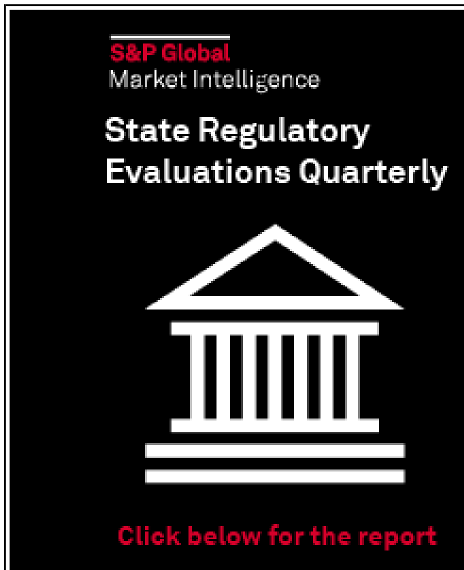
RRA REGULATORY FOCUS

Rankings of 6 states revised as regulatory risk for energy utilities assessed

Thursday, March 26, 2020 8:49 AM ET

By Lillian Federico
Market Intelligence

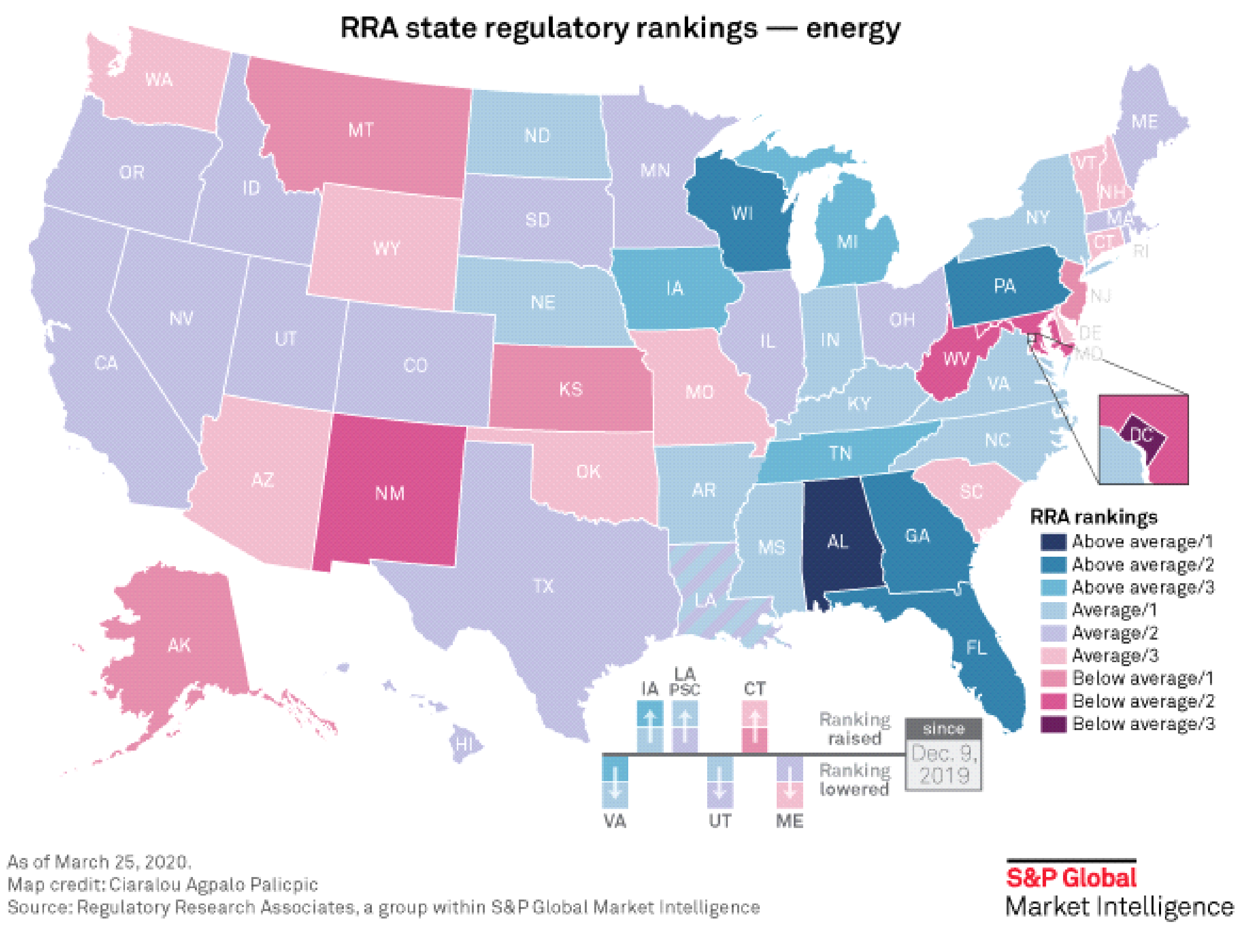
In a review of its State Regulatory Evaluations conducted over recent weeks, Regulatory Research Associates, a group within S&P Global Market Intelligence, revised the ranking of six jurisdictions. RRA's rankings are designed to reflect the relative level of investor risk associated with owning the securities of the utilities regulated by the 53 state-level jurisdictions RRA covers.



