Regulatory Issues Overview

RRA Presentation to NARUC’s Gas Committee

July 13, 2015
Lillian Federico
President
Regulatory Research Associates, a division of SNL Energy

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Who is RRA and what do we do?

- Established in 1982
- Dedicated team of professionals each with up to 35 years of experience in the industry
- Identify financial trends shaping the industry
- Independent research and analysis -- allowing clients to make better investment decisions
- Two-Tiered Approach—
  - RRA Regulatory Focus
  - RRA Financial Focus
- Principles -- Timeliness, Accuracy, Comprehensiveness
Regulatory Trends for 2015 and beyond

- **Capital Expenditures** – Focused on infrastructure
- **Rate Cases** – High level of activity
- **Earning the Authorized ROE** – Regulatory lag?
- **Riders** – Scope and complexity continues to expand
- **Alternative Regulation** – Streamline the regulatory process
- **Rate design** – Inter-/Intra-class rate subsidies -- SFV
- **Settlements** – To address complex/controversial issues
- **Mergers** – Drivers changing
- **Effects of Shale Gas** – Resource mix, new technology
- **Cyber Security** – How to address?
Capital Expenditure Trends

Graph 1

Total Capital Expenditures for 45-Company Universe (Historical and Forecast- $ Billions)

Source: RRA / SNL Energy
# Capital Expenditures—Gas Utilities

## Total Capital Expenditures for Gas Utility Holding Companies

<table>
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<td>259</td>
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<td>510</td>
<td>427</td>
<td>775</td>
<td>731</td>
<td>769</td>
<td>1,070</td>
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<td>623</td>
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<td>1,509</td>
<td>1,303</td>
<td>1,212</td>
<td>1,286</td>
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<td>1,472</td>
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<td>INTEGRYS ENERGY</td>
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<td>533</td>
<td>444</td>
<td>259</td>
<td>310</td>
<td>594</td>
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<td>865</td>
<td>983</td>
<td>978</td>
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<td>NISOURCE</td>
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<td>801</td>
<td>1,123</td>
<td>1,499</td>
<td>1,880</td>
<td>2,029</td>
<td>2,342</td>
<td>2,462</td>
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<td>ONE Gas</td>
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<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>272</td>
<td>292</td>
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<td>PIEDMONT NATURAL GAS CO.</td>
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<td>181</td>
<td>129</td>
<td>199</td>
<td>244</td>
<td>530</td>
<td>600</td>
<td>460</td>
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<td>680</td>
<td>625</td>
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<td>3,123</td>
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<td>SOUTHWEST GAS</td>
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<td>215</td>
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<td>364</td>
<td>397</td>
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<td>428</td>
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<td>QUESTAR CORP.</td>
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<td>320</td>
<td>368</td>
<td>371</td>
<td>399</td>
<td>319</td>
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<tr>
<td>VECTREN CORP.</td>
<td>281</td>
<td>335</td>
<td>391</td>
<td>432</td>
<td>277</td>
<td>321</td>
<td>366</td>
<td>393</td>
<td>448</td>
<td>405</td>
<td>395</td>
<td>360</td>
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<tr>
<td>WGL HOLDINGS</td>
<td>160</td>
<td>165</td>
<td>135</td>
<td>139</td>
<td>130</td>
<td>202</td>
<td>251</td>
<td>312</td>
<td>395</td>
<td>593</td>
<td>582</td>
<td>810</td>
</tr>
<tr>
<td><strong>Total ($ Millions)</strong></td>
<td><strong>6,995</strong></td>
<td><strong>8,054</strong></td>
<td><strong>7,991</strong></td>
<td><strong>7,410</strong></td>
<td><strong>7,702</strong></td>
<td><strong>9,029</strong></td>
<td><strong>11,031</strong></td>
<td><strong>11,451</strong></td>
<td><strong>12,401</strong></td>
<td><strong>15,280</strong></td>
<td><strong>15,980</strong></td>
<td><strong>15,399</strong></td>
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</table>
Rate Case Trends

Major Rate Case Decisions -- 1980 - 2014

Source: Regulatory Research Associates
As of Dec. 31, 2014
Drivers of Cap Ex/Rate Case Activity

- Remediating aging infrastructure
- Storm restoration costs
- Reliability- system hardening
- DSM/Energy conservation program mandates
- Environmental compliance
- Need for new generation
- Renewable Resource Requirements
- Transmission expansion

- Rising employee costs—pension and healthcare
- Weakness in (or lack of) sales growth
Authorized Return on Equity

Average Authorized ROEs in the U.S.- 1980 - 2014

Source: Regulatory Research Associates/SNL Energy
As of Dec. 31, 2014

SNL Energy
Drivers of Authorized ROE

- Interest rates – near historical lows
- Impact/timing of quantitative easing??
- Economic hardship for customers
- “Risk-reducing” mechanisms

- Economic uncertainty for utilities
- Utility liquidity/Financial health
- Incentive ROE premiums
Authorized Capital Structures

Average Common Equity to Total Capital (%) -- 1980 - 2014 YTD

Source: Regulatory Research Associates
As of: Dec. 31, 2014

SNL Energy
Weighted Average Cost of Capital

Average Authorized RORs in the U.S.-- 1980 - 2014 YTD

Source: Regulatory Research Associates/SNL Energy
As of Dec. 31, 2014
Earning the Authorized ROE—Regulatory Lag

More to it than the length of time to complete a rate case...

Statutory Time Frame/Rules (months)

- No requirements: 18%
- Less than or equal to 6 months: 9%
- Greater than 12 months: 6%
- 7 to 12 months: 67%

Source: Regulatory Research Associates
Test Year (at filing)

- Fully Historical: 66%
- Fully Forecast: 15%
- Hybrid: 19%

Source: Regulatory Research Associates
Rate Base Valuation Methodology

Rate Base Valuation Methodology

- Date Certain: 2%
- Year-end: 47%
- Average: 51%

Source: Regulatory Research Associates
Mitigation Approaches

- CWIP in rate base vs. AFUDC
- Fully forecast vs. historical test years
- Post-test-year adjustments
- Interim rate increases
- Rider Mechanisms
- Alternative regulation plans
- Use of Settlements
Rider Mechanisms

What are they being used for?

- Gas Commodity
- New capital investment
- Revenue Decoupling
- Conservation/DSM program costs
- Environmental compliance
- Extraordinary storm restoration costs
- Uncollectibles
Alternative Regulation Plans

- Formula-based rates and/or ROE
- Rate base additions
- Earnings sharing
- DSM/energy efficiency
- Fuel/gas procurement
- Service quality/management performance
- Merger savings sharing
- Capacity release/off-system sales
- Plant performance
- Renewables
- Emissions
- Energy trading
QUESTIONS?
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NARUC 2015 Summer Committee Meetings

Committee on Gas ROE / Wall Street investment
Regulators hold up their end of bargain by limiting reduction in ROE and ROR when compared to decline in 10yr UST
GAAP adjusted earned ROE’s are flat, and low risk LDC’s outperform.
FFO to debt is rising, but should reverse over time due to bonus depreciation / deferred taxes
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