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COMMENT

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Takeaways from NARUC Regulatory Meetings

On Monday we hosted meetings with 15 Commissioners from 12 States (AR, AZ, CO, GA, IL, MI, MO, ND, OH, OK, WA, WY) in conjunction with the National Association of Regulatory Utility Commissioners (NARUC) Summer Policy Summit in Scottsdale, AZ. Following our meetings we provide some of our key takeaways from our meetings. Feel free to reach out to the team with any questions or to setup a follow up call.

Key Takeaways:

- **WA**. Hydro-One/Avista merger consideration period ending soon but could be extended.
- **CO**. ROEs may be trending higher with interest rates, but risk reduction is a factor.
- **GA**. Skilled labor crunch at Vogtle, but holding firm on liability above the contingency.
- **ND**. Baaken activity continues to drive utility load growth as the need for pipeline capacity and NGL processing grow rapidly
- **AR**. Trade wars weigh heavy in Arkansas, and possibly its ROEs too.
- **MO**. Capital structure – SR case should not be seen as a precedent.
- **MI**. Emphasizing continued fair and reasonable treatment in Michigan after recent CMS and DTE electric rate outcomes.
- **OK**. Wind Catcher – watching Texas on a tight timeframe – a split vote is a distinct possibility.
- **WY**. BKH likely to file a Wyoming ratecase in the next year or two.
- **AZ**. If the Arizona Renewable Energy Standards Initiative passes in November, see the recovery of any possible stranded costs as important to maintain quality of service.
- **IL**. Support for nuclear under FEJA is bipartisan.
- **OH**. An FRR alternative for troubled baseload plants could require reopening all four utility Electric Security Plans (ESPs), a result that neither the utilities nor the regulators would prefer.

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Washington – Commissioner Balasbas

- **Hydro-One/Avista merger consideration period ending soon but could be extended.** The pending nine-party merger settlement remains under consideration through the 11-month statutory deadline for a decision that ends August 14. However, this could be extended by up to four months anytime up to that date. Washington has operated under the "net benefits for customers" and "public interest" standards ever since the Puget Sound merger in 2009.
- **US regulators have not yet consulted with the Ontario government.** Recall that on July 11, Hydro One CEO Mayo Schmidt announced his immediate retirement followed by the en masse resignation of Hydro One's Board of Directors. These actions occurred after the Ontario government under new Premier Doug Ford announced that it had reached an agreement with the company. On July 12, the commission issued a Notice of Intent on July 12 to conduct additional process in review of the proposed acquisition of Avista (AVA; uncovered) by Hydro One. Commissioner Balasbas noted that the Washington Utilities and Transportation Commission (UTC) had not yet communicated with the Ontario government regarding its intentions, nor has the UTC had an opportunity to review the agreement it reached with Hydro One.
- **Our Canadian colleague Andrew Kuske recently downgraded Hydro One to Neutral on the resulting political uncertainty.** We've noted previously that US investors have been keenly focused on the potential impact for the merger, still targeted for 2H18 closing after regulatory approvals are obtained from Washington, Oregon, and Idaho. Although Hydro One reiterated its commitment to the purchase on Friday, the new Board of Directors will not be in place until August 15 and US investors remain concerned. In May, we had noted the diluted influence of Ontario province ownership after closing (currently 47.4%; see our AVA notes from the AGA conference), with some investors at the conference highlighting this as a possible motivating factor behind the transaction. We continue to think that US state regulatory approvals are likely to face additional strain, especially considering the region's prior experience with unstable acquirers (Enron/PGE) and the importance that these regulators place on supportive sponsorship.
- **Considering options after tax reform.** While the UTC expects the benefit of a lower federal tax rate to flow to customers, it continues to consider options for the treatment of regulatory liabilities from excess deferred taxes. For example, this may include support for investment funding as well as rate credits.
- **On ROE and capital structure,** Commissioner Balasbas is supportive of rate settlements that are fair, just, and reasonable, with three possible outcomes: approve, reject, or approve with conditions (the last option is rarest). AVA's latest authorized ROE was left unchanged at 9.5% in the April GRC order approving a settlement. The utilities are generally authorized their actual capital structures, with hypotheticals granted only in extraordinary circumstances.
- **Supportive of multi-year settlements.** Although generally supportive, also note that AVA's last rate order trimmed the three-year request to a single year to account for merger uncertainty, a pending depreciation study, and tax reform impacts.
- **On generation investment recovery,** Commissioner Balasbas expressed some personal willingness to consider providing an equity return for imputed debt associated with utility power purchase contracts. Recall that last year, Chairman Danner cautioned that although such a benefit was granted for the Centralia contract, this was a unique circumstance and should not be taken as a precedent for future PPAs.
- **Aggressive carbon target initiative has made it to the November ballot.** If approved, the initiative would set a \$15/ton carbon price in 2020, escalating \$2 per year. Furthermore, the legislature is apparently considering a 100% clean energy

