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Regulatory Responses To COVID-19 Are Key To Utilities' Credit Prospects

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Key Takeaways

- Many state and provincial governments in North America have instituted mandatory moratoriums on shutting off customers during the COVID-19 pandemic.
- Utilities may experience material hits to cash flow in coming quarters unless credit supportive measures are taken.
- Utilities will be tested to maintain liquidity and operating cash flow to support credit quality.
- Regulatory jurisdictions will be tested to find creative and supportive ways to bolster the credit quality of their utilities.
- Widening gaps in cost recovery could impact utilities.

The COVID-19 pandemic has created an unprecedented level of uncertainty and regulatory action in North America. Throughout the United States and Canada, many state and provincial governments have instituted mandatory moratoriums on utilities shutting off customers, or they have worked together to institute voluntary moratoriums during the COVID-19 pandemic. These moratoriums, along with any lost revenues due to the economic impact of COVID-19 pandemic and the potential incurrence of higher operating expenses, may weaken financial measures of utilities. S&P Global Ratings has been monitoring these actions and their impact on credit quality of U.S. and Canadian regulated utilities.

North American Moratoriums

The maps below indicate the states and provinces that have instituted mandatory and voluntary moratoriums. A few states have multiple regulators that utilize both voluntary and mandatory moratoriums.

Chart 1

United States Jurisdiction Service Moratoriums Enacted
As of May 18, 2020

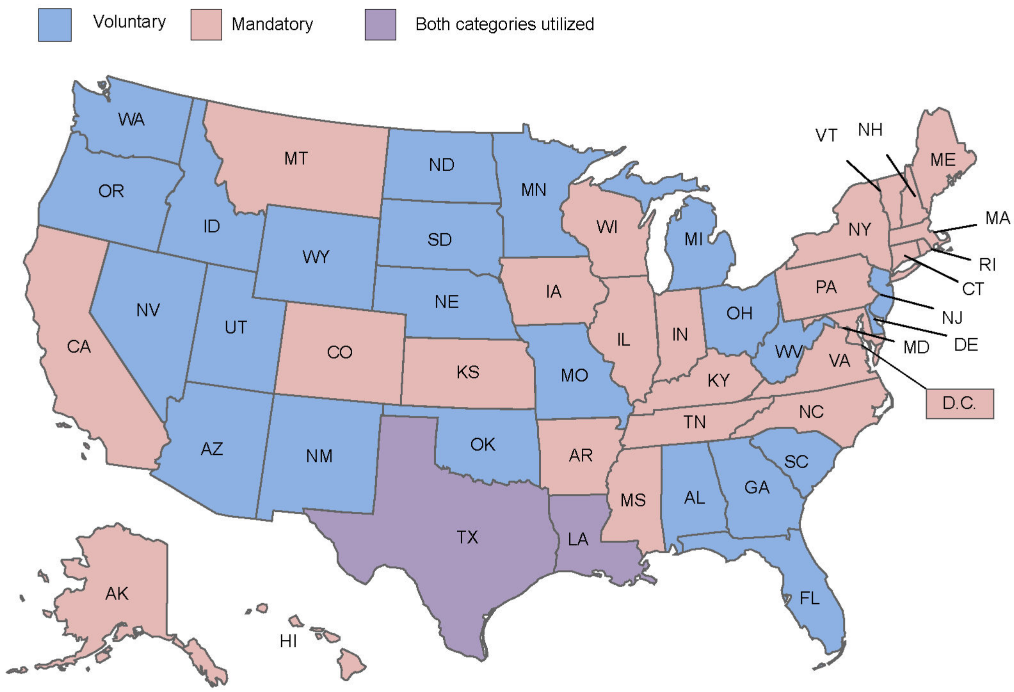
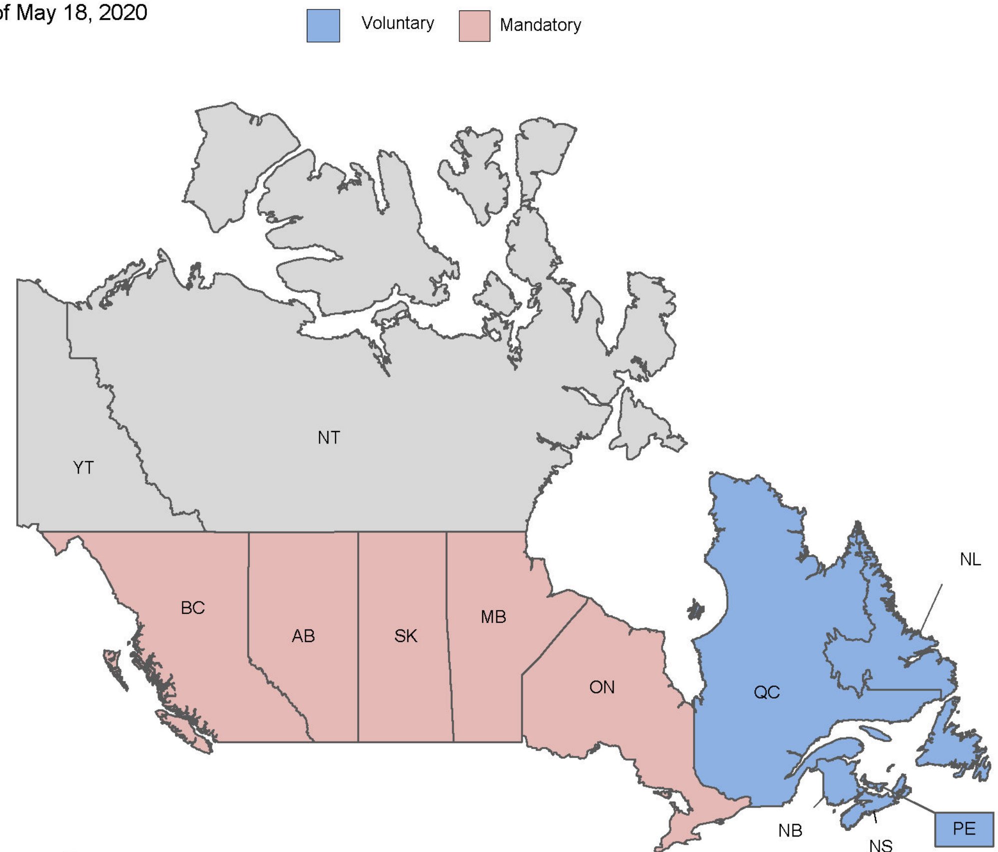


Chart 2

Canadian Jurisdiction Service Moratoriums Enacted
As of May 18, 2020



Regulatory Responses & Credit Implications

While no jurisdiction's response is exactly the same, we have identified several broad categories of response. Jurisdictions and regulatory commissions have authorized utilities to:

- Defer costs for future recovery;
- Enter into payment arrangements with customers;
- Enter into bill mitigation measures, such as the acceleration of refunds for fuel costs; and
- Seek rate recovery through various mechanisms such as rate surcharges, future rate cases, or formula rate plans.

Deferrals

One of the main responses we've seen from commissions are the authorization of utilities to accrue COVID-19-related costs and defer them for future prudence reviews and rate recovery for both residential and nonresidential customers.

Residential

The Arkansas Public Service Commission authorized the utilities to establish regulatory assets to record costs resulting from the suspension of disconnections. In future proceedings, the commission will consider whether each utility's request for recovery of these regulatory assets is reasonable and necessary. We expect Entergy Corp. utility Entergy Arkansas LLC to file a formula rate plan in the summer of 2020, and that revenue changes and costs from COVID-19 should be captured in the new rates that take effect at the beginning of 2021.

On March 4, California Gov. Gavin Newsom declared a statewide emergency due to the COVID-19 outbreak. As a result, Edison International subsidiary Southern California Edison Co. (SCE) suspended all disconnections for nonpayment, waived late fees and deposits, and implemented flexible payment plans upon request for all residential and nonresidential customers. SCE is among the many investor-owned utilities that have suspended customer service disconnects for nonpayment during the pandemic. SCE's electric rate case request to institute interim rates this summer is being challenged by interveners with claims that the increase would be counterproductive amid the COVID-19 pandemic. Absent the interim rate increase, SCE indicated it will experience a "significant lag for cost recovery...expenses incurred to protect current customers."

In Mississippi, "The [Mississippi] Commission acknowledges that the protective measures for customers and utility employees could pose a financial strain on the utilities subject to its rate regulation and that such utilities should be provided regulatory certainty by authorizing the use of an accounting mechanism and a subsequent process through which they may seek future recovery of costs or expenses resulting from such measures, and hereby enters this order to mitigate the financial impacts of such actions." Entergy Corp. subsidiary Entergy Mississippi LLC has a pending formula rate plan that has a 2020 test period, resulting in timely rate recovery of costs when new rates take effect mid-year.

As mandated by the Alberta government in Canada, electricity providers (both competitive and regulated) are absorbing the costs for nonpaying customers for 90 days until June 18, 2020. The utility payment deferral program allows residential customers to defer electricity and natural gas bill payments regardless of the service provider.

Some jurisdictions in Canada have determined that residential and small business customers can stop paying for up to 90 days. On March 19, 2020, the Ontario government extended its winter ban on residential disconnections through July 31, 2020. The extension also applies to small businesses. Ontario local distribution utilities cannot disconnect these customers for nonpayment. Residential and small business customers on time-of-use pricing are paying 10.1 cents per kilowatt hour (kWh), the off-peak price, throughout the day and until June 1, 2020. The government indicated that order would be in place for 45 days. The Ontario province is paying generators for the loss of peak pricing. Paying for generation while not collecting from ratepayers could cause a cash flow squeeze--the local distribution companies (LDCs) continue to pay the Independent Electricity System Operator (IESO) for generation and transmission while customers may not be paying the monthly invoices. How LDCs account for losses in future rate recovery has yet to be defined.

Nonresidential

Larger customers typically have energy charges based on consumption and demand charges that are paid even if consumption declines. Demand charges may reset more frequently; therefore, if consumption by a larger customer has dropped due to COVID-19 shutdowns, cash flow from the customer could be reduced as compared to previous periods. In North Carolina, an intervener requested that the North Carolina Utilities Commission (NCUC) suspend minimum demand charges for commercial and industrial customers during the COVID-19 crisis. The commission is reviewing the filing. If they were to accept it, utilities could lose operating cash flow until the pandemic has passed. Duke Energy Corp. subsidiary Duke Energy North Carolina, among other utilities, has petitioned the NCUC against deferring industrial demand charges. This move is indicative of the NCUC not just looking at the COVID-19 impact to residential customers but also actively considering the interests of companies in the industrial segment. That being said, a deferral of demand charges could cut down once-thought-to-be-fixed cash flows for utilities and potentially weaken their stand-alone cash flows.

Credit Implication of Cost Deferrals. Without an additional and explicit timeline of recovery, deferrals represent a less credit-supportive regulatory response, despite any good will created with customers or their jurisdictional authority. This is due to a combination of the immediate near-term impact and the prolonged uncertainty of future recovery. Once costs are deferred, utilities may face an immediate reduction to operating cash flow in the near term, which may bring them close to or below their outlook downgrade threshold. Compounded with the increased uncertainty of when the utility will recover any deferred costs, this method--without any explicit notion of when costs will be recovered from their jurisdictional authority--has the potential to increase the risk the utility takes on more than any other response.

Payment Arrangements

The next category of response we've identified is situated around payment arrangements that utilities created for their customers. These allow utilities to resolve payments proactively instead of deferring them for future recovery, as well as interact directly with customers through an agreed-upon payment schedule or payment assistance program.

An example of this response can be seen in North Carolina. On March 19, an order issued by the NCUC, with respect to the moratorium on service terminations during the COVID-19 state of emergency, states: "At the end of the State of Emergency, customers having arrearages accrued during the State of Emergency shall be provided the opportunity to make a reasonable payment arrangement over no less than a six month period and shall not be charged any late fees for late payment for arrearages accrued during the State of Emergency. No provision in this Order shall be construed as relieving a customer of their obligation to pay bills for receipt of any utility service covered by this Order." This order removes additional uncertainty in terms of recovery for utilities as it allows the applicable utilities to plan and coordinate with customers, contrasted with the need to go through additional NCUC proceedings (although they still may be necessary).

As opposed to direct agreements between utilities and their customers to address arrearages, some jurisdictions have leaned upon federally funded programs to stave off the effect of the COVID-19 outbreak on the customer bill. The Colorado governor's March 5, 2020, order placed a moratorium on service disconnections. The Colorado Public Utilities Commission was directed to work with all public utilities to develop and provide payment assistance programs to aid customers. Since the initial orders, utilities including Black Hills Corp. utility Black Hills Energy, Xcel Energy Inc.'s utility Public Service Co. of Colorado, and Atmos Energy Corp. have made efforts to set up payments for low-income customers during the state of emergency through the Colorado Low-income Energy

Assistance Program (LEAP), a federally funded state-supervised, county-administered system. To the south, the Arizona Corporation Commission has urged utility customers to work with their utility providers, such as Pinnacle West Capital Corp. subsidiary Arizona Public Service Co., and take advantage of payment assistance programs like the Low-Income Home Energy Assistance Program (LIHEAP) as costs have not formally been deferred. While not isolated to just Colorado and Arizona, the response in these states is reflective of the heightened coordination of commissions and utilities with their customers through federal, state, and local programs to alleviate financial hardships and allow for the recovery energy costs.

Credit Implication of Payment Arrangements. As compared to deferrals without any cost recovery timing, payment arrangements provide greater certainty regarding the timing of cost recovery for utilities. Regardless of greater certainty, the utility may still face a reduced operating cash flow as these payment arrangements may not come into effect until after the COIVD-19 state of emergencies. Therefore, the utility may still face the same short-term immediate impact deferrals.

Bill Mitigation

In many of the jurisdictions in which payment arrangements are utilized, the onus of a payment solution is placed on the consumer to contact their utilities and payment assistance programs to reduce their energy bills. Even if these payment arrangements are made, there is a degree of lag between when utilities will start receiving payment, causing a lapse in recovery. Other jurisdictions have chosen to take more proactive roles in reducing customer bills through bill mitigation actions during the COVID-19 outbreak. While there could still be a lag in payment, these actions make customer bills more affordable, which we believe increases the probability of the ultimate cost recovery through rates.

An example of this occurred in Washington. As part of an authorized electric rate increase of about $29 million for utility Avista Corp., the Washington Utilities and Transportation Commission (WUTC) wanted to ease the financial impact on electric and gas customers during the COVID-19 pandemic, and fast-tracked customer rate refunds. The WUTC expects to mitigate the authorized rate increase and achieve a roughly net-zero impact on electric customers in the first year of the new rates. The refund largely consists of a rebate of energy costs through the company's energy recovery mechanism.

A similar approach was also taken in Florida, where the commission allows for the issuance of a bill credit for the state's four largest utilities. Approved by the Florida Public Service Commission in April, customers of Florida Power & Light Co., Duke Energy Florida LLC, and Gulf Power Co. will receive a one-time bill reduction in May to reflect over collection of fuel and capacity cost recovery factors. Tampa Electric Co.'s approved proposal will pass fuel-cost savings to customers from June through August, with smaller monthly savings through December. The credits reduce customer bills, which mitigates customers' financial hardships during the COVID-19 pandemic.

Credit Implication of Bill Mitigation Bill mitigation provides utilities the ability to collect payment in the near term and while retaining the ability to set up payment arrangements with customers to collect in the long term. While this response does not completely remove uncertainty around the collection of costs, it takes a meaningful step to mitigate risk for the utility while ensuring the customer is benefiting as well.

Table 1

North American Jurisdictional Responses

As of May 14, 2020

Collecting Costs / Deferral	Customer Payment Arrangements	Pending
Alaska	Alabama	Arizona
Alberta	Alberta	Delaware
Arkansas	Colorado	Idaho
British Columbia	Florida *	Illinois
California	Indiana	Kansas
Connecticut	Montana	Kentucky
District of Columbia	New Foundland & Labrador *	Louisiana
Georgia	New Hampshire	Maine
Hawaii	New Jersey	Massachusetts
Idaho	North Carolina	Michigan
Iowa	Ohio	Minnesota
Kansas	Prince Edward Island	Missouri
Maryland	Quebec	Nebraska
Michigan	Rhode Island	New Mexico
Minnesota	Saskatchewan *	Pennsylvania
Mississippi	South Carolina	Utah
Nebraska	South Dakota	Virginia
Nevada	Washington *	West Virginia
Oklahoma		Wisconsin
Ontario		
South Carolina		
Wyoming		

* States have a bill credit program in place that will ultimately reduce customer bill but payment arrangement will still have to be made with reduced bill.

