RRA Regulatory Focus
Major Rate Case Decisions — January - March 2019

The average ROE authorized electric utilities was 9.73% in rate cases decided during the first quarter of 2019, somewhat above the 9.60% average for cases decided in calendar-2018. There were 12 electric ROE determinations in the first three months of 2019 versus 48 in the full year 2018. This data includes several limited-issue rider cases. Excluding these cases, the average authorized ROE was 9.57% in rate cases decided in the first quarter of 2019, largely in line with the 9.56% in full year 2018. The difference between the ROE averages including rider cases and those excluding the rider cases is largely driven by ROE premiums of up to 200 basis points approved by the Virginia State Corporation Commission in riders related to certain generation projects (see the [Virginia Commission Profile](#)).

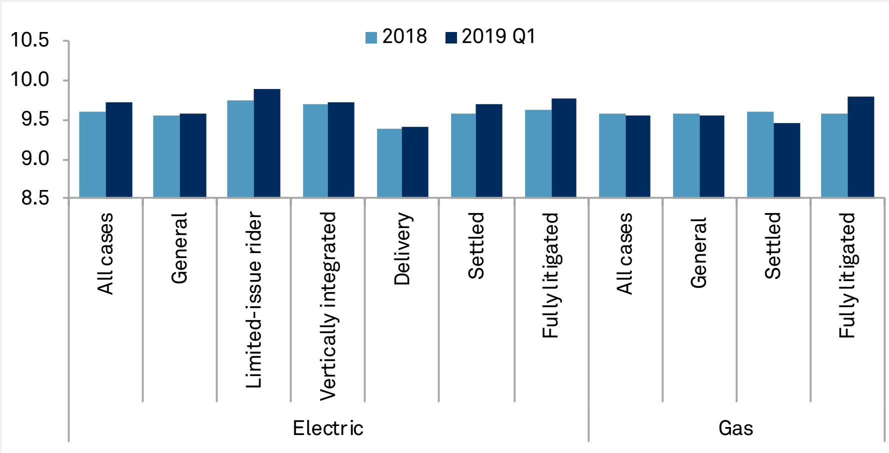
The average ROE authorized gas utilities was 9.55% in the first quarter of 2019 versus 9.59% in full year 2018. There were only four gas cases that included an ROE determination in the first three months of 2019, versus 40 in 2018.

In the first three months of 2019, the median authorized ROE for all electric utilities was 9.7% versus 9.58% in full year 2018. For gas utilities, the median authorized ROE in the first three months of 2019 was 9.7% versus 9.6% in 2018.

From a longer-term perspective, interest rates, as measured by the 30-year U.S. Treasury bond yield, fell almost steadily from the early 1980s until 2015 or so, placing downward pressure on authorized ROEs. Even though the decline has been less dramatic in the period since 1990, average authorized ROEs fell below 10% for gas utilities in 2011 and for electric utilities in 2014.

Authorized return on equity (%)

Dashboard



Electric	2018	Q1'19	
All cases	9.60	9.73	▲
General rate cases	9.56	9.57	▲
Limited-issue rider cases	9.74	9.90	▲
Vertically integrated cases	9.70	9.72	▲
Delivery cases	9.38	9.42	▲
Settled cases	9.57	9.69	▲
Fully litigated cases	9.63	9.78	▲
Gas			
All cases	9.59	9.55	▼
General rate cases	9.59	9.55	▼
Settled cases	9.60	9.47	▼
Fully litigated cases	9.57	9.80	▲
U.S. Treasury			
30-year bond yield	3.11	3.03	▼