standard by 2045. Aside from these possibilities, the utilities' most recent Integrate Resource Plan (IRP) filings show little need for new generation through the mid-2020s (Puget Sound is running an all-source RFP). Renewable mandates are currently 9% but grow to 15% in 2020, with all utilities appearing able to meet the targets.

Colorado – Commissioners Ackerman and Moser

- **ROEs may be trending higher with interest rates, but risk reduction is a factor too.** Commissioner Ackerman noted that conceptually, rider mechanisms and multi-year rate plans are risk-reducing factors that potentially reduce an appropriately authorized ROE. For similar reasons, both Commissioners Ackerman and Moser see gas utilities as less risky enterprises versus electric utilities, which justifies an ROE spread between the two (Moser thinks ~25 bps seen in other states may be too narrow). We note that recent authorized ROEs in Colorado have been somewhat below the 9.6% national average (9.35% recommended in XEL's pending gas case)

- **On parent vs operating company leverage**, Commissioner Ackerman thinks it's fair to consider consolidated holding company leverage in establishing authorized capital structures, although rate filings also typically include operating company leverage. Commissioner Moser thought that holding company leverage should be the primary factor, although she was also amenable to settled outcomes, even if above the 48%-52% equity range she previously indicated as reasonable. In our opinion, this makes sense as settled outcomes usually include a variety of compromises expressed through all of the final operating metrics, hence a full evaluation should not focus on any one particular settled number in isolation.

- **On renewables,** Commissioner Moser emphasized her support for reasonably priced projects and programs, but noted that more work needs to be done to educate the public on the economics of renewable power. Many constituents she's spoken to appear to believe that renewable power is essentially free since there are no fuel charges, hence adding more to the system should always result in bill reductions. There is little recognition among them for the need to recover capital expenses and pay for any excess undepreciated plant upon the early retirement of fossil units (stranded assets problem). Commissioner Ackerman noted that the IRP process with competitive bidding governs the resulting ownership of renewables (utility ratebase vs PPA), with XEL proposing an ambitious ownership plan in its latest plan (although the recent "120-day report" had lower percentages). Commissioner Moser added that having the utilities ratebase some projects through build-transfer agreements helps boost the financial health of the utilities, while Commissioner Ackerman noted that utility ownership demonstrates a commitment to the state's "portfolio approach", which comes largely from XEL (Black Hills is more one project at a time rather than a large continuous program). On geography, the southern half of the state is sunnier and more amenable to solar installations.

- **On battery storage, electric vehicles (EV), time-of-use rates, and distributed energy,** Commissioner Moser noted small pilot programs are in place but it will probably be "awhile" before gaining meaningful scale. On EV charging stations, Commissioner Ackerman noted that although the law currently prohibits utilities from owning charging stations, he thinks the utilities are in a good position to understand how EV load fits into the larger system and how to optimize that load placement and integration (makes a comparison to long-standing utility management of demand-side-management programs, which are in some ways a mirror image of incremental EV load). Recent legislation encourages more electric storage through utility IRPs, and there is a "truce" on net energy metering policy for time being. Commissioner Ackerman expressed hope that storage compensation and costs could be handled effectively through innovative rate designs, but also noted that there is much to learn about storage capabilities, cycling rates, etc… that can only be learned over time with units in the field.