Options Of Regulatory Recovery

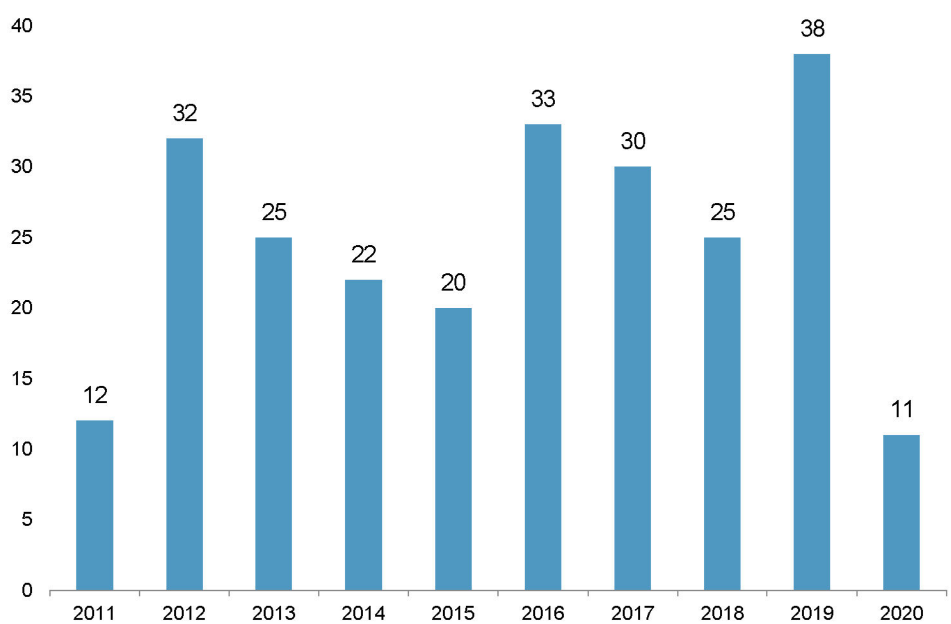
Options of rate recovery for COVID-19 costs by utilities can include rate cases and various rate riders.

Rate Cases

Recovery could be addressed through a rate case, although our data suggests that many utilities are reluctant to file new rate cases during this period of hardship for rate payers (see RRA chart below). Still, there are several rate cases underway. For example, Columbia Gas of Pennsylvania Inc., a subsidiary of NiSource Inc., filed for a rate increase that should capture the impact of COVID-19 when new rates go into effect later in 2020. Ameren Corp. subsidiary Ameren Illinois Co. recently filed a gas rate case in Illinois that will reflect a projected test period and will likely include the impact of COVID-19 on the utility's test period revenues.

Chart 3

2011-2020 Rate Case Filings
March 13-May 8



As of May 11, 2020. Source: Regulatory Research Associates, a group within S&P Global Market Intelligence.

For electric, Ameren Illinois has a formula rate plan that is updated periodically. The utility has been submitting annual filings for its formula rate plan based on a test period composed of the previous calendar year. Therefore, in a 2021 filing, we would expect COVID-19-related costs to be incorporated within a test period of calendar 2020. Another recovery option could be through decoupling mechanisms whereby revenues are reset; this could capture the weaker cash flows from bad debt expense and reduced revenues from COVID-19 inactivity.

In addition to the requested rate increase, Columbia Gas of Pennsylvania wants to implement a revenue normalization adjustment, or RNA, that would allow the gas utility to adjust rates for changes in revenue for reasons such as customer participation in energy conservation programs and overall economic conditions. The company is also proposing to increase the fixed monthly customer charges for residential and small commercial customers to allow a greater proportion of fixed costs to be recovered through these fixed charges. Mechanisms such as these will further decouple the utility's revenue from weak economic activity and customer conservation.

To alleviate the impact of COVID-19 on ratepayers, utilities could seek to remain out of or delay rate case proceedings. For example, Wisconsin Power & Light Co. recently proposed not to submit its expected rate review that Wisconsin utilities typically file every two years with the state commission. Duke Energy Kentucky Inc. notified the Kentucky commission in March that the company was "keenly aware" of the "great strain upon government agencies at the federal, state, and local levels," and would therefore "avoid placing further burdens upon the commission, and to help customers who are affected by present circumstances, by delaying the potential effective date of new rates in the company's pending electric rate case" before the month of May. This allowed an additional month before new rate as the decision was expected April 2.

Under these actions, rates would remain largely in line with current levels, mitigating utility costs to ratepayers during the pandemic. Utilities may seek such an approach if they can maintain financial measures while remaining out of rate cases for an extended period.

Credit Implications of Rate Cases. Rate cases may prove effective at recovering lost revenue or COVID-19 costs but are likely to take months or years to complete, thereby exposing the utilities to lag. We also note that very few utilities are filing rate cases in the current environment and opting to suspend and even forgo review this year.

Rider Recovery

Some jurisdictions have bad debt expense riders, or something similar, that provide more timely cost recovery. In Illinois, gas distribution companies are authorized to recover uncollectible debt expense through a surcharge. Multiple gas utilities, including Ameren Illinois Co., Southern Co. subsidiary Northern Illinois Gas Co., and Exelon Corp. utility Commonwealth Edison Co. use rate riders to recover this cost. The rider provides for cost recovery or refund of uncollectible expense based on the difference between actual uncollectible write-offs and the amounts recovered in current base rates.

A recent Georgia commission rate case authorized Southern Co. subsidiary Georgia Power Co. to defer all lost revenue and increased costs associated with COVID-19. In contrast, gas utility Atlanta Gas Light Co. (AGL) and the Georgia commission staff have proposed a revenue true-up process within the Georgia Rate Adjustment Mechanism. The mechanism was initially approved in 2017. In addition, AGL uses a modified straight-fixed-variable rate design that enables the company to recover non-gas costs throughout the year, consistent with the incurrence of these costs, essentially eliminating the need for a revenue decoupling mechanism.

Texas regulators took a different approach for electric utilities within the Electric Reliability Council of Texas (ERCOT). For residential electricity customers that have retail choice of electricity providers and are in danger of disconnection, late fees will be suspended and deferred payment plans will be offered. A COVID-19 Electricity Relief Program has been established with $15 million from ERCOT. This fund will reimburse retail electricity providers (REPs) for unpaid energy charges and transmission and distribution utilities (TDUs) for unpaid delivery charges of customers certified as experiencing COVID-19-related hardship and not disconnected. This would pertain to CenterPoint Energy Houston Electric LLC, Oncor Electric Delivery Co. LLC, and AEP Texas Inc. ERCOT and each TDU will enter into an interest-free loan associated with the COVID-19 Electricity Relief Program. TDUs will establish rate riders in which all customer classes will pay a 33 cent per megawatt hour charge to reimburse REPs for unpaid energy charges and TDUs for unpaid delivery charges, and to repay ERCOT's initial contribution. The riders will stay in effect until the TDUs have been reimbursed and ERCOT has been repaid.

Water utilities and vertically-integrated electric utilities outside ERCOT, such as Entergy Texas Inc., El Paso Electric Co., Southwestern Public Service Co., and Southwestern Electric Power Co., may not charge late fees or disconnect customers for nonpayment during the COVID-19 pandemic.

Credit Implications of Rider Recovery. Regulatory responsiveness through rate riders may prove more effective at recovering lost revenue or COVID-19 costs as they may provide for stronger cash flow and reduced uncertainty around ultimate recovery, and may strengthen a utility's credit quality. Rate recovery through riders may efficiently adjust rates for the impact of COVID-19 on the company, bolstering revenues and cash flow to the benefit of creditors.

Impact To Credit Quality From COVID-19 On U.S. And Canadian Utilities

The effects on credit quality from the COVID-19 pandemic and regulatory responses have been occurring in real time across the industry. These effects include weakening of operating cash flow and capital structures, access to liquidity, and alterations in capital spending plans.

Weaker Operating Cash Flow

Utilities that had weaker financial measures, possibly close to the downgrade triggers in their rating outlook, could see financial measures further degrade due to COVID-19. Without improved operating cash flow or any strengthening of the balance sheet, we could revise the outlook or change the ratings. Rebalancing a capital structure could be challenging, particularly for those with weakened operating cash flow, because issuing equity in times of financial stress can be especially difficult.

Looking ahead, several companies have assumed equity issuance as part of their 2020 plans, given the industry's high capital spending that we estimate at about $150 billion. While the capital markets remained mostly accessible to the industry during the first two months of 2020, we anticipate a significant decline in equity issuances over the remainder of 2020 given the level of uncertainty surrounding COVID-19. When combined with our expectation of reduced volumetric sales, increased bad debt expense, and delayed rate case filings, the industry could experience a weakening of credit measures. Given that many companies are already strategically operating with minimal financial cushion at current rating levels, weaker financial measures could lead to downgrades (See "COVID-19: While Most Of The U.S. Is Shut Down, Utilities Are Open For Business," May 4, 2020).

For the most strained issuers, or those that may not fare as well in front of regulators vis-à-vis COVID-19 costs, this is where the rubber will hit the road in terms of evaluating financial policy priorities. Companies will have to consider tough tradeoffs, and some may even need to take proactive steps to forestall downgrades (see "North American Regulated Utilities Face Tough Financial Policy Tradeoffs To Avoid Ratings Pressure Amid The COVID-19 Pandemic," May 11, 2020).

Liquidity

Operating cash flow will decline and operating income will be squeezed as revenues erode, while costs of goods sold and operating expenses continue to be incurred. This will make liquidity critical to cover expenses. Despite the challenges associated with the economic downturn, the utility industry has preserved its investment-grade profile and maintained adequate liquidity in part by securing multiyear revolving credit facilities that are sized to sufficiently cover cash needs over a 12-month period. Also, as commercial paper interest rates spike to levels last seen during the 2008 financial crisis, we saw many utilities enter into 364-day term loans to lock-in liquidity at reasonable rates. We view this as allowing the industry to circumvent the volatile commercial paper markets, strengthening the industry's near-term liquidity position.

Greater Uncertainty Could Drive Capital Expenditure Changes

The combination of weaker operating cash flow and uncertainty could result in lower capital spending and delays in projects spread out over a longer period. An example is CenterPoint Energy Inc., which, in response to a large distribution cut from its investment in a midstream energy company Enable Midstream Partners LP, lowered 2020 capital spending $300 million. Enable Midstream cut its distributions after oil and gas prices dropped. In its first-quarter 2020 earnings call, American Electric

Power Co. Inc. lowered 2020 capital spending by $500 million following lower revenue due to warmer-than-normal weather. Less capital spending should free up cash to partly offset expected revenue loss. Although Unitil Corp. is continuing its capital spending program, it stated in its first-quarter 2020 earnings call that COVID-19 had the potential to cut revenues by about $400,000 for every 1% drop in power usage in its operations. The company can offset these losses and increase cash if it can reduce capital spending.

Moreover, a major target of capital spending in the utility sector, clean and renewable energy projects (such as the offshore wind projects that Eversource Energy, Dominion Energy Inc., and AVANGRID Inc. are engaged in), could see forms of delay in construction and operation. AVANGRID recently stated on its 2020 first quarter earnings call that while its offshore wind project is slated to be operable on time, the company has experienced a number of force majeure events from suppliers due to COVID-19, a trend that may affect other offshore wind project providers. In order to maintain credit quality, utilities with similar projects may need to adjust capital investment to preserve assets while ensuring adequate liquidity.

That being said, despite the effect of the COVID-19 pandemic, several jurisdictions have pushed to ensure the trajectory of their clean energy goals. In April, the New York Public Service Commission authorized the New York State Energy Research and Development Authority to procure at least an additional 1,000 megawatts of offshore wind energy in 2020. In the same month, the Virginia legislature passed the Clean Energy Economy Act, mandating that by 2045 100% of the power supplied by any competitive retail electric provider, including Dominion Energy Inc. subsidiary Virginia Electric & Power Co., must be sourced from renewable and carbon-free resources. The aggressive standards for clean energy goals in these jurisdictions and others around the country may provide enough incentive for utilities to continue to advance such projects.

This report does not constitute a rating action.

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COVID-19: The Outlook For North American Regulated Utilities Turns Negative

April 2, 2020

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Key Takeaways

- We are revising our assessment of the North America regulated utility industry to negative from stable.
- We expect that the utility industry will remain a high-credit-quality investment-grade industry.
- We expect that the industry's median rating, which is 'A-', could weaken to the 'BBB+' level.
- Prior to the coronavirus outbreak in North America about 25% of the utilities had a negative outlook or ratings that were on CreditWatch with negative implications.
- Additionally, many utilities with a stable outlook have minimal financial cushion at the current rating level.
- We expect COVID-19 will weaken the industry's 2020 funds from operations (FFO) to debt by about 100 basis points.

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

S&P Global Ratings is revising downward its assessment of the North America utility industry to negative from stable. The North America utility industry consists of about 250 water, gas, and electric utilities. While we expect the sector to remain an investment-grade industry, we nevertheless project a modest weakening of credit quality within the industry. Credit quality had been gradually weakening prior to the COVID-19 outbreak with about 25% of companies on negative outlook or with ratings on CreditWatch with negative implications. We view COVID-19 as a source of incremental pressure and expect that the recession will lead to an increasing number of downgrades and negative outlooks. Currently, the median rating within the industry is 'A-' and over the next 12 months, we expect that the industry median could move to 'BBB+'.

Credit Quality Was Weakening Even Before COVID-19

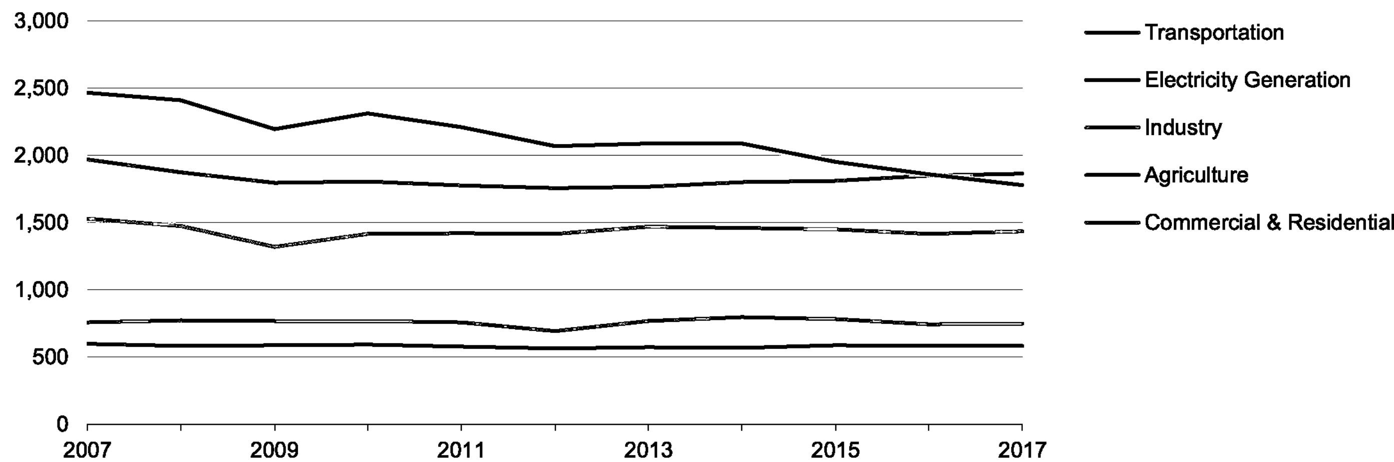
The North America regulated utility industry's credit quality was already weakening prior to COVID-19. This reflected companies' more consistent ability to manage credit measures closer to the downgrade threshold, leaving very minimal financial cushion at the current rating level. We generally view the industry's cash flows as more predictable and steady than most other corporate industries. Even so, unless a management team can proactively implement corrective actions, a utility with minimal financial cushion at the current rating coupled with an unexpected material event, typically results in a negative outlook or a downgrade.

The industry has faced many unexpected events and credit obstacles over the past two years. Some of these include safety (NiSource Inc.), wildfires (PG&E Corp., Edison International, and Sempra Energy), large capital projects (Southern Co., SCANA Corp., Eversource Energy, Duke Energy Corp., and Dominion Energy Inc.), utility acquisition (Fortis Inc., Emera Inc., ENMAX Corp., and NextEra Energy Inc.), and nonutility acquisitions (DTE Energy Co.). Each of these instances have either significantly reduced the prior cushion at the current rating level, triggered negative outlooks, or downgrades.

Also pressuring the industry's credit quality is the critical focus on environmental, social, and governance (ESG) factors. Over the past decade, the industry has done an outstanding job to significantly reduce its greenhouse gas emissions and reduce its reliance on coal-fired generation.

Chart 1

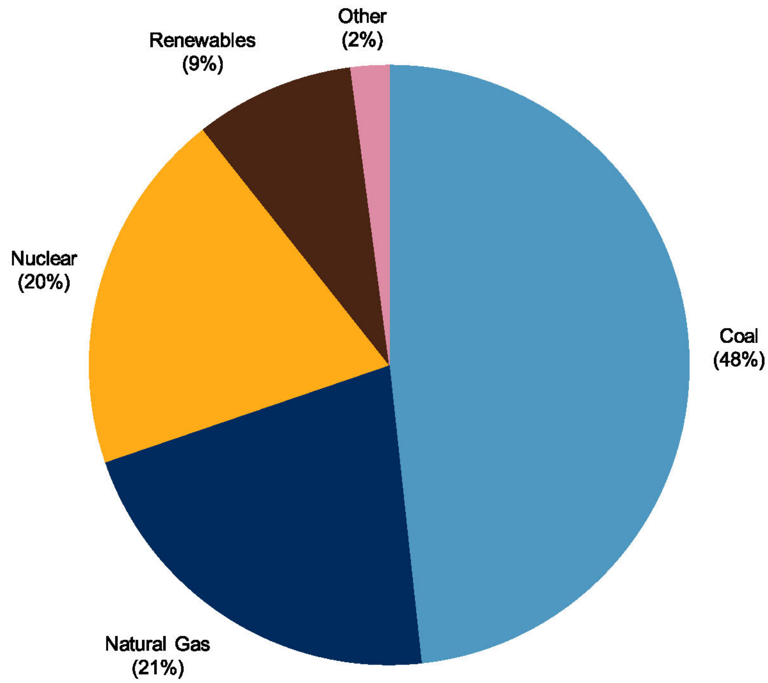
Total U.S. Greenhouse Gas Emissions By Economic Sector From 2007 -2017
Million metric tons of CO2 equivalents



Source: U.S. Energy Information Administration.

