

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Inquiry Regarding the Commission's Policy for Determining Return on Equity

Docket No. PL19-4-000

**Initial Comments of the
New Jersey Board of Public Utilities and
the New Jersey Division of Rate Counsel**

The New Jersey Board of Public Utilities (“NJBP” or “Board”) and the New Jersey Division of Rate Counsel (“NJRC”) (collectively the “NJ Parties”) provide these comments to the Federal Energy Regulatory Commission (“the FERC” or “Commission”) in response to its March 21, 2019 Notice of Inquiry (“NOI”)¹ in the above captioned docket regarding the *Commission’s Policy for Determining Return on Equity*.

I. BACKGROUND

The Commission seeks input regarding its return on equity (“ROE”) calculation for public utilities.² The Commission is also considering if the revisions to its ROE policies should be applied to interstate natural gas and oil pipelines.³ The Commission acknowledges the potential significant and widespread effect its ROE policies can have on its public utilities.⁴ The FERC poses a series of questions in the NOI and invites comments on a revised approach to determining an ROE. Specifically, the FERC seeks comments in eight broad areas, including:

(1) the role of the FERC’s base ROE in investment decision-making and what objectives should

¹ Inquiry Regarding the Commission's Policy for Determining Return on Equity, 166 FERC ¶ 61,207 (Mar. 21, 2019).

² *Id.* at P 1.

³ *Id.*

⁴ *Id.* at P 3.

guide the Commission's approach; (2) whether uniform application of the FERC's base ROE policy across the electric, natural gas pipeline and oil pipeline industries is appropriate and advisable; (3) the discounted cash flow ("DCF") model's performance; (4) the composition of proxy groups; (5) the choice of financial model(s) used; (6) the mismatch between market-based ROE determinations and book-value rate base; (7) how the FERC determines whether an existing ROE is unjust and unreasonable under the first prong of Federal Power Action ("FPA") section 206; and (8) the mechanics and implementation of the models.

This NOI was issued in light of the D.C. Circuit Court of Appeals' decision in *Emera Maine v. FERC*,⁵ which reversed and vacated Opinion No. 531.⁶ In Opinion 531, the FERC adopted a two-step DCF methodology to determine the base ROE for electric utilities⁷ and it set the ROE for the New England Transmission Owners ("NETOs") at 10.57 percent after concluding that the existing base ROE of 11.14 percent was unjust and unreasonable.⁸ The D.C. Circuit held, among other things, that under Section 206 of the FPA, the Commission did not adequately justify that its decision to set the NETOs ROE at the midpoint of the upper half of the zone of reasonableness, rather than at the midpoint, was just and reasonable. Further, the D.C. Circuit stated that "while the evidence in this case may have supported an upward adjustment from the midpoint of the zone of reasonableness, the FERC failed to provide any reasoned basis for selecting 10.57 percent as the new base ROE."⁹ In remanding Opinion No. 531, the D.C. Circuit acknowledged that, "although it is not our role to tell the Commission what the 'correct' rate of return calculation is . . . we do have an obligation to remand when the Commission's

⁵ *Emera Maine v. FERC*, 854 F.3d 9 (D.C. Cir. 2017).

⁶ 166 FERC ¶ 61,207 at P 2.

⁷ *Martha Coakley, et al. v. Bangor Hydro-Electric Co., et al.*, Order on Initial Decision, 147 FERC ¶ 61,234 at P 1 (June 19, 2014) ("Opinion 531").

⁸ *Id.* at page 7

⁹ *Emera Maine v. FERC*, 854 F.3d 9, 30 (D.C. Cir. 2017).

conclusions are contrary to substantial evidence or not the product of reasoned decision making.”¹⁰

Following the remand, the FERC issued the *Coakley Briefing Order*, which proposed an “equal weight to the results of the four financial models in the record, instead of primarily relying on the DCF model.”¹¹ Specifically, the Commission proposed to rely on the DCF, capital-asset pricing model analysis (“CAPM”), and the expected earnings analysis (“Expected Earnings”) models to produce the zone of reasonableness.¹² If a transmission utility’s ROE falls outside of this zone, the Commission proposed to use the DCF, CAPM, and Expected Earnings models, plus the Risk Premium model; giving an equal weight to each model to determine an average.¹³ In November 2018, the Commission initiated a similar proceeding for the transmission owners operating in Midcontinent Independent System Operator (“MISO”), in the *MISO Briefing Orders*.¹⁴

The NJ Parties have historically advocated for just and reasonable ROEs. The NJBPU was a party to the NETOs’ ROE proceeding.¹⁵ In addition, the NJ Parties have challenged the ROEs of many of New Jersey’s transmission owners (“TOs”). For example, in 2013 and 2014, the NJ Parties, along with several co-litigants, filed complaints at the FERC challenging the formula rate for Pepco Holdings, the parent company of Atlantic City Electric Company (“ACE”).¹⁶ A Settlement, including a prospective 10 percent base ROE and refunds, was

¹⁰ *Id.* at 29.

