COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

COMMONWEALTH OF VIRGINIA, *ex rel.*

STATE CORPORATION COMMISSION CASE NO. PUR-2024-00144

Ex Parte: Electric Utilities and Load Growth

EXHIBIT A

Comments of Scott Hempling

Data Centers in Competitive Retail Electricity Markets:

Protecting Nonshopping Customers from Stranded Cost, and Compensating Them for the Value They Provide, Requires Tariff Revision and Corporate Separation

Scott Hempling[1]

When data centers come to Virginia, the incumbent electric utilities play two conflicting roles. They have an obligation to serve, and an opportunity to compete. This duality creates two risks for the utilities' legacy customers. The first risk to customers is stranded costs—the obligatory costs incurred by the utility to serve projected load that doesn't arrive, and connected load that arrives but later leaves. The second risk to customers is insufficient compensation. A utility's captive customers pay for the balance-sheet strength and internal resources that allow the utility-as-competitor to offer favorable terms to shopping customers. Most utilities get these customer-funded benefits without paying for them.

The first risk is the one that receives regulatory attention. The second risk is too often suppressed by utilities and missed by regulators.

These two risks to the utility's captive customers create a problem for the utility's competitors. The problem is competition distorted by incumbent bias, replacing competition

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This paper was funded by NRG Energy. All conclusions are my own. Not being a Virginia-barred lawyer, I cannot opine authoritatively on Virginia law. References to Virginia law have been vetted by Virginia-barred attorneys.

on the merits. When a utility has both a state-supported, monopoly obligation to serve large customers, and an opportunity to compete for those same large customers, its monopoly role gives it unearned advantages in its competitive role. These unearned advantages flow directly from the customer harm—the utility's ability to shift competitive costs to its captive customer base, and it practice of taking customer-provided benefits without paying for them.

These problems exist in Virginia. The state continues to attract large loads, especially data-center loads.[2] Before utilities, competitors, and date centers incur more costs and risks, the state should create a regulatory solution that aligns all actors' self-interests with the public interest. That solution must (a) protect monopoly customers from bearing utility costs incurred to supply competitive customers; (b) ensure that the competition to serve large loads is competition on the merits, undistorted by incumbent utilities' unearned advantages; and (c) compensate monopoly customers for the value they provide the utility when it competes for those loads. Central to the solution is corporate separation: If the incumbent utility wants to act as both monopoly and competitor, it must do so only through separate corporations that operate at arm's-length.

Virginia Electric and Power Company (referred to here as Dominion) has suggested that there are no problems, and therefore no need for solutions, because its competitive activities are "ring-fenced." Dominion has misused the term. This misuse has caused confusion in multiple orders of the State Corporation Commission, placed customers at risk, and deprived the state of the merits-based competition deserved by all consumers, large and small. This paper explains the problems and the solutions, in four parts:

- *Vision for the public interest:* Effective competition, cost-effective transactions, customer protection, and compensation to customers.

- *Deficiencies in the status quo:* Customer risks, insufficient customer compensation, and unearned competitive advantage.

- *Diagnosis of the deficiencies:* Incumbent utilities' simultaneous roles—monopoly provider to the captive market and competitor in the large-load shopping market.

- *Solution:* Tariff revisions, to reduce customer risks and provide customer compensation; and real ring-fencing, to require corporate separation for competitive services.

[2] *See generally* L. Preston Bryant Jr., *The General Assembly's Consideration of the Data Center Industry's Growth in Virginia*, 28 RICH. PUB. INT. L. REV. 45 (2024) (detailing data centers' longstanding and still-growing interest in Virginia).

I. *Vision for the public interest:* Customer protection, customer compensation, effective competition, and cost-effective transactions

A rational, economic, internally consistent policy on new data-center loads has four inarguable features:

- The data-center customer will be free to choose the most economical power source available, and will have multiple suppliers to choose from. Competition among the suppliers will be competition on the merits. The utility-as-competitor will have no unearned advantage.

- The relationship between each data center and its electricity supplier will be a cost-effective relationship. The costs and risks arising from their transaction will be borne solely by them. In the data-center context, a prominent supplier risk is losing the load before recovering the sunk cost of serving the load. A prominent large-customer risk is building the data center, then facing an electricity supply that is insufficient or uneconomic. Neither party will be able to shift its risks to, or take uncompensated benefits from, third parties.

- Nonshopping customers, who receive obligatory service from the utility,[3] will be no worse off as a result of data-center arrangements. The arrangement will impose no costs or risks on them. It will compensate them for the value of their contributions to the transaction. These conditions will last through the life of the arrangement, and through the life of the power sources created to supply the arrangement.