State Regulatory Evaluations—Energy

RRA monitors state-level regulatory developments on an ongoing basis and ranking changes for an individual jurisdiction may occur at any time in response to an event or a series of events. The team also performs a comprehensive review of the rankings on a quarterly basis to ensure that they remain appropriately synchronized and balanced.

At this time, RRA is changing the rankings in six jurisdictions — the team is raising the rankings of Connecticut, Iowa and Louisiana, indicating that these jurisdictions have become relatively more constructive, or less risky, from an investor standpoint and is lowering the rankings of Maine, Utah and Virginia, as these jurisdictions have become less constructive, or more risky from an investor standpoint in RRA's view.



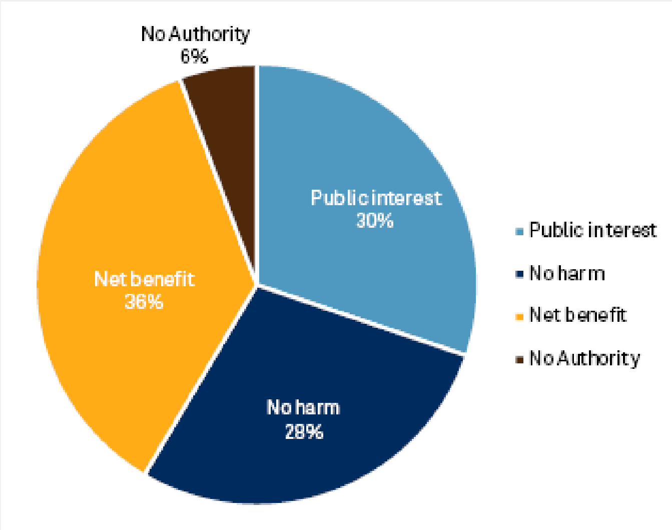
The ranking of Connecticut regulation is moving to Average/3 from Below Average/1. The ranking shift accounts for modestly constructive ratemaking actions the Connecticut Public Utilities Regulatory Authority, or PURA, has taken in recent years, including a focus on grid modernization. Although the authorized ROEs in recent years for both the electric and gas utilities have been considerably below national averages, the PURA has adopted these returns as part of multi-year rate plans that streamline the regulatory process and provide an enhanced degree of certainty with respect to the rate recognition of planned investments.

RRA is also raising the ranking of Iowa regulation to Above Average/3 from Average/1, as constructive measures stemming from the state's omnibus energy legislation enacted in 2018 materialized in 2019. Key to moving the needle in the ranking was the use of forward-looking test years in rate cases, as allowed by that 2018 legislation, in two separate 2019 rate case proceedings.

