MCR

MANAGING COSTS TO MITIGATE RATES: THE NEW UTILITY IMPERATIVE

From mainstream media to regulatory conferences, rising utility bills have become a current topic, even though recent research shows that nationally prices have kept pace with inflation or—in some states—declined in real terms. At the same time, substantial utility capital investments, coupled with rising energy demand especially from AI and data centers, have increasingly focused investor attention on the utility sector. In other words, utility rates, growth, and spending are getting noticed, and that's not necessarily positive.

While growth is good for a utility's financial performance, history shows that simply passing costs on to customers—especially when sensitivity to bill inflation is heightened—can pose considerable regulatory and therefore financial risk. To better understand what's driving today's rate pressure, MCR examined publicly available capital and operating cost data from the last 10 years for a cross-section of 10 U.S. utilities. Our findings are summarized in this paper.

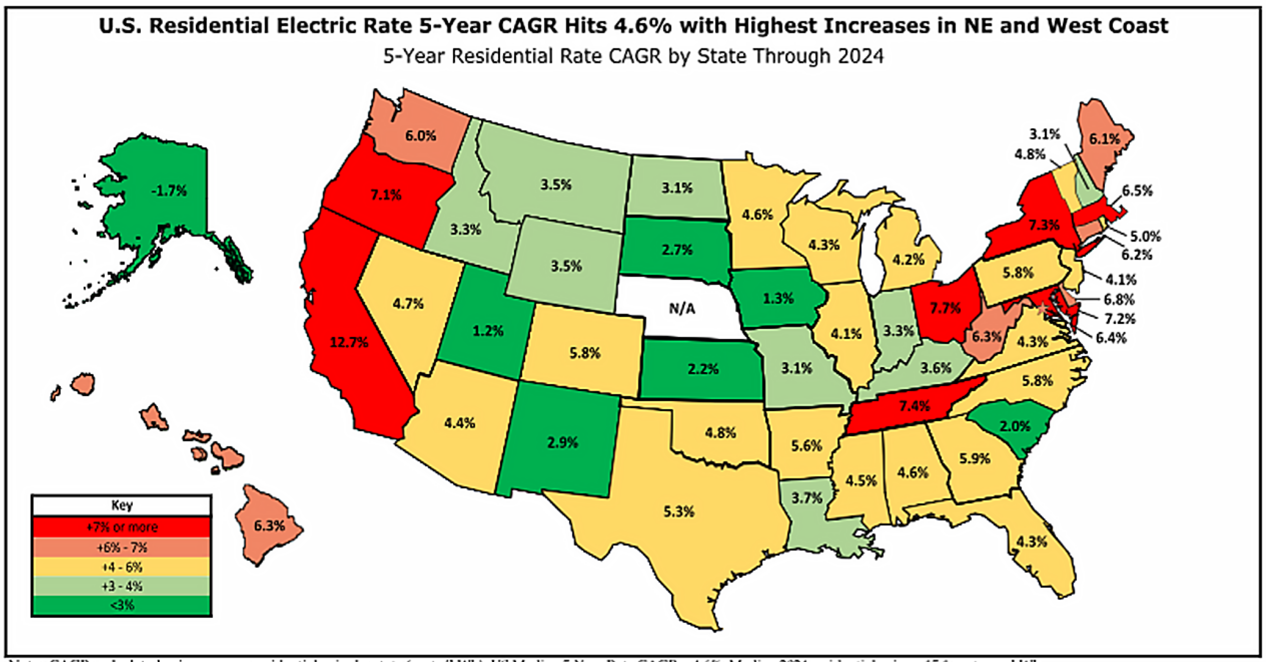
While some cost drivers, such as fuel or commodity inputs, may be difficult to control, a comprehensive and strategic approach to managing both operating and capital costs across the utility enterprise is a powerful tool to mitigate rate pressure and avoid the rate case arena. In our view, this can support constructive relationships with key stakeholders including regulators, customers, and policymakers—and steer clear of costly past mistakes, detailed below.

