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July 2, 2024

VIA ELECTRONIC MAIL

Mr. Adam J. Teitzman, Commission Clerk
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Docket 20240025-EI, Petition for Rate Increase by Duke Energy Florida, LLC

Dear Mr. Teitzman,

Please find enclosed for electronic filing on behalf of Duke Energy Florida, LLC (“DEF”), DEF’s Rebuttal Testimony and Exhibits KWN-1 through KWN-5 of Karl Newlin.

Thank you for your assistance in connection with this matter. Please feel free to call me at (727) 820-4692 should you have any questions concerning this filing.

Respectfully submitted,

/s/Dianne M. Triplett

Dianne Triplett

DMT/mh

Attachments

CERTIFICATE OF SERVICE

Docket No. 20240025-EI

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished by electronic mail this 2nd day of July, 2024, to the following:

/s/ Dianne M. Triplett

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

**In re: Petition for rate increase by
Duke Energy Florida, LLC**

**Docket No. 20240025-EI
Submitted for filing: July 2, 2024**

REBUTTAL TESTIMONY

OF

KARL W. NEWLIN

On behalf of Duke Energy Florida, LLC

1 **I. INTRODUCTION AND SUMMARY**

2 **Q. Please state your name and business address.**

3 A. My name is Karl W. Newlin. My business address is 525 South Tryon Street,
4 Charlotte, North Carolina 28202.

5
6 **Q. Did you previously file direct testimony in this proceeding?**

7 A. Yes. I submitted pre-filed direct testimony in this docket on April 2, 2024. My
8 direct testimony addressed Duke Energy Florida's ("DEF's" or "the Company's")
9 financial objectives, capital structure, and cost of capital; discussed the Company's
10 current credit ratings and forecasted capital needs; emphasized the importance of
11 DEF's continued ability to meet its financial objectives; and addressed the parent-
12 debt revenue adjustment that is the subject of Rule 14.004, F.A.C. ("parent-debt
13 rule" or "Rule").

14
15 **Q. Has your job title changed since providing direct testimony?**

16 A. No.

17
18 **Q. What is the purpose of your rebuttal testimony?**

19 A. The purpose of my rebuttal testimony is to respond to certain assertions and
20 recommendations contained in the direct testimony filed in this docket by a number
21 of intervenor witnesses, specifically:

- 1 • David E. Dismukes, on behalf of the Office of Public Counsel (“OPC”), who
2 criticizes the Company’s proposed multi-year rate plan, despite the credit
3 ratings agencies’ endorsement of such plans as key mitigants of regulatory lag;
- 4 • Daniel J. Lawton, also on behalf of OPC, who recommends a return on equity
5 (“ROE”) for the Company of 9.45%, a level fully 65 basis points below the
6 Company’s currently authorized ROE, a result which runs entirely counter to
7 logic and common sense given the dramatic rise in interest rates over the past
8 two years;
- 9 • Helmuth W. Schultz, III, also on behalf of OPC, who implements a parent-debt
10 adjustment despite the Rule’s obsolescence and the current capital structure and
11 circumstances of DEF; and
- 12 • Rose Anderson, on behalf of the Sierra Club, who recommends that DEF apply
13 for Department of Energy (“DOE”) loan funding to mitigate customer costs
14 associated with her advocacy of early retirement of fossil fuel plants, without
15 assessing the all-in costs of the DOE program.

16

17 **Q. Do you have any exhibits to your rebuttal testimony?**

18 A. Yes. I sponsor the following exhibits:

- 19 • Exhibit KWN-1: Moody’s Investor Service May 29, 2024, DEF Credit Opinion.
- 20 • Exhibit KWN-2: S&P Global March 1, 2024 RRA State Regulatory
21 Evaluations – Energy.
- 22 • Exhibit KWN-3: S&P Global RRA Regulatory Focus – Quarterly update on

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decided rate cases (Major energy rate case decisions in the US – January-March 2024).

- Exhibit KWN-4: Moody’s Investor Service (“Moody’s”) May 22, 2023, DEF Credit Opinion.
- Exhibit KWN-5: S&P Global February 14, 2024 Ratings Rising Risks: Outlook for North American Investor-Owned Regulated Utilities Weakens.

Q. Please summarize your rebuttal testimony.

A. At the outset, I note that intervenors accept one of the core recommendations of my direct testimony, namely that on a financial basis the Company’s capital structure be set for ratemaking purposes at 53% equity and 47% debt. Also, no intervenor challenges the importance of DEF’s continued ability to meet its financial objectives, including maintaining its current credit ratings which are a key component of the Company’s ability to attract debt and equity investment, which in turn is the key to the Company’s ability to continue to invest in its system so as to provide cost-effective, safe, reliable, and increasingly cleaner electric service to its customers.

DEF’s strong balance sheet and credit quality give the Company the flexibility to access the market during various market conditions and not be forced to pick only favorable issuance windows to raise capital. This flexibility is imperative to ensure DEF can continue funding its operations at the most economical terms possible and

1 is a form of insurance against downgrades that will be the likely consequence of
2 weakening the Company's financials. Credit downgrades work not only to the
3 detriment of DEF but also to its customers, by raising the cost of capital, an increase
4 that ultimately customers pay.

5
6 Nevertheless, as outlined above, intervenor witnesses have advanced other
7 positions and recommendations that in my opinion will be detrimental to the
8 Company's financing flexibility and credit quality and, therefore, its ability to
9 access and attract capital—both debt and equity—upon reasonable terms. For
10 example, OPC Witness Dismukes recommends that the Commission reject the
11 second (2026) and third (2027) years of the Company's requested multi-year rate
12 plan. Other Company witnesses address this recommendation as well, but my
13 rebuttal testimony addresses the impact the recommendation would have upon
14 credit ratings agencies, which are likely to view the Commission's about-face on
15 multi-year rate plans as a negative development in the Company's regulatory
16 environment. As the regulatory environment counts for fully 50% of the Moody's
17 credit score, a change in the Commission's attitude towards multi-year rate plans
18 could impact the Company's credit ratings.

19
20 Further, OPC Witness Lawton advocates an ROE of 9.45%, based on the results of
21 his analyses. While the main rebuttal to his ROE testimony is provided by Company
22 Witness Adrien McKenzie, I discuss in my rebuttal the overall financial impacts to

1 the Company of OPC's 9.45% ROE recommendation. I urge the Commission to
2 consider the negative consequences the arguments put forth by Witness Lawton
3 will have on the Company and its customers if adopted. Witness Lawton's
4 recommendation would increase the risk of the Company, and lead to reduced cash
5 flows, stressed credit metrics, lower financial flexibility, and ultimately higher
6 costs of capital (both debt and equity), to the detriment of our customers. My
7 position is further supported by the testimony of Witness McKenzie.

8
9 I respond also to OPC Witness Helmuth W. Schultz's implementation of the parent-
10 debt rule and his recommendation imposing a revenue reduction that requires the
11 Company to reflect the income tax expense of parent debt that is presumed to be
12 invested in DEF, even though my direct testimony demonstrates unequivocally that
13 this state of affairs simply does not exist.

14
15 Lastly, my rebuttal testimony responds to Sierra Club Witness Anderson's
16 recommendation that the Company should consider Energy Infrastructure
17 Reinvestment program ("EIR Program") funding to allow it to retire Crystal River
18 North Units 4 and 5 earlier than the currently planned 2034 retirement date. Again,
19 other Company witnesses address other aspects of Witness Anderson's
20 recommendation, but my testimony notes that while Duke Energy continues to
21 assess the feasibility of accessing EIR Program funding for projects such as this,
22 our preliminary assessment indicates that even though EIR loans offer slightly

1 lower interest rates, those interest rate savings are largely offset by increased
2 compliance costs that are required in order to obtain and service the loans over their
3 life. Because of constructive regulation and the Company's resulting credit quality,
4 DEF is generally able to obtain debt financing at very attractive rates without the
5 need to seek federal EIR loans.
6

7 **II. MULTI-YEAR RATE PLAN**

8 **Q. Witness Dismukes asserts that the Company's multi-year rate plan should be**
9 **rejected for the second (2026) and third (2027) years. What would be the likely**
10 **reaction by credit rating agencies were his recommendation to be adopted by**
11 **the Commission?**

12 A. While I cannot speak directly for the rating agencies, I believe based upon my
13 experience in dealing with them over a number of years that there would almost
14 certainly be a negative reaction, which will only result in instability in the
15 Company's credit ratings, to the ultimate detriment of customers. Multi-year rate
16 plans have been a mainstay of the Florida utility rate regulatory environment for
17 years. The Company's current rates result from a multi-year rate plan implemented
18 in 2021, and before that rates in effect during 2019-21 resulted from a multi-year
19 rate plan implemented in 2018. And other investor-owned utilities that operate in
20 Florida, such as Florida Power & Light and Tampa Electric, also operate within
21 multi-year rate plan frameworks, and have done so over many years. While these
22 multi-year rate plans were approved as part of settlements, and therefore cannot be

1 relied upon by DEF as precedent for the Commission to approve the current multi-
 2 year rate plan, there is no fundamental difference to the rating agencies between
 3 having a multi-year plan from a settlement as opposed to a litigated rate case. The
 4 value of these multi-year rate plans has been recognized by rating agencies.

5
 6 As I noted in my direct testimony, the regulatory environment in which a utility
 7 operates is one of the most important qualitative factors that the ratings agencies
 8 evaluate when assigning credit ratings. One of the major agencies that rates DEF's
 9 credit is Moody's Investor Services (Moody's), which very recently updated its
 10 credit opinion for the Company.¹ Moody's publishes a ratings "scorecard" in its
 11 credit opinions, and reproduced below is the scorecard from its May 2024
 12 publication:

Rating methodology and scorecard factors

We use our global Regulated Electric and Gas Utilities rating methodology as the primary methodology for Duke Energy Florida, LLC.

Exhibit 7
Rating factors
 Duke Energy Florida, LLC.

Regulated Electric and Gas Utilities Industry Scorecard	Current FY Dec-23		Moody's 12-18 month forward view	
	Measure	Score	Measure	Score
Factor 1 : Regulatory Framework (25%)				
a) Legislative and Judicial Underpinnings of the Regulatory Framework	A	A	A	A
b) Consistency and Predictability of Regulation	Aa	Aa	Aa	Aa
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	Aa	Aa	Aa	Aa
b) Sufficiency of Rates and Returns	A	A	A	A
Factor 3 : Diversification (10%)				
a) Market Position	Baa	Baa	Baa	Baa
b) Generation and Fuel Diversity	Baa	Baa	Baa	Baa
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	6.1x	Aa	5.5x - 6.0x	A
b) CFO pre-WC / Debt (3 Year Avg)	18.9%	Baa	19% - 22%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	18.3%	A	17% - 19%	A
d) Debt / Capitalization (3 Year Avg)	46.3%	Baa	42% - 45%	A
Rating:				
Scorecard-Indicated Outcome Before Notching Adjustment		A2		A2
HoldCo Structural Subordination Notching		0		0
a) Scorecard-Indicated Outcome		A2		A2
b) Actual Rating Assigned		A3		A3

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Moody's forecasts are Moody's opinion and do not represent the views of the issuer. Source: Moody's Financial Metrics™ and Moody's Ratings forecasts

13

¹ See Exhibit KWN-1: Moody's Investor Service ("Moody's") May 29, 2024, DEF Credit Opinion.

1 Factors 1 and 2 are qualitative assessments of the Company’s regulatory
2 environment and its ability to recover its prudently incurred costs and earn an
3 appropriate return and represent fully 50% of DEF’s assigned credit rating. A
4 drastic shift in the Commission’s attitude toward multi-year rate plans, as advocated
5 by OPC Witness Dismukes, would likely lead Moody’s to reassess the Company’s
6 regulatory environment, and specifically their assessment of the subfactor related
7 to “Consistency and Predictability of Regulation.”
8

9 In Exhibit KWN-1, Moody’s references Florida’s “supportive regulatory
10 environment” as one of DEF’s credit strengths, a view that is shared by the other
11 rating agency that rates the Company’s credit, S&P Global, which also publishes
12 an annual evaluation of state regulatory commissions, the most recent of which is
13 attached as an Exhibit KWN-2 to my testimony.² I note that Florida is one of the
14 higher rated jurisdictions in S&P Global’s assessment, and also that at pages 18-19
15 of the publication the authors discuss the impact of forecasted test years upon their
16 analysis of constructiveness of regulation. They indicate (page 19) that “A fully
17 forecast test year is generally considered to be most constructive, particularly in
18 periods of robust level of capital spending, high inflation and rising interest rates.”
19

20 **Q. Have ratings agencies commented upon the impact of multiyear rate plans**
21 **upon their credit ratings?**

² See Exhibit KWN-2: S&P Global March 1, 2024 RRA State Regulatory Evaluations – Energy.

1 A. Yes. In its current credit opinion (Exhibit KWN-1, page 2), Moody’s specifically
2 calls out multiyear rate settlements as a credit strength and premises its stable
3 ratings outlook upon “Florida’s credit supportive regulatory framework, including
4 multiyear rate settlements.” Multiyear plans provide a measure of certainty both to
5 the utility and its customers, and more certainty is a credit-positive condition for
6 the ratings agencies and the market. By contrast, were (as Witness Dismukes
7 advocates) the Commission to eliminate the second and third years of the
8 Company’s multiyear rate plan, effectively converting the plan from a “multi-year”
9 to a single year, ratings agencies and the market would likely view this as
10 introducing more *uncertainty*, decidedly a credit negative.

11
12 As shown in both my direct testimony and this rebuttal testimony, DEF is currently
13 in a period of robust capital spend in order to ensure that it can continue to provide
14 reliable, safe, and increasingly clean energy, and to serve the growth in Florida.
15 Further, the current capital market environment is characterized by high inflation
16 and interest rates. Were the Commission to accept any of Witness Dismukes’
17 recommendation, it would be taking a step backward, while the focus instead
18 should be on looking forward.

19
20 In short, approval of the Company’s multi-year rate plan is a key factor in allowing
21 DEF to attract debt and equity investment—investment which is required in order
22 to provide DEF with the means to invest in its system so as to provide effective

1 service to its customers.

2
3 **III. RETURN ON EQUITY AND ITS IMPACT UPON CREDIT QUALITY**

4 **Q. Witness Lawton's analyses estimated the Company's ROE to be 9.45%. How**
5 **does this compare with Company Witness McKenzie's ROE recommendation?**

6 A. The ROE recommendation of Witness Lawton is 170 basis points below Company
7 Witness McKenzie's ROE recommendation of 11.15% supported by his direct
8 testimony. Approval of Witness McKenzie's recommended ROE will allow the
9 Company to maintain its healthy credit profile, generate adequate cash flow to
10 support its critical capital investments, and fairly balance the needs of affordable
11 electric rates for customers and an acceptable ROE for equity investors. This will
12 be especially important during this period of intensive capital investments as DEF
13 is competing directly for access to capital from investors.

14
15 **Q. When deciding where to invest capital, do investors consider each utility**
16 **company's authorized ROE?**

17 A. Yes. Just as the Company must compete for capital among fixed income investors
18 in the debt capital markets, it must also be well positioned against its peers to attract
19 equity capital. A pivotal factor in any investment decision is the risk-return profile
20 of the subject company. Authorized ROE is of paramount importance because it
21 drives a company's ability to earn a return on invested capital and share that return
22 with equity investors. If the Commission were to adopt one of the intervenor

witnesses' ROE recommendations it could negatively impact DEF's ability to attract debt and equity capital on reasonable terms, especially in times of financial stress or under volatile market conditions.

Q. Have you considered authorized ROEs of other comparable investor-owned utilities?

A. Yes. In Table 1 below, I compare the authorized ROEs since 2022 of vertically integrated utilities located in the Southeastern United States that I would consider direct peers of DEF. These companies have risk profiles similar to DEF's profile and represent alternative investment opportunities for investors. When reviewing the authorized ROEs of comparable utility companies, it is clear the Company's requested 11.15% ROE is more in-line with the currently authorized ROEs of DEF's peers, particularly in light of current and projected market conditions. The same simply cannot be said of Witness Lawton's recommended ROE of 9.45%.

Table 1: Authorized ROE Comparison of Non-Duke Peer Utilities in the Southeast since 2022

Regulated Utility	State	Docket/Case No.	Year of Order	Current Authorized ROE
Alabama Power Company	AL	reported by S&P, under RSE mechanism	2022	11.90% ⁽¹⁾
Georgia Power	GA	44280	2022	10.50% ⁽²⁾
Florida Power & Light	FL	20210015 - ROE Trigger	2022	10.80% ⁽³⁾
Tampa Electric Co.	FL	20220122-EI	2022	10.20% ⁽⁴⁾
Average				10.85%

Source: S&P Capital IQ, Past Rate Cases pulled on June 17, 2024.

(1) Alabama Power has a formula rate mechanism that allows for annual adjustments, and they have a variety of mechanisms to allow for the inclusion of new plant. Under this mechanism, they are allowed a relatively high ROE (S&P reported 11.90% in year 2022) that is balanced against limited annual rate adjustments with certain caps.

(2) Authorized retail ROE set under the 2022 Alternative Rate Plan approved by the Georgia Public Service Commission and evaluated against a range of 9.50% to 11.90%. Any retail earnings above 11.90% will be shared with Georgia Power retaining 20%, 40% applied to reduce regulatory assets, and 40% directly refunded to customers.

(3) ROE Trigger increased authorized ROE to a midpoint of 10.80% from 10.60%

(4) Originally approved ROE band was 9.00% to 11.00%. The ROE band will increase by 25 basis points beginning in 2023 as a result of the average 30-year U.S. Treasury rate increasing by more than 50 basis over a six-month period.

1 As demonstrated in the table, the average authorized ROE of Southeast peer utilities
2 that would compete with DEF for equity capital is 10.85%. Note, however, that the
3 table reflects authorized ROEs in 2022. Capital markets conditions have since
4 changed significantly, as I will discuss next.

5
6 **Q. How does the overall state of the market today compare to the market
7 dynamics that were present at the time of DEF's 2021 settlement agreement?**

8 A. The market has changed dramatically since 2021 and even more so in just the last
9 18-24 months. Persistently high inflation following the easing of fiscal and
10 monetary policy during the COVID-19 pandemic, geopolitical issues from the
11 ongoing wars in Ukraine and Mideast, and mixed signals of ongoing economic
12 conditions have created and perpetuated market uncertainty. In an effort to curtail
13 40-year high inflation, the federal reserve has undertaken one of the most
14 aggressive Federal Funds hiking cycle in its history, raising the Fed Funds rate over
15 500 basis points since March of 2022. The 5.25% to 5.50% Fed Funds target range
16 is the highest level since 2006.

17
18 Long-term interest rates have also spiked and remain highly volatile. As shown in
19 Table 2 below, 10-year and 30-year spot U.S. Treasury rates are up 245 to 271 basis
20 points since the end of 2021. The forward yield curves also show the expectation
21 that rates are expected to remain elevated from their 2021 levels.

Table 2: US Treasury Yield Curve Comparison

UST Fwd Yield Curve Comparisons - 12/31/21 vs 6/19/24					
As of 12/31/21					
UST Rate	Spot	6 Months Forward	1 Year Forward	2 Years Forward	3 Years Forward
10-year	1.52%	1.63%	1.73%	1.87%	1.97%
30-year	1.90%	1.94%	1.97%	2.00%	2.02%
As of 6/19/24					
UST Rate	Spot	6 Months Forward	1 Year Forward	2 Years Forward	3 Years Forward
10-year	4.23%	4.18%	4.17%	4.21%	4.31%
30-year	4.35%	4.32%	4.30%	4.30%	4.31%
Difference in Rates - 12/31/21 vs 6/19/24					
UST Rate	Spot	6 Months Forward	1 Year Forward	2 Years Forward	3 Years Forward
10-year	2.71%	2.55%	2.44%	2.34%	2.34%
30-year	2.45%	2.38%	2.33%	2.30%	2.29%

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On top of rising interest rates, both corporate and utility issuers’ credit risk premiums or credit spreads have been extremely volatile since 2021. Investors are certainly aware of the significant rise in U.S. Treasury rates and overall market volatility as compared to the market environment surrounding DEF’s 2021 Settlement Agreement. DEF’s current ROE as authorized in the 2021 Settlement Agreement is 10.10% (which includes the ROE trigger adjustment of +25 bps effective in August 2022). Since then, there has been a significant increase in benchmark Treasury rates, resulting in an upward trend of ROEs. As described in Exhibit KWN-3 (April 19, 2024, S&P Global - RRA Regulatory Focus, Quarterly update on decided rate cases), “averages calculated for the first quarter of 2024 show that electric and gas authorized ROEs are trending modestly higher as the high-interest-rate environment begins to impact authorized ROEs.” Indeed, Table 9

1 of Witness Lawton's direct testimony demonstrates how the authorized ROEs of
2 Duke Energy's operating companies have steadily increased from January 2023 to
3 January 2024.

4
5 **Q. Do you agree with Witness Lawton's assertion that a 3.0% - 4.0% range in 30-**
6 **year US Treasury bond rates is reasonable?**

7 A. No. Witness Lawton employs a 3.0% to 4.0% range 30-year US Treasury bond yield
8 in his CAPM analysis. Table 12 of Witness Lawton's testimony reflects a 3-month
9 average (Feb 2024 - Apr 2024) 30-year bond yield of 4.45%. He describes the 3.0%
10 - 4.0% range as being reasonable due to the expectation that the Federal Reserve
11 may lower the federal funds rate over the proposed 2025 – 2027 test year periods
12 in this rate case. Witness Lawton appears to assume that the 30-year US Treasury
13 yield will decline in lockstep with the overnight federal funds borrowing rate. This
14 would suggest that the inversion of the yield curve will continue over the 2025 –
15 2027 test year periods, as the 30-year US Treasury yield is currently ~100 bps lower
16 than the federal funds rate. In a normal yield curve environment, borrowers would
17 expect to have higher returns on longer-dated debt since they assume more duration
18 risk. The inverted yield-curve environment that we are currently experiencing is not
19 expected to remain over the next three years. Witness Lawton failed to reference
20 current market data in his analysis, that would suggest the 30-year US Treasury
21 yield is not expected to change materially over the foreseeable future. Based on
22 Table 2, sourced from Bloomberg, it is evident that a forward 30-year US Treasury

1 bond yield of 3.0% - 4.0% is not a reasonable assumption. Bloomberg forward
2 market data suggesting a 30-year US Treasury yield in the range of 4.25% - 4.50%
3 would be a more appropriate assumption. This represents a significant increase as
4 compared to his over-simplified logic that short-term and long-term rates will
5 decline at the same levels in unison. Anticipated changes in the federal funds
6 overnight rate should not be used as a proxy for expected long-term interest rates.
7

8 **Q. Do you agree with Witness Lawton's assertion that Duke Energy Florida does**
9 **not present as much risk as the other Duke subsidiaries?**

10 A. No. Witness Lawton stresses throughout his testimony that DEF is actually less
11 risky than all other Duke operating companies due to its supportive regulatory
12 environment, and therefore requires a lower return.³ Florida certainly is a
13 supportive environment, but that is not the full story. For example, we have
14 witnessed the impact that hurricanes have historically had to DEF's credit metrics.
15 Moody's May 29, 2024, credit opinion of DEF (Exhibit KWN-1) explains that the
16 frequency and intensity of hurricanes appear to be increasing and the Company's
17 credit profile could be persistently weak if severe storms occur more regularly.
18 While there are mechanisms in place that allow for proactive recovery of storm
19 costs, Moody's stresses that they only somewhat mitigate the credit risk associated

³ In this Witness Lawton appears to be at odds with Witness Dismukes' recommendation that the Commission reject the Company's multi-year rate plan, as rejecting the plan is likely to result in a degradation of Florida's regulatory environment, as I note above.

1 with operating in DEF's service territory. DEF's average FFO/Debt⁴ over the
2 previous five years (2019-2023) is 18.7%, which is below Moody's downgrade
3 threshold of 19.0%. If DEF continues to experience costly storms, the Company
4 could continue to see the FFO/Debt metric remain under 19.0% on a sustained
5 basis, which Moody's lists as a factor that could lead to a downgrade. To
6 demonstrate the impact of strong storms to credit metrics, in Moody's May 22,
7 2023, credit opinion of DEF (Exhibit KWN-4), it is estimated that DEF's FFO/
8 Debt in 2018 and 2019 of 12.7% and 16.9%, respectively, would have each been
9 closer to 20% absent the impact of strong storms. It should also be noted that
10 Moody's rates Duke Energy's other southeast operating companies, Duke Energy
11 Carolinas, and Duke Energy Progress, one notch above DEF, implying that DEF is
12 a riskier investment.

13
14 **Q. What is the impact of Witness Lawton's ROE recommendation on the**
15 **Company's credit metrics?**

16 A. Witness Lawton's recommended of 9.45% ROE would be detrimental to the
17 Company's FFO/Debt credit metric. This is the primary credit metric the rating
18 agencies use to measure a utility's ability to service its financial obligations.
19 Witness Lawton proclaims in his testimony that the impact of a 50 basis point
20 reduction in return on equity would result in an approximate \$62.1 million per year

⁴ The FFO/Debt ratio is a measure of cash flow, and is the principal financial metric used by Moody's in its quantitative assessment of the Company's credit rating. In Moody's parlance, the ratio is noted as "CFO pre-WC to debt" but that has the same meaning as FFO/Debt.

1 reduction in annual revenue requirements, demonstrating the material impact an
 2 authorized ROE has on the Company's revenues. As shown in Table 3 below, DEF
 3 estimates that reducing DEF's requested ROE from 11.15% to 9.45% would lower
 4 2025's weighted capital cost rate (and, therefore, it is allowed return on rate base)
 5 from 7.01% to 6.23%.

Table 3: 2025 Weighted Cost Rate Impact of Implementing a 9.45% ROE
 (5000s)

CLASS OF CAPITAL	COMPANY TOTAL PER BOOKS	TAX PRORATION ADJUSTMENT	COMPANY TOTAL PER BOOKS ADJUSTED	JURISDICTIONAL FACTOR	RETAIL PER BOOKS	SPECIFIC ADJUSTMENTS	PRO RATA ADJUSTMENT	JURISDICTIONAL ADJUSTED	RATIO	COST RATE	WEIGHTED COST RATE
Common Equity	11,380,605	2,829	11,383,434	0.92147	10,489,465	(107,831)	(1,015,082)	9,366,552	45.61%	9.45%	4.31%
Long Term Debt	9,937,274	2,470	9,939,744	0.92147	9,159,152	99,446	(905,275)	8,353,323	40.68%	4.49%	1.83%
Short Term Debt	(38,677)	(10)	(38,686)	0.92147	(35,648)	(8,737)	4,340	(40,045)	-0.20%	3.25%	-0.01%
Customer Deposits Active	173,411	43	173,454	1.00000	173,454	-	(16,960)	156,494	0.76%	2.61%	0.02%
Customer Deposits Inactive	1,666	0	1,667	1.00000	1,667	-	(163)	1,504	0.01%	0.00%	0.00%
Investment Tax Credit	246,828	61	246,889	0.92147	227,500	-	(22,244)	205,256	1.00%	8.01%	0.08%
Deferred Income Taxes	3,216,299	(5,394)	3,210,906	0.92147	2,958,745	(197,581)	(269,978)	2,491,187	12.13%	0.00%	0.00%
Total	24,917,406	-	24,917,406		22,974,335	(214,702)	(2,225,362)	20,534,271	100.00%		6.23%

6
 7 In Table 4 below, DEF calculates the 2025 revenue impact of the ROE reduction
 8 from 11.15% to 9.45% to be approximately (\$214) million, using the same logic
 9 presented in Table 6 of Witness Lawton's testimony. This represents a material cash
 10 flow impact to the Company's requested 2025 revenues.

Table 4: 2025 Revenue Impact of Implementing a 9.45% ROE as opposed to the Company's requested 11.15%

Description	Amount (\$000)
Jurisdictional Adjusted Rate Base	\$ 20,534,271
Rate of Return on Rate Base Requested	x 6.23%
Jurisdictional Net Operating Income Requested	\$ 1,279,285
Jurisdictional Adjusted Net Operating Income	996,671
Net Operating Income Deficiency (Excess)	\$ 282,614
Earned Rate of Return	<u>4.85%</u>
Net Operating Income Multiplier	x 1.3433
Revenue Increase (Decrease) by Implementing a 9.45% ROE	<u>\$ 379,629</u>
Revenue Increase (Decrease) Requested (11.15% ROE)	593,446
Revenue Increase (Decrease) - 9.45% ROE vs 11.15% ROE	<u>(213,817)</u>

1 Additionally, in Tables 5 and 6 below, DEF has calculated the weighted cost of debt
 2 and corresponding impact to revenues of adjusting the currently authorized DEF
 3 ROE of 10.10% down to 9.45%, using DEF's 12/31/2023 capital structure and rate
 4 base.

Table 5: 2023 Capital Structure and Weighted Cost Rate

CLASS OF CAPITAL	JURISDICTIONAL ADJUSTED	RATIO	COST RATE (10.10% ROE)	WEIGHTED COST RATE (10.10% ROE)	COST RATE (9.45% ROE)	WEIGHTED COST RATE (9.45% ROE)
Common Equity	8,128,295,758	44.58%	10.10%	4.50%	9.45%	4.21%
Long Term Debt	6,879,093,834	37.73%	4.60%	1.74%	4.60%	1.74%
Short Term Debt	341,874,282	1.87%	5.17%	0.10%	5.17%	0.10%
Customer Deposits Active	152,886,542	0.84%	2.61%	0.02%	2.61%	0.02%
Customer Deposits Inactive	1,470,405	0.01%				
Investment Tax Credit	191,133,741	1.05%	7.04%	0.07%	7.04%	0.07%
Deferred Income Taxes	2,539,458,377	13.93%				
Total	18,234,212,939	100.00%		6.43%		6.14%

5
 6 As seen in Table 5, adjusting the currently authorized DEF ROE of 10.10% down
 7 to 9.45%, using DEF's 12/31/2023 capital structure, results in an approximate 30
 8 basis points reduction in the weighted cost rate. As seen in the below Table 6,
 9 applying this 30 basis point reduction in weighted cost rate results in a return on
 10 rate base revenue reduction of approximately (\$53) million.

