Regulatory Research Associates
REGULATORY FOCUS

RRA is an offering of S&P Global Market Intelligence May 11, 2017

STATE REGULATORY EVALUATIONS
Regulatory Climate for Energy Utilities
~ Including an Overview of RRA's ranking process ~

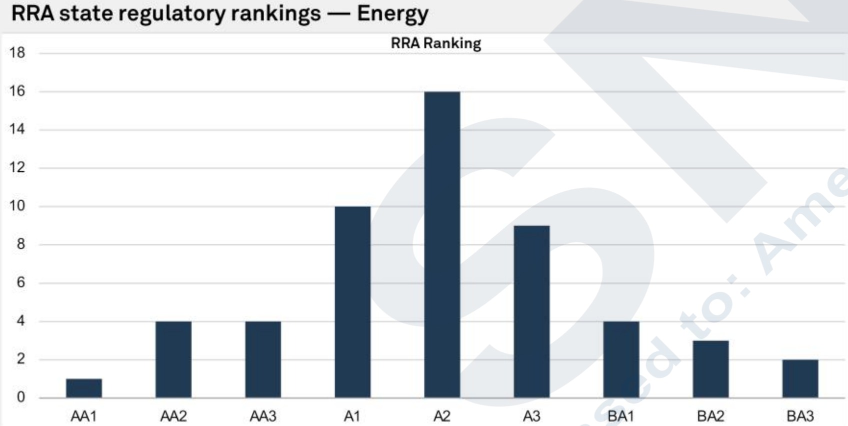
Regulatory Research Associates, or RRA, evaluates the regulatory climates for ***energy utilities*** of the jurisdictions within the 50 states and the District of Columbia (a total of 53 jurisdictions) on an ongoing basis. The evaluations are assigned from an investor perspective and indicate the relative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

Each evaluation is based upon consideration of the numerous factors affecting the regulatory process in the state, and may be adjusted as events occur that cause RRA to modify its view of the regulatory risk accruing to the ownership of utility securities in that individual jurisdiction.

RRA also reviews evaluations when updating Commission Profiles, and when publishing this quarterly comparative report. The issues considered are discussed in Focus Notes, Commission Profiles, or Final Reports. RRA also considers information obtained from contacts with commission, company, and government personnel in the course of its research. The final evaluation is an assessment of the probable level and quality of the earnings to be realized by the state's utilities as a result of regulatory, legislative, and court actions.

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

RRA state regulatory rankings — Energy



Graph is based on rankings of regulatory climate for energy utilities only.
As of May 10, 2017.
AA = Above Average; A = Average; BA = Below Average
Source: Regulatory Research Associates, an offering of S&P Global Market Intelligence

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

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

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

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

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

RRA attempts to maintain a "normal distribution" of the rankings, with the majority of the states classified in one of the three Average-range categories. The remaining states are the split relatively evenly between the Above Average and Below Average classifications, as seen in the accompanying chart that depicts the current distribution of the rankings. ***For a more in-depth discussion of the factors RRA reviews as part of its ratings process, see the Overview that begins on page 3***.

RRA's previous "State Regulatory Evaluations" report was published on Oct. 18, 2016, and since then RRA has been conducting a comprehensive audit of its rankings in order to realign the ratings assigned to each jurisdiction. As a result, the rankings of many jurisdictions changed, in some cases significantly. These changes are not necessarily the result of a single dramatic action or actions, but rather in many cases resulted from gradual incremental relative shifts over time that were not previously reflected in the relative rankings.

Ranking Changes

As noted above, many, in fact, more than half of the jurisdictions under coverage had some type of shift in their assigned ranking as a result of the audit. The table below lists the 32 jurisdictions where the rankings were adjusted since the issuance of RRA's previous evaluations summary on Oct. 18, 2016.

