UTILITY REFORM FOR AFFORDABLE CLEAN ENERGY

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WHY IT MATTERS

As Virginia undergoes a historic expansion of its electric infrastructure and a transition to clean energy (*see Charting Virginia's Clean Energy Path, page 95*), ensuring that the regulatory system promotes affordability, efficiency, and prudent investment will be critical to protecting Virginia's environmental goals and ratepayers. Electric utilities in the state are facing unprecedented growth in electricity demand, overwhelmingly driven by the rapid expansion of data centers. Meeting this demand will require tens of billions of dollars in new generation, transmission, and distribution infrastructure (*see Addressing Data Center Energy Demand, page 99*). At the same time, since 2007, electricity costs for customers of Virginia's investor-owned utilities have risen faster than inflation.[1] Reforms to rebalance investment risk between shareholders and ratepayers, and to improve competitiveness in resource procurement, among other measures, are critical to advancing an affordable clean energy transition.

CURRENT LANDSCAPE

In 2023, the General Assembly (HJR 30 and SJR 47) tasked the **State Corporation Commission (SCC)** with examining the regulatory structure of electric investor-owned utilities and recommending reforms to better align utility incentives with Virginia's goals of clean and affordable energy. The SCC report recommendations included:

CONTINUED REFORM OF RATE ADJUSTMENT CLAUSES (RACS)

Rate Adjustment Clauses (RACs), or riders, allow utilities to recover costs and make a profit on infrastructure projects through separate charges on customer bills. In contrast, base rates require utilities to budget in advance for all utility costs in a single proceeding.

The key difference between base rates and riders lies in who bears the investment risk. Traditional base rates operate like a budget: if utility revenues fall short due to fluctuating sales or management decisions, shareholders absorb the loss. As in any business, profits are not guaranteed. With riders, customer rates automatically increase whenever revenues fall short of the utility's profit target. The result is that investment risk shifts from shareholders to customers, and utilities lose a major incentive to control costs.[2,3] Contrary to best practice, more than 70% of Dominion's planned capital spending is now eligible for rider recovery – a finding that prompted the SCC report to recommend scaling riders back.[4,5]

IMPROVING COMPETITIVE PROCUREMENT PROCESSES

SCC staff have identified multiple flaws in procurement processes used by utilities to select new generation resources. They have also repeatedly called for greater transparency.[6] A key concern is that the utility acts as both a bidder and the evaluator of bids, and the Commission has limited visibility until after the process is complete. The SCC's report recommended stronger oversight, including independent evaluators and regulatory review of solicitation criteria before bids are issued.[7]

Another key part of monopoly utility regulation is setting the profit investors are allowed to earn on utility investments. The SCC is tasked with setting a **Return on Equity (ROE)** high enough to incentivize prudent investment but not so high that customers pay more than necessary. Much evidence supports that the approved ROE for utilities in Virginia is higher than necessary to attract investment.[8,9] Reducing a utility's ROE to better reflect actual market risks would produce significant bill savings for customers. For example, even reducing Dominion's current authorized ROE of 9.8% by 0.1% would save customers about $10 million per year. In addition, providing stronger financial incentives or disincentives based on whether a project advances existing Virginia energy laws, including the requirements of the Virginia Clean Economy Act, could better align utility investments while still allowing fair shareholder returns.

OPPORTUNITIES

In 2026, the General Assembly passed HB903 and SB251, directing the SCC to develop additional utility reform recommendations by July 1, 2027. This process provides an opportunity to help shape reforms to rate adjustment clauses, competitive procurement, and other regulatory elements to improve cost control and promote other sustainability goals.

Giving the SCC more discretion to determine the best cost recovery method for customers– through base rates or, in certain situations, through a rider—could rebalance risk between utility shareholders and customers while strengthening incentives for cost control and compliance with the state's energy goals.

Improving competitive solicitations and leveling the playing field between utility-owned and third-party-owned resources will help ensure that resources used by utilities are the least-cost, highest-quality available in the market and are consistent with the public interest. For example, some states, including Connecticut, Illinois, and New York, have shifted some procurement responsibilities to independent state agencies to improve transparency, reduce conflicts of interest, and assure alignment with state policy.[10,11,12]

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Finally, states across the country are also exploring ways to right-size utility ROEs, including both caps and reforms to ROE-setting methodologies.[13] An ROE that better reflects the low-risk nature of utility monopolies can help control costs and align profit incentives with other policy goals, such as increasing reliability, expanding energy efficiency, and deploying more cost-effective clean energy resources. If the underlying ROE is higher than necessary, those incentives may be missing or less effective.

TOP TAKEAWAYS

Elements of the current regulatory system are making the clean energy transition slower and more expensive than necessary.

Virginia utility customers are facing above-inflation rate increases. With tens of billions in new infrastructure spending on the horizon, reforming how utilities recover costs and earn profits has never been more consequential for achieving affordability and a sustainable clean energy transition.

Flawed competitive procurement processes compound the problem, allowing utilities to direct their own spending with insufficient regulatory oversight. Alternative approaches could help ensure that competitive solicitations respond to the public interest.

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