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U.S. And Canadian Utility Regulatory Updates And Insights: June 2020

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Sector	**Infrastructure & Utilities, Utilities & Power, Midstream**
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Key Takeaways

- S&P Global Ratings periodically assesses each regulatory jurisdiction in the U.S. and Canada with a rated utility or where a rated entity operates.
- These assessments--with categories from "credit supportive" to "most credit supportive"--provide information for reference in determining the regulatory risk of a regulated utility or holding company with more than one utility. We made no changes since our last report, but examine developments in several jurisdictions.
- We base our analysis on quantitative and qualitative factors, focusing on regulatory stability, tariff-setting procedures and design, financial stability, and regulatory independence and insulation.
- The presence of utility regulation, no matter where in the spectrum of our assessments, strengthens the business risk profile and generally supports utility ratings.

S&P Global Ratings conducts periodic assessments of each regulatory jurisdiction in the U.S. and Canada where a rated utility operates as a reference when determining a utility's regulatory advantage or regulatory risk. Regulatory advantage is a heavily weighted factor in our analysis of a regulated utility's business risk profile.

Our analysis covers quantitative and qualitative factors, focusing on regulatory stability, tariff-setting procedures and design, financial stability, and regulatory independence and insulation. (See "Key Credit Factors For The Regulated Utilities Industry," published Nov. 19, 2013, for more details on each category.)

Sorting Through Regulatory Jurisdictions In The U.S. And Canada

We updated our assessments of regulatory jurisdictions since our commentary "U.S. And Canadian Regulatory Jurisdiction Updates And Insights: November 2019," published Nov. 4, 2019. Our assessments of U.S. jurisdictions' and Canadian provinces' approaches to regulation over the past several months are unchanged. Here, we provide our current snapshot of each regulatory jurisdiction (Table 1, Charts 1 and 2). We group the jurisdictions by the quantitative and qualitative factors and collective opinions expressed in the regulatory advantage determinations made in rating committees for the approximately 225 U.S. and 30 Canadian utilities we rate.

The categories indicate an important point regarding utility regulation and its effect on ratings: They are denoted credit supportive to one degree or another, as all utility regulation sustains credit quality when compared with corporate and infrastructure ratings. The presence of regulators, no matter where in the spectrum of our assessments, reduces business risk and generally supports utility ratings. We describe all these jurisdictions in a range from credit supportive to most credit supportive, and these vary only in degree rather than in kind.

Assessing U.S. And Canadian Regulatory Jurisdictions

Table 1

Regulatory Jurisdictions For Utilities Among U.S. States And Canadian Provinces

Credit supportive	More credit supportive	Very credit supportive	Highly credit supportive	Most credit supportive
Hawaii	Alaska	Connecticut	Arkansas	Alabama
Mississippi	Arizona	Delaware	Georgia	Alberta
New Mexico	California	Idaho	Indiana	British Columbia
Prince Edward Island	District of Columbia	Illinois	Kansas	Colorado
	Maryland	Missouri	Louisiana	FERC (electric)
	Montana	Nebraska	Maine	Florida
	New Jersey	Nevada	Massachusetts	Iowa
	Oklahoma	New Orleans	Minnesota	Kentucky
	South Carolina	New York	New Hampshire	Michigan
	Washington	Ohio	Newfoundland & Labrador	North Carolina
		Rhode Island	North Dakota	Nova Scotia
		South Dakota	Oregon	Ontario
		Texas	Pennsylvania	Quebec
		Vermont	Tennessee	Wisconsin
		West Virginia	Texas RRC	
		Wyoming	Utah	
			Virginia	