RRA regulatory rankings changes since prior report

State	Ranking as of 05/10/17	Ranking as of 10/18/16
Alabama	Above Average / 1	Above Average / 2
Alaska	Below Average / 1	Average / 3
Arkansas	Average / 1	Average / 2
California	Above Average / 3	Average / 1
Colorado	Average / 2	Average / 1
Connecticut	Below Average / 3	Below Average / 2
District of Columbia	Below Average /2	Below Average / 1
Florida	Above Average / 2	Above Average / 3
Georgia	Above Average /2	Above Average / 3
Illinois	Average / 2	Below Average / 1
Indiana	Average / 1	Above Average / 3
Iowa	Average /1	Above Average / 3
Kansas	Below Average/1	Average / 2
Louisiana—NOCC	Average /2	Average / 1
Louisiana—PSC	Average / 2	Average / 1
Maryland	Below Average / 3	Below Average / 2
Missouri	Below Average / 1	Average / 2
Montana	Average / 3	Below Average / 1
Nebraska	Average / 1	Average / 2
New Jersey	Below Average/ 2	Average / 3
New Mexico	Below Average /2	Below Average / 1
New York	Average /1	Average / 2
Oklahoma	Average / 3	Average / 2
Oregon	Average / 2	Average / 3
Pennsylvania	Above Average / 3	Average / 2
Rhode Island	Average / 2	Average / 3
South Dakota	Average / 2	Average / 3
Tennessee	Above Average / 3	Average / 1
Texas—PUC	Average /3	Below Average / 1
Texas—RRC	Average / 2	Average / 3
Vermont	Average/2	Average/3
Wyoming	Average / 3	Average / 2

As of May 10, 2017.
PUC = Public Utility Commission; RRC = Railroad Commission;
PSC = Public Service Commission; NOCC = New Orleans City Council
Source: Regulatory Research Associates, an offering of S&P Global Market Intelligence

For the most part, the states that changed only moved one ranking up or down, and given the subjective nature of the rankings this is not surprising. However, certain changes bear discussion.

Prior to the recent review, RRA had declined to assign any state an Above Average/1 ranking, due to concerns that such a ranking could prove politically challenging with unintended consequences for the utilities in the state(s) that are so ranked.

As part of the recent review, the team determined that in order to maximize the accuracy of the rankings, it was necessary to eliminate this "bias."

Consequently, the ranking of **Alabama** moved to Above Average/1 from Above Average/2.

There were five jurisdictions where the ranking moved by more than one rating up or down: Illinois, Kansas, Missouri, New Jersey and Pennsylvania.

The ranking of **Illinois** was raised to Average/2 from Below Average/1. The ranking change accounts for the constructive ratemaking steps the state has taken in recent years, including allowing the use of formula rate plans for the large electric utilities and infrastructure investment mechanisms for the gas utilities. Although the authorized ROEs in recent years for both the electric and gas utilities have been considerably below prevailing industry averages at the time established, the statutory use of a formulaic approach to setting electric ROEs is the primary impetus for many of these returns.

RRA's ranking of **Kansas** was lowered to Below Average/1 from Average/2 to reflect a gradual shift toward a more "consumerist" approach to ratemaking, as well as the commission's recent decision to block Great Plains Energy's proposed acquisition of Westar Energy, which is negative from an investor vantage point.

RRA's ranking of **Missouri** was lowered to Below Average/1 from Average/2 in light of the state's inability to adopt meaningful changes to its regulatory structure, despite the considerable effort put forth by the utilities, and the recognition by the commission and certain members of the legislature that certain changes could be warranted. The state's traditional approach to ratemaking is less investor-friendly than the more constructive frameworks now being utilized in many other jurisdictions.

The ranking of the **New Jersey** regulatory climate was lowered to Below Average/2 from Average/3. This change stems largely from attrition rather than an identifiable shift in policy; i.e., the jurisdiction has not moved to implement certain innovative policies that have been adopted in other jurisdictions, and has retained others, such as consolidated tax adjustments, albeit in a modified form. In addition, the state’s consumer advocacy agency remains vocal and has a strong influence, rendering it difficult for the utilities to achieve constructive regulatory outcomes.

RRA's ranking of **Pennsylvania** regulation was raised to Above Average/3 from Average/2. This move reflects an overdue change to fully recognize the state's transition to fully forecasted test years, which was effectuated by a change in state law and has been embraced by the commission. Another constructive aspect of the Pennsylvania regulatory climate has been the implementation of mechanisms to reflect new infrastructure investment in rates on a basis, through quarterly rate adjustments, for almost all of the state's utilities. While this was occurring, the commission has sought to maintain authorized ROEs at levels that are attractive to investors, despite the declining interest rate/ROE environment.

The tables below provide summaries of RRA's rankings with respect to the regulatory climate in the 53 Jurisdictions, first by ranking category and then by state. A map depicting the rankings is provided on page 9.