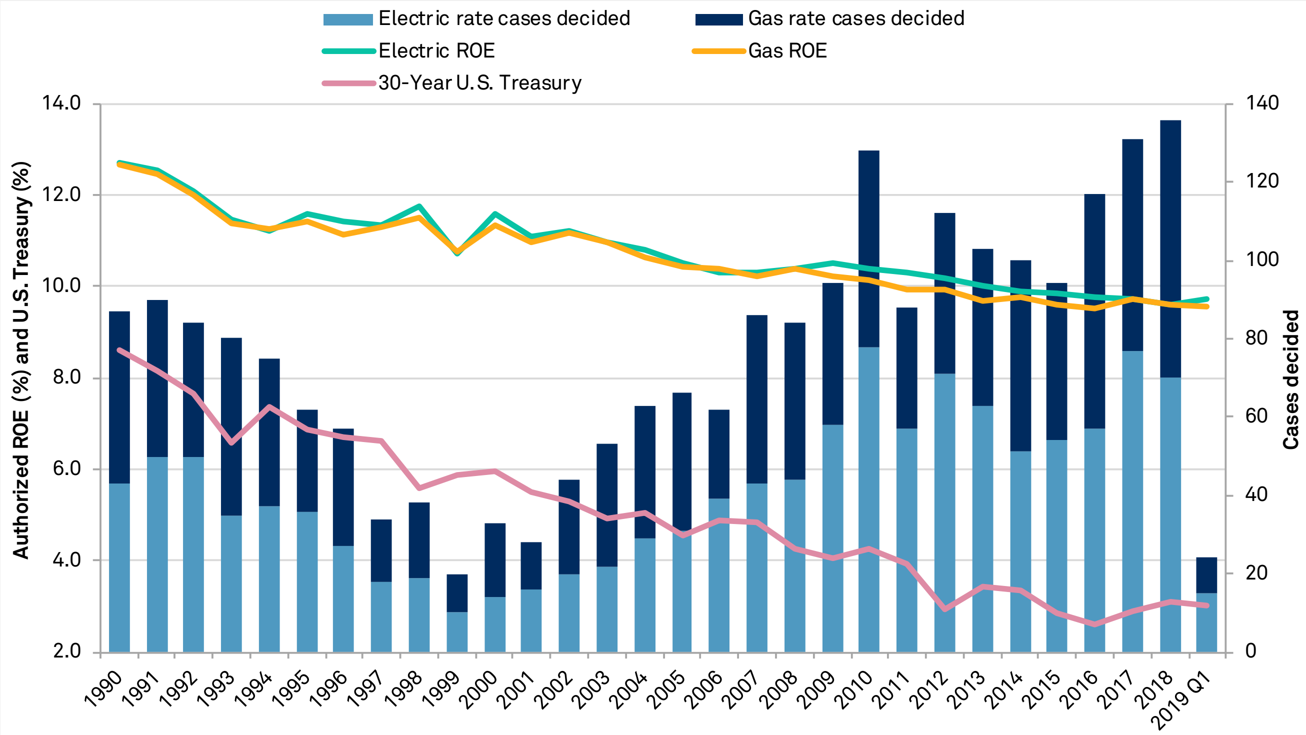
Data compiled April 9, 2019.
Source: Regulatory Research Associates, a group within S&P Global Market Intelligence

Lisa Fontanella, CFA
Research Director

Sales & subscriptions
Sales_NorthAm@spglobal.com

Enquiries
support.mi@spglobal.com

Average electric and gas authorized ROEs and number of rate cases decided



Data compiled April 9, 2019.
Source: Regulatory Research Associates, a group within S&P Global Market Intelligence