Table 6: 2023 Return on Rate Base Impact of 10.10% ROE vs. 9.45% ROE

2023 FPSC- ADJUSTED AVERAGE RATE BASE	WEIGHTED COST RATE (10.10% ROE)	RETURN ON RATE BASE (10.10% ROE)	WEIGHTED COST RATE (9.45% ROE)	RETURN ON RATE BASE (9.45% ROE)	REVENUE IMPACT (10.10% ROE vs. 9.45% ROE)
18,234,212,938	6.43%	1,172,517,242	6.14%	1,119,683,320	(52,833,922)

11
 12
 13 **Q. What impact to the Company's FFO to debt credit metric would result from**
 14 **Witness Lawton's ROE recommendation?**

15 A. In Table 7 below, I demonstrate the impact of a (\$53) million revenue reduction to
 16 DEF's FFO to Debt credit metric, using Moody's 12/31/2023 FFO to Debt
 17 calculation as a baseline.

Table 7: Proforma Moody's FFO/Debt (\$ in Millions)

	Actual as of 12/31/2023	Proforma Adjustment	Proforma FFO/Debt
FFO	\$2,063	(\$53)	\$2,010
Debt	\$9,963		\$9,963
FFO/Debt	20.7%		20.2%

1
2 The (\$53) million reduction in revenues would equate to a 50 bps decline in DEF's
3 FFO/Debt. If adopted by the Commission, Witness Lawton's recommendation will
4 have an impact to the quantitative (weaker credit metrics) aspects in evaluating
5 DEF's credit quality, and it could have an impact to the qualitative (less constructive
6 regulatory environment) aspects as well.

7
8 **Q. Please elaborate upon the qualitative and quantitative impacts.**

9 A. As I indicated earlier in my rebuttal testimony in connection with my discussion of
10 OPC Witness Dismukes' multi-year rate plan recommendation, fully 50% of the
11 Moody's credit score is based upon the regulatory environment. In the qualitative
12 assessment, Factors 1 and 2 in the Moody's scorecard (reproduced at page 7, above,
13 and also at page 21, below) are closely inter-related and represent qualitative
14 assessments of the Company's regulatory environment and its ability to recover its
15 prudently incurred costs and earn an appropriate return. Moody's may look to
16 reassess the Company's regulatory environment, and specifically their assessment
17 of the subfactors related to "Consistency and Predictability of Regulation" and
18 "Sufficiency of Rates and Returns." If Moody's were to lower their qualitative

1 assessment of these subfactors, Moody's could require stronger quantitative metrics
2 from higher cash flow and / or reduced debt to offset this qualitative change.

3
4 Factor 4 evaluates the Company's credit metrics and accounts for 40% of Moody's
5 evaluation of DEF's credit rating. CFO pre-WC/Debt (FFO/Debt) is the key credit
6 metric Moody's uses to evaluate a utility's ability sufficiently meet its financial
7 obligations. Moody's 3-year average calculation of FFO/Debt was 18.9%,
8 equivalent to a "Baa" rated entity, which is low for DEF's assigned "A2" issuer
9 rating. Witness Lawton's recommendation would place further pressure on this and
10 other metrics. Coupled with the potential for more stringent credit requirements
11 from a revaluation of the regulatory environment due to awarding of an ROE that
12 is below the currently allowed ROE, in a time where ROEs are trending higher, the
13 agencies may reconsider DEF's credit rating outlook if an ROE of 9.45% were to
14 be approved by the Commission and implemented by the Company.

15
16 **Q. A drop in the FFO/Debt to 20.2% as shown in your Table 7 is still above the**
17 **Company's downgrade threshold as measured by Moody's. Why is this a**
18 **concern?**

19 A. First, the calculation in Table 7 only takes into account a quantitative analysis to
20 arrive at the 20.2% FFO/Debt metric. It does not take into account any qualitative
21 impacts, which could be considerable, in that the qualitative portion of the Moody's

1 assessment counts for fully 50% of the Company’s credit rating. This problem is
 2 highlighted by closer examination of the Moody’s scorecard:

Rating methodology and scorecard factors

We use our global Regulated Electric and Gas Utilities rating methodology as the primary methodology for Duke Energy Florida, LLC.

Exhibit 7

Rating factors

Duke Energy Florida, LLC.

Regulated Electric and Gas Utilities Industry Scorecard	Current FY Dec-23		Moody’s 12-18 month forward view	
	Measure	Score	Measure	Score
Factor 1 : Regulatory Framework (25%)				
a) Legislative and Judicial Underpinnings of the Regulatory Framework	A	A	A	A
b) Consistency and Predictability of Regulation	Aa	Aa	Aa	Aa
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	Aa	Aa	Aa	Aa
b) Sufficiency of Rates and Returns	A	A	A	A
Factor 3 : Diversification (10%)				
a) Market Position	Baa	Baa	Baa	Baa
b) Generation and Fuel Diversity	Baa	Baa	Baa	Baa
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	6.1x	Aa	5.5x - 6.0x	A
b) CFO pre-WC / Debt (3 Year Avg)	18.9%	Baa	19% - 22%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	18.3%	A	17% - 19%	A
d) Debt / Capitalization (3 Year Avg)	46.3%	Baa	42% - 45%	A
Rating:				
Scorecard-Indicated Outcome Before Notching Adjustment		A2		A2
HoldCo Structural Subordination Notching		0		0
a) Scorecard-Indicated Outcome		A2		A2
b) Actual Rating Assigned		A3		A3

All figures and ratios are based on adjusted financial data and incorporate Moody’s Global Standard Adjustments for Non-Financial Corporations.

Moody’s forecasts are Moody’s opinion and do not represent the views of the issuer.

Source: Moody’s Financial Metrics™ and Moody’s Ratings forecasts

3
 4 Both the current and future view portions of the scorecard show the FFO/Debt
 5 metric bearing a ratings outcome of Baa, which is *below* the A3 rating Moody’s
 6 actually assigns to the Company. The ratings outcomes for Factors 1 and 2, by
 7 contrast, are A and Aa, respectively—*above* the assigned A3 rating. It is evident
 8 that Moody’s compensates in its overall credit rating of the Company for a
 9 relatively low quantitative score with relatively high qualitative scores. Pushing
 10 down the high qualitative scores is not an outcome that would be desirable for either
 11 DEF or its customers.

12

1 Second, both Moody's and S&P consider at least 100 basis points of financial
2 cushion above the utility's downgrade threshold as providing the appropriate
3 amount of margin to weather unforeseen, exogenous credit events.⁵ Examples of
4 such events would include the spike in natural gas prices we saw in 2022 and
5 frequent severe weather impacting DEF's service territory. Eroding this cushion by
6 artificially lowering ROE is again not an outcome desirable for the Company or its
7 customers.

8
9 **Q. How do you believe fixed income investors will react if Witness Lawton's**
10 **recommendations were adopted?**

11 A. When evaluating investment alternatives, fixed income investors use a set of
12 criteria similar to that of the rating agencies. As previously demonstrated, if the
13 intervening witnesses' recommendations were to be adopted, DEF's cash flows
14 would decrease. For a fixed income investor, the risk of investing in DEF's debt
15 securities would increase and investors will want to be compensated not only due
16 to the potential for ratings action but also by the regulatory risk such a change
17 inflicted on investors' existing portfolio. An investor looking to invest in new-issue
18 securities from DEF would want to guard against negative ratings action and could
19 seek an interest rate coupon likely higher than comparable debt upon a new issue.

⁵ S&P published an Outlook piece on February 14, 2024, attached hereto as Exhibit KWN-5, in which it observed (page 9) that a large segment of the industry is operating with minimal financial cushion, "reflecting funds from operation (FFO) to debt that is less than 100 basis points (bps) above their downgrade threshold."

1 This may increase the cost of future debt issuances, and ultimately the rates DEF's
2 customers will pay for service.

3
4 **Q. Do you have any final comments on Witness Lawton's ROE recommendation?**

5 A. Yes. Witness Lawton's artificially low returns could harm the Company's
6 credit ratings and degrade the Company's ability to obtain credit on reasonable
7 terms. This will increase the cost of operations for DEF, which will ultimately be
8 reflected in customer rates, and complicate DEF's ability to obtain capital on
9 competitive terms necessary to continue to provide high-quality electric service to
10 Florida customers. It could also impact the ratings agencies views as to how
11 supportive the regulatory environment in Florida remains – which could have
12 negative cost consequences for all utilities operating in Florida. And while I agree
13 that there is a reasonable range for DEF's allowed ROE in this case, Witness
14 Lawton's proposal is well below that range, in my opinion.

15
16 **IV. PARENT-DEBT ADJUSTMENT**

17 **Q. Do you agree with Witness Schultz's recommended parent-debt revenue**
18 **reduction?**

19 A. No. As explained in my direct testimony, the Company believes that the parent-debt
20 adjustment is obsolete and no longer makes sense based on current day financing
21 practices. Regardless, Witness Schultz recommends reducing DEF's revenues by
22 (\$10,383,000) on a jurisdictional level based on the estimated 2024 adjustment as

1 provided in MFR C-2. He recommends using the parent-debt adjustment calculated
2 for 2024 throughout the 2025-2027 forecast test period. This adjustment assumes
3 that DEF is being funded by parent company debt, which is an inaccurate
4 assumption that is disproven in both my direct testimony and my following rebuttal
5 testimony. Arbitrarily imposing a revenue reduction based on a set of financing
6 assumptions that is not reflective of DEF's current structure will negatively impact
7 the Company's cash flow and lower DEF's allowed return.

8
9 **Q. What are the consequences of DEF continuing to make the parent-debt**
10 **adjustment?**

11 A. The adjustment will continue to grow as parent debt grows. The high interest rate
12 environment has made the adjustment even larger recently. As additional debt is
13 issued by the parent company, at higher rates, DEF forecasts that the adjustment
14 will grow to (\$17,211,711) by 2027, as computed in response to the Staff of the
15 Florida Public Service Commission Sixth Set of Interrogatories to DEF, Question
16 56 (STAFF ROG 6-56). The parent company capital structure, as calculated for
17 purposes of this adjustment, will continue to be skewed further towards debt, since
18 additional debt is forecasted to be issued, and since equity balances will decline due
19 to dividend payouts and since subsidiary retained earnings are excluded from the
20 parent company's equity balance, as Witness Schultz agrees. In his testimony,
21 Witness Schultz questions how the parent company's equity balance can go
22 negative under the parent-debt calculation over the test year periods, however this

1 is easily explained as common stock dividends are paid to Duke Energy's
2 shareholders, reducing Duke Energy's equity balance, while not allowing the
3 retained earnings of its subsidiaries to be included in the calculation. Since a capital
4 structure must sum to 100%, the perverse outcome of this calculation of omitting
5 the retained earnings of the subsidiaries and the parent equity balance going
6 negative, is for the debt to 'plug the gap' such that the capitalization table sums to
7 100%. This not only leads to an outsized parent debt adjustment but is also not
8 representative of the Duke parent capital structure at a forecasted point in time.
9 Based on DEF's projections, the adjustment will grow by nearly \$7 million between
10 2024 and 2027. Continuing to recognize this outdated rule, while taking into
11 account its forecasted trajectory, could negatively impact the Company's credit and
12 ultimately harm DEF's customers.

13
14 **Q. On what basis do you state that the parent-debt rule is obsolete?**

15 A. I understand that the Rule was promulgated in 1982 and underwent legal challenge
16 thereafter. In approving the Rule the Supreme Court of Florida provided
17 background information concerning the reason for the Rule:

18 In the normal course of a parent-subsidiary relationship, the parent
19 issues debt in order to acquire capital to support the operations of its
20 subsidiaries. The capital is transferred to the subsidiary in exchange
21 for stock in the subsidiary. As a practical matter, the equity of the
22 subsidiary is thus directly supported by the debt of the parent. The
23 debt of the parent used to support the subsidiary generates interest
24 expense for the parent, which in turn is tax deductible. Although the
25 capital is passed on through to the subsidiary, there is no
26 corresponding pass-through of interest expense because the parent
27 passes on the capital to acquire an ownership interest in the

1 subsidiary as opposed to a creditor's interest. Therefore, the nature
2 of the acquired capital changes from debt to equity at the point the
3 capital passes from parent to subsidiary.

4 *General Tel. Co. of Fl. v. Florida Public Service Commission*, 446 So. 2d 1063,
5 1069 (Fl. 1984). The structure as described by the Supreme Court, whereby debt
6 raised by a parent corporation is infused into a subsidiary corporation as equity, is
7 known as “double leverage.” While this may have been the “normal course of
8 events” back in the early to mid-1980s, it is not the “normal course of events”
9 anymore, at least with respect to the relationship between DEF and its ultimate
10 parent, Duke Energy.

11
12 **Q. Does DEF engage in the practice of double leverage?**

13 A. No. Moody’s rates Duke Energy and its individual subsidiaries on a standalone
14 basis, and DEF does not rely on its parent to raise capital. As described in my direct
15 testimony, DEF has not received capital from its parent in the form of an equity
16 contribution since 2009. The debt that was issued to fund that \$620 million equity
17 contribution has since matured and been repaid. Additionally, DEF sent dividends
18 totaling \$730 million back to the parent company in the three years following the
19 infusion, essentially fully returning the funds contributed by the parent in 2009. No
20 equity has been provided by Duke Energy Corporation to DEF since 2009, which
21 demonstrates the Company is not engaged in the practice of double leverage.

22
23 Witness Schultz claims that since DEF is a participant in Duke’s master credit
24 facility, and since DEF benefits from operational efficiencies from shared corporate

1 services, that Duke Energy is making investments in DEF. These claims are without
2 merit, however, and provide benefits to DEF's customers as these efficiencies help
3 keep interest rates and O&M costs lower. Also, any funds borrowed from Duke
4 Energy's master credit facility by DEF would appear on the Company's balance
5 sheet as short-term debt and be included as debt in DEF's capital structure. The
6 master credit facility borrowings would not flow into DEF through an equity
7 transfer from parent to sub. The parent debt adjustment assumes that parent
8 company debt is being used to equitize the subsidiary, and that is simply not the
9 case for DEF today. It is for this reason that my direct testimony indicates that the
10 rebuttable presumption embedded in the parent-debt rule has indeed been rebutted.
11

12 **Q. Did Duke Energy partially fund its initial investment in DEF with debt, as**
13 **Witness Schultz claims?**

14 A. No. Duke Energy and Progress Energy combined under a stock-for-stock merger
15 agreement. Debt was not taken out, as Witness Schultz implies, to fund Duke
16 Energy's investment in Progress Energy and its subsidiaries. The argument that
17 Duke Energy must have financed its initial investment in DEF with a portion of the
18 debt that is embedded in Duke Energy's capital structure is not true based on the
19 fact that the merger took place under an equity financing arrangement. The
20 assumption that parent debt was used to fund the acquisition of DEF is inaccurate
21 and further bolsters the argument that the parent-debt adjustment is no longer
22 reflective of current day financing practices.

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V. DOE FUNDING

Q. Does the Company have concerns about the cost-effectiveness of EIR Program loans as compared to other debt financing alternatives?

A. Yes. To fully evaluate the EIR Program, one must compare the “all-in” cost of the program, including administrative and compliance costs, to utility debt financing options. The purpose of this methodical approach to EIR Program evaluation is to determine whether this financing opportunity would result in benefits for customers. Given that the compliance requirements are highly nuanced and complex and exact costs will not be known until after the conditional commitment of the loan guarantee, we must work to ensure the analysis considers a reasonable range of potential costs.

In addition, issuers such as DEF are well known by the capital markets and as part of the Duke Energy complex of issuing utilities, are regularly followed by institutional buy-side investors. These investors stay current on DEF and sister company’s credits in anticipation of future new issues and enjoy not only participating in the investment but also the liquidity of sizeable new issues. A meaningful EIR Program would likely cannibalize the regular-way corporate issue calendar for DEF and perhaps others. This lack of new issues could lead to smaller issuance sizes, less liquidity, less effective pricing and ultimately less interest by large banks who participate in the Duke Energy master credit facility in part to earn

1 fees from debt capital markets transactions.

2
3 **Q. Witness Anderson refers to a Rocky Mountain Institute (“RMI”) analysis**
4 **throughout her testimony. Does the RMI agree that compliance costs are likely**
5 **to offset any interest rate savings provided by the EIR Program?**

6 A. Essentially, yes. RMI observes that if utilities “use EIR loans to displace corporate
7 debt, overall ratepayer savings will be minimal, since most utilities can already
8 borrow at reasonably attractive interest rates without the added complication and
9 expense of participating in a government program.”⁶ The “added complication and
10 expense” referenced in the analysis are the additional compliance costs I have
11 previously noted. The analysis by RMI highlights that the administrative and
12 compliance costs associated with this federal financing opportunity would
13 significantly reduce or fully offset the benefit of the difference in interest rates
14 between the EIR loan guarantee and typical utility financing.

15
16 **VI. CONCLUSION**

17 **Q. Do you have any concluding remarks?**

18 A. Yes. While I do not intend to be an alarmist concerning downgrade potential
19 suggested by the OPC witnesses’ recommendations, those recommendations need
20 to be placed in the context of industry-wide trends. The S&P Global publication
21 previously referenced (Exhibit KWN-5) revised their view on the entire North

⁶ RMI’s May 24, 2024 analysis, *available at*: <https://rmi.org/maximizing-the-value-of-the-energyinfrastructure-reinvestment-program-for-utility-customers/>.

1 American investor-owned regulated electric and gas utilities sector to “negative”
2 from “stable.” Such an industry outlook by S&P is a signal to investors that
3 downgrades may be forthcoming. Why? S&P cited “[t]he industry faces rising
4 physical risks and high cash flow deficits that may not be sufficiently funded in a
5 credit-supporting manner,” further explaining that “[t]he industry’s capital
6 spending remains at record levels, supporting initiatives for safety, reliability,
7 energy transition and growth. We consider these trends long term and expect that
8 capital spending will only continue to increase over this decade.” These external
9 factors certainly impact a utility’s financial wherewithal as well as customer bills
10 but are largely beyond the issuer’s control. If the utility were already in a weakened
11 or downgraded situation due to regulatory rate case outcomes, these new,
12 exogenous events could well lead to a further downgrade, most likely beyond what
13 the regulators intended.

14
15 Second, once a downgrade occurs below a ratings trigger, the agencies require not
16 only a recovery to the downgrade metric, but a significant improvement beyond
17 that standard to secure the upgrade. For example, Moody’s current downgrade
18 threshold for DEF is 19.0% FFO/Debt. If the Company were to fall below this
19 metric and suffer a downgrade, Moody’s would reevaluate the Company’s credit
20 profile and set new FFO/Debt downgrade and upgrade thresholds for the Company
21 based on its new credit rating. If Moody’s views that the overall business or
22 regulatory risk of the utility has increased, they would likely set the Company’s

1 new upgrade threshold above the utility's downgrade threshold prior to the ratings
2 downgrade. For this reason, simply recovering to your prior credit metrics does not
3 guarantee a return to the Company's previous ratings.

4
5 The risk of ratings action is not rhetoric but a valid concern that this Commission
6 should weigh heavily. The Company will be making significant capital investments
7 to ensure reliable, safe, and increasingly clean energy, and to serve the growth in
8 its service territory. An artificially low ROE could harm the Company's credit
9 ratings, which will be detrimental to the Company and our customers. The
10 Company's proposed ROE strikes the appropriate balance in keeping rates
11 reasonable for DEF's customers, while allowing for the necessary level of leverage
12 and cash flows to maintain DEF's current credit ratings and I respectfully request
13 the Commission approve the Company's request.

14
15 **Q. Does this conclude your rebuttal testimony?**

16 **A.** Yes, it does.

CREDIT OPINION

29 May 2024

Update

✓ Send Your Feedback

RATINGS

Duke Energy Florida, LLC.

Domicile	Florida, United States
Long Term Rating	A3
Type	LT Issuer Rating
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Duke Energy Florida, LLC.

Update to credit analysis

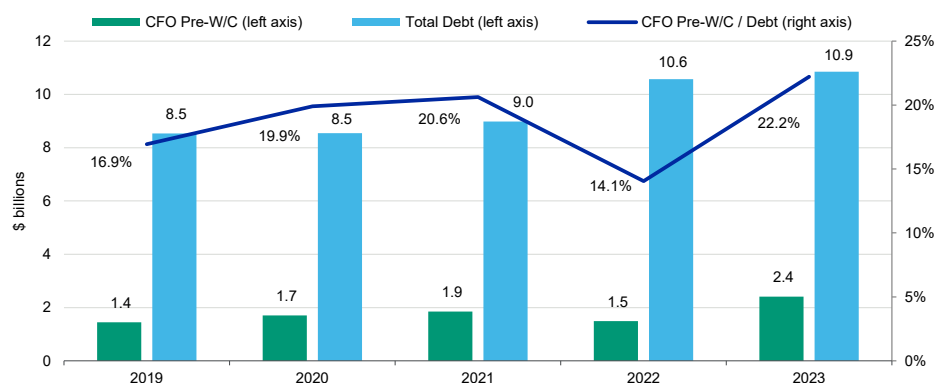
Summary

Duke Energy Florida LLC's (Duke Energy Florida) credit profile reflects a supportive regulatory environment for investor owned utilities in Florida including a history of comprehensive rate settlements approved by the Florida Public Service Commission (FPSC). Our view also recognizes historical credit metrics that have been negatively impacted by the financial effects of hurricanes. The implementation of an augmented capital program to strengthen the system in light of frequent storm activity and to execute a clean energy transition plan will maintain pressure on credit metrics. However, given the utility's supportive multiyear rate plan, its ability to petition for storm cost recovery outside of a rate case, and Florida legislation that provides timely recovery of storm hardening investments, we expect credit metrics to be supportive of the current A3 rating.

Duke Energy Florida's 2023 credit metrics benefited from the recovery of storm and deferred fuel costs which negatively impacted credit metrics in 2022. Over the next two years, we project a ratio of cash flow from operations excluding changes in working capital (CFO pre-WC) to debt in the 19% to 22% range, when adjusted for securitization debt, in the absence of unusually severe storms.

Exhibit 1

Historical CFO Pre-WC, Total Debt and CFO Pre-WC to Debt



All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Periods are fiscal year-end unless indicated.

The 2023 CFO pre-WC to debt ratio, adjusted for the financial impact of securitization bonds and the cash flow impact of unusually high deferred fuel costs which are being recovered over 21 months effective April 2023, is approximately 20.7%. See Exhibit 4 for details.

Source: Moody's Financial Metrics™

Credit strengths

- » Credit supportive Florida regulatory framework
- » Multiyear rate settlements with the ability to petition for storm cost recovery outside of a base rate case

Credit challenges

- » Storm prone service territory
- » Significant capital program drives sizable negative free cash flow that requires external financing

Rating outlook

The stable outlook reflects Duke Energy Florida's credit supportive regulatory framework, including multiyear rate settlements, the prescriptive nature of base rate adjustments for new solar investments, the ability to petition for storm cost recovery outside of a base rate case, and the ability to recover storm hardening investments via a rider mechanism. The outlook also considers financial metrics that we expect will be appropriate for the rating going forward, including a ratio of CFO pre-WC to debt in the 19%-22% range when securitization debt is excluded.

Factors that could lead to upgrade

- » Improved cash flow coverage metrics, for example CFO pre-WC to debt, excluding securitization debt, above 22% on a sustained basis

Factors that could lead to downgrade

- » A decline in the supportiveness of the regulatory framework in Florida
- » If CFO pre-WC to debt, excluding securitization debt, is sustained below 19%

Key indicators

Exhibit 2

Duke Energy Florida, LLC

	2019	2020	2021	2022	2023
CFO Pre-W/C + Interest / Interest	5.2x	6.0x	6.6x	5.0x	6.7x
CFO Pre-W/C / Debt	16.9%	19.9%	20.6%	14.1%	22.2%
CFO Pre-W/C – Dividends / Debt	16.9%	19.9%	20.6%	12.4%	22.2%
Debt / Capitalization	49.0%	46.7%	45.6%	47.2%	45.9%

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Periods are fiscal year-end unless indicated.

The 2023 CFO pre-WC to debt ratio, adjusted for the financial impact of securitization bonds and the cash flow impact of unusually high deferred fuel costs which are being recovered over 21 months effective April 2023, is approximately 20.7%. See Exhibit 4 for details.

Source: Moody's Financial Metrics™

Profile

Duke Energy Florida, LLC, is a vertically integrated public utility providing electricity to approximately 2 million customers in the north central part of Florida with an earnings base of about \$19.1 billion. Duke Energy Florida is a subsidiary of intermediate holding company Progress Energy, Inc. (Progress, Baa1 stable) and ultimate parent company Duke Energy Corporation (Duke, Baa2 stable).

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

Detailed credit considerations

Credit supportive Florida regulatory framework

The regulatory environment for investor owned utilities in Florida remains credit supportive. In its last several proceedings, Duke Energy Florida has been able to achieve multiyear rate settlements which ultimately resolved issues relating to retiring a nuclear plant, provided for increased system investment, and addressed the impacts of federal tax reform and increased storm restoration costs. The utility also benefits from ongoing credit supportive cost recovery mechanisms, such as fuel and capacity clauses that are adjusted at least annually based on expected fuel and power prices, and for prior period differences between projected and actual costs; and an environmental cost recovery clause that is adjusted annually for capital spending and operating expenses related to emission controls.

In April 2024, Duke Florida filed a multiyear general rate case application with the FPSC requesting a revenue increase of \$819.9 million over three years including \$593.4 million in 2025, \$97.9 million in 2026 and \$128.6 million in 2027. The request is based on a 11.15% ROE and 53% equity layer. The FPSC will hold a final hearing on this application on 12 August 2024.

In March 2023, the FPSC approved recovery of \$469 million of deferred fuel costs, which included 2022 actual under-recovery of \$1.2 billion, less projected declining fuel costs in 2023 due to lower natural gas prices. The actual 2022 costs were approved to be recovered over a 21-month period from April 2023 through December 2024, while the decline in 2023 fuel costs were approved to be returned to customers over nine months from April 2023 through December 2023.

In November 2023, the FPSC approved Duke Florida's 2024 fuel projection filing, which included the fuel factors for 2024. The filing included an additional estimated 2023 over-recovery of approximately \$120 million that is being returned to customers from January 2024 through December 2024. In April 2024, DEF filed a fuel midcourse petition requesting to lower fuel rates due to falling natural gas prices; DEF estimated a 2024 over-recovery of approximately \$234 million and requested it be returned to customers over 12 months, beginning June 2024. The FPSC approved DEF's petition, as filed, in May 2024.

Storm prone service territory but with good history of cost recovery

Duke Energy Florida's service territory is prone to hurricanes. The company has historically been able to recover storm costs via timely, credit supportive means. This is a key credit consideration as the state is prone to hurricanes, the frequency and intensity of which appear to be increasing.

To help protect against recurring severe weather, Florida lawmakers enacted legislation in 2019 that requires investor-owned utilities to harden their transmission and distribution infrastructure, and also provides for cost recovery outside of a general rate case, a credit positive. In April 2020, the Florida utilities, including Duke Energy Florida, submitted their infrastructure improvement plans. Duke Energy Florida intends to invest approximately \$6 billion over 10 years to harden its system, and increase reliability including an initiative to upgrade overhead distribution systems. In August 2020, the FPSC determined the utility's plans were in the public interest and approved a rider mechanism to recover the related costs. The requests for specific cost recovery are reviewed separately. The utility filed an updated plan in April 2022 to invest \$7 billion over the ten years beginning in 2023. The plan was approved by the FPSC in October 2022.

In January 2023, Duke Florida filed for recovery of \$442 million of costs associated with various storms, including Hurricane Ian in 2022, and to replenish its storm reserve. The utility requested a recovery period of 12 months beginning in April 2023. In March 2023, the FPSC approved interim cost recovery, subject to refund and directed the utility to file documentation of the actual costs incurred once known. Duke Florida filed the required documentation for total actual storm costs of \$431 million in September 2023 and received final FPSC approval for actual cost recovery in May 2024.

Duke Florida's service territory was affected by Hurricane Idalia in August 2023. In January 2024, following FPSC approval, revised rates went into effect reflecting a 12 month recovery of \$166 million. The recovery amount includes \$92 million associated with Hurricane Idalia and \$74 million of costs already approved for recovery, primarily related to storm reserve replenishment. Duke Florida must file documentation of total actual Idalia storm costs once certain.

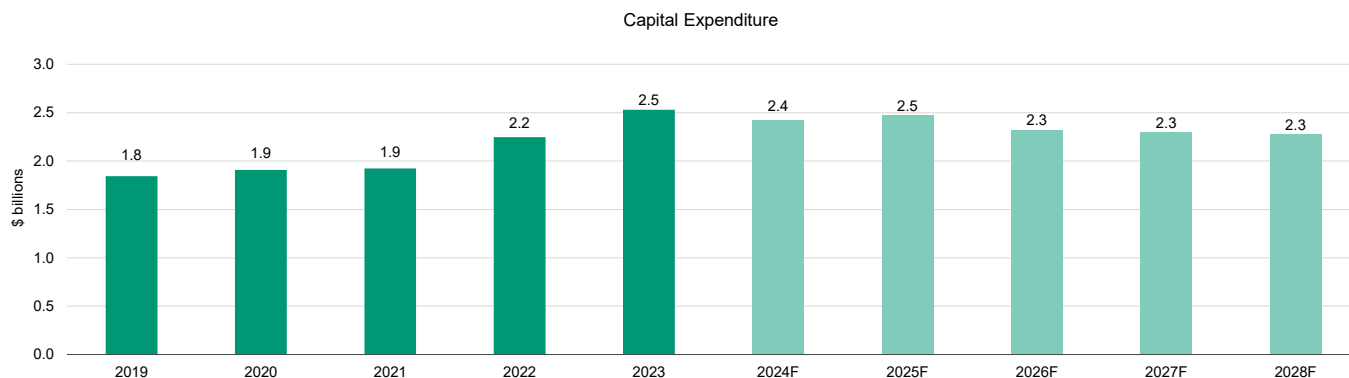
Elevated capital plans and the potential for storms constrain credit profile

Duke Energy Florida's capital expenditures have increased in recent years as the utility invests to harden its system and to implement its clean energy plans. The company's 2024-2028 capital forecast totaling around \$11.8 billion is approximately \$1.4 billion higher than

it spent over 2019-2023. Although much of this spending will be recovered through the utility's multiyear rate plan and existing rider mechanisms, there is still some lag as recovery generally does not begin until projects are placed in service. Incremental debt to fund negative free cash flow will pressure credit metrics in the meantime.

Exhibit 3

Duke Energy Florida, LLC



Source: Moody's Financial Metrics™ and Company filings

Hurricanes have negatively affected Duke Energy Florida's historical credit metrics. The risk of storms is somewhat mitigated by the credit supportive regulatory treatment discussed above. Nevertheless, the company's credit profile could be persistently weaker than expected if severe storms recur on a regular basis.