RRA state regulatory evaluations — Energy

Above Average/1	Above Average/2	Above Average/3	Average/1	Average/2	Average/3	Below Average/1	Below Average/2	Below Average/3
Alabama	Georgia	California	Arkansas	Colorado	Arizona	Alaska	Dist. of Columbia	Connecticut
	Florida	Mississippi	Indiana	Hawaii	Delaware	Kansas	New Jersey	Maryland
	Virginia	Pennsylvania	Iowa	Idaho	Massachusetts	Missouri	New Mexico	
	Wisconsin	Tennessee	Kentucky	Illinois	Montana	West Virginia		
			Michigan	Louisiana NOCC	New Hampshire			
			Nebraska	Louisiana PSC	Oklahoma			
			New York	Maine	Texas PUC			
			North Carolina	Minnesota	Vermont			
			North Dakota	Nevada	Washington			
			South Carolina	Ohio	Wyoming			
				Oregon				
				Rhode Island				
				South Dakota				
				Texas RRC				
				Utah				

As of May 10, 2017.
Source: Regulatory Research Associates, an offering of S&P Global Market Intelligence

RRA state regulatory evaluations — State-by-state listing — Energy

State	Ranking	State	Ranking	State	Ranking
Alabama	Above Average / 1	Louisiana--NOCC	Average /2	Ohio	Average / 2
Alaska	Below Average / 1	Louisiana--PSC	Average / 2	Oklahoma	Average / 3
Arizona	Average / 3	Maine	Average / 2	Oregon	Average / 2
Arkansas	Average / 1	Maryland	Below Average / 3	Pennsylvania	Above Average / 3
California	Above Average / 3	Massachusetts	Average / 3	Rhode Island	Average / 2
Colorado	Average / 2	Michigan	Average / 1	South Carolina	Average / 1
Connecticut	Below Average / 3	Minnesota	Average / 2	South Dakota	Average / 2
Delaware	Average / 3	Mississippi	Above Average / 3	Tennessee	Above Average / 3
District of Columbia	Below Average /2	Missouri	Below Average / 1	Texas--PUC	Average /3
Florida	Above Average / 2	Montana	Average / 3	Texas--RRC	Average / 2
Georgia	Above Average /2	Nebraska	Average / 1	Utah	Average / 2
Hawaii	Average / 2	Nevada	Average / 2	Vermont	Average / 3
Idaho	Average / 2	New Hampshire	Average / 3	Virginia	Above Average / 2
Illinois	Average / 2	New Jersey	Below Average/ 2	Washington	Average / 3
Indiana	Average / 1	New Mexico	Below Average /2	West Virginia	Below Average / 1
Iowa	Average /1	New York	Average /1	Wisconsin	Above Average / 2
Kansas	Below Average/1	North Carolina	Average / 1	Wyoming	Average / 3
Kentucky	Average / 1	North Dakota	Average / 1		

As of May 10, 2017.
PUC = Public Utility Commission; RRC = Railroad Commission; PSC = Public Service Commission; NOCC = New Orleans City Council
Source: Regulatory Research Associates, an offering of S&P Global Market Intelligence

Overview of RRA rankings process

As noted above, RRA maintains three principal rating categories, Above Average, Average, and Below Average, with Above Average indicating a relatively more constructive, lower-risk regulatory environment from an investor viewpoint, and Below Average indicating a less constructive, higher-risk regulatory climate. Within the three principal rating categories, the numbers 1, 2, and 3 indicate relative position. The designation 1 indicates a stronger or more constructive rating from an investor viewpoint; 2, a mid-range rating; and, 3, a less constructive rating within each higher-level category. Hence, if you were to assign numeric values to each of the nine resulting categories, with a "1" being the most constructive from an investor viewpoint and a "9" being the least constructive from an investor viewpoint, then Above Average/1 would be a "1" and Below Average/3 would be a "9."

The rankings are subjective and are intended to be comparative in nature. RRA endeavors to maintain a "normal distribution" with an approximately equal number of rankings above and below the average. The variables that RRA considers in determining each state's ranking are largely the broad issues addressed in our State Regulatory Reviews/Commission Profiles and those that arise in the context of rate cases and are discussed in RRA Rate Case Final Reports.

The rankings reflect not only the decisions rendered by the state regulatory commission, but also take into account the impact of the actions taken by the governor, the legislature, the courts, and the consumer advocacy groups. The policies examined pertain largely to rate cases and the ratemaking process, but issues such as industry restructuring, corporate governance and approach to proposed mergers are also considered.