On the Radar

"When I take office, the average New Jersey family won't see an increase in utility rates for an entire year," proclaimed the Garden State's next governor during her campaign. Rising utility rates and bills are also attracting attention from major media outlets such as CNBC, CBS News, and Bloomberg, with theories on root causes ranging from rising use of renewable energy to tariffs to cancellation of renewable energy projects.

According to S&P Capital IQ data, the five-year compound annual growth rate (CAGR) of residential electricity rates averaged 4.6% for the period ending in December 2024. Amid rising inflation for consumer goods, that rate is not particularly shocking. However, as Figure 1 shows, the growth rate varies widely by state and region. The Lawrence Berkeley National Laboratory notes that residential electricity prices have risen faster than prices for commercial and industrial consumers. For a household budget item that barely increased at all between 2010 and 2020, this is a very big change.

Figure 1: Residential Electricity Price Heat Map



Note: CAGRs calculated using average residential price by state (cents/kWh); US Median 5-Year Rate CAGR = 4.6%; Median 2024 residential price = 15.1 cents per kWh
Note: Nebraska does not have any Investor-Owned Utilities
Source: SNL Financial LC and Wells Fargo Securities, LLC
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Reasons for upward rate pressure vary. Energy demand, particularly from data centers, is frequently cited, and indeed, data and studies reflect that growth. However, research by MCR and S&P Capital IQ indicates that utility capital investment (which drives rate base growth) began trending upward more than a decade ago, long before data centers entered the picture. As reflected in Figure 2, S&P expects even greater energy utility capital expenditures in the coming three years.

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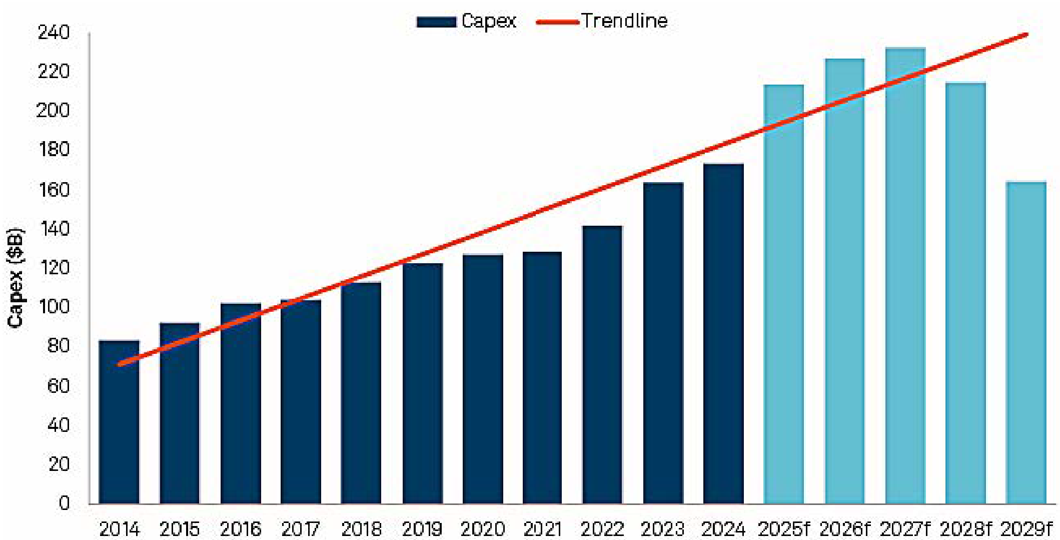
At the same time, rising U.S. exports of liquefied natural gas also exert upward rate pressure by increasing demand for gas, which supplies over 40% of U.S. electricity generation and heats over half of U.S. homes. Supply chain issues are another driver. Utilities are also experiencing rising costs and/or scarcity of everything from steel to transformers and gas turbines. Finally, financing is impacted by higher interest rates.

Looking forward, the looming expiration of tax credits for renewable energy likely adds inflationary pressure.