In 2016, Duke Florida issued about \$1.3 billion of securitization financing related to the recovery of costs associated with the closed Crystal River 3 nuclear facility. Our GAAP based calculation of Duke Energy Florida's financial metrics are negatively impacted by the securitization debt. However, our assessment of the company's credit quality considers metrics that exclude the securitization debt. This is because the securitization bonds are legally a customer obligation, with the utility serving as a conduit for its repayment via a charge on customer bills.

In 2023, Duke Energy Florida's ratio of CFO pre-WC to debt was 22.2% or 23.7% when adjusted for securitization debt. However, excluding the cash flow impact of recovery of deferred fuel costs, the CFO pre-WC to debt ratio would have been 20.7% as shown below. Assuming normal storm activity, we expect Duke Energy Florida's ratio of CFO pre-WC to debt, excluding securitization debt, to be in the 19%-22% range.

Exhibit 4

Duke Energy Florida adjusted 2023 CFO pre-WC to debt detail

(in \$ millions)	2023
Cash flow from operations (GAAP)	2,387
Exclude changes current assets/liabilites (working capital)	(41)
Unadjusted CFO pre-WC	2,346
Primary adjustments	
Lease obligation	65
Other analyst adjustments	
Securitization	(53)
LT deferred fuel costs	(295)
Preliminary adjusted CFO pre-WC (excl. other analyst adjustments)	2,411
Fully adjusted CFO pre-WC (incl. other analyst adjustments)	2,063
Debt (GAAP)	10,553
Primary adjustments	
Lease	300
Other analyst adjustments	
Securitization	(890)
Preliminary adjusted debt (excluding other analyst adjustments)	10,853
Fully adjusted debt (including other analyst adjustments)	9,963
Preliminary adjusted CFO pre-WC/debt	22.2%
Fully adjusted CFO pre-WC/debt	20.7%

Period is fiscal year-end unless indicated.

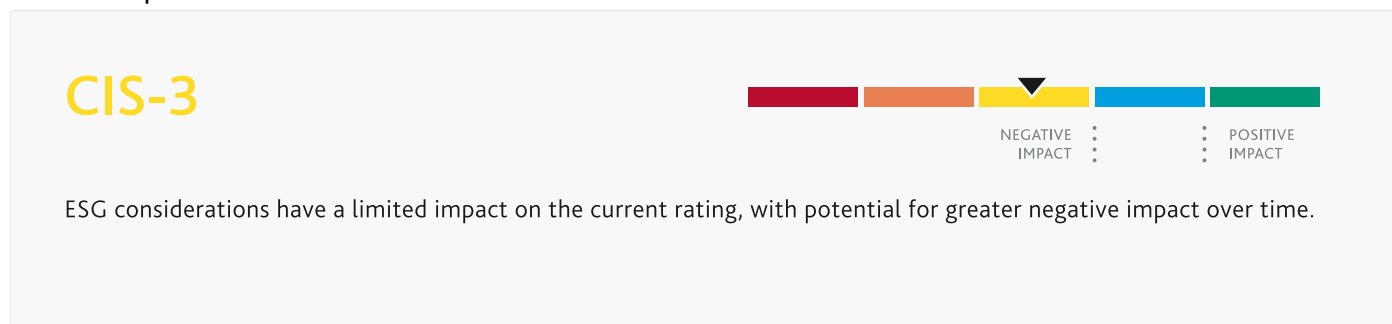
Source: Moody's Financial Metrics™ and Company filings

ESG considerations

Duke Energy Florida, LLC.'s ESG credit impact score is CIS-3

Exhibit 5

ESG credit impact score

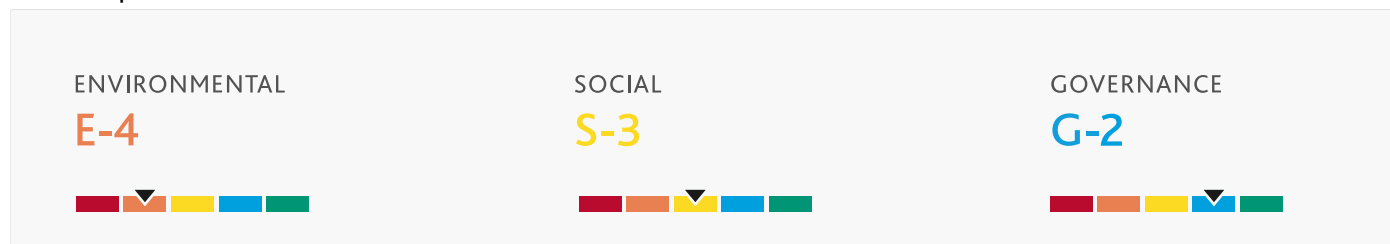


Source: Moody's Ratings

Duke Energy Florida's **CIS-3** indicates that ESG considerations have a limited impact on the current rating, with greater potential for future negative impact over time. Physical climate risks such as storms, and demographic and societal trends that raise affordability concerns and lead to a less supportive regulatory environment, could weaken credit quality over the long-term.

Exhibit 6

ESG issuer profile scores



Source: Moody's Ratings

Environmental

Duke Energy Florida's **E-4** issuer profile score is driven by its high exposure to storm-caused damage to physical assets because of the location of its service territory in a hurricane prone region. The company's fossil fuel generation fleet presents moderate exposure to carbon transition risk.

Social

Duke Energy Florida's **S-3** issuer profile score reflects the risk that demographics and societal trends could trigger customer affordability concerns that could lead to adverse regulatory or political intervention.

Governance

Duke Energy Florida's **G-2** issuer profile score is driven by that of its parent Duke Energy and the financial strategy to maintain the utility's capital structure established in its regulated rate construct. Duke Energy's **G-2** issuer profile score is broadly in line with other utility holding companies and does not pose a particular risk.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moody's.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Liquidity analysis

Duke Energy Florida has an adequate liquidity profile. During the fiscal year ending December 2023, the utility generated approximately \$2.4 billion of cash from operations (CFO), invested approximately \$2.5 billion in capital expenditures and made no distributions to parent Duke, resulting in negative free cash flow of approximately \$142 million. We expect Duke Energy Florida to remain free cash flow negative over the next few years as capital expenditures remain elevated.

As of 31 March 2024, the utility had \$4 million of cash and \$950 million of borrowing capacity under Duke's \$9.0 billion multiyear master bank credit facility due in March 2029. At 31 March 2024, the utility had \$66 million of commercial paper outstanding and \$7 million of outstanding letters of credit. The credit facility does not contain a material adverse change clause for new borrowings and has a single financial covenant requiring that Duke and its utility subsidiaries each maintain a consolidated debt to capitalization ratio of no more than 65%, except for Piedmont.

Duke Energy Florida's next debt maturity is \$650 million of debt due in January of 2027.

Rating methodology and scorecard factors

We use our global Regulated Electric and Gas Utilities rating methodology as the primary methodology for Duke Energy Florida, LLC.

Exhibit 7

Rating factors

Duke Energy Florida, LLC.

Regulated Electric and Gas Utilities Industry Scorecard	Current FY Dec-23		Moody's 12-18 month forward view	
	Measure	Score	Measure	Score
Factor 1 : Regulatory Framework (25%)				
a) Legislative and Judicial Underpinnings of the Regulatory Framework	A	A	A	A
b) Consistency and Predictability of Regulation	Aa	Aa	Aa	Aa
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	Aa	Aa	Aa	Aa
b) Sufficiency of Rates and Returns	A	A	A	A
Factor 3 : Diversification (10%)				
a) Market Position	Baa	Baa	Baa	Baa
b) Generation and Fuel Diversity	Baa	Baa	Baa	Baa
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	6.1x	Aa	5.5x - 6.0x	A
b) CFO pre-WC / Debt (3 Year Avg)	18.9%	Baa	19% - 22%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	18.3%	A	17% - 19%	A
d) Debt / Capitalization (3 Year Avg)	46.3%	Baa	42% - 45%	A
Rating:				
Scorecard-Indicated Outcome Before Notching Adjustment		A2		A2
HoldCo Structural Subordination Notching		0		0
a) Scorecard-Indicated Outcome		A2		A2
b) Actual Rating Assigned		A3		A3

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Moody's forecasts are Moody's opinion and do not represent the views of the issuer.

Source: Moody's Financial Metrics™ and Moody's Ratings forecasts

Appendix

Exhibit 8

Peer comparison

Duke Energy Florida, LLC.

(In \$ millions)	Duke Energy Florida, LLC. A3 Stable			Florida Power & Light Company A1 Stable			Tampa Electric Company A3 Negative		
	FY Dec-21	FY Dec-22	FY Dec-23	FY Dec-21	FY Dec-22	FY Dec-23	FY Dec-21	FY Dec-22	FY Dec-23
Revenue	5,259	6,353	7,036	14,102	17,282	18,365	2,695	3,169	2,637
CFO Pre-W/C	1,853	1,485	2,411	6,124	7,529	7,731	840	951	958
Total Debt	8,982	10,570	10,853	20,092	22,911	27,903	4,171	4,988	4,465
CFO Pre-W/C + Interest / Interest	6.6x	5.0x	6.7x	11.0x	10.8x	7.9x	6.5x	6.3x	5.0x
CFO Pre-W/C / Debt	20.6%	14.1%	22.2%	30.5%	32.9%	27.7%	20.1%	19.1%	21.5%
CFO Pre-W/C – Dividends / Debt	20.6%	12.4%	22.2%	27.8%	24.1%	11.4%	9.3%	8.7%	10.9%
Debt / Capitalization	45.6%	47.2%	45.9%	33.0%	32.6%	37.1%	42.6%	43.6%	44.3%

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Source: Moody's Financial Metrics™

Exhibit 9

Moody's-adjusted cash flow metrics

Duke Energy Florida, LLC.

(in \$ millions)	2019	2020	2021	2022	2023
FFO	1,753.8	1,798.0	1,990.6	2,171.3	2,147.0
+/- Other	(308.0)	(97.0)	(138.0)	(686.0)	264.0
CFO Pre-WC	1,445.8	1,701.0	1,852.6	1,485.3	2,411.0
+/- ΔWC	145.0	37.0	(390.0)	(583.0)	41.0
CFO	1,590.8	1,738.0	1,462.6	902.3	2,452.0
- Div	0.0	0.0	0.0	175.0	0.0
- Capex	1,936.8	2,002.0	2,002.6	2,327.3	2,616.0
FCF	(346.0)	(264.0)	(540.0)	(1,600.0)	(164.0)
(CFO Pre-W/C) / Debt	16.9%	19.9%	20.6%	14.1%	22.2%
(CFO Pre-W/C - Dividends) / Debt	16.9%	19.9%	20.6%	12.4%	22.2%
FFO / Debt	20.5%	21.0%	22.2%	20.5%	19.8%
RCF / Debt	20.5%	21.0%	22.2%	18.9%	19.8%
Revenue	5,231.0	5,188.0	5,259.0	6,353.0	7,036.0
Interest Expense	343.8	341.0	331.8	371.8	425.0
Net Income	652.3	744.7	702.5	896.1	981.2
Total Assets	20,454.0	20,957.0	22,733.0	25,554.0	26,601.0
Total Liabilities	13,739.0	13,399.0	14,438.0	16,531.0	16,558.0
Total Equity	6,715.0	7,558.0	8,295.0	9,023.0	10,043.0

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Periods are fiscal year-end unless indicated.

Source: Moody's Financial Metrics™

Ratings

Exhibit 10

Category	Moody's Rating
DUKE ENERGY FLORIDA, LLC.	
Outlook	Stable
Issuer Rating	A3
First Mortgage Bonds	A1
Senior Secured Shelf	(P)A1
Senior Unsecured	A3
Underlying Senior Secured	A1
Underlying Senior Unsecured	A3
ULT PARENT: DUKE ENERGY CORPORATION	
Outlook	Stable
Issuer Rating	Baa2
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured	Baa2
Jr Subordinate	Baa3
Pref. Stock	Ba1
Commercial Paper	P-2
PARENT: PROGRESS ENERGY, INC.	
Outlook	Stable
Senior Unsecured	Baa1

Source: Moody's Ratings

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RRA State Regulatory Evaluations — Energy

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For detailed data

Access [RRA's State Regulatory Rankings February 2024](#).

Regulatory Research Associates, a group within S&P Global Commodity Insights, evaluates the regulatory climate for energy utilities in each of the jurisdictions within the 50 states and the District of Columbia — a total of 53 jurisdictions — on an ongoing basis. S&P Global Commodity Insights produces content for distribution on S&P Capital IQ Pro.

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Table of Contents

Executive Summary	3
Introduction	3
About This Report	3
The Take	4
Recent ranking changes	5
Jurisdictions to watch	6
Outlook	10
RRA's rankings process	12
Methodology	12
Further Reading	29
About the Author(s)	30
About Regulatory Research Associates	30

Executive Summary

Introduction

RRA evaluates the regulatory climate for energy utilities in each 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 energy utilities.

Each evaluation is based upon consideration of the numerous factors affecting the regulatory process, including gubernatorial involvement, legislation and court activity, and may be adjusted as events occur that cause RRA to modify its view of the regulatory risk for a given jurisdiction.

RRA reviews the ranking of a particular jurisdiction on an ongoing basis as developments occur and then holistically reviews the rankings when preparing the quarterly comprehensive ranking reports. The issues considered are discussed in RRA Research Notes, Commission Profiles, Topical Special Reports and Rate Case analyses. RRA also considers information obtained from contacts with the commissioners and staff, as well as company and government personnel in the course of its research. The final evaluation is an indicator 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.

It is important to note that RRA's rankings are from an investor perspective and are intended to provide insight into the relative risk associated with owning the securities of the jurisdictions in question. They are not an assessment of whether regulators are "doing a good job." In addition, the rankings look at not only the commission's actions but those taken by the jurisdiction's legislature, courts and chief executive, as well as the various stakeholders that intervene in the regulatory process.

About This Report

This report provides a discussion of recent changes in RRA's energy regulatory rankings, with details regarding the rationale for these changes. The report also identifies jurisdictions with ongoing proceedings or developing issues that have the potential to impact the relative regulatory risk for utilities operating within a given jurisdiction and, by extension, the ranking of that jurisdiction. The report also provides a discussion of key regulatory issues that impact the sector outlook as a whole. Finally, the report includes an overview of RRA's ranking methodology and the issues RRA examines in deriving the rankings.

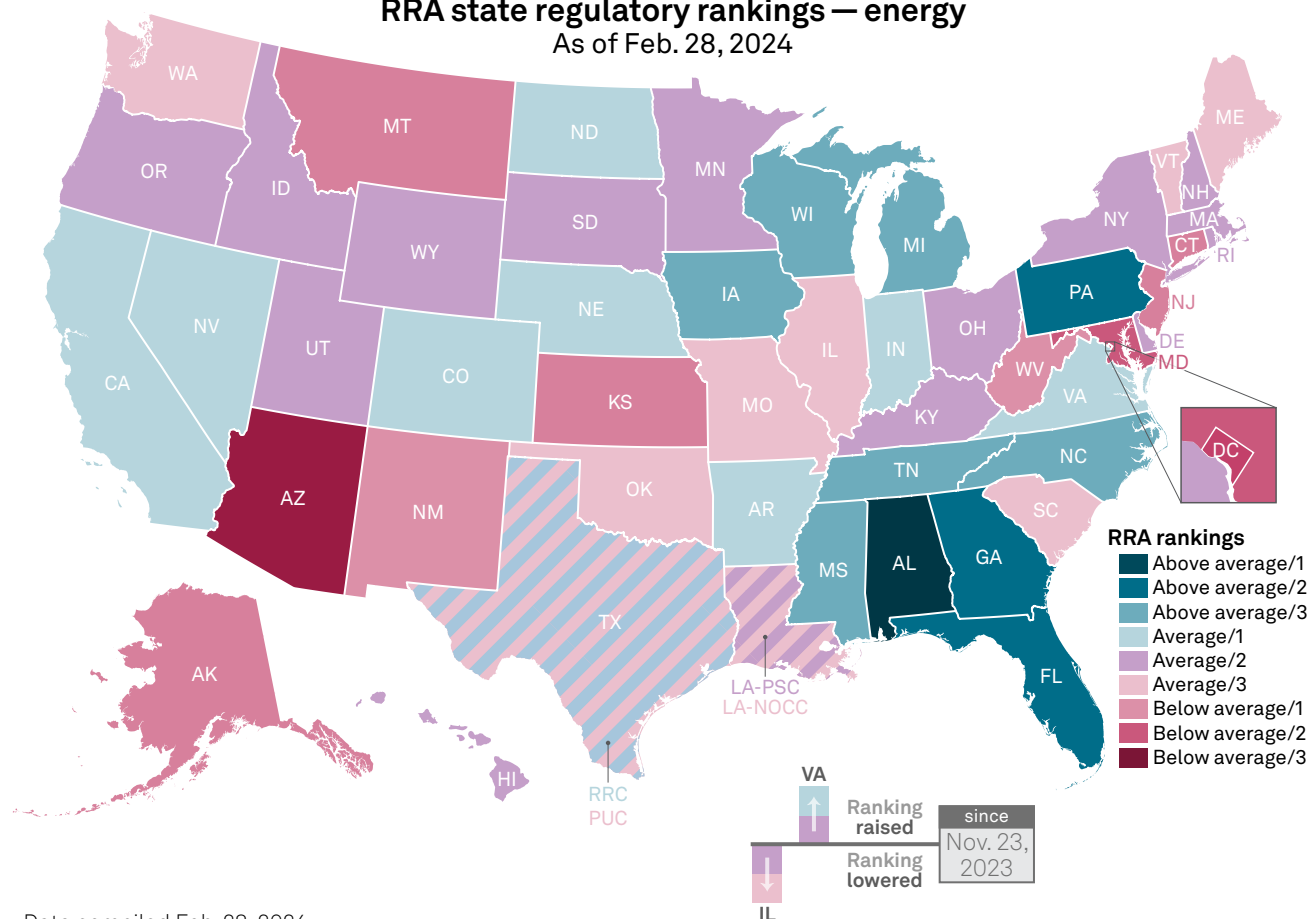
The Take

In light of recent and ongoing developments, Regulatory Research Associates has altered the regulatory rankings of two state-level jurisdictions under coverage and identified 10 jurisdictions that bear watching, given recent commission, legislative, gubernatorial and/or court activity.

Developments continue to unfold on a variety of key issues across the regulated utility sector nationwide on an ongoing basis, including evolving public policy related to the energy transition, accelerated capital spending driven largely by programs to meet a variety of societal goals, and higher inflation and interest rates than the US had seen in the four prior decades.

State regulators will play a pivotal role in determining the direction and magnitude of these impacts on the financial performance of the utilities that fall under their purview. How the individual jurisdictions meet these challenges will continue to inform RRA's prospective comparative risk assessments.

RRA state regulatory rankings — energy
 As of Feb. 28, 2024



Data compiled Feb. 28, 2024.

RRC = Railroad Commission; PUC = Public Utility Commission;
 PSC = Public Service Commission; NOCC = New Orleans City Council.

Map credit: Joe Felizadio.

Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.

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Recent ranking changes

In conjunction with the [prior review](#) conducted during November 2023, RRA changed the ranking of five jurisdictions — Delaware, Maryland, New Mexico, Ohio and Oklahoma. These changes reflect increased risk for investors in utilities that operate in Maryland and Oklahoma, and a relatively more constructive atmosphere in Delaware, New Mexico and Ohio.

Shortly after that report was published, on Dec. 15, 2023, RRA lowered the ranking of the Illinois regulatory climate to Average/3 from Average/2 to reflect the impact of adverse rulings issued for Exelon Corp. subsidiary Commonwealth Edison Co. (ComEd) and Ameren Corp. subsidiary Ameren Illinois Co. in their respective multiyear grid and rate plan proceedings. In addition to approving below-industry average returns on equity (ROEs), the Illinois Commerce Commission (ICC) rejected detailed infrastructure investment proposals from ComEd and Ameren Illinois finding that the proposals did not comply with certain aspects of the state’s Climate and Equitable Jobs Act of 2021. As such, the companies are not permitted to commence their planned investment program for 2024–2027 at this time. The ranking change was also made to recognize the ICC’s decisions in late-2023 to adopt ROEs in several gas distribution rate cases that were meaningfully below both prevailing industry averages and the equity returns put forth by the commission’s in-house personnel.

RRA state regulatory evaluations

State-by-state listing — Energy

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

Data compiled Feb. 28, 2024.

NOCC = New Orleans City Council; PSC = Public Service Commission; PUC = Public Utility Commission; RRC = Railroad Commission.

* Ranking raised since Nov. 30, 2023.

** Ranking lowered since Nov. 30, 2023.

Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.

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RRA is now raising the ranking of Virginia regulation to Average/1 from Average/2, in part to maintain a balance in the rankings, but also to reflect the removal of significant regulatory uncertainty with the election of two individuals to fill longstanding vacancies on the Virginia State Corporation Commission. The Virginia General Assembly voted unanimously on Jan. 24, 2024, to elect Samuel T. Towell and Kelsey A. Bagot to fill the open slots. Towell was elected to serve a partial term commencing March 17, 2024, and extending to February 2028. Bagot was elected for a term of six years commencing April 1, 2024; presumably the term will extend to February 2030 to conform to the usual convention in Virginia

Jurisdictions to watch

In addition to the jurisdictions discussed above, where RRA has observed a shift in the regulatory climate, there are 10 states where recent trends and expected near-term developments could signal a shift in the level of regulatory risk for investors.

While the **Arizona** regulatory climate has shown signs of becoming more constructive in recent months, RRA views the outcome of a rate case for the state's largest electric utility, Pinnacle West Capital Corp. subsidiary Arizona Public Service Co (APS), as key indicator of future policy. While the Arizona Corporation Commission (ACC) deliberated on the issues on Feb. 22, a final written order will not be available immediately. Notably, it appears that the ACC approved a rate increase somewhat below that sought by the company, but still substantial, as well as an ROE that is in line with prevailing industry averages and a system reliability benefit mechanism that would recognize rate base additions between rate cases. A similar mechanism was approved in a recent ACC decision for Fortis Inc. subsidiary UNS Electric Inc. The mechanism would mitigate regulatory lag associated with the ACC's practice of relying on historical test years. By contrast, in APS's prior base rate case, the ACC approved an ROE that was among the lowest equity returns authorizations observed by RRA in the last 40 years.

Other developing matters may also impact the quality of the regulatory environment. The ACC has opened a docket to examine repealing commission rules regarding renewables. The existing renewable energy standard and tariff currently require that the utilities obtain renewable energy credits in increasing amounts plateauing at 15% of each utilities' annual kWh sales in 2025. Some ACC commissioners have made public statements that these rules are unnecessary and harm ratepayers. Even so, several rulemakings undertaken by the commission in recent years have taken considerable time without leading to any significant changes.

Also worth watching is the upcoming 2024 elections, where three of the ACC's five seats will be on the ballot, in addition to the governor's office and both chambers of the state legislature.

Connecticut continues to be one of the most challenging regulatory jurisdictions in the US, and although RRA recently lowered the ranking of Connecticut regulation, the jurisdiction continues to bear watching. Recent rate case decisions have demonstrated significant constriction in the regulatory climate and have created additional uncertainty surrounding the overall tenor of regulatory policy in the state. In a rate case decided in August 2023, the Connecticut Public Utilities Regulatory Authority (PURA) approved a rate increase for Avangrid Inc. subsidiary The United Illuminating Co., with an ROE of 8.63%, which reflected a 47-basis-point reduction to account for various management and operational performance issues. Even without the penalty, the implied base ROE of 9.10% is among the lowest approved for an energy utility in recent years. That decision is under appeal. The regulatory environment remains active with two pending gas rate cases for Avangrid's Connecticut gas utilities and a legislatively mandated alternative ratemaking proceeding where the PURA is reviewing rules governing multiyear rate plans (MRP), earnings-sharing mechanisms, revenue decoupling and potential performance-based ratemaking (PBR) measures for the electric utilities.

The **Florida** regulatory climate bears watching, as investigations are ongoing into allegations of corruption, bribery and campaign financing violations leveled by members of the Florida House of Representatives against the state's largest investor-owned electric utility, NextEra Energy Inc. subsidiary Florida Power & Light Co. A complaint is also pending before the Federal Election Commission, alleging violations of the Federal Election Campaign Act. While Florida Power indicated it had reviewed the allegations and asserted that the company was not likely to be found liable for any violations of Florida law, soon after the report was issued, then-CEO of NextEra, Eric Silagy, resigned.

Also worth watching is a recently initiated proceeding regarding a court remand of a rate case settlement approved in 2021 by the Florida Public Service Commission for Florida Power. The court ruled that the PSC had not provided a sufficient basis for meaningful judicial review of its conclusion, which stated that the settlement "provides a reasonable resolution of all issues raised, establishes rates that are fair, just and reasonable, and is in the public interest."

In addition, in April 2024, Duke Energy Inc. subsidiary Duke Energy Florida LLC is expected to file a multiyear rate case, seeking \$818 million in rate increases between 2025 and 2027.

In **Georgia**, controversy surrounding the 2022 commissioner elections and the whole election process continues to drag on, creating persistent uncertainty with respect to the future makeup of the Georgia Public Service Commission. The US Supreme Court enjoined the state from holding elections for two PSC seats, originally scheduled to take place in November 2022, following allegations that the method of electing PSC members violates the federal Voting Rights Act. PSC members are elected statewide; however, they are assigned to and must reside in one of the five PSC districts. A special election expected to take place in 2024 has yet to occur and questions linger regarding whether the existing or a new electoral method will apply, as litigation continues. Two incumbent commissioners, who would have stood for reelection absent the controversy, have retained their seats.

Even though RRA recently lowered the ranking of **Illinois** to reflect restrictive rulings issued in late 2023, the state continues to bear watching, as ComEd and Ameren have filed for reconsideration of their respective rate case decisions and are expected to file revised grid plan requests in March 2024. There is apparently no statutory deadline by which the commission must act on the requests.

Further, the ICC's determinations in recent gas proceedings raise the possibility that the ICC could continue to disregard the recommendations put forth by its own internal experts to the detriment of the state's utilities, raising the potential for further constriction in the regulatory climate. Three of the five commissioners are relatively new, having been in office for less than a year; so, even though one of the "new" commissioners has served before, the commissioners are evolving in terms of how they work together. In addition to the reconsideration requests, there is one pending rate case, but that is for a relatively small company.

Iowa remains a jurisdiction to watch, considering the Iowa Utilities Board's (IUB's) actions in recent advanced ratemaking decisions for new renewable generation projects. In an October 2023 advanced ratemaking decision for Alliant Energy Corp. subsidiary Interstate Power and Light Co. (IPL), the IUB made significant modifications to a settlement that had been signed by IPL, the consumer advocate and two environmental groups. Among the modifications was a meaningful reduction in the authorized ROE that is to apply to 400 MW of new solar generation; the settlement had specified a 10.75% ROE, but the IUB authorized a 10.25% ROE. While higher than prevailing industry averages, this ROE is below previously approved ROEs for these types of facilities.

Prior to that, in April 2023, the IUB approved Berkshire Hathaway Inc. subsidiary MidAmerican Energy Co.'s Wind PRIME project but rejected a settlement regarding the advance ratemaking principles to apply to the investment. Instead, the board approved an alternative plan that left the authorized ROE to be determined in a future rate case. On rehearing, the parties reached a revised agreement that the IUB approved without modification in December 2023, including a 10.75% ROE. Even so, one commissioner expressed concern regarding the approval of a "premium ROE." The commissioner opined that considerable testimony in the case pointed toward ending the practice of approving premium ROEs for these types of investments, given the maturity of the renewable energy market.

While the board's rehearing decision is more in line with historical advance ratemaking decisions, two base rate cases that are yet to be decided in 2024 may face some uncertainty. In 2023, IPL tendered its first major electric and gas base rate case filings since 2019, and MidAmerican Energy filed its first gas base rate case since 2002. It is noteworthy that two of the three current commissioners are relatively new to the IUB, having joined the board in May 2023.

RRA state regulatory evaluations — Energy*

(By category, jurisdictions to watch highlighted)

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

Data compiled Feb. 28, 2024.

NOCC = New Orleans City Council; PSC = Public Service Commission; PUC = Public Utility Commission; RRC = Railroad Commission.

* Within a given subcategory, states are listed in alphabetical order, not by relative ranking.

Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.

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Kentucky continues to bear watching, as the Kentucky Public Service Commission's pattern of imposing modifications to rate case settlements over the past couple of years remains a cause for concern. The most recent rate case decision for a large utility occurred in January 2024, when the PSC authorized American Electric Power Co. Inc. subsidiary Kentucky Power Co. a rate increase that was meaningfully below the stipulated hike the parties had agreed to in a November 2023 settlement; the revenue requirement difference stemmed largely from an adverse ruling on recovery of transmission-related costs. The commission also rejected a settlement provision that called for the company to implement a distribution reliability rider.

Separately, legislation enacted earlier in 2023 prohibits the PSC from approving requests to retire fossil fuel-fired facilities, unless the utility can demonstrate that the plant's retirement would not adversely impact ratepayers or the region's electric grid reliability. The PSC recently approved one such proposal — by PPL Corp. subsidiaries Louisville Gas and Electric Co. and Kentucky Utilities Co. — that will result in meaningful changes to the composition of the companies' generation portfolios. On a constructive note, a separate bill signed in 2023 allows the electric utilities to securitize certain costs associated with retired generation facilities and storm restoration efforts. The PSC recently approved Kentucky Power's securitization request. It is unclear whether this provides insight regarding the commission's likely approach to future requests.

New Jersey bears watching at this juncture as Public Service Enterprise Group Inc. subsidiary Public Service Electric and Gas Co. — the largest utility in the state — recently filed its first combination electric and gas rate case in several years; the company is seeking rate increases aggregating to almost \$945 million. New Jersey Resources Inc. subsidiary New Jersey Natural Gas Co. has also filed for a substantial rate increase. South Jersey Gas Co. and Elizabethtown Gas Co. are also expected to file cases later this year. These smaller gas local distribution companies are held by South Jersey Industries Inc., which is owned by Infrastructure Investments Fund US Holding 2 LP, one of two master partnerships that comprise Infrastructure Investments Fund, an equity fund managed by J.P. Morgan Investment Management Inc.'s Infrastructure Investment Group.

With these cases, as well as various energy transition proceedings under way, the New Jersey Board of Public Utilities is operating with one vacancy and three new members who took office in 2023, including the recently named president.