Chart 2

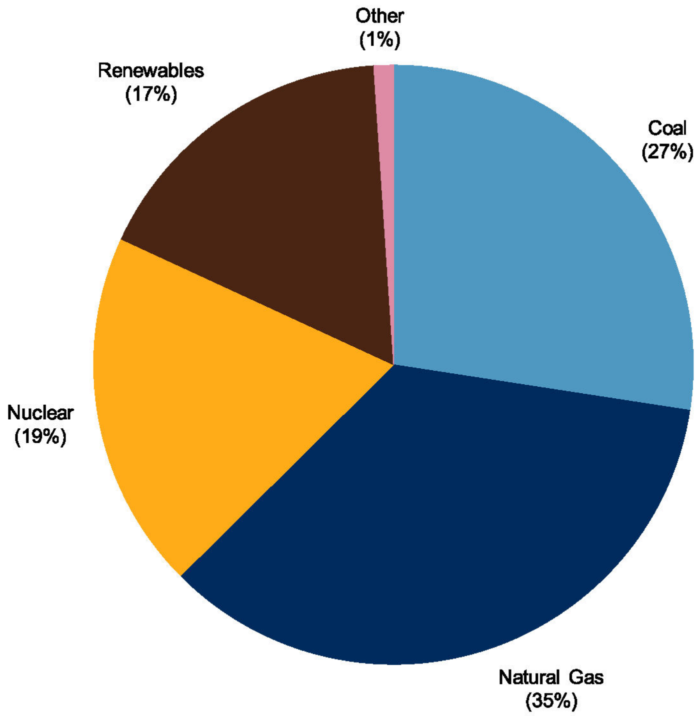
U.S. 2008 Generation Mix



Source: U.S. Energy Information Administration.

Chart 3

U.S. 2018 Generation Mix



Source: U.S. Energy Information Administration.

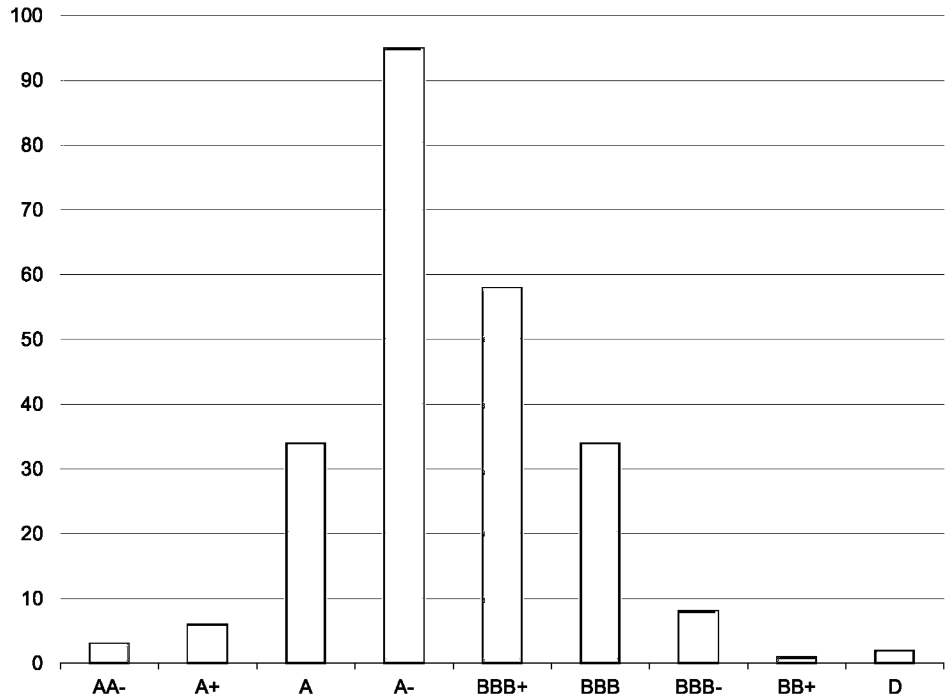
However, there are individual companies such as American Electric Power Co. Inc., Ameren Corp., and Evergy Inc. that despite having long-term plans to reduce their reliance on coal-fired generation, will continue to rely heavily on that fuel source for the next decade, possibly pressuring credit quality.

Rating Upgrades And Downgrades

Over the past decade, there have been generally more upgrades than downgrades in the sector. This has strengthened the utilities' credit quality since the financial recession and currently, the median rating within the industry is 'A-'.

Chart 4

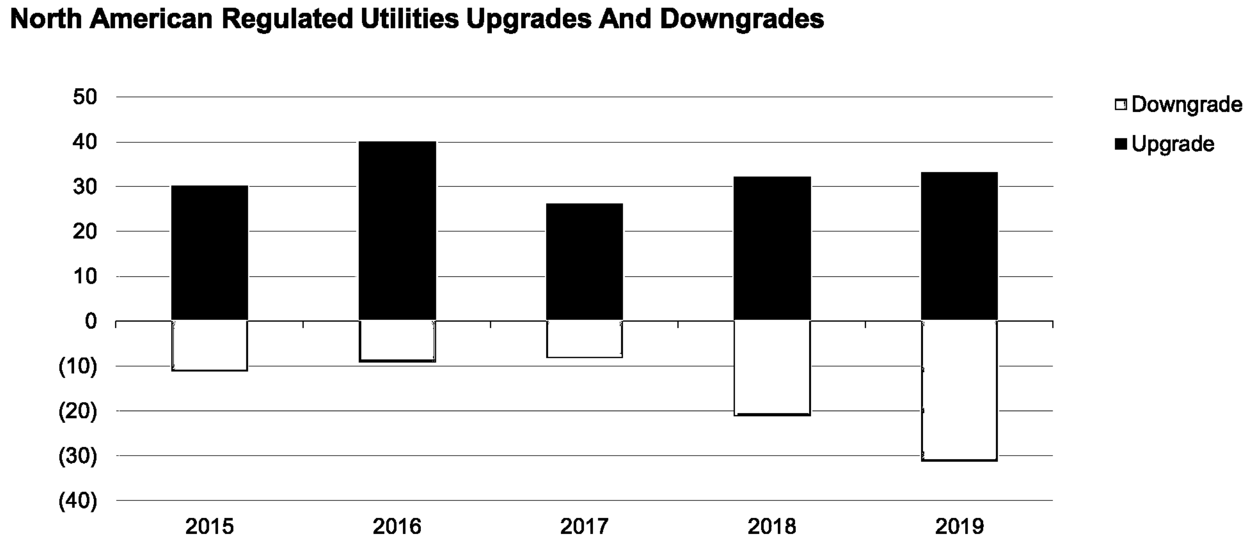
North American Regulated Utilities Ratings Distribution 2019



Source: S&P Global Ratings.

When analyzing our rating upgrades and downgrades in the sector for 2019, even prior to COVID-19, we note a weakening of credit quality.

Chart 5



Source: S&P Global Ratings.

While 2019 may initially appear to be similar to prior years with upgrades outpacing downgrades at 33 to 31, the underlying analysis tells a different story. In 2019, about 60% of the upgrades were attributed to S&P Global Ratings' revised group rating methodology criteria. Under the revised criteria, we placed more emphasis on the regulation of a utility allowing for a subsidiary with effective regulation and with a stand-alone credit profile that is higher than its group to potentially be rated higher. Absent the revised criteria, downgrades would have outpaced upgrades by 30 to 13 in 2019. This is a clear indication that even before COVID-19, the credit quality of the North America regulated utility sector had weakened.

Operating With Minimal Financial Cushion

While many companies with a negative outlook such as Puget Energy Inc. have minimal financial cushion at their current rating level, many others with a stable outlook also have minimal financial cushion at their current rating level. Companies with a stable outlook and minimal financial cushion include Exelon Corp., ALLETE Inc., American Water Works Co. Inc., Edison International, AVANGRID Inc., DPL Inc., CenterPoint Energy Inc., and Madison Gas & Electric Co. As the financial effects of COVID-19 continue to take hold, we expect that even companies with stable outlooks may experience ratings downward pressure. This is another reason that underscores our assessment that the industry outlook has turned negative.

How COVID-19 May Affect The Sector

In general, we assume that the U.S. will experience more than a 12% contraction in GDP during the second quarter and estimate the pandemic will peak between June and August (Global Macroeconomic Update, March 24: A Massive Hit To World Economic Growth, March 24, 2020).

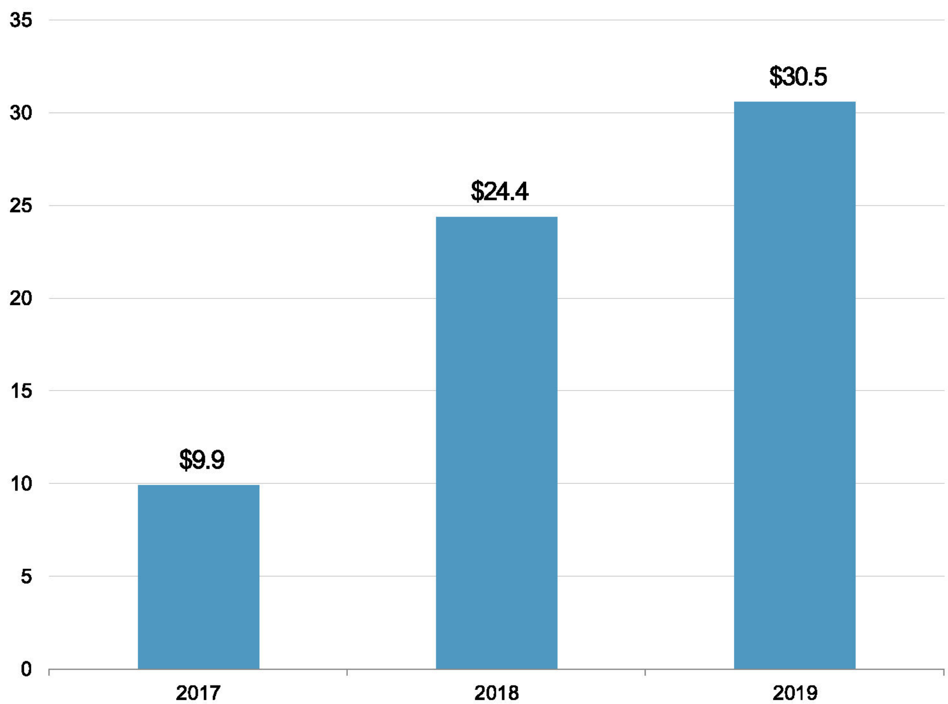
For the North America utility industry, we expect that COVID-19 will reduce the commercial and industrial (C&I) usage (North American Regulated Utilities Face Additional Risks Amid Coronavirus Outbreak, March 19, 2020). While some utilities will be able to offset some of the lower C&I usage through various regulatory mechanisms that include decoupling of revenues mechanisms and formula rates, many others will see a weakening of sales. Furthermore, as the recession continues to take hold, we expect bad debt expense will increase as it becomes increasingly more difficult for customers to pay their bills. While many utilities can defer these costs for future recovery, as these balances grow, historically we have seen incidents where utilities negotiate with their commission's to write off some of these costs as part of a larger agreement. Overall, we expect that these effects will result in a weakening of credit measures.

On a positive note, the industry continues to exhibit adequate liquidity and access to the debt markets, despite uneven performance of the commercial paper market for tier 2 issuers. The industry is benefiting from proactive risk management of establishing large credit facilities, having good access to additional liquidity through new term loans from banks, and public issuance of utility debt. These positive developments contrast to the last financial recession, when many utilities fully drew on their available credit lines and access to the banks or to the public debt market was effectively shut for many weeks.

Yet availability to the equity markets remains extraordinarily challenging. In 2019, the industry issued more than $30 billion in equity to preserve credit quality and heading into 2020 many companies within the industry assumed equity issuances as part of their financing plans. Given the industry's negative discretionary cash flow because of its high capital spending and lack of access to the equity markets, we expect that this will also lead to a weakening of credit measures.

Chart 6

North American Regulated Utilities Equity Issuance In Billions



Source: S&P Global Ratings.

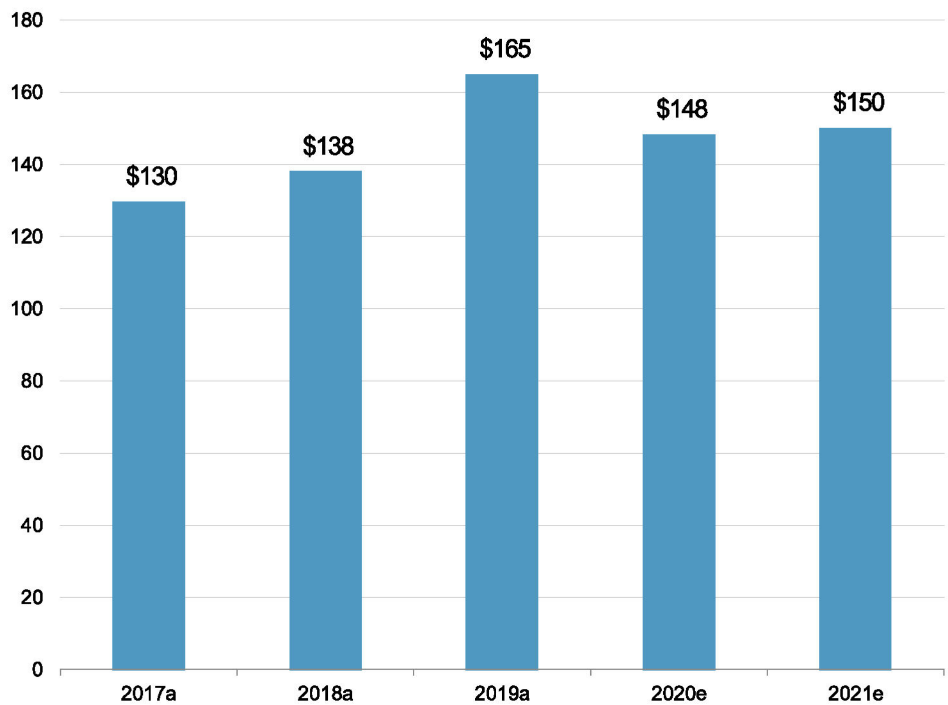
Another area of concern are utilities that rely to various degrees on nonutility businesses that have commodity exposure (S&P Global Ratings Cuts WTI And Brent Crude Oil Price Assumptions Amid Continued Near-Term Pressure, March 19, 2020). These include OGE Energy Corp., CenterPoint Energy Inc., DTE Energy Co., Dominion Energy Inc., Public Service Enterprise Group Inc., NextEra Energy Inc., and Exelon Corp. While many of them are well hedged in the near term, volumetric risk and a longer-term weakening of commodity prices could have a material effect on their credit measures. Overall, assuming that the effects of COVID-19 is only temporary, we would expect that the industry's 2020 FFO to debt will weaken by about 100 basis points, consistent with our revised negative outlook for the industry.

The Industry Has Levers

Depending on the severity of the recession, the industry has important levers that could mitigate some of the risks. This includes reducing capital spending and dividends. Currently, we estimate that 2020 capital spending will approximate $150 billion.

Chart 7

North American Regulated Utilities Capital Expenditures In Billions



a--actual. e--estimate. Source: S&P Global Ratings.

Based on our conversations with the companies within the industry there is a wide range as to how deeply a utility can reduce its capital spending and still maintain safe and reliable services. Some utilities can only reduce capital spending by as little as 15%, others by as much as 60%. Our analysis indicates that the majority of utilities could reduce their capital spending on a temporary basis by about 40% and maintain safe operations. Should the recession prolong, we would expect that the industry would generally first reduce capital spending and only afterward cut dividends. There is precedent that during times of high financial stress, utilities have reduced their dividends and we would expect that the industry, if necessary, would use this lever, acting prudently to preserve credit quality.

Credit quality of the North America regulated utility industry was already weakening prior to COVID-19. We believe that incremental challenges that the industry will face from this recession exacerbates financial pressure and underpins our revised negative outlook for the industry. However, we also expect that this industry's credit quality will continue to outperform most other corporate industries despite these challenges. Furthermore, we expect that the utilities will use the levers available to them to reduce credit risks and limit the financial impact from COVID-19. Overall, while we expect a weakening to the industry's credit quality, we continue to firmly believe that this industry will remain a high-quality, investment-grade industry.

This report does not constitute a rating action.