Figure 2: Energy Utility Capital Expenditure Trends



Compiled Sept. 15, 2025.
f = forecast.
Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.
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History May Not Always Repeat, But It Resonates

In our experience, utilities generally don't benefit from being in the news, particularly when the headline is about rate increases. History has shown that the so-called "regulatory compact" can be strained by rapidly rising customer bills. Today's surging energy demand from data centers echoes a similar pattern that emerged with industrial demand and adoption of air conditioning in the mid-20th century, followed by the 1973 oil embargo, natural gas shortages, political upheaval, increasing energy/environmental tensions, and challenging economic conditions.

To address demand and energy supply challenges, utilities invested heavily in infrastructure like large central station nuclear and coal-generating stations, built and financed in an era of high inflation and high interest rates (sound familiar?). By the mid-1970s, regulators were pushing back on utilities' ability to pass along increased costs to customers, leading at least one major utility to miss a dividend payment, a bombshell in that period.

Things only got worse as nuclear development suffered a crushing blow with the 1979 Three Mile Island incident, leading to prudency reviews, cost disallowances, and project cancellations, all of which further weakened utility industry finances. Utility bankruptcies, unheard of since the Great Depression, occurred in 1988 and 1992, while other companies endured years of financial strain. Even public power utilities faced financial distress.

Deregulation of electricity generation took off in the 1990s, and while about a dozen states retained competitive power markets, others abandoned those early efforts. California, which led the deregulation drive, saw its nascent competitive markets manipulated by bad actors, the largest of which collapsed in bankruptcy in 2001. While competition and improved technology have limited wholesale electricity price increases in real terms, a recent white paper by a Connecticut-based energy infrastructure investment firm concludes that distribution investments drove 65% of the increase in average U.S. electricity rates over the past decade. S&P also expects electric distribution spending to comprise a third of all utility capital expenditures between 2025 and 2028 (Figure 3).

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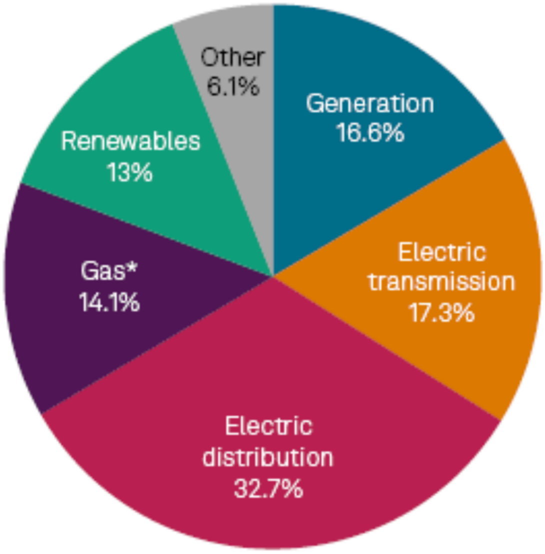
Figure 3: Utility Capital Expenditure Forecast by Business Functional Area, 2025–2028



Compiled Sept. 15, 2025.

* Gas includes pipeline, storage, distribution and other gas infrastructure.