Due to uncertainty caused by changes in the composition of the **Oklahoma** Corporation Commission (OCC) in early-2023, the combative stance taken in recent proceedings by one of the long-time OCC members and the commission's decision to depart from customary practice and require significant changes to a rate case settlement, RRA lowered its ranking of Oklahoma regulation on Nov. 30, 2023. RRA continues to consider Oklahoma a state to watch, as two of the major energy utilities in the state have substantial rate requests pending. In addition, legislation considered during the 2023 session that would have allowed the utilities to operate under a PBR framework, the bill failed to advance further. It remains to be seen whether a similar bill will be more palatable during the 2024 legislative session.

The regulatory climate in **Texas**, as it pertains to the electric utilities under the purview of the Public Utility Commission of Texas, continues to bear watching. Various proceedings are in progress to implement the mandates the PUC received from the legislature during the 2021 session to revamp the electric regulatory framework and the structure within the Electric Reliability Council of Texas power market in response to the impacts of a severe winter storm, as well as new initiatives laid out in legislation enacted during the 2023 session.

The PUC recently finalized rules for the filing by the utilities of three-year resiliency programs, and it remains to be seen how these proceedings will play out. In addition, in March, CenterPoint Energy Inc. subsidiary CenterPoint Energy Houston Electric LLC is expected to file its first base rate case in several years.

The makeup of the PUC continues to be a source of uncertainty with: the November 2023 resignation of Commissioner Will McAdams, creating a vacancy; the preexisting vacancy left by the June 2023 departure of then-Chairman Peter Lake; and questions regarding the status of Commissioner Lori Cobos, who is serving beyond the end of a term that expired in 2021. A new PUC chair was recently named, Thomas Gleeson, who was previously the PUC's executive director. Gleeson will serve pending confirmation when the legislature reconvenes in 2025.

With recent developments and pending legislative activity occurring in **Wyoming**, the regulatory climate in the state bears watching. In a contentious electric general rate proceeding for Berkshire Hathaway Inc. subsidiary PacifiCorp, the Wyoming Public Service Commission’s decision to lower the utility’s Wyoming-allocated base net power costs (NPC) level and total-company forecasted base NPC significantly reduced the authorized rate increase. Additionally, the regulator denied PacifiCorp’s proposal to recover costs associated with Washington’s “cap and invest” program from Wyoming ratepayers. This contested issue led the commissioners to discuss the future of the utility’s multistate jurisdictional allocation protocol, raised the potential for future reviews of the protocol and was the impetus for new legislation.

State lawmakers are also looking at legislation that could modify the state’s low-carbon standard, which was passed in 2020. The statute mandates that at least 20% of a power company’s portfolio consist of coal-fired power plants equipped with carbon emissions reduction technology by 2030. The pending legislation would amend various requirements, deadlines and rate recovery mechanisms associated with the standard.

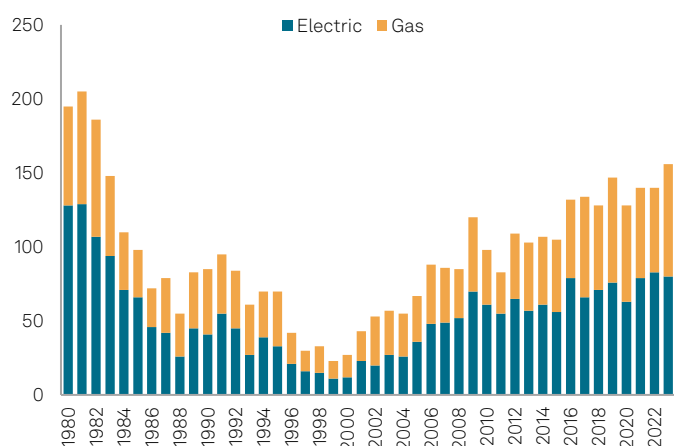
Outlook

Developments continue to unfold on a variety of key issues across the regulated utility sector nationwide. Accelerating capital spending to address a variety of public policy goals, inflation and rising interest rates present challenges for utilities and regulators and are driving an active rate case agenda across the US.

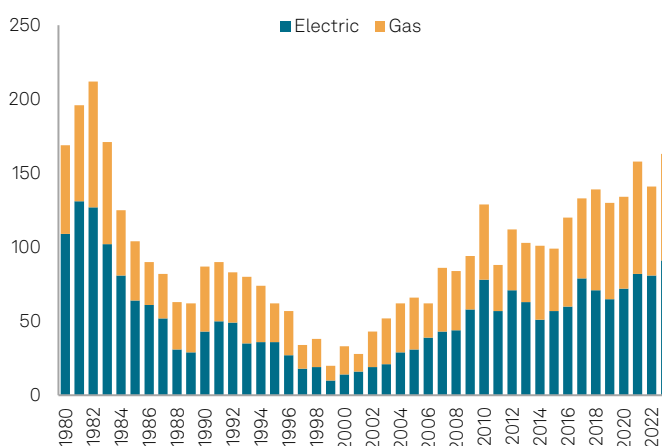
There were 164 electric and gas rate cases decided for the US investor-owned energy utilities in RRA’s coverage universe during 2023, with an aggregate \$9.3 billion of rate increases approved in those cases. In 2022, there were 141 electric and gas cases decided, with authorized rate increases aggregating to \$4.3 billion.

The covered companies filed 156 new electric and gas rate cases, including limited-issue rider proceedings in 2023, compared to 140 that were initiated in 2022. The combined rate increases requested in the 2023 cases aggregated to more than \$18.1 billion compared to almost \$16.9 billion in 2022.

Major rate cases filings, 1980-2022



Major rate cases decisions, 1980-2022



Data compiled Jan. 23, 2024.
 Source: Regulatory Research Associates, a group within S&P Global Commodity Insights
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RRA anticipates this trend of robust rate case activity will persist for the foreseeable future, driven by continued expansion in capital spending.

Capital spending has risen steadily since 2006, when the energy utilities included in RRA's sample of the publicly traded US energy utilities reported total actual capital spending of about \$52 billion.

Actual results for 2023 are not yet available, but forecasts put 2023 capital spending at roughly \$172 billion. The 2024 estimate is \$179 billion growing, to \$185 billion in 2025 and bringing the total for the forecast period (2023-2025) to \$536 billion.

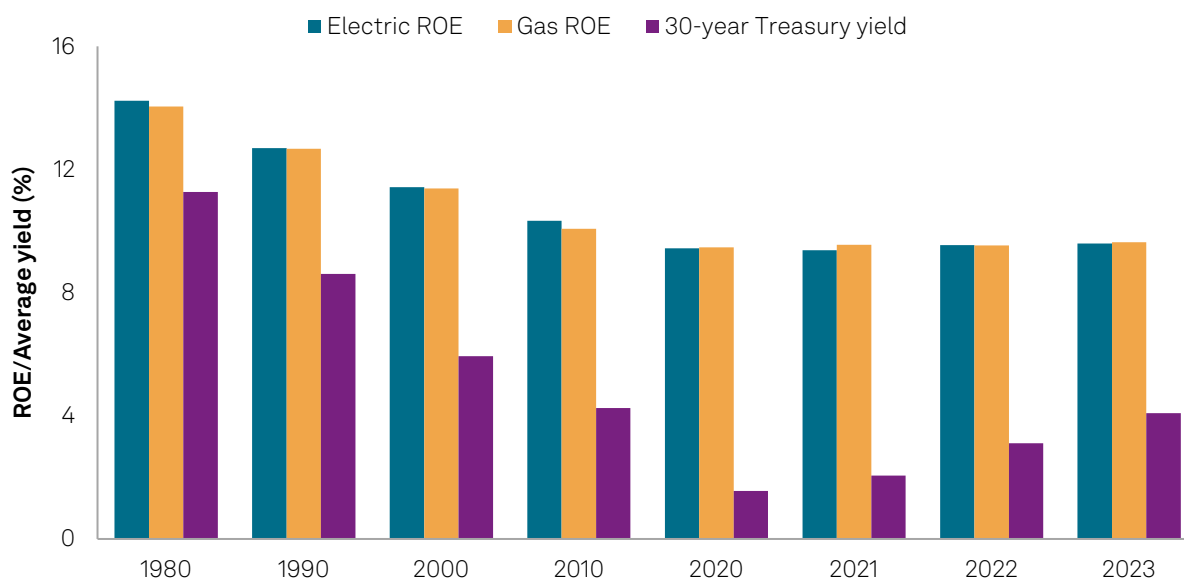
The impacts of severe weather events, such as hurricanes, winter storms and wildfires, continue to play a more prominent role in utility financial outlooks and are contributing to the active rate case agenda.

The need to recover the related costs, together with the previously listed factors, will continue to put upward pressure on rates, raising concerns about ratepayer impacts and affordability, resulting in a contraction in authorized ROEs.

Since 2020, the spread between average authorized ROEs and US Treasury bond yield contracted to roughly 550 basis points in 2023 from almost 800 basis points. By comparison, during the early 1980s, the spread between Treasuries and authorized ROEs was less than 300 basis points.

Average US utility authorized ROEs; 30-year US Treasury bond yields

Select calendar years, 1980-2022, LTM Sept. 30, 2023



Data compiled Jan. 24, 2024.
 ROE=return on equity; LTM = last 12 months.
 Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.
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The evolving energy transition presents unique challenges for the electric and gas utility sector, but also offers potential for growth. Much of the evolution has come via state legislative initiatives and energy issues continue to be a focus in the current legislative session.

Energy issues are likely to factor into the 2024 US presidential election, as well as state level elections, with gubernatorial elections scheduled in 11 states, legislative elections to be held in 44 states and utility commissioners on the ballots in 10 states.

These factors raise the overall level of uncertainty, or investor risk, across the sector. State regulators will play a pivotal role in determining the direction and magnitude of these impacts on the financial performance of the utilities that fall under their purview. How the individual jurisdictions meet these challenges will continue to inform RRA's prospective comparative risk assessments.

RRA's rankings process

RRA ranks the regulatory climate in a total of 53 state-level jurisdictions, including the District of Columbia and the New Orleans City Council, and two regulatory bodies in Texas — the Public Utility Commission of Texas regulates electric utilities, while the Railroad Commission of Texas regulates gas local distribution companies.

RRA maintains three principal ranking 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 each principal ranking categories, the numbers 1, 2 and 3 indicate relative position. The designation 1 indicates a stronger or more constructive ranking from an investor viewpoint; 2, a midrange rating; and 3, a less constructive rating.

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."

Methodology

The rankings are designed to reflect the interest of both equity and fixed-income investors across more than 30 individual metrics. The metrics are scored based on the covering analysts' subjective judgement and then aggregated to create a single score for each state, with certain categories, such as the state's history with respect to authorized equity returns, practice with respect to rate case test years and presence, or lack of alternative ratemaking provisions, weighted more heavily than others.

RRA State Regulatory Evaluations

Above Average/1	Average/1	Below Average/1
Alabama	Arkansas	Alaska
	California	Kansas
	Colorado	Montana
	Indiana	New Mexico
	Nebraska	New Jersey
	Nevada	West Virginia
	North Dakota	
	Texas — RRC	
	Virginia	

Above Average/2	Average/2	Below Average/2
Florida	Delaware	Connecticut
Georgia	Hawaii	District of Columbia
Pennsylvania	Idaho	Maryland
	Kentucky	
	Louisiana — PSC	
	Massachusetts	
	Minnesota	
	New York	
	New Hampshire	
	Ohio	
	Oregon	
	Rhode Island	
	South Dakota	
	Utah	
	Wyoming	

Above Average/3	Average/3	Below Average/3
Iowa	Illinois	Arizona
Michigan	Louisiana — NOCC	
Mississippi	Maine	
North Carolina	Missouri	
Tennessee	Oklahoma	
Wisconsin	South Carolina	
	Texas — PUC	
	Vermont	
	Washington	

Data compiled Feb. 28, 2024.
 NOCC = New Orleans City Council; PSC = Public Service Commission; PUC = Public Utility Commission;
 RRC = Railroad Commission.
 * Within a given subcategory, states are listed in alphabetical order, not by relative ranking.
 Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.
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The states are then ranked from lowest to highest and distributed among the nine categories to create an approximate normal distribution. This distribution is then reviewed by the team, and individual state rankings may be adjusted based on the covering analysts’ recommendations, subject to review by a designated panel of senior analysts.

The variables that RRA considers in determining each state’s ranking are largely the broad issues detailed in state commission profiles and those that arise in the context of rate cases, generic policy proceedings, legislation and gubernatorial directives.

RRA’s articles and reports on these issues are accessible through the S&P Capital IQ Pro platform, as are the jurisdictional commission profiles and RRA’s database of major investor-owned utility rate case decisions going back to 1980.

As implied by the above discussion, the rankings reflect not only the decisions rendered by the state regulatory commission but also the impact of the actions taken by the governor, the legislature, the courts and consumer advocacy groups. The policies examined pertain largely to rate cases and the ratemaking process, but issues such as industry restructuring, corporate governance, treatment of proposed mergers and those related to the ongoing energy transition are also considered.

In the charts within this report that depict the rankings by category, the jurisdictions within each category are listed in alphabetical order rather than by relative position within the category.

State regulatory rankings distribution — energy



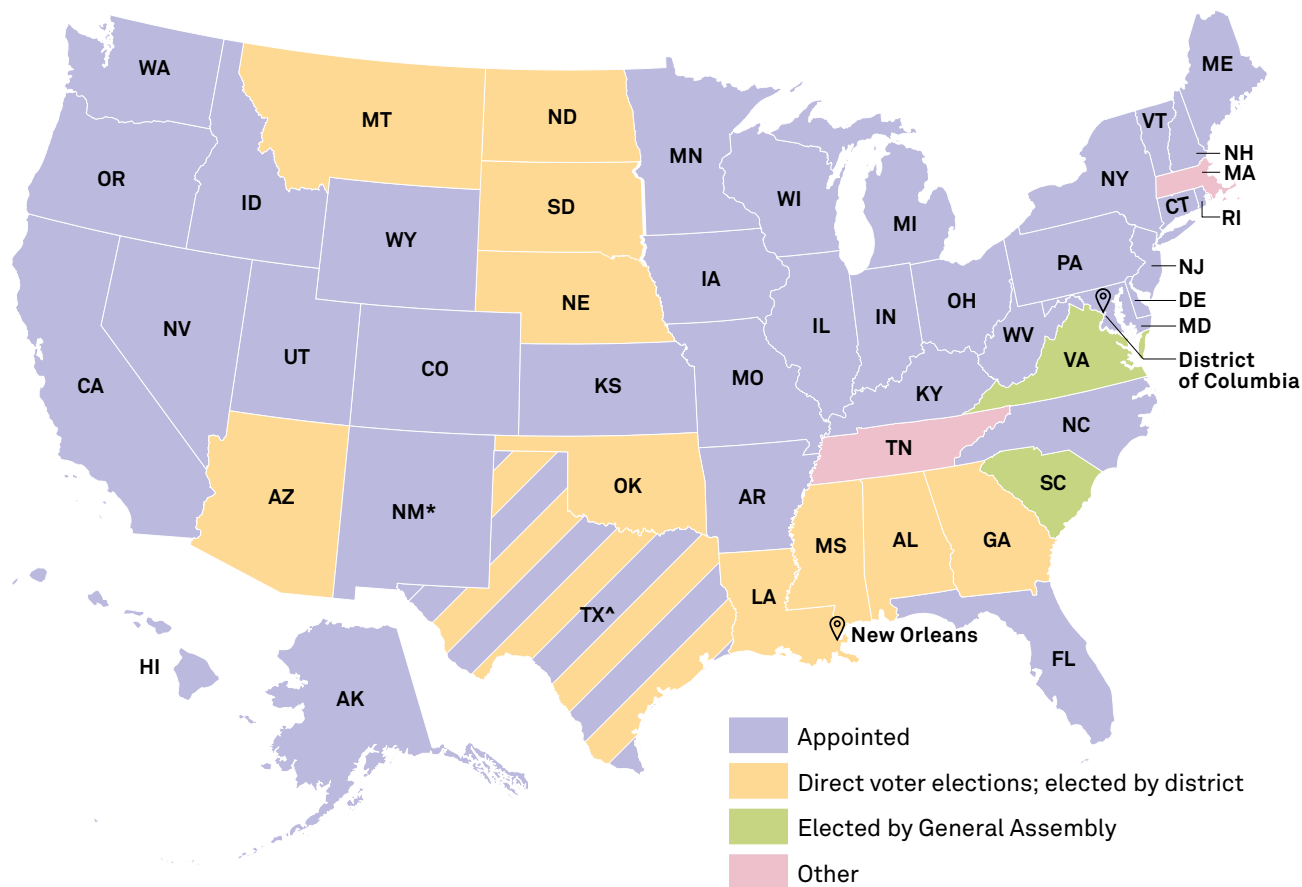
Data compiled Feb. 28, 2024.
 AA = Above Average; A = Average; BA = Below Average.
 Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.
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RRA endeavors to maintain an approximately “normal” distribution, with the majority of the rankings in the three average categories and the remainder split almost evenly between the Above Average and Below Average categories.

Governor/Mayor — Actions of the governor (or the mayor in the District of Columbia/City of New Orleans) may impact a jurisdiction’s ranking. RRA takes no view on which political party is the more constructive option but does consider: whether energy issues were a topic of debate in recent elections and what the tone/topic of the debate was; whether the governor seeks to become involved in the regulatory process; and the type of influence the governor is 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.

Commissioner selection methods in US



Data compiled Feb. 28, 2024.

* Prior to Jan. 1, 2023, commissioners were chosen through general elections.

^ The Public Utility Commission of Texas members are appointed by the governor, while members of the Railroad Commission of Texas are elected in statewide elections.

Source: Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.

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Realistically, a commissioner candidate who indicates support for the utilities and their shareholders or appears to be amenable to rate increases is not likely to be popular with the voting public. In addition, there might not be specific experience requirements to run for commissioner, so, a newly elected candidate may have a steeper learning curve with respect to utility regulatory and financial issues, which could make discerning the decisions that an individual might make more difficult and could increase uncertainty.

There have been some notable instances, however, in which energy issues played a key role in gubernatorial/senatorial elections in states where commissioners are appointed, with detrimental consequences for the utilities.

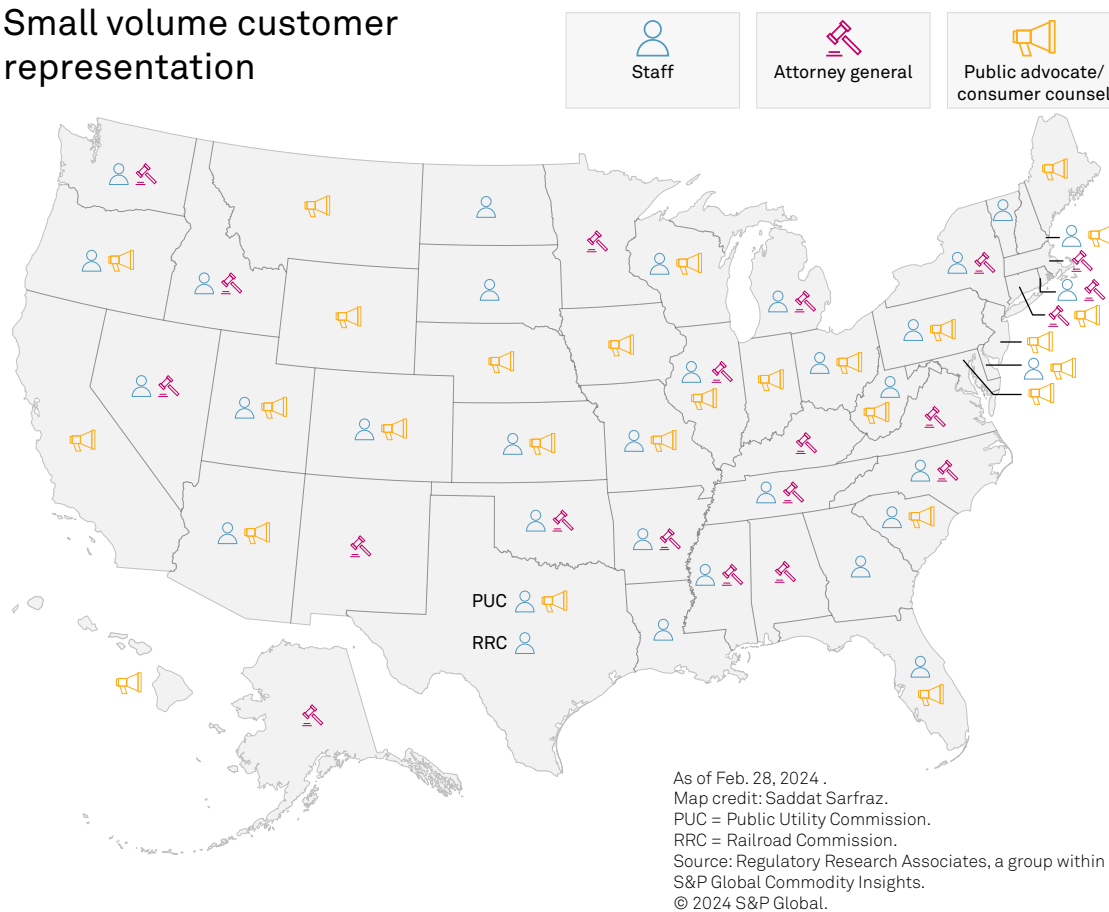
In addition, RRA looks at the commissioners themselves and their backgrounds. Experience in economics and finance and/or energy issues is generally seen as a positive sign. Previous employment by the commission or a consumer advocacy group is sometimes viewed as a negative indicator.

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 their actions or the time they will take to “get up to speed.” Controversy or “scandal” surrounding an individual and/or the potential for a conflict of interest are also crucial factors to consider.

Similarly, a high rate of turnover or the tendency to allow vacancies to stand unfilled for a long period of time adds to the level of regulatory risk in RRA’s view.

Commission staff/consumer interest — Most commissions have a staff that participates in rate proceedings. In some jurisdictions, the staff has a responsibility to represent the consumer interest; in others, the staff’s role is advisory; and in some, 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, such as the attorney general or a consumer advocate, coalitions of cities in which the utility operates, private consortia or lobbying groups that represent certain stakeholder groups and/or large-volume commercial and industrial customers that intervene directly in rate cases.

Small volume customer representation



Generally, the greater the number of consumer intervenors, the greater the level of uncertainty for investors, as in most instances, the only party representing investors' interests is the company. 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 experience and observations.

Settlements — An increasing number of cases in recent years have been resolved by settlements rather than through a fully litigated process. There are often clear incentives for utilities and entities with vested interests in the sector to compromise. Utilities often obtain settlement benefits in the form of key utility policy objectives and more timely and favorable rate case outcomes than would otherwise be achievable. In some instances, however, settlement negotiations can be protracted and extend the duration of a rate case.

A settlement may set out all of the typical rate case parameters, such as rate of return and rate base, but many are “black box” settlements. These black box settlements are filed when the parties are able to settle all, or nearly all, of their differences in the proceeding but none of the parties want to disclose the final outcome on a given issue in order to avoid establishing a precedent.

Or, during settlement discussions, each party may have contemplated a certain revenue change amount as acceptable and may have performed calculations regarding the rate base and rate-of-return parameters behind their revenue requirement positions. Different values for these inputs, however, could be used in varying combinations to determine the same revenue requirement.

In most instances, the ability of the parties to reach agreement without having to go through a fully litigated proceeding is considered constructive, particularly since it reduces the likelihood of an after-the-fact court review. However, RRA 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 even less favorable than the intervenors', or that the intervenors will take a more extreme position in a litigated framework than in a closed-door settlement negotiation, resulting in a less constructive outcome.

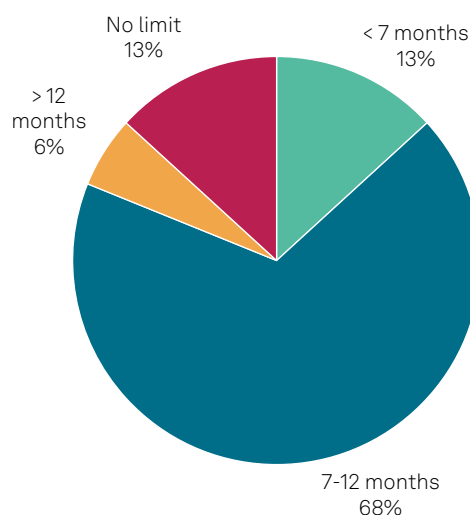
In some instances, the parties may agree on only certain issues and will execute a partial settlement on those issues, while the remaining issues in the case will be litigated.

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.

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; very few have requirements that a case be completed in less than seven months.

Shorter time frames may apply for limited-issue proceedings and as noted in the settlements section, if the parties reach an agreement, the time frame may be truncated.

Rate case time frame



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RRA generally 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. In some states, however, the time frame may be extended with the company’s agreement.

In addition, a shorter time frame for a decision generally reduces 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.

In jurisdictions that allow interim rate increases, the utility is required to refund any related over-collections, generally with interest, if the commission approves a rate change that is below the interim rates.

In some instances, an interim increase requires prior approval by the commission, which 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 procedure. 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.

Rate base — A utility’s rate base is essentially the company’s “prudent” capital investment as determined by the applicable regulatory authorities, net of accumulated depreciation and other adjustments. Rate base is the net asset base of an electric, gas or water utility upon which an allowed rate of return — usually the company’s weighted-average cost of capital — is applied. The rate base value is a key variable that regulatory bodies use in a rate case to determine a utility’s revenue requirement.

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.

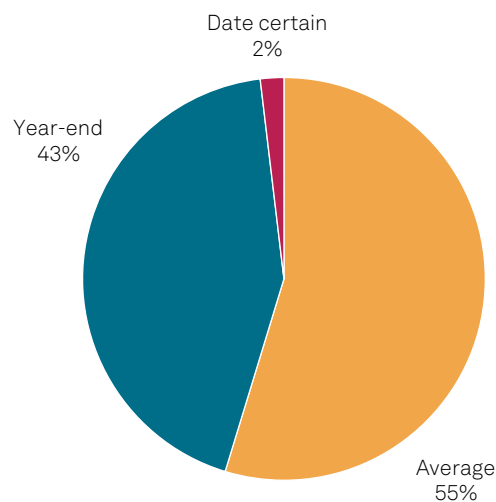
A key factor in assessing whether the company has been accorded a reasonable opportunity to earn the authorized return is the methodology the commission uses to determine rate base.

Commissions are about evenly split between those that employ a year-end, or terminal, valuation and those that utilize an average approach, with one using a “date certain” methodology. In some instances, the commission may employ a different rate base valuation method, depending on the utility type or case type, or based on the test year selected by the company. For example, a forward-looking test year may be used in a limited-issue rider proceeding or an MRP, even though a historical test year is used in traditional single-step base rate cases. Some states allow the utility to choose between a forecast or historical test year but require that an average rate base be used if a forecast test year is requested, while a year-end rate base must be used if a historical test period is selected.

In general, assuming that rate bases are rising, i.e., new investment is outpacing depreciation, a year-end valuation is preferable from an investor viewpoint.

This again 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

Rate base valuation method



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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 in periods where operating costs are rising and/or the company is making significant investments in infrastructure and other capital items.

The rules with respect to what constitutes a known and measurable adjustment, however, are not always specific, and there can be a good deal of controversy about what is and is not acceptable under state law or commission rules.

Another key consideration is whether state law and/or the commission generally permits the inclusion in rate base of construction work in progress (CWIP) for a cash return. CWIP represents assets that are not yet, but ultimately will be, operational in serving customers. Some states prohibit inclusion in rate base of items that are not currently, i.e., during the test year or within a reasonably short period of time following the end of the test year, “used and useful” in providing service to customers, thus CWIP must be excluded.

In these instances, the companies are permitted to accrue allowance for funds used during construction (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.

Investors generally view the 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. In addition, if the company is not able to time its next rate case to coincide with the in-service date of a project, there may be a time period where the plant is operating and, therefore, the company can no longer accrue AFUDC, but the utility is incurring operations and maintenance costs and booking depreciation expense, none of which are yet reflected in rates.

This becomes particularly challenging when the utility’s construction program consists of several smaller projects with short ramp-up times, making it more difficult for the company to file a case quickly enough to reflect each new project.

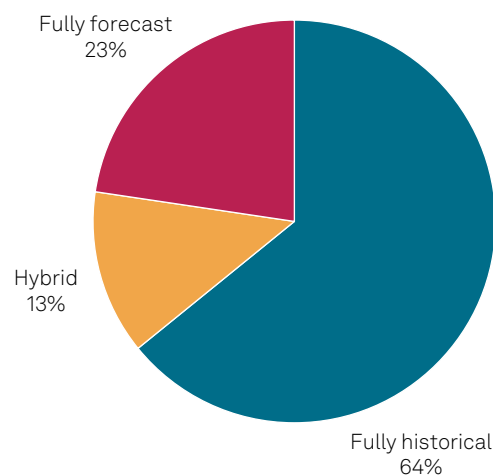
Test year — The rate case test year is simply the 12-month period used as a baseline in examining the utility’s actual revenues, expenses and rate base. In assessing the level of regulatory risk, RRA examines whether a historical test year is chosen or a future 12-month period with a forecast of the utility’s revenues, expenses and rate base.

Some states employ a hybrid approach, which is a combination of the two methods. In these instances, the test year is partially forecast at the time the case is filed but is historical by the time the case is decided. The company generally files updates during the course of the proceeding to reflect actual results as they become available.

In some states, the commission uses a historical test year for single-year base rate cases, but uses forward-looking test years for multiyear rate cases, alternative regulation plans and/or adjustment clauses.

Almost two-thirds of the 53 jurisdictions covered by RRA utilize a test year that is historical at the time of filing. As with rate base valuation, commissions in some states use different test period types for different kinds of proceedings or utilities.

Rate case test year



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A fully forecast test year is generally considered to be most constructive, particularly in periods of robust level of capital spending, high inflation and rising interest rates. The use of a historical test year in these periods would exacerbate regulatory lag, as the ultimately approved rates would likely not fully reflect the utility's cost to provide service.

Many of the jurisdictions allow for known and measurable adjustments to the test year, but there is considerable variability regarding how far beyond the end of the test year these adjustments may go, and statutes governing the definition of known and measurable can be ambiguous. Consequently, there can be wide disagreement among the rate case parties as to which adjustments qualify.

Conversely, in periods where there is only a modest amount of capital spending, i.e., depreciation is outpacing new spending, low inflation and falling interest rates, the use of a historical test year and the associated regulatory lag would actually work in the utility's favor, as rates would likely reflect higher costs than the utility is actually incurring.

Rate of return — The capital structure, debt cost rates and authorized equity return combine to determine the company's weighted average cost of capital, which is known as the return on rate base in the context of a rate case.