COMMENTS — 20 Jan, 2021 | 18:22 —

APAC, United States of America, Latin America, Canada, EMEA, APAC

North American Regulated Utilities' Negative Outlook Could See Modest Improvement

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Sector	**Oil & Gas, Oil & Gas, Corporates, Infrastructure & Utilities, Utilities & Power**
Tags	**Americas, Latin America, APAC, EMEA**

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Key Takeaways

- Credit quality for the North American regulated utility industry weakened in 2020. At the beginning of the year about 18% of the industry had a negative outlook or ratings on CreditWatch with negative implications. By the end of the year that percentage had doubled, to about 36%.
- For the first time in a decade downgrades outpaced upgrades for the predominately investment-grade industry.
- The industry generally performed well throughout the pandemic and we expect it will continue to mostly manage through the remaining COVID-19-related risks.
- The main causes of weakening credit quality reflected environment, social, and governance (ESG) risks, regulatory issues, and companies' practice of strategically managing financial measures close to their downgrade threshold with little or no cushion.
- Despite our negative 2021 industry outlook, we expect a modest improvement to credit quality over the next 12 months. We believe Congress is more likely to raise the corporate tax rate, which would improve the industry's financial measures, offset in part by a continued focus on ESG risks.

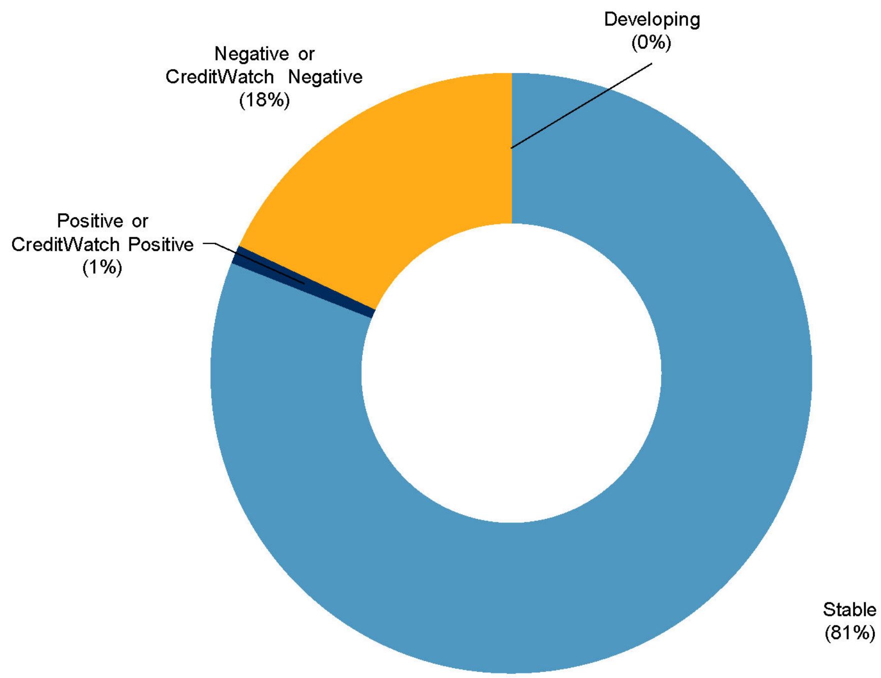
Credit Quality Weakened In 2020

We revised the industry's outlook to negative in the first quarter (
COVID-19: The Outlook For North American Regulated Utilities Turns Negative
, April 2, 2020), citing the already high percentage of companies with a negative outlook or ratings on CreditWatch with negative implications (18%) and the additional potential credit risks from COVID-19. During the year, the utility industry performed poorly from a credit quality perspective. The negative outlooks or CreditWatch negative listings

doubled and downgrades outpaced upgrades for the first time in a decade by about 7 to 1. As a result, while the median rating for the industry remains at 'A-', it is slowly creeping closer to 'BBB+'.

Chart 1

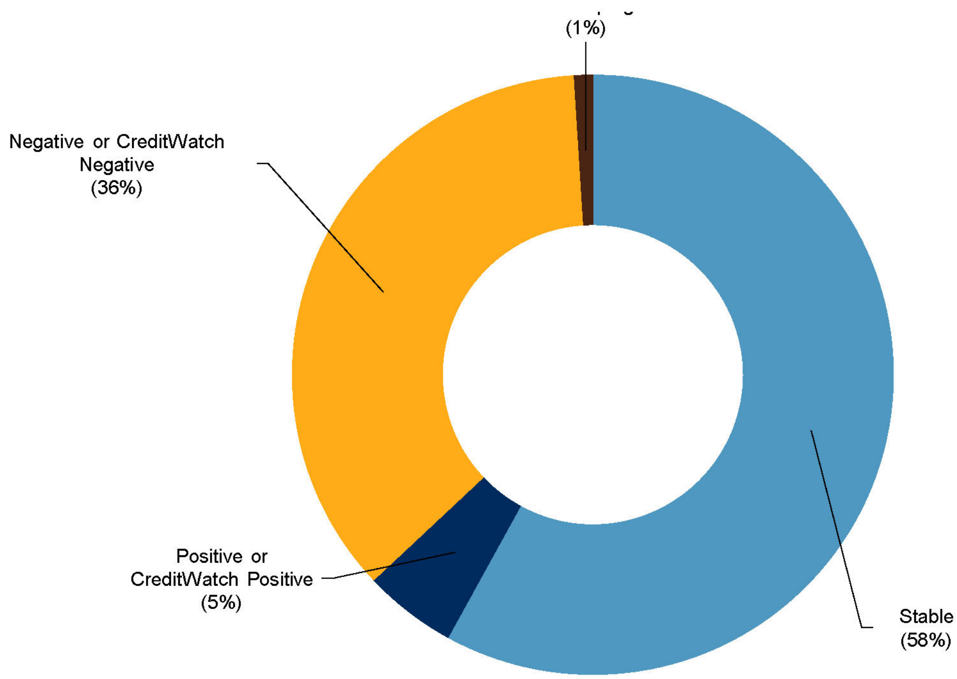
Ratings Outlooks At The Beginning Of 2020



Source: S&P Global Ratings.

Chart 2

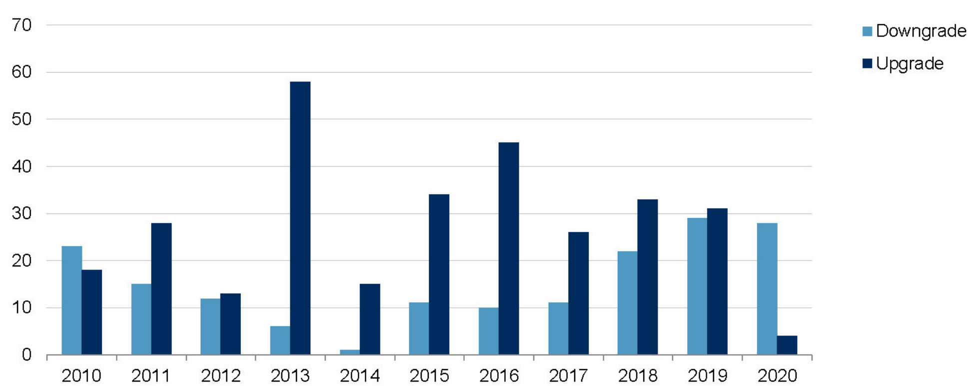
Ratings Outlooks At The End Of 2020



Source: S&P Global Ratings.

Chart 3

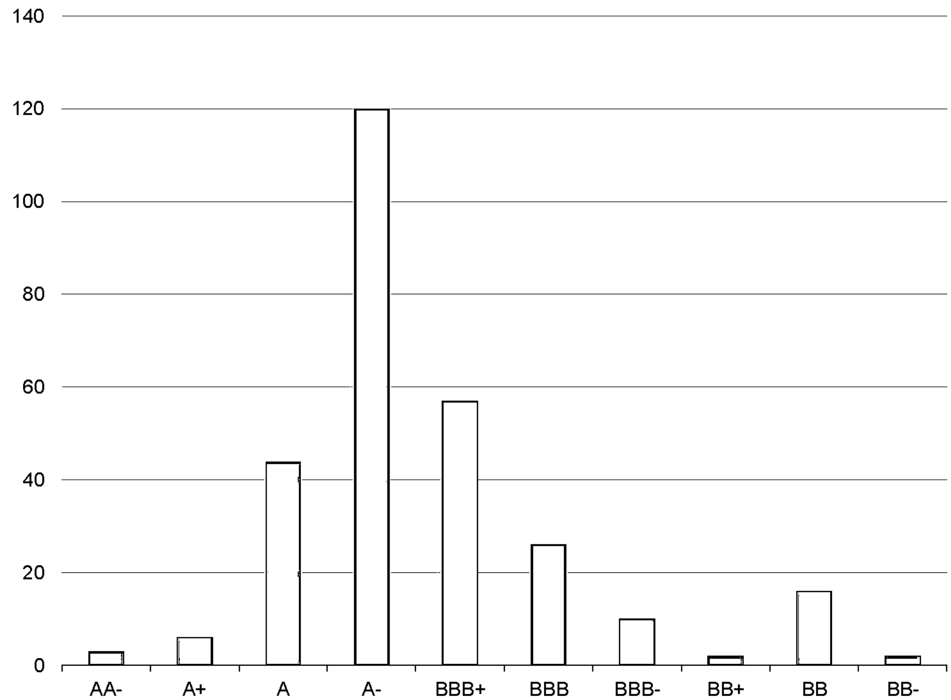
North America Regulated Utilities Upgrades And Downgrades



Source: S&P Global Ratings.

Chart 4

North America Regulated Utilities Rating Distribution



As of Jan. 8, 2021. Source: S&P Global Ratings.

COVID-19 Was Not The Culprit For Weaker Credit Quality

In March 2020, we identified five COVID-19-related risks that could lead to a weakening of the industry's credit quality. We expected that these developments could bring about a deterioration in the industry's 2020 funds from operations (FFO) to debt of about 100 basis points. These risks included the following:

- Lower deliveries to commercial and industrial (C&I) customers;
- Higher bad debt expense;
- Delayed rate case filings, delayed rate case orders, or lower-than-expected rate case outcomes;
- Lack of consistent access to the capital markets; and
- Weaker market returns that could increase postretirement benefit obligations.

Encouragingly, the industry has generally performed well throughout the pandemic. Lower electric and gas deliveries to C&I customers were mostly offset by higher residential deliveries, the industry generally worked well with regulators to defer COVID-19-related costs for future recovery, market returns improved, and the industry generally had consistent access to the capital markets. The one area that we saw some weakness was with regard to rate cases. Many rate case filings were delayed, rate case orders often took longer than expected, and many of the orders were below expectations. This trend generally reflected the weak economy caused by COVID-19 and the difficulties of passing on higher costs to customers during the pandemic. We expect that as vaccines take hold and the pandemic dissipates, the economy will gradually recover, as will the industry's rate case performance.

As vaccine rollouts in several countries continue, S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic and its economic effects. Widespread immunization, which certain countries might achieve by midyear, will help pave the way for a return to more normal levels of social and economic activity. We use this assumption about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: **www.spglobal.com/ratings**). As the situation evolves, we will update our assumptions and estimates accordingly.

Here's What Happened

The stark weakening of credit quality in 2020 primarily reflected environmental, social, and governance (ESG) factors, regulatory issues, and the industry's practice of continuing to manage its financial measures with little or no financial cushion from the downgrade threshold.

During 2020, we saw a number of ESG-related events that included:

- A bribery charge filed against Exelon Corp.'s subsidiary (
Exelon Corp. Outlook Revised To Negative On Bribery Charge; Subsidiary Commonwealth Edison Co. Downgraded
, July 21, 2020).
- Unprecedented wildfire activity throughout California at the beginning of the wildfire season that could have indicated a worsening environment more susceptible to frequent wildfires. (
Edison International And Subsidiary Outlooks Revised To Negative On Adverse Wildfire Conditions; 'BBB' Ratings Affirmed
, Sept. 16, 2020;
PG&E Corp. And Subsidiary Outlooks Revised To Negative On Adverse Wildfire Conditions; 'BB-' Ratings Affirmed
; Sept. 16, 2020;
San Diego Gas & Electric Co. Outlook Revised To Negative On Adverse Wildfire Conditions; 'BBB+' Rating Affirmed
, Sept. 16, 2020).
- Climate change risks.
Entergy New Orleans LLC Downgraded To 'BBB' From 'BBB+' On Storm Risks, Outlook Negative
, Oct. 8, 2020.
- FirstEnergy Corp. terminated three executives including its CEO after it determined that they violated company policies and its code of conduct. This followed the U.S. government filing a criminal complaint against the Speaker of the Ohio House of Representatives and four associates for participating in an approximately $60 million racketeering scheme (
FirstEnergy Corp. Downgraded to 'BB+' On Termination Of CEO; Ratings Remain On CreditWatch Negative
, Oct. 30, 2020).
- Duke Energy Corp.'s potentially higher risks regarding its ability to fully and consistently recover coal ash costs (
Duke Energy Corp. And Subsidiaries Outlooks Revised To Negative On Higher Regulatory Risks, Elevated Spending Plan
, Dec. 15, 2020).

Regulatory issues also contributed to a weakening of credit quality and included the following 2020 actions:

- **Puget Energy Inc. And Subsidary Ratings Placed On CreditWatch Negative Over Regulatory Concerns**, July 23, 2020.
- **Consolidated Edison Inc. And Subs Outlooks Revised To Negative Amid Potential Political Headwinds; Ratings Affirmed**, Nov. 24, 2020.
- Following our assessment of a modest weakening of the regulatory environment in Alberta we revised our rating outlook on FortisAlberta Inc. to negative. (**FortisAlberta Inc. Ratings Affirmed; Outlook Negative**, Nov. 24, 2020).

During 2020, we revised the outlook on a number of companies to negative and downgraded other companies, reflecting weak financial measures.

- South Jersey Industries Inc. And Subsidiaries Outlook Revised To Negative On Weaker Financial Results; Ratings Affirmed

  , March 10, 2020.
- Emera Inc. And TECO Downgraded On Weak Financials, Outlook Stable; Subsidiaries Ratings Affirmed

  , March 24, 2020.
- ENMAX Corp. Downgraded To 'BBB-'; Off CreditWatch; Outlook Stable, March 24, 2020.
- PNM Resources Inc., Public Service Co. Of New Mexico, Texas-New Mexico Power Co. Downgraded One Notch; Outlook Stable

  , April 6, 2020.
- ALLETE Inc. Downgraded To 'BBB' On Expected Weaker Financial Measures; Outlook Stable

  , April 22, 2020.
- CenterPoint Energy Resources Corp. Ratings Affirmed On Completed Sale Of CenterPoint Energy Services, Outlook Negative

  , June 5, 2020.
- Otter Tail Corp. Outlook Revised To Negative; Ratings Affirmed, Aug. 18, 2020.
- National Grid North America Inc. And Subsidiaries Outlooks Revised To Negative Following Outlook Revision On Parent

  , Aug. 25, 2020.
- ATCO Ltd. And Canadian Utilities Ltd. Outlooks Revised To Negative; Operating Subsidiary CU Inc. Outlook Remains Stable

  , Sept. 17, 2020.

  Fortis TCI Ltd. Downgraded To 'BBB-' On Weaker Financial Measures; Outlook Stable

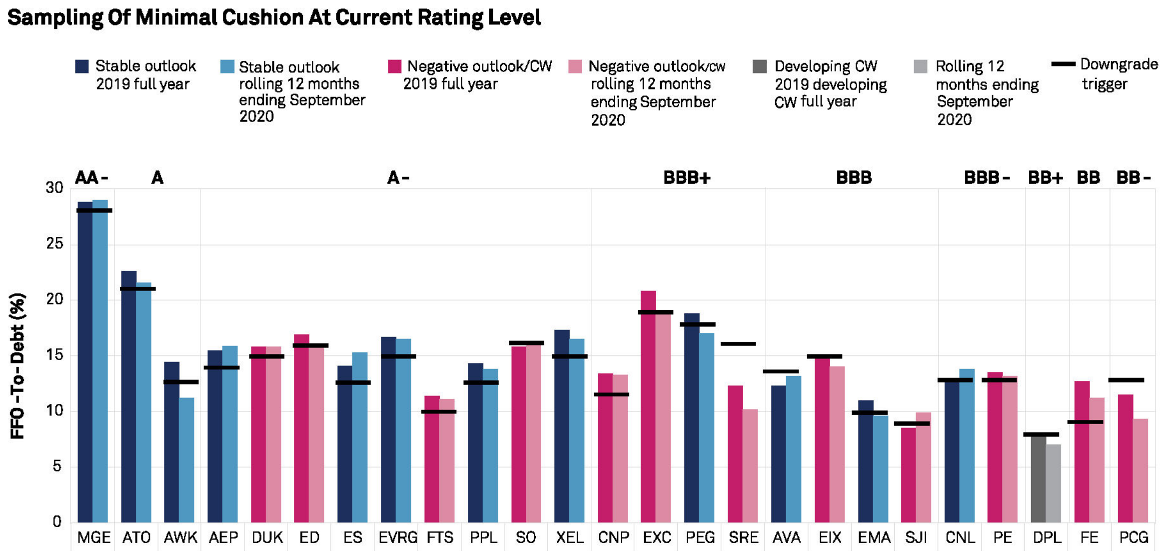
  , Oct. 21, 2020
- Middlesex Water Co. Outlook Revised To Negative On Weaker Financial Measures; 'A+' Rating Affirmed

  , Nov. 3, 2020.
- Unitil Corp. And Subsidiaries Outlooks Revised To Negative On Weaker Consolidated Financial Measures; Ratings Affirmed

  , Nov. 5, 2020.

The industry's credit quality continues to be squeezed by the industry's tendency to strategically manage financial measures with only minimal financial cushion.

Chart 5



Note: PE is Puget Energy Inc. Source: S&P Global Ratings and company data.