In May 2017, the regulatory team undertook a comprehensive review/recalibration of the then-effective rankings. While the issues that RRA considers when assigning its rankings has not changed, the team adopted a more formalized process whereby each state is accorded a score for each of more than 30 variables that relate to the issues that RRA deems to be significant from an investor viewpoint. The variables are designed to reflect the interests of both equity and fixed income investors.

The individual scores are assigned based on the covering analysts' subjective judgement. The scores are then aggregated to create a single score for each state, with certain categories weighted more heavily than others. The states are then ranked from lowest to highest, and distributed among the nine ratings categories to create an approximation of a normal distribution. The distribution is then reviewed by the team as a whole and individual state rankings may be adjusted, based on the covering analysts' recommendation, subject to review by a designated panel of senior analysts.

The summaries below are intended to provide an overview of these variables and how each can impact a given regulatory environment.

Governor/Mayor — The impact a governor, or in the District of Columbia the Mayor, may have varies depending largely on the individual; the issue of elected versus appointed commissioners is evaluated separately. RRA takes no view on whether Republican governors or Democratic governors are more/less constructive. However, attributes of the governor or the gubernatorial election process that can move the needle here are: whether energy issues were a topic of debate in recent elections and what the tone/topic of the debate was; and, does the governor seek to involve him/herself in the regulatory process, and what type of influence is the governor seeking to exert.

Commissioner Selection Process/Membership — RRA looks at how commissioners are selected in each state. All else being equal, RRA attributes a greater level of investor risk to states in which commissioners are elected rather than appointed. Generally, energy regulatory issues are less politicized when they are not subject to debate in the context of an election. Realistically, a commissioner candidate who indicates sympathy for utilities and appears to be amenable to rate increases is not likely to be popular with the voting public.

However, there have been some notable instances in which energy issues in appointed-commission states became gubernatorial/senatorial election issues, with detrimental consequences for the utilities, e.g., Illinois, Florida, and Maryland, all of which were downgraded by RRA at the time in order to reflect the risk associated with increased politicization of the regulatory process.

In addition, RRA looks at the commissioners themselves and their backgrounds. Experience in economics and finance and/or energy issues is generally seen as a positive sign. Previous employment by the commission or a consumer advocacy group is sometimes viewed as a negative indicator. In some instances, new commissioners have very little experience or exposure to utility issues, and in some respects, these individuals represent the highest level of risk, simply because there is no way to foresee what they will do or how long it will take them to "get up to speed."

Commission Staff/Consumer Interest — Most commissions have a staff that participates in rate proceedings. In some instances the staff has a responsibility to represent the consumer interest and in others the staff's statutory role is less defined. In addition, there may or may not be: additional state-level organizations that are charged with representing the interests of a certain class or classes of customers; private consortia that represent certain customer groups; and/or, large-volume customers that intervene directly in rate cases.

Generally speaking, the greater the number of consumer intervenors, the greater the level of uncertainty for investors. The level of risk for investors also depends on the caliber and influence of the intervening parties and the level of contentiousness in the rate case process. Even though a commission may not adopt an extreme position taken by an intervenor, the inclusion of an extreme position in the record for the case widens the range of possible outcomes, reducing certainty and increasing the risk of a negative outcome for investors. RRA's opinion on these issues is largely based on past experience and observations.

Settlements — Generally speaking, the ability of the parties to reach agreement without having to go through a fully litigated proceeding is considered constructive. However, RRA also endeavors to ascertain whether the settlements arise because of a truly collaborative approach among the parties, or if they result from concern by the companies that the commissioners' views may be more extreme than the intervenors, or that the intervenors will take a much more extreme position in litigated framework than in a closed-door settlement negotiation.

Rate Case Timing — For each state commission, RRA considers whether there is a set time frame within which a rate case must be decided, the length of any such statutory time frame and the degree to which the commission adheres to that time frame. Generally speaking, RRA views a set time frame as preferable, as it provides a degree of certainty as to when any new revenue may begin to be collected.

About two thirds of state commissions nationwide have a rule or statute that requires a rate case to be decided within seven to 12 months of filing. Shorter time frames may apply for limited issue proceedings, but there are very few states where a rate case will take less than 7 months to be decided. In addition, a shorter time frame for a decision generally reduced the likelihood that the actual conditions during the first year the new rates will be in effect will vary markedly from the test period utilized to set new rates, thus keeping regulatory lag to a minimum.