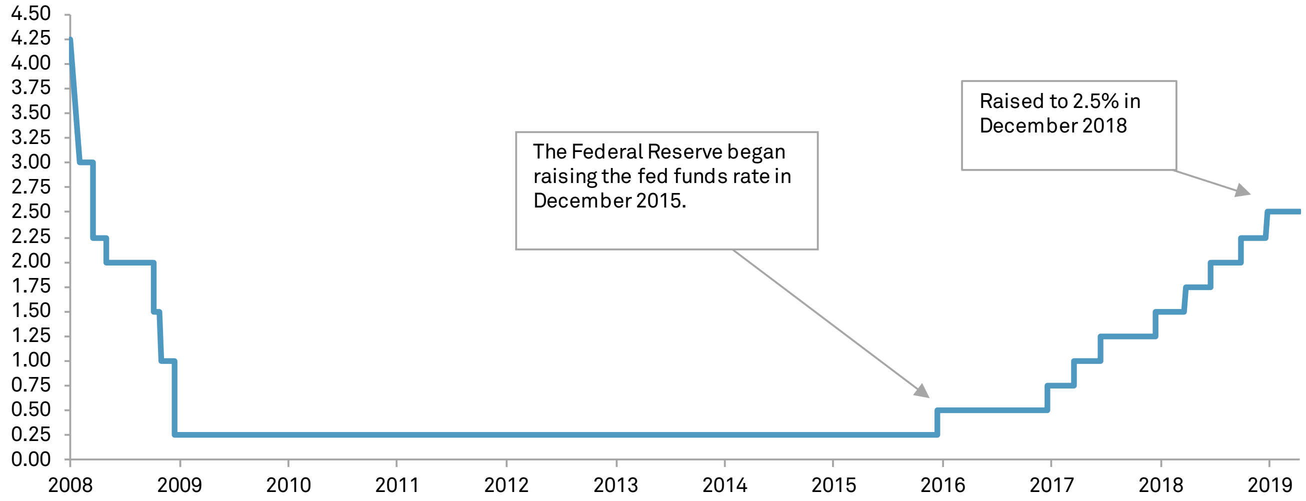
After brisk rate case activity in 2018, where almost 140 cases were decided, there were 24 electric and gas cases resolved in the first quarter of 2019. In fact, since 2010 rate case activity has been robust, with 100 or more cases adjudicated in seven of the last nine calendar years. This count includes electric and gas cases where no ROEs have been specified; however, withdrawn cases are not included.

Increased costs associated with environmental compliance, generation and delivery infrastructure upgrades and expansion, renewable generation mandates, storm and disaster recovery, cybersecurity and employee benefits argue for the continuation of an active rate case agenda over the next few years. In addition, the need to address the impacts of the 2017 federal tax reform has caused rate case agendas to be more active than previously expected.

In addition, rising interest rates could also contribute to increased rate case activity. In 2015, the Federal Reserve began to gradually raise the federal funds rate. Subsequent to that hike, the Federal Reserve has increased rates by 25 basis points eight times, with the most recent hike occurring in December 2018, bringing the federal funds rate to the range of 2.25% to 2.5%. Although additional increases were anticipated in 2019, recent commentary from the Federal Reserve indicates a willingness to remain "patient" about hikes in 2019 due to a slowdown in the global economy and low inflationary pressures.

While increases in the federal funds rate do not move in lockstep with longer-term treasuries and authorized ROEs do not move in lockstep with interest rates, the expectation is that as interest rates rise, authorized ROEs would also begin to rise. However, several factors impact the timing and magnitude of this anticipated shift. Normal regulatory lag, i.e., the amount of time it takes for a utility to put together a rate case filing and tender it to the commission and then for the commission to process the case, would without any other influences delay a rise in average authorized ROEs relative to interest rates.

Federal funds target rate, upper limit (%)



Source: Federal Reserve

Another consideration is that while authorized ROEs have fallen over time, the gap between authorized ROEs and interest rates has widened somewhat, largely as a result of an often-unstated understanding by regulators that the drop in interest rates caused by Federal Reserve intervention was unusual. Therefore, as interest rates rise, regulators may be content to allow the gap between interest rates and authorized ROEs to narrow to more "normal" ranges.

Capital structure trends

To offset the negative cash flow impact of federal tax reform, many utilities sought higher common equity ratios, and the average authorized equity ratios adopted by utility commissions in the first three months of 2019 were modestly higher than the levels observed in 2018 and 2017. The average authorized equity ratio for electric utility cases nationwide was 49.51% in the first three months of 2019, 49.02% in full year 2018 and 48.90% in 2017. The average allowed equity ratio for gas utilities nationwide was 51.40% in the first three months of 2019, 50.09% in 2018 and 49.88% in 2017.