¹¹ 165 FERC ¶ 61,030 at P 15 (Oct. 16, 2018) (“Coakley Briefing Order”).

¹² *Id.* at P 16.

¹³ *Id.* at P 17.

¹⁴ 165 FERC ¶ 61,118 at PP 16-18 (Nov. 15, 2019) (“MISO Briefing Orders”).

¹⁵ *In re Commonwealth of Massachusetts et al. v. Bangor Hydro-Electric Co., et al.*, New Jersey Board of Public Utilities Motion to Intervene, Docket No. EL11-66 (Oct. 19, 2014).

¹⁶ *Delaware Division of the Public Advocate, et al. v. Baltimore Gas and Electric Co., et al.*, Complaint Challenging Base Return on Equity and Formula Transmission Rate Implementation Protocols, Docket No. EL13-48 (Feb. 27, 2013); *Delaware Division of the Public Advocate, et al. v. Baltimore Gas and Electric Co., et al.*, Complaint Challenging Base Return on Equity and Motion to Consolidate, Docket No. EL15-27 (Dec. 8, 2014).

ultimately reached and later approved by the FERC on February 23, 2016.¹⁷ On October 28, 2016, the NJ Parties, joined by the Indicated Intervenors, protested Jersey Central Power & Light's ("JCP&L's") petition for formula rates in part due to the company's 11% ROE.¹⁸ Moreover, the NJ Parties also jointly filed a Protest in Rockland Electric Company's ("RECO's") January 27, 2017 rate increase application.¹⁹ The parties' ultimately reached a settlement with a 9.5 percent base ROE. In addition to advocating for lower ROEs, the NJ Parties have argued for the Commission to set the ROEs based on its central tendency measure in each of the three above proceedings.²⁰ Many of these long-standing positions are continued in the following Comments.

II. COMMENTS

The Commission requests comments in the NOI on many aspects of its ROE policies in the wake of the D.C. Circuit Court's decision in *Emera Maine v. FERC*. The NJ Parties provide comments on specific areas of the ROE policies and respond to some of the questions in detail. Since the Commission has a nearly 40-year precedent of using the DCF model to determine ROEs, the comments focus on addressing the so-called anomalous market conditions that the Commission has identified in recent cases. In advocating for a solution, the Comments

¹⁷ 154 FERC ¶ 61,125 (Feb. 23, 2016).

¹⁸ *Jersey Central Power & Light Co. and PJM Interconnection, L.L.C.*, Indicated Intervenors' Protest of Jersey Central Power & Light's Application for a Formula Transmission Rate, Docket No. ER17-217 (Nov. 11, 2016).

¹⁹ *PJM Interconnection, L.L.C. and Rockland Electric Co.*, Protest of New Jersey Division of Rate Counsel and New Jersey Board of Public Utilities, Docket No. ER17-856 (Feb. 2, 2017).

²⁰ *Delaware Division of the Public Advocate, et al. v. Baltimore Gas and Electric Co., et al.*, Complaint Challenging Base Return on Equity and Formula Transmission Rate Implementation Protocols, Testimony of Matthew I. Kahal at 34, Docket No. EL13-48 (Feb. 27, 2013); *Delaware Division of the Public Advocate, et al. v. Baltimore Gas and Electric Co., et al.*, Complaint Challenging Base Return on Equity and Motion to Consolidate, Testimony of Matthew I. Kahal at 32, Docket No. EL15-27 (Dec. 8, 2014); *Jersey Central Power & Light Co. and PJM Interconnection, L.L.C.*, Indicated Intervenors' Protest of Jersey Central Power & Light's Application for a Formula Transmission Rate at 7, Docket No. ER17-217 (Nov. 11, 2016); *PJM Interconnection, L.L.C. and Rockland Electric Co.*, Protest of New Jersey Division of Rate Counsel and New Jersey Board of Public Utilities at 10, Docket No. ER17-856 (Feb. 2, 2017).