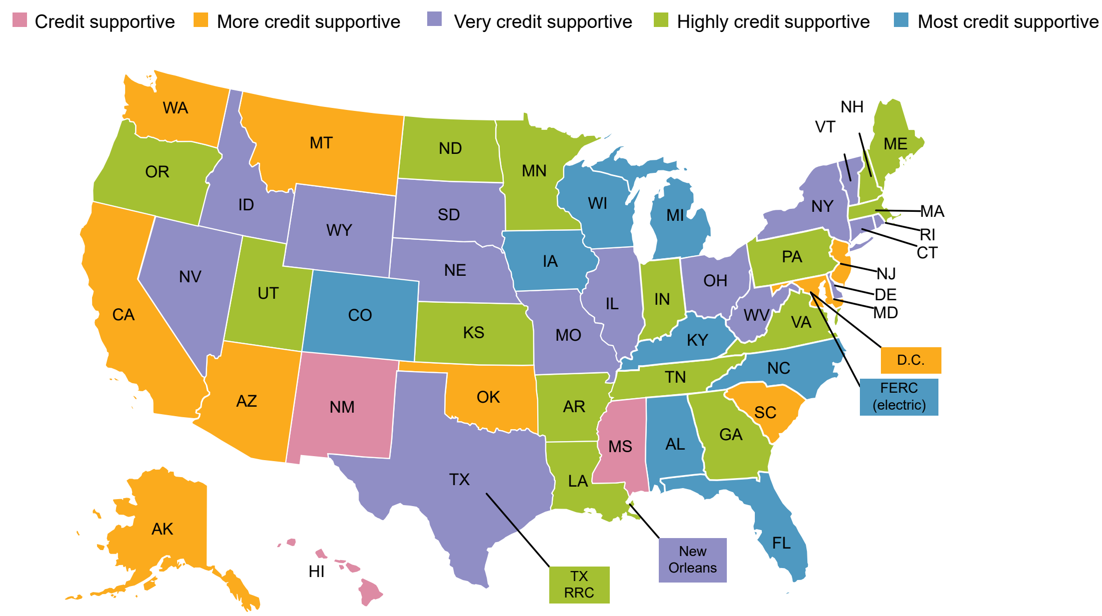
FERC--U.S. Federal Energy Regulatory Commission. RRC--Railroad Commission of Texas.

Mapping Regulatory Jurisdictions

For jurisdictions assessed in these maps (Charts 1 and 2), colors delineate our assessments of credit supportiveness. (We do not have assessments on some Canadian provinces where we don't rate any utilities.) The assessments offer some scale and detail in our thinking regarding the rules and implementation of regulation. Often they simply designate a stable jurisdiction slightly better or worse than its closest peers in credit quality.

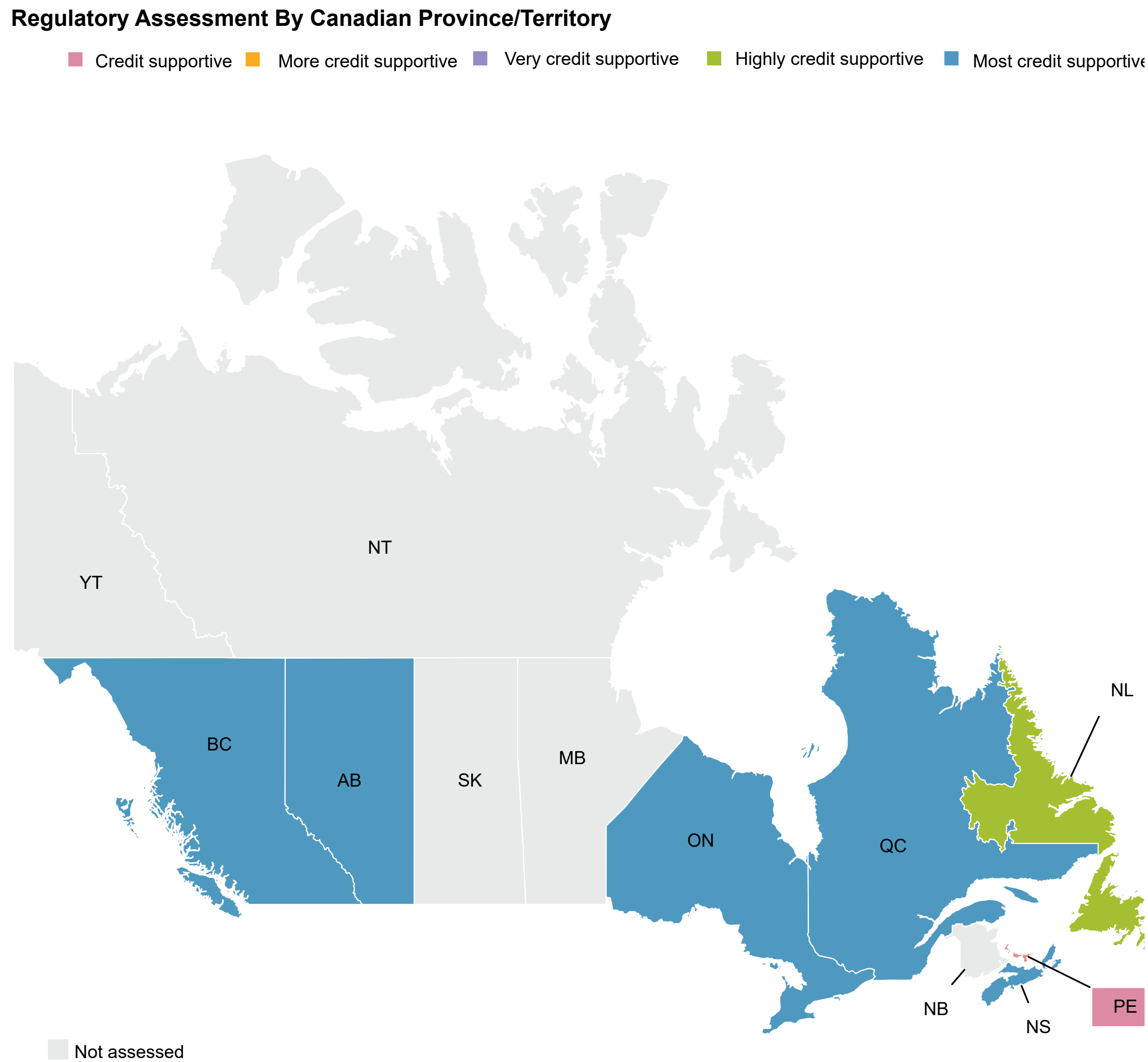
Chart 1

Regulatory Assessment By State



FERC—Federal Energy Regulatory Commission. RRC—Railroad Commission of Texas. Data as of June 2020.

Chart 2



Notable Topics Throughout North America

Although our biannual review found no material events that would change a jurisdictional assessment amid the COVID-19 pandemic, there have been an unprecedented number of regulatory actions with respect to cost recovery and bad debt collection moratoriums ("Regulatory Responses To COVID-19 Are Key To Utilities' Credit Prospects", published May 20, 2020). In addition, other notable developments have occurred in several jurisdictions.

Alberta

Compared to our assessment in November, the Alberta regulatory construct is weakening as regulatory lag has not improved. In addition, utilities are continually exposed to the risk of absorbing the undepreciated capital cost of stranded assets due to extraordinary retirement. Furthermore, the recent regulatory decision by the Alberta Utilities Commission regarding the Alberta Electric System Operator's customer contribution policy, under which requiring distribution operators to transfer transmission related investments to transmission operators at net book value, somewhat calls into question the regulatory framework's consistency.

FERC Electric

Recent U.S. Federal Energy Regulatory Commission (FERC) rulings on Midcontinent Independent System Operator (MISO) transmission owners' authorized return on equity (ROE) indicate inconsistency in how ROE decisions could be applied toward New England transmission owners' ROEs. Specifically, in late 2018, FERC proposed using a new ROE calculation method that focused on four factors. However, in late 2019, FERC did not use that methodology to establish the new ROE for MISO transmission owners, instead using a method that relied on two factors. Furthermore, FERC further revised the methodology in May 2020 by adding a third approach to calculate transmission owner ROEs. It was marginally favorable for MISO transmission owners compared to the two-factor approach, but resulted in a slight base ROE reduction.

Although there are inconsistencies regarding ROEs for electric transmission owners, we continue to consider FERC regulation toward electric transmission as one of the most credit supportive.

Hawaii

The state is undergoing regulatory reform, and the Hawaii Public Utilities Commission (HPUC) is proceeding with a performance-based regulation (PBR) framework. HPUC plans to finalize the implementation details by the end of 2020. The proposal includes a five-year rate plan with an indexed annual revenue adjustment mechanism, coupled with existing capital recovery mechanisms in between rate cases. We expect this will improve the timeliness of both capital and operating cost recovery for utilities that could lead to improved profitability.

In addition, an earnings-sharing mechanism (ESM) and various performance incentive mechanisms (PIMs) are included. The proposed ESM shares excess earnings with customers and protects the utilities from extreme financial shortfalls. PIMs may provide potential earnings to a utility should it meet certain performance targets. Overall, we expect the new PBR framework will lead to more regulatory predictability and cash flow stability for utilities in Hawaii, including Hawaiian Electric Industries Inc.

Massachusetts

Due to the state regulatory commission's recent rate decision for utility Massachusetts Electric Co. in late 2019, we believe the regulatory environment is gradually improving. The Mass Electric rate case decision was the second major case that included a PBR mechanism, the first being NSTAR Electric Co. Such mechanisms provide for a more predictable formulaic rate setting construct that accounts for utilities' capital and operational spending, inflation over a five-year period, and a decoupling mechanism that provides downside protection irrespective of sales volume declines.

NSTAR Gas Co. recently filed for a similar PBR mechanism in their gas distribution rate case, and we are monitoring this development. Overall, even with our view of gradual improvement, we believe there could be regulatory lag since the state uses historical test years when setting rates.

Mississippi

We continue to monitor the pending regulatory commission decision on Mississippi Power Co.'s (MPC) reserve margin plan (RMP), a request by the regulator to develop alternatives to lower its reserve margin. This plan could accelerate retirements for some of MPC's coal-fired power plants by 2022. We continue to monitor this proceeding to determine how the rate recovery of remaining book value of retired assets will be addressed.

Nevada

Following a legislative initiative in 2019, the Public Utilities Commission of Nevada (PUCN) initiated a proceeding and has conducted workshops regarding the options around alternative ratemaking plans that could include formula rates, decoupling, earnings sharing, and multiyear rate plans. In April 2020, PUCN released the first report that outlines efforts regarding potential alternative ratemaking mechanisms for Nevada's electric utilities. Ultimately a draft proposal may be issued in 2021 with regulations adopted after reviewing feedback from workshop participants. PUCN is evaluating whether alternative ratemaking would provide better incentives than traditional cost-of-service ratemaking for NV Energy Inc.'s regulated utilities, Nevada Power Co. and Sierra Pacific Power Co. This is to achieve state policy goals for lower carbon emissions, renewable energy, energy efficiency, and electric vehicle adoption while keeping costs down.

Also, the commission is examining whether alternative rates such as flexible pricing options for customer classes will capture utilities' cost of doing business and support financial stability while assuring the delivery of safe and reliable electricity at a reasonable cost. The final determination is expected in 2021, and we will continue to monitor developments.

New York

Political attention toward utilities in the state was somewhat heightened during the past year following a blackout in summer 2019 in Consolidated Edison Inc.'s (Con Ed) service territory. In addition, Con Ed's and National Grid North America's (NGNA) implementation of gas distribution moratoriums to manage gas supply issues in the region added to the regulatory uncertainty. The moratoriums led to a letter in late 2019 from Gov. Andrew Cuomo indicating the state would move to revoke NGNA's certificate to operate its downstate gas franchise in response to NGNA's management of the gas supply issues in its service territory.

NGNA subsequently agreed to pay $36 million to compensate customers affected by its moratorium and support other energy conservation measures and projects, all of which reduced regulatory uncertainty. However, regulatory risk is still likely to persist because gas supply constraints remain a key issue for gas utilities in the state.

Con Ed has faced political pushback for some of its actions, including on the gas supply moratorium and summer 2019 blackout, but has avoided formal reprimands. This somewhat limits its regulatory and political risks. Despite the negative political attention, Con Ed achieved a somewhat constructive rate case decision from the New York State Public Service Commission (NYSPSC), including on a multiyear rate plan for its electric and gas operations at Consolidated Edison Co. of New York Inc. for rate increases totaling nearly $1.2 billion over three years beginning in 2020. While the multiyear rate plan provides some cash flow predictability, under this plan the authorized return on equity is 8.8%, lower than what is typical for peers.

New Mexico

In 2019, the state passed the Energy Transition Act (ETA) to eliminate carbon emissions by 2045 from electric utilities with interim targets. We believe this provides credit support to the retirement of fossil-fuel generation in the state. PNM Resources Inc. subsequently sought approval to close units at the San Juan coal-fired plant and securitize the plant abandonment costs. In early 2020, a New Mexico Supreme Court ruling confirmed the applicability of the ETA to PNM's plan and replacement power project. The commission is reviewing different options of the proposed replacement project.

An initiative is expected to be included on the state's 2020 general election ballot that, if approved, would require Public Regulation Commission members to be appointed. The constitutional amendment would change the PRC from a five-person elected body to a three-person agency, with members chosen by the governor from a list of candidates compiled by a nominating committee, beginning in 2023.

North Carolina

While some developments suggest possible improvement to regulatory risks, other issues remain unresolved. Specifically, passage of Senate Bill 559, a storm securitization measure, permits recovery for certain storm recovery costs. Duke Energy Corp. utilities Duke Energy Carolinas LLC and Duke Energy Progress LLC can use a new financing measure to recover restoration costs incurred after several storms and hurricanes in 2018.

We consider this favorable for credit quality. Separately, in 2019, Duke Energy settled with the North Carolina Department of Environmental Quality and certain community groups to excavate seven of the nine remaining coal ash basins in North Carolina and partly excavate the other two. Although this reduces legal uncertainty associated with the company's ash pond closure strategy, cost recovery for coal ash costs is still pending, which indicates some regulatory uncertainty.

Texas

We have not revised our regulatory jurisdiction assessment on the Public Utilities Commission of Texas (PUCT), which we consider to be very credit supportive. But we believe recent orders related to COVID-19 in addition to noteworthy trends stemming from recent rate proceedings require a comment.

In March 2020, PUCT issued orders related to COVID-19, suspending utility service disconnections for nonpayment and creating the COVID-19 Electricity Relief Program. We find this program to be constructive from a credit standpoint, specifically as it relates to the recoverability of unexpected costs arising from customer nonpayment due to the pandemic. We believe PUCT's action to be more proactive and demonstrates a commitment to credit quality compared to responses from other jurisdictions that relied only on deferrals of these costs as regulatory assets.

In multiple recent rate case decisions, PUCT approved more-leveraged hypothetical capital structures that reflect an equity ratio of 42.5%. This differs from previous trends when PUCT approved equity ratios of 45%. We believe these actions could weaken credit quality as utilities manage equity ratios down to this lower level, possibly weakening financial measures without offsetting adjustments.

Virginia

The Virginia Clean Economy Act passed in March 2020, which requires electric utilities to supply 100% of electricity from renewable sources by 2050. Intermediate targets are also set for utilities, including Virginia Electric & Power Co. and Appalachian Power Co., that require 30% of power to be supplied from renewables by 2030 and to close all carbon-emitting power plants by 2045 and 2050, respectively. The Grid Transformation and Security Act passed in 2018 allows utilities to rate-base large renewable projects. However, certain key risks remain, including concerns on the leveled cost of energy provided by new offshore wind projects, even though lawmakers have been historically supportive to the utilities' effort to expand wind capacity. The Clean Economy Act also grants the Virginia State Corporation Commission more oversight over major projects, including the 2.6-gigawatt offshore wind project with construction slated to start in 2024. Some risks may arise due to potential cost overruns or project delays, which could create pressure on the timely cost recovery and ratepayer affordability. We are closely monitoring the 12-megawatt pilot project, which may complete construction this summer.

Renewable Portfolio Standard And Clean Energy Standards

State-level clean and renewable energy standards greatly influence the overall strategic direction and growth investments of North American regulated utilities. Regulatory support through timely cost recovery helps support credit quality and facilitate the energy transition. A number of states are passing or proposing legislation that would require utilities to further scale back carbon emissions from power plants and utilize a greater percentage of renewable energy generation. Today, 31 states have a mandatory renewable portfolio standard (RPS), and seven have a voluntary renewable energy standard target.

The most recent state to adopt a mandatory RPS target is Virginia, which as of 2020 requires investor-owned utilities to achieve 100% renewable generation by either 2045 or 2050, depending on the entity, and a certain amount from solar and wind sources. Other states are revising their targets or passing additional legislation. Washington passed a bill to achieve net-zero carbon emissions by 2050. Maine requires state greenhouse gas emissions to be below 1990 levels by at least 45% by 2030 and at least 80% by 2050. Iowa, New Mexico, and Maryland have either passed or proposed legislation that would curb emissions and require more clean energy sources.

We will continue to monitor these developments for any impact.

Related Research

- Regulatory Responses To COVID-19 Are Key To Utilities' Credit Prospects, May 20, 2020
- U.S. And Canadian Regulatory Jurisdiction Updates And Insights: November 2019, Nov. 4, 2019
- Key Credit Factors For The Regulated Utilities Industry, Nov. 19, 2013

This report does not constitute a rating action.

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