The aforementioned averages include allowed equity ratios adopted by utility commissions in Arkansas, Florida, Indiana and Michigan — jurisdictions that authorize capital structures that include cost-free items or tax credit balances. Excluding these jurisdictions, the average authorized equity ratio for electric utilities nationwide was 50.86% for the first three months of 2019, 50.53% in cases decided during 2018 and 50.02% in 2017. For gas utilities, there were no determinations from the aforementioned states thus far in 2019, however, excluding these jurisictions from prior years, the average allowed equity ratio was 51.47% in 2018 versus 51.13% in 2017.

Taking a longer-term view, equity ratios have generally increased over the last 15 years — the average equity ratio approved in electric rate cases decided during 2004 was 46.96%, while the average for gas utilities was 45.81%. Many commissions began approving more equity-rich capital structures in the wake of the 2008 financial crisis.

A more granular look at ROE trends

The discussion thus far has looked broadly at trends in authorized ROEs; the sections that follow provide a more granular view based upon the types of proceedings/decisions in which these ROEs were established.

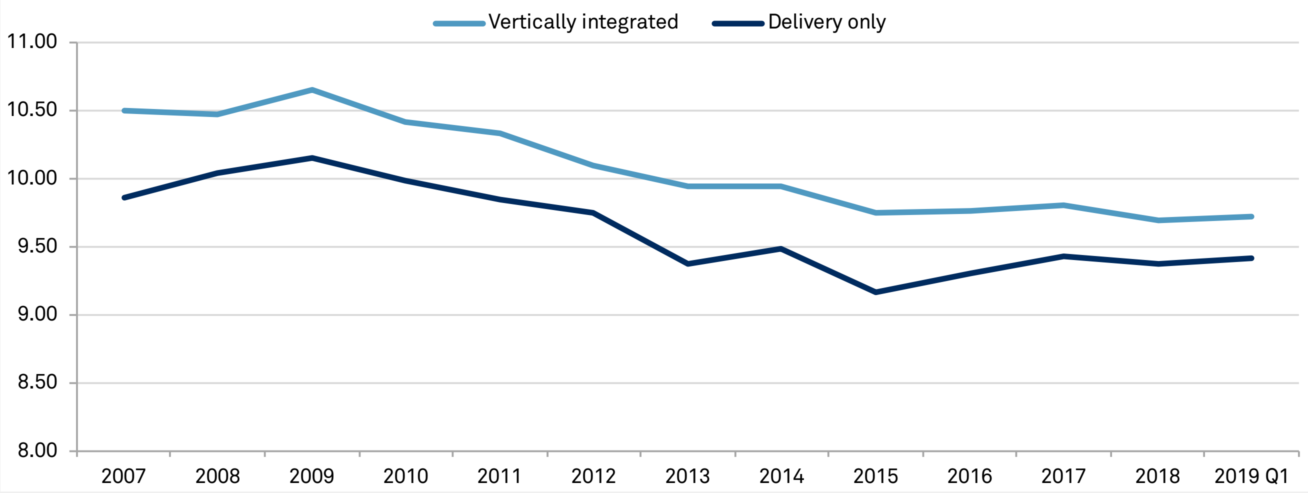
Regulatory Research Associates, a group within S&P Global Market Intelligence, has observed that there can be significant differences between the ROE averages from one subcategory of cases to another.

As a result of electric industry restructuring, certain states unbundled electric rates and implemented retail competition for generation. Commissions in those states now have jurisdiction only over the revenue requirement and return parameters for delivery operations.

Comparing electric vertically integrated cases versus delivery-only proceedings over the past 12 years, RRA finds that the annual average authorized ROEs in vertically integrated cases typically are about 30 to 65 basis points higher than in delivery-only cases, arguably reflecting the increased risk associated with ownership and operation of generation assets.

The industry average ROE for vertically integrated electric utilities was 9.72%, based on rate cases concluded for the first quarter of 2019, versus 9.70% in full year 2018. For electric distribution-only utilities, the industry average ROE authorized in the first quarter of 2019 was 9.42% versus 9.38% in full year 2018.