What will occur in 2021?

We expect a marginal improvement in credit quality in 2021. We think it's likely that Congress will enact a higher corporate tax rate. This will help strengthen the industry's financial measures, partially offset by continued focus on ESG related risks.

Because President-elect Biden won the U.S. presidency and the democrats have control of the U.S House of Representatives and Senate, we expect Congress will more likely implement a higher corporate tax rate. While details of such a plan are limited, a key element of the proposal would likely call for an increase in the corporate tax rate to 28% from 21%. We estimate that this higher tax rate would improve the industry's funds from operations to debt by about 100 basis points (

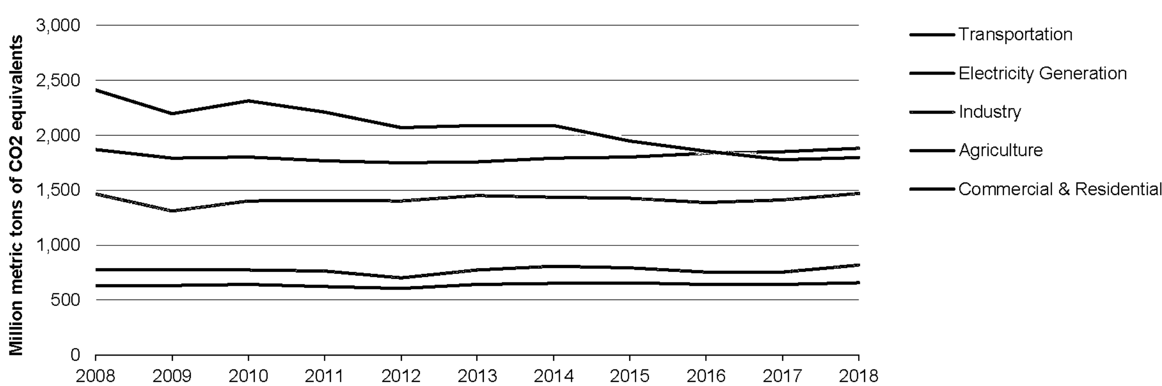
U.S. Regulated Utilities' Credit Metrics Could Strengthen Under Proposed Biden Tax Plan

, Oct. 29, 2020). The improving financial measures would likely boost credit quality, enhancing utilities' financial cushions from their downgrade thresholds.

The industry's environmental risks including its exposure to greenhouse gas (GHG) emissions remain a key concern for investors. Despite the industry's enormous progress over the past decade, it has a way to go. Over the past decade, the industry significantly reduced its reliance on coal-fired generation and its associated level of carbon based emissions. The industry is no longer the number one North American emitter of carbon-based pollutants, reducing its carbon emissions by about 25% and has reduced its reliance on coal-fired generation by about 50%.

Chart 6

GHG Emissions By U.S. Economic Sector

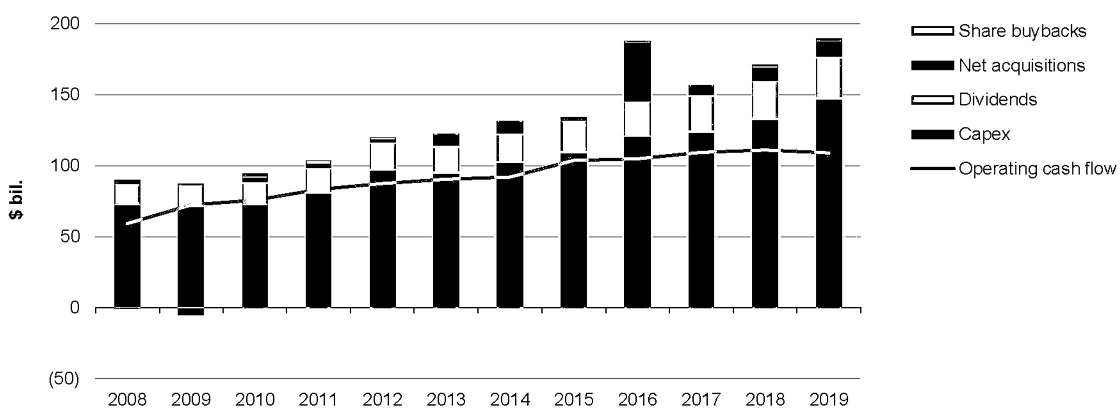


Source: U.S. Environmental Protection Agency.

Still, about 30% of the electric utility industry relies on coal-fired generation for at least 50% of its owned electricity production and about two-thirds of those utilities depend on coal-fired generation for more than 70% of their total generation. Investors are increasingly focused on environmental issues and given that the industry typically operates with negative discretionary cash flow, it relies on consistent access to reasonably priced capital markets. We expect that the continued focus on these ESG risks will weaken credit quality, offsetting much of the credit benefits from a potentially higher corporate tax rate.

Chart 7

Cash Flow And Primary Uses



Source: S&P Global Ratings and company data.

This report does not constitute a rating action.

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COMMENTS — 20 Jul, 2021 | 14:55 —

APAC, United States of America, Latin America, Canada, EMEA, APAC

Will Rising Inflation Threaten North American Investor-Owned Regulated Utilities' Credit Quality?

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Research Assistant:	**Sumeet P Ghodke**
Sector	**Utilities & Power, Oil & Gas, Coronavirus, Credit Analysis, Infrastructure & Utilities, Utilities & Power**
Segment	**Corporations**
Tags	**Americas, Latin America, North America, APAC, EMEA**

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Key Takeaways

- The U.S. economy is showing signs of growth after a difficult year, with S&P Global economists now forecasting real GDP growth for 2021 and 2022 of 6.7% and 3.7%, respectively.
- This pace of growth also raises renewed questions about the risk of higher inflation and widening spreads on debt.
- The June consumer price index (CPI) rose 5.4% year-over-year, which could make it harder for North American investor-owned regulated utilities to offset higher costs on a timely basis through traditional rate increases.
- While we expect modest revenue growth correlations to inflation to continue, cost recovery is unlikely to recapture 100% of the inflation due to regulatory lag.
- We note that GDP increases are also typically associated with rising capital spending and higher debt levels in the sector.
- Given these observations, we believe that a period of prolonged inflation could further constrain credit metrics for some utilities.
- For some utilities already facing limited financial cushions, higher inflation and debt costs could mean incremental downward pressure on ratings.

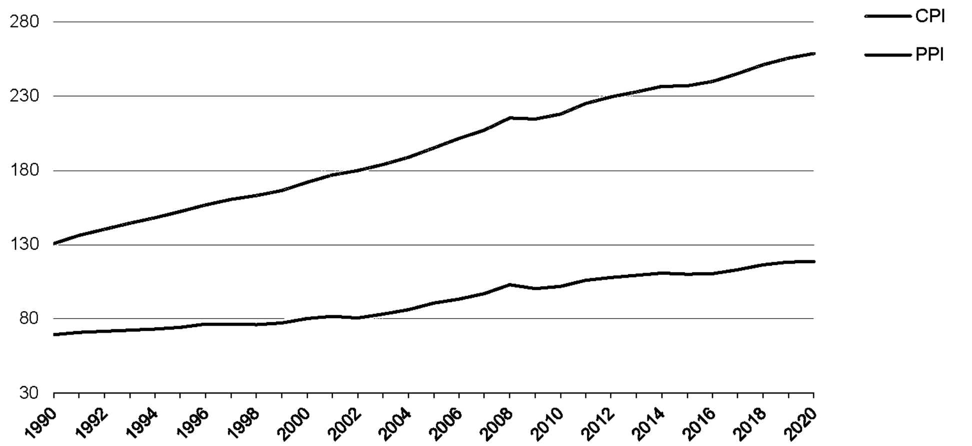
After a prolonged bout with COVID-19-induced economic malaise, the U.S. economy is showing strong signs of renewed growth. S&P Global economists now forecast real GDP growth for 2021 and 2022 of 6.7% and 3.7%, respectively. With this increase in economic activity has come rising concerns about inflationary pressure. Recent reports have sounded alarms with increases noted in everything from labor costs, amid a shortage of qualified workers, to higher costs for commodities and materials including metals, corn, and gasoline.

While the Federal Reserve Bank will likely take steps to contain this threat in line with its policy objectives, the timing of any policy changes is uncertain. The most recent data released during mid-June indicated that the CPI rose 5.4% in June from the prior year, which could make it more difficult for a utility to offset these costs on a timely basis through traditional rate increases. While our economists expect the jump in inflation to be largely transitory, they recently noted that the risk that U.S. inflation will stay higher and last longer than our earlier forecasts could force the fed to move on interest rates earlier than planned, potentially fueling market volatility and widening spreads on debt. Although inflation is not a new challenge for utilities, it had taken a backseat to other more pressing problems the sector faces, such as dealing with the energy transition, record debt burdens, and the potential for more rigorous environmental regulation. Now, recent headlines remind us that utilities tend to face pressure to raise rates during periods of cost inflation and that regulatory lag can constrain their financial performance.

In this report, we focus on North American regulated investor-owned utilities, and examine how various economic indicators, including CPI and producer price index (PPI) data, correlate to the changes in revenues, gross margins, and cash flows. We also assess the likely impact on key credit metrics that are already under strain in the sector and offer some views on the potential of inflation risk further constraining credit quality among investor-owned utilities.

Chart 1

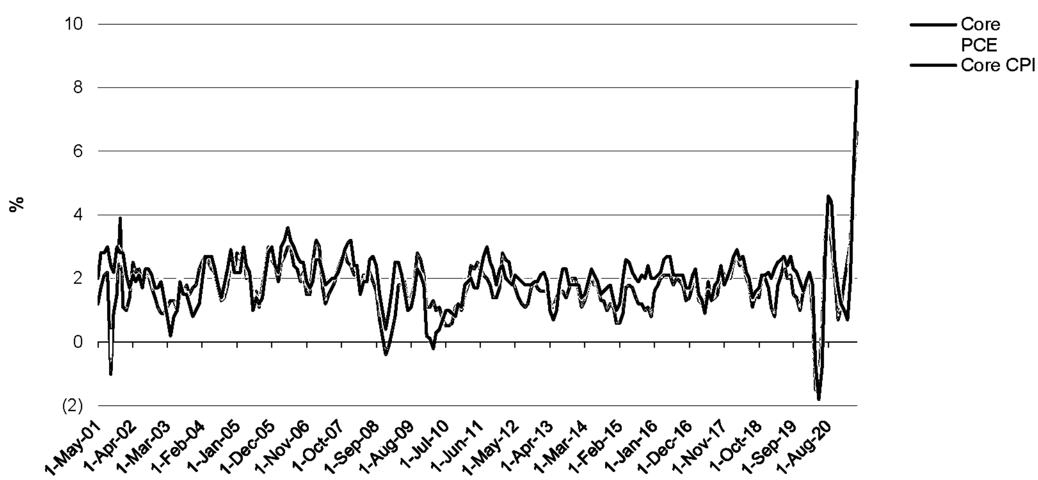
CPI And PPI Over The Years



CPI--Consumer price index. PPI--Producer price index. Source: S&P Global Ratings.

Chart 2

U.S. Core Inflation Measures
Previous three months, seasonally adjusted, annualized



PCE--Personal Consumption Expenditures. CPI--Consumer Price Index. Sources: Federal Reserve Economic Data (FRED); S&P Global chief economist's calculations.

Regulatory Lag Or Riders To The Rescue

With inflation risks rising, the ability to recover costs through rates on a timely basis will become increasingly important to utilities' financial strength. While we evaluate each regulatory relationship on its own merit, in general, we consider such regulatory mechanisms as rate surcharges, formula rate plans, and the use of partly or fully forecast test periods in base rate case proceedings to be supportive of credit quality during times of inflationary cost pressure.

Rate surcharges that provide for recovery of costs outside of a base rate case and are updated periodically could boost the timeliness of cost recovery. Surcharge updates could include a revised return on capital used for determining the cost levels the utilities recover through the surcharge. Surcharges could also relate to capital investments while construction is occurring, providing utilities with an opportunity to reflect increased costs including financing costs. Still other rate surcharges provide recovery of operations and maintenance expenses on new investments once operations begin and outside of rate case. That would allow for quicker rate recovery of operating costs on new generation, particularly if we begin to see increased costs from inflation. Rate surcharges for fuel, purchased power, and natural gas can be updated to capture rising commodity costs.

Similarly, formula rates that reset periodically, or at least annually, will provide quicker rate recovery of escalating costs from inflation. This would include higher interest costs and possibly rising costs of equity.

For base rate cases, utilities can use partly or fully forecast test periods to capture inflationary pressures in expenses and funding costs and help reduce lag in cost recovery. As a comparison, historical test periods result in significant regulatory lag since rates are set at levels based on older data. If inflation steps up, this regulatory lag could materially lengthen, weakening a utility's financial measures even further than during periods of low inflation. During inflationary times, credit quality benefits from forecast test periods and less so from updated historical test periods.

For cases where there are few rate surcharges available in a regulatory jurisdiction, or if these surcharges are not periodically updated, more frequent rate case filings by utilities will help them recover higher costs. The faster a commission approves new rates, the quicker cash flow improves and the better a utility's chances of earning its authorized return due to reduced regulatory lag. If a commission cannot issue a final ruling in a timely manner, its ability to issue an interim rate ruling provides rate relief and lowers financial uncertainty about ultimate rate recovery.

Correlation Between Utility Gross Margin Growth And Macroeconomic Factors

Utility type	Real GDP growth (%)	Consumer prices growth (%)	Producer prices growth (%)
All utilities	2	24	21
Electric utilities	(10)	17	13
Gas utilities	30	44	52
Multi-utilities	23	21	22
Water utilities	10	(4)	(21)

Note: Correlation above 70% is considered strong, between 30%-70% is considered good correlation, and below 30% is considered a weak correlation. Source: S&P Global Ratings.

Credit Measures Are Already Under Pressure

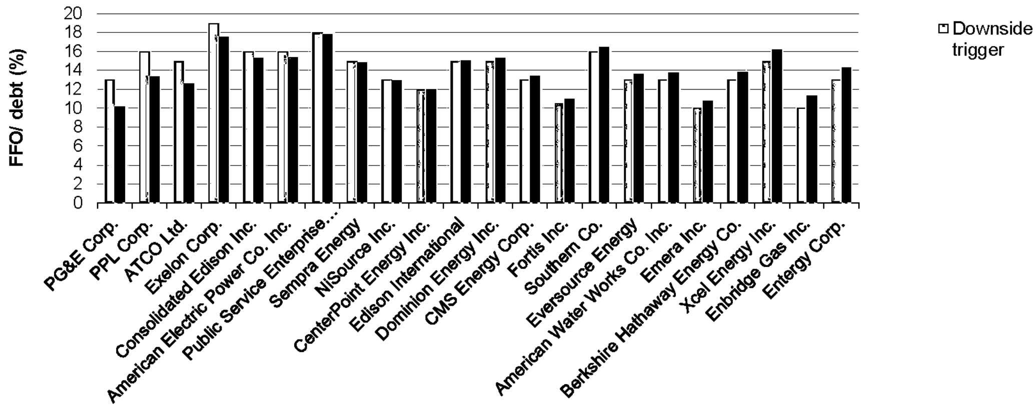
Unfortunately for many utilities in the sector, the threat of inflation comes at a time when credit metrics are already under pressure relative to downside ratings thresholds. Based on the data correlation analysis above, we expect that rising inflation will remain only somewhat positively correlated to revenue growth and margin gains. While we've seen positive revenue growth correlations to inflation over the past 20 years, cost recovery is unlikely to recapture 100% of the inflation due to regulatory lag. The data suggests that we can expect revenue and margin growth when inflation increases, although these gains occur at a slower pace then necessary to fully recover costs. Thus we expect some incremental pressure on funds from operations during periods of rising inflationary pressure. At the same time, we note that GDP increases typically are associated with rising capital spending and higher debt levels in the sector.

Given these observations, and the added concern that inflationary pressure could be accompanied by a rising interest rate environment and wider spreads, we believe that a period of prolonged inflation could further constrain credit metrics for some utilities. Higher rates will also pressure unhedged variable rate borrowings and raise the costs of refinancing fixed-rate debt maturities. This comes as companies in the sector have already added record levels of debt to offset historically high capital spending aimed at modernizing the grid, building new transmission lines, reducing coal generation, and adding renewable power investments.

Taken together, if inflation increases last longer than currently expected, we could see somewhat reduced profitability from regulatory lag coupled with higher interest rates and increasing debt burdens. These factors could add to an already downward trajectory in key credit metrics in the sector.

Chart 3

Minimal Cushion At Key Credits
FFO/debt



Source: S&P Gloal Ratings.

Some Utilities Are More Exposed To Inflationary Risks

We expect companies operating with minimal financial cushion will be more susceptible to rising inflation risks and regulatory lag. We believe this would likely include Sempra Energy, Edison International, PG&E Corp., Consolidated Edison Inc., Southern Co., and Puget Energy Inc.. All of these companies currently have a negative outlook and have been consistently operating with less than 100 basis points of cushion from their funds from operations to debt downgrade threshold. Additionally, they are operating with negative discretionary cash flow reflecting their robust capital spending plans. This spending is earmarked for costs involved in reducing their carbon footprint, enhancing safety and reliability, and, in the case of California's utilities, wildfire mitigation technology. Each company requires timely recovery of costs. In this scenario, inflation combined with regulation lag could lead to a weakening of credit quality. While many of these companies have riders and other regulatory mechanisms that have the potential to protect them from much of the inflation risks, because the degree of financial cushion is relatively small, even modest incremental negative financial results could hurt their credit quality.