In addition, RRA is raising the ranking of Louisiana regulation to Average/1 from Average/2, recognizing the impact of the state's use of alternative regulation plans. For many years Louisiana's utilities have operated under these mechanisms that provide for periodic rate adjustments outside of base rate cases. Many of the plans contain earnings-sharing provisions and include other constructive provisions that address various utility costs and investments in a timely manner, including new generation capacity additions. The plans also have generally incorporated benchmark equity returns that were in line with or above prevailing industry averages at the time they were established.

At this time, RRA is lowering the ranking of Maine regulation to Average/3 from Average/2 due to recent restrictive developments related to mergers and rate case activity. Legislation was enacted in 2019 that amends the Maine Public Utilities Commission's standard of approval for public utility corporate reorganizations to a "net benefits" standard from a "no net harm" standard. While the PUC ultimately approved the proposed sale of Emera Inc. subsidiary Emera Maine to ENMAX Corp. under the new stricter test, it did so only after a revised settlement was reached outlining more stringent conditions, including extending a rate freeze for Emera Maine by an additional six months and restricting the level of dividend payments. The transaction closed on March 24, 2020.

Merger review standards



As of March 25, 2020.
Source: Regulatory Research Associates, an offering of S&P Global Market Intelligence

In a recent rate case for Central Maine Power Co., or CMP, the PUC imposed a penalty to reflect "imprudent" management decisions with respect to a new billing system. The penalty reduced the utility's authorized ROE by 100 basis points to 8.25%. This ROE is significantly below the average of ROEs authorized by state commission in cases decided in 2019, and is the lowest equity return authorization for an electric utility nationwide since RRA began tracking equity returns in the 1980s. CMP is subsidiary of Avangrid Inc., which is owned by Iberdrola SA.

RRA is reducing the rating of Utah regulation to Average/2 from Average/1. This is driven primarily by a recent restrictive Public Service Commission of Utah decision for Dominion Energy Inc. subsidiary Questar Gas Co., in which the commission adopted a below industry average equity return and directed the company to phase-in a relatively modest rate increase. This in conjunction with constructive developments in certain other jurisdictions caused a shift in Utah's relative position within the RRA rankings framework.

RRA is lowering the ranking of Virginia regulation to Average/1 from Above Average/3. This is the second ranking reduction RRA has made for Virginia in the last 12 months — the ranking was lowered to Above Average/3 from Above Average/2 in August 2019. These rankings actions indicate that while RRA perceives an increase in the level of regulatory risk for the utilities operating in the state, the Virginia regulatory climate remains somewhat more constructive than average from an investor viewpoint.

These changes were precipitated by several factors including a declining trend in authorized ROEs, backlash concerning the use of rider mechanisms for new investment, as evidenced by commercial customer initiatives to aggregate load to qualify to procure power from a source other than the utility, legislative initiatives to implement broad-based retail competition for electric generation and the failure of the General Assembly to either re-elect a sitting commissioner or elect a replacement in a timely manner.

RRA's previous comprehensive review of its rankings was conducted in the fourth quarter of 2019, when RRA reported that the team had made no rankings changes. Subsequent to that report, RRA released State Regulatory Reviews affirming the rankings of the North Carolina and South Carolina jurisdictions.

In a review published Jan. 6, RRA affirmed its Average/3 ranking of South Carolina regulation indicating that while generally balanced, the environment in the state is somewhat more restrictive than average from an investor viewpoint.

In a review published March 10, RRA affirmed the Average/1 ranking of the North Carolina regulatory climate. In RRA's view, North Carolina is also generally balanced from an investor viewpoint, but is a bit more constructive than average.