encourage the Commission to rely on the DCF model to determine the ROE and use various other models as additional information, which will allow for consideration of any perceived anomalous market conditions and minimize the need for the Commission to deviate from its practice of setting the ROE using the central tendency measure. Furthermore, the Commission should continue its practice of using the median of the zone of reasonableness for single TOs and the midpoint for multiple TOs. The Comments also encourage the Commission to align transmission ROEs with distribution ROEs since the state commissions similarly account for the changed market conditions in setting the base ROE. Moreover, the NJ Parties recommend that the Commission establish a uniform approach to determining ROEs for all industries under its jurisdiction. Finally, the Commission can minimize the burden of analyzing multiple methodologies by establishing a standard database which includes actual information from rate cases as well as other company data derived from various investment resources. The output from the database would allow a user to calculate a zone of reasonableness based on the data input and the companies selected by the user.

A. Addressing Anomalous Market Conditions

Question E8. To what extent is it reasonable for the Commission to use a simplified version of a model that does not reflect all the variables that investors consider?

The Commission should maintain the DCF methodology and not replace it with a more simplified version. To address anomalous market conditions, the Commission is considering revisions to its well-established policy of utilizing the DCF methodology, which has guided the cost-of-service ratemaking since the 1980s.²¹ The NJ Parties acknowledge that the FERC has

²¹ 166 FERC ¶ 61,207 at P 4 (“Since the 1980s, the Commission has used the DCF model to develop a range of returned earned on investments in companies with corresponding risks for purposes of determining the ROE for regulated entities.”).

made periodic changes to the DCF model during the decades that it has been used.²² For example, through Opinion No. 531, the Commission adopted the “two-step, constant growth DCF model” used in natural gas and oil pipeline cases for the last 20 years, for application in public utility cases.²³ By including a long-term growth projection in the two-stage DCF model, the Commission sought to “normalize any distortions that might be reflected in short-term data limited to a narrow segment of the economy.”²⁴ Although the two-stage DCF model produced a “narrower zone of reasonableness,” the Commission confirmed that this was “consistent with the fact different firms in a regulated industry would not ordinarily be expected to have widely varying levels of profitability.”²⁵ The Commission’s method for calculating an ROE has continued to evolve to account for a variety of factors since the 1980s. The NJ Parties support the Commission’s on-going reevaluation of the ROE policies.

The capital market conditions following the 2008-2009 financial crisis –“in particular, the low yields on bonds, including U.S. Treasury bonds”²⁶– decreased the Commission’s confidence that the midpoint of the zone of reasonableness produced by the DCF model satisfied the standards of *Hope* and *Bluefield*.²⁷ These standards require an ROE at a level that assures “confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital, and must be commensurate with returns on investments in enterprises with comparable risks.”²⁸ In the NETOs proceeding, the Commission compared the results of other methodologies to the DCF model and sought to address the anomalous market conditions present by setting the ROE at the midpoint of the upper end of the zone of reasonableness compared to

²² *Id.* at P 7.

²³ *Id.*

²⁴ *Id.* at P 11.

²⁵ *Id.*

²⁶ *Id.* at PP 17-18.

²⁷ *Id.*

²⁸ *Delaware Division of the Public Advocate, et al. v. Baltimore Gas and Electric Co., et al.*, Complaint Challenging Base Return on Equity and Motion to Consolidate at 13, Docket No. EL15-27 (Dec. 8, 2014).

its standard practice of the midpoint of the zone.²⁹ Following *Emera Maine*, the FERC proposed to give “equal weight to four financial models” to determine ROEs that more “accurately reflect how investors make their investment decisions.”³⁰

The NJ Parties do not find a basis to abandon the DCF methodology in place of a different model or a simplified version of a model. The Commission is attempting to address fluctuating market conditions in the calculation of the ROE. Where the Commission has felt that the DCF model, alone, is not truly capturing all possible conditions within a market,³¹ the same will be true of any other model or a simplified version of any model. No financial model can guarantee a perfect outcome that captures all market conditions. In the end, it is the Commission’s duty to evaluate the record presented in any rate proceeding and determine the just and reasonable rate.