Related Research

- **Industry Top Trends Update: Regulated Utilities North America**, July 15, 2021
- **Global Economic Outlook Q3 2021: Picking Up Steam, Fueled By Vaccinations**, June 30, 2021

This report does not constitute a rating action.

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COMMENTS — 22 Mar, 2021 | 16:18 —

APAC, United States of America, Latin America, Canada, EMEA, APAC

Updates And Insights On Regulatory Jurisdictions Shaping Policies For North American Utilities--March 2021

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Sector	**Infrastructure & Utilities, Utilities & Power**
Tags	**Americas**

View Analyst Contact Information

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Key Takeaways

- S&P Global Ratings periodically assesses every regulatory jurisdiction in the U.S. and Canada with a rated utility or where a rated entity operates.
- These assessments--with categories ranging from "credit supportive" to "most credit supportive"--provide a reference when determining the regulatory risk of a regulated utility or a holding company with more than one utility.
- Since our last report, we have revised our assessments of three jurisdictions and examined developments in numerous others.
- 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 continuum 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. This information provides a reference when determining a utility's regulatory advantage or 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-procedures and design, financial stability, and regulatory independence and insulation. See "
Key Credit Factors For the Regulated Utilities Industry," Nov. 19, 2013, for more details on each category.

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

We've updated our assessments of regulatory jurisdictions since we published "
Updates And Insights On Regulatory Jurisdictions Shaping Policies For North American Utilities--November 2020
," on Nov. 9, 2020. Below, we provide our current snapshot of each regulatory jurisdiction. For the approximately 225 U.S. and 30 Canadian utilities we rate, rating committees make regulatory advantage determinations that reflect quantitative and qualitative factors as well as the committee's opinions. We group the jurisdictions by these determinations.

The categories are an important starting point for assessing utility regulation and its effect on ratings. They are all credit-supportive to one degree or another, as all utility regulation tends to sustain credit quality. The presence of regulators, no matter where in the spectrum of our assessments, reduces business risk and generally supports utility ratings. We therefore designate all these jurisdictions from "credit supportive" to most "credit supportive," and these vary only in degree.

Assessing U.S. And Canadian Regulatory Jurisdictions

Utility Regulatory Jurisdictions Among U.S. States And Canadian Provinces

Credit supportive (Adequate)	More credit supportive (Strong/Adequate)	Very credit supportive (Strong/Adequate)	Highly credit supportive (Strong/Adequate)	Most credi supp (Stro
New Mexico	Alaska	Connecticut	Alberta	Alabar
Prince Edward Island	Arizona	Delaware	Arkansas	British Colum
	California	Idaho	Georgia	Colora
	District of Columbia	Illinois	Indiana	FERC (Elect
	Hawaii*	Maryland*	Kansas	Florid
	Mississippi	Missouri	Louisiana	Iowa
	Montana	Nebraska	Maine	Kentu
	New Jersey	Nevada	Massachusetts	Michig
	Oklahoma	New Orleans	Minnesota	Nova S
	South Carolina	New York	North Carolina¶	Ontari
	Washington	Ohio	New Hampshire	Quebe
		Rhode Island	Newfoundland & Labrador	Wisco
		South Dakota	North Dakota	
		Texas	Oregon	
		Vermont	Pennsylvania	
		West Virginia	Tennessee	
		Wyoming	Texas RRC	
			Utah	
			Virginia	

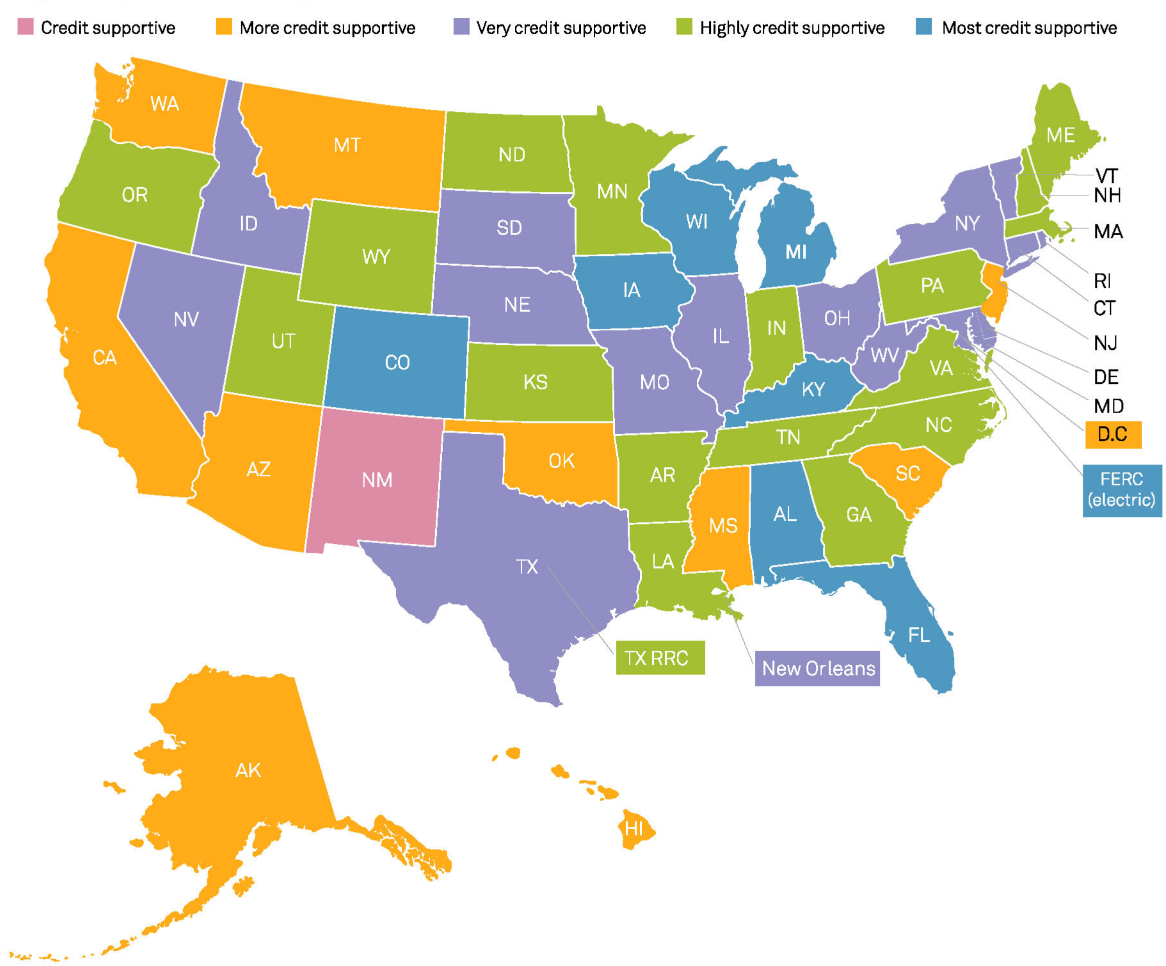
*Assessment revised upward. ¶Assessment revised downward.

Mapping Regulatory Jurisdictions

For jurisdictions assessed in the maps in Charts 1 and 2, colors delineate our assessment of credit supportiveness. (We do not have assessments on Canadian provinces where we do not have utility ratings.) 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

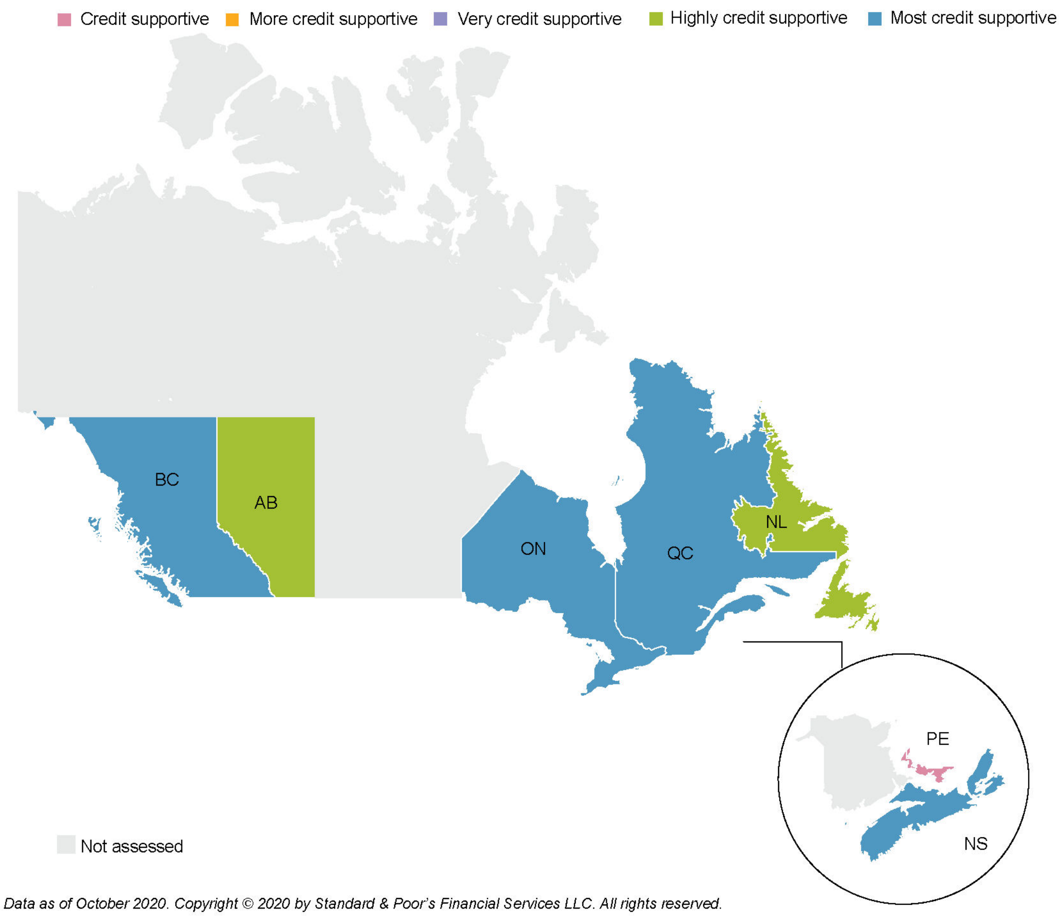
Regulatory Assessment By State



Source: S&P Global Ratings.

Chart 2

Regulatory Assessment By Canadian Province/Territory



Recent Regulatory Assessment Revisions

We periodically evaluate regulatory jurisdictions in order to discern a shift of credit quality. Based on our most recent evaluation, the following jurisdictions have shifted their credit supportiveness.

Hawaii: We revised our regulatory jurisdiction assessment on Hawaii to "more credit supportive" from "credit supportive." The revision reflected the December 2020 decision by the Hawaii Public Utilities Commission on Phase 2 of its performance-based regulation (PBR) proceeding, which includes a five-year multi-year rate plan with an index-driven annual revenue adjustment (ARA) mechanism. Overall, we concluded the new PBR framework is generally credit supportive. The multi-year rate plan and the ARA mechanism provide transparency and predictability to base-rate increases each year. In addition, we expect the PBR framework to reduce regulatory lag with the ARA mechanism, and we expect the continued use of revenue decoupling to support cash-flow stability between rate cases, which is favorable for credit quality.

Maryland: We revised our regulatory jurisdiction assessment on Maryland to "very credit supportive" from "more credit supportive." This reflected our view that the Maryland regulatory construct has strengthened. The Maryland Public Service Commission (MDPSC) recently approved the first multi-year rate plan for Baltimore Gas & Electric Co.'s (BGE) electric and natural gas rates. The MDPSC considers BGE's multiyear rate plan as a pilot for the commission to evaluate as it continues to explore alternative ratemaking in the state. Maryland's tariff-setting is based on historical test years, which can add to regulatory lag. We expect the multiyear rate plan, which incorporates forward-looking test years, will improve BGE's timeliness of capital and operating cost recovery. We view this as a more credit supportive tariff-setting design and could improve long-term capital attraction.

North Carolina: We revised our regulatory jurisdiction assessment on North Carolina to "highly credit supportive" from "most credit supportive." In January 2021, Duke Energy Corp. subsidiaries Duke Energy Carolinas (DEC) and Duke Energy Progress (DEP) agreed to not seek recovery of a combined $1 billion of deferred coal ash costs. This resulted in a pretax charge at both DEC and DEP of approximately $500 million in the fourth quarter of 2020. Although several complex matters related to the companies' coal ash remediation costs were resolved, we view the lack of full recovery and the sharing of costs between ratepayers and shareholders as negative for the companies' credit quality. In general, we expect utilities that prudently incur costs will fully recover those costs through rate mechanisms. We therefore revised downward our regulatory assessment for North Carolina. Other factors--including our collective view of regulatory stability, financial stability, and regulatory independence for the state--continue to suggest that North Carolina remains supportive of credit quality for its utilities, albeit at a lower level than our previous assessment reflected.

No Assessment Revisions But Notable Developments

District of Columbia (D.C.): Potomac Electric Power Co. (Pepco) filed a multi-year rate plan in 2019, the first of its kind in D.C. A decision is expected by mid-2021. Currently, D.C.'s tariff-setting is based on historical test years, which can add to regulatory lag. We continue to monitor this regulatory proceeding to determine if and how the alternative ratemaking mechanisms are applied and the potential impacts they may have on utilities in the district. We expect a multi-year rate plan will improve these utilities' timeliness of capital and operating cost recovery.

New York: Over the past few years, there has been heightened political scrutiny of issues such as the temporary gas moratoriums by Consolidated Edison and National Grid as well as the storm responses of many of the state's utilities. Most recently, we revised the outlook on Consolidated Edison and its subsidiaries to negative, stemming from announcements by the New York governor's office that Consolidated Edison Co. of New York Inc. (CECONY) faces potential penalties and possible certificate revocation because of its response to power outages in Manhattan and Brooklyn in July 2019. In addition, CECONY, Orange and Rockland Utilities Inc. (O&R), and Central Hudson Gas & Electric Corp. face potential penalties (and CECONY and O&R also potentially face certificate revocation) for their response and service-restoration efforts following Tropical Storm Isaias in August 2020. The extent to which a regulatory construct is insulated from political intervention is a component of our regulatory assessment analysis. Relative to other jurisdictions, we believe the New York Public Service Commission

(NYPSC) may be more exposed to intervention-related risks. We will continue to monitor regulatory developments in the state for all regulated utilities we rate, and if we reassess the regulatory framework in the state, it could affect our analyses of the state's rated regulated utilities.

Ohio: We continue to monitor the investigations into FirstEnergy Corp. (FE) and the potential for regulatory ramifications for the company. As part of a broader agreement with Ohio's Attorney General, the state regulators have effectively eliminated decoupling charges for FE's distribution utilities serving Ohio. In addition, FE's Ohio utilities will not seek to recover lost distribution revenues from residential and commercial customers that are currently authorized under utilities' existing Electric Security Plans. We will continue to monitor the jurisdiction for any material changes in regulatory support.

South Carolina: We continue to monitor the South Carolina legislature for developments around reforming the state's electricity market. In September 2020, the legislature voted to initiate a committee to evaluate the potential for future electricity reform measures and recommend proposals, including a possible restructuring of the state's energy market. The committee may assess the current structure--in which vertically integrated utilities provide electric distribution and transmission services--and consider potential reforms. These could include whether to:

- Establish a regional transmission organization (RTO) in the Southeastern U.S. or join an existing RTO;
- Implement partial or full retail competition that, if enacted, would require vertically integrated utilities to divest their generation or transmission assets; and
- Allow for community choice aggregation.

The study is expected to be completed by Nov. 1, 2021, at which time the committee will issue a report to the general assembly with its analysis and recommendations.

Texas: We are currently monitoring the Public Utility Commission of Texas's (PUCT) multiple meetings and actions in the aftermath of extreme winter weather from Winter Storm Uri in February 2021. The PUCT has oversight of investor-owned transmission and distribution companies operating in Texas and the Electric Reliability Council of Texas (ERCOT), the operator of the Texas electricity grid. During the first open meeting addressing the storm, the then-two sitting commissioners of the PUCT voted for ERCOT to retract ancillary services revenue from utilities that did not perform. The commissioners indicated they will need to review the potential of repricing ancillary services during the winter storm emergency. Given that the last remaining commissioner resigned, we will monitor the PUCT for any delays in investigations or proceedings regarding the impact of the winter storm on utilities.

During Winter Storm Uri, several vertically integrated utilities in Texas experienced higher fuel costs from much higher demand, commodity costs, and purchased power. Although we believe there will be lags in recovering these much higher costs through fuel-adjustment clauses, we do believe they will be recovered.

Texas RRC: In the midst of extremely cold winter weather across Texas in mid-February 2021, Texas Governor Greg Abbott declared a state of disaster for all Texas counties. The Railroad Commission of Texas (RRC) subsequently indicated that natural gas local distribution companies (LDCs) "...may be required to pay extraordinarily high prices in the market for natural gas and may be subjected to other extraordinary expenses when responding..." to this extreme weather. The RRC "...encourages LDCs to continue to work to ensure that the citizens of the State of Texas are provided with safe and reliable natural gas service." The RRC authorized

LDCs to record a regulatory asset for the expenses incurred due to the winter weather, including commodity and transportation costs. The RRC will review these expenses in future rate cases for reasonableness and accuracy. The LDCs will be required to prove that the expenses occurred because of the extremely cold winter weather. The RRC continues to monitor the weather and natural gas expenses.

We will monitor proceedings to recover these commodity and transportation costs by LDCs. Regulatory asset treatment reflects credit supportiveness, yet it is not authorizing timely and complete rate recovery of these costs, which is ultimately the most critical aspect for credit quality. Atmos Energy Corp. has indicated that it expects costs of about $2.5 billion, of which 95% is for Texas operations. ONE Gas Inc. has about $2.2 billion, of which a portion is from Texas utility operations. CenterPoint Energy Resources Corp., a gas LDC owned by CenterPoint Energy Inc., had gas costs of about $2.3 billion, of which $1.2 billion was incurred for customers in Texas. All three gas LDCs have massive amounts of gas costs to recover along with their typical costs. Given the magnitude of the costs, expeditious cost recovery would be most supportive of the LDC's credit quality. However, passing these costs along to ratepayers might be difficult given the ongoing impact of COVID-19 and potential rate pressure. The LDCs mostly issued shorter-term debt to cover the costs. As a result, prolonged uncertainty regarding cost recovery could increase the balances as carrying charges are accrued, and liquidity could be squeezed as short-dated debt nears maturity. Regarding securitization of these costs, the Texas general assembly, which meets every two years, would need to authorize the RRC to authorize securitization. If legislation is passed that provides the RRC with this authority, expectations are that it would take at least a year to finalize the securitization.

Washington: The state of Washington's legislative House Bill 1084 would reduce statewide greenhouse gas emissions by achieving greater decarbonization of residential and commercial buildings. The house bill would require construction of increasingly low-emission, energy-efficient homes and buildings and achieve construction of zero fossil-fuel greenhouse gas emission homes and buildings by 2030. This could phase out natural gas utilities' role in delivering energy over the next 30 years through changes to the state code, regulatory mechanisms, and incentives. We continue to monitor this proposed legislation, as it could have major implications for state gas distributors Avista Corp., Puget Sound Energy Inc., Northwest Natural Holding Co., and MDU Resources Group Inc.'s subsidiary Cascade Natural Gas Corp.

Renewable Portfolios And Clean Energy Standards

We continue to monitor renewable and clean energy standards and developments, their potential impact on credit quality, and their influence on the overall strategic direction and growth investments of North American regulated utilities. To date in the U.S., 30 states and Washington, D.C., have adopted mandatory clean energy and renewable portfolio standards. In addition, seven states have adopted voluntary renewable energy goals or objectives.

Over the past year, states have continued to propose legislation requiring utilities to reduce their carbon emissions and utilize a greater percentage of renewable energy generation. For example:

- This year, Delaware extended its renewable portfolio standard to 40% by 2035 from 25% by 2025. This includes a compliance target for each year until 2035, and it raises the minimum energy derived from solar to 10% by 2035 from 3.5% by 2025.
- Last year, the Arizona Corporation Commission (ACC) proposed an increase in the state's renewable energy standard, which includes nuclear power, to 100% by 2050 from 15% by 2025--with interim requirements. During the current legislative session, Arizona state lawmakers are reviewing the powers of the ACC to enact the proposal.
- Other states--such as Oregon, Maryland, Massachusetts, and Rhode Island--also proposed or enacted legislation to reduce emissions.

We expect enhanced review by states, utilities, and the federal government into grid reliability, storage options, and the energy transition. In December 2020, the Pennsylvania Public Utilities Commission initiated an investigation into methods to enhance grid reliability and resiliency as well as options for utilizing energy storage. In addition to state-level legislation, we are monitoring proposed federal legislation, such as the CLEAN Future Act, and the potential impact on states and the sector. While standards expand, utilities are continuing to work toward meeting their own targets in both states with and without mandatory requirements. For example, Dominion Energy Inc. aims to achieve companywide net-zero greenhouse gas emissions by 2050.

Related Research

- **Why We See Alberta's Electricity And Gas Regulatory Framework As Highly Credit Supportive**, March 3, 2021
- **Why We See Ontario's Electricity And Gas Regulatory Framework As Strong**, Jan. 13, 2021
- **Updates And Insights On Regulatory Jurisdictions Shaping Policies For North American Utilities--November 2020**, Nov. 9, 2020
- **Key Credit Factors For The Regulated Utilities Industry**, Nov. 19, 2013

This report does not constitute a rating action.

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COMMENTS — 29 Jun, 2021 | 21:34 —

APAC, United States of America, Latin America, Canada, EMEA, APAC

Updated Views On North American Utility Regulatory Jurisdictions - June 2021

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Sector	**Credit Analysis, Infrastructure & Utilities, Utilities & Power, Midstream**
Segment	**Corporations**
Tags	**Americas, Latin America, APAC, EMEA, Global**

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- Since our last report in March, we revised our assessments of three jurisdictions--Colorado, Connecticut, and Washington--and examined developments in numerous others.
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- Utility regulation, no matter where on the continuum of our assessments, strengthens the business risk profile and generally supports utility ratings.

S&P Global Ratings revised its assessments of regulatory jurisdiction in three U.S. states--Colorado, Connecticut, and Washington--to reflect incremental shifts as it relates to creditworthiness of utilities we rate. We also monitored developments in other regions.

Our periodic assessments of regulatory jurisdictions in the U.S. and Canada where a rated utility operates provide a reference for determining a utility's regulatory advantage or 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-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.

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Table 1

Utility Regulatory Jurisdictions Among U.S. States And Canadian Provinces

Credit supportive (adequate)	More credit supportive (strong/adequate)	Very credit supportive (strong/adequate)	Highly credit supportive (strong/adequate)	Most credit suppor (strong
New Mexico	Alaska	Colorado**	Alberta	Alabam
Prince Edward Island	Arizona	Delaware	Arkansas	British Columb
	California	Idaho	Georgia	Federal Energy Regulat Commis (electric
	Connecticut**	Illinois	Indiana	Florida
	District of Columbia	Maryland	Kansas	Iowa
	Hawaii	Missouri	Louisiana	Kentuck
	Mississippi	Nebraska	Maine	Michiga
	Montana	Nevada	Massachusetts	Nova Sc
	New Jersey	New Orleans	Minnesota	Ontario
	Oklahoma	New York	North Carolina	Quebec
	South Carolina	Ohio	New Hampshire	Wiscons
		Rhode Island	Newfoundland & Labrador	
		South Dakota	North Dakota	
		Texas	Oregon	
		Vermont	Pennsylvania	
		Washington*	Tennessee	
		West Virginia	Texas RRC	
		Wyoming	Utah	
			Virginia	

*Assessment revised upward. **Assessment revised downward.

Mapping Regulatory Jurisdictions

For jurisdictions assessed in Charts 1 and 2, colors delineate our assessment of credit supportiveness. (We do not have assessments on Canadian provinces where we do not have utility ratings.) They 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

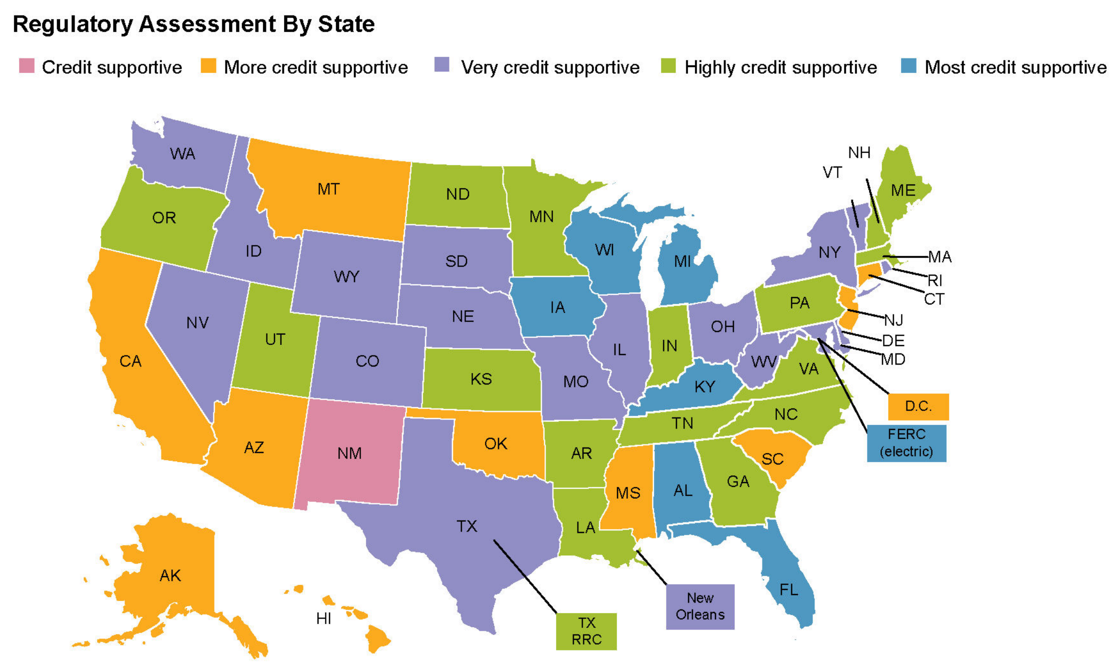
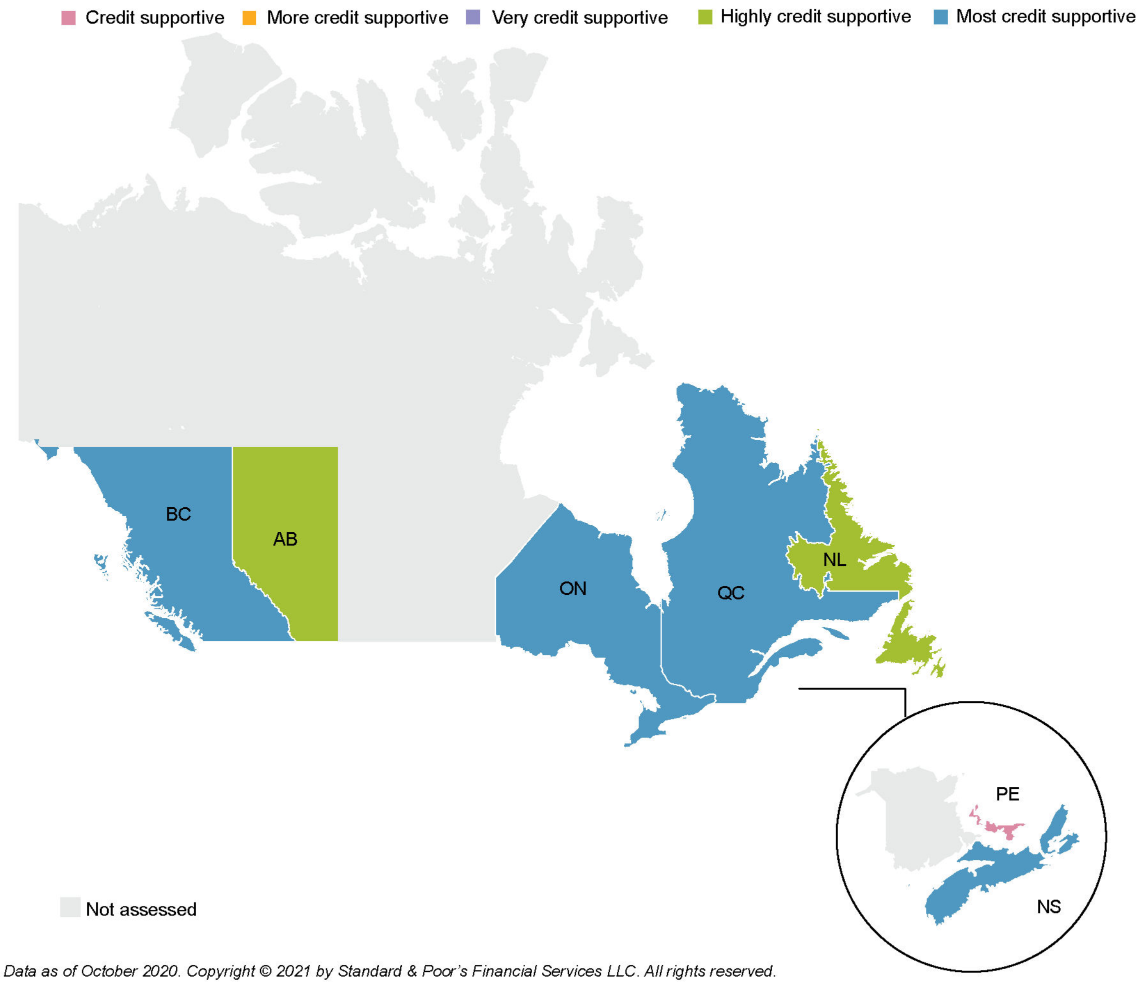


Chart 2

Regulatory Assessment By Canadian Province/Territory



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Recent Regulatory Assessment Revisions

We periodically evaluate regulatory jurisdictions to discern a shift of credit quality. Based on our most recent evaluation, these jurisdictions shifted in their credit supportiveness.

Colorado

We believe the regulatory framework in Colorado weakened over the past several years primarily due to increased politicization of the regulatory process. Frequent turnover of Public Utilities Commission (PUC) members reduced the predictability of the regulatory process. Past behavior of regulators and other participants raises questions about the balance of the interests and concerns of stakeholders. Although the use of forecast test periods is authorized, they have been contentious and not permitted outside of settled rate cases. Historically, the PUC relies upon year-end rate bases for energy utilities. But recent energy cases utilized average rate bases, and the commission has opposed utility proposals for a year-end rate base.

Also in recent years, authorized capital structure parameters including return on equity (ROE) for investor-owned natural gas and electric utilities have been below industry norms. Due to the politicization, the frequency of litigated rate proceedings has risen. We therefore revised the overall score on the Colorado PUC downward to very credit supportive from most credit supportive.

Connecticut

We revised our regulatory jurisdiction assessment on Connecticut to more credit supportive from very credit supportive. Over the past year, several incidents regarding Connecticut's electric utilities in our view increased regulatory risk in the state. For example, in July 2020, the Connecticut Light & Power Co. (CL&P) was ordered to reverse an approved and implemented rate increase pending an investigation into its rate-setting mechanisms following political pressure. In addition, CL&P and The United Illuminating Co. (UIL) were investigated for their restoration efforts following Tropical Storm Isaias in August 2020. The Connecticut Public Utilities Regulatory Authority lowered CL&P's authorized ROE 90 basis points (bps) and UIL's 15 bps. The commission also left open the possibility for storm cost disallowances and assessed civil penalties on CL&P of 2.5% of its electric distribution revenues. These penalties and ROE reductions were larger than past actions, which in our view lowers the predictability of the framework. Furthermore, given that many of these actions followed political criticism of the utilities, we believe such pressure could lead to more scrutiny and affect their ability to effectively manage regulatory risk, a key component to our analysis of credit quality.

Washington

We revised our regulatory jurisdiction assessment on Washington state to very credit supportive from more credit supportive. This reflected our view that the Washington regulatory construct has strengthened. Gov. Jay Inslee recently signed Senate Bill (SB) 5295 into law. It includes the mandatory filing of multiyear rate plans and performance-based rate making that we view as credit supportive. We expect the multiyear rate plans will enable utilities to reduce regulatory lag and smooth cash flow volatility. Utilities now must file a multiyear rate plan that is in place from two to four years. Furthermore, power costs may be trued-up after the second year, improving cash flow predictability. We view this as a more credit supportive tariff-setting design. Recoverability of operating and capital costs could improve long-term capital attraction.

No Assessment Revisions, But Notable Developments

Kansas

We believe the regulatory framework has improved incrementally in Kansas following passage of a law that authorizes the state's electric and natural gas utilities to use securitization financing to recover qualified extraordinary costs, including those during the deep freeze that swept the region in February and costs associated with a past or future retirement or abandonment of generation facilities. Notably, utilities can accrue carrying charges associated with any qualified extraordinary costs at their respective weighted-average cost of capital. We believe the prompt action taken by the Kansas legislature is highly constructive for credit quality, given the materiality of these costs--which on a combined basis surpassed $5 billion in total for ONE Gas Inc., Atmos Energy Corp., Evergy Inc., and Black Hills Corp. Although our overall view of the Kansas Corporation Commission is unchanged and we continue to assess the jurisdiction as highly credit supportive, we believe the landscape around energy policy, as it supports the long-term credit quality of utilities, has strengthened.

Nebraska

In a recent decision, Black Hills Nebraska Gas, a subsidiary of Black Hills Corp., received approval from the Nebraska Public Service Commission (PSC) to recover about $87 million in expenses from the February freeze over 36 months through a special purpose, one-time use rider. The amount to be recovered includes approximately $80 million in gas supply costs plus approximately $7 million in anticipated carrying costs. The amount was calculated at a rate of 0.92% for the period between February to September 2021 and 6.71% annually, representing the utility's weighted-average cost of capital approved in its most recent rate review, for the remainder of the 36 months. We view this blended approach as credit positive as it more accurately compensates the utility at its cost of issuing either equity or debt capital. Although our overall view of the PSC is unchanged, we believe this action demonstrates a commitment to credit quality.

Nevada

Under a new law, electric transmission should receive a boost. NV Energy Inc.--owner of the state's largest electric utilities, Nevada Power Co. and Sierra Pacific Power Co.--will likely expand its high-voltage transmission infrastructure. This accelerates completion of two new 525-kilowatt transmission lines in the state. NV Energy is a subsidiary of Berkshire

Hathaway Energy Co. The law also mandates transmission providers to join a regional transmission organization by Jan. 1, 2030, and the creation of a Regional Transmission Coordination Task Force. NV Energy must also file a three-year, $100 million transportation electrification plan to build out the state's electric vehicle charging infrastructure, including stations along interstate highways.

Oklahoma

We continue to monitor developments in Oklahoma despite no change to our regulatory assessment. A law passed in April requires utilities to file with the Oklahoma Corporation Commission (OCC) for use of securitized financing for any extreme purchase costs and other extraordinary costs incurred during the February freeze. These costs include extreme fuel, purchased power, and natural gas commodity expenses, as well as certain unprecedented utility operating expenses because of that storm. We view this legislation as potentially favorable for the regulatory environment in Oklahoma due to features of the mechanism that support off-balance-sheet debt treatment. The next steps we continue to monitor include how the OCC will implement a securitization financing order consistent with the new law.

Ontario

Although we did not revise our regulatory jurisdiction assessment of most credit supportive, we believe Ontario has weakened within this category. On June 17, the Ontario Electric Board (OEB) adopted with minimal changes a staff proposal regarding guidelines for rate recovery of incremental costs incurred during the COVID-19 pandemic. To assess if a utility should be given recovery of these costs, the OEB states that only if incremental costs incurred during the COVID-19 pandemic result in a utility's authorized ROE declining by at least 300 bps, the utility would be allowed to recover up to 50%. On a case-by-case basis, if the utility demonstrates its financial viability would still be compromised should recovery be limited to 50%, the OEB could consider a higher recovery rate. The OEB's adoption weakens our assessment of recoverability of all prudently incurred operating and capital costs in full and flexibility to recover unexpected costs if they arise.

Major rate case parameters such as ROE are formula-driven, and regulated capital structures have remained consistent for years, promoting predictability. However, these parameters have become the lowest in the Canadian provinces, which could weaken investment in regulated utilities. Coupled with the OEB's report on COVID-19 pandemic cost recovery, we believe the interests of various stakeholders have become unbalanced.

Oregon

In May, the Oregon PUC issued temporary rules governing and standardizing public safety power shutoffs (PSPS), when lines are de-energized in extreme weather conditions. The rules apply to investor-owned utilities operating in the state such as Portland General Electric Co., PacifiCorp (operating as Pacific Power), and Idaho Power Co. The rules also create communication protocols between utilities and other stakeholders, including state agencies and the public, as well as reporting requirements for the 2021 wildfire season. They remain in effect until mid-November as regulators develop permanent rules in collaboration with utilities and local communities. According to the Oregon PUC, wildfires burned approximately 1 million acres in the state in 2020. Oregon's Department of Forestry officially announced in May the beginning of a new fire season in certain areas, the earliest such declaration in over 40 years. We will continue to monitor developments surrounding the implementation of the PSPS rules and the wildfire season in the state and the region.

The Oregon legislature proposed House Bill (HB) 2021, which would require retail electricity providers to reduce greenhouse gas emissions associated with electricity sold to 100% below baseline emissions by 2040. The bill also proposes interim targets of 80% below baseline emissions by 2030 and 90% by 2035. In addition, it bans new construction or expansion of power plants that burn natural gas or other fossil fuels. We will continue to monitor the bill and if it passes.

Railroad Commission of Texas (RRC)

On June 17, Texas Gov. Greg Abbott signed HB 1520 to address the over $5 billion in natural gas costs that local distribution companies (LDCs) incurred during the February storm. Natural gas LDCs can seek approval from the RRC to securitize these extraordinary costs along with carrying charges. Our view of the RRC is unchanged at highly credit supportive. However, we believe this action demonstrates a commitment to credit quality for investor-owned gas utilities in the state.

Texas Public Utilities Commission

Abbott signed HB 1510 into law June 8 for investor-owned electric utilities. It broadens legislation around the recovery of system restoration costs through securitization financing for non-Electric Reliability Council of Texas vertically integrated utilities (VIU), but it doesn't address the recovery of the extraordinary fuel and purchased power costs incurred during the freeze. Compared to the securitization route taken for other stakeholders, we view this as less favorable for credit quality primarily due to the lack of clarity around future recovery of the extraordinary fuel and purchased power costs. VIUs can normally recover fuel and purchased power costs through riders, but given the size of the costs, recovery over a short period would be too onerous on customer bills.

While some utilities requested deferral treatment of these costs, approval in full, including associated holding costs, is uncertain and could contribute to regulatory lag.

In the wake of the winter storm, all three Texas PUC commissioners resigned amid pressure from some state politicians. While our overall view of the regulatory framework under the Texas PUC is unchanged at very credit supportive, we believe this demonstrates greater risk of political intervention. That ultimately can be negative for credit quality, especially with multiple rate proceedings pending at the time.

West Virginia

Gov. Jim Justice signed SB 542 in April and it becomes law July 9. It requires utilities to maintain a minimum 30-day aggregate coal supply under contract for the remainder of a plant's life, and public electric utilities are to provide notice before plant closures or permanent idling to the PSC of West Virginia, the West Virginia Office of Homeland Security and Emergency Management, and the legislature's Joint Committee on Government and Finance.

Renewable Portfolios And Clean Energy Standards

We continue to monitor developments in renewable and clean energy standards, their influence on the overall strategic direction and growth investments of regulated utilities, and their potential impact on credit quality. Since our March update, states, cities, and utilities alike have continued to make progress toward reducing carbon emissions and utilizing a greater percentage of renewable energy generation. For example, Arizona, Illinois and New Orleans also proposed or enacted legislation setting timelines to reduce emissions.

Offshore wind has picked up traction in the U.S., specifically on the East Coast. This spring, the first large commercial-scale offshore wind project received federal approval. The joint venture of Avangrid Renewables, a subsidiary of Avangrid Inc., and Copenhagen Infrastructure Partners plans to install up to 84 wind turbines in the Atlantic Ocean near Massachusetts. Another offshore wind project in the approval process is Ocean Wind, a joint venture between Orsted A/S and Public Service Enterprise Group Inc. off the coast of New Jersey that would add 1,100 megawatts (MW) of capacity. And the first offshore wind farm in New York, off Long Island, will add 132 MW of capacity. We expect this joint venture between Orsted and Eversource Energy to begin construction in 2022 and be in operation by the end of 2023.

The Biden Administration has committed to expanding offshore wind opportunities along the Atlantic Coast, Gulf of Mexico, and Pacific Coast. It aims to deploy 30,000 MW of offshore wind power by 2030 and potentially 110,000 MW by 2050. Besides these long-term goals, the Administration announced that the northern and central coasts of California would be open to an estimated 4,600 MW of offshore wind power development capacity.

Related Research

- **Our View Of The Texas Railroad Commission Remains Highly Credit Supportive For Invested-Owned Utilities**
, June 22, 2021
- **For Investor-Owned Utilities, Winter Storm Uri Hasn't Affected Our View Of Texas' Regulatory Framework**
, June 8, 2021
- **Why We See Alberta's Electricity And Gas Regulatory Framework As Highly Credit Supportive**
, March 3, 2021
- **Why We See Ontario's Electricity And Gas Regulatory Framework As Strong**
, Jan. 13, 2021
- **Updates And Insights On Regulatory Jurisdictions Shaping Policies For North American Utilities—March 2021**
, March 22, 2021
- **Key Credit Factors For The Regulated Utilities Industry**, Nov. 19, 2013

This report does not constitute a rating action.

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Industry Top Trends Update

Regulated Utilities

Credit quality is weakening

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What's changed?

Texas storm. Climate risks continue to weaken credit quality. The severe winter storm drove up commodity prices and we downgraded two regional gas distribution utilities that were exposed to these higher costs.

Energy transformation. The industry is focused on reaching net zero by further reducing its greenhouse gas (GHG) emissions. The industry's GHG emissions were down about 25% over the past decade and we expect a further 40% reduction in the coming decade, reflecting the growth of renewable generation displacing coal-fired generation.

High capital spending. Annual capital spending has been growing at about 9% and now exceeds $160 billion. This has contributed to negative discretionary cash flow and weaker financial measures.

How is recovery taking shape?

Credit quality is weakening. Year-to-date downgrades are outpacing upgrades by about 7 to 1. We expect that 2021 will be the second consecutive year that downgrades outpace upgrades.

Effective management of COVID-19-related risks. The industry effectively navigated the pandemic-related risks. Higher residential sales somewhat offset lower commercial and industrial sales. Many utilities are filing with their regulators for recovery of COVID 19-related costs.

Minimal financial cushion. About 50% of the industry strategically operates with minimal financial cushion to their downgrade threshold, pressuring credit quality.

What are the key risks around the baseline?

Tax reform. A higher corporate tax rate would improve the industry's financial measures. Should the corporate tax rate rise to 28%, we estimate the industry's funds from operations to debt would improve by about 100 basis points.

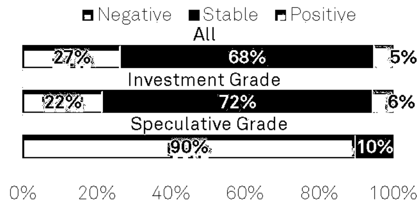
Wildfires. California again received below-average rainfall, remaining susceptible to catastrophic wildfires. However, the utilities have invested billions in wildfire mitigation that they believe will offset the rising environmental risks.

Inflation. The consumer price index (CPI) for the 12-month percentage change rose to 4.2% and 5% for April and May 2021, respectively. The last time the CPI exceeded 5% was 2008. Should inflation take hold and given the regulatory lag for utilities to recover their costs, the industry's financial measures would likely weaken.

Latest Related Research

- Credit FAQ: How Are California's Wildfire Risks Affecting Utility Credit Quality? June 3, 2021
- How ESG Factors Are Shaping North American Regulated Investor-Owned Utilities' Credit Quality, April 28, 2021
- North American Regulated Utilities' Credit Quality Begins The Year On A Downward Path, April 7, 2021

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	263	20	283
Downgrades	26	0	26
Upgrades	4	0	4

Ratings data as of end-June, 2021

COVID-19 Heat Map

	Utilities
Estimated Recovery To 2019 Credit Metrics	2022
Potential Negative Long-Term Industry Disruption	--

2020 v. 2019		
Revenue Decline	**EBITDA Decline**	**Incremental Borrowings**
0% to 5%	0% to 10%	<5%

2021 Estimates v. 2019	
Revenue Decline	**EBITDA Decline**
≥2019	≥2019

S&P Global Roundtable

S&P Global Ratings – North America Regulated Utilities

Jan. 29, 2021

S&P Global
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1096

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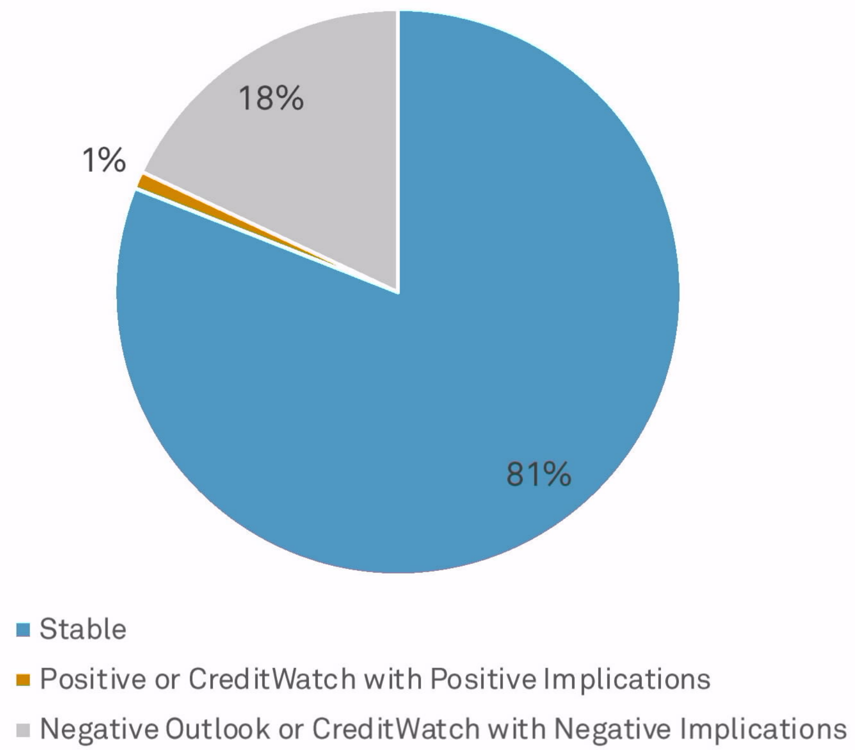
Ratings Outlook At The Beginning Of 2020

North America Regulated Utility Industry Outlook and CreditWatch Distribution – Beginning Of 2020



– High percentage of negative outlooks due to:
1. Climate change
2. Conservation – no growth
3. Mergers and acquisitions
4. Large capital spending
5. Gas explosions
6. Managing regulatory risks
7. Strategic financial management

Source: S&P Global Ratings

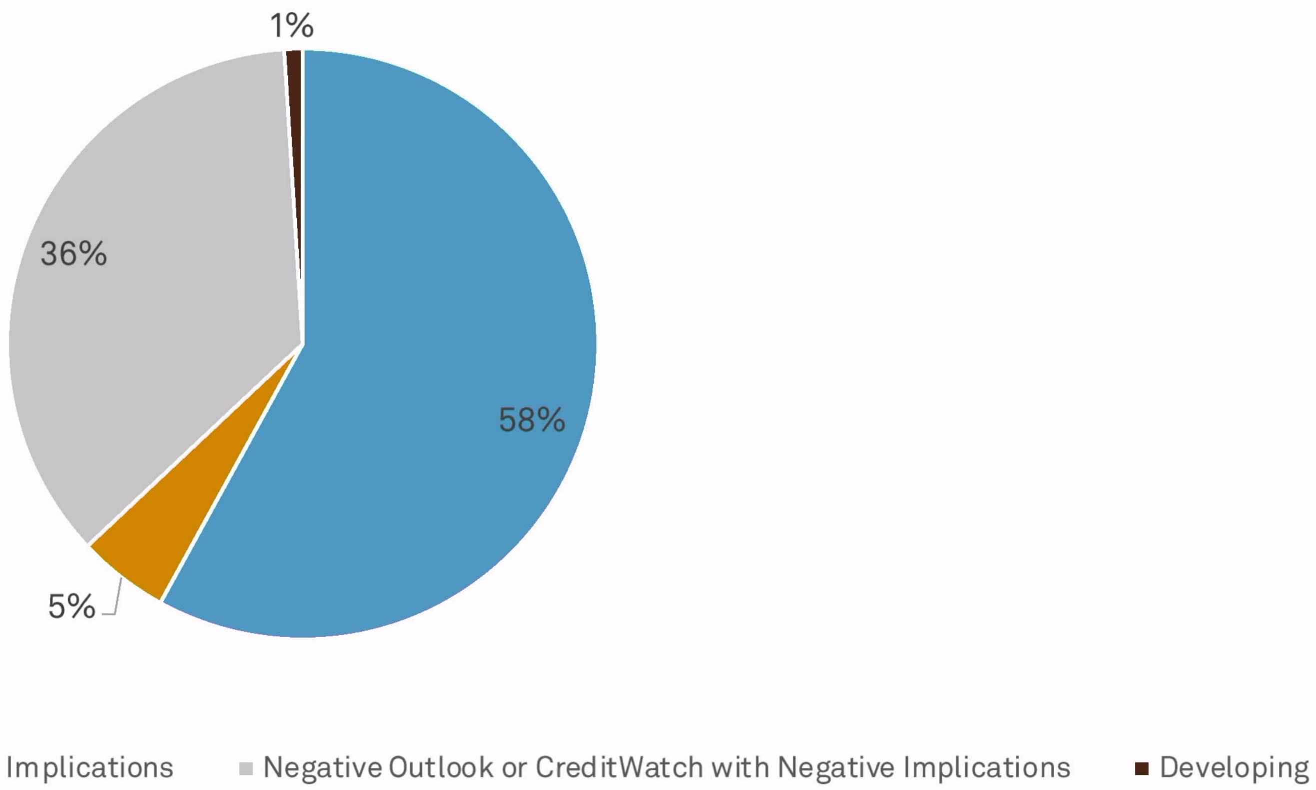
Credit Risks Of COVID-19

- ✓ Lower commercial and industrial electric and gas deliveries were partially offset by higher residential usage and the effective use of regulatory mechanisms
- ✓ The industry has effectively worked with their regulators to defer much of the COVID-19-related costs including bad debt expense
- ✓ The industry has been able to generally access the equity markets and issue hybrid securities
- ✗ Delayed rate-case filings and lower-than-expected outcomes
- ✓ Higher equity valuations improved underfunded pension positions

Source: S&P Global Ratings

Ratings Outlook At The End Of 2020

North America Regulated Utility Industry Outlook and CreditWatch Distribution – Year-End 2020



Source: S&P Global Ratings