Average authorized electric ROEs (%)

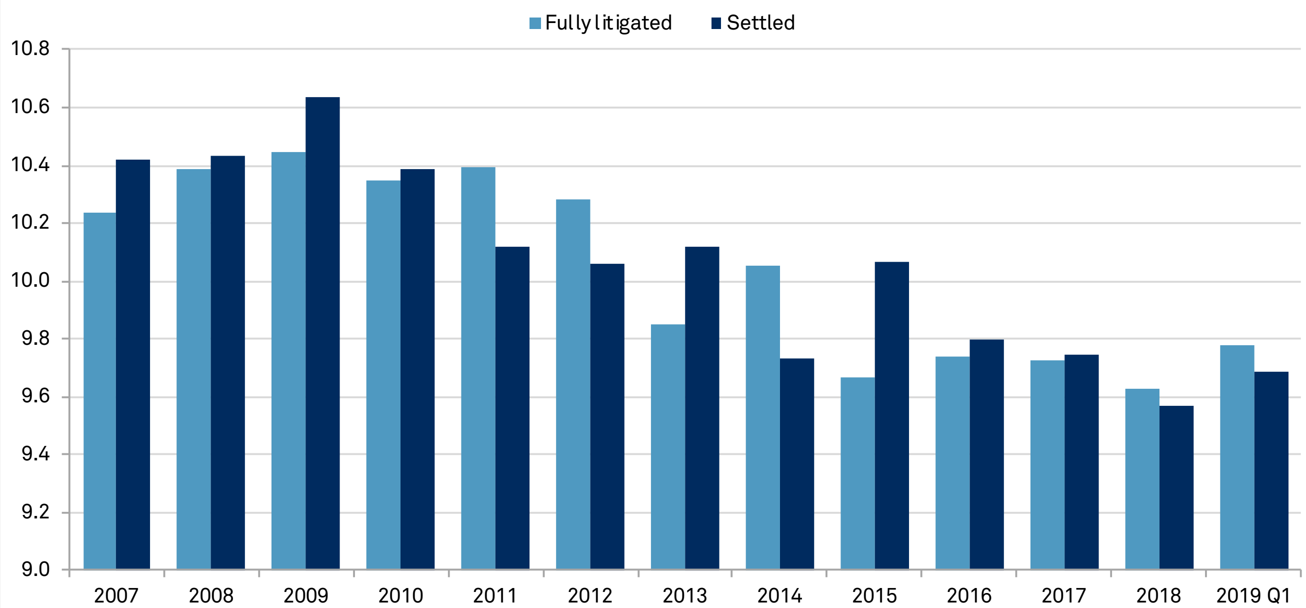


Data compiled April 9, 2019.
Source: Regulatory Research Associates, a group within S&P Global Market Intelligence

Settlements have frequently been used to resolve rate cases over the last several years, and in many cases, these settlements are “black box” in nature and do not specify the ROE and other typical rate case parameters underlying the stipulated rate change. However, some states preclude this type of treatment, and so, settlements must specify these values if not the specific adjustments from which these values were derived.

For both electric and gas cases, RRA has found no discernible pattern in the average authorized ROEs in cases that were settled versus those that were fully litigated. In some years, the average authorized ROE was higher for fully litigated cases, in others, it was higher for settled cases, and in a handful of years, the authorized ROE was similar for both fully litigated and settled cases.

Average authorized electric ROEs, settled vs. fully litigated cases (%)