Interim Procedures — The ability to implement all or a portion of a proposed rate increase on an interim basis prior to a final decision in a rate case is viewed as constructive. However, should the commission approved a rate change that is markedly below the rates implemented on an interim basis, the utility would be required to refund any related over-collections, generally with interest.

In some instances commission approval is required prior to the implementation of an interim increase, and may or may not be easy to obtain, while in others state law or commission rules permit the companies to implement interim rate increases as a matter of course. In some instances, the commission may establish a date prior to the final decision in the case that will be the effective date of the new rates. In these instances the company may be permitted to recoup any revenue that was not collected between the effective date and the decision date.

Return on Equity--Return on equity is perhaps the single most litigated issue in any rate case. There are two aspects RRA considers when evaluating an individual rate case and the overall regulatory environment: (1) how the authorized ROE compares to the average of returns authorized for energy utilities nationwide over the 12 months, or so, immediately preceding the decision; and, (2) whether the company has been accorded a reasonable opportunity to earn the authorized return in the first year of the new rates.

Even if a utility is accorded a "reasonable opportunity" to earn its authorized ROE, there is no guarantee that the utility will do so. The revenue requirement and ROE established in a rate case are targets that the commission believes the established rates will allow the utility to attain. But various factors such as weather, management efficiency, unexpected events, demographic shifts, fluctuations in economic activity and customer participation in energy conservation programs may cause revenue and earnings to vary from the targets set.

With regard to the first criteria, RRA looks at the ROEs historically authorized for utilities in a given state and compares them to utility industry averages, as calculated in *RRA's Major Rate Case Decisions Quarterly Updates*. Intuitively, authorized ROEs that meet or exceed the prevailing averages at the time established are viewed as more constructive than those that fall short of these averages.

With regard to the second consideration, in the context of a rate case, a utility may be authorized a relatively high ROE, but factors, e.g., capital structure changes, the age or "staleness" of the test period, rate base and expense disallowances, the manner in which the commission chooses to calculate test year revenue, and other adjustments, may render it unlikely that the company will earn the authorized return on a financial basis. Hence, the overall decision may be negative from an investor viewpoint, even though the authorized ROE is equal to or above the average. For a more detailed discussion of the rate case process, refer to the RRA report entitled *The Rate Case Process: A Conduit to Enlightenment*.

Rate Base — As noted above, a commission's policies regarding rate base can impact the ability of a utility to earn its authorized ROE. These policies are often outlined in state statutes and the commission usually does not have much latitude with respect to these overall policies. With regard to rate base, commissions are about evenly split between those that employ a year-end, or terminal valuation, and those that utilized an average valuation, with one using a date certain.

In general, assuming rate bases are rising, i.e., new investment is outpacing depreciation, a year-end valuation is preferable from an investor viewpoint. Again, this relates to how well the parameters used to set rates reflect actual conditions that will exist during the rate-effective period; hence, the more recent the valuation, the more likely it is to approximate the actual level of rate base being employed to serve customers once the new rates are placed into effect. Some commissions permit post-test-year adjustments to rate base for "known and measurable" items, and, in general, this practice is beneficial to the utilities. However, the rules with respect to what constitutes a known and measurable adjustment are not always specific, and there can be a good deal of controversy about what does and does not pass muster.

Another key consideration is whether state law and/or the commission generally permits the inclusion in rate base of construction work in progress, or CWIP, for a cash return. CWIP represents assets that are not yet, but ultimately will be, operational in serving customers. Generally, investors view inclusion of CWIP in rate base for a cash return as constructive, since it helps to maintain cash flow metrics during a large construction cycle. Alternatively, the utilities accrue allowance for funds used during construction, or AFUDC, which is essentially booking a return on the construction investment as a regulatory asset that is recoverable from ratepayers once the project in question becomes operational. While this method bolsters earnings, it does not augment cash flow and does not support credit metrics. For a more in-depth look at rate base issues, refer to the RRA report entitled. *Rate Base: Shining Light on a Topic That Continues to Fuel Discussion*.

Test Period — With regard to test periods, there are a number of different practices employed, with the extremes being fully-forecasted, which is considered to be most constructive, on the one hand, and fully historical, considered to be least constructive, on the other. Some states utilize a combination of the two, in which a utility is permitted to file a rate case that is based on data that is fully or partially forecast at the time of filing, and is later updated to reflect actual data that becomes known during the course of the proceeding. Generally speaking in these cases the test year is historical by the time a decision is ultimately rendered, and so regulatory remains something of a problem.

