enforce water, gas, electric and sewerage rates and rates and charges for public utilities or other services, products or conveniences operated, rendered or furnished by the city and to assess or cause to be assessed, water, gas, electric and sewerage rates and charges against the proper tenant or tenants of such persons, firms or corporations as may be legally liable therefor. The council may, by ordinance, require a deposit of such reasonable amount as it may prescribe before furnishing any of such services to any person, firm or corporation. The city may refuse to restore any such services to any person, firm or corporation, after the same have been disconnected for any reason, unless and until such person, firm or corporation has fully paid to the city any unpaid amount or amounts owing to the city by such person, firm or corporation for past utility services.

B. The provisions of this section shall apply to utility or other services rendered outside the boundaries of the city, as well as to those rendered within the city.

Martinsville's charter, at § 2 (13), empowers the city:

To own, operate and maintain electric light and/or gas works, either within or without the corporate limits of the said City for the generating of electricity and/or the supplying of gas for illuminating, power and other purposes, and to supply the same whether said gas and/or electricity be generated or purchased by said City to its customers and consumers both at such price and upon such terms as it may prescribe, and to that end it may contract with owners of land and water power for the use thereof, or may have the same condemned, and to purchase such electricity and/or gas from the owners thereof, and to furnish the same to its customers and consumers, both within and without the corporate limits of the said City at such price and on such terms as it may prescribe.

Recognizing that its electric rates have increased to levels above those of surrounding utilities, Danville conducted an assessment of its electric services and released a report in January 2015 detailing the reasons for its decision not to sell its electric utility. Though selling its utility would have produced near-term rate reductions for some customers, selling the utility was found not to be financially feasible for two reasons. First, the sales proceeds, net of the costs of retiring outstanding debt, fulfilling contractual commitments, and selling power already purchased, would not be adequate to keep the city financially whole and would result in the loss of \$11 million in annual general fund transfers and administrative fees. Second, it is unlikely that the city could unwind substantial commitments associated with several AMP generation projects. Danville participates in \$510 million of AMP power generation projects. Each project is covered by a power sales contract, or shared generation arrangement, that commits the city to take a specific electric power outlet at a price that covers debt service and operating costs and to pay transmission and congestion charges to deliver the power to its distribution system. Danville's report identified options short of selling its utility to address concerns with its rates, including adjusting service boundaries, opening the system to other power providers, modifying rate structures, and installing generation facilities in its service territory.

## **VI. Concerns with Proposed Legislation**

### **A. Concerns with the First Enactment of Senate Bill 1396**

The first enactment of SB 1396 would authorize the city of council of either of two localities (the Cities of Danville and Martinsville) by vote of two-thirds of all of its members to "(i) abolish all or part of its utilities or (ii) sell all or part of its utilities, including all of its related assets, or transfer the functions thereof, to an investor-owned utility, a merchant utility service provider, or a cooperative regulated by the [SCC] if it is found to be in the public interest."

The first enactment raises several issues, including:

#### **1. Constitutional Requirement for Three-Fourths Vote**

Article VII, Section 9 of the Constitution of Virginia provides that no rights of a city or town in or to its "electric works shall be sold except by an ordinance or resolution passed by a recorded affirmative vote of three fourths of all members elected to the governing body."

By requiring only a two-thirds vote of its members, SB 1396 appears to be constitutionally infirm on its face. It was suggested that the three-fourths requirements would apply only to a

sale of all of a municipality's electric works and that SB 1396 provides flexibility by allowing each of these cities to abolish its utility, or transfer less than all of its assets, upon a vote of two-thirds of its members. Regardless of whether such a distinction between a sale of all or part of a municipal electric utility would pass muster under Article VII, Section 9 of the Constitution of Virginia, if the bill is intended to require only a vote of two-thirds of the council's members for partial dispositions yet maintain the constitutionally-required three-fourths vote for a sale of all its electric works, such a reading is not apparent from the bill as drafted.

## 2. Special Legislation

By limiting its scope to two cities, Senate Bill 1396 is special legislation. Per Article VII, Section 1 of the Constitution of Virginia, passage of a special act (defined as a law applicable to a county, city, town, or regional government) requires an affirmative vote of two-thirds of the members elected to each house of the General Assembly.

## 3. Martinsville's Referendum Requirement

The Martinsville city charter requires approval by referendum of any proposed disposition of utility assets. Section 2 (16) of the charter provides in part:

Any public utility owned or operated by the City of Martinsville, whether it be water, gas, electric plant or otherwise shall not be sold until the same shall have been first submitted to the qualified voters of the City at a general or special election and shall have been approved by two-thirds of such voters voting on the question of such sale, which two-thirds shall include the majority of qualified registered voters owning real estate in said City and voting in such election on such sale.

The interplay of the Martinsville city charter and proposed SB 1396 is unclear. Code § 15.2-100, captioned "Charter powers not affected by title," states:

Except when otherwise expressly provided by the words, "Notwithstanding any contrary provision of law, general or special," or words of similar import, the provisions of this title shall not repeal, amend, impair or affect any power, right or privilege conferred on counties, cities and towns by charter.

While this section of the Code may be determinative if SB 1396 was enacted as a codified law, it is not. Though SB 1396 includes the required statement "notwithstanding any other provision of law, general or special," it is not drafted for placement in Title 15.2. Consequently, the portion of Code § 15.2-100 that establishes the condition under which provisions of Title 15.2 may repeal or amend a provision of a charter appears on its face not to be applicable.

## 4. Approval Required for Expansion of Utility's Service Territory

The first enactment of SB 1396 authorizes the two named municipalities (Danville and Martinsville) to take either of two alternative actions. The first clause authorizes a city to "abolish all or part of its utilities." The second clause authorizes a city to sell all or part of its utility or transfer its functions to certain entities. If a city were to exercise the first option of abolishing its utility, it is not clear how the existing customers of the city's electric utility would obtain service. Were a city to exercise this option, an investor-owned utility or a distribution cooperative may wish to add the area that had been served by the former municipal utility to its service territory. However, such an amendment to the service territory of the investor-owned utility or a distribution cooperative would appear to require an amendment to its existing

certificated service territory. Such an amendment would appear to require the approval of the SCC under the Utility Facilities Act, Chapter 10.1 (§ 56-265.1 et seq.) of Title 56 of the Code of Virginia. The application of the chapter to municipal utilities is cast in doubt, however, because the definition of a "company" in Code § 56-265.1 excludes municipal corporations

Subdivision A 2 of Code § 56-265.2 provides that it shall be unlawful for any public utility to acquire any facilities for use in public utility service, except ordinary extensions or improvements in the ordinary course of business, without first having obtained a certificate from the SCC that the public convenience and necessity require the exercise of such right or privilege.