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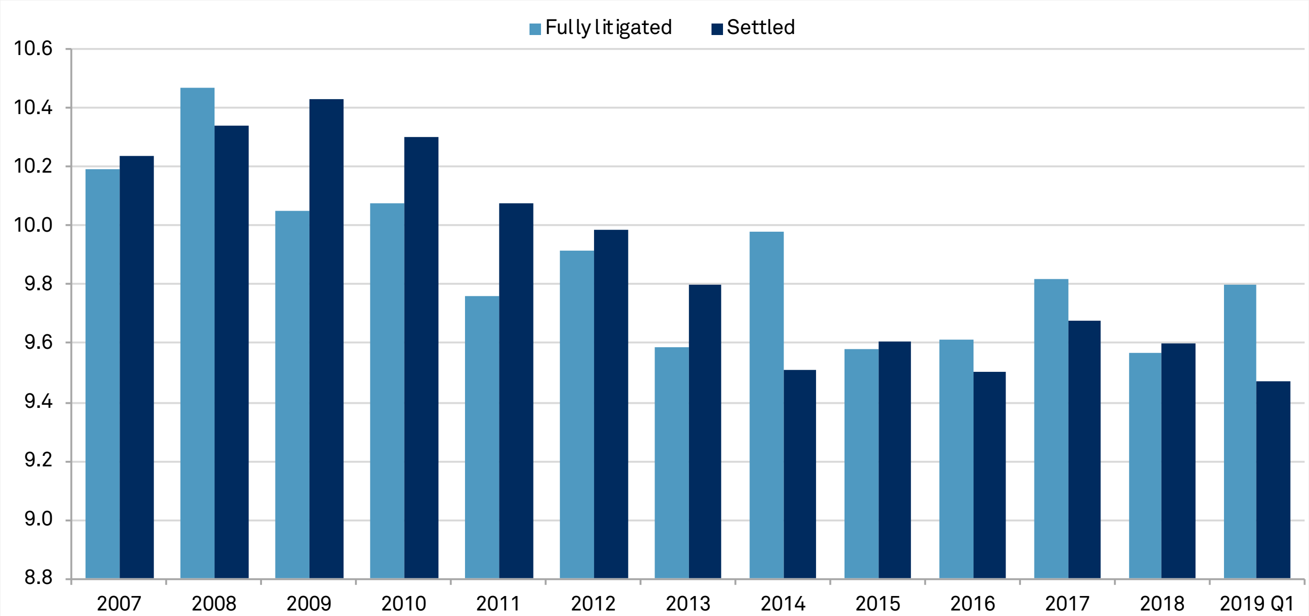
Average authorized gas ROEs, settled vs. fully litigated cases (%)



Data compiled April 9, 2019.
Source: Regulatory Research Associates, a group within S&P Global Market Intelligence

Over the last several years, the annual average authorized ROEs in electric cases that involve limited-issue riders were typically meaningfully higher than those approved in general rate cases, driven by the ROE premiums authorized in Virginia. Limited-issue rider cases in which a separate ROE is determined have had limited use in the gas industry, as most of the gas riders rely on ROEs approved in a previous base rate case.

The following discussion focuses on the corresponding tables available here.

Table 1 shows the average ROE authorized in major electric and gas rate decisions annually since 1990 and by quarter since 2015, followed by the number of observations in each period. Table 2 indicates the composite electric and gas industry data for all major cases, summarized annually since 2004 and by quarter for the past five quarters.

Included in Tables 3 and 4 of the spreadsheet are comparisons since 2007 of average authorized ROEs for settled versus fully litigated cases, general rate cases versus limited issue rider proceedings and vertically integrated cases versus delivery-only cases for electric and gas utilities, respectively.

The individual electric and gas cases decided in 2019 are listed in Table 5 of the spreadsheet, with the decision date shown first, followed by the company name, the abbreviation for the state issuing the decision, the authorized rate of return, the ROE and the percentage of common equity in the adopted capital structure. Next, RRA indicates the month and year in which the adopted test year ended, whether the commission utilized an average or a year-end rate base and the amount of the permanent rate change authorized. The dollar amounts represent the permanent rate change ordered at the time decisions were rendered. Fuel adjustment clause rate changes are not reflected in this study.

The simple mean is utilized for the return averages. In addition, the average equity returns indicated in this report reflect the ROEs approved in cases that were decided during the specified time periods and are not necessarily representative of either the average currently authorized ROEs for utilities industrywide or the returns actually earned by the utilities.

Please note: In an effort to align data presented in this report with data available in S&P Global Market Intelligence's online database, earlier historical data provided in previous reports may not match historical data in this report due to certain differences in presentation, including the treatment of cases that were withdrawn or dismissed.

Subsequent to our publication of our year-end 2018 report, the New Mexico Public Regulation Commission issued a revised decision in an electric rate case decision, the outcome of which impacted several of our electric return determinations in 2018. The instant report reflects the newly revised numbers.