RRA State Regulatory Reviews are issued periodically and are static in nature, but the information provided in these *reviews is updated on a real-time basis in RRA's Commission Profiles.*

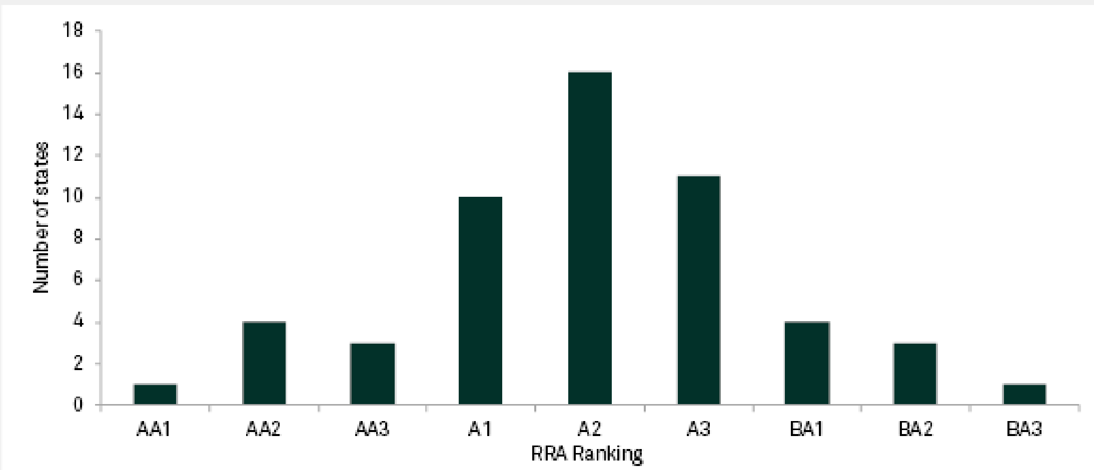
Overview of RRA rankings process

RRA evaluates the regulatory climates for energy utilities of the jurisdictions within the 50 states and the District of Columbia, a total of 53 jurisdictions, on an ongoing basis. The evaluations are assigned from an investor perspective and indicate the relative regulatory risk associated with the ownership of securities issued by each jurisdiction's electric and gas utilities.

The rankings look at various state commission policies but also take into account actions by state governors, legislatures, courts and intervening parties in major proceedings before the commissions.

RRA maintains three principal rating categories: Above Average, Average and Below Average.

State regulatory rankings distribution*



As of March 25, 2020.
* Graph is based on rankings of regulatory climate for energy utilities only.
AA = Above Average; A = Average; BA = Below Average
Source: Regulatory Research Associates, a group within S&P Global Market Intelligence

An Above Average designation indicates that, in RRA's view, the regulatory climate in the jurisdiction is relatively more constructive than average, representing lower risk for investors that hold or are considering acquiring the securities issued by the utilities operating in that jurisdiction.

At the opposite end of the spectrum, a Below Average ranking would indicate a less constructive, higher-risk regulatory climate from an investor viewpoint.

A rating in the Average category would imply a relatively balanced approach on the part of the governor, the legislature, the courts and the commission when it comes to adopting policies that impact investor and consumer interests.

Within the three principal rating categories, the designations 1, 2 and 3 indicate relative position, with a 1 implying a more constructive relative ranking within the category, a 2 indicating a midrange ranking within the category and a 3 indicating a less constructive ranking within the category.

RRA attempts to maintain a "normal distribution" of the rankings, with the majority of the states classified in one of the three Average-range categories. The remaining states are the split relatively evenly between the Above Average and Below Average classifications.

For a more in-depth discussion of the factors RRA reviews as part of its ratings process, see the March 25 report, State Regulatory Evaluations — Energy.

Regulatory Research Associates is a group within S&P Global Market Intelligence.

For a discussion of the regulatory climate in each jurisdiction, refer to RRA's Commission Profiles.

For a complete, searchable listing of RRA's in-depth research and analysis, please go to the S&P Global Market Intelligence Energy Research Library.

Ciaralou Palicpic contributed to this article.

This article was published by S&P Global Market Intelligence and not by S&P Global Ratings, which is a separately managed division of S&P Global.