Georgia – Commissioner Pridemore

- **Skilled labor crunch at Vogtle.** Commissioner Pridemore noted that labor unions have extended their search to Canada as they assist Southern Nuclear and Bechtel staff up on increasing requirements for specialized craft Standard Occupation Codes (SOCs). The higher-skilled labor is required for the construction and connection of more complex internal systems at the Vogtle nuclear construction site as the project progresses beyond the initial structural and modular installation phase. Pridemore noted that Vogtle remains eight months ahead of its official schedule for completion in Nov 2021/22.

- **Holding firm on the budget though.** Pridemore noted that it is not yet known whether budgeted contingencies will be enough to cover possible excess labor costs, although she was firm that the Vogtle's owners (including SO) are expected to cover any amounts that exceed the contingency.

- **Republicans largely favor Vogtle, but there are opposition groups.** These include three major organized groups that support renewable power, including (1) Nuclear Watch South, (2) Georgia Power Watch, and (3) Interfaith Power and Light. Although the state has a history of Republican dominance, we note that the runoff this year in the Governor's race illustrates a strain of "purple" that investors should monitor.

- **Georgia Power equity ratio to be revisited in the ratecase.** This is not a surprise, with the recently granted 55% authorized equity layer (in response to tax reform impacts on cash flow) to be reevaluated along with all other parameters in next year's general rate filing, required to be filed no later than Jun 2019 as a condition of the AGL acquisition approval. Commissioner Pridemore noted that the 55% was granted to keep the utility and its credit ratings healthy and she would expect the same considerations to remain in play next year as well.

- **Georgia Power IRP to be filed in early 2019.** We expect some focus on the coal power fleet as well as renewables. Under the Georgia Renewable Energy Development Initiative, 1,200 MWs of market-priced renewables are sought from 2018-2021 through a competitive bidding process with no restriction on utility ratebased ownership. In addition, 200 MWs of self-build renewables for utility ratebase are authorized (FSLR to begin construction in Nov 2018) and up to 200 MW for commercial/industrial customers have been approved as well.

- **No EV program… Hmmmm.** There are no significant programs to encourage either distributed renewables or electric vehicles (EVs) in the state. The lack of a major EV initiative remains a bit of a mystery to us given the Vogtle project will increase Georgia's supply mix to 25% nuclear (from 17% now) and is an ideal carbon-free supply for EVs. The extra load growth (at the expense of the oil industry) would boost Vogtle's value to customers as well.

- **Grid security a focus, storm hardening not so much.** While Hurricane Irma caused more inland damage to the state's agricultural industry than Matthew, storm hardening is not as high a priority as investors might think due to the relative lack of coastline in Georgia (compared with the Carolinas for example). Instead, Commissioner Pridemore emphasized grid security, particularly for its abundance of military bases, as a higher priority.