B. Various Financial Methodologies

Question E11. To what extent, if any, should the Commission exercise judgment in using financial models to set ROEs under various capital market conditions?

In Opinion No. 551, the Commission highlights the importance of considering alternative methodologies beyond the DCF model. The Commission states that “the DCF methodology, like all cost of equity estimation methodologies, ‘may be affected by potentially unrepresentative financial inputs’ as a result of unusual economic conditions.”³² Although the current market conditions may not be “anomalous,” the NJ Parties agree that alternative methodologies can be

²⁹ 166 FERC ¶ 61,207 at P 18.

³⁰ *Id.* at P 23.

³¹ *Id.*

³² Assn. of Business Advocating Tariff Equity, et al. v. Midcontinent Independent System Operator, Inc., et al., 156 FERC ¶ 61,234 at P 116 (Sept. 28, 2016) (“Opinion 551”).

considered along with the DCF method to guard against returns that may be inconsistent with *Hope* and *Bluefield*.

At the distribution level, parties have generally relied on the DCF model, while using the CAPM as a reference point to determine ROEs. The Commission can apply a similar approach of relying first on the DCF model and using other financial models, such as CAPM,³³ Expected Earnings³⁴ and the Risk Premium Models³⁵ as additional decision support. This approach would allow for greater confidence that various market conditions were considered in determining the ROE and ensure that the ROE is consistent with the *Hope* and *Bluefield* capital attraction standards. Using various models as additional information to the DCF analysis will, also, minimize the effect of any “anomalous” market conditions.³⁶

The Commission’s use of judgment in selecting a specific model to set the ROEs based on various capital market conditions may create a level of uncertainty in the market, making it difficult for investors to predict the ROE. If that judgment is not based upon known and measured standards, it may be subject to reversal. Thus, the NJ Parties urge the Commission to continue use of the DCF methodology, while using the other models to provide supplemental information.

C. Commission’s Central Tendency Measure Should be Used to set the ROEs

The Commission should preserve its practice of relying on the central tendency of the zone of reasonableness to determine the just and reasonable ROE of a utility.

Under its DCF model, the Commission sets the appropriate ROE at the center of the properly derived range of DCF results. In setting

³³ 166 FERC ¶ 61,207 at P 13.

³⁴ *Id.* at P 15.

³⁵ *Id.* at PP 16-17.

³⁶ *Id.* at P 18.

the ROE for a single transmission owner, the Commission has found that the best measure of the center of the range is the median. In certain cases involving multiple transmission owners in an RTO that operate under a single transmission formula rate, the Commission has located the center at the midpoint of the range. The Commission generally sets ROEs at the center of the range because, absent evidence to the contrary, the utility is assumed to be of average risk compared to the proxy group.³⁷

The NJ Parties have repeatedly challenged the ROEs within New Jersey. In doing so, the NJ Parties have advocated for an ROE set at the median for each utility, in line with the Commission's precedent regarding single transmission owners.³⁸ "The single best measure would be the median because that measure—which is the center point of the distribution of individual company DCF results—avoids placing undue weight on 'outlier' DCF calculations."³⁹ The FERC should retain its practice of using the central tendency measure and setting the ROE at the median for single TOs and at the midpoint for multiple TOs. The Commission's reliance on data from various other methodologies, as discussed above, will further eliminate the need for the Commission to deviate from its use of the central tendency measure.

D. The Commission Should More Closely Align Transmission ROEs and Distribution ROEs

Question E9. How, if at all, should the Commission consider state ROEs?

Question E9.b. How are certain state ROEs more or less comparable to Commission ROEs?

³⁷ *Delaware Division of the Public Advocate, et al. v. Baltimore Gas and Electric Co., et al.*, Complaint Challenging Base Return on Equity and Formula Transmission Rate Implementation Protocols at 14, Docket No. EL13-48 (Feb. 27, 2013).

³⁸ *Supra* note 20.

³⁹ *Delaware Division of the Public Advocate, et al. v. Baltimore Gas and Electric Co., et al.*, Complaint Challenging Base Return on Equity and Motion to Consolidate, Testimony of Matthew I. Kahal at 32, Docket No. EL15-27 (Dec. 8, 2014).

