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Dominion Takes On ITC Rules

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Testimony on Feb. 23 to Virginia's State Corporate Commission from an advisor to the commission described the strategy of Dominion's Virginia Electric and Power Co. (VEPC) to escape the grasp of the Internal Revenue Code's normalization rules that prohibit utility-owned and -operated solar projects from effectively using the investment tax credit (ITC).

Utilities charge their customers rates set by state public utility commissions. The rate is based on the "cost of service" plus a level of profit set by the commission based on the utility's "rate base." The "cost of service" includes operating and maintenance expenses, economic depreciation, interest, and tax expense. The "rate base" is supposed to reflect the value of the utility's assets and is a dollar amount that is multiplied by the rate of return set by the commission. If a utility's cost of service is $10 million a year, it has a rate base of $100 million and the commission has set the regulated return at 6%, then the utility could charge a rate for electricity that would generate $16 million (i.e., $10 million plus 6% of $100 million) for the year.

The normalization rules for the ITC provide that it is not available if it is used by a utility commission as an offset to a utility's "cost of service." If the ITC is not used as an offset to the cost of service, the normalization rules impose a second requirement: The utility's "rate base" cannot be reduced by more than a ratable portion of the ITC. The annual ratable portion is determined by dividing the ITC benefit by the useful life for regulatory depreciation purposes of the solar project. If a utility built a $20 million solar project, then it would be eligible for a 30% ITC or a $6 million tax benefit in the first year. If, for regulatory purposes, the solar project has a 30-year life, the rate base could be reduced by only $200,000 a year, resulting in a customer savings of only $12,000 a year if the regulated return is 6%.


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These ITC restrictions have disincentivized utilities from investing in solar. Rather, utilities have preferred to sign power purchase agreements (PPAs) to buy solar power. VEPC is on the last step of a three-step strategy to own solar, claim the tax benefits and avoid normalization.

The first step occurred in 2015 when the Virginia General Assembly enacted a statute allowing for a regulated utility to charge consumers for providing solar power "based on a market index in lieu of a cost of service model."

The second step required the Internal Revenue Service (IRS) to issue a private letter ruling. The IRS has yet to release it to the public; however, the testimony states it was issued on Feb. 17. The testimony describes the IRS ruling as providing "that if the commission were to adopt the market index rate adjustment clause, the [solar projects] would not constitute 'public utility property'" (i.e., VEPC could use the ITC). The testimony to the commission explains that a "market index rate adjustment" is an increase to customers' utility rates that reflects the highest-price PPA proposal received by VEPC in response to a 2015 request for proposals.

The last step is VEPC's pending request to the commission to charge consumers for providing solar power from its own projects using the "market index rate" rather than the traditional "cost of service" methodology.

Other states have yet to enact statutes similar to that enacted by Virginia. Other utilities may now lobby their legislatures for "market index rate" statutes to enable them to own and operate solar projects and use the ITC. So long as the IRS does not vary from the ruling issued to VEPC and utility commissions adopt the market index rate approach, such a strategy could effectively mean the end of the ITC normalization rules, which no longer serve as a worthwhile policy objective.

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