Accounting — RRA looks at whether a state commission has permitted unique or innovative accounting practices designed to bolster earnings. Such treatment may be approved in response to extraordinary events such as storms, or for volatile expenses such as pension costs. Generally, such treatment involves deferral of expenditures that exceed the level of such costs reflected in base rates. In some instances the commission may approve an accounting adjustment to temporarily bolster certain financial metrics during the construction of new generation capacity. From time-to-time commissions have approved frameworks under which companies were permitted to, at their own discretion, adjust depreciation in order to mitigate under-earnings or eliminate an over-earnings situation without reducing rates. These types of practices are generally considered to be constructive from an investor viewpoint.

Alternative Regulation — Generally, RRA views as constructive the adoption of alternative regulation plans that are designed to stream-line the regulatory process and cost recovery or allow utilities to augment earnings in some way. These plans can be broadly or narrowly focused. Narrowly-focused plans may: allow a company or companies to retain a portion of cost savings relative to a base level of some expense type, e.g. fuel, purchased power, pension cost, etc.; permit a company to retain for shareholders a portion of off-system sales revenues; or, provide a company an enhanced ROE for achieving operational performance and/or customer service metrics or for investing in certain types of projects, e.g., demand-side management programs, renewable resources, new traditional plant investment.

The use of plans with somewhat broader scopes, such as ROE-based earnings sharing plans is, for the most part, considered to be constructive, but it depends upon the level of the ROE benchmarks specified in the plan, and whether there is symmetrical sharing of earnings outside the specified range.

Some states employ even more broad-based plans, such as formula based ratemaking, where authorized return parameters are set at the inception of the plans, and rates are permitted to adjust automatically on an annual basis within a certain range to reflect changes in expenses and new capital investment.

Court Actions — This aspect of state regulation is particularly difficult to evaluate. Common sense would dictate that a court action that overturns restrictive commission rulings is a positive. However, the tendency for commission rulings to come before the courts, and for extensive litigation as appeals go through several layers of court review, may add an untenable degree of uncertainty to the regulatory process. Also, similar to commissioners, RRA looks at whether judges are appointed or elected, as political considerations are more likely to influence elected jurists.

Legislation — While *RRA's Commission Profile*s provide statistics regarding the make-up of each state legislature, RRA has not found there to be any specific correlation between the quality of energy legislation enacted and which political party controls the legislature. Of course, in a situation where the governor and legislature are of the same political party, generally speaking, it is easier for the governor to implement key policy initiatives, which may or may not be focused on energy issues. Key considerations with respect to legislation include: how prescriptive newly enacted laws are; whether the bill is clear or ambiguous and open to varied interpretations; whether it balances ratepayer and shareholder interests rather than merely "protecting" the consumer; and, whether the legislation takes a long-term view or is a "knee-jerk" reaction to a specific set of circumstances.

Corporate Governance — The term corporate governance generally refers to a commission's ability to intervene in a utility's financial decision-making process through required pre-approval of all securities issuances, limitations on leverage in utility capital structures, dividend payout limitations, ring-fencing, and authority over mergers. Corporate governance may also include oversight of affiliate transactions. In general, RRA views a modest level of corporate governance provisions to be the norm, and in some circumstances these provisions, such as ring-fencing, have protected utility investors as well as ratepayers. However, a degree of oversight that would allow the commission to "micromanage" the utility's operations and limit the company's financial flexibility would be viewed as restrictive.

Merger Activity — In cases where the state commission has authority over mergers, RRA reviews the type of approval standard that is contained in state law and/or has been applied by the commission in specific situations. Generally speaking, RRA views a "no net harm" standard as more constructive than a "positive net benefits approach."

RRA also examine the conditions, if any, placed on the commission's approval of these transactions, specifically: whether the company will be permitted to retain a portion of any merger-related cost savings; if guaranteed rate reductions or credits were required; whether certain assets were required to be divested; and, whether the commission placed stringent limitations on capital structure and/or dividend policy.

See the RRA reports entitled *Electric and Gas Utility Mergers and Acquisitions Regulatory Overview of Merger Review Standards* and *Electric and Gas Utility Mergers and Acquisitions — Timeline of Transactions 1985-2016* for additional detail on statutory guidelines for merger reviews, and detail concerning approved/rejected mergers and the associated conditions imposed, respectively.