- Unless the General Assembly changes the statutory prohibition against undue discrimination,[4] the regulatory treatment of new industrial loads will be comparable to treatment of comparable existing industrial loads.

As discussed next, Virginia's status quo market structure and regulatory policies do not align with these four features.

[3] Va. Code § 56-234 A ("It shall be the duty of every public utility to furnish reasonably adequate service and facilities at reasonable and just rates to any person, firm or corporation along its lines desiring the same.").

[4] Va. Code § 56-234 B ("It shall be the duty of every public utility to charge uniformly therefor all persons, corporations or municipal corporations using such service under like conditions.")

II. *Deficiencies in the status quo:* Customer risks, insufficient customer compensation, and unearned competitive advantage

Virginia's market to supply retail electricity to data centers has these characteristics:

- a legal option to buy retail electricity[5] competitively, for most large customers (referred to here as "shopping-eligible customers");[6]

- a Dominion obligation to serve the shopping-eligible customers if they don't shop competitively, or if their competitive suppliers, mid-contract, fail or depart;[7]

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[5] In Virginia, the competitive retail products include (a) energy and capacity, purchased either (i) from competitive suppliers provided doing business in PJM, or (ii) through PJM's organized markets; and (b) transmission service, purchased from PJM-as-legal-transmission-provider, by the competitive seller for rebundling to the end-user, or by the end-user directly, at PJM's FERC-tariffed rate.

[6] Va. Code § 56-577 A 3, opening paragraph, provides:

> Subject to the provisions of subdivisions 4 and 5, only individual retail customers of electric energy within the Commonwealth, regardless of customer class, whose demand during the most recent calendar year exceeded five megawatts but did not exceed one percent of the customer's incumbent electric utility's peak load during the most recent calendar year unless such customer had noncoincident peak demand in excess of 90 megawatts in calendar year 2006 or any year thereafter, shall be permitted to purchase electric energy from any supplier of electric energy licensed to sell retail electric energy within the Commonwealth, except for any incumbent electric utility other than the incumbent electric utility serving the exclusive service territory in which such a customer is located, subject to the following conditions . . . .

[7] Va. Code § 56-577 A 3 c provides:

> If such customer does purchase electric energy from licensed suppliers after the expiration or termination of capped rates, it shall not thereafter be entitled to purchase electric energy from the incumbent electric utility without giving five years' advance written notice of such intention to such utility, except where such customer demonstrates to the Commission, after notice and opportunity for hearing, through clear and convincing evidence that its supplier has failed to perform, or has anticipatorily breached its duty to perform, or otherwise is about to fail to perform, through no fault of the customer, and that such customer is unable to obtain service at reasonable rates from an alternative supplier. If, as a result of such proceeding, the Commission finds it in the public interest to grant an exemption from the five-year notice requirement, such customer may thereafter purchase electric energy at the costs of such utility, as determined by the Commission pursuant to subdivision 3 d hereof, for the remainder of the five-

- a Dominion obligation to serve, and plan to serve, and stand ready to serve, all customers of any size that do not buy from competitive suppliers;[8] and

- a regulatory regime that does not fully assign risks to the risk-causers, costs to the cost-causers, and benefits to the benefit-creators.

This market will not have competition on the merits. The incumbent utility has, as competitive tools, one or more of the following:

> year notice period, after which point the customer may purchase electric energy from the utility under rates, terms and conditions determined pursuant to § 56-585.1. However, such customer shall be allowed to individually purchase electric energy from the utility under rates, terms, and conditions determined pursuant to § 56-585.1 if, upon application by such customer, the Commission finds that neither such customer's incumbent electric utility nor retail customers of such utility that do not choose to obtain electric energy from alternate suppliers will be adversely affected in a manner contrary to the public interest by granting such petition. In making such determination, the Commission shall take into consideration, without limitation, the impact and effect of any and all other previously approved petitions of like type with respect to such incumbent electric utility. Any customer that returns to purchase electric energy from its incumbent electric utility, before or after expiration of the five-year notice period, shall be subject to minimum stay periods equal to those prescribed by the Commission pursuant to subdivision C 1.

