

# SHIFTING UTILITIES' INCENTIVES FOR AFFORDABLE, CLEAN ENERGY

Peter Anderson // Appalachian Voices // peter@appvoices.org  
Laura Gonzalez Guerrero // Clean Virginia // laura@cleanvirginia.org  
Joy Loving // Climate Action Alliance of the Valley // jal\_1998@yahoo.com

## EXECUTIVE SUMMARY

Virginia's largest investor-owned utility (IOU) monopolies are currently incentivized to prioritize capital-intensive investments, which puts their profit motive at odds with cutting costs for consumers and meeting their mandated clean energy goals. Aligning utilities' profit incentives with sustainability goals, such as the interconnection of distributed resources, grid reliability, and efficiency measures, can facilitate a swift and affordable clean energy transition that advances least-cost solutions.

## CHALLENGE

Virginians pay some of the highest energy prices in the nation, which disproportionately impacts low-income households and historically marginalized communities.<sup>1,2,3</sup> High energy costs are tied to the regulations of Virginia's investor-owned utility (IOU) monopolies that reward utilities for capital-intensive investments rather than cost-saving measures – i.e., the more expensive a project is, the more profits the utility collects.<sup>4</sup>

Under the current regulations, reducing energy usage with energy efficiency and expanding customer-owned distributed resources like rooftop solar conflict with utilities' profit sources: building capital and selling electricity.<sup>5</sup> Utilities' incentives also conflict with buying clean energy from third-party developers through purchase agreements (PPAs) even when PPAs are less expensive than utility-owned projects.

Additionally, although utility monopolies' regulation should simulate competitive incentives for cost reduction, the current framework undermines cost control incentives.<sup>6</sup> A salient example is the usage of cost trackers – called rate adjustment clauses (RACs) in Virginia. Trackers allow utilities to recover costs and profits with zero risk to the IOUs, which removes incentives for efficient spending.<sup>7</sup> Experts suggest restricting trackers to a few selected costs,<sup>8,9</sup> yet trackers are around 50% of IOUs customers' electric bills.<sup>10</sup> The fuel factor, for example, is a tracker that allows utilities to pass all fossil fuel costs to customers without affecting the utility's profits, reducing the financial urge for minimizing fossil fuel expenses.<sup>11</sup>

Recent legislation improved Virginia's regulations by

restoring the State Corporation Commission's authority to prevent customer overcharges.<sup>12</sup> However, strong incentives for inefficient spending, that threaten an affordable clean energy transition, remain in Virginia's code.

## SOLUTION

Virginia should further improve IOUs' regulations to guarantee affordability while transitioning towards 100% clean energy. Needed improvements include lifting the cap on PPAs and shifting towards performance-based regulations that better align utility profits with affordability and environmental goals.

The cost of PPAs for utility-scale solar has dramatically declined nationwide.<sup>13</sup> However, utilities have argued that the Virginia Clean Economy Act caps PPAs at 35% of the clean energy requirements. Thus, utilities do not consider PPAs beyond 35%, even when there are qualified PPAs that would be less expensive than utility-owned projects.<sup>14</sup> To reduce clean energy costs, utilities should consider all qualified and cost-competitive PPAs.

Multiple states are studying broader reforms to utilities' incentives through performance-based regulation (PBR). PBR shifts utilities' exclusive focus on expensive capital projects towards other critical goals by creating financial incentives.<sup>15</sup> Connecticut, Hawaii, Illinois, North Carolina, and Washington, among others, have initiated regulatory reforms to connect utility profits with goals like decarbonization, affordability, interconnection of distributed resources, and energy efficiency.<sup>16</sup>

For a successful PBR framework, it is crucial to also address the role of RACs or trackers in undermining cost control incentives. Virginia should align with regulatory best practices that suggest mainly using the base rate instead of trackers, to incentivize cost containment. Some states have also reformed the fuel factor, making IOUs responsible for part of fossil fuel costs, incentivizing greater control of fossil fuel expenses.<sup>17</sup>

Exploring reforms to Virginia's IOUs incentives system will help ensure that an affordable, reliable, and equitable clean energy future is achievable.

## POLICY RECOMMENDATIONS

Remove the 35% cap on power purchase agreements to allow all available, qualified, and cost-competitive PPAs to compete for being part of Virginia's energy mix.

Implement a cost-sharing mechanism that splits the risks of fossil fuel costs and price volatility between utilities and electricity customers.

The State Corporation Commission and Virginia Energy should study regulatory reforms that address disincentives for cost containment and include compensation for IOUs based on environmental and social outcomes rather than a project's price.