Subsection B of Code § 56-65-265.3 in the Utility Facilities Act may require SCC approval before an investor-owned utility or distribution cooperative could start serving the former customers of Danville's or Martinsville's municipal electric utility. This provision states:

On initial application by any company, the [SCC], after formal or informal hearing upon such notice to the public as the [SCC] may prescribe, may, by issuance of a certificate of convenience and necessity, allot territory for development of public utility service by the applicant if the [SCC] finds such action in the public interest.

An area of potential inquiry is whether the standards used by the SCC in determining whether to approve a request in such an instance is in the public interest are appropriate when the territory to be allotted consists of an area that had been served by a municipal utility that has been abolished. For example, an issue in such proceedings may be whether the contractual obligations entered into by the city, such as long-term power purchase agreements, survive the abolition of the municipal utility, and if so whether the municipality's liabilities thereunder would be assumed by the expanding utility and become obligations for which all of its customers, including current customers not served by the municipal utility, would be liable.

##### 5. Approval Required for Acquisition of a Utility

The second clause of the first enactment of SB 1396, which authorizes Danville and Martinsville to sell all or part of its electric utility (or transfer its functions) to certain entities, raises another set of questions in addition to the issues relating to the application of provisions of the Utility Facilities Act discussed previously.

As a general rule, the Utility Transfer Act, Chapter 5 (§ 56-88 et seq.) of Title 56 of the Code of Virginia, provides that the acquisition or disposition of control of a public utility requires SCC approval. The application of the Utility Transfer Act's provisions to transfers involving municipal utilities is limited. Code § 56-88 excludes municipal corporations from the scope of the definition of a company subject to the chapter. Code § 56-88.1, which prohibits a person from acquiring or disposing of control of a public utility without SCC approval, does not apply to any company engaged in the business of generating electricity whose rates and services are not regulated by the SCC.

Moreover, Code § 56-89 provides that if authorized by the SCC, a public utility may acquire or dispose of utility assets situated within the Commonwealth, but "no such authorization by the [SCC] shall confer upon any county or municipality authority, other than that otherwise conferred by law, to acquire or to dispose of any utility assets or utility securities."

The standard for SCC approval of a utility that may seek to acquire the assets of another utility is set out in Code § 56-90. The section provides that the SCC may approve an acquisition if it is "satisfied that adequate service to the public at just and reasonable rates will not be impaired or

jeopardized" by granting the request. The provision is expressly subject "to the exception contained in § 56-89 as to counties and municipalities."

Members of the SCC staff have advised that they are not aware of a case where a municipal electric utility has opted to sell itself to another entity, and have stated that they are not certain how the SCC would address a situation contemplated by SB 1396. The Utility Transfer Act's exclusions for municipalities appear to foreclose the ability of a city to petition for approval of a sale or transfer.

Assuming the acquiring entity was a public utility, it apparently would be required to obtain SCC approval under Code §§ 56-89 and 56-90, but it is not clear what would happen to a municipality's ability to sell or transfer its utility if the SCC did not find that the proposed sale or transfer satisfied the standard enunciated in Code § 56-90 regarding the provision of adequate service to the public at just and reasonable rates.

One question that bears upon the potential implications of a sale of a municipal electric utility is its effect on power purchase contracts and other contractual obligations. The City of Danville has concluded that a sale of its electric utility is not financially feasible in part as a result of its likely inability to unwind substantial commitments associated with several AMP generation projects. The city has concluded that it would remain financially liable for any generation project shares that are not purchased by other members of AMP.

#### 6. Scope of Requirement That Acquiring Entity Be Subject to SCC Regulation

The second clause in the first enactment of SB 1396 is complicated by the provision that a city may sell all or part of its utilities, or transfer the functions thereof, "to an investor-owned utility, a merchant utility service provider, or a cooperative regulated by the State Corporation Commission."

It is not clear whether the conditional phrase "regulated by the State Corporation Commission" modifies only "cooperative," or whether it is intended to also modify investor-owned utilities and merchant utility service providers. If the intent is the former, the clause would on its face allow the sale to investor-owned utilities that are not regulated by the SCC. This interpretation may allow a sale to a utility based in an adjacent state. Such a reading of the clause may not be far-fetched, as Duke's service territory is adjacent to areas served by Danville's municipal electric utility.

Moreover, the SCC does not regulate any "merchant utility service provider." This term is not used in the Code of Virginia, and it is not clear to whom it refers. Under Chapter 23 (§ 56-576 et seq.) of Title 56 of the Code of Virginia, a procedure is established for the licensing of retail electric energy suppliers. Under Code § 56-587, any person (other than a default service provider) providing retail electric energy supplies or other competitive services is required to obtain a license from the SCC. And while licensed retail electric energy suppliers are required to demonstrate financial responsibility, post a bond, and satisfy other conditions as a condition for doing business, they are not regulated by the SCC as public utilities.

#### 7. Application of Requirement That Disposition Be in the Public Interest

Both the first and second clauses of the first enactment of SB 1396 are subject to the condition that a city may abolish, sell, or transfer its utility "if it is found to be in the public interest." This condition may be intended to require that the city council of Danville or Martinsville make a finding that the sale or other action is in the public interest. Alternatively, the condition may be

intended to require the SCC to find that such action is in the public interest, as the "public interest" standard is cited more than 30 times in Title 56 of the Code of Virginia. If the latter is the intended result, it is unclear whether the SCC's determination as to whether an action is in the public interest would be made prior to or after the city council's vote to approve a proposed abolition, sale, or transfer.