Va. Code § 56-577 A 3 d then provides that customers exempt from the five-year requirement pay the incumbent utility for electricity at a price reflecting

> the market-based costs of the utility, including (i) the actual expenses of procuring such electric energy from the market, (ii) additional administrative and transaction costs associated with procuring such energy, including, but not limited to, costs of transmission, transmission line losses, and ancillary services, and (iii) a reasonable margin as determined pursuant to the provisions of subdivision A 2 of § 56-585.1. The methodology established by the Commission for determining such costs shall ensure that neither utilities nor other retail customers are adversely affected in a manner contrary to the public interest.

[8] *See* Va. Code §§ 56-234 and 56-577 A 3 a. In addition, Dominion is required to file an integrated resource plan ("IRP") every two years. *See* Va. Code § 56-599 A. The IRP, by definition, is "a document developed by an electric utility that provides a forecast of its load obligations *and a plan to meet those obligations* by supply side and demand side resources over the ensuing 15 years to promote reasonable prices, reliable service, energy independence, and environmental responsibility." Va. Code § 56-597 (emphasis added).

- the ability to raise capital for its competitive activities at a cost below its competitors' costs, because providers of capital view the utility's exclusive franchise as a balance-sheet strengthener and its captive-customer base as a risk-reducer;

- the ability to offer favorable nonprice terms (such as shorter contract durations), because its captive customers will be available to absorb capacity costs not recovered when the contract ends;

- immediately available supply, offered at prices based on the utility's average cost rather than its marginal, cost, because (a) the utility's franchise responsibility includes an obligation to acquire resources for reasonably forecasted load before that load appears, and (b) captive customers are symmetrically obligated to bear that anticipatory cost if the load doesn't appear; and

- ready access to captive-customer-funded resources (e.g., legal services, accounting, headquarters space, employee expertise and time, and human resources staff)—with that access available at cost rather than at market prices.

These utility advantages undermine competition on merits because they don't arise from the utility's merit. They arise from the utility's monopoly-franchise privilege.

Those same elements harm the utility's captive customers:

- Though the utility gets its financial strength from its customers' captivity, the utility doesn't compensate the customers for the value they provide.

- The captive customers' years of payments for employee and management expertise, headquarters building space, human resources, and other support services have a market value exceeding the cost allocated to the utility's competitive activity, but the typical allocation process credits the customers only for the cost, not the market value.

- As near-guarantors of the utility's cost of service, the captive customers are like obligatory investors in the capacity acquired by the utility in advance of, and for purpose of attracting, the new load. Yet they receive no compensation for the risk associated with that obligatory investment. Only if the load arrives, and only when the load arrives, do they receive recovery of their share of the capacity investment that they financed, but they receive no return on that investment.

These asymmetries of risk and reward worsen with the entry of data-center loads. Building generation, transmission, and distribution to meet new large loads is a multiyear process. There are uncertainties even when the utility knows all the facts that affect the development timeline. But a utility never knows all the facts. There are siting delays, property-owner holdouts, supply-chain obstacles, and interest-rate changes. The obligation to stand ready to serve means that the utility cannot wait for actual demand; it must acquire

capacity based on projections of demand. If a data center load arrives, the utility must have available the resources to serve it. A utility that says "Come back in five years when we have the necessary capacity" fails in that duty. The data center will go elsewhere—depriving the utility, its nonshopping customers, and the local economy of that new load's benefits. That is why data centers today are choosing territories with surplus capacity.

In retail competitive markets, therefore, having surplus capacity is a competitive advantage. Using captive customers to finance surplus capacity is how a utility gains that competitive advantage. Because nonutility competitors have no captive customers, they lack that advantage. Because that advantage derives from the utility's government-granted monopoly position rather than the utility's performance merits, the advantage is unearned.

III. *Cause of the deficiencies:* Dominion's simultaneous roles as monopoly provider in the captive market and competitor in the large-load market

Where the utility simultaneously acts as a retail monopoly and a retail competitor, the resulting market structure invites opportunism. Opportunism is the activity of seeking benefits free of the associated costs. In the data-center context, the opportunists are Dominion and the shopping-eligible customers. Consider:

- *Dominion:* Dominion conducts its two activities—monopoly supplier to captive customers and competitive supplier to shopping-eligible customers—with no arm's-length relationship between them. Dominion might say that it serves that load as an obligated monopoly, but its true market role is as a competitor. As a competitor it profits from the upside; as the monopoly provider it has captive customers to cover the downside. Dominion's competitors have no comparable advantage.

- *The shopping-eligible customer:* This customer has it both ways. As a monopoly customer it can benefit from the utility's statutory obligation to serve; as a competitive customer it can benefit from shopping the market. The one restriction—a five-year wait before returning to normal rates (or a right to return sooner but pay market rates)[9]—doesn't bear any necessary relationship to the costs that this customer leaves behind when it departs the utility's obligatory service. And the customer can seek to return sooner than five years if its competitive supplier "has failed to perform, or has anticipatorily breached its duty to perform, or otherwise is about to fail to perform, through no fault of the customer, and that such customer is unable to obtain service at reasonable rates from an alternative supplier"—though in certain situations the returning customer faces the risk of

[9] Va. Code § 56-577 A 3 c.

paying market rates.[10] All three of these situations—waiting five years, returning sooner voluntarily but paying market prices, and returning sooner involuntarily but paying no penalty—create for the shopping-eligible customer an upside of shopping opportunity without a downside of full cost responsibility.

By definition, opportunism is available only to those with opportunities. The costs avoided by those with opportunities fall on those without opportunities. In this context of dual utility roles, those without opportunities are the utility's nonshopping customers and its competitors. Consider:

- *The captive customers:* They have no choice but to compensate the utility for the reasonable costs incurred to carry out the obligation to serve. That obligation to serve requires acquiring capacity ahead of anticipated load. If the load doesn't appear, the captive customers pay for the unused capacity—if prudently planned and built.

- *The competitors:* Lacking the various forms of support that captive customers provide the utility, the competitors risk coming in second place for reasons other than merit; or coming in first place only by showing extraordinary merit or absorbing costs that the utility doesn't absorb. These factors make competing in Virginia less attractive.

Virginia has a competitive market in which the competition is distorted—by captive-customer subsidy and unearned utility advantage. Virginia also has a franchised-monopoly market in which customers are covering costs they shouldn't be covering, bearing risk they shouldn't be bearing, and receiving insufficient compensation for the value they are contributing. By allowing a regulated monopoly market to overlap with a competitive market, Virginia's policy undermines both. We can have competition on the merits, or we can have competition distorted by regulatory error. We can't have the latter while calling it the former.

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[10] *Id*. In *Joint Petition of James Hardie Building Products Inc. and Appalachian Power Company for a Declaratory Judgment or, in the Alternative, for an Exemption Pursuant to § 56-577 A 3 c of the Code of Virginia*, a customer that had been purchasing from a competitive service provider wanted to return to the utility, Appalachian Power Company, without giving five years' notice. APCo did not oppose the return. Together they petitioned the Commission. The Commission had to interpret the passage in Va. Code § 56-577 A 3 c providing that a returning customer "shall not thereafter be entitled to purchase electric energy from the incumbent electric utility without giving five years' advance written notice." The Commission first held that under this provision, the term "'entitled' refers to a legal right that can be claimed by the customer." The Commission then held that because the customer wishing to return to the utility was "not attempting to claim such right," it could return without giving the five years' notice. Case No. PUR-2019-00213, Final Order at 5 (Mar. 30, 2020).

IV. *Solution:* Tariff revision to reduce risks, and real ring-fencing to require corporate separation for competitive services

The market deficiencies described in Part II stem from the market-structure problem described in Part III: Dominion plays a monopoly role in a market that the General Assembly intended to be competitive. Dominion says that it is providing "regulated services." By that phrase, Dominion means, I assume, that the services are authorized by the Commission and are subject to a tariff approved by the Commission. But labels don't determine substance. What Dominion calls regulated services are competitive services, for a simple, obvious reason: the services are comparable to those offered by nonutilities to the same customers in the same geographic market. This conclusion applies to all services provided to the shopping-eligible customers; as well as services provided under certain riders, such as the carbon-free generation tariff and the market-based rates tariff.[11] Indeed, the Commission has said that Dominion's purpose in proposing a market-based rates tariff was to "provide an avenue for the Company to compete with third-party suppliers of electric energy."[12]

This classic market-structure problem—a monopoly utility engaged in competitive activities—existed well before large data-center loads arrived. But their arrival—literally a step change in projected demand—-increases the adverse consequences to a point where action is necessary.

The classic problem always had a classic solution: Separate the competitive services from the monopoly services, completely. To achieve complete separation of the services, the classic solution has been complete separation of the corporate entities providing those services. Virginia does not have the standard solution. Instead, it allows Dominion to provide both types of services through the same corporation.

Part IV.A addresses this status-quo scenario, offering ways to improve it but cautioning that the improvements don't solve the problems. Dominion says that some of its activities under the status quo are "ring-fenced," but in saying so Dominion has misapplied the phrase and diluted its strength. **Part IV.B** turns to corporate separation—true ring-fencing. True ring-fencing doesn't eliminate all risks, but it reduces some and brings into the open the others.

In these recommendations, I have not considered myself confined to current statutory law or regulatory rules. I recognize that the Commission has found that Virginia statutes do not permit a public utility to transfer its statutory obligation to serve to anyone else, including a wholly owned affiliate. *See Petition of Rappahannock Elec. Cooperative, Hyperscale*

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[11] The carbon-free generation tariff, known as Rider CFG, was approved by the Commission in Case No. PUR-2024-00114. The market-based rates tariff, known as Rider MBR, was approved in Case No. PUR-2018-00192.

[12] *Application of Virginia Elec. & Power Co. for Approval to Establish a Rate Schedule Designated Rate Schedule MBR, Pursuant to § 56-234 B of the Code of Virginia*, Case No. PUR-2018-00192, Final Order at 3 (Jan. 14, 2020).

Energy Services, LLC, and Hyperscale Energy 1, LLC, for a Declaratory Judgment and, if Necessary, a Partial Waiver of the Requirements of 20 VAC 5-312-20 E:[13] "[W]e do not find authority to permit a cooperative, or any public utility, to relinquish its statutory obligation to provide retail power supply to its customers at reasonable and just rates established by the Commission." I appreciate that the Commission "has initiate[d] a separate proceeding, open to all interested persons, to explore the identification of one or more potential frameworks that could be utilized by utilities, including electric cooperatives, to serve this new projected load."[14]

A. The status quo: Competitive and noncompetitive services in the same corporation

For large industrial customers, Dominion carries out its monopoly obligation to serve through its Sch. GS-4 tariff.[15] The tariff allocates to those customers a capacity-cost share reflecting their load share. But because it contains no minimum-take obligation and no minimum-years commitment, the other customers face two risks: that the costs that Dominion incurs to serve anticipated GS-4 load go unused because that load never appears; and that the GS-4 customer will depart to a competitive supplier, leaving sunk capacity costs behind.

Dominion also has elective tariffs. An example is the Carbon-Free-Generation tariff, Sch. CFG. Dominion argues that these elective services are "ring-fenced"—meaning that captive customers are protected—because the renewable resources that Dominion proposes to buy or own will not enter the revenue requirement that it proposes to collect from regular tariffed customers. But because Dominion finances these resources using the same debt and equity that are supported by its nonshopping customers, the criteria for true ring-fencing are not satisfied.

In both situations, GS-4 and elective services, Dominion is competing with others; in both situations, nonshopping customers are bearing the risk of stranded cost, and providing benefits without compensation. If the Commission continues to allow Dominion to provide competitive and noncompetitive services in the same corporation—an approach that creates all the deficiencies discussed in Part II above—it can at least improve the situation by putting the competitive risks on the parties to the competitive transaction. That improvement means requiring the parties to the transaction to bear the capacity costs associated with the transaction. As so revised, the Sch. GS-4 tariff would partially replicate the competitive-market conditions, in ways that would reduce nonshopping customers' exposure to costs arising from competitive market activities. Here are examples of necessary tariff changes:

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[13] Case No. PUR-2024-00015, Final Order at 7 (Oct. 2, 2024).

[14] *Id.* at 8.

[15] *See* Virginia Elec. & Power Co., Schedule GS-4 Large General Service Primary Voltage, filed Aug. 20, 2024, available at https://www.dominionenergy.com/-/media/pdfs/virginia/business-rates/schedule-gs4.pdf.

- Dominion would bear the stranded cost risk, but charge the GS-4 and electric service customers a price that reflected that risk. Alternatively, Dominion could require the customer to commit to a payment obligation, either in terms of annual charges or a number of years, that reduced the risk of stranded cost to zero.

- Alternatively, Dominion would avoid incurring any capacity cost itself, becoming only a conduit. It would buy capacity from the PJM market and pass that market-based cost on to the customer.

- Alternatively, Dominion would contract with a third party to provide the supply that Dominion would resell to the end-use customer. (The third party could be a truly ring-fenced Dominion affiliate.) That third party would do one of two things: It would either buy the capacity from the PJM market, or build the capacity itself. In either situation, the third party would sell the product to Dominion, who would resell it to the end-user.

These steps reduce some of the risks to nonshopping customers. But they don't protect the nonshopping customers from the costs that go unrecovered if Dominion builds capacity in advance of load that never appears. And these approaches leave unsolved the competition-distorting effects of Dominion's unearned advantages—the ones gained from using as competitive tools its captive-customer-funded experience and its captive-customer-supported balance sheet, without compensating those customers for the market value of those tools.

B. True ring-fencing: Competitive and noncompetitive services in separate corporations

Dominion has said that its competitive activities are "ring-fenced." The company treats this phrase as allowing it to provide both franchise-monopoly services and competitive services from the same corporate entity, as long as the company keeps separate the operating costs, capital expenditures, and revenues of each type of service. Commission orders have repeatedly accepted Dominion's usage.[16] **Part IV.B.1** explains that Dominion misuses the

[16] *See*, *e.g., Application of Virginia Elec. & Power Co. for Approval and Certification of the Proposed Remington Solar Facility Pursuant to §§ 56-46.1 and 56-580 D of the Code of Virginia*, Case No. PUE-2016-00048, Final Order at 6 (Feb. 1, 2017) ("To 'ensure that Virginia jurisdictional customers do not subsidize the Project in any respect,' Dominion proposes to isolate the costs of constructing and operating the Remington Solar Facility and associated interconnection facilities, such that '[t]here will be no impacts to the Virginia jurisdiction cost of service, base rates, fuel rates, or RACs....'"); *Application of Virginia Elec. & Power Co. for Approval and Certification of the Proposed Oceana Solar Facility pursuant to §§ 56-46.1 and 56-580 D of the Code of Virginia*, Case No. PUE-2016-00079, Final Order at 6 (Mar. 27, 2017) (same); *Application of Virginia Elec. and Power Co. for Approval to Establish a Companion Tariff, Designated Schedule RG, Pursuant to § 56-234 of the Code of Virginia*, Case No. PUR-2017-00163, Order Approving Tariff at 11 (Nov. 6, 2018) (accepting utility's view that "Company renewable resources serving Schedule RG customers 'will never

phrase, thereby diluting its efficacy. **Part IV.B.2** then explains that true ring-fencing, as objective professionals have used the phrase, means corporate separation, with that separation subject to strict arm'-length rules. **Part IV.B.3** applies these points to Dominion's current situation.

1. Dominion's "ring-fencing" misuses the phrase and dilutes its efficacy

Dominion has described some of its efforts to serve competitive load as "ring-fenced." As used by Dominion, the phrase overstates and underdelivers.

If by "ring-fenced" Dominion means that its efforts to attract and serve data-center load (a) receive no benefits from its state-protected monopoly role, and (b) cause no risk to its captive customers, Dominion speaks nonfactually. **Parts II** and **III** above explained why. Compounding this factlessness is Dominion's narrowness. Dominion's definition answers only this question:

> *Will Dominion's actions cause captive customers to pay for Dominion's project?*

That question is the wrong question, because it diverts attention from the right question:

> *Do Dominion's actions give Dominion unearned competitive advantages, allow Dominion to keep for itself benefits arising from burdens borne by captive customers, and create asymmetry of risk and reward?*

The error is to focus only on protecting customers against cost, while failing to compensate them for value. As I have explained, Dominion's captive customers have been the near-guarantors of cost recovery for assets and activities that this government-protected utility uses when it acts as a competitor. The captive customers' compensation, if any, has been in the form of credits against the revenue requirement—but only for their contributions' cost rather than their market value. That practice of cost allocation violates a standard principle: When a utility provides a service to its nonutility business, the price must be the higher of cost or market.[17] The principle not only aligns the customers' benefits with their burdens; it also prevents the utility from having an unearned advantage over its competitors.

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be placed into the Company's cost of service revenue requirement that it collects from jurisdictional ratepayers'"); *Application of Virginia Elec. & Power Co. for Approval to Establish a Voluntary, Experimental Companion Tariff to Support Carbon-Free and Renewable Energy Generation, Designated Schedule CFG, pursuant to § 56-234 B of the Code of Virginia*, Case No. PUR-2024-00114, Final Order at 2, 4 (Dec. 23, 2024) (accepting utility's "ring-fence" proposal as "reasonable and sufficient to protect non-participating customers").

[17] *See*, *e.g.*, *Joint Application of GTE South Inc. and GTE Consolidated Services Inc, for Approval of Affiliated Transactions Pursuant to Chapter 4 of Title 56 of the Code of Va.,* Case No. PUA-2020-00036, Order Granting Approval (July 5, 2000) ("GTE South should

Dominion's definition of ring-fencing means that when high-load customers want to bring to Virginia their business, their jobs, and the resulting economic expansion, they won't be assured of having the fullest choices among the most competitive, least-cost, highest-value suppliers that would result from a market undistorted by Dominion's dual position.

2. For industry professionals, real ring-fencing is corporate separation

In its usage of "ring-fenced," Dominion has severed the phrase from its origins. By misdefining the phrase, Dominion escapes its inevitable consequence: corporate separation.

Ring-fencing's origins lie in the electric utility merger-and-acquisition-transaction trend that began in the 1980s and continues today. These transactions converted many standalone, pure-play utilities into subsidiaries of holding companies—multistate entities that own multiple utility companies and nonutility companies.[18] Proponents of those transactions customarily testified in state proceedings that "ring-fencing" would protect customers from the risks arising from their utility's affiliation with all these other businesses.

Epitomizing this consistent explanation of ring-fencing is recent testimony by Ms. Ellen Lapson, who often testifies for utilities in these acquisition cases. In testimony before the Minnesota Public Utilities Commission (which testimony she titled "CORPORATE SEPARATENESS AND RING-FENCING"), Ms. Lapson describes ring-fencing as having, among other things, these elements: [19]

> The Protected Company's assets are protected from diversion by having a *separate legal identity*, *separate bank accounts and asset accounts, with no commingling of assets*. Fixed assets needed to carry out the business should be in the Protected Company's own name. Transfers of goods, services, and supplies with other members of the group should be conducted on an *arm's length* basis.

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compare the market price with its cost of providing similar services and charge CSI the higher of GTE South's cost or the cost of obtaining services from an outside party (the market). In future rate proceedings, GTE South should bear the burden of proving that CSI received the higher of cost or market.") *See generally* Hempling, *Regulating Mergers and Acquisitions of U.S. Electric Utilities: Industry Consolidation and Corporate Complication* at chap. 6.5.5.1 (Edward Elgar Publishing 2020).

[18] I detail this trend, and discuss its implications for regulators, customers, and competitors, in my *Regulating Mergers and Acquisitions of U.S. Electric Utilities.* See in particular Chapters 3 and 6.

[19] In Ms. Lapson's testimony, "Protected Company" refers to the utility, which ring-fencing purports to protect from the risks of the nonutility affiliates.

> The Protected Company can maintain *its own access to funding and to sources of liquidity.* The Protected Company should have access to a liquidity credit arrangement that is available for drawing even despite the default of the company's parent or affiliated companies. The default by a parent or affiliate should not trigger a cross default or cross acceleration of the Protected Company's debt. If the Protected Company is an accepted issuer of debt in its own name in the public or private debt market, that will enhance access to funding, and maintaining a credit rating also helps to foster that aim.
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> The Protected Company is insulated from the liabilities of its parent and affiliates of the parent (sister companies*). It does not guarantee the debt or obligations of other members of its group*, and the other members of the group never represent to the public or to counterparties that the Protected Company is responsible for the obligations of other group members.
>
> The Protected Company can further protect its viability by limiting its financial leverage and preserving its individual solvency. This is not a requirement for ring-fencing, but it is a protective element.[20]

Dominion has done none of these things. In its efforts to attract and serve new data-center load, Dominion is not "ring-fenced."

In several proceedings, I have testified that ring-fencing, even as described by Ms. Lapson, is insufficient to create full separation of utility activities from nonutility activities. My position on the limits of ring-fencing was adopted by the Hawaii Public Utilities Commission in its order rejecting NextEra's proposed acquisition of Hawaii Electric Company and its affiliates:

> Office of State Planning Witness Hempling opined that there are five risks that even ring-fencing does not address:
>
> > Ring-fencing does not purport to remove, and does not remove, five risks NextEra brings to HECO's utilities: holding company-imposed limits on the utilities' access to equity capital, increases in the utilities' cost of equity and debt capital, certain bankruptcy risks, NextEra's interference in the utilities' business decisions, and inter-affiliate transaction abuse. Nor does ring-fencing add

[20] Direct Testimony of Ellen Lapson, before the Minnesota Public Utilities Commission, on behalf of Petitioners, OAH Docket No. 25-2500-40339, MPUC Docket No. E015/PA-24-198 (*In the Matter of the Petition of Minnesota Power for the Acquisition of ALLETE by Canada Pension Plan Investment Board and Global Infrastructure Partners*) at 12-13 (December 12, 2024) (emphasis added). I am also a witness in that case, appearing on behalf of the Minnesota Citizens Utility Board.