The Commission should more closely align state and federal ROEs. The Board argued in 2011,⁴⁰ and continues to maintain, that “transmission projects face little internal competition for capital investments from distribution projects when base ROEs for transmission alone (i.e., absent premiums) already exceed a public utility’s corresponding retail ROE allowances.”⁴¹ “Reduced state-approved ROEs reflecting current economic conditions create situations where utilities have the incentive to build transmission facilities at the expense of distribution facilities, increasing overall costs to ratepayers.”⁴² The Commission’s current inquiry is an opportunity to align transmission ROEs with distribution ROEs.

The Commission should be cautious about the potential adverse impacts of its ROE policies on distribution investment. Misalignment between the state and federal ROEs can “skew utility investment decisions” between transmission and distribution infrastructure projects.⁴³ “In other words, because the utility has only a finite amount of capital to invest, increased investments in transmission will translate into underinvestment in distribution.”⁴⁴ As the NJ Parties stated in their Initial Comments in the Incentives NOI,⁴⁵ the Commission’s incentive strategy has already resulted in significant transmission growth. Therefore, the current market conditions no longer require the FERC to proceed with the same strategy of providing transmission ROEs that are more generous than distribution ROEs. Now is the right time for the Commission to make these changes.

State Commissions have accounted for market changes in determining distribution ROEs. The NJBPU noted in its response to the 2011 NOI, “a number of state regulatory authorities have

⁴⁰ *Promoting Transmission Investment Through Pricing Reform*, Joint Comments, Docket No. RM11-26 (Sept. 12, 2011).

⁴¹ *Id.* at 15.

⁴² *Id.* at 81.

⁴³ *Id.* at 35.

⁴⁴ *Id.*

⁴⁵ *Inquiry Regarding the Commission’s Electric Transmission Incentives Policy*, 166 FERC ¶ 61,208 (Mar. 21, 2019).

adjusted allowed ROEs . . . but such adjustments have not occurred as frequently at the wholesale level.”⁴⁶ Moreover, distribution ROEs have historically been trending downwards. ROEs for electric utilities in New Jersey currently average 9.6 percent and 9.64 percent for gas utilities based on settled cases.⁴⁷ The Board will continue its practice of evaluating distribution ROEs on a case-by-case basis as the Commission should also determine Transmission ROEs on a case-by-case basis.⁴⁸ Similar to NJ’s distribution ROEs, nationally the average allowed ROE for electric utilities in 2018 was 9.57% and the average allowed ROE for natural gas utilities was 9.59%.⁴⁹ While earning the lowered distribution ROEs, these utilities “have successfully attracted capital and maintained strong credit ratings.”⁵⁰ Given this fact, the Commission has an opportunity to align its ROEs with state ROEs, which continue to trend downwards.

Natural Gas Pipeline ROEs vary significantly from gas distribution utility ROEs. Whereas New Jersey gas distribution utilities currently earn an average of 9.62 percent ROE,⁵¹ the ROEs for Gas Pipelines are much higher.⁵² As NJRC recognized in its PennEast filing, the

⁴⁶ *Promoting Transmission Investment Through Pricing Reform*, Joint Comments at 37, Docket No. RM11-26 (Sept. 12, 2011).

⁴⁷ Each of the State’s electric and natural gas utilities earns a 9.6% ROE with the exception of New Jersey Natural Gas, who currently earns a 9.75% ROE. See NJBPU Docket No. GR15111304, 2016 N.J. PUC LEXIS 219 (Sept. 23, 2016) (New Jersey Natural Gas Co. settled rate case with a ROE of 9.75%); NJBPU Docket No. ER16040383, 2016 N.J. PUC LEXIS 288 (Dec. 12, 2016) (Jersey Central Power & Light Co. settled rate case with a ROE of 9.6%); NJBPU Docket No. ER16050428, 2017 N.J. PUC LEXIS 42 (Feb. 22, 2017) (Rockland Electric Company settled rate case with a ROE of 9.6%); NJBPU Docket No. GR16090826, 2016 N.J. PUC LEXIS 239 (Sept. 23, 2016) (Elizabethtown Gas settled rate case with a ROE of 9.6%); NJ BPU Docket No. GR17010071, 2017 N.J. PUC LEXIS 222 (Oct. 20, 2017) (South Jersey Gas Co. settled rate case with a ROE of 9.6%); NJBPU Docket Nos. ER18010029 & GR18010030, 2018 N.J. PUC LEXIS 244 (Oct. 29, 2018) (Public Service Electric & Gas Co. settled rate case with a ROE of 9.6%); NJBPU Docket No. ER18080925, 2019 N.J. PUC LEXIS 55 (Mar. 13, 2019) (Atlantic City Electric Co. settled rate case with a ROE of 9.6%).