#### 8. Lack of Statutory Procedure for Effecting Disposition or Acquisition of Municipal Utilities

The Code of Virginia provides limited guidance as to how such a disposition of a municipality's own utility would be effected. Under subsection A of Code § 15.2-2109, a municipality has the right to establish or acquire an electric system to serve customers or the residents and businesses within the municipal corporate limits. Subsection B of Code § 15.2-2109 authorizes a locality to take over facilities of an existing utility only if authorized by a majority of voters in a referendum. However, no such vote is needed if the existing utility consents to the acquisition, if the acquiring municipality provided electric service as of January 1, 1994, or with respect to the use of energy generated from landfill gas in the City of Lynchburg or Fairfax County. Under Code § 25.1-102, the exercise of the power of eminent domain in takeovers of corporations with the power of eminent domain are subject to SCC approval on the basis of public necessity or essential public convenience.

#### **B. Concerns with the Second Enactment of Senate Bill 1396**

The second enactment of SB 1396 states that "due to the growing disruptions in the electric utility markets and their impact on consumers and localities," the Commission, the SCC, and the Attorney General shall report "on tax practices, return on investment practices, purchase power practices, regional congestion pricing practices, and general municipal utility efficiencies that have led to higher costs for some municipal electric utility and natural gas consumers compared with average statewide consumers." This enactment also raises several questions.

##### 1. Are the Agencies to Examine Disruptions in Electric Utility Markets?

The bases for the conclusory statements that disruptions in the electric utility markets are growing and that these unidentified disruptions are affecting consumers and localities are not provided. Absent such information, it is not clear whether the request that the Commission report on the subject matter contained in SB 1396 encompasses a request that the frequency of such disruptions be identified and their impacts on consumers and localities be quantified.

##### 2. Are the Agencies to Examine Only Topics That Have Led to Higher Costs?

At its essence, the second enactment directs three entities (the Commission, the SCC, and the Attorney General) to report on five topics "that have led to higher costs for some municipal electric utility and natural gas consumers compared with average statewide consumers." It is not clear whether the directive to these three agencies applies only to those of the five topics that are found to have led to such higher costs, and thus excuses the three agencies from reporting on any of these five topics that are not found to be a source of higher costs. While the second enactment does not specifically direct the three agencies to track the costs paid by "some municipal electric utility and natural gas consumers" compared with average statewide consumers over some period of time, without such data it would not be possible to know which of the topics, if any, is

responsible for increased costs. Moreover, even if such data was available, it is not apparent how the three agencies would be expected to address the statement that some or all of these five topics have led to higher costs for some municipal electric utility and natural gas consumers. It is not clear how the agencies would determine the costs paid by all municipal electric utility and natural gas consumers and focus only on those whose costs are higher than the costs paid by average statewide consumers. Apparently, the agencies would be required to ignore instances where municipal customers' costs are lower than those of average statewide consumers. Finally, it is not clear how the agencies would determine what the costs are for "average statewide consumers." For example, would the statewide average include customers of municipal utilities? Would the costs be based on rates or on actual billing amounts that reflect amounts of consumption? Would the average customer be based on the mean or median of the relevant population?

### 3. Are the Agencies to Study Issues Relating to Municipal Natural Gas Utilities?

The second enactment references higher costs for municipal electric utility and natural gas consumers. By asking for reports that address issues relating to the costs paid by customers of municipal natural gas utilities, the scope of the study has expanded exponentially. As noted at the outset of this report, the Commission's powers and duties relate only to electric utilities, and the Commission does not have knowledge or experience regarding natural gas utilities. Moreover, it is not clear how certain of the five items listed in the second enactment, specifically "regional congestion pricing practices," relate to municipal natural gas utilities. Congestion pricing typically involves increased electric energy costs due to redispatch during hours when the regional transmission organization's transmission system is constrained. Within the PJM Interconnection area, these increased costs are assessed to market participants on the basis of the congestion price component of PJM's locational market price.

### 4. How Is an Agency to Determine Which Topics to Study?

The second enactment directs three agencies (the Commission, the SCC, and the Attorney General) to report on five topics that have led to higher costs. Assuming that the five topics have led to higher costs and therefore are within the scope of the required reports, it is not clear which of the three agencies is required to report on which of the five topics. If the intent is to have all three agencies report on all five topics, the result would be an intractable amount of duplication and inefficiency. Further, it must be apparent that the Commission, as a legislative body without any full-time dedicated staff, lacks a fraction of the resources that are available to the SCC or the Office of the Attorney General in conducting the research and analysis that reporting on these five topics would entail.

### 5. Are the Agencies the Appropriate Entities to Study the Topics?

It is not apparent that any of the three agencies is the appropriate entity to report on some of the five topics. For example, with regard to the first topic (tax practices), the Department of Taxation would be better able to conduct a study of the issue. With regard to the fifth topic (general municipal utility efficiencies), it is not clear that any state agency has access to the records and other data relating to the administration and operational activities of municipal utilities that would be required to assess their "general efficiencies," even if the term was defined.

### 6. Is the Deadline for Completing the Requested Study Unreasonable?

Finally, the letter from the Clerk of the Senate requests that a report on SB 1396 be completed by November 1, 2015. Given the lack of resources available to the Commission, the massive complexity of the issues involved, and the lack of clarity regarding the scope of the endeavor that results from the inartful drafting of SB 1396, the Commission regrets that complying with the request is beyond the realm of the possible.

### **C. Concerns with Senate Joint Resolution 300**

Senate Joint Resolution 300 directs the Commission to study whether the SCC should have the authority to regulate the rates of municipal electric utilities. In conducting its study, the Commission is directed to determine whether SCC regulation or review of the rates charged by municipal electric utilities would be permitted under the Constitution of Virginia; if so, whether the General Assembly should direct the SCC to regulate such rates; and if not, whether the Constitution of Virginia should be amended to so permit.

#### 1. Constitutional Authority of General Assembly to Require SCC Regulation of Municipal Electric Utilities

Article IX, Section 2 of the Constitution of Virginia provides that "[s]ubject to such criteria and other requirements as may be prescribed by law, the [SCC] shall have the power and be charged with the duty of regulating the rates, charges, and services . . . of railroad, telephone, gas, and electric companies. This section further provides that "[t]he Commission shall have such other powers and duties not inconsistent with this Constitution as may be prescribed by law."

Article IX, Section 7 of the Constitution of Virginia states that the term "corporation" or "company" as used in Article IX "shall exclude all municipal corporations, other political subdivisions, and public institutions owned or controlled by the Commonwealth."

Read together, these two sections do not expressly grant to the SCC the authority to regulate the rates, charges, and services of electric utilities operated by municipal corporations. They do not answer the related questions of whether the General Assembly could enact general laws giving the SCC the power to regulate the rates of municipal electric utilities.

This issue was addressed in an Opinion of the Attorney General issued to Senator Frank Wagner on July 2, 2015. Senator Wagner had asked whether the General Assembly may enact a general law requiring the SCC to regulate the rates, charges, and services of electric utilities operated by municipal corporations.

The Attorney General opined that the General Assembly does have such power, reasoning:

It is critical to observe that while Article IX fails to grant the SCC express authority to regulate municipal utilities, it does not bar the SCC from regulating them. Article IX also authorizes the General Assembly to expand the jurisdiction of the SCC: Article IX, § 2 states that "[t]he Commission shall have such other powers and duties not inconsistent with this Constitution as may be prescribed by law." This provision affirms the General Assembly's power to add to the SCC's authority. That is, the General Assembly has the power to enact laws that augment or supplement the SCC's jurisdiction provided that such laws do not contravene the SCC's fundamental power and duty to regulate the "rates,

charges, and services ... of railroad, telephone, gas, and electric companies." (citations omitted)

The Attorney General cited Article IV, Section 14 of the Constitution for the proposition that the Constitution of Virginia gives the General Assembly broad authority that "shall extend to all subjects of legislation not ... forbidden or restricted [by the Constitution]; and a specific grant of authority in [the] Constitution upon a subject shall not work a restriction of [the General Assembly's] authority upon the same or any other subject." Thus, he concludes, "the General Assembly has all powers except those prohibited by either the Virginia or United States Constitutions." Opinion to the Honorable Frank W. Wagner, \_\_ O.A.G. \_\_ (July 2, 2015) at 2.

In support of his conclusion that while the Constitution does not give the SCC jurisdiction over electric utilities operated by municipal corporations, the General Assembly retains the authority to enact a general law giving the SCC that jurisdiction, the Attorney General cites a 1975 opinion to Delegate James R. Tate. Delegate Tate had asked for an opinion on the constitutionality of legislation that would place the Fairfax County Water Authority and other such local authorities under the regulation of the SCC. The Attorney General opined that the legislature has the authority to confer upon the SCC jurisdiction over any subject matter not clearly and expressly limited by the Constitution, which jurisdiction could extend to local water authorities. In his view, Article IX, Section 7 of the State Constitution "is a clear and express limitation upon the constitutional grant of power of the Commission over municipal corporations, other political subdivisions, and public institutions owned or controlled by the Commonwealth, [but] it does not constitute a limitation on the power of the legislature." In his opinion:

[W]hen Sections 2 and 7 of Article IX are read together, the only reasonable interpretation of the Commission's authority is that the Commission shall not be charged with the duty of administering laws providing for the regulation and control of municipal corporations, other political subdivisions, and public institutions owned or controlled by the Commonwealth, except as may otherwise be provided by general laws consistent with the other requirements of the Constitution.

The effect of Section 7 is merely to establish that there is no constitutional grant of authority to the Commission over governmental entities. It does not constitute a prohibition against action by the General Assembly to confer such jurisdiction upon the Commission. Although the Constitution is clear on this issue, and consequently there is no need to resort to legislative history, this conclusion is consistent with the constitutional debates. Proceedings and Debates of the House of Delegates pertaining to Amendment of the Constitution, Extra Session 1969, Regular Session 1970, at 709-716.

The Attorney General notes that the General Assembly has already conferred a limited jurisdiction upon the Commission with respect to authorities created under the Virginia Water and Sewer Authorities Act [ §§ 15.1-1239 through 15.1-1270, Code of Virginia (1950), as amended]. 1974-75 Op. Att'y Gen. Va. 421, 423 (January 8, 1975).

The Attorney General's opinion to Senator Wagner also cites Lewis Trucking Corp. v. Commonwealth, 207 Va. 23 (1966), for the proposition that the Virginia Supreme Court has recognized that the General Assembly has authority to confer powers to the SCC that are not explicitly provided by the Constitution of Virginia. That case involved a challenge that Section 156 of the Constitution of 1902 did not empower the Commission to enter a judgment for any tax that "appears" to be owing the Commonwealth. The Court held that Section 156 "is not inclusive

of all the powers and duties of the Commission; it does not prohibit or limit the power of the legislature to impose additional duties on the Commission in the performance of its duties." 207 Va. at 29.

In addition to being consistent with a previous opinion, the Attorney General's interpretation of the General Assembly's power is consistent with the view of Professor A. E. Dick Howard in his Commentaries on the Constitution of Virginia (Univ. of Va. Press 1974). Professor Howard observed that the 1902 Constitution "did not preclude the General Assembly from placing aspects of municipal corporations, such as their operation of gas or water utilities, under SCC regulation; it simply meant that, unless the Assembly acted, such corporations would not, by virtue of the Constitution itself, fall under SCC dominion." Commentaries at 1002. Professor Howard then noted that the Commission on Constitutional Revision "proposed to retain the principal obliquely stated in the 1902 Constitution but to frame the rule in more straightforward language":

Municipal Corporations or other political subdivisions of the Commonwealth shall not be subject to the jurisdiction of the State Corporation Commission except as may be prescribed by law. Id.

In recounting the history of Article IX, Section 7, Professor Howard observed how that House of Delegates and Senate deadlocked on the issue, with the House supporting exempting municipal corporations from SCC regulation of their rates, charges, and services within their territorial limits and the Senate supporting a version that would have extended the exemption to include areas outside their territorial limits and to include regulation of rates, charges, services, and facilities provided by contract between political subdivisions. Both versions, in Professor Howard's judgment, would have created a vast no-man's land where the General Assembly would have been powerless to act to protect consumers or correct abuses in a number of areas, including tunnels and turnpikes operated by authorities. Id. at 102-1003.

In the end, the General Assembly returned to the approach taken by the Commission on Constitutional Revision but with language in Article IX, Section 7 that, as in the 1902 Constitution, excludes municipal corporations and other public institutions from the definition of a corporation or company. Per Professor Howard, "this definition simply precludes the excluded classes from automatically falling within SCC jurisdiction by operation of the Commonwealth itself" and "it lies with the Assembly to determine by statute whether aspects of the operations of municipal corporations . . . shall be regulated by the SCC or by any other body." Id. at 1003-1004.

Richmond attorney Roger C. Wiley, appearing at the Commission's July 13 meeting on behalf of MEPAV, characterized the constitutionality of any effort to have the SCC regulate municipal electric utilities as "dubious." Since the ratification of the 1902 Constitution, which included provisions essentially the same as Article XI, Sections 2 and 7, local governments have always read the sections together to mean that the SCC has no constitutional jurisdiction or authority over municipal or county utility systems or those operated by water and sewer authorities or other local or state governmental entities. In support of his conclusion that over that same period the General Assembly has agreed with that reading of the sections, Mr. Wiley cited the enactment of legislation that repeats the exclusory constitutional language of Article IX, Section 7 in the statutory definition of a corporation in Code § 56-1.

Mr. Wiley respectfully disagrees with the July 2, 2015, opinion of the Attorney General to Senator Wagner. He suggests that the opinion glosses over the five words of limitation in the last sentence of Article IX, Section 2, which say that additional powers and duties and duties conferred on the SCC by general law must be "not inconsistent with this Constitution." According to Mr. Wiley:

The Attorney General offers no explanation why giving the SCC statutory authority over utilities operated by municipalities, other political subdivisions and state agencies would not be inconsistent with the exclusion of those entities in Article IX, Section 7. We believe legislation to do that would indeed be completely inconsistent, under the plain, unambiguous meaning of that term.

Mr. Wiley notes that neither the 2015 opinion nor the 1975 opinion referenced in it cites a court decision supporting its conclusion. He asserts that this is because there has never been any decision on the point and adds that "[t]he issue has never been litigated, because, since 1902, the General Assembly has never passed a bill giving the SCC authority over municipal utility rates." Regardless of the outcome of the debate over this issue, the Commission recognizes the novel nature of this argument that the legislature's failure to have adopted legislation addressing an issue should be construed as evidence that the General Assembly lacks the constitutional authority to do so.

In the view of Mr. Wiley, the drafters of the 1902 Constitution understood that it was not necessary to give the SCC similar authority over utilities owned by the public because the officials setting those rates have no duty to maximize profits to shareholders and are subject, directly or indirectly, to the political process. Mr. Wiley concluded that this policy "has served the Commonwealth well for over a century" and that "it would be a huge error to change that policy just because some businesses are unhappy with electric rates in one jurisdiction." Moreover, once the SCC's jurisdiction was extended to public electric utilities, "there would no longer be any logical reason not to extend it to other types of local-government operated utility systems, which number in the hundreds."

At the July 13, 2015, Commission meeting, Mr. Wiley noted that opinions of the Attorney General do not have the force of law and observed that the Commonwealth's courts have not issued a decision on this point. It should be noted that the Virginia Supreme Court has held that the legislature is presumed to have had knowledge of the Attorney General's interpretation of the statutes, and its failure to make corrective amendments evinces legislative acquiescence in the Attorney General's view. Browning-Ferris, Inc. v. Commonwealth, 225 Va. 157, 161-62, 300 S.E.2d 603, 605-06 (1983)

## 2. Whether the General Assembly Should Subject Municipal Electric Utilities to Regulation by the SCC

If it is assumed that the General Assembly has the authority to direct the SCC regulation or review of the rates charged by municipal electric utilities, SJR 300 asks the Commission to determine whether the General Assembly should direct the SCC to regulate such rates. The simplicity of this question masks its complexity. While it appears straightforward to consider whether SCC regulation of the rates of municipal electric utilities is appropriate public policy, an overview of some of the ways in which rates could be subject to SCC regulation reveals the dilemma. The following questions identify some of the ways in which the General Assembly could interject the SCC into regulating rates of municipal electric utilities:

a. Should directing the SCC to regulate the rates of municipal electric utilities be interpreted as requiring the SCC to supplant courts in reviewing ratemaking decisions made by local governments?

Currently, a locality's adoption of rates (including revenue allocation and rate design) is a legislative decision that subject to judicial review. One proposal might be to require that challenges to such decisions of a local government be heard by the SCC rather than by circuit courts. To the extent that the source of dissatisfaction with the regulation of municipal electric utilities involves who provides oversight (rather than, for example, the standard for review), giving the responsibility to the SCC may provide the advantages of expertise with utility accounting and other complex regulatory issues. It may also have the advantage of uniformity, as all such cases would be heard by in the same forum.

b. Should directing the SCC to regulate the rates of municipal electric utilities be interpreted as requiring the establishment of a new standard for appellate review of ratemaking decisions made by local governments?

The current standard for court review of ratemaking decisions made by local governments is deferential. The Virginia Supreme Court held in Town of Leesburg v. Giordano, 280 Va. 597 (2010), that if there is any evidence in the record sufficiently probative to make a fairly debatable issue of the municipality's decision, the municipality's decision would be upheld.

This case involved water and sewer rates set by the town, which had the exclusive right to provide water and sewer services to properties located in a certain area of the county that were outside the town. The town council increased the water and sewer consumption rates by adding a 100 percent surcharge on water rates charged to residents of the county who reside outside of the town. The complainants claimed that the water rates charged to out-of-town customers were unfair and unreasonable. The issue on appeal was whether any of the evidence was sufficiently probative to make a fairly debatable issue of the fairness and reasonableness of the water rate charged to out-of-town customers and the practicability, equitableness, and uniformity of the sewer rate charged to out-of-town customers. If the locality's action was fairly debatable, the court would defer to the town's decision.

The court found that an expert's testimony that the water rate charged to out-of-town customers was fair and reasonable, and that the sewer rate charged to out-of-town customers was practicable, equitable, and uniform, was supported by the expert's justifications for his opinion. The grounds given for the rate differential included statements that the town's customers bear "owner's risk" and that demand for the county customers was more variable, which resulted in greater cost to provide service. The court's majority found that this was evidence sufficient to make the issue fairly debatable.

In dissent, Justice Russell, joined by Justice Mims, asserted that legislative deference is inappropriate in a case like this where the customers receiving service in the county are not entitled to vote for the town officials that set the rates. More than 80 Virginia cities and towns, located in more than 50 counties, serve out-of-town customers and charge them higher rates than their own constituents.

Footnote 3 of the dissenting opinion focuses on the practice of collecting surcharges on out-of-town customers, observing:

The complainants concede that the Town is entitled to collect a surcharge in some amount to cover the Town's "owner's risk." Their expert witness calculated the amount of such an added charge, which the circuit court found fair and reasonable. The Town's expert, however, made no such calculation but contented himself with merely concluding that the Town's previously adopted "policy decision" to impose a 100% surcharge on out-of-town customers was reasonable. His only justification for that conclusion was that surcharges imposed by other jurisdictions are worse. He said that they ran as high as 200% in Virginia and 300% nationally. Pressed, he conceded that 500% might cross the boundary of reasonableness. That is the evidence the majority opinion found sufficient to meet the "fairly debatable" standard. 280 Va. at 610, n. 3.

The dissenting justices contend that the "fairly debatable" standard is appropriate when reviewing a legislative judgment made by the duly-elected representatives of the people. However, they contend that the rationale supporting the fairly debatable standard is nonexistent in the case of legislative acts affecting persons and territory outside the jurisdiction in which the legislative body has the authority to govern. In their view, "[a] town council's decision setting utility rates outside the town should be accorded no more deference than the decision of the board of directors of a private business operated for profit" and "[i]f the 'fairly debatable' standard is applied to such cases, the out-of-town customers are left to the mercies of an unregulated monopoly against which they have no redress either at the polls or in the courts." 280 Va. at 610.

If the current standard of deference to municipal decisions is to be retained if the SCC is tasked with reviewing the ratemaking decisions of a municipal electric utility, SCC review may not be expected to produce results that differ from the results produced under the current standard of review.

If the General Assembly finds that the current standard of review is inappropriate, it will then be required to address the question of what standard should be adopted in its stead. A broad range of options could be considered. For example, the reviewing entity, be it the SCC or circuit court, could be directed, among other options, to: (i) conduct a de novo review of the ratemaking decisions, (ii) uphold determinations if supported by substantial evidence, (iii) uphold determinations if they are supported by a preponderance of the evidence, or (iv) uphold determinations in the absence of an abuse of discretion.

Of course, if the General Assembly decides that it is appropriate to require the use of a less differential standard in cases involving the ratemaking decisions of municipal utilities, it could direct that courts apply such new standard, thereby achieving greater scrutiny without shifting the duty of conducting the reviews from courts to the SCC.

c. Should directing the SCC to regulate the rates of municipal electric utilities be interpreted as requiring the SCC to supplant local governments in making ratemaking decisions?

An exponentially greater shift from the status quo would be to require a local governing body (or Virginia Tech, an authority, a utility commission, or another entity charged with operating the public electric utility) to cede its ratemaking authority to the SCC. An initial question is whether giving SCC ratemaking authority would allow the locality to develop proposed rates and make the locality's decisions subject to review by the SCC upon petition filed in a rate case proceeding. Alternatively, giving the SCC ratemaking authority could be construed as requiring that

decisions relating to such matters as the utility's revenue requirement, revenue allocation, and rate design be made by the SCC rather than by the public body.

d. Should directing the SCC to regulate the rates of municipal electric utilities be interpreted as requiring the SCC to regulate other aspects of a utility's operations?

The regulation of public utilities involves decisions that extend beyond the rates that a utility may charge its customers. Among these matters are review of the adequacy and reliability of service and the reasonableness of operational decisions. A decision regarding whether the SCC should be tasked with regulating the rates of municipal utilities should address whether the SCC's authority should extend to these matters. The General Assembly would also be required to determine whether the SCC should have authority to review contracts and other decisions of a local governing body for reasonableness and to disallow recovery for costs found to be imprudent. Among the questions raised by this approach are whether the SCC would have the authority to decide whether a municipality should buy power on the wholesale market or build its own power generation facilities and what role, if any, the SCC would have in managerial decisions that pertain to the utility's functioning, such as the use of public facilities and personnel matters.

e. Should directing the SCC to regulate the rates of municipal electric utilities be interpreted as requiring the use of procedures and standards that are used in other SCC rate cases?

If the General Assembly wanted the SCC to regulate the rates charged by municipal electric utilities, it would need to establish applicable procedures and standards. In so doing, the General Assembly has a great deal of latitude, as a review of several provisions the Code of Virginia demonstrates.

Chapter 10 (§ 56-232 et seq.) of Title 56 of the Code of Virginia establishes the framework for the SCC's traditional ratemaking powers. Under Code § 56-235.2, rates of a public utility are required to be just and reasonable. Under traditional utility ratemaking, rates are set at levels, for various classes of customers, that are expected to provide the utility with the opportunity (not a guarantee) over a future period to collect sufficient payments to cover its revenue requirement. The revenue requirement includes the utility's reasonably-incurred costs (including operating expenses, depreciation, and taxes) and an adequate, but not excessive, rate of return on rate base, which is the value of the utility's capital investment in things like generating facilities and the distribution grid. Subdivision D 1 of Code § 56-249.6 requires that a utility's fuel costs and purchased power costs can be recovered if they are reasonable and were not the result of the utility's unreasonable failure to minimize such costs.

The potential application of this standard to municipal electric utilities raises several questions. Would the SCC be required to set a revenue requirement for the municipal utility? Would the SCC look at what is an adequate or excessive return on equity for a municipality's operations? Would the SCC have the authority to establish the utility's revenue allocation (which determines which portion of the revenue requirement will be collected from each consumer class) and rate design (which includes, among other factors, a determination of the extent to which sums are collected through fixed charges or usage-based charges)? If the SCC is charged with setting a municipal utility's revenue allocation, should it require municipalities to collect revenues from rate classes in proportion to the costs that they cause the utility to incur to serve them, taking into account rate design goals?