Electric Regulatory Reform/Industry Restructuring — RRA generally does not view a state's decision to implement retail competition for generation as either positive or negative from an investor viewpoint. About 20 states have implemented retail competition. However, for those states that have implemented retail competition, RRA considers: whether up-front guaranteed rate reductions were required; how stranded costs were quantified and whether the utilities were accorded a reasonable opportunity to recover stranded costs; the length of the transition period and whether utilities were at risk for power price fluctuations associated with their default service responsibilities during the transition period; how default service is procured following the end of the transition period; and, how any price volatility issues that arose as the transition period expired were addressed.

Gas Regulatory Reform/Industry Restructuring — Retail competition for gas supply is more widespread than is electric retail competition, and the transition was far less contentious, as the magnitude of potential stranded asset costs was much smaller. Similar to the electric retail competition, RRA generally does not view a state's decision to implement retail competition for gas service as either positive or negative from an investor viewpoint. RRA primarily considers the manner in which stranded costs were addressed and how default service obligation-related costs are recovered.

Securitization — Securitization refers to the issuance of bonds backed by a specific existing revenue stream that has been "guaranteed" by regulators. State commissions have used securitization to allow utilities to recover demand-side management costs, electric-restructuring-related stranded costs, environmental compliance costs, and storm costs. RRA views the use of this mechanism as generally constructive from an investor viewpoint, as it virtually eliminates the recovery risk for the utility.

Adjustment Clauses — Since the 1970s, adjustment clauses have been widely utilized to allow utilities to recover fuel and purchased power costs outside a general rate case, as these costs are generally subject to a high degree of variability. In some instances a base amount is reflected in base rates, with the clause used to reflect variations from the base level, and in others, the entire annual fuel/purchased power cost amount is reflected in the clause.

Over time, the types of costs recovered through these mechanisms was expanded in some jurisdictions to include such items as pension and healthcare costs, demand-side management program costs, FERC-approved transmission costs, and new generation plant investment. Generally, RRA views the use of these types of mechanisms as constructive, but also looks at the frequency with which the adjustments occur, whether there is a true-up mechanism, whether adjustments are forward-looking in nature, where applicable, whether a cash return on construction work in progress is permitted and whether there may be some ROE incentive for certain types of investment.

Other mechanisms that RRA views as constructive are weather normalization clauses that are designed to remove the impact of weather on a utility's revenue and decoupling mechanisms that may remove not only the impact of weather, but also the earnings impacts of customer participation in energy efficiency programs.

Generally, an adjustment mechanism would be viewed as less constructive if there are provisions that limit the utility's ability to fully implement revenue requirement changes under certain circumstances, e.g., if the utility is earning in excess of its authorized return.

Integrated Resource Planning — RRA generally considers the existence of a resource planning process to be constructive from an investor viewpoint, as it may provide the utility at least some measure of protection from hindsight prudence reviews of its resource acquisition decisions. In some cases, the process may also provide for pre-approval of the ratemaking parameters and/or a specific cost for the new facility. RRA views these types of provisions as constructive, as the utility can make more informed decisions as to whether it will proceed with a proposed project.

Renewable Energy/Emissions Requirements — As with retail competition, RRA does not take a stand as to whether the existence of renewable portfolio standards or an emissions reduction mandate is positive or negative from an investor viewpoint. However, RRA considers whether there is a defined pre-approval and/or cost-recovery mechanism for investments in projects designed to comply with these standards. RRA also reviews whether there is a mechanism such as a rate increase cap, that ensures that meeting the standards does not impede the utility's ability to pursue other investments and/or recover increased costs related to other facets of its business. RRA also looks at whether incentives, such as an enhanced ROE, are available for these types of projects.