Arkansas & North Dakota – Commissioners Thomas, O'Guinn, and Kroshus

- **Trade wars weigh heavy in Arkansas.** Recent ROE orders have been in the 9.5%-9.75% range (ETR's gas and electric utilities, respectively). Formula rate bands are similar, although the mechanism is new and so far has operated more like an annual ratecase that probably needs more streamlining. While higher interest rates have put some upward pressure on ROEs, recent trade war pronouncements have had a significant negative effect on crop pricing (particularly for soybean prices, down 20%) and give the commission pause on raising ROEs and utility bills during a time of economic distress (albeit, Commissioner Thomas remarked that their cost of capital modeling may not be long term enough).
- **While in North Dakota, Baaken activity continues to drive utility load growth.** A notable feature is that oil and gas producers are limited on flaring no more than 12% of their gas as of Nov 1, 2018 (declining to 10% in 2019). This forces them to move gas to markets, driving strong growth for pipeline infrastructure and natural gas liquids (NGL) processing, with five plant expansions in the last 12 months. With a relatively sparse population density, even strong residential load growth is not a significant mover for the state's utilities, but strong industrial growth keeps the state and its regulatory policies generally pro-business.
- **Rising interest rates and ROEs are a challenge in North Dakota too.** Despite a robust oil-patch economy, industrial customers remain sensitive to rising ROEs. However, Commissioner Kroshus also sees healthy utilities as major contributors to the state's economic health and employment. See ROEs in the 9.5%-9.75% as reasonable for now, which is a bit higher than the 9.35%-9.45% more appropriate a year ago.
- **Wind Catcher musings….** Although the project has been approved in Arkansas, it awaits critical approvals in Oklahoma and Texas (see Oklahoma section). Commissioner Thomas mused that a partially merchant Wind Catcher project could still be profitable delivering power out of the "LMP black hole" that exists in the Oklahoma panhandle. However, our understanding is that failure to receive regulatory approval in Texas or Oklahoma as a utility-sponsored project would likely halt it outright.
- **Black Hills – in the right place.** Commissioner Thomas noted that BKH's SourceGas territory is among the faster growing economic regions of Arkansas (faster than CNP's), with load growth driven by Walmart, Tyson, among others.
- **On renewables, neither Arkansas nor North Dakota have mandatory standards.** Commissioner Thomas explained that Arkansas prefers a free market approach, especially given new technologies with rapidly declining costs. Furthermore, utilities are allowed to keep 20% of any margins earned on renewables vs MISO market pricing. He emphasized that the state continues to prepare for a future possible reincarnation of the Clean Power Plan, but with more of a market solutions emphasis. In North Dakota, Commissioner Kroshus explained that with 3,000 MW of wind already installed and another 3,000 MW being discussed, there has been no need to set any mandates beyond the voluntary 10% renewable goals now in place.
- **Coal powered cars.** Commissioner Kroshus made the point that with shifting demographics, North Dakota may surprise with some clean initiatives, including faster electric vehicle (EV) adoption driven in part by support from the state's sizable lignite industry seeking to boost electric demand. We note in the Wyoming section that the coal industry remains focused on various clean coal and carbon sequestration initiatives despite the industry's sharp decline in recent years combined with most utilities planning to phase coal out of their generation fleets over the next few decades.

Missouri – Commissioners Hall and Rupp

- **Modest impact expected from electric legislation.** Both Commissioners Hall and Rupp expect a relatively moderate impact from recently passed SB 564. The law should help reduce regulatory lag through a combination of options, notably (1) Plant In-Service Accounting (PISA) deferrals, or (2) decoupling mechanisms. Electric utilities may apply PISA by committing 25% of planned capital spend on grid modernization programs, although Commissioner Hall noted that this is unlikely to boost grid modernization plans much beyond that already planned before the law was passed.

- **Legislation for utilities is done for now.** Considering the amount of political energy expended this year to pass SB 564, it's unlikely we'll see any follow-on effort for gas utility regulatory reform in the next few years, at least. This is consistent with comments we heard from SR management at the AGA conference in May (they also said the urgency for reforms has been significantly tempered by the recent completion of a major ratecase this Spring.

- **Missouri continues to shift away from coal, but stranded cost economics may keep some plants open longer.** Currently, about 70% of the state's electric supply comes from coal but this is declining as the state continues toward a higher percentage of renewables in the mix, with a large interconnection queue for new units awaiting hookup. As such, Commissioner Hall foresees a future where regulators and the public will have to deal increasingly with potential stranded generation assets, with a need to factor in stranded costs into least-cost resource planning when deciding whether it makes sense to retire some coal plants early. For example, a regulated coal plant may still be competitive even against newer (and subsidized) renewable or gas assets when including the need to recover the stranded regulated investment.

- **Higher ROEs as a reward for good service.** Commissioner Hall noted that lower risk profiles at the utilities might justify a lower ROE, but the trend for ROEs was upward with rising interest rates, although not a dramatically shift thus far. Commissioner Rupp expressed his opinion that it would be appropriate to encourage and reward well-managed utilities with higher ROEs.