As an alternative to the traditional ratemaking regime for investor-owned utilities, the SCC could be directed to use some variant of a Times Interest Earning Ratio (TIER) method. The TIER method, under which the return component of the revenue requirement includes interest paid on long-term debt instruments plus a margin shown as a percentage of the interest amount, has been used with distribution cooperatives.

With the 2007 legislation re-regulating Virginia's major investor-owned electric utilities, the General Assembly jettisoned many elements of traditional ratemaking under Chapter 10 (§ 56-232 et seq.) of Title 56 and adopted a hybrid model as set out in the Electric Utility Regulation Act (Code § 56-576 et seq.). One model for ratemaking for municipal electric utilities would be to make them subject to the Electric Utility Regulation Act. It bears noting that subsection F of Code § 56-580 provides that municipal electric utilities are exempt from the Electric Utility Regulation Act unless the municipality elects to have this chapter apply to that utility or the utility, directly or indirectly, sells, offers to sell or seeks to sell electric energy to any retail customer eligible to purchase electric energy from any supplier in accordance with Code § 56-577 if that retail customer is outside the geographic area that was served by such municipality as of July 1, 1999, with certain exceptions. If a municipal electric utility is made subject to the provisions of such Act, then its provisions applicable to incumbent electric utilities shall also apply to any such utility, mutatis mutandis.

A provision within the Electric Utility Regulation Act provides another model for rate regulation. Distribution cooperatives are permitted pursuant to Code § 56-585.3 to self-regulate to a large degree. These cooperatives are permitted to increase rates five percent in a three-year period (not including fuel increases) without SCC approval.

Yet another model for SCC rate regulation established under the Code of Virginia is set out in the Highway Corporation Act of 1988, under which the General Assembly tasked the SCC with regulating the operator of the Dulles Greenway as a public service corporation. Code § 56-542 states:

The Commission also shall have the duty and authority to approve or revise the toll rates charged by the operator. Initial rates shall be approved if they appear reasonable to the user in relation to the benefit obtained, not likely to materially discourage use of the roadway and provide the operator no more than a reasonable rate of return as determined by the Commission. Thereafter, the Commission, upon application, complaint or its own initiative, and after investigation, may order substituted for any toll being charged by the operator, a toll which is set at a level which is reasonable to the user in relation to the benefit obtained and which will not materially discourage use of the roadway by the public and which will provide the operator no more than a reasonable return as determined by the Commission.

These examples illustrate the fact that there is not a single model that would automatically be applied should the General Assembly decide that the SCC should regulate the rates of municipal electric utilities. The selection of an appropriate existing model or the creation of a new system tailored specifically to municipal electric utilities would be a daunting task even for agencies with a full-time staff and unlimited time.

f. Should directing the SCC to regulate the rates of municipal electric utilities be based on actions in other states?

According to data provided by the American Public Power Association, as of June 2014 municipal electric rates were fully regulated by state commissions in five states (Maine, Maryland, Rhode Island, Vermont, and Wisconsin). In addition, Indiana's Utility Regulatory Commission has jurisdiction over the rates of municipal utilities unless the municipality, by ordinance or majority vote of citizens, removes itself from the Commission's jurisdiction. The state's utility commission has regulation over service offered outside of municipal limits in eight states (Colorado, Kansas, Mississippi, New Hampshire, New Jersey, Pennsylvania, South Carolina, and Wyoming), though in Kansas and Mississippi the jurisdiction is limited to service provided more than a certain distance from the municipal limits and in Colorado and New Hampshire the jurisdiction is limited to cases where rates charged to customers outside the municipal limits exceed rates charged to customers inside the municipal limits. Eight other states have rate regulation under specific conditions, such as when the municipality elects to be subject to state regulation (Alaska, Louisiana, and New Mexico) or customers petition the state commission to review, approve or modify rates on grounds of discrimination between customers or customer classes, or between customers inside and outside the municipality's boundaries (West Virginia). While actions by other states may provide examples of how state regulation may be implemented, an in-depth analysis of their actions would not be the optimal use of the limited resources of the Commission's staff at the present time.

## **VII. CONCLUSIONS**

Though it is not realistic to attempt to undertake the reports requested with regard to SB 1396 and SJR 300 by the November 1, 2015, deadline, the Commission offers the following observations with regard to the rates charged by certain municipal electric utilities:

- As a general rule, the residential rates charged by most municipal electric utilities are not consistently and materially higher than the rates charged by distribution cooperatives and investor-owned utilities. While the relatively fewer number of commercial and industrial customers of municipal electric utilities makes it more difficult to compare their rates for commercial and industrial electric service with those of Virginia distribution cooperatives and investor-owned utilities, the rates charged by some municipal electric utilities for certain classes of commercial and industrial customers tend to be marginally higher than the rates of Virginia investor-owned utilities and comparable to those of most distribution cooperatives. It bears noting that none of the municipal electric utilities charged rates for industrial service at the demand and consumption levels surveyed that exceeded the national average charged by investor-owned utilities.
- The costs of power provided by the Danville electric utility are at or near the top of the list of the most expensive municipal utilities in the Commonwealth. As noted by the reference to this city in SB 1396 and by the testimony provided at the Commission's meeting on July 13, 2015, Danville has been the focus of concerns about the rates changed by municipal utilities. However, it appears that Danville's situation has resulted in large part from its participation in several power generation projects as a member of AMP. Opponents to SB 1396 and SJR 300 have contended that the cost issues will ease

over time as new generation facilities are completed, and that the long-term prospects are for lower electricity costs for the city's customers.