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

From Tailwinds to Headwinds

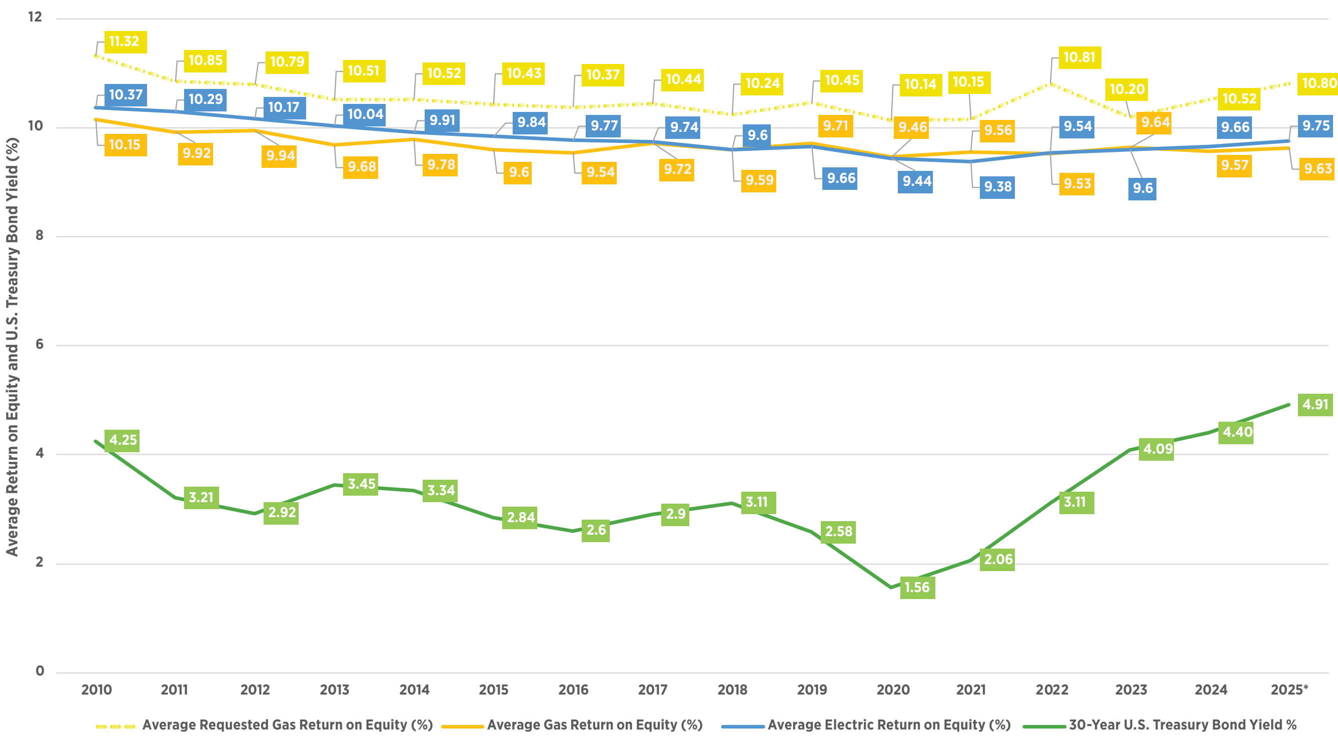
U.S. utilities are on more solid financial ground today. However, MCR first raised the issue of rising costs and rates in our "Triple-2" white paper in 2024. A decade of utility sector growth leaned heavily on the 2-2-2 tailwinds: $2.00 natural gas, 2% interest rates, and 2% inflation. That trifecta allowed utilities to invest cheap capital into their rate base, driving unprecedented earnings growth with everything from smart meters to transmission to renewable generation. However, it was becoming increasingly clear that managing costs, both operating and capital, would be critical to mitigate commodity volatility, customer bill pressure, and associated regulatory and political challenges.

Why Should Utility Managers Care?

In 2024 over 180 U.S. rate cases were filed and 155 were decided, split evenly between electricity and natural gas. As noted, rising utility bills are a growing topic in mainstream and financial media. The issue has also emerged in regulatory webinars and conferences, often couched in terms of affordability and energy justice. Regulators and policymakers face pressure to address rising utility bills as states consider drastic actions such as exiting regional power grids or re-regulating generation.

Faced with rising political pressure and sensitivity to issues of affordability, utility regulators may seek ways to mitigate rate growth, which could include lowering allowed returns on equity capital or increasing reliance on cheaper debt capital (interest expense is tax deductible). Figure 4 demonstrates this by showing that allowed equity returns have remained relatively static as interest rates have risen.

Figure 4: U.S. Utility Return on Equity vs. Interest Rates from 2010 to July 1, 2025



Source: MCR research, S&P Capital IQ, Bloomberg

Harsher regulatory actions aimed at mitigating bill inflation could include prudence reviews and cost recovery disallowances, as seen in decades past. Rate case backlogs in many states also may limit implementation of higher rates. Any combination of lower return on capital, disallowances, or delayed rate recovery of costs or capital investments can cause financial stress for utilities in the form of lower credit ratings, reduced access to capital, and higher financing costs—which are ultimately borne by customers.