- **Capital structure – SR case should not be seen as a precedent.** Recall that in the recent SR ratecase, the issue of whether to use operating company or holding company leverage ratios to set authorized capital structure became a highly contentious issue. Ultimately, the commission ruled in favor of using the higher 54% operating company equity ratio as the company had proposed. However, both Commissioners Hall and Rupp cautioned against seeing this as any sort of precedent for future rate proceedings, although Commissioner Hall also acknowledged the value to investors of consistency in regulatory approach over time. Generally speaking, Hall was supportive of 50%/50% capital structures but when holding companies start to differ greatly from their operating companies as a result of acquisitions, this requires more scrutiny. In the SR case, Hall was supportive of using the lower holding company structure while Rupp supported the higher opco ratio. In the last KCP&L ratecase, the holding company ratios were applied in the final order, although Hall indicated this would probably require a new review in their next case, especially considering the likelihood of a major stock buyback at KCP&L's holding company Evergy as the merger was completed at a lower premium than initially contemplated.

- **On Electric Vehicles (EVs) and renewables,** Commissioner Rupp reiterated his longstanding position that utilities should be in the business of installing and owning (in ratebase) EV chargers, although currently AEE is prohibited from doing so as per their last rate order. As such, Rupp indicated that KCP&L would be advised to file an EV charger proposal of their own for the commission to consider.

Michigan & Wyoming – Commissioners Saari and Fornstrom

- **Emphasizing fair and reasonable treatment in Michigan.** Commissioner Saari stressed that the Public Service Commission (PSC) is committed to fair and reasonable rate reviews and treatment for all its utilities ("no favorites") and expressed some surprise at investor perception of the latest DTE electric rate order was disappointing on revenue requirements versus expectations. Both CMS and DTE currently have gas ratecases under review and DTE just filed a new electric case on July 6.

- **A June 28th order on Local Clearing Requirements (LCR) was rejected** by the Michigan Court of Appeals. The order as written created a pretty moderate requirement to begin with (only 4% of non-utility supplier capacity sourced locally starting in 2023/24, then escalating to 90% in the deep future), so this snag has only a small, virtually immaterial impact on CMS's valuation versus possible upside. The Court ruled that the 2016 Michigan energy law does not grant regulators the authority to create an LCR. An appeal from the utilities is possible, as without an LCR, they are ultimately responsible for backfilling any capacity deficiency from alternative energy suppliers that might result in reduced reliability. On the margin, CMS stands to benefit from an LCR as it might eventually result in higher capacity contract pricing for its unregulated Dearborn plant once the requirement is higher.

- **Wyoming coal industry woes.** Wyoming is responsible for 40% of US coal production and generates 90% of its power from coal, with 2/3 of that power exported to other states. Commissioner Fornstrom noted a continued severe economic impact from the decline of coal revenues and the loss of 500 coal mining jobs in Gillette in March 2016. Over 80% of electric load in Wyoming originates from industrial customers, and the city of Gillette alone shed 23% of its load in 2016. While higher oil prices have helped partially offset the impact, she also noted that there is no state income tax, so the loss of coal tax support has created a serious government funding hole that the state is only slowly climbing out of. The commissioner also highlighted approved transmission projects in support of coal by wire to Pacificorp as well as "45Q" carbon sequestration tax credit legislation and Wyoming as a showcase for new carbon capture technologies.

- **BKH likely to file a Wyoming ratecase in the next year or two.** This was the opinion of Commissioner Fornstrom and is consistent with our expectation for the company to wait until next year given healthy earned ROEs in Wyoming. She also noted that while the premium BKH paid for SourceGas was high, the company did not seek any recovery in rates. Should BKH seek to consolidate its gas utilities, we expect a fairly complex process of fairly resolving rate design issues between customer classes and utilities.

Oklahoma – Commissioner Hiett

- **Wind Catcher – watching Texas.** Commissioner Hiett expressed strong interest in the outcome of the Texas review for the proposed $4.5B, 2-GW Wind Catcher project, with a vote at the Public Utility Commission of Texas (PUCT) possible at the next open meeting on July 26. If approved by Texas and Oklahoma, the project would be jointly owned by AEP's SWEPCO utility in Texas (70%) and AEP's PSO utility in Oklahoma (30%). A 360-mile, 765-kV transmission line from the Oklahoma panhandle to Tulsa is a key component. Texas regulators have expressed reservations regarding customer guarantees and protections for Wind Catcher following a Texas Court of Appeals remand of a separate case where the PUCT had previously authorized cost recovery for the John Turk plant. Although Oklahoma would be eligible for "most favored" status that promises the same guarantees as other states, we expect Commissioner Hiett to conduct a thorough review, in tandem with PUCT, of guarantees provided to Oklahoma in the settlements, particularly in regard to the 103% cost capping provisions.

- **Tight timeframe for a decision is noted.** Commissioner Hiett also noted that the Oklahoma Corporation Commission has had only two weeks so far to review Wind Catcher settlements, which he acknowledged included more guarantees and concessions since parties agreed to extend the regulatory review period beyond the 240-day statutory clock that expired back in March 2018. AEP and its contractors (Invenergy and Quanta Services) have requested a decision from both states prior to August 6th in order to allow construction to proceed in time to capture the 18% federal Production Tax Credit (PTC). Although Commissioner Hiett stressed that this deadline is indeed possible, he questioned whether contractors were as rigid as they have expressed on the need for an August 6th decision. He also noted that he has not yet had the opportunity to review their contracts with AEP, nor has the commission yet been provided with an estimate of how much project value may be at risk if a decision is delayed beyond August 6th.

- **A split vote is a distinct possibility.** Commissioner Hiett appears to be in control of when a vote is scheduled as he is in possession of the only draft order (a product of many months unlikely to be replicated by either Commissioners Murphy or Anthony). Any announcement of a vote would lilkely be made with the usual 24 hours notice, with regular commission meeting held on Tuesday/Wednesday/Thursdays. Only two affirmative votes are needed to approve the project in Oklahoma, with approval possible even if the third commissioner remains silent. Should two votes be rendered in opposition to each other, this would effectively leave the third commissioner with a swing vote for an indeterminate time period. With Commissioner Murphy in a runoff election for Lieutenant Governor on Aug 28th, investors we've spoken with have noted her apparent opposition to Wind Catcher and the election support she has received from the oil and gas industry in the state (opposed to Wind Catcher) as a former oil and gas transaction and title lawyer. Our sense is that given his preference, Commissioner Hiett would like to postpone a vote until after Commissioner Murphy's runoff, although again, he stressed to us that as of now, it is possible to meet the Aug 6th deadline.

- **If Texas says no, unlikely to see a partial project.** Commissioner Hiett said that his understanding is that approvals are required across all jurisdictions for the project to move forward.