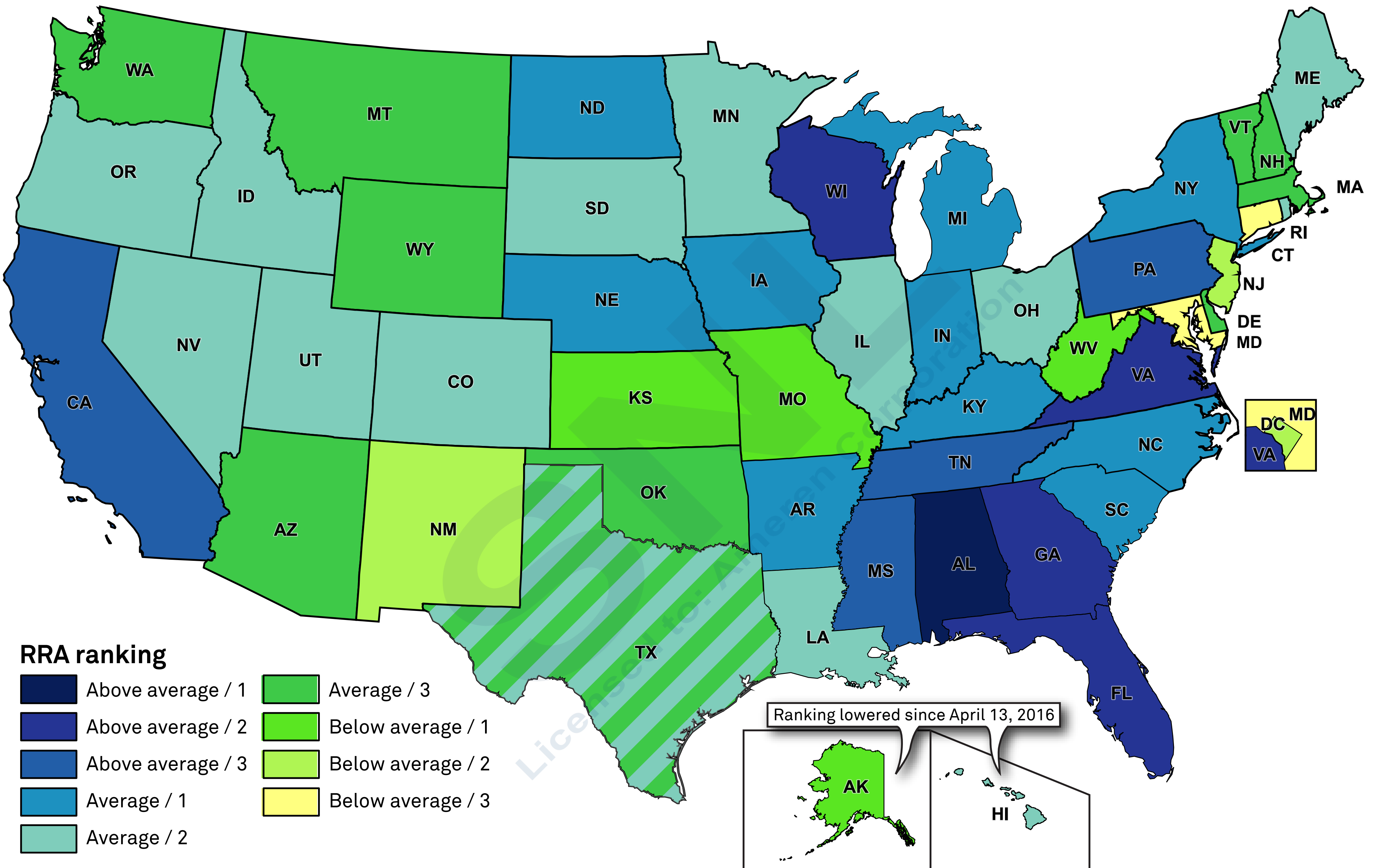
Rate Structure — RRA looks at whether there are economic development or load-retention rate structures in place, and if so, how any associated revenue shortfall is recovered. RRA also looks at whether there have been steps taken over recent years to reduce/eliminate inter-class rate subsidies, i.e., equalize rates of return across customer classes. In addition, RRA considers whether the commission has adopted or moved towards a straight-fixed-variable rate design, under which a greater portion of a company's fixed costs are recovered through the fixed monthly customer charge, thus according the utility greater certainty of recovering its fixed costs.

For a full listing of past and pending rate cases, rate case statistics and upcoming events, visit the S&P Global Market Intelligence Energy Research Home Page.

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

Lillian Federico
Sara May Bellizzi
Jim Davis
Heike Doerr
Russell Ernst
Lisa Fontanella
Monica Hlinka
Dennis Sperduto

RRA state regulatory rankings--energy



Source: Regulatory Research Associates, an offering of S&P Global Market Intelligence
As of May 10, 2017.
Texas PUC is ranked Average/3 and the Texas RRC is Average/2