NORTHROP GRUMMAN

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Northrop Grumman Shipbuilding
February 15, 2011

The Hon. Thomas K. Norment
Senate of Virginia
Chairman, Commission on Electric Utility Regulation

Dear Chairman Norment,

Northrop Grumman Shipbuilding, Inc., located in Newport News, is a major customer of the Virginia Electric Power Company. We spend between $25 and $28 million a year on electric service to our shipyard, and our 20,000 employees and hundreds of suppliers spend even more. Our margins are tight and our principal customer, the U.S. Navy, is highly motivated to control costs. We listen to our customer.

We are writing to recommend various amendments to §56-585.1 and 585.2 that we believe will lower future electric rates for all Virginia consumers, while maintaining strong utilities in Virginia with sufficient financial rewards for attracting capital, rewarding shareholders and building additional native generation. We have found VEPCO an excellent and reliable supplier and wish them continued success for years to come.

The decision by the legislature to return to regulated electric rates in 2007 was the right decision to protect ratepayers and maintain Virginia's economic leadership. The alternative of full deregulation would have proven a disaster, and many concerned about where we are now forget where we might have been. We recall and again commend your leadership in that effort.

The dramatic increases in rates in the Appalachian Power territory cannot be blamed on that legislation. The costs being recovered by the higher rates are valid and there is no reason to believe that had they been submitted to traditional Chapter 10 regulation the outcome would have been significantly different. There is no evidence that Appalachian has been earning excess revenue that could have been applied to meeting those costs.

The situation in the VEPCO territory is more muddled, as the 2009 rate case audit conducted by the State Corporation Commission staff found that the utility had substantial excess earnings. The case did not reach a litigated conclusion but ended in a settlement. Under that settlement, a substantial portion of those excess earnings were returned as credits on the main bill and on the various rate adjustment clauses. Recently, VEPCO made an unsuccessful effort to avoid the 2011 rate review also called for in that settlement. We submit there is no better proof that the 2007 legislation did not eviscerate the SCC than the lengths to which VEPCO has gone to avoid a Commission-decided case.

According to the federal Energy Information Administration, in 2009 Virginia's average industrial electric rate of 6.91 cents per KWh was above the national average of 6.44 cents per KWh. Just three years earlier Virginia's industrial rates were below the national average (4.69¢ vs. 6.0¢). The Edison Electric Institute chart distributed at a recent meeting of the Senate Commerce and Labor Committee had slightly different cost numbers but exactly the same pattern – it showed Virginia industrial rates were basically at the national average in 2009 (6.53¢ vs. 6.63¢) and second only to Florida in the southeast.

Changing the law will not lower current rates, but perhaps it can change the momentum and keep Virginia's industrial (and residential) rates at or around the national average.

To that end, we recommend the following changes in the statute, some of which are gleaned from legislation which was presented unsuccessfully in 2011 (see in particular Senate Bill 882 and House Bill 1736).

First and foremost, either repeal the language in 585.1(A)(6) giving the utilities automatic bonus return on equity for building new generation, or make those bonuses discretionary and empower the State Corporation Commission to decide. Arguments that these bonuses are necessary ignore the contrary evidence provided in other states where plants are being built without them. They also ignore the growing role of federal programs and loan guarantees that reduce investor risk on certain forms of generation. We are confident the Commission can and will sort this out in a fair manner.

The current base return on equity for VEPCO under the 2010 stipulation is 11.3 percent, enhanced by a 60 basis point performance bonus, for an allowed rate of return of 11.9. But since the statute allows the utility to earn an additional 50 bonus points without triggering a rate change or customer rebates, it can be argued the authorized ROE is really 12.4 percent. More importantly, in this case the utility has proven it can hit that mark consistently. We don't believe VEPCO will need 13.4, 14.4 or even 15.4 percent returns to attract capital. If they can make the case they need a higher rate of return, let the SCC decide.

Second, the entire spectrum of charges should be bundled for purposes of a future rate review and any rate adjustment clauses approved between rate reviews should be folded into the base rate at the first opportunity.

Third, if it is deemed in the public interest to require that 15 percent of energy generation in Virginia be from renewable sources by 2025 (§56-585.2), then mandate it. The utilities should receive their costs and a reasonable return on any capital, but it is uncessary to reward the utilities 50 basis points of bonus ROE on their entire rate base for meeting these modest goals. It was of dubious justification when first proposed and it has become a mockery as the General Assembly is now rewarding triple points and even quadruple points for certain favored technologies. Some even tried this year to designate methane a "renewable" fuel. Despite the use of the term voluntary to describe this program, the ratepayers won't feel like volunteers when they start paying for it through higher rates.

Likewise with conservation programs – the utility should be paid its costs for any program, but it should receive a return only on any capital investments. The idea of Virginians paying the utility for electricity they do not buy, authorized in 585.1 (5)(c) despite your no vote in 2009, needs to be stripped from the code. When the cost for that is added to bills in the future, as it eventually will be, it will be impossible for legislators to justify.

Finally, the ROE peer formula in 585.1(A) has proven to be unnecessary and confusing. In the rate cases we saw various consultants reach widely different conclusions as to what the formula dictated, and in the APCO case the Commission stated it would have awarded a base ROE 50 basis points lower without the formula. This is not a huge cost difference, but again, this was an innovative feature in the 2007 law which the other states have not stampeded to copy, and we should drop it, as well.

One thread running through all the provisions discussed above is that they really have not come into play yet, except for the last one. Changing these provisions now would not lower current rates, but neither would the recommended changes endanger the profitability or development of the utilities going forward. Implementing these reforms would take nothing away but the potential (if not certainty) that the utilities will over-earn.

Thank you for this opportunity to present our views.

Sincerely,

Stephen D. Haner
Manager, State Government Affairs