A Closer Look—What's Putting Upward Pressure on Utility Rates?

To identify key drivers of upward pressure on utility rates, MCR examined trends in publicly available financial data from the last decade for 10 major U.S. utilities. Our research demonstrates that utility cost increases are not attributable to one single driver or class of customers. While clear trends emerged, performance differed between individual companies and regions. Thus, a combination of factors are collectively increasing rates, catching the attention of the media and regulators alike. Certain trends provide key insights into how utilities can manage costs in today's rising tide.

In sheer magnitude, the largest driver of rising costs over the last decade was growth in capital investment, consistent with S&P's findings noted above. Between 2015 and 2024, year-end plant-in-service increased by over 70% for these 10 utilities, ballooning from $220 billion in 2015 to over $374 billion as of year-end 2024. Figure 5 displays the growth in utility plant investment over this period.

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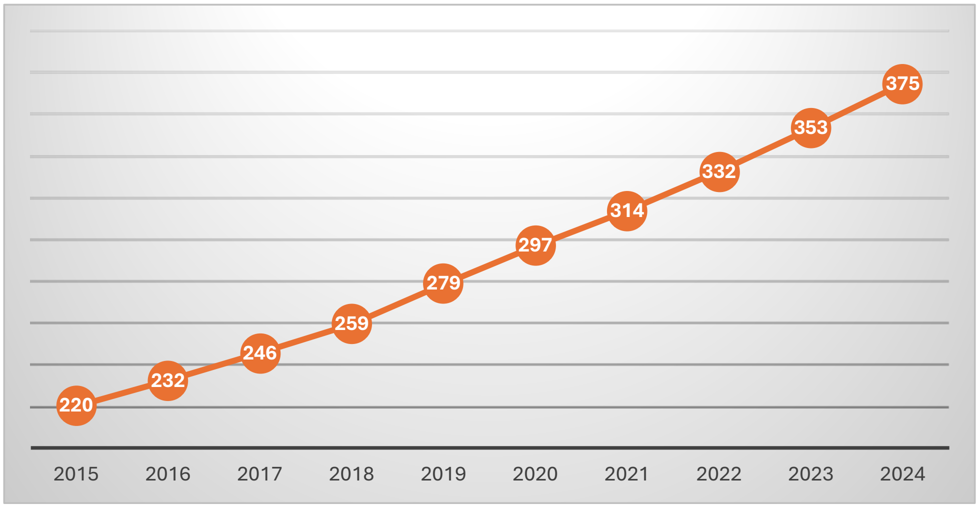
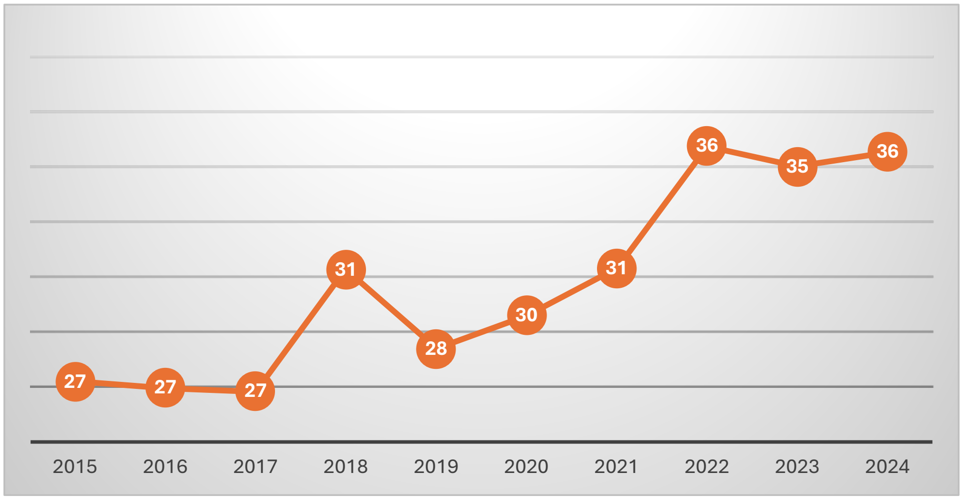
Figure 5: Plant-in-Service for 10 Major U.S. Utilities, 2015-2024 ($B)