The authorized ROE is perhaps the single-most litigated issue in any rate case. Commissions generally rely on financial formulas, such as the discounted cash flow, capital asset pricing model and risk premium approaches, as applied to a proxy group of companies with similar risk characteristics.

While these financial models appear objective, there are subjective judgments that go into many aspects of the analysis: the appropriate peer group; the level of risk in the subject company's operations and how it may differ from that of the proxy group; and whether there are any other factors that warrant an adjustment to the base calculations.

There are two ROE-related issues that RRA considers when evaluating an individual rate case and the overall regulatory environment: (1) how the authorized ROE(s) 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.

In establishing rankings, RRA looks at the ROEs historically authorized utilities in a given state and compares them to utility industry averages, as calculated in RRA's Major Rate Case Decisions Quarterly Update reports. When referring to these "averages," RRA means the simple average of the ROEs approved in cases decided in a particular period; returns carried over from prior years are not included in the averages.

Authorized ROEs overall declined steadily from 1980 to 2014 and fell below 10% for the first time in 2011 for gas utilities and in 2014 for electric utilities, remaining below that benchmark since.

Interest rates were a key factor driving authorized ROEs downward, but commission determinations that various alternative or innovative ratemaking mechanisms have reduced risk for the companies and their investors across the board played a role as well.

Between 2015 and 2018, RRA observed a modest recovery in authorized ROEs, as the US Federal Reserve unwound its quantitative easing policy and implemented a series of gradual interest rate increases. As has typically been the case, authorized ROEs lagged interest rate trends somewhat and continued to rise modestly during 2019, even though the US Federal Reserve lowered interest rates by 75 basis points that year in order to combat a slowing economy.

In 2020, with the US economy challenged by fallout from the COVID-19 pandemic, the average of the equity returns authorized for both electric and gas utilities nationwide fell to their lowest levels then on record, with the Fed lowering interest rates 150 basis points in the early part of that year.

Interest rates remained stable during the latter half of 2020 and all of 2021; meanwhile, the average gas ROE rebounded slightly but remained near historical lows, while the electric ROE continued to decline.

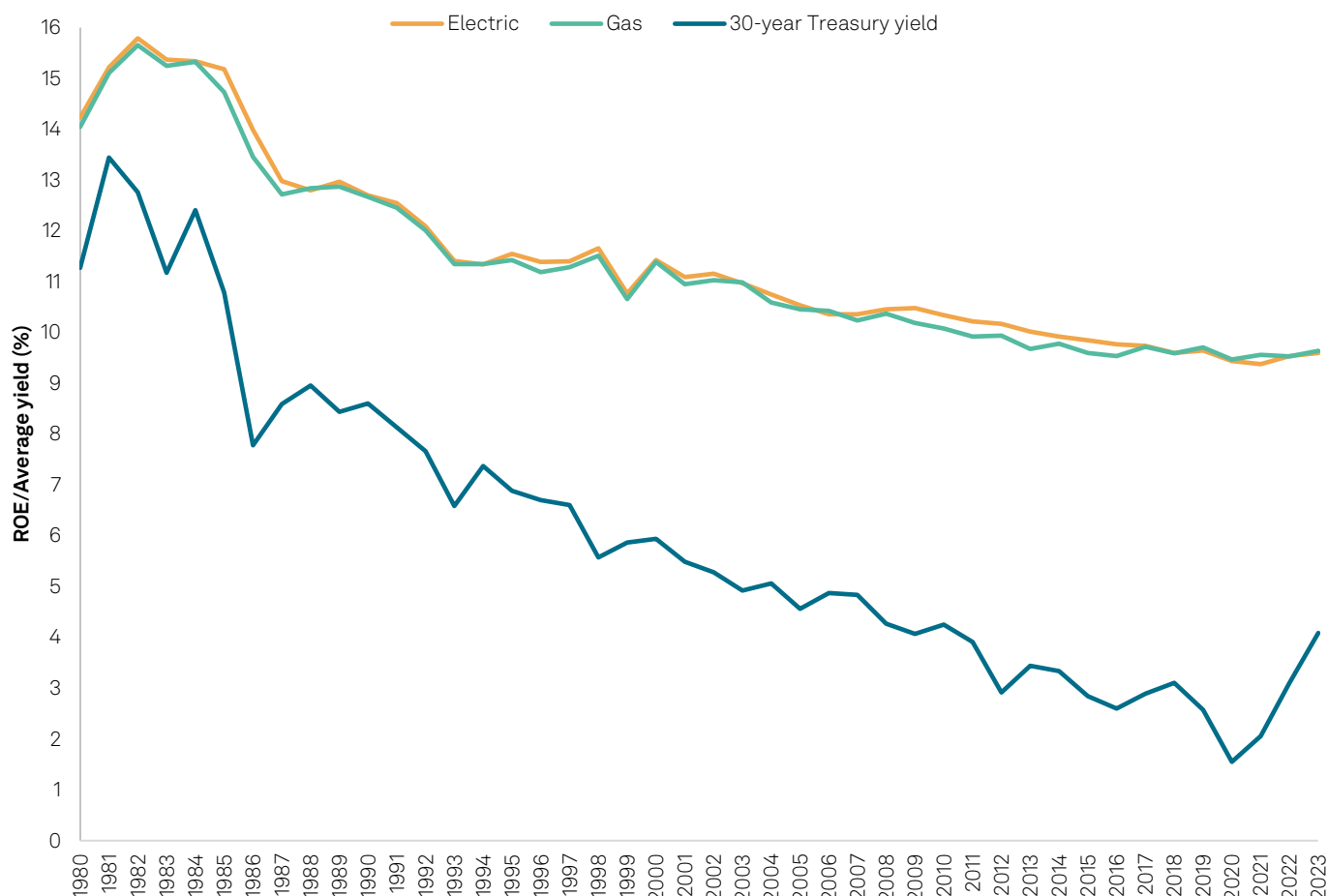
In 2022, to combat burgeoning inflation, the Fed increased interest rates seven times for an aggregate increase of 425 basis points that year. The average ROE authorized in electric rate cases decided in 2022 ticked up slightly to 9.54%, while the average authorized ROE for gas utilities fell slightly to 9.53%.

In 2023, the Fed implemented four changes, raising interest rates by 100 basis points in aggregate.

Against this backdrop, the authorized ROE for electric utilities rose modestly to 9.60% in rate cases decided during 2023. The average ROE authorized for gas utilities was 9.64% in cases decided in 2023.

Average authorized ROE for US utilities, 30-year Treasury bond yields

Calendar years 1980 - 2023



Data compiled Feb. 28, 2024
 Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.
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How the authorized ROEs in a given state compare to prevailing nationwide industry averages is one aspect that RRA looks at, but there is more to it. Any given utility may be authorized a relatively high ROE, but factors such as the age or “staleness” of the test period, rate base valuation method, adjustments to company-proposed rate base and expenses, and the way 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, a given rate case decision may be restrictive from an investor viewpoint, even though the authorized ROE is equal to or above the average.

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 achieve on a prospective basis.

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 deviate from expectations.

The equity layer in the authorized capital structure is another aspect of a commission rate case decision that may impact the utility’s ability to earn the authorized ROE. Most commissions utilize the company’s actual capital structure at a given point in time, but in some instances, the commission may rely on an imputed capital structure that represents a mix of debt and equity that the commission views as more reasonable or economically efficient. These are known as hypothetical capital structures.

In others, the commission may include short-term debt and/or other items not generally considered to be part of the utility’s cost of capital for financial reporting purposes, such as job development investment tax credits, customer deposits or accumulated deferred taxes (as an alternative to reflecting accumulated deferred tax balances as an offset to rate base). These are generally considered “ratepayer supplied capital” and are accorded a blended cost based on the company’s financial weighed average cost of capital or may be assigned a cost rate of zero. Such capital structures are known as regulatory capital structures.

If a commission uses a capital structure that is more highly leveraged than the company’s actual structure, this will lower the authorized overall return and the revenue requirement ultimately approved and render it more difficult for the company to earn the authorized return on its actual equity, all else being equal.

The cost rates for long- and short-term debt are generally set at the weighted average interest rate on the outstanding issuances. The cost of preferred stock, where there is any, is set based on the guaranteed dividend rate on the outstanding shares. While it is rare, a commission may choose to exclude a recent debt refinancing that alters the company’s debt cost rate or may determine that the company was slow to take advantage of opportunities to refinance debt at a lower cost rate. If this occurs, and the senior capital cost rates used to set rates are lower than those that the company will experience while rates are in effect, then the utility will have a more difficult time earning its authorized ROE.

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 severe weather events or the COVID-19 pandemic, or for volatile expenses, such as fuel and 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 to mitigate underearnings or eliminate an overearnings situation without reducing rates. These types of practices are generally considered to be constructive from an investor viewpoint.

Federal tax law changes that became effective in 2018, particularly the reduction in the corporate federal income tax rate to 21% from 35%, had sweeping impacts on utilities, causing a flurry of related ratemaking activity during 2018 and 2019.

For most of the companies, rates were initially reduced to reflect the ongoing impact of the lower tax rate; refunds were later ordered to return to ratepayers amounts related to deferred overcollections over relatively short time periods; and the utilities were directed to amortize the related excess accumulated deferred federal income tax (ADFIT) liabilities generally over extended time frames. For “protected” ADFIT balances, the liabilities were ordered to be amortized over the lives of the companies’ assets that gave rise to the ADFIT balances; for liabilities tied to “unprotected assets,” the balance was most often required to be amortized over five to 10 years.

In the wake of the energy transition movement, an increasing number of fossil generation facilities and legacy meters are being retired early. Other types of utility assets are also at risk of becoming “stranded” costs as the transition progresses. In some states, companies have been permitted to accelerate depreciation of certain facilities to complete recovery of the investment prior to an accelerated shutdown of the asset. In others, the utilities are permitted to defer the remaining book value at closure as a regulatory asset that is to be recovered over a period of years; the unamortized balance may or may not be accorded a return.

Alternative regulation — RRA generally views as constructive the adoption of alternative regulation plans that are designed to streamline 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 the company 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, etc.

Broad-based plans include ROE-based sharing mechanisms, formula-based rates and MRPs that apply to all cost-of-service issues rather than specific investments or expenses. There may also be performance-based incentives included in these types of plans.

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 — if any deadband that applies is symmetrical around the ROE target, and whether variations from the benchmark or outside the deadband are shared symmetrically.

Formula-based ratemaking plans generally refer to frameworks where the commission establishes a revenue requirement, including a target ROE, capital structure and rate of return for an initial rate base as part of a traditional cost-of-service base rate proceeding. Once the initial parameters are set, rates may adjust periodically to reflect changes in expenses, revenue and capital investment. These changes generally occur on an annual basis, and there may be limitations on the percentage change that can be implemented in a given year or a period of years.

Others use MRPs, under which the commission approves a succession of rate changes that are designed to consider anticipated changes in revenues, expenses and rate base. The commission may approve a static authorized ROE, or the plan may provide for adjustments to the ROE during the plan's term. These plans often include true-up mechanisms to ensure that the company makes the investments it committed to at the time the plan was approved. The plans often include earnings-sharing mechanisms and may also include PBR provisions or stay-out provisions, preventing a company from filing a successive rate case until a future point in time.

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 and sometimes protracted litigation as appeals go through several layers of court review may add an untenable degree of uncertainty to the regulatory process. Also, as is the case with 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 profiles provide statistics regarding the makeup of each state legislature, RRA has not found a specific correlation between the quality of energy legislation enacted and the political party controlling the legislature.

If the governor and legislature are of the same political party, it is less likely that controversy will arise around key policy initiatives, which may directly or indirectly impact the energy regulatory framework. In instances where energy issues are a main focus, a lack of consensus between the legislative and executive branch of the state government can create uncertainty and increase risk not only for utility investors but for other industry stakeholders as well.

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 only "protecting" the consumer; whether the legislation takes a long-term view or is a "knee-jerk" reaction to a specific set of circumstances; and whether it could constrict the utilities' opportunities to achieve their business objectives.

Legislative activity impacting utility regulatory issues has been robust in recent years, as state policymakers, utilities and industry stakeholders seek to address "disruptors" that challenge the traditional regulatory framework.

RRA follows these developments closely with an eye toward assessing whether the states are taking a balanced, sustainable approach and how legacy utility providers will be affected by the policies being adopted.

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 preapproval of all securities issuances, limitations on leverage in utility capital structures, dividend payout limitations, ring fencing protocols and authority over mergers. Corporate governance may also include oversight of affiliate transactions.

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, limit the company's financial flexibility or significantly reduce the company's ability to pursue strategic mergers would be viewed as restrictive.

In recent years, RRA has observed an increasing emphasis on environmental, social and governance issues, and supplier and workforce diversity and social justice issues. In many instances, these policies are part and parcel of the ongoing energy transition. At this time, RRA takes no view on whether policymakers/regulators should adopt these practices, but where specific policies or targets are implemented, RRA evaluates the way costs associated with compliance are addressed.

M&A activity — During the 1980s and early 1990s, there was not a lot of M&A activity in the sector. The years 1998 through 2000 saw a spike in activity, a lot of which centered around electric industry restructuring. After that, activity moderated but has remained fairly steady.

Though activity slowed during the first half of 2020 due to the COVID-19 pandemic, transactions regained their momentum in the latter half of the year. The number of deals has since remained stable, but the transactions more often center on specific assets or business lines versus whole-company transactions; there continues to be interest from private equity, primarily infrastructure funds, with a handful of partial ownership transactions taking place in the last few years.

Aside from the involved entities' boards of directors and shareholders, deals involving regulated utilities must be acceptable to some, or all, of a variety of federal and state regulatory bodies. The states generally look at the day-to-day issues, such as the impact on rates, safety and reliability.

Looking more closely at the role of state regulators, 50 of the 53 non-federal jurisdictions that RRA follows have some type of review authority over proposed mergers. In Indiana and Florida, preapproval by state regulators is not required before a transaction can proceed. Approval by the Texas PUC is required before a transaction involving an electric utility can take place, but Railroad Commission of Texas approval is not required for a transaction involving a gas local distribution company.

In evaluating a commission's stance on mergers, RRA looks at several broad issues, such as whether there is a statutory time frame for consideration of a transaction and, where there is no statutory deadline, the amount of time a commission generally takes to review a proposed deal.

For the 50 jurisdictions where commission preapproval is required, the review process and standards vary widely. In 20 of the jurisdictions, the commission must complete a merger review within a prescribed period, but the remaining jurisdictions have no timeline for their merger reviews, which means a commission could effectively "pocket veto" a transaction by delaying a decision until either the merger agreement between the applicants expires or pursuing the transaction is no longer feasible.

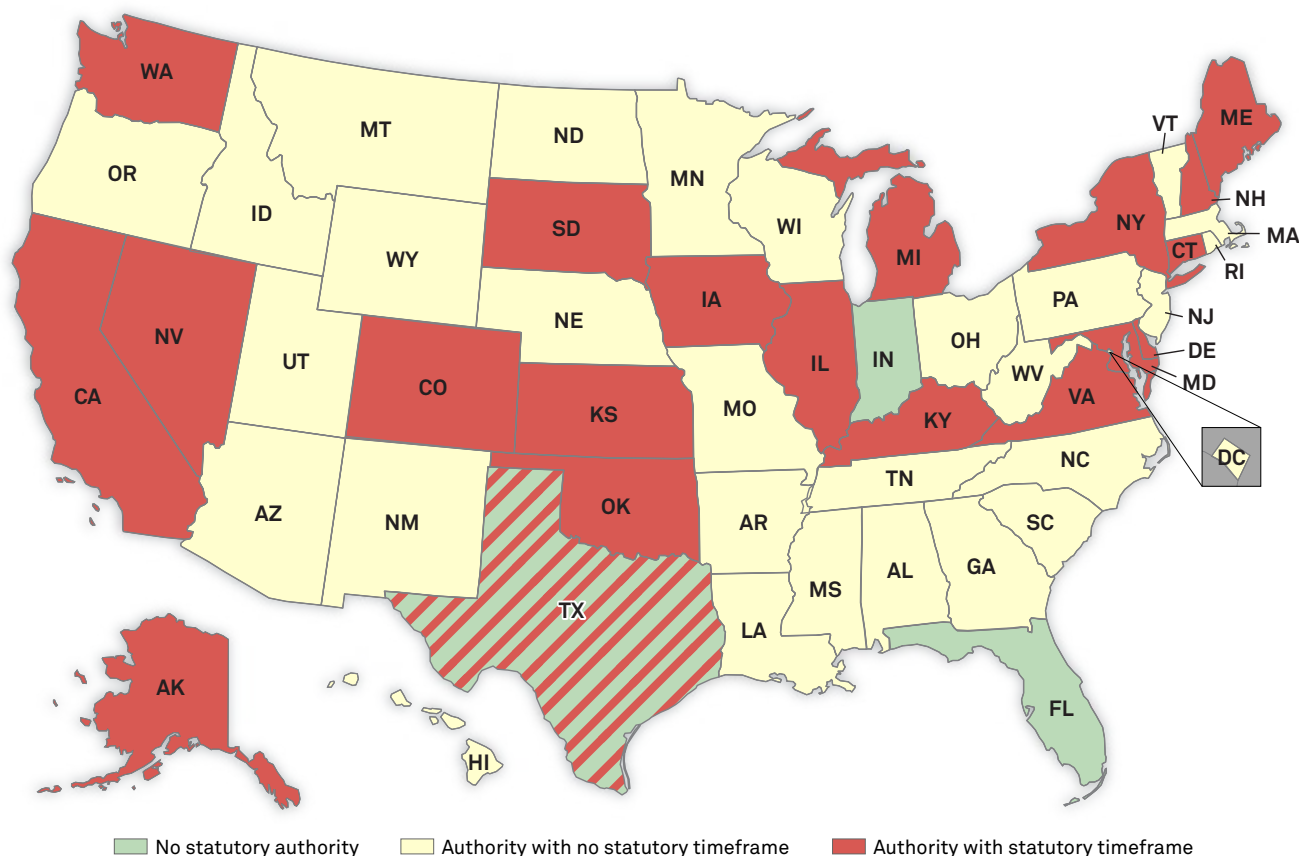
The definition of what constitutes a transaction that is subject to review can vary widely and may include sales of individual assets or a marginal minority interest, as well as larger transactions where a controlling interest or the whole company is changing hands. State law often lacks specificity with respect to what constitutes a transaction that is subject to regulatory review.

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 in specific situations.

For discussion purposes, RRA groups the statutory standards into three general buckets: public interest, which is generally thought to be the least restrictive; no net ratepayer harm, which is somewhat more restrictive; and net ratepayer benefit, which is the most restrictive.

In many instances, regulators have broad discretion to interpret what the statutes mean by these terms. So, the standard of review is often more readily apparent by looking at how prior transactions were addressed than by reading the statutory language — one commission's public interest might be another's net ratepayer benefit.

Utility mergers – statutory authority



As of Feb. 28, 2024.

In Texas, mergers involving electric utilities are subject to commission review; mergers involving local gas distribution companies are not.

Map credit: Arleigh Andes.

Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.

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In addition, RRA considers whether a settlement was reached among the parties and, if so, whether the commission honored that settlement or required additional commitments. RRA also examines how politicized the process was: Did the governor (or the mayor in the District of Columbia and City of New Orleans) play a role? Did the transaction garner a lot of local media attention in the affected jurisdiction?

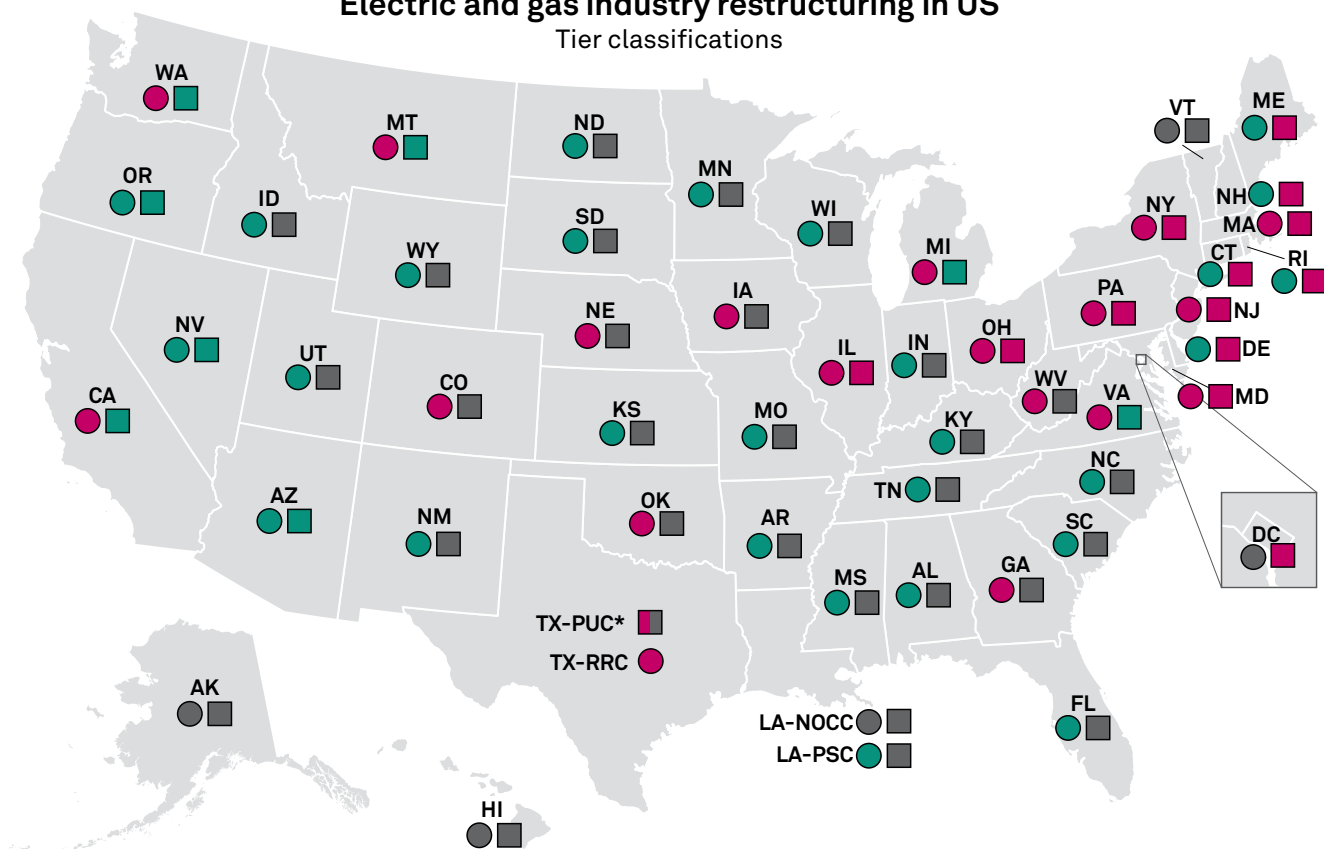
More narrowly, RRA reviews the conditions placed on the commission’s approval of these transactions, including: whether the company will be permitted to retain a portion of any merger-related cost savings; if guaranteed rate reductions or credits are required that are or are not directly related to merger savings; whether certain assets were required to be divested; the type of local control and workforce commitments required; whether there are requirements for certain types of investment to further the state’s public policy goals that may or may not be consistent with the companies’ business models and if the related costs will be recoverable from ratepayers; and whether the commission placed stringent limitations on capital structure and/or dividend policy or composition of the board of directors.

Electric regulatory reform/industry restructuring — Electric industry restructuring refers to the implementation of a framework under which some or all retail customers can obtain their generation service from a competitive supplier of their choice. In a movement that began in the mid-1990s, about 20 jurisdictions implemented retail competition for all or a portion of the customers in the utilities' service territories. The last of the transition periods ended as recently as 2011, when restructuring-related rate freezes concluded for certain Pennsylvania utilities.

Once the transition periods were completed, RRA focused more on how standard-offer or default service is procured for customers who do not select an alternative provider and how much, if any, market-price risk the utility must absorb. RRA classifies each of the regulatory jurisdictions into one of three tiers, based on their relative electric industry restructuring status.

Electric and gas industry restructuring in US

Tier classifications



Gas tiers

- Tier 1 ● All customers are permitted to competitively procure their gas supply, irrespective of volumes.
- Tier 2 ● Select customers are permitted to competitively procure their gas supply, usually based on volume.
- Tier 3 ● All customers procure their gas supply from the utility under bundled rates.

Power tiers

- Tier 1 ■ Power prices are competitively determined for all retail customers within the jurisdiction; both standard-offer-service and retail-access customers. Retail access is permitted for all customers.
- Tier 2 ■ Retail access is permitted to at least some customers/customer classes. Competitively priced power is limited to retail access customers. Power prices for standard-offer-service customers remain regulated. For the most part, utilities remain vertically integrated.
- Tier 3 ■ Power prices are fully regulated for all retail customers. All retail customers must purchase their power from the franchised utility. Utilities are vertically integrated.

As of Feb. 28, 2024.

NOCC = New Orleans City Council; PSC = Public Service Commission; PUC = Public Utility Commission; RRC = Railroad Commission.

* One in the Electric Reliability Council of Texas territory; three outside of it.

Map credit: Joe Felizadio.

Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.

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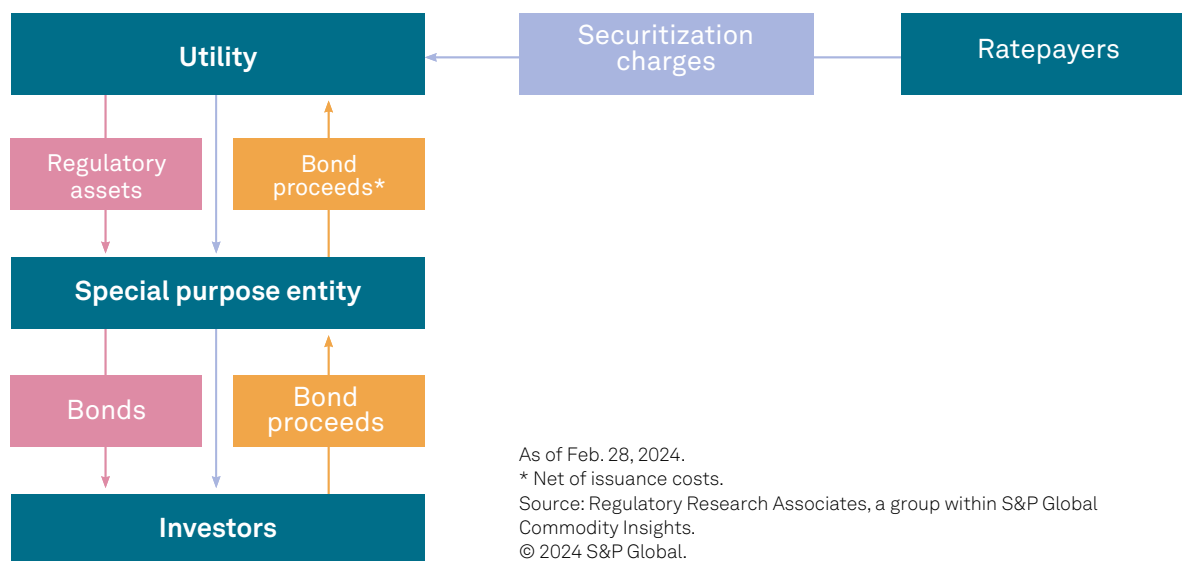
Gas regulatory reform/industry restructuring — Retail competition for gas supply is more widespread than electric retail competition, and the transition was far less contentious, as the magnitude of stranded asset costs was much smaller due to the more disaggregated structure of the industry.

Large volume customers in most states can select their gas supply provider; the availability of gas customer choice is much more limited for small-volume customers. Like 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 way stranded costs were addressed and how default-service, obligation-related costs are recovered.

Securitization — As it pertains to utilities, securitization refers to the issuance of bonds backed by a specific existing revenue stream that regulators and/or state legislators have “guaranteed.” This does not mean that the securities are backed by the “full faith and credit” of the jurisdiction, but instead provides certainty that the revenue collections and/or underlying assets cannot be deemed imprudent and disallowed in the future.

Securitization generally requires a utility to assign an eligible regulatory asset and a designated revenue stream for that asset to a “bankruptcy remote” special-purpose entity or trust; in some instances, a state financing authority fulfills this role. The trust or financing authority in turn issues bonds that will be serviced by the transferred revenue stream. The proceeds from the bond issuance flow to the utility, and in many cases, are used to retire outstanding higher-cost debt and/or buy back common equity, thus lowering the company’s weighted average cost of capital.

Securitization flow chart



While it is unclear if securitization requires legislation, a specific legislative mandate generally improves the rating accorded securitization bonds and lowers the associated cost of capital, given that a legislatively supported revenue stream may be more difficult to rescind than a stand-alone order of a state commission. In RRA’s experience, no state commission has authorized securitization in the absence of enabling legislation.

Securitization is viewed as an attractive option because it allows regulators to minimize the customer rate impacts related to recovery of a particular utility asset. The carrying charge on the asset would be the lower interest rate applied to a highly rated, usually AAA, corporate bond rather than the utility's weighted-average cost of capital or even the interest rate on typical utility bonds, which are generally rated BBB and carry higher interest rates.

At the same time, securitization reduces the investment risk for the utility by providing the utility up front recovery of its investment in what are usually non-revenue-producing assets. The company can then redeploy those investment dollars elsewhere.

The energy industry's introduction to asset securitization occurred in the mid-1990s when legislation was enacted in certain states, enabling utilities to securitize mandated conservation investments.

In the late 1990s and early 2000s, several states that implemented retail competition for electric generation enacted legislation allowing securitization to be used for items such as: recovery of uneconomic generating or other physical assets; costs associated with above-market purchased power contracts; regulatory assets; nuclear decommissioning costs; and other items that had the potential to become unrecoverable, or stranded, in a fully competitive market for generation supply.

In recent years, changing industry dynamics have once again begun to raise concerns about the prospects of stranded costs, and in some cases, securitization is being used to address generation facilities that are retired prematurely.

Securitization has also been used as part of bankruptcy-related reorganization plans to finance fuel/purchased power balances, distribution system improvements and demand-side management programs, and recover extraordinary storm costs.

Most recently, certain states have allowed companies to securitize extraordinarily large, deferred fuel balances that arose due to price volatility in commodity markets caused by weather events and the ongoing impacts of the war in Ukraine on global markets and supply chains.

Adjustment clauses — Since the 1970s, adjustment clauses have been widely utilized to allow utilities to recover fuel and purchased power costs outside of base rate cases, as these costs are generally subject to a high degree of variability. In some instances, a baseline level is reflected in base rates, with only deviations from that amount addressed in the adjustment clause, whereas 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 were expanded in some jurisdictions to include items such as pension and healthcare costs, demand-side management program costs, Federal Energy Regulatory Commission-approved regional transmission organization costs, new generation plant investment, and transmission and distribution infrastructure spending.