- It is not apparent that authorizing the SCC to regulate municipal electric utilities would result in lower costs to customers. Adding regulatory requirements would increase costs, as putting on a rate case at the SCC entails substantial fees for attorneys, accountants, and consultants. State regulation would not change the terms of long-term power contracts, and it is not clear in all instances what entity would assume the municipal utility's financial obligations under these agreements. And as noted previously, the vast majority of the power provided by municipal electric utilities is purchased on the wholesale market. The FERC would still have regulatory authority over wholesale power purchases. Under Code § 56-249.6, regulated utilities are authorized to pass through their purchased power costs through the "fuel factor." Therefore, the net result of SCC rate regulation may not provide material immediate benefit to the customers of the municipal electric utilities.
- One factor blamed for the rates charged by Danville's municipal electric utility is the assessment of transmission charges. AMP has reported that the decision by FirstEnergy and Duke-Ohio to move from the Mid-Continent Independent System Operator ISO to the PJM RTO has created additional transmission costs and "seams" issues for participating members. In addition, RTO market rule changes have driven up costs. It is not apparent that subjecting municipal electric utilities that purchase wholesale power from other regions to SCC rate regulation will have any effect on these costs.
- Subjecting municipal electric utilities to regulation by the SCC may have the unintended consequence of eliminating some of the flexibility these utilities currently have in structuring arrangements to address unique circumstances. Examples of localities with municipal flexibility include Manassas, which modified its franchise territory to allow Dominion to serve its largest industrial customer, and Bedford, which considered special power supply arrangements and rates for industrial customers. In addition, while a municipal electric utility may elect to allow a customer to purchase power from a competitive service provider, the customer of a utility that is subject to the Electric Utility Regulation Act (Code § 56-576 et seq.) does not have the same degree of flexibility. Code § 56-577, as amended in 2007, allows a regulated customer to purchase electric energy from any licensed retail supplier only if certain conditions are satisfied, such as having demand that exceeds five megawatts. Even if the conditions are satisfied by a customer that is located in the certificated service territory of a regulated electric utility, the customer is prohibited from buying electric power from any other regulated electric utility.
- The issue of the constitutional authority of the General Assembly to empower the SCC to regulate municipal electric utilities has been addressed by a recent opinion of the Attorney General. While the Attorney General has opined that the General Assembly

does have this power, a representative of MEPAV has taken issue with the opinion's conclusions. Absent a decision by the Virginia Supreme Court addressing this aspect of the Constitution of Virginia, neither side is likely to concede its position. The Commission, as a legislative body created for the purpose of monitoring the SCC's implementation of the Virginia Electric Utility Regulation Act, does not have the resources or statutory authority to interject itself into this long-running constitutional question. This is not an issue for which it is possible to unearth a conclusive answer through any amount of additional legal research. A recommendation by the Commission on the issue would not be binding on anyone. Accordingly, the Commission declines to offer an opinion on this issue.

- Moreover, if the Commission were to conclude that the General Assembly did have the authority to require the SCC to regulate municipal electric utilities, Senate Joint Resolution 300 would have the Commission determine whether the General Assembly should require the SCC to regulate these utilities. However, SCC regulation can take any one of many forms, each of which raises complex practical and legal issues. Rather than attempting to address the plethora of issues that would need to be explored in any legitimate effort to determine the appropriate scope of such regulation, the Commission declines to take a position on whether, or how, the General Assembly should make municipal electric utilities subject to SCC regulation.
- Though it is beyond the capabilities of the Commission to determine whether the SCC can, or should, regulate the rates charged by municipal electric utilities to their customers, one aspect of the debate that may benefit from analysis is whether such utilities are appropriately setting rates for different customer classes. The objective of a rate structure is to enable the utility to collect its revenue requirement without creating inequity between customer classes that burdens one class for the benefit of another. Proper rate design results in rates for classes of customers that are proportionate to the cost of serving each class of customer and which serve to encourage efficient utilization of the system. The concern has been expressed that municipal utilities adopt rate distributions that require commercial and industrial customers to bear a greater proportion of the utility's revenue requirement than is borne by residential customers. Such an outcome may be a function of the fact that residents vote in greater numbers than owners and operators of businesses. It may be appropriate to determine whether the rate distributions adopted by municipalities allocate revenue requirement among residential, commercial, and industrial classes of customers in ways that are consistent with standard regulatory principles and whether such allocations are materially different from the allocations among classes that are made by investor-owned utilities and distribution cooperatives. Such a study should be conducted by an agency, such as the SCC, that has the capabilities to gather the appropriate data and conduct the required analysis.
- Though it is beyond the scope of the specific issues raised by SB 1396 and SJR 300, one issue that may bear scrutiny by the General Assembly if the opportunity arises involves the standard of review exercised by courts in cases involving decisions of local governing

bodies in setting rates and fees for utility services within areas served by a public utility that are outside the locality's boundaries. Justice Russell's dissenting opinion in Town of Leesburg v. Gioradano, *supra*, contends that the "fairly debatable" standard should be applied in the ordinary situation in which a legislative body has made a decision operating upon its own constituency and affecting the territory it was elected to govern. The rationale underlying the "fairly debatable" standard is that the decision affects those who elected the legislators, empowering those elected to make decisions for them. If displeased by those decisions, the voters have a ready remedy at the next election. Such a remedy is not available to the utility's out-of-town customers. However, the legal issues raised are more appropriately addressed by the General Assembly's Committees for Courts of Justice.

- Another issue that ranges beyond the scope of the specific issues raised by SB 1396 and SJR 300 is whether the standard for review of the rates of a municipal electric utility should be codified. Pursuant to Code § 15.2-2143, rates for water provided by municipal utilities are to be fair and reasonable. Pursuant to Code § 15.2-2119, rates for sewerage service provided by municipal utilities are to be practicable, equitable, and uniform. The Code of Virginia does not expressly set out a corresponding standard for the rates for electric service provided by municipal utilities. If the General Assembly sought to codify the standard to be applied in reviewing a municipal electric utility's rates, the issue would be within the jurisdiction of the House Committee on Counties, Cities and Towns and the Senate Committee on Local Government.

The Commission extends its gratitude to all of the individuals and organizations that have provided assistance in the course of its review of the issues generated by Senate Bill 1396 and Senate Joint Resolution 300.

Respectfully submitted,

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Delegate Jackson H. Miller, Vice Chair  
Senator L. Louise Lucas  
Senator Richard L. Saslaw  
Senator John C. Watkins  
Delegate Terry G. Kilgore  
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Delegate Matthew James