While this reflects plant-in-service across the system, investment was focused less on production, which grew by 32%, and much more on the transmission and distribution (T&D) components of the electrical grid, which increased by 80% and 74%, respectively. The emphasis on T&D spending is consistent with findings by S&P reflected in Figure 3, as well as recent research by the Lawrence Berkeley National Laboratory. Here again, note that costs have steadily risen over the last ten years, even before the current surge driven by data centers and new technologies.

On the expense side, annual spending has also increased significantly. In total, annual operations and maintenance (O&M) expenses for the 10 utilities were 31% higher at year-end 2024 compared with 10 years earlier (Figure 6).

Figure 6: O&M Expense for 10 Major U.S. Utilities, 2015-2024 ($B)



While the 10 utilities' annual O&M spending remained relatively flat over the last three years, it is important to note that unlike capital expenditures, annual O&M spending is subject to more immediate recovery, meaning that any increase in costs has a more immediate impact on customers' bills.

Although drivers of O&M expenses vary by utility, two key trends emerged from our research. First, annual costs of providing customer service have risen by over 50% in the past decade, adding approximately $500 million per year compared with 2015 levels. Second, annual property insurance expenses—while a relatively small fraction of total O&M costs for certain utilities—increased by a staggering 241% over the prior decade, as, for example, utilities in wildfire-prone areas faced skyrocketing insurance costs. This single component resulted in over $340 million in increased annual spending compared with 2015.

While these key trends highlight some prominent drivers of today's rising utility costs, every utility's cost structure is different. Of the 10 utilities examined by MCR, some experienced significant increases in property insurance costs due to wildfire risk, while others experienced more pronounced cost growth due to distribution system upgrades and expansion. That is why a nuanced and detailed examination of a utility's cost structure has never been more important than it is today.

What Utilities Can Do—A Call to Action

Regulators may not directly order utilities to manage costs better, but they can set the level and timing of rate recovery. Once rates are set, company management has to run the business within the regulated revenue constraints. The current environment, in our view, presents a less-than-ideal backdrop for seeking increased revenue. Thus, now is a critical time for utilities to focus on costs, many of which—unlike revenue—are squarely within management's control and don't require regulatory approval to implement.

Aside from avoiding a regulatory proceeding, lowering costs offers a number of benefits, not least of which is improved profitability and returns, which enhance share price valuation, in turn lowering the cost of capital. Avoiding a regulatory proceeding is generally perceived as lowering risk in the capital markets, which also supports share prices, credit metrics, and ratings.

Beyond financial benefits, credible cost management plans and processes can give regulators, stakeholders, and customers compelling evidence that a utility is serious about efficient, cost-effective operation. Intelligent, transparent planning and cost management are also far more likely to support workforce engagement than periodic across-the-board headcount reductions and belt-tightening.

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Strategic Cost Management

MCR has helped numerous utilities implement and sustain processes to intelligently manage both operating and capital costs. These include risk-informed zero-based budgeting, detailed process and workflow analysis, capital project planning and portfolio optimization, implementation of best practices, and more. Most importantly, MCR's approach aligns spending with long-term corporate strategy rather than simply implementing short-term across-the-board "quick fixes."

MCR's cost management expertise has saved clients billions of dollars, and we are further refining our approach with AI-based analytical tools that enhance data capture as well as pattern and trend recognition. These important tools support informed, risk-based spend management and process optimization which in turn drive greater cost efficiency with the potential to moderate rates. Today's heightened focus on utility bills favors the utility that can avoid seeking increased rates. When a rate case is mandated or can't be avoided, the ability to demonstrate prudent, risk-informed O&M and capital spend helps convey a message of being part of the solution rather than part of the problem.

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