⁴⁸ NJBPU Docket Nos. ER18010029 and GR18010030, Direct Testimony of Jonathan A. Lesser on behalf of Staff of the New Jersey Board of Public Utilities at 68.

⁴⁹ S&P Global Market Intelligence, RRA Regulatory Focus Major Rate Case Decisions—January-December 2018, January 31, 2019..

⁵⁰ *Delaware Division of the Public Advocate, et al. v. Baltimore Gas and Electric Co., et al.*, Complaint Challenging Base Return on Equity and Motion to Consolidate, Testimony of Matthew I. Kahal at 9, Docket No. EL15-27 (Dec. 8, 2014).

⁵¹ *Supra* note 47. $(9.75+9.6+9.6+9.6+9.6+9.6+9.6)/7 = 9.62$.

⁵² *PennEast Pipeline Co., LLC*, Comments of the New Jersey Division of Rate Counsel at 12, Docket No. CP15-559 (Sept. 12, 2016).

Commission began granting 14% ROEs for new greenfield projects nearly two decades ago.⁵³ However, “present capital markets require much lower returns and investors no longer require the same returns that they required twenty years ago.”⁵⁴ When compared to current gas distribution ROEs, the FERC’s standard practice of a generous 14% ROE is unduly burdensome on the ratepayers. As the impacts of higher electric transmission ROEs can lead to underinvestment in distribution, the FERC’s standard practice of awarding higher ROEs for pipelines can adversely affect investment in natural gas distribution and result in over development of natural gas transmission pipelines.⁵⁵ The Commission should avoid incenting infrastructure additions that are built for the sake of achieving higher ROEs. Such practice is not in the interest of the ratepayers. The high pipeline investment returns bring into question the just and reasonableness of the Commission’s current policies and their impact on the ratepayers.

The FERC’s current ROE calculation methods are resulting in inconsistencies between its regulated industries as discussed further below. Similar to the FERC’s obligation, state commissions also account for changes in the capital market when awarding distribution ROEs and ensure that the return is “sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.”⁵⁶ However, the same discrepancies between the ROEs awarded to electric and gas utilities are not seen in New Jersey, because the same DCF methodology is utilized for all New Jersey utilities. Now is the time to align the

⁵³ *Id.*

⁵⁴ *Id.* at 13.

⁵⁵ Furthermore, the FERC’s compliance filings of Form 501-G, following the Tax Cuts and Jobs Act, has revealed that some pipelines are currently enjoying alarmingly high ROEs. For example, Iroquois Gas Transmission System, LP’s current ROE is estimated at 29.1%. *Iroquois Gas Transmission System, L.P.*, FERC Form 501-G Compliance Filing, Docket No. RP19-445 (Dec. 6, 2018).

⁵⁶ *PennEast Pipeline Co., LLC*, Comments of the New Jersey Division of Rate Counsel at 12, Docket No. CP15-559 (Sept. 12, 2016).

FERC's ROEs with the moderate and sufficient state ROEs for both electric utilities and natural gas pipelines.

E. The FERC should implement a uniform approach to calculating ROEs across all FERC-Regulated Industries and regions

Question A3. Currently, public utilities in different Independent System Operators (ISOs) or RTOs may receive different ROEs, despite all using national proxy groups, due primarily to differences in when FPA section 205 or 206 proceedings were initiated. Are such variations justified, and, if not, should the Commission consider applying the same ROE to all utilities in RTOs/ISOs based on the most recent proceeding?

Question B1. In Opinion No. 531, the Commission found that the same DCF methodology should be used to determine an ROE for all its regulated industries, including public utilities, as well as gas and oil pipelines. If the Commission departs from our sole use of a two-step DCF methodology for public utilities, should the new method or methods also be used to determine natural gas and oil pipeline ROEs?

The FERC should implement a uniform approach to calculating ROEs across all industries and regions. When evaluating the methods and frequency for reviewing and setting utility ROEs as well as the actual percentage of ROEs awarded across all FERC-regulated industries, the Commission lacks standardization. The Commission's current process for determining ROEs involves many layers that add complexity to what could otherwise be a standardized process across all industries under the FERC's jurisdiction. As discussed above, