Q. In Order No. P.U. 13(2013), page 31, lines 13-16 and Order No. P.U. 18(2016), page 39, lines 14-25 the Board decided a downward adjustment of 50 to 100 basis points should be made to the DCF method to account for differences in U.S. and Canadian experience. On page 33, lines 16-20 and on page 34, line 12-13 of his report, Mr. Coyne states that an adjustment in the U.S. results is not required and states the results for the U.S. proxy groups are already below the Canadian proxy group. Figure 9 from Mr. Coyne's October 16, 2015 Report in Newfoundland Power's 2016-2017 General Rate Application shows that DCF results were also higher for the Canadian proxy group than the U.S. one at that time. Why should the Board conclude now that the fact the DCF results are higher for the Canadian proxy group than the U.S. group is a relevant factor?

A. There have been three decisions issued by Canadian regulators since the Board's Order No. P.U. 18(2016) that discussed the use of the DCF method and U.S. data. Those decisions are provided in the response to PUB-NP-056. All three decisions accepted the use of U.S. data and U.S. proxy groups to estimate the cost of equity for a Canadian utility. None of those decisions made a downward adjustment to the DCF results to account for differences in risk between utilities in Canada and the U.S., although the British Columbia Utilities Commission indicated in its 2016 decision that it placed limited weight on the DCF results for the U.S. proxy group. The recent Alberta Utilities Commission order in the 2018 Generic Cost of Capital proceeding indicated the AUC considered Mr. Coyne's multi-stage DCF analysis using a North American proxy group (which consisted of 11 electric utilities in the U.S. and three electric utilities in Canada) to be the most reasonable DCF result.

Mr. Coyne has presented evidence in this proceeding to demonstrate that the U.S. Electric proxy group is more risk comparable to Newfoundland Power than the Canadian proxy group. The U.S. DCF results are lower than the Canadian results because the Canadian proxy companies derive more of their operating income and have more of their assets devoted to operations that are gas operations and to unregulated activities, unlike Newfoundland Power which derives 100 percent of its operating income from regulated electric utility operations. The growth opportunities and risk profile for gas pipelines, gas distribution companies and unregulated businesses are not the same as for Newfoundland Power's regulated electric utility business. A downward adjustment to the U.S. data is not necessary for the reasons stated in response to PUB-NP-058.

Additionally, Standard and Poor's (S&P) has recently issued a report ranking the regulatory environments in the U.S. and Canada, as it has harmonized its approach to evaluating the risks of utilities, factoring "regulatory stability, tariff-setting procedures and design, financial stability, and regulatory independence and insulation." In its recent assessment, S&P ranks Newfoundland & Labrador in the "Highly Credit Supportive" category, which is the same ranking for the majority of the U.S. utilities it ranks. So there is no basis for any reduction to U.S. results based on this comparison. The S&P report is provided as PUB-NP-059, Attachment A.

S&P Report

S&P Global
Market Intelligence

U.S. And Canadian Regulatory Jurisdictions Support Utilities' Credit Quality--But Some More So Than Others

Jun 25, 2018

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Regulatory risk, what S&P Global Ratings calls "regulatory advantage" is a heavily weighted factor in its analysis of a regulated utility's business risk profile. Some recent developments are influencing our view of regulation in certain jurisdictions and the specific factors that we can use to determine the initial regulatory advantage when we are completing our credit analysis of each U.S. and Canadian regulated utility. In addition, because the U.S. and Canada have so many regulatory jurisdictions and numerous companies may operate in a single jurisdiction, we create assessments of the regulatory jurisdictions in U.S. and Canadian provinces that regulate the electric, gas, and water utilities that we rate. These provide starting points from which an analyst can begin to develop the initial regulatory advantage of a regulated utility or holding company with more than one regulated utility. For both determining the initial regulatory advantage of a rated entity and developing the assessment of a regulatory jurisdiction, we base our analysis on quantitative and qualitative factors, focusing on regulatory stability, tariff-setting procedures and design, financial stability, and regulatory independence and insulation. (See "**Assessing U.S. Investor-Owned Utility Regulatory Environments**," published Aug. 10, 2016, for more details on each category.)

Key Takeaways

- Regulatory risk is a heavily weighted factor in S&P Global Ratings' analysis of a regulated utility's business risk.
- Our assessments of U.S. and Canadian utility regulatory jurisdictions only differ in degree of credit supportiveness rather than in kind.
- We have reassessed our view of certain U.S. jurisdictions based on recent developments.
- The presence of utility regulation, no matter where in the spectrum of our assessments, strengthens the business risk profile and generally supports utility ratings.

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

Below we provide our snapshot view of each regulatory jurisdiction in the U.S. and Canada that has the presence of a rated utility, or operations of a rated utility. We group the jurisdictions based on the factors we've discussed above and the collective opinions expressed in the regulatory advantage determinations made in rating committees for approximately 225 U.S. and 30 Canadian utilities we rate. We've updated our assessments of regulatory jurisdictions (see the table listing the jurisdictions alphabetically within each category, and the maps of the U.S. and Canada indicating our updated assessments of regulatory jurisdictions). We designed the category titles to indicate one other important point regarding utility regulation and its effect on ratings. For the purposes of this commentary, we denote all categories as "credit supportive". To one degree or another, all utility regulation sustains credit quality when compared with the rest of corporate and infrastructure ratings at S&P Global Ratings. The presence of regulators, no matter where in the spectrum of our assessments, reduces business risk and generally supports utility ratings.

Assessing Regulatory Jurisdictions For Credit-Quality Supportiveness

Although we consider some jurisdictions "most credit supportive" it does not indicate that we think a commission in this category is a good regulator. Likewise, those jurisdictions we assess as only "credit supportive" does not indicate that we believe a commission is a bad regulator. We describe all jurisdictions as "credit supportive" and the designations only differ in degree rather than in kind. Finally, we designed the assessments to portray utility regulation in terms of its effect on credit quality (see table below).

Download Table

Assessments Of U.S. And Canadian Regulatory Jurisdictions

Credit supportive	More credit supportive	Very credit supportive	Highly credit supportive	Most credit supportive
Hawaii	Arizona*	Alaska	Arkansas	Alabama
Mississippi	California*	Delaware	Georgia	Alberta
New Mexico*	Connecticut	Idaho	Indiana	British Columbia
Prince Edward Island	District of Columbia	Illinois	Kansas	Colorado
	Maryland	Missouri	Louisiana	Florida

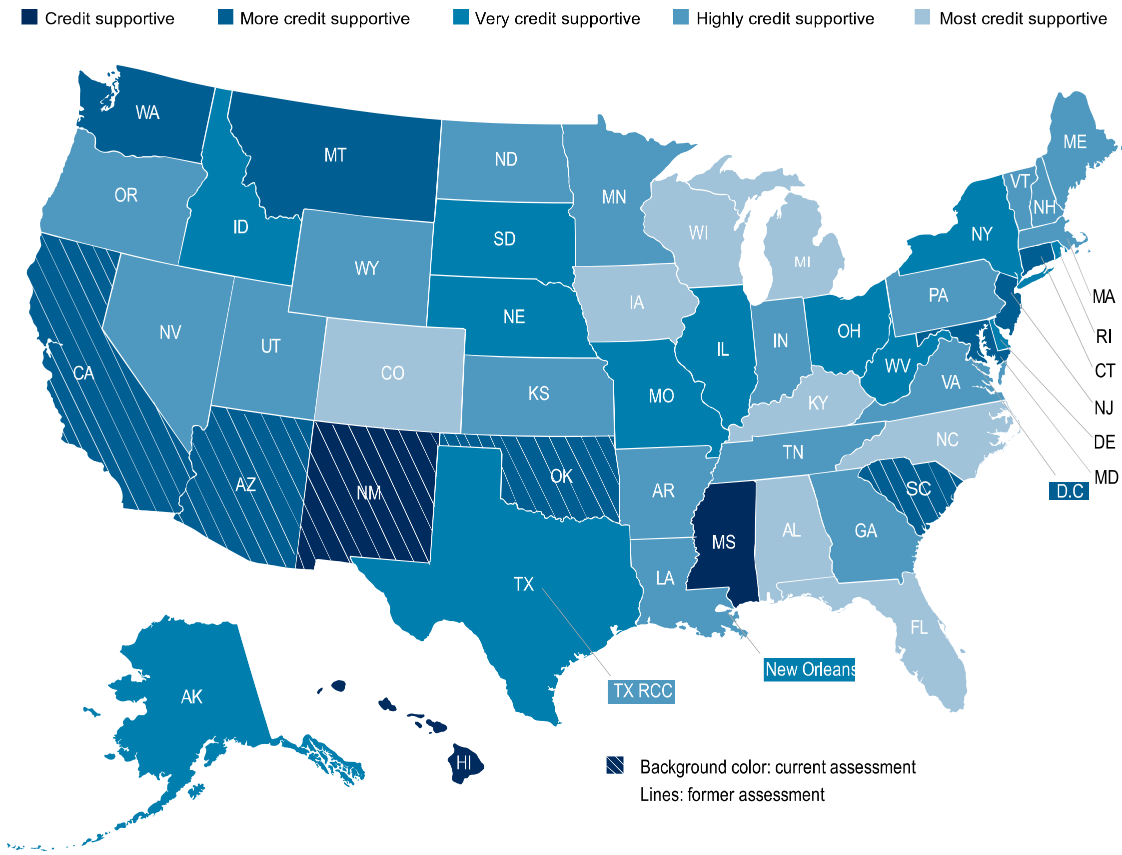
Montana	Nebraska	Maine	Iowa
New Jersey	New Orleans	Massachusetts	Kentucky
Oklahoma*	New York	Minnesota	Michigan
South Carolina*	Ohio	Nevada	North Carolina
Washington	Rhode Island	New Hampshire	Nova Scotia§
	South Dakota	Newfoundland & Labrador	Ontario
	Texas	North Dakota	Quebec
	West Virginia	Oregon	Wisconsin
		Pennsylvania	
		Tennessee	
		Texas RRC	
		Utah	
		Vermont	
		Virginia	
		Wyoming	

*Assessment lowered §Assessment raised. Source: S&P Global Ratings.

Mapping the regulatory jurisdictions

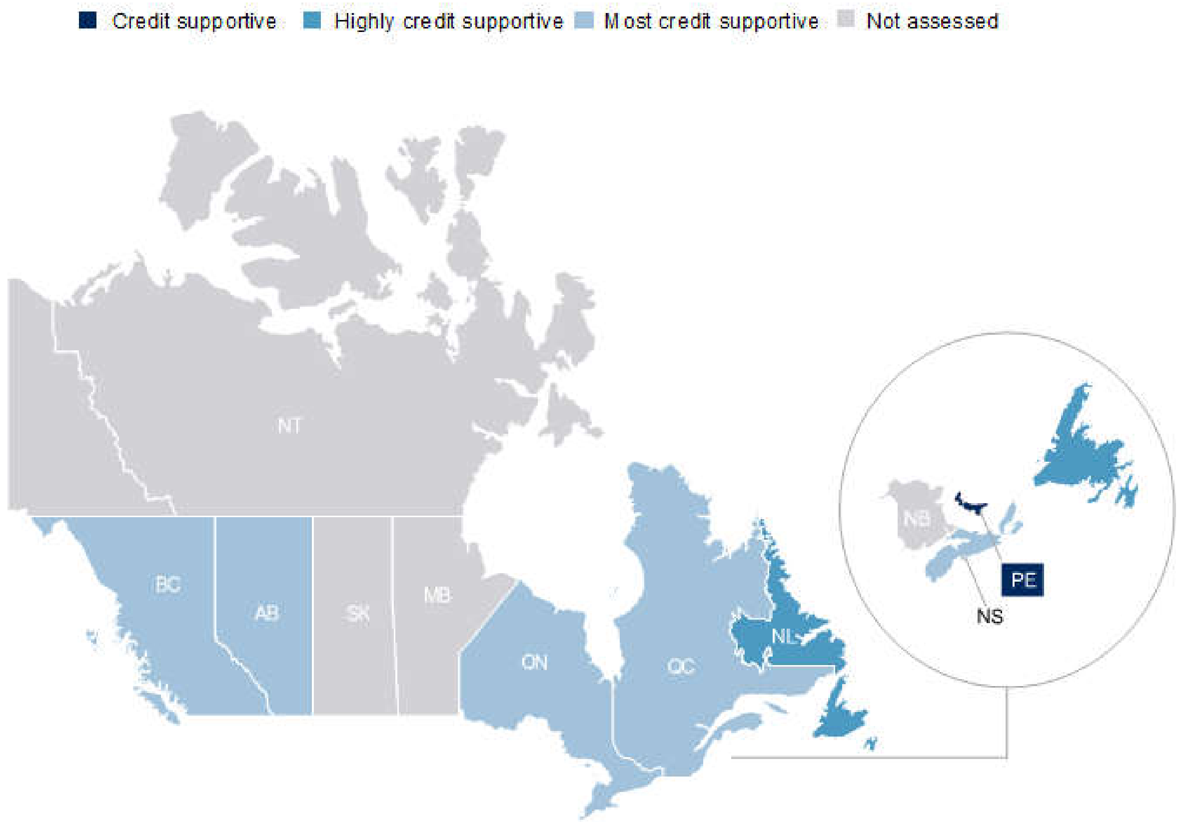
For jurisdictions assessed in the maps below, we have delineated the degree of credit support using shades of blue indicating those we consider credit supportive to those we believe are the most credit supportive. (We currently don't have assessments on some of the Canadian provinces.) The different assessments offer some granularity in our thinking about these jurisdictions' approach to regulation. Sometimes it will be due to trends such as the troublesome trends in the regulatory jurisdictions of California and South Carolina. Often it simply designates a stable jurisdiction that is slightly better or worse than its closest peers from a credit-quality perspective. We will be publishing in-depth updates on selected jurisdictions to bring even more focus on how regulatory developments could affect credit quality across the North American regulatory landscape.

S&P Global Ratings U.S. Utility Regulatory Assessments



As of May 2018. Source: S&P Global Ratings.

S&P Global Ratings Canadian Utility Regulatory Assessments



As of May 2018. Note: Currently there are no jurisdictions considered in the "more credit supportive" or "very credit supportive" categories. Source: S&P Global Ratings.

Recent Regulatory Assessment Revisions

We periodically evaluate regulatory jurisdictions and may determine that there has been a shift in terms of support for credit quality. Based on recent developments, we have determined that the following jurisdictions have experienced shifts around credit supportiveness.

Arizona

We revised our regulatory jurisdiction assessment on Arizona to "more credit supportive" from "very credit supportive," reflecting our opinion that regulatory independence and insulation has weakened lately. The regulatory environment is politicized in part because the commissioners at the Arizona Corporation Commission are elected, diminishing, to some extent, the credit supportiveness. Lately there has been increased leadership turnover at the commission as recently evidenced when the chairman of the commission left for the U.S. Department of Energy. In addition, in our view outside groups have asserted significant political pressure in regulatory proceedings.

California

We revised our regulatory jurisdiction assessment on California to "more credit supportive" from "highly credit supportive" because financial stability has weakened in the state. Over 20 wildfires in regulated utility Pacific Gas & Electric Co.'s (PG&E) Northern California service territory collectively spread over 245,000 acres. Regarding these wildfires, California's inverse condemnation rule could impose liability on California utilities for wildfire damages involving their equipment even without a determination of negligence. PG&E, and potentially other utilities in the future, could be held responsible for billions of dollars because of inverse condemnation with recovery of these costs not clarified. California regulators ruled in November 2017 in a Sempra Energy subsidiary San Diego Gas & Electric Co. case that it cannot permit rate recovery of costs that were the result of imprudence or negligence by the utility even though in legal proceedings an inverse condemnation determination had been found. The inability to recover through rates the wildfire costs in excess of insurance proceeds is not credit supportive.

New Mexico

We revised our regulatory jurisdiction assessment on New Mexico to "credit supportive" from "more credit supportive" to reflect a reduction in overall regulatory stability because of inconsistency in the regulatory framework in the state. In 2017, the New Mexico Public Regulatory Commission did not approve rate cases based on future test years despite the 2009 state law permitting the use of fully forecast test years in base-rate proceedings. In addition, the tariff-setting procedures that evaluates the ability of utilities to recover costs, including operating costs, and the disallowance of several capital investments weakens the overall credit supportiveness of the jurisdiction.

Oklahoma

We revised our regulatory jurisdiction assessment on Oklahoma to "more credit supportive" from "highly credit supportive," reflecting our opinion that there is reduced regulatory stability and less transparency of the regulatory framework. We've observed increased uncertainty in regulatory actions, which lowers the predictability of cash flow support of higher expenses, including depreciation expense, and a lag in processing rate cases. On the tax reform front, the state has been aggressive, including a request from the Oklahoma Attorney General for utilities to refund changes related to the tax reform.

South Carolina

Finally, we revised our regulatory jurisdiction assessment on South Carolina to "more credit supportive" from "most credit-supportive," reflecting our opinion that the political and regulatory framework is less transparent, less predictable, and has not been consistent with regard to historical actions. The construction cancellation of V.C. Summer nuclear units 2 and 3 resulted in reduced regulatory stability and less consistency. Regulatory independence has been eroded in South Carolina since the state legislature introduced legislation that could jeopardize existing cost recovery around the cancelled Summer units and the governor has publicly supported a rate reduction related to current cost recovery of already incurred Summer construction costs.

Related Criteria And Research

Related Criteria

- Criteria - Corporates - General: **Corporate Methodology**, Nov. 19, 2013
- Criteria - Corporates - Utilities: **Key Credit Factors For The Regulated Utilities Industry**, Nov. 19, 2013

Related Research

- **Assessing U.S. Investor-Owned Utility Regulatory Environments**, Aug. 10, 2016

Only a rating committee may determine a rating action and this report does not constitute a rating action.

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