**NEW LEGISLATION WILL END RATE CAPS, REINSTITUTE COST-OF-SERVICE REGULATION OF ELECTRIC UTILITIES**

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New legislation proposed to the 2007 Virginia General Assembly would end electric utilities' capped rates at an earlier date and replace the previous market-based default service pricing system of the Restructuring Act with a cost-of-service ratemaking model to ensure new infrastructure and service reliability while maintaining reasonable prices.

**Highlights of the new legislation:**

Capped rates will end for all electric utilities in 2008, rather than 2010 under current law.

Electric utilities will provide default service at capped rates until that date.

Retail electric choice will end at the same time, except for those large industrial and commercial customers with greater than 5 megawatts demand, who may be able to benefit from a competitive market due to their sophisticated power procurement abilities.

After default service ends, rates of investor-owned electric utilities will be reviewed and set under a new cost-of-service ratemaking model:

The State Corporation Commission will examine utility books and records every two years. The first review will use a 2008 calendar-year test period (the last year of capped rates). The Commission's decision must be made within eight months of the end of the test period, and any rate adjustments or credits will take effect, at the latest, 60 days after the order.

If the review shows the utility is earning more than what is a fair and reasonable return on equity under the standards set by the new legislation, one-half of the overage will be refunded to Virginia customers. If the utility is not earning a sufficient amount to continue to ensure new infrastructure and service reliability, rates can be increased, but will be reviewed again in two years.

A proper return on equity under the legislation will be determined by adding 6% to the yields of investment grade (Baa) long-term utility bonds, but the Commission can increase or reduce this return by up to one-half percent based on the generating performance, operations and efficiency of the utility. So long as the utility does not earn more than 1% above that return, its rates will be deemed fair and reasonable.

Utilities can request approval from the Commission for rate adjustment riders to cover vital and necessary costs, such as the construction of the new southwest Virginia coal plant or other generation facilities, transmission charges, distribution system improvements, compliance with state and federal laws and environmental regulations, flood and storm damages, and for conservation, energy efficiency, load management or other demand-side management programs. No such riders can take effect prior to the end of rate caps.

The Commission can adjust returns on equity, up or down, based on a utility's performance and efficiency.

## Highlights of Proposed Regulatory System

- Eliminates market-based default rates.

- Terminates capped rate period at end of 2008 – two years ahead of current timetable.

- Ends retail choice except for large customers most likely to exercise it.

- Maintains pass-through fuel factor.

- Essentially continues base rates at current capped levels – but with increased SCC oversight.

- Emulates successful regulatory plans in place elsewhere, in states such as Florida.

## Under the proposed regulatory model:

- Utility earnings under existing rates will be subject to SCC review and adjustment when appropriate.
- Proposal sets standards for “fair and reasonable” return on equity based on long-term bond yields.
- Proposal also ensures returns for Virginia utilities are comparable to those of their peers.
- SCC can adjust return based on utility performance.
- Earnings above the “fair and reasonable” return split between customers and company.
- Rates can be increased if utility not earning enough to ensure new infrastructure and service reliability.
- SCC-approved riders allowed to cover vital new costs and facilities, such as new generation, transmission costs, severe storm damage, environmental compliance.

**Proposal preserves strengths of restructuring – while recognizing its weaknesses.**

- Maintains incentives for more efficient utility operations.

- Recognizes retail competition likely will never be an efficient retail price regulator, especially for smaller customers.

- Continues to provide benefits of PJM membership, including economic dispatch, transmission planning, wholesale market access.

- Provides better incentives than restructuring for constructing new baseload generation.