RRA generally views the use of these types of mechanisms as constructive, but also looks at the frequency with which the adjustments occur, as well as whether: there is a true-up mechanism; adjustments are forward-looking or based on a historical period; a cash return on CWIP is permitted for mechanisms involving new investments; the mechanism includes an earnings-sharing mechanism that offers the utility upside earnings potential; or incentive(s) for making certain types of investment or for achieving benchmark performance that provide the opportunity to increase earnings.

Another class of adjustment clauses, known as revenue decoupling mechanisms, allows utilities to adjust rates between rate cases to reflect fluctuations in revenues versus the level approved in the most recent base rate case due to a variety of factors.

Some of these factors, such as weather, are beyond a utility's control, and the mechanism can work both ways — it can allow the company to raise rates to recoup revenue losses associated with weather trends that reduce customer usage, and conversely, it can also require the company to reduce rates when weather trends cause usage to be higher than normal.

As energy efficiency initiatives have expanded, decoupling mechanisms have also been implemented to reduce the disincentive for utilities to pursue these types of programs by making the utilities whole for reductions in sales volumes and revenues associated with customer participation.

Some of these mechanisms also allow the utility to adjust rates to reflect fluctuations in customer usage that are brought about by broader economic issues, such as demographic shifts, large commercial/industrial customers migrating to other service areas, businesses shutting down due to changes in their respective industries, recessions and, theoretically, broad-based crises like the COVID-19 pandemic.

RRA considers a decoupling mechanism that adjusts for all three of these factors to be a “full” decoupling mechanism and designates those that address only one or two of these factors as “partial” decoupling mechanisms.

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 more than its authorized return or if the adjustment exceeds a certain threshold.

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 preapproval of the ratemaking parameters and/or a specific cost for a 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 based on the expected level of support a utility proposal receives from regulators.

Renewable energy/emissions requirements — Goals for renewable energy deployment and emissions reductions have become increasingly intertwined in recent years and often need to be viewed in tandem.

As with retail competition, RRA does not take a stand as to whether the implementation 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 preapproval and/or cost-recovery mechanism for investments in projects, designed to comply with these standards.

RRA also reviews if there is a mechanism, such as a rate increase cap, that limits the impact of the related public policy goals on customers. Such a mechanism could impede the utility's ability to recover program-related costs, pursue additional 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.

The proliferation of renewables, particularly those that are customer-sited or distributed resources, and the related rise of battery storage and electric vehicles have raised questions regarding the traditional centralized industry framework and whether that framework needs to change, ushering in a second phase of electric industry restructuring. How these changes are implemented is something RRA considers in its rankings.

With respect to emissions, the threat of a federal carbon emissions standard for utilities and the spread of state-level initiatives have caused many companies to rethink legacy coal-fired generation, causing plants to be shut down sooner than anticipated. The way the commissions address these potential stranded costs also poses a risk for investors and is factored into the rankings.

The zero-carbon movement has also caused utilities/states to reexamine investments in nuclear facilities and, in some cases, to develop programs designed to support the continued operation of those facilities, even though they may not be economic from a competitive-market standpoint. RRA also considers the way these issues are addressed.

Rate structure — RRA looks for existing rate structures related to economic development or load retention. If such structures are in place, RRA examines whether and how any associated revenue shortfall is addressed. More broadly, RRA looks at any steps taken in rate cases to reduce/eliminate interclass rate subsidies, i.e., to equalize rates of return across customer classes.

In addition, RRA considers whether the commission has adopted or moved toward 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 providing the utility greater certainty of recovering its fixed costs.

This is increasingly important in an environment where weather patterns are more volatile, organic growth is limited due to the economy, and the proliferation of energy efficiency/conservation programs and large amounts of nonrevenue-producing capital spending is required to upgrade and strengthen the grid.

In conjunction with the influx of renewables and distributed generation, issues surrounding the level of compensation owed to customer-owners for excess power they put back into the grid have become increasingly important and, in some instances, controversial. The way these pricing arrangements, known as net metering, are structured can impact the ability of the utilities to recover their fixed distribution system costs and, by extension, their ability to earn their authorized returns.

RRA also looks at whether the state has implemented policies to address electric vehicle charging and time-of-use rates, as well as tariffs for renewable natural gas.

Fixed vs. variable costs

Fixed	Variable
Depreciation	Gas commodity
Delivery O&M	Electric commodity
Property taxes	Generation O&M
Return on investment	
Customer service	

Data compiled as of Feb. 28, 2024
 O&M=operations and maintenance.
 Source: Regulatory Research Associates, a group within S&P
 Global Commodity Insights.
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Further Reading

Jurisdictions with ranking changes

[Concerning pattern of restrictive Ill. rate actions prompts rankings revision](#)

[Va. legislators fill long-standing utility commission vacancies](#)

[Quality of regulatory climate shifts in 5 US state-level jurisdictions](#)

Jurisdictions to watch

[UNS Electric rate case decision viewed as constructive for investors](#)

[Conn. Consumer Counsel recommends rate reductions for Avangrid gas utilities](#)

[Duke Energy Florida proposes multiyear rate increase for grid upgrade, new solar](#)

[With new grid plan coming, Commonwealth Edison seeks review of past rate orders](#)

[Unsatisfied with recent Illinois rate orders, Ameren set for possible rehearing](#)

[Alliant solar generation projects approved for future ratemaking in Iowa](#)

[Ky. trend of altering settlement terms continues with Kentucky Power case ruling](#)

[New Jersey Natural Gas seeks rate hike to reflect new investment, shore up ROE](#)

[PSE&G files for 1st electric, gas rate increases since 2018](#)

[With sting of last Okla. decision barely behind it, AEP utility seeks rate hike](#)

[Texas PUC gains new chairman; 1 vacancy remains](#)

[Wyo. regulator reduces PacifiCorp's power costs, maintains allocation method](#)

[Heading into 2024, 12 state-level utility regulatory bodies bear watching](#)

Industry trends

[Macro factors, industry evolution to challenge US utilities in 2024](#)

[Energy authorized returns up modestly as rate case activity soared in 2023](#)

[Average authorized energy ROEs rise in 2023 amid record rate case activity](#)

[Key state-level races take shape as 2024 US election cycle gets underway](#)

[Rate requests by US energy utilities set record in 2023 for 3rd straight year RRA](#)

RRA reference reports

[The rate case process: a conduit to enlightenment](#)

[Rate base: It's more complicated than it sounds](#)

[Frequently Asked Questions](#)

For detailed information about each jurisdiction's policies and regulatory ranking, visit the [Commissions page](#) on S&P Capital IQ Pro.

For a full listing of past and pending rate cases, rate case statistics and upcoming events, visit the [Energy Research Home Page](#) on S&P Capital IQ Pro.

For a complete, searchable listing of RRA's in-depth research and analysis, please go to the [Energy Research Library](#) S&P Capital IQ Pro.

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Regulatory Research Associates, a group within S&P Global Commodity Insights, is the leading authority on utility securities and regulation. Understanding the financial and strategic impact of federal and state regulation is a key to success in the energy business. For more than 40 years, Regulatory Research Associates has been the leading provider of independent research, expert analysis, proprietary data and consultation on utility securities and regulation. S&P Global Commodity Insights produces content for distribution on S&P Capital IQ Pro.

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Major energy rate case decisions in the US — January-March 2024

Quarterly update on decided rate cases

Lisa Fontanella, Research Director

Contributors: Brian Collins, Jim Davis, Russell Ernst, Lillian Federico, Monica Hlinka, Jason Lehmann, Dan Lowrey

Editor: Adam Rihner

For detailed data

Access the [Major Energy Rate Case Decisions – January – March 2024](#) and related data.

Averages calculated for the first quarter of 2024 show that electric and gas authorized returns on equity are trending modestly higher.

To learn more or to request a demo, visit spglobal.com/marketintelligence.

Table of Contents

Executive Summary	3
Introduction	3
About this report	4
The Take	4
Overview of electric and gas authorizations	5
Capital structure trends	6
A more granular look at ROE trends	7
Further Reading	11
About Regulatory Research Associates	11

Executive Summary

Introduction

The average electric and gas authorized returns on equity are trending upward.

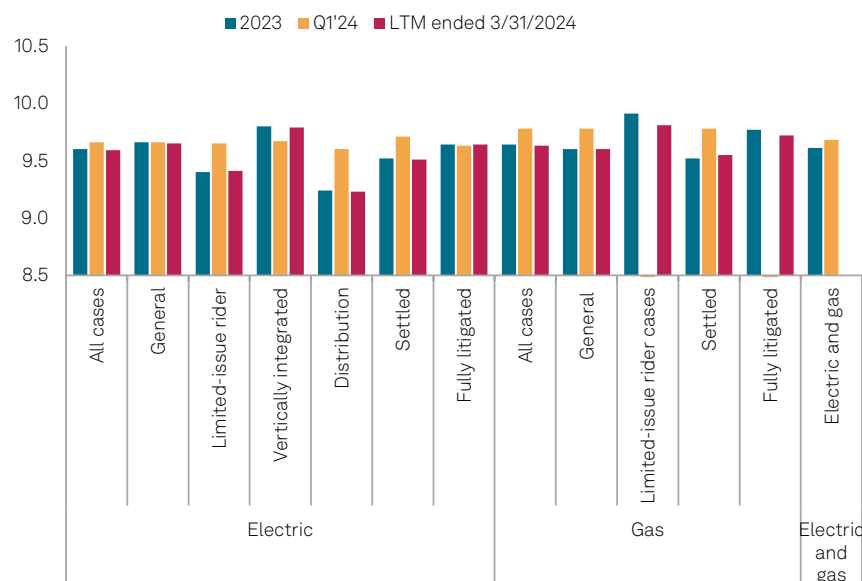
As per calculations from Regulatory Research Associates, the average authorized return on equity (ROE) authorized electric utilities was 9.66% in rate cases decided in the first quarter of 2024, above the 9.60% average for full-year 2023. There were 12 electric ROE authorizations in the first quarter of 2024 versus 63 in full-year 2023.

The average ROE authorized gas utilities was 9.78% in rate cases decided in the first quarter of 2024, above the 9.64% average for full-year 2023. There were two gas ROE authorizations in the first quarter of 2024 versus 43 in full-year 2023.

Rate case activity reached record-high levels in 2023, with nearly 165 decisions issued by state public utility commissions, including 106 electric or gas equity return determinations.

While the reasons for a rate case filing are numerous, the main driver continues to be the recovery of capital expenditures. Energy utilities are investing in infrastructure to modernize transmission and distribution systems; build new natural gas, solar and wind generation; and deploy new technologies to accommodate the expansion of electric vehicles, battery storage and advanced metering infrastructure that facilitate the transition toward decarbonization. Other reasons for rate filings include rising expenses, revised cost-of-capital parameters, the impact of broader economic and sectorwide forces on operations, recovery of storm and severe-weather-related costs, regulatory approval for alternative regulatory mechanisms, and the need to address rate treatment to be accorded generation facilities being retired prior to the end of their planned service lives due to the energy transition.

Average authorized ROE (%)



	2023	Q1'24	LTM ended 3/31/2024
Electric averages			
All cases	9.60	9.66	9.59
General rate cases	9.66	9.66	9.65
Limited-issue rider cases	9.40	9.65	9.41
Vertically integrated cases	9.80	9.67	9.79
Distribution cases	9.24	9.60	9.23
Settled cases	9.52	9.71	9.51
Fully litigated cases	9.64	9.63	9.64
Gas averages			
All cases	9.64	9.78	9.63
General rate cases	9.60	9.78	9.60
Limited-issue rider cases	9.91	--	9.81
Settled cases	9.52	9.78	9.55
Fully litigated cases	9.77	--	9.72
Composite electric and gas averages			
Electric and gas	9.61	9.68	9.60
US Treasury			
30-year bond yield	4.09	4.33	4.24

Data compiled April 16, 2024.

ROE = return on equity; LTM = last 12 months.

Sources: Regulatory Research Associates, a group within S&P Global Commodity Insights; US Treasury Department.

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About this report

This quarterly report offers a detailed overview of electric and gas rate case decisions issued in the US during the first quarter of 2024 and select aggregated historical data. The information presented in this report utilizes the data compiled by Regulatory Research Associates for its rate case database, which is available on the S&P Capital IQ Pro platform. RRA endeavors to follow all “major” rate cases for investor-owned utilities nationwide, with “major” defined as a case in which the utility’s request would result in a rate change of at least \$5 million or in which the commission approves a rate change of at least \$3 million. In addition to base rate cases, the rate case history database includes details regarding certain limited-issue rider proceedings, primarily those involving significant rate base additions recognized outside of a general rate case. In some of these cases, the rate change coverage criteria may not apply. Historical data in this report may not match earlier data provided in previous reports due to differences in presentation, including the treatment of withdrawn or dismissed cases and the addition of cases not previously included in RRA’s coverage.

The Take

Averages calculated for the first quarter of 2024 show that electric and gas authorized ROEs are trending modestly higher as the high-interest-rate environment begins to impact authorized ROEs. The effect of interest rate increases on authorized returns is not proportional, however, as regulators are slower to adjust ROEs upward than downward, and affordability concerns persist as regulators contend with customer rate increases stemming from significant but necessary capital investment in the energy transition during a period of high inflation.

In recent years, rate case activity for investor-owned electric and gas utilities in the US has been elevated, with state public utility commissions issuing almost 165 decisions in 2023. With higher interest rates, elevated inflation and accelerating capital spending to address public policy goals, particularly the energy transition, RRA anticipates that the flurry of rate case activity will continue.

Overview of electric and gas authorizations

Both the electric and gas average authorized ROEs in the first quarter of 2024 inched gently higher than the averages for full-year 2023.

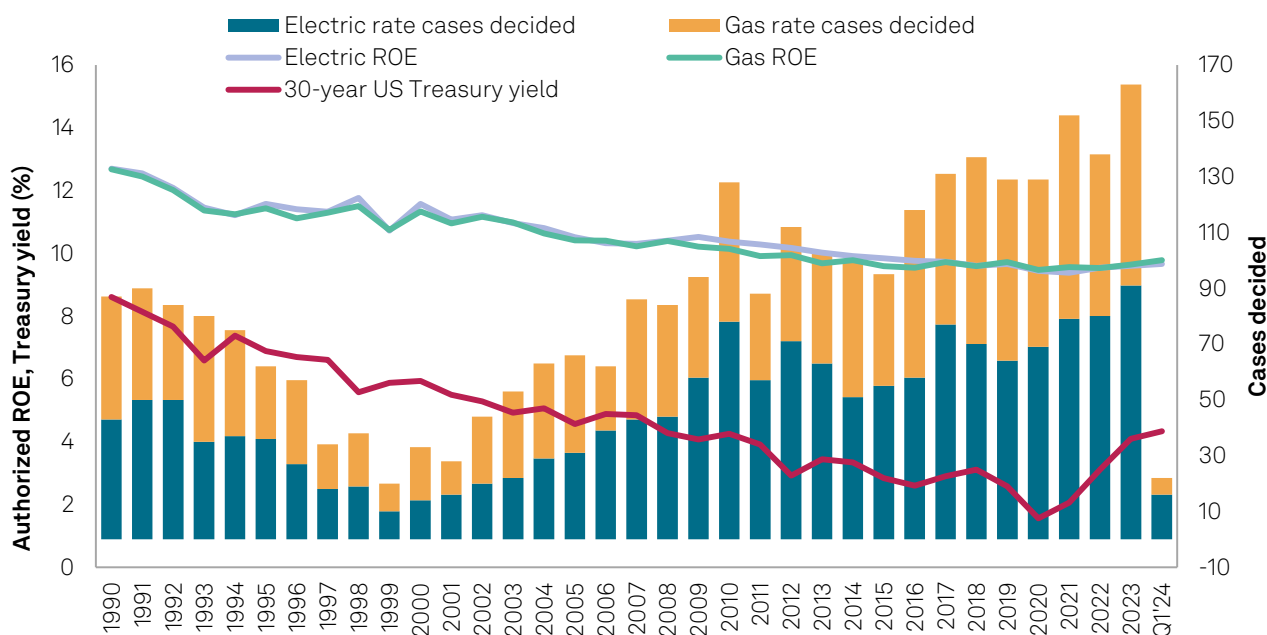
The average ROE authorized for electric utilities was 9.66% for rate cases decided in the first quarter of 2024, above the 9.60% average observed in full-year 2023. There were 12 electric ROE determinations reflected in the calculations for the first quarter of 2024 versus 63 in full-year 2023.

The average ROE authorized for gas utilities was 9.78% for cases decided in the first quarter of 2024, above the 9.64% average observed in full-year 2023. There were two ROE determinations reflected in the calculations for the first quarter of 2024 versus 43 in full-year 2023.

The electric data set includes several limited-issue rider cases. Historically, the ROEs authorized in limited-issue rider cases were meaningfully higher than those approved in general rate cases, driven primarily by incentives allowed in Virginia for certain types of generation investment. These premiums have largely expired. Excluding rider cases, the average authorized ROE for electric cases was 9.66% in the first quarter of 2024, equal to the average for full-year 2023. There were no limited-issue rider cases with a gas authorized ROE in the first quarter of 2024. Excluding the six rider cases, the average authorized ROE for gas cases was 9.60% in full-year 2023. For the most part, limited-issue riders have a limited impact on average ROEs in the gas sector, as most of the gas riders rely on ROEs approved in a previous base rate case.

In the first quarter of 2024, the median ROE authorized in all electric utility rate cases was 9.70% versus 9.50% in full-year 2023; for gas utilities, the metric was 9.78% in the first quarter of 2024 and 9.60% in full-year 2023.

Average electric, gas authorized ROEs; number of rate cases decided



Data compiled April 16, 2024.

ROE = return on equity.

“Sources: Regulatory Research Associates, a group within S&P Global Commodity Insights; US Treasury Department.

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Looking at the last 12 months ended March 31, 2024, the average ROE authorized in all electric utility rate cases was 9.59%, and the median was 9.55%. For gas utilities in the 12-month period ending March 31, 2024, the average was 9.63% and the median was 9.63%.

Historically, authorized returns have generally tracked the overall direction of interest rates, albeit with two important caveats to keep in mind — the magnitude of the change in authorized ROEs may not be as dramatic as that observed in interest rates, and changes in authorized ROEs may lag changes in interest rates, especially in the upward direction.

Interest rates — as measured by the 30-year US Treasury bond yield — fell almost steadily between 1990 and 2020, placing downward pressure on authorized ROEs. Between 1990 and 2020, Treasury yields fell more than 700 basis points, to 1.56% from 8.61%, while average authorized ROEs for electric and gas utilities combined fell less than 325 basis points, to 9.45% from 12.69%. The average authorized ROEs did not fall below 10% until 2011 for gas utilities and until 2014 for electric utilities. The calendar-year averages fell below 9.50% for the first time in 2020.

The decline in authorized ROEs has coincided with an upswing in rate case activity, with 100 or more cases adjudicated in 12 of the last 15 calendar years. This count includes electric and gas cases where no ROEs were specified but does not include withdrawn cases. At almost 165 cases decided, rate case activity in 2023 was the most robust observed in any year during the 1990–2023 period, with authorized increases totaling about \$12 billion.

With interest rates and authorized ROEs declining at different rates between 1990 and 2020, the spread between authorized ROEs and the average yield on 30-year US Treasuries somewhat widened over this period — going from a little over 400 basis points in 1990 to a peak of just under 800 basis points in 2020.

The widening spread is attributable primarily to the regulators' often-unstated understanding that the drop in interest rates caused by the Fed intervention was unusual. Consequently, regulators did not necessarily fully reflect the interest rate drop in newly authorized ROEs in some instances; in others, regulators acknowledged that the changing dynamics of the industry and instability in the overall economy presented increased risks for investors, justifying a higher premium over interest rates.

However, with the uptick in interest rates since 2020, the spread has begun to narrow, falling to around 550 basis points in 2023.

With the myriad factors putting upward pressure on customer bills, the spread may continue to narrow as regulators may become more reluctant to raise authorized returns.

Capital structure trends

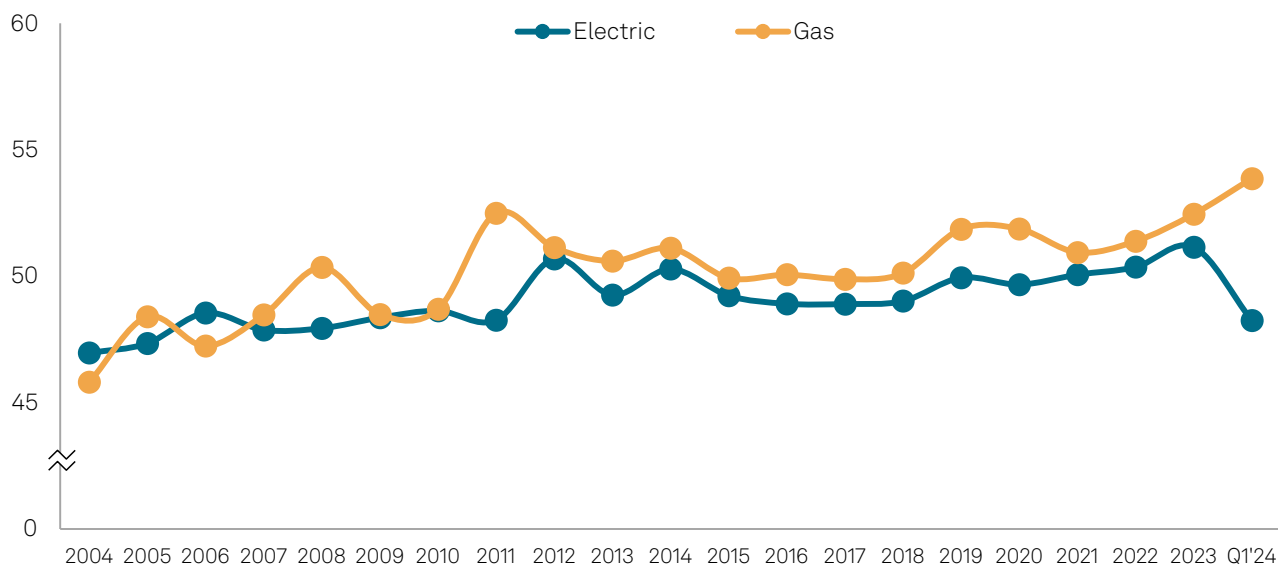
The negative cash flow impact of federal tax changes that took effect in 2018 raised concerns regarding utility liquidity and credit metrics. In response, many utilities sought higher common equity ratios, and the average authorized equity ratios adopted by utility commissions in 2019 were modestly higher than those observed in 2018 and 2017.

For full years 2023, 2022, 2021, 2020 and 2019, the average equity ratios authorized in electric utility cases were 51.15%, 50.36%, 50.06%, 49.67% and 49.94%, respectively. The average equity ratios authorized gas utilities for these years were 52.45%, 51.38%, 50.94%, 51.87% and 51.86%, respectively.

In the first quarter of 2024, the average authorized equity ratio for electric utility cases nationwide was 48.25%. For gas utilities, the average authorized equity ratio nationwide was 53.86%.

From a longer-term perspective, equity ratios have generally increased over the last several 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%. In the wake of the 2008 financial crisis, many commissions began approving capital structures that were more equity-rich. Authorized equity ratios for gas utilities have been above those of electric utilities for the bulk of the period since 2004.

Average authorized equity ratio (%)



Data compiled April 16, 2024.

Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.

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A more granular look at ROE trends

Thus far, the discussion has looked at broad trends in authorized ROEs; the following sections provide a more detailed view.

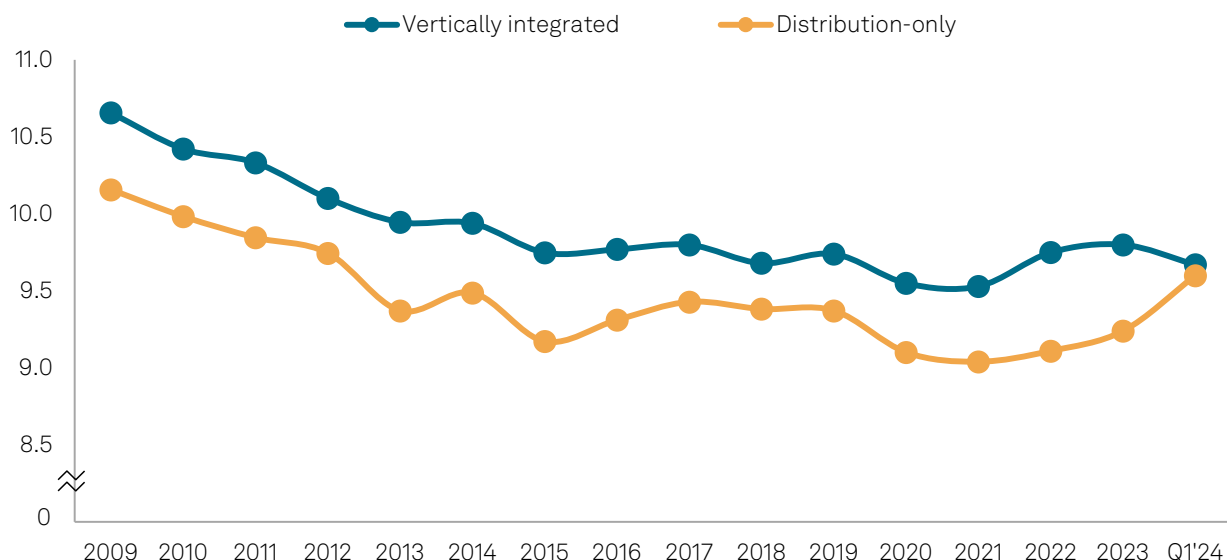
RRA has observed that there can be significant differences between average ROEs based on the types of proceedings/decisions in which these ROEs were established.

As a result of the 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 distribution operations.

RRA finds that the annual average authorized ROEs in vertically integrated cases involving generation have been about 30-65 basis points higher than in distribution-only cases, arguably reflecting the increased risk associated with the ownership and operation of generation assets.

The industry average ROE for vertically integrated electric utilities was 9.67% in cases decided in the first quarter of 2024 versus the 9.80% average in full-year 2023. For electric distribution-only cases, the industry average ROE was 9.60% in the first quarter of 2024 versus the 9.24% average in full-year 2023.

Average authorized electric ROEs (%)



Data compiled April 16, 2024.

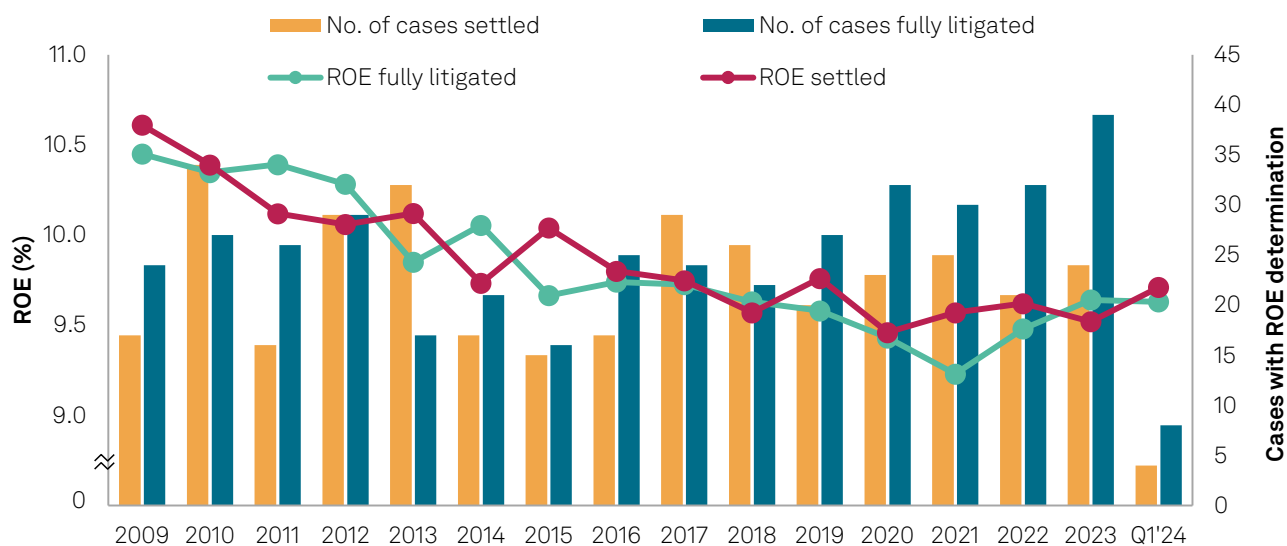
ROE = return on equity.

Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.

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

Average authorized electric ROEs: settled vs. fully litigated cases



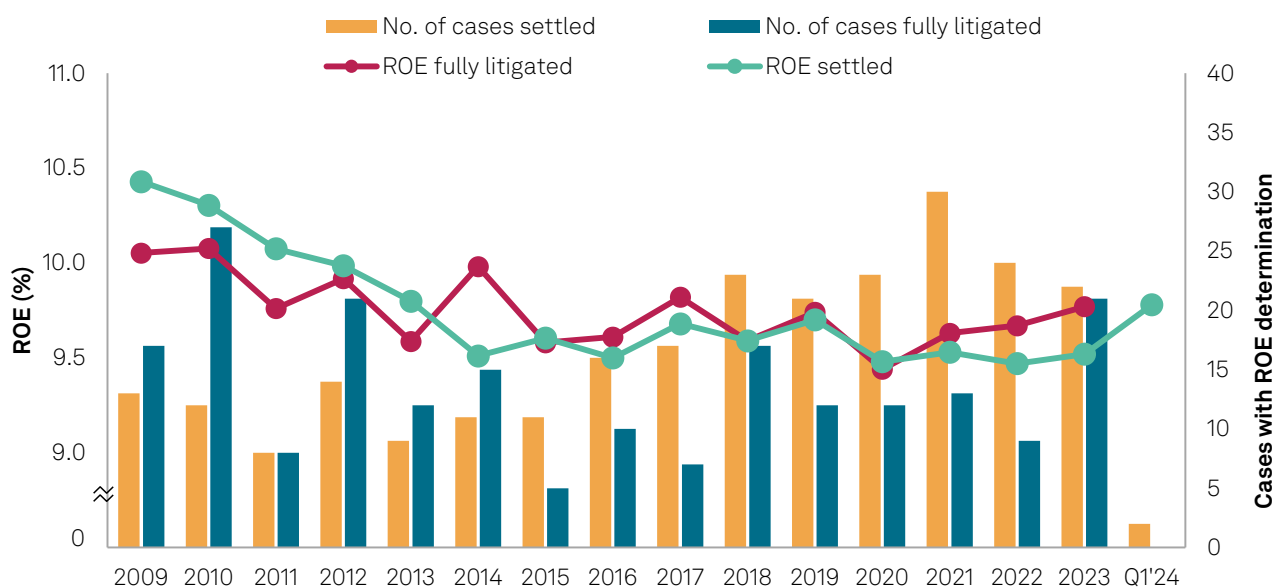
Data compiled April 16, 2024.

