UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Inquiry Regarding the Commission's Policy	)	
for Determining Return on Equity	)	Docket PL19-4-000

COMMENTS OF DUQUESNE LIGHT COMPANY

I. INTRODUCTION

Duquesne Light Company ("Duquesne Light") respectfully submits the following comments in response to the Notice of Inquiry ("NOI")[1] issued by the Federal Energy Regulatory Commission ("FERC" or "Commission") on March 21, 2019. In the NOI, the Commission "seeks information and stakeholder views to help the Commission explore whether, and if so, it should modify its policies concerning the determination of return of equity ("ROE") to be used in designing jurisdictional rates charges by public utilities."[2]

Duquesne Light is a FERC-jurisdictional Transmission and Distribution only utility that serves approximately 590,000 customers and operates in parts of Allegheny and Beaver Counties, located in Western Pennsylvania and including the city of Pittsburgh. Duquesne Light operates over 670 miles of high-voltage transmission lines and over 7,200 miles of distribution lines. Duquesne Light has transferred operational control of its electric transmission facilities to the PJM Interconnection, L.L.C. ("PJM"), a Regional Transmission Operator ("RTO"). As a member of PJM, Duquesne Light is a Participating Transmission Owner ("PTO") that participates in PJM.

[1] Inquiry Regarding the Commission's Policy for Determining Return on Equity, 166 FERC ¶ 61,207 (2019) ("NOI").

[2] *Id.*

II. COMMENTS

The energy industry is undergoing tremendous change, including growth in distributed energy resources, increasing demand for electric vehicles, the emergence of Smart Cities and changing customer demands that include a desire for cleaner energy resources and an increasingly digital lifestyle. The industry must be able to attract sufficient capital in order to make investments to address these changes. As such, it is imperative that the Commission establish just and reasonable ROEs that fairly compensate electric utilities for the risks related to investing in transmission facilities in these circumstances. In establishing ROEs, the Commission should use multiple models to ensure that the composite zone of reasonableness fairly reflects the market and minimizes the shortcomings inherent in the use of any single model. The Commission should also ensure that it employs a proxy group that is large enough to provide a representative sample for establishing the composite zone of reasonableness. In addition, the Commission should seek to minimize the administrative burden on utilities related to both address multiple challenges of a utility's established ROE as well as the accounting required to track the returns of the utilities' investments in transmission assets. In doing so, along with providing proper incentives, the Commission will provide stable and predictable returns that are able to attract the capital needed to satisfy required investment going forward.

1. Duquesne Light Generally Supports The Proposed Methodology Proposed In The Emera Maine, Coakley And FERC Briefing Orders.

a. Duquesne Light supports using multiple models to provide a balanced approach to determine a zone of reasonableness for ROEs for public utilities.

The FERC Briefing Orders propose a new methodology in which a composite zone of reasonableness is established by averaging the results of the Discounted Cash Flow ("DCF") methodology, the Capital Asset Pricing Model ("CAPM"), and the Comparable, or Expected,

Earnings ("CE") model. This composite zone of reasonableness will then be divided in quartiles to determine presumptively just and reasonable ROEs for (1) below-average risk utilities, (2) average risk utilities, and (3) above-average risk utilities. Any complaint or challenge to an existing ROE under section 206 of the Federal Power Act ("FPA") will be dismissed if the Commission determines that the existing ROE falls within the quartile of the presumably just and reasonable ROEs for a utility of similar risk.

If an existing ROE is deemed to be unjust and unreasonable under this standard, the Commission will then determine a new just and reasonable ROE by averaging the estimated cost of equity produced by each of the three methodologies referenced above in addition to the Risk Premium model. Using this average cost of equity, the Commission will place the ROE in the central tendency of the respective zone of reasonableness for utilities of similar risk profiles. Subsequently, the newly determined ROE, plus any incentives, will be capped at the top of the broader zone of reasonableness determined in the first prong of the section 206 analysis.

While Duquesne Light generally supports the above methodology, Duquesne Light recommends that rather than use three of the four well-recognized measures of ROE proposed by the Commission, DCF, CAPM, and CE for establishing the composite zone of reasonableness, Duquesne Light also recommends using the Risk Premium ("RP") analysis in determining the zone.

Each model proposed rests on simplifying assumptions that do not comport with the real world functioning of the equity markets and/or investor expectations. For example, the DCF assumes a set of assumptions that include a constant rate of growth in earnings per share, dividends per share, book value per share and price per share. It therefore assumes that the price-earnings multiple, dividend payout ratio, earned return on book equity and market-to-book

ratio is unchanging. Any casual observation in the equity markets show that these assumptions are unrealistic. The Commission has previously recognized the shortcoming of the DCF when it referred to "model risk." But the unrealistic assumptions underlying DCF are not limited to this model alone.

Due to the limitations and constraints in each model, using more models is superior to using any single model in order to avoid unreliable or anomalistic results. Further, because no one model incorporates all market factors and conditions, using several models provides a better estimate of investor demands and reduces volatility inherent with using a single model.

Likewise, Duquesne Light recommends the Commission, accept inputs to these multiple models from various, well-regarded sources. For example, rather than accept analysts' forecasts on growth only from the Institutional Brokers Estimate System ("IBES"), the Commission should consider growth rate estimates from other sources used by investors, such as Value Line or Zacks. Investors do not typically rely on one single model form for making decisions, as described above. Similarly, investors do not seek out and depend on a single source of data on which to make decisions.

Finally, though Duquesne Light agrees with establishing bands of risk for establishing a just and reasonable rate, Duquesne Light recommends using a simplified approach of three segments of equal-size, divided in to higher risk, average risk and lower risk. In doing so, the middle third of the composite zone would represent reasonable ROEs for average risk utilities, into which most utilities should fall. In doing so, the Commission would provide greater assurance that the composite zone is not too narrow and therefore provides a just and reasonable ROE.

b. Duquesne Light supports the requirement to show prima facia case before a challenge to a public utility ROE.

Duquesne Light supports establishing an approach to determining whether an existing ROE is "just and reasonable" in order to address the successive complaint or "complaint pancaking" issue. Successive challenges to ROE eliminates the stability and predictability of ROEs that the Commission should support in order for transmission owners to be able to continue to attract capital. In addition, the process for adjudicating such challenges creates a waste of resources for the utility, its customers, the Commission and taxpayers. The process for establishing a composite zone of reasonableness based on the utility's risk, as described above, will assist in limiting challenges of ROEs. The Commission should establish an expectation that any challenge of ROE must be based on clear evidence that an ROE is unjust and unreasonable. If not, any such challenge that does not meet this expectation should be dismissed.

c. Duquesne Light supports determining the central tendencies of the upper and lower halves of the zone of reasonableness for single utilities based on a midpoint analysis.

Duquesne Light agrees that it would be reasonable to determine the central tendencies of the upper and lower halves of the zone of reasonableness for single utilities based on a midpoint analysis, so as to produce approximately equal ranges of presumptively just and reasonable ROEs for below average, average and above average risk utilities. However, there is no reason to differentiate the measure of central tendency between the return set for all transmission owning members of an RTO and a single company. The Commission now uses the median as a measure of central tendency for a single company. This approach unduly discriminates against individual companies viewed alone, where the combined medians for individual companies is unlikely to replicate the midpoint return that all members of an RTO would enjoy if their returns were set simultaneously.

2. Duquesne Light Supports Revisiting Proxy Group Formation for ROE Analysis, Including Companies Outside The Industry In The Proxy Group.

Duquesne Light supports the Commission's historic approach of establishing proxy groups for ROE analysis of comparable electric utilities with credit ratings that differ by no more than one "notch" from the credit rating of the utility for which the ROE is being established. However, if this approach yields a proxy group with too few comparable companies to produce a representative sample, the Commission should expand the proxy group to generate a more robust sample size.

Duquesne Light supports a procedure that looks to other industries in the formation of the proxy group, so long as those industries were comparable in risk. As an example, investment grade companies in the railroad industry would provide a good fit to expand the proxy group. The railroads have large capital investment in fixed assets, just like the electric transmission business. Further, the earnings of the railroad are monitored by the Surface Transportation Board ("STB") as a successor to the Interstate Commerce Commission. So, the STB regulation of the railroad companies provides a suitable proxy for rate regulated companies. Therefore, the railroads, among other industries with similar attributes, should also be considered a candidate for the proxy group.

3. Duquesne Light Does Not Support the Use of an RTO-Wide ROE.

Rather than an RTO-wide ROE, it is more appropriate to continue to allow for ROEs to reflect the unique risk attributes of each utility. Even within an ISO or RTO, you have a broad range of customers with a broad range of attributes, including but not limited to credit ratings. Specific ROEs better accommodate the credit quality of specific utilities.

4. **Duquesne Light Does Not Support the Use of a "Vintage-Approach".**

Duquesne Light does not support a "vintage approach" which fails to recognize that the transmission system is comprised of long-lived assets that are constantly being upgraded and expanded. Accounting for these multiple "vintages" of both original investments, as well as the myriad of improvements over time, with different "vintages" would be administratively burdensome for no benefit to the utility or customers. This approach could lead to modifications to the formula rate implementation protocols that are currently included in the PJM Open Access Transmission Tariff ("OATT"), as well modifying the actual transmission formula rates in order to account for and support individual project "vintages". This could include tracking individual project "vintages" plant in service additions, retirements, accumulated depreciation, and associated accumulated deferred income taxes, all of which would be administratively burdensome for no benefit to the utility or customers.

III. CONCLUSION

Duquesne Light thanks the Commission for the opportunity to respond, respectfully submits these comments, and requests that the Commission consider them prior to any final determination in this proceeding.

Respectfully Submitted,

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V. COMMUNICATIONS

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Date: June 26, 2019

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