> the extra staff the Commission will need to ensure that NextEra complies with the ring- fencing measures.
>
> The commission considers the concerns expressed by Witness Hempling, in conjunction with the findings above, as sufficiently serious to conclude that the current proposed ring-fencing measures are inadequate to protect the interests of the public.[21]

If the utility and its competitors are all seeking to supply the same load, they are competitors in the same market. It is that simple. And if they are competitors in the same market, the utility cannot also be the monopoly supplier in that market. Such a situation violates regulatory principles that have guided regulators for decades.

3. Applied to Dominion, true ring-fencing would improve customer protection and supports competition on the merits

Virginia deserves a solution that protects captive customers, provides proper compensation to those customers, and promises shopping customers competition on the merits, undistorted by incumbent advantage. The solution must separate, in all ways, the provision of competitive services from the provision of monopoly services. The solution has at least the five parts summarized next.

1. Recognize that any customer having the right to shop competitively is, as a practical matter, shopping competitively—whether buying from Dominion under the utility's obligation to serve, or buying from someone else. A "competitive service," therefore, is any service provided by Dominion that is also provided by a competitor, even if it is a service that Dominion is obligated by its franchise to provide.

2. Require that Dominion provide these defined competitive services only through a competitive affiliate. The customers that take service under GS-4 would still have a legal right to be served by that Dominion affiliate, but their terms and conditions of service would be cleansed of any advantages attributable to the provider's affiliation with Dominion.

3. All customers that have no legal right to shop competitively would continue to take service under their original Dominion tariff.

4. Require the relationship between Dominion and its competitive affiliate to be an arm's-length relationship. It will be an arm's-length relationship only if there is ring-fencing—as defined not by Dominion but by Ms. Lapson. That arm's-length relationship would comply, at minimum, with the following five requirements:

- The competitive affiliate must have its own financing and its own credit rating.

[21] *Hawaiian Electric Company, et al.,* Docket No. 2015-0022, Order No. 33795 at 211/265 (July 15, 2016) (quoting Hempling Direct Testimony, OSP Ex. 4 at 87).

- The competitive affiliate must buy its inputs from independent entities when there are independent entities willing to provide those inputs at reasonable prices.

- The competitive affiliate must receive from its utility affiliate no assistance that is not available to the unaffiliated competitors on the same terms and conditions.

- All uses by the competitive affiliate of resources provided by the utility affiliate must be invoiced as an interaffiliate transaction. The price for each interaffiliate transaction must comply with standard interaffiliate pricing principles: sales from the competitive affiliate to the utility affiliate must be at the lower of cost or market; sales from the utility affiliate to the competitive affiliate must be at the higher of cost or market.

- The affiliate may not hire or use employees from the utility, except at market rates approved by the Commission. The affiliate also must pay the utility a Commission-set royalty payment that compensates captive customers for their history of costs borne to train the employees.[22] The royalty payment would reduce the revenue requirement used to set the utility's rates.

5. The Commission must have sufficient resources to ensure that the affiliate operates at arm's-length, and that the terms of service offered by the affiliate reflect no advantage gained by its affiliation with the utility. On detecting favoritism, the Commission needs to

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[22] The New York Public Service Commission has stated:

> Because ratepayers have funded the salaries, training, advertising, and other activities that generate good will, they are entitled to rate recognition of revenues received by the utility in exchange for the use of that asset by an affiliate or otherwise. Where the asset is used and no revenues are received in exchange, an imputation may well be warranted. . . .
>
> A utility in an arms-length transaction could be expected to receive revenues for allowing the use of its employees or goodwill, and our statutory obligation to set just and reasonable rates permits us to impute such revenues, ... where they are not in fact received.

The Commission found that the imputed royalty payment was not an unconstitutional taking, since shareholders have no reasonable "investment-backed expectation" that they can keep the full value of an affiliate's relationship with a regulated utility. *Rochester Telephone Corp.,* Case No. 87-C-8959, 1993 N.Y. PUC LEXIS 13, at *44 (N.Y. Pub. Serv. Comm'n July 6, 1993). *See also Germantown Telephone Co*., Case No. 95-C-0730, 1996 N.Y. PUC LEXIS 23, at *6 (N.Y. Pub. Serv. Comm'n Jan. 30, 1996) (reserving for ratepayers, on utility's formation of an unregulated affiliate, a royalty imputation because utility's reputation will benefit the unregulated affiliate and because of the risk to ratepayers of the "diversion of managerial attention and regulated resources").

exercise its powers to apply penalties sufficient to compensate those harmed and to deter future misconduct. The penalties will include revoking the affiliate's license to sell elective services.

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