ROE = return on equity.

Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.

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Average authorized gas ROEs: settled vs. fully litigated cases



Data compiled April 16, 2024.

ROE = return on equity.

Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.

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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, while in others, it was higher for settled cases.

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 quarterly since 2019, 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 quarterly since 2021.

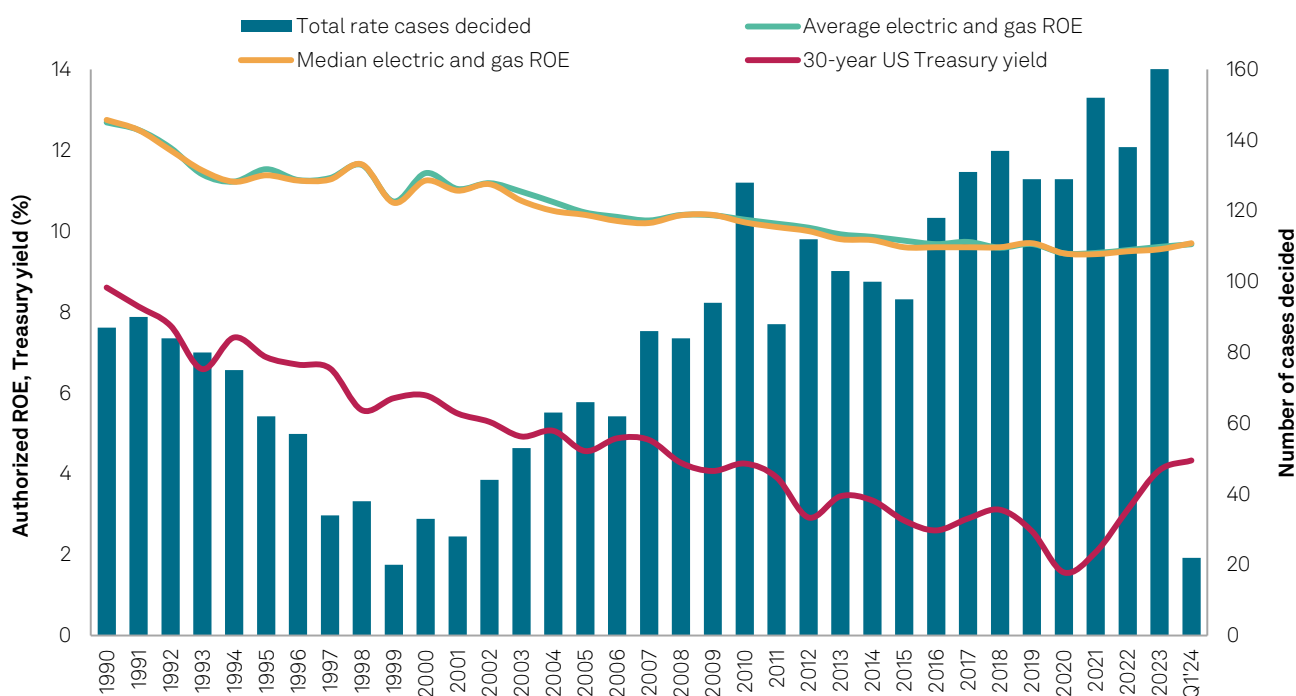
Tables 3 and 4 provide comparisons since 2009 of average authorized ROEs for settled versus fully litigated cases, general rate cases versus limited-issue rider proceedings and vertically integrated cases versus delivery-only cases for electric and gas utilities, respectively.

The individual electric and gas cases decided in the first quarter of 2024 are listed in **Table 5**, 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 the decisions were rendered. This study does not reflect fuel adjustment clause rate changes.

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 decided during the specified time periods and are not necessarily representative of the average currently authorized ROEs for utilities industrywide or the returns earned by the utilities.

Table 6 and the graph below track the average and median equity return authorized for all electric and gas rate cases combined since 1990. As the table indicates, authorized ROEs have generally trended downward since 1990, reflecting the significant decline in interest rates and capital costs over this time frame.

Composite electric, gas average authorized ROEs; total number of rate cases



Data compiled April 16, 2024.

ROE = return on equity.

“Sources: Regulatory Research Associates, a group within S&P Global Commodity Insights; US Treasury Department.

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Further Reading

[The Commissions](#)

[The rate case process: a conduit to enlightenment](#)

[Rate base: It's more complicated than it sounds](#)

[Frequently Asked Questions](#)

[Intro to Water Utilities — Current Trends and Growth Drivers](#)

[An Overview of FERC Regulation](#)

[FERC Regulatory Review](#)

[State Regulatory Evaluations — Energy](#)

[Major energy rate case decisions in the US – January-December 2023](#)

[Major energy utility cases in progress in the US - Quarterly update on pending rate cases](#)

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MOODY'S
 INVESTORS SERVICE

CREDIT OPINION

22 May 2023

Update

Send Your Feedback

RATINGS

Duke Energy Florida, LLC.

Domicile	Florida, United States
Long Term Rating	A3
Type	LT Issuer Rating
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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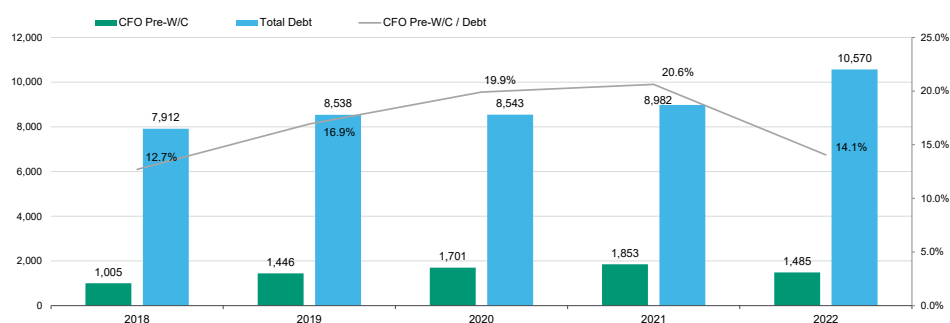
Duke Energy Florida, LLC.

Update to credit analysis

Summary

Duke Energy Florida LLC's (Duke Energy Florida) credit profile reflects a supportive regulatory environment for investor owned utilities in Florida including a history of comprehensive rate settlements approved by the Florida Public Service Commission (FPSC). Our view also recognizes historical credit metrics that have been negatively impacted by the financial effects of hurricanes, and additional leverage due to the 2016 issuance of over \$1 billion of securitization debt. The implementation of an augmented capital program to strengthen the system in light of frequent storm activity and to execute a clean energy transition plan will maintain pressure on credit metrics. The company's 2022 credit metrics were very weak due to storm and deferred fuel costs. However, given the utility's supportive multiyear rate plan, its ability to petition for storm cost recovery outside of a rate case, and Florida legislation that provides timely recovery of storm hardening investments, we expect credit metrics to recover going forward. Over the next two years, we project a ratio of cash flow from operations excluding changes in working capital (CFO pre-WC) to debt in the 19% to 22% range, when adjusted for securitization debt, in the absence of unusually severe storms.

Exhibit 1
 Historical CFO Pre-WC, Total Debt and CFO Pre-WC to Debt (\$ MM)



Note: The 2022 CFO pre-WC to debt ratio, adjusted for the financial impact of securitization bonds and the cash flow impact of deferred fuel costs which are being recovered over 21 months effective April 2023, would have been approximately 17.9%. See Exhibit 4 for details.

Source: Moody's Financial Metrics

Credit strengths

- » Credit supportive Florida regulatory framework
- » Multiyear rate settlements with the ability to petition for storm cost recovery outside of a base rate case

Credit challenges

- » Weak 2022 credit metrics
- » Storm prone service territory
- » Significant capital program drives sizable negative free cash flow that requires external financing

Rating outlook

The stable outlook reflects Duke Energy Florida's credit supportive regulatory framework, including multiyear rate settlements, the prescriptive nature of base rate adjustments for new solar investments, the ability to petition for storm cost recovery outside of a base rate case, and the ability to recover storm hardening investments via a rider mechanism. The outlook also considers financial metrics that we expect will be appropriate for the rating going forward, including a ratio of CFO pre-WC to debt in the 19%-22% range when securitization debt is excluded.

Factors that could lead to an upgrade

- » Improved cash flow coverage metrics, for example CFO pre-WC to debt, excluding securitization debt, above 22% on a sustained basis

Factors that could lead to a downgrade

- » A decline in the supportiveness of the regulatory framework in Florida
- » If CFO pre-WC to debt, excluding securitization debt, is below 19% a sustained basis

Key indicators

Exhibit 2

Duke Energy Florida, LLC. [1]

	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
CFO Pre-W/C + Interest / Interest	4.1x	5.2x	6.0x	6.6x	5.0x
CFO Pre-W/C / Debt	12.7%	16.9%	19.9%	20.6%	14.1%
CFO Pre-W/C – Dividends / Debt	11.7%	16.9%	19.9%	20.6%	12.4%
Debt / Capitalization	49.8%	49.0%	46.7%	45.6%	47.2%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Note: The 2022 CFO pre-WC to debt ratio, adjusted for the financial impact of securitization bonds and the cash flow impact of deferred fuel costs which are being recovered over 21 months effective April 2023 would have been approximately 17.9%. See Exhibit 4 for details.

Source: Moody's Financial Metrics

Profile

Duke Energy Florida, LLC. is a vertically integrated public utility providing electricity to approximately 1.9 million customers in the north central part of Florida with an earnings base of about \$17.4 billion. Duke Energy Florida is a subsidiary of intermediate holding company Progress Energy, Inc. (Progress, Baa1 stable) and ultimate parent company Duke Energy Corporation (Duke, Baa2 stable).

Detailed credit considerations

Credit supportive Florida regulatory framework

The regulatory environment for investor owned utilities in Florida remains credit supportive. In its last several proceedings, Duke Energy Florida has been able to achieve multiyear rate settlements which ultimately resolved issues relating to retiring a nuclear plant, provided for increased system investment, and addressed the impacts of federal tax reform and increased storm restoration costs. The utility also benefits from ongoing credit supportive cost recovery mechanisms, such as fuel and capacity clauses that are adjusted at

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least annually based on expected fuel and power prices, and for prior period differences between projected and actual costs; and an environmental cost recovery clause that is adjusted annually for capital spending and operating expenses related to emission controls.

The Florida Public Service Commission (FPSC) has also authorized mechanisms for the recovery of Duke Energy Florida's investment in various generating assets. As part of its January 2021 rate settlement, Duke Energy Florida received approval for a new solar program, the Clean Energy Connection, to invest approximately \$1 billion in 750 MW of new cost-effective solar power from 2022 through 2024. The rate case settlement includes costs associated with placing the 750 MW of new solar into rate base with revenue requirements which are partially offset by the program subscription fees. The approval remains in effect pending the outcome of an appeal to the Supreme Court. We view the certainty provided by these mechanisms as supportive of credit quality; however, recovery and return does not begin until the plant is in service, resulting in moderate regulatory lag.

In January 2021, Duke Energy Florida filed its most recent, multiyear rate settlement agreement with the FPSC. The FPSC approved the settlement in May 2021 and issued a final order in June 2021. The terms include incremental base rate increases of \$67 million in 2022, \$49 million in 2023 and \$79 million in 2024, subject to adjustment in the event of tax reform during the 2021-2023 period. Parties to the settlement agreed to an ROE band of 8.85%-10.85% and a 53% equity layer. The ROE can also be increased by 25 basis points if the average 30-year US Treasury rate increases 50 basis points or more over a six-month period; in this case, the mid-point of the ROE range would rise to 10.10%. This provision was triggered in July 2022 because of high interest rates and new rates went into effect in January 2023. We view the ability to reach multiyear settlements, with forward looking provisions relating to future interest and tax rates, as supportive of credit quality.

The 2021 settlement also included a provision to recover from or return to customers, the effects of tax law changes. Pursuant to the Inflation Reduction Act enacted in August 2022, Duke Energy Florida is eligible for production tax credits (PTC) associated with solar facilities placed in service beginning in January 2022. In October 2022, Duke Energy Florida filed a request with the FPSC to reduce base rates by \$56 million to return expected 2023 and 2022 PTCs to customers via an adjustment to the utility's capacity cost recovery clause. The FPSC approved Duke Energy Florida's request in December 2022 and new rates became effective in January 2023.

In 2022, Duke Energy Florida incurred storm costs associated with Hurricane Ian and unusually high fuel costs due to high natural gas prices. The company has regulatory approval to recover Hurricane Ian costs over 12 months effective April 2023. Duke Energy Florida has also received regulatory approval to recover approximately \$795 million of deferred fuel costs over 21 months effective April 2023.

Storm prone service territory but with good history of cost recovery

Duke Energy Florida's service territory is prone to hurricanes. The company has historically been able to recover storm costs via timely, credit supportive means. This is a key credit consideration as the state is prone to hurricanes, the frequency and intensity of which appear to be increasing.

To help protect against recurring severe weather, Florida lawmakers enacted legislation in 2019 that requires investor-owned utilities to harden their transmission and distribution infrastructure and also provides for cost recovery outside of a general rate case, a credit positive. In April 2020, the Florida utilities, including Duke Energy Florida, submitted their infrastructure improvement plans. Duke Energy Florida intends to invest approximately \$6 billion over 10 years to harden its system and increase reliability including an initiative to upgrade overhead distribution systems. In August 2020, the FPSC determined the utility's plans were in the public interest and approved a rider mechanism to recover the related costs. The requests for specific cost recovery are reviewed separately. The utility filed an updated plan in April 2022 to invest \$7 billion over the ten years beginning in 2023. The plan was approved by the FPSC in October 2022.

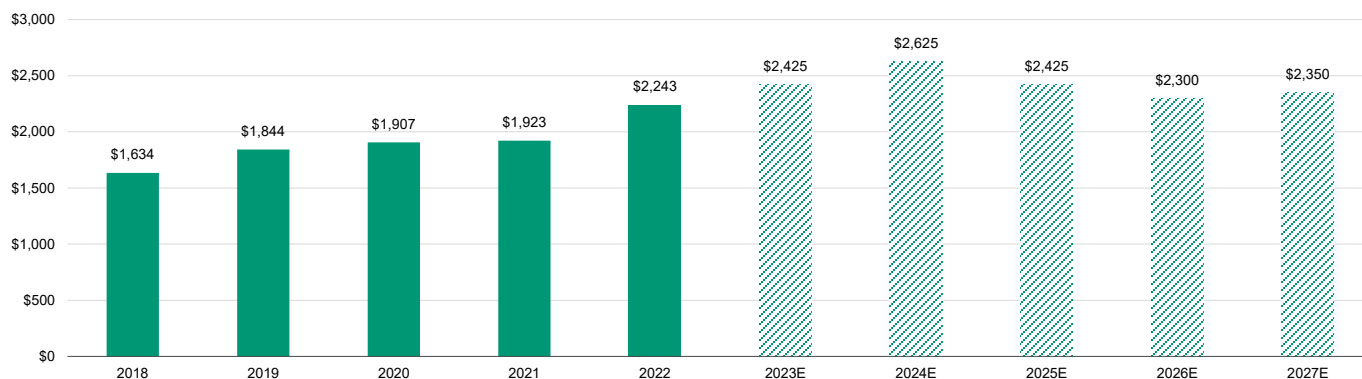
On 28 September 2022, most of Duke Energy Florida's territory was impacted by Hurricane Ian causing significant property damage. The relatively quick restoration of power to about one million customers, or over 97% of affected customers, within three days after the storm exited the state in October 2022 demonstrates the success of its infrastructure hardening investments. As of 31 December 2022, Duke Energy Florida had about \$353 million of deferred Hurricane Ian costs and has received regulatory approval to recover these costs over 12 months effective April 2023, and to replenish its storm reserve.

Elevated capital plans and the potential for storms constrain credit profile

Duke Energy Florida's capital expenditures have been increasing steadily in recent years as the utility invests to harden its system and to implement its clean energy plans. The company's 2023-2027 capital forecast totaling around \$12 billion is approximately \$2.6 billion higher than it spent over 2018-2022. Although much of this spending will be recovered through the utility's multiyear rate plan and existing rider mechanisms, there is still some lag as recovery generally does not begin until projects are placed in service. Incremental debt to fund negative free cash flow will pressure credit metrics in the meantime.

Exhibit 3

Duke Energy Florida Capital Forecast [1] (\$ MM)



Source: Company Filings & Presentations

Hurricanes have negatively affected Duke Energy Florida's historical credit metrics. For example, absent the impact of severe storm activity, we estimate the ratios of CFO pre-WC to debt in 2018 and in 2019 of 12.7% and 16.9%, respectively, would have been closer to 20% in both years. The risk of storms is somewhat mitigated by the credit supportive regulatory treatment discussed above. Nevertheless, the company's credit profile could be persistently weaker than expected if severe storms recur on a regular basis.

The 2016 issuance of about \$1.3 billion of securitization financing related to the recovery of costs associated with the closed Crystal River 3 nuclear facility continues to negatively impact cash flow credit metrics. Our GAAP based calculation of Duke Energy Florida's financial metrics includes securitization debt. However, our assessment of the company's credit quality considers metrics that exclude the securitization debt. This is because the securitization bonds are legally a customer obligation, with the utility serving as a conduit for its repayment via a charge on customer bills.

In 2022, Duke Energy Florida's ratio of CFO pre-WC to debt was particularly weak at 14.1% or 14.8% when adjusted for securitization debt. When excluding the cash flow impact of deferred fuel costs, the CFO pre-WC to debt ratio would have been 17.9% as shown below, still weak for the rating because storm and deferred fuel costs were funded with incremental debt. Going forward, assuming normal storm activity, we expect Duke Energy Florida's ratio of CFO pre-WC to debt, excluding securitization debt, to recover to the 19%-22% range.

Exhibit 4

Duke Energy Florida adjusted 2022 CFO pre-WC to debt detail

	2022
Cash flow from operations (GAAP)	842
Exclude changes current assets/liabilities (working capital)	583
Unadjusted CFO pre-WC	1,425
Primary adjustments	
Lease obligation	60
Other analyst adjustments	
Securitization	(62)
LT deferred fuel costs	295
Preliminary adjusted CFO pre-WC (excl. other analyst adjustments)	1,485
Fully adjusted CFO pre-WC (incl. other analyst adjustments)	1,718
Debt (GAAP)	10,314
Primary adjustments	
Lease	256
Other analyst adjustments	
Securitization	(946)
Preliminary adjusted debt (excluding other analyst adjustments)	10,570
Fully adjusted debt (including other analyst adjustments)	9,624
Preliminary adjusted CFO pre-WC/debt	14.1%
Fully adjusted CFO pre-WC/debt	17.9%

Source: Moody's Investors Service, Company

ESG considerations

Duke Energy Florida's ESG Credit Impact Score is CIS-3 (Moderately Negative)

Exhibit 5

ESG Credit Impact Score

CIS-3

Moderately Negative

NEGATIVE IMPACT : : POSITIVE IMPACT

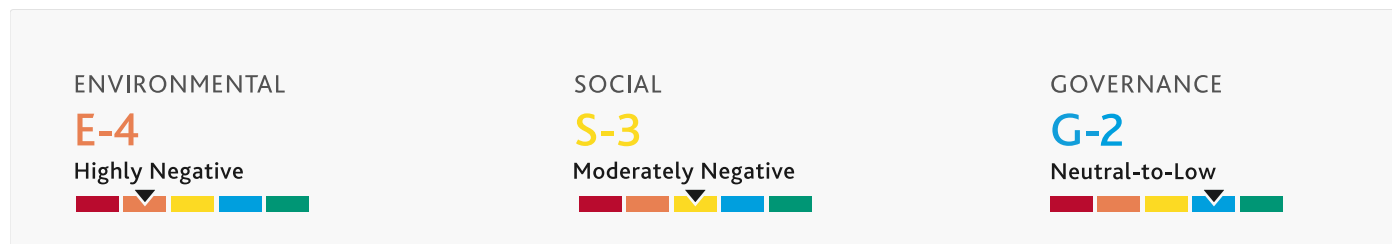
For an issuer scored CIS-3 (Moderately Negative), its ESG attributes are overall considered as having a limited impact on the current rating, with greater potential for future negative impact over time. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-2.

Source: Moody's Investors Service

Duke Energy Florida's ESG Credit Impact Score is moderately negative (**CIS-3**), where its ESG attributes are overall considered as having a limited impact on the current rating, with greater potential for future negative impact over time. Duke Energy Florida's **CIS-3** reflects highly negative environmental risk, moderately negative social risk and neutral to low governance risk.

Exhibit 6

ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

Duke Energy Florida's highly negative exposure to environmental risk (**E-4** issuer profile score) is driven by its high exposure to storm-caused damage to physical assets because of the location of its service territory in a hurricane prone region. The company's fossil fuel generation fleet presents moderate exposure to carbon transition risk. Risks associated with water management, natural capital and waste and pollution are neutral to Duke Energy Florida's credit profile.

Social

Exposure to social risks is moderately negative (**S-3** issuer profile score) reflecting the utility sector's fundamental risk that demographics and societal trends could trigger customer affordability concerns that could lead to adverse regulatory or political intervention. These risks are balanced by neutral to low risks related to human capital, customer relations, employee health and safety and responsible production.

Governance

Duke Energy Florida's **G-2** governance issuer profile score is driven by that of its parent Duke. Duke's governance (**G-2** issuer profile score) is broadly in line with other utilities and does not pose a particular risk. Duke Energy Florida's governance profile is supported by neutral to low risks associated with financial strategy and risk management, management credibility and track record, organizational structure, compliance and reporting and board structure policies and procedures.

ESG Issuer Profile Scores and Credit Impact Scores for Duke Energy Florida are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for Duke Energy Florida on Moodys.com and view the ESG Scores section.

Liquidity analysis

Duke Energy Florida has a constrained but acceptable liquidity profile. During the fiscal year ending December 2022, the utility generated approximately \$842 million of cash from operations (CFO), invested approximately \$2.2 billion in capital expenditures and made distributions of \$175 million to parent Duke, resulting in negative free cash flow of approximately \$1.6 billion. We expect Duke Energy Florida to remain free cash flow negative over the next few years as capital expenditures remain elevated.

As of 31 December 2022, the utility had \$45 million of cash and \$1.15 billion of borrowing capacity under Duke's \$9.0 billion multiyear (recently extended to 2028) master bank credit facility. At 31 December 2022, the utility had \$605 million of commercial paper outstanding and \$7 million of outstanding letters of credit. The credit facility does not contain a material adverse change clause for new borrowings and has a single financial covenant requiring that Duke and its utility subsidiaries each maintain a consolidated debt to capitalization ratio of no more than 65%, except for Piedmont. Duke Energy Florida's next debt maturity is \$800 million of term loans due in April of 2024.

Rating methodology and scorecard factors

Exhibit 7

Methodology Scorecard Factors

Duke Energy Florida, LLC.

Regulated Electric and Gas Utilities Industry Scorecard [1][2]	Current FY 12/31/2022		Moody's 12-18 Month Forward View As of Date Published [3]	
	Measure	Score	Measure	Score
Factor 1 : Regulatory Framework (25%)				
a) Legislative and Judicial Underpinnings of the Regulatory	A	A	A	A
b) Consistency and Predictability of Regulation	Aa	Aa	Aa	Aa
Factor 2 : Ability to Recover Costs and Earn Returns (25%)				
a) Timeliness of Recovery of Operating and Capital Costs	Aa	Aa	Aa	Aa
b) Sufficiency of Rates and Returns	A	A	A	A
Factor 3 : Diversification (10%)				
a) Market Position	Baa	Baa	Baa	Baa
b) Generation and Fuel Diversity	Baa	Baa	Baa	Baa
Factor 4 : Financial Strength (40%)				
a) CFO pre-WC + Interest / Interest (3 Year Avg)	5.8x	A	5.5x - 6x	A
b) CFO pre-WC / Debt (3 Year Avg)	17.9%	Baa	19% - 22%	Baa
c) CFO pre-WC – Dividends / Debt (3 Year Avg)	17.3%	A	19% - 22%	A
d) Debt / Capitalization (3 Year Avg)	46.5%	Baa	42% - 45%	A
Rating:				
Scorecard-Indicated Outcome Before Notching Adjustment		A2		A2
HoldCo Structural Subordination Notching		0		0
a) Scorecard-Indicated Outcome		A2		A2
b) Actual Rating Assigned		A3		A3

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

[2] As of 12/31/2022

[3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

[4] Duke Energy Florida's metrics for financial strength are analyzed using the Standard Grid.

Source: Moody's Financial Metrics

Appendix

Exhibit 8

Cash Flow and Credit Metrics [1]

CF Metrics	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
As Adjusted					
FFO	1,494	1,754	1,798	1,991	2,171
+/- Other	-489	-308	-97	-138	-686
CFO Pre-WC	1,005	1,446	1,701	1,853	1,485
+/- ΔWC	136	145	37	-390	-583
CFO	1,141	1,591	1,738	1,463	902
- Div	75	0	0	0	175
- Capex	1,665	1,937	2,002	2,003	2,327
FCF	-599	-346	-264	-540	-1,600
(CFO Pre-W/C) / Debt	12.7%	16.9%	19.9%	20.6%	14.1%
(CFO Pre-W/C - Dividends) / Debt	11.7%	16.9%	19.9%	20.6%	12.4%
FFO / Debt	18.9%	20.5%	21.0%	22.2%	20.5%
RCF / Debt	17.9%	20.5%	21.0%	22.2%	18.9%
Revenue	5,021	5,231	5,188	5,259	6,353
Interest Expense	329	347	341	332	372
Net Income	474	650	745	703	896
Total Assets	19,075	20,454	20,957	22,733	25,554
Total Liabilities	13,073	13,739	13,399	14,438	16,531
Total Equity	6,002	6,715	7,558	8,295	9,023

[1] All figures and ratios are calculated using Moody's estimates and standard adjustments. Periods are Financial Year-End unless indicated. LTM = Last Twelve Months

Source: Moody's Financial Metrics

Exhibit 9

Peer Comparison Table [1]

(In USD millions)	Duke Energy Florida, LLC. A3 (Stable)			Florida Power & Light Company A1 (Stable)			Tampa Electric Company A3 (Negative)		
	FYE	FYE	FYE	FYE	FYE	LTM	FYE	FYE	FYE
	Dec-20	Dec-21	Dec-22	Dec-21	Dec-22	Mar-23	Dec-20	Dec-21	Dec-22
Revenue	5,188	5,259	6,353	13,060	14,102	17,489	2,272	2,695	3,169
CFO Pre-W/C	1,701	1,853	1,485	6,253	5,986	6,576	804	840	959
Total Debt	8,543	8,982	10,570	18,987	20,092	23,657	3,690	4,171	4,793
CFO Pre-W/C + Interest / Interest	6.0x	6.6x	5.0x	10.8x	10.7x	8.8x	6.5x	6.5x	6.3x
CFO Pre-W/C / Debt	19.9%	20.6%	14.1%	32.9%	29.8%	27.8%	21.8%	20.1%	20.0%
CFO Pre-W/C - Dividends / Debt	19.9%	20.6%	12.4%	21.3%	27.1%	27.8%	10.7%	9.3%	9.2%
Debt / Capitalization	46.7%	45.6%	47.2%	34.7%	33.0%	32.8%	42.5%	42.6%	42.6%

[1] All figures & ratios calculated using Moody's estimates & standard adjustments. FYE = Financial Year-End. LTM = Last Twelve Months. RUR* = Ratings under Review, where UPG = for upgrade and DNG = for downgrade

Source: Moody's Financial Metrics

Ratings

Exhibit 10

Category	Moody's Rating
DUKE ENERGY FLORIDA, LLC.	
Outlook	Stable
Issuer Rating	A3
First Mortgage Bonds	A1
Senior Secured Shelf	(P)A1
Senior Unsecured	A3
Underlying Senior Secured	A1
Underlying Senior Unsecured	A3
ULT PARENT: DUKE ENERGY CORPORATION	
Outlook	Stable
Issuer Rating	Baa2
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured	Baa2
Jr Subordinate	Baa3
Pref. Stock	Ba1
Commercial Paper	P-2
PARENT: PROGRESS ENERGY, INC.	
Outlook	Stable
Senior Unsecured	Baa1

Source: Moody's Investors Service

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REPORT NUMBER 1367668

Rising Risks: Outlook For North American Investor-Owned Regulated Utilities Weakens

February 14, 2024

Key Takeaways

- We are updating our 2024 outlook on the investor-owned North American regulated utility industry to negative.
- Given the relatively high percentage of companies with negative outlooks, we expect that 2024 will likely be the fifth consecutive year that downgrades outpace upgrades.
- The industry faces rising physical risks and high cash flow deficits that may not be sufficiently funded in a credit-supportive manner.
- Still, we expect that the utility industry will maintain a median investment-grade rating of 'BBB+'.
- We also expect that a smaller percentage of companies rated 'BBB' or lower are more likely to implement measures to maintain or even improve credit quality.

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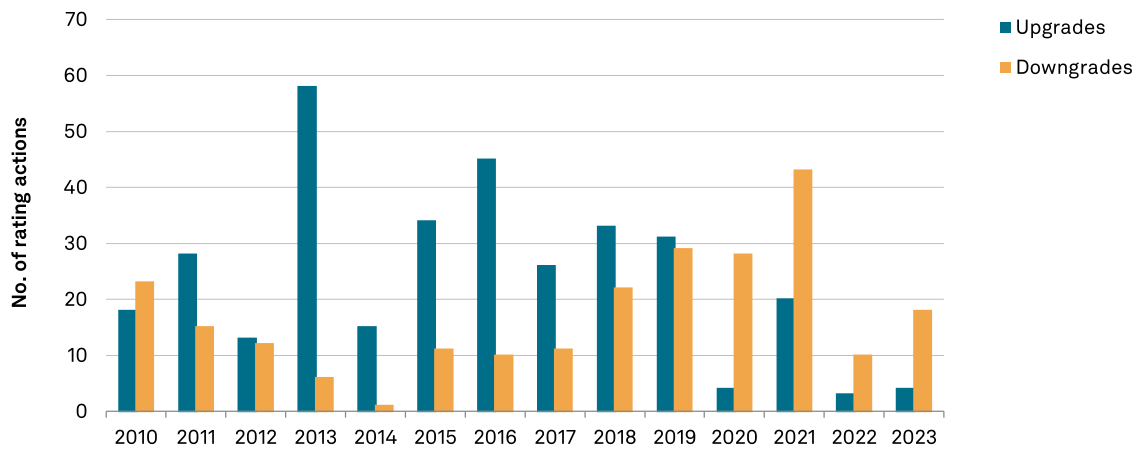
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Credit quality for North American investor-owned regulated utilities has weakened over the past four years, with downgrades outpacing upgrades by more than three times. We expect downgrades to again surpass upgrades in 2024 for the fifth consecutive year. In the decade prior to 2020, upgrades generally outpaced downgrades in the industry.