Arizona – Commissioner Olson

- **Voter education effort expected soon.** With the Arizona Renewable Energy Standards Initiative now likely to appear before voters in November, Commissioner Olson expects a privately funded education initiative to begin across the state. Olson has been consistently opposed to this initiative, which has been funded by Tom Steyer and would set a 50% renewable energy target by 2030 without any financial off-ramps or safety valves to protect the state's economy. Olson's early estimate is that the average residential customer bill could increase as much as $1,000/year as the cost of a vast rampup of renewable infrastructure works its way into purchased power costs and utility rates.
- **Compliance may be more complicated than voters imagine, possibly mitigating impacts.** Olson noted that if the initiative passes, there would be many bridges to cross toward compliance, and that the commission would be obligated to review all legal and regulatory alternatives to bridge the gap. We see these points as potentially mitigating the possible economic fallout from the initiative if it passes.
- **Recovery of stranded costs seen as important to maintain quality of service.** As we've noted previously, investors have been concerned that a rapid and vast rollout of mandated renewables could end up stranding PNW's prior investment in the Palo Verde nuclear facility, the nation's largest. On this issue, Olson said he doesn't want to prejudge the outcome of either the initiative's chances of passage or the regulatory response. Nevertheless, he also noted that Arizona would have a tougher time attracting future infrastructure and utility investment if investors were asked to shoulder stranded costs, with quality of utility service likely to suffer as well.
- **Ethics in the forefront of this year's election campaigns.** Unlike many other states, Arizona's commissioners are elected (so are Georgia's), and Commissioner Olson noted that ethical issues are front and center in the wake of corruption charges (bribery) against former commissioner Pierce. Olson voted in favor of several proposed amendments this year that would have adopted a new code of ethics and a rule against accepting campaign contributions from regulated companies, but these were rejected. Instead, the commission adopted rules requiring disclosure of such relationships with the reading of related statements into the record.
- **Could the voter initiative have down-ballot effects?** We see the possibility that Steyer's renewable ballot initiative may have the effect of drawing out additional Democratic voters this season, such that regardless of whether the initiative passes, there may be a secondary effect of boosting Democratic candidates for Commission seats this year. This, in combination with a focus on Pierce's bribery case, may create some incremental political and regulatory uncertainty into the election. However, we continue to note that with only two seats up for election this year, the Republican majority of the ACC is not in question, nor do we expect a major upheaval of state policies supporting both Arizona Public Service and increased renewable standards. The ACC includes five sitting commissioners, all currently Republicans who are elected for a four year term. The chairperson is chosen by fellow commissioners and keeps that role for two years. These currently include Chairman Tom Forese (term ends Jan 2019), Robert Burns (Jan 2021), Andy Tobin (Jan 2021), Boyd Dunn (Jan 2021), and Justin Olson (Jan 2019).

Illinois & Ohio – Commissioners Oliva and Haque

- **PJM "Paper Hearing" on capacity reforms could result in new state regulatory burdens.** Chairman Haque noted that if PJM approves a new "Fixed Resource Requirement" (FRR) alternative for financially troubled baseload units, this may create a requirement in Ohio to reopen all four of the state's Electric Security Plans (ESPs), an outcome that neither the utilities nor regulators would like to see. Alternatively, a fully expanded MOPR-ex proposal would be easier to implement. Haque also noted that potential cost impacts are still being evaluated but that he would expect default service to become incrementally more expensive if AEP's OVEC units and associated load were moved to an FRR regime. He also noted that there has been no dialogue with FES yet on these possibilities.
    - ***From our 7/2 Utilities Roundup*****: FERC capacity market proposal for PJM would go further than earlier proposals to accommodate state subsidies for nuclear and renewables.** On 6/29, FERC rejected PJM's "jump ball" and the independent monitor's "MOPR-ex" capacity reform proposals in favor of an expanded solution that would set minimum prices for all units without exception. States may also be given a new Fixed Resource Requirement (FRR) alternative to exclude subsidized units (and associated load) from competitive auctions, a small step toward state re-regulation, in our opinion. FERC opened a new docket (EL18-178) and intervenors have 60 days to comment plus 30 days for replies. However, FERC also proposed postponing next year's capacity auction (normally May) if needed and we agree with Commissioner LaFleur that 90 days may not be enough time for states with legislative requirements to make required decisions. Commissioner Glick also dissented on the grounds that PJM is oversupplied and prices are already too high. While Commissioners Powelson, McIntyre, and Chatterjee supported the new docket, we note that Powelson also announced on 6/28 his intention to resign in mid-August for a water industry lobbying post last week. We note that Powelson has been a strong supporter of competitive markets and was highly critical of the Trump administration's proposals for coal and nuclear subsidies. In any event, we continue to view PJM's consideration of energy market reforms this year as far more consequential for EXC's nuclear revenues than any of these capacity market reforms (the "Fast Start" docket should be decided around September, worth potentially \$1-\$2/MWh around-theclock with an impact to EXC's valuation of about \$1/sh). See our EXC note "Summer of Catalysts" for further detail.
- **No chance of Ohio nuclear support this year, but it's on the table for 2019.** Essentially, the process took a toll this year and expended political and regulatory capital. However, both gubernatorial candidates have come out in support of the Davis Besse nuclear plant, so supporting legislation may have a chance next year.
- **In Illinois, support for nuclear is bipartisan.** Commissioner Oliva represents Illinois on the Organization of MISO States (OMS), but noted that the state's Future Energy Jobs Act (FEJA) received bipartisan support in furtherance of both the state's clean energy goals as well as employment at the subsidized nuclear units (Quad Cities and Clinton) through the payment of Zero Emission Credit (ZEC) subsidies.
    - In our opinion, we see any possible implementation of an FRR alternative for EXC's nuclear fleet as creating a new regulatory burden in Illinois too, albeit easier than opening four ESPs in Ohio. However, as we see it, the state has already illustrated firm support for its nuclear units through a bipartisan legislative process. Under FRR, Illinois customers would no longer pay PJM for capacity credit on its nuclear units but we would

expect the state to redirect these revenues back toward the units (on top of the ZEC payments) in order to maintain the approximate same level of financial support currently paid to achieve the goals laid out in FEJA. Units that did not clear the last auction (Dresden, Byron) would essentially get their associated paying load "back" rather than have these customers now pay PJM for capacity from other sources.

- **With Illinois AMI deployment complete, looking at microgrids.** The next Illinois stakeholder grid study is expected in December. While Ameren's microgrid project is non-regulated, ComEd's microgrid is a ratebased program.

Companies Mentioned *(Price as of 17-Jul-2018)*

AES Corporation (AES.N, $12.85)
Ameren (AEE.N, $61.27)
American Electric Power (AEP.N, $70.44)
Avista US (AVA.N, $50.59)
Black Hills Corp (BKH.N, $60.89)
CMS Energy Corp (CMS.N, $47.6)
CenterPoint Energy Inc (CNP.N, $27.71)
DTE Energy (DTE.N, $106.38)
Duke Energy (DUK.N, $80.65)
Entergy Corp (ETR.N, $81.7)
Evergy (EVRG.N, $56.03)
Exelon Corporation (EXC.N, $41.92)
FirstEnergy Corp (FE.N, $36.26)
OGE Energy (OGE.N, $35.24)
Pinnacle West Capital Corp. (PNW.N, $80.24)
Southern Company (SO.N, $47.65)
Xcel Energy (XEL.N, $47.65)

Disclosure Appendix

Analyst Certification

Michael Weinstein, ERP, and Maheep Mandloi each certify, with respect to the companies or securities that the individual analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

As of December 10, 2012 Analysts' stock rating are defined as follows:

Outperform (O) : The stock's total return is expected to outperform the relevant benchmark* over the next 12 months.
Neutral (N) : The stock's total return is expected to be in line with the relevant benchmark* over the next 12 months.
Underperform (U) : The stock's total return is expected to underperform the relevant benchmark* over the next 12 months.

**Relevant benchmark by region: As of 10th December 2012, Japanese ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. As of 2nd October 2012, U.S. and Canadian as well as European ratings are based on a stock's total return relative to the analyst's coverage universe which consists of all companies covered by the analyst within the relevant sector, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities. For Latin American and Asia stocks (excluding Japan and Australia), ratings are based on a stock's total return relative to the average total return of the relevant country or regional benchmark (India - S&P BSE Sensex Index); prior to 2nd October 2012 U.S. and Canadian ratings were based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe. For Australian and New Zealand stocks, the expected total return (ETR) calculation includes 12-month rolling dividend yield. An Outperform rating is assigned where an ETR is greater than or equal to 7.5%; Underperform where an ETR less than or equal to 5%. A Neutral may be assigned where the ETR is between -5% and 15%. The overlapping rating range allows analysts to assign a rating that puts ETR in the context of associated risks. Prior to 18 May 2015, ETR ranges for Outperform and Underperform ratings did not overlap with Neutral thresholds between 15% and 7.5%, which was in operation from 7 July 2011.*

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