Rising Risks: Outlook For North American Investor-Owned Regulated Utilities Weakens

Chart 1

Upgrades and downgrades for North American regulated utilities



Source: S&P Global Ratings.
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High Percentage Of Negative Outlooks

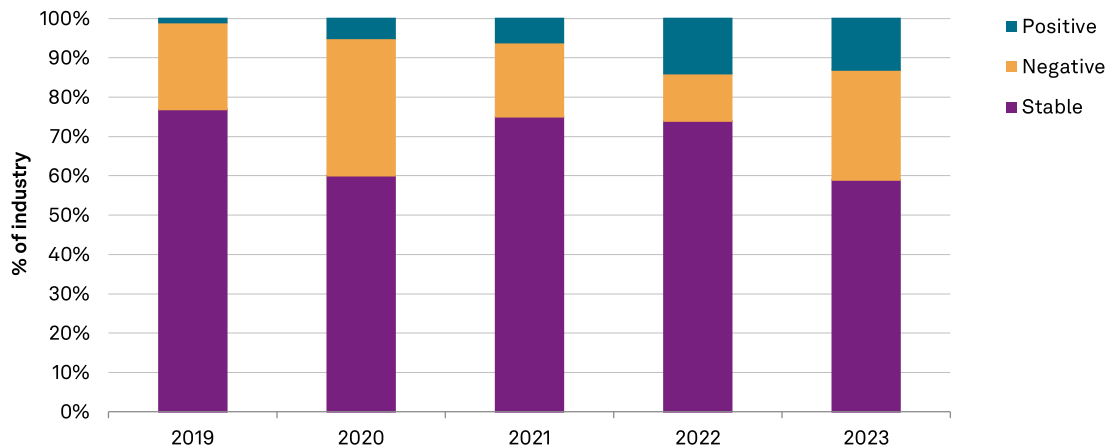
Currently, about 28% of the industry has a negative outlook or is listed on CreditWatch with negative implications. This is now the third time in the past five years that the year-end percentage of negative outlooks and CreditWatch listings has exceeded 20%. Given the current high percentage of negative outlooks it is increasingly likely that credit quality will again weaken in 2024.

Rising Risks: Outlook For North American Investor-Owned Regulated Utilities Weakens

Chart 2

Outlooks for the North American regulated utilities industry

At year end.

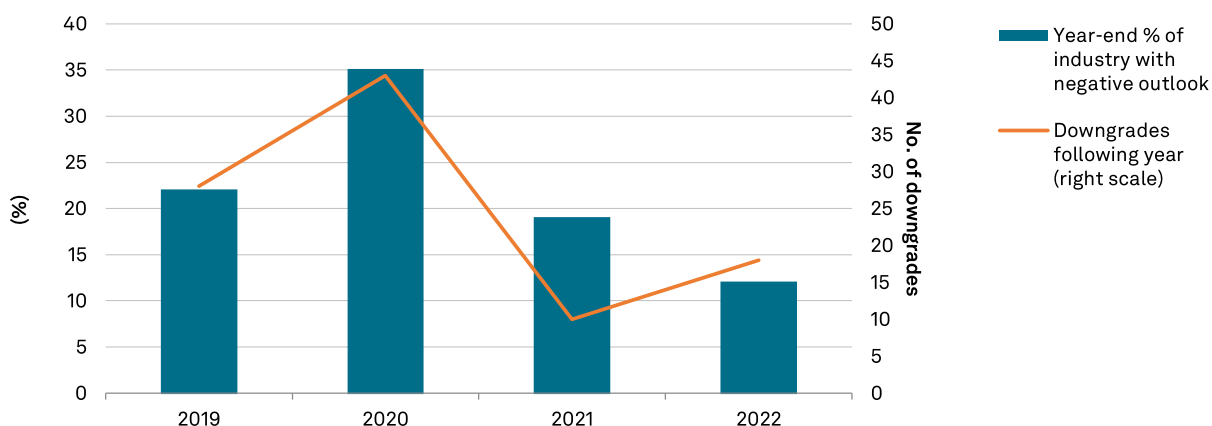


Source: S&P Global Ratings.
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Future rating actions are typically correlated with our outlooks. The industry's share of negative outlooks reached a record high of 35% at year-end 2020, and the following year saw a record 43 downgrades. The industry's current percentage of negative outlooks is significantly larger than it was at year-ends 2021 and 2022, when downgrades still materially outpaced upgrades the following year. As such, given the current high percentage of negative outlooks, we anticipate that 2024 will be another challenging year for the industry's credit quality.

Chart 3

North American regulated utilities' correlation of negative outlooks to downgrades



Source: S&P Global Ratings.
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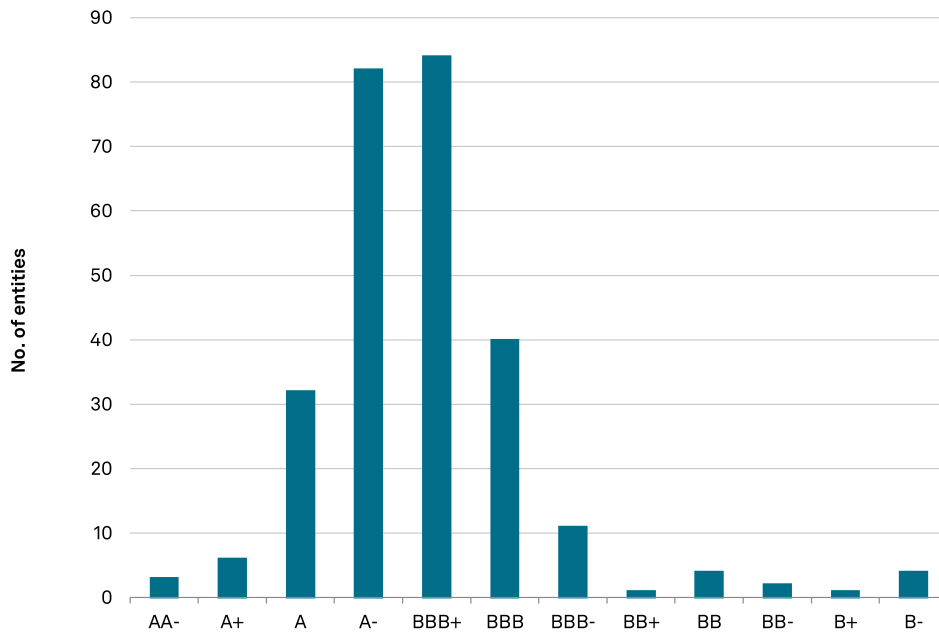
Median Credit Rating To Remain Investment Grade

The median rating among North American investor-owned regulated utilities is 'BBB+'. Despite our expectations for downgrades to again outpace upgrades in 2024, we expect that the median rating will remain 'BBB+'. To weaken the median rating to 'BBB', the industry would need about 70 downgrades to 'BBB' from the 'BBB+' level or above. This degree of credit weakening is well above our base-case expectations for 2024. However, this magnitude of weakening could occur over the next three years if this negative pace persists.

Chart 4

North American regulated utilities ratings distribution

As of Feb. 1, 2024.



Source: S&P Global Ratings.

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Headwinds To Credit Quality

The industrywide negative outlook reflects rising physical risks as well as financial measures, which are weakening due to rising capital spending and cash flow deficits that are not funded in a sufficiently credit supportive manner. Furthermore, much of the industry operates with minimal financial cushion from their downgrade threshold. This increases the susceptibility to a downgrade if negative events occur beyond our base case.

Rising Risks: Outlook For North American Investor-Owned Regulated Utilities Weakens

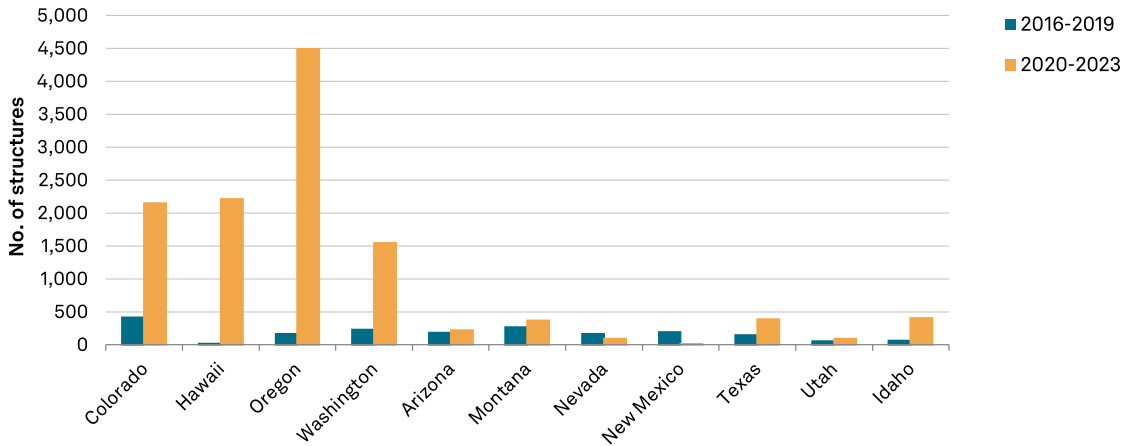
Increase in physical risk

Climate change and an increase in wildfire risks are threatening credit quality. Wildfire risk was generally limited to California utilities just five years ago but has spread over the past several years.

Chart 5

Structures destroyed by wildfires in Western U.S. states

Excludes California

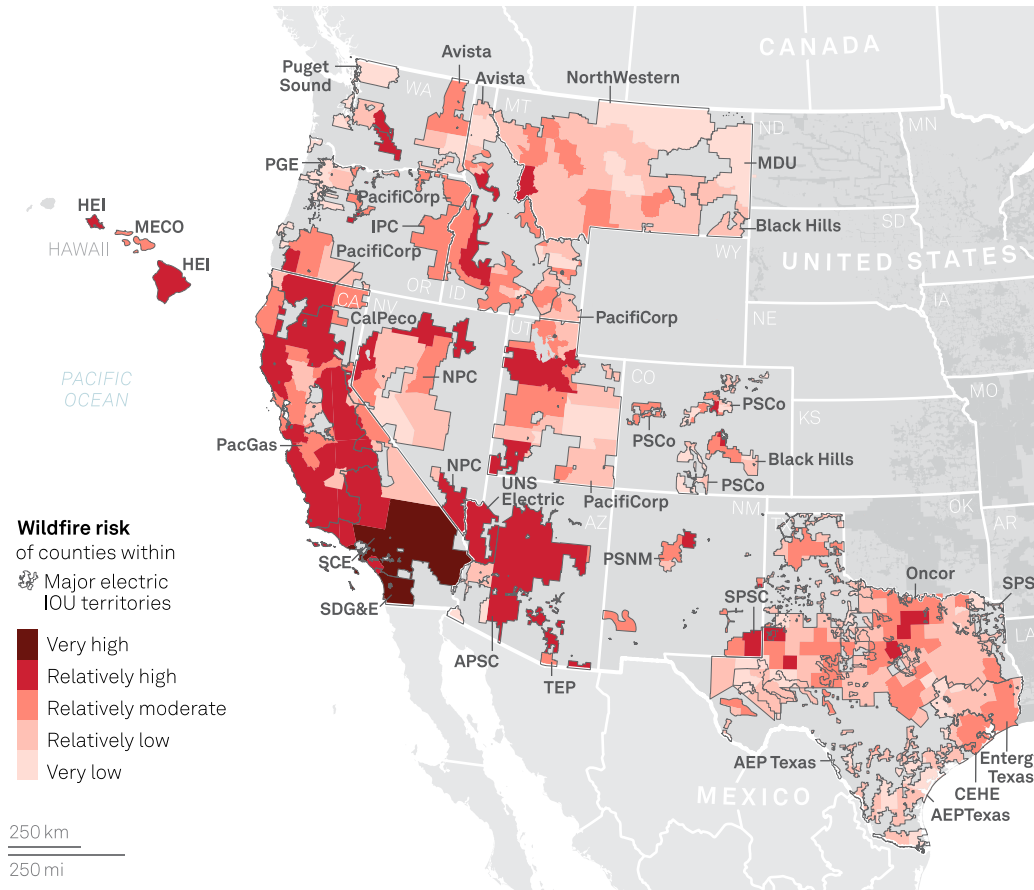


Sources: Headwaters Economics; National Fire and Aviation Management (FAMWeb).
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Since 2020, the number of structures destroyed by wildfires in Colorado, Hawaii, Idaho, Oregon, Washington, and Texas have all increased by more than 100% compared to 2016-2019. Meanwhile, Arizona, Montana, and Utah have each experienced increases of at least 20% over the same timeframe. Additionally, areas designated as high fire risk continue to increase across the Western U.S. due to climate change. To reduce these risks, many utilities are actively implementing mitigation plans designed to reduce wildfire exposure and litigation risks.

Rising Risks: Outlook For North American Investor-Owned Regulated Utilities Weakens

Wildfire risk across West Coast electricity territories



Source: FEMA, S&P Global Market Intelligence.
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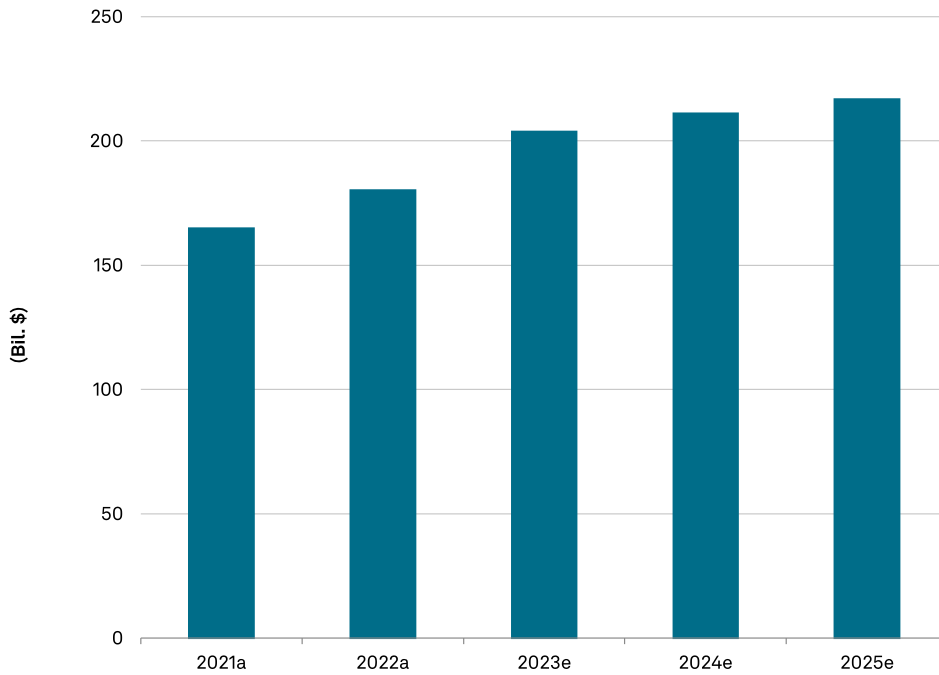
Increase in capital expenditure and cash flow deficits

The industry's capital spending remains at record levels, supporting initiatives for safety, reliability, energy transition, and growth. We consider these trends long term and expect that capital spending will only continue to increase over this decade.

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Chart 6

North American regulated utilities' capital expenditure is rising



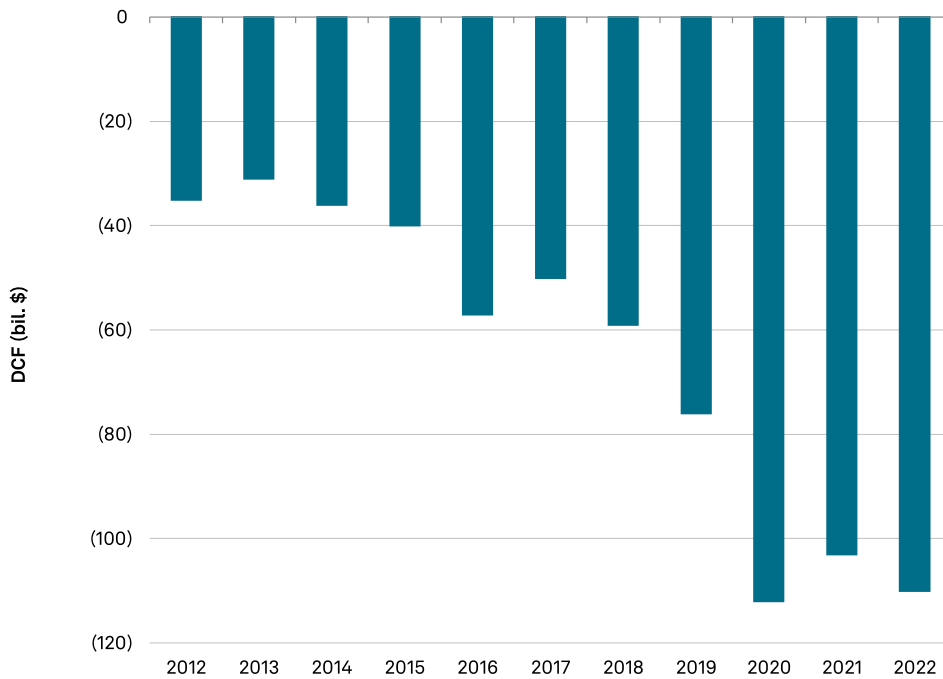
a--Actual. e--Estimate. Source: S&P Global Ratings.

Accordingly, cash flow deficits have increased, pressuring the industry's credit quality. For 2024, our base case assumes that the industry will fund its approximate \$85 billion of cash flow deficits with about \$40 billion in asset sales and equity issuance.

Rising Risks: Outlook For North American Investor-Owned Regulated Utilities Weakens

Chart 7

Discretionary cash flow (DCF) of rated investor-owned utilities



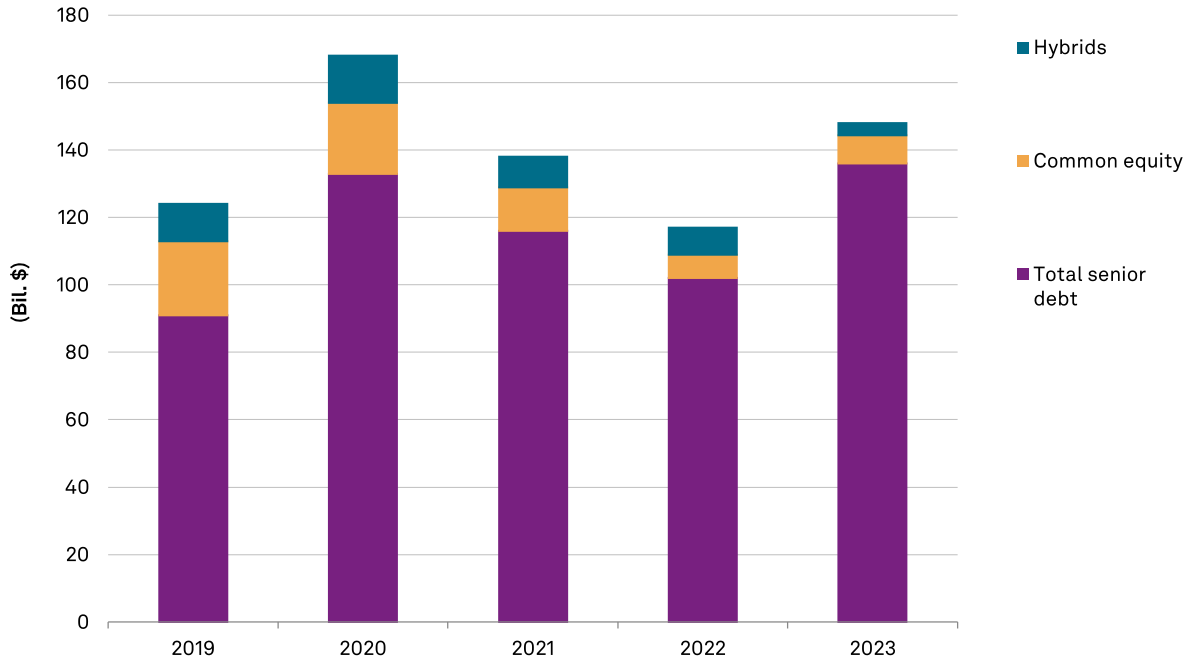
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For 2023, the industry's actual equity issuance was considerably below our expectations, resulting in a weakening of financial performance and credit quality. If this trend persists, credit quality will again likely experience pressure in 2024.

Rising Risks: Outlook For North American Investor-Owned Regulated Utilities Weakens

Chart 8

Capital market issuance for North American regulated utilities



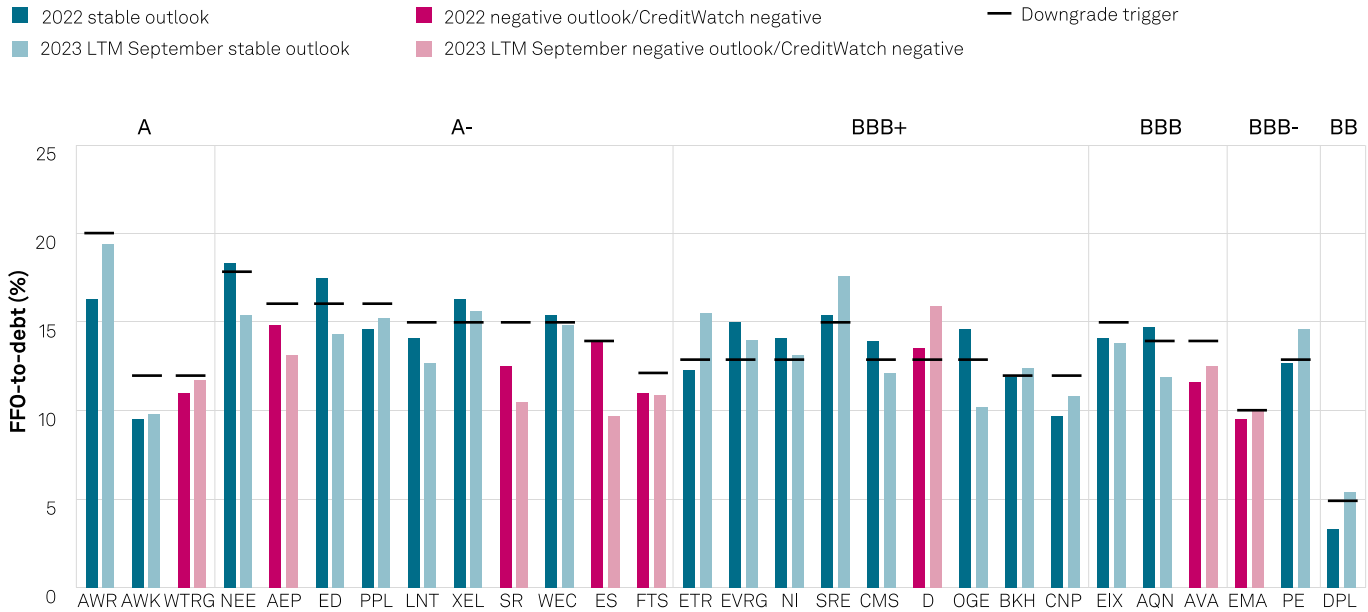
Senior debt includes first-mortgage bonds and senior unsecured. Hybrids includes junior subordinated debt, preferreds, subordinated debt, and equity units. Source: S&P Global Ratings, S&P Market Intelligence. Copyright © 2024 by Standard & Poor's Financial Services LLC. All rights reserved.

Strained financial cushion

About 35% of the industry is sustaining performance with minimal financial cushion, reflecting funds from operations (FFO) to debt that is less than 100 basis points (bps) above their downgrade threshold. The limited financial cushion affects a company's ability to absorb unexpected events beyond the base case for our ratings, increasing its susceptibility to a downgrade. Such unexpected events include higher interest rates, changes to inflation, delays to offshore wind projects, and rising taxes.

Rising Risks: Outlook For North American Investor-Owned Regulated Utilities Weakens

North American regulated utilities with minimal financial cushion



Data as of Feb. 6, 2024. FFO--Funds from operations. LTM--Last 12 months. AWR--American States Water Co. AWK--American Water Works Co. Inc. WTRG--Essential Utilities Inc. NEE--NextEra Energy Inc. AEP--American Electric Power Co. Inc. ED--Consolidated Edison Inc. PPL--PPL Corp. LNT--Alliant Energy Corp. XEL--Xcel Energy Inc. SR--Spire Inc. WEC--WEC Energy Group Inc. ES--Eversource Energy. FTS--Fortis Inc. ETR--Entergy Corp. EVRG--Eversgy Inc. NI--NiSource Inc. SRE--Sempra. CMS--CMS Energy Corp. D--Dominion Energy Inc. OGE--OGE Energy Corp. BKH--Black Hills Corp. CNP--CenterPoint Energy Inc. EIX--Edison International. AQN--Algonquin Power & Utilities Corp. AVA--Avista Corp. EMA--Emera Inc. PE--Puget Energy Inc. DPL--DPL Inc. Source: S&P Global Ratings. Copyright © 2024 by Standard & Poor's Financial Services LLC. All rights reserved.

Upcoming debt maturities amid higher interest rates

The industry has considerable near-term debt maturities that must be refinanced, as well as rising discretionary cash flow deficits that are mostly funded with debt. Because of the regulatory lag, which is the timing difference between when a utility incurs costs and when it's recovered from ratepayers, rising interest rates weaken financial performance. S&P Global economists expect the federal funds rate will stabilize in 2024 and then begin to modestly decrease. Accordingly, as interest rates stabilize, it will ease pressure on the industry's financial performance.

Additionally, the spread between the 10-year treasury and the average authorized return on equity (ROE) has narrowed. Over the past three years, the 10-year treasury has increased by about 250 bps to about 4.0% from about 1.5% at year-end 2020. At the same time, average authorized ROE has essentially remained flat at about 9.5%. The narrowing of this spread directly hinders the industry's financial performance.

Elevated inflation rates

Although the rate of inflation has slowed from 2022 levels, it remains elevated relative to historical levels. We anticipate this will result in higher operations and maintenance (O&M) costs that could weaken financial performance. While some utilities have interim mechanisms that reduce the regulatory lag, most will have to file rate cases on a more frequent basis if inflation remains higher

Rising Risks: Outlook For North American Investor-Owned Regulated Utilities Weakens

over the longer term.

Delayed renewable energy projects

Recently, several large offshore wind projects were delayed or canceled because of rising costs for these more challenging projects. For example, we recently placed Eversource Energy's ratings on CreditWatch with negative implications directly related to its share of higher costs associated with its offshore wind projects.

Alternative minimum tax (AMT)

The Inflation Reduction Act of 2022 includes a 15% corporate AMT that we expect will weaken the financial measures of only about 10% of the industry. This is because the AMT is applicable to corporations with at least \$1 billion of income that also do not have sufficient offsetting tax credits. Accordingly, we expect that most fully integrated large utilities with a growing or significant renewable generation portfolio will use their renewable tax credits to minimize or eliminate the AMT. However, the AMT could weaken financial measures of large electric transmission and distribution utilities, large natural gas local distribution companies, and large water utilities.

Lower-Rated Companies Will Likely Protect Credit Quality

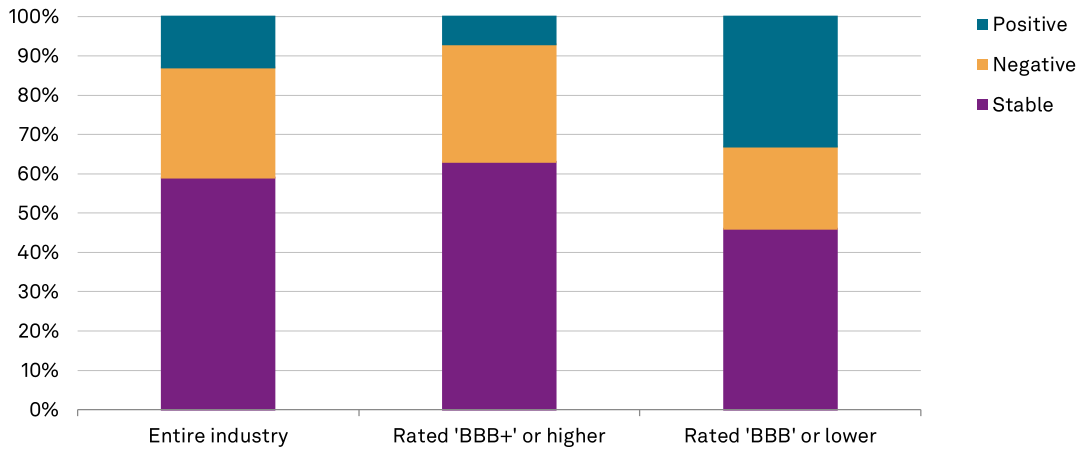
We expect a majority of the industry's future downgrades will come from companies that are currently rated 'BBB+' or higher, as about 30% of companies in this category have a negative outlook. Overall, these higher-rated companies account for about 75% of the industry's portfolio. Conversely, we expect companies rated 'BBB' or lower will likely take measures to support or improve credit quality. This reflects the more than 30% of companies in this category that have a positive outlook.

Consequently, there is a broad industry trend that is bifurcating higher-rated and lower-rated companies that will likely result in weakening credit quality for the higher-rated companies and stable to improving credit quality for the smaller percentage of lower-rated companies. We believe this trend is consistent with the industry's current economic conditions of robust growth, cash flow deficits, and higher interest rates. Some higher-rated companies are determining that, under current conditions, they have excess credit capacity while lower-rated companies believe it is most optimal for them to operate at a higher rating.

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Chart 9

North American regulated utilities outlook at year-end 2023



Source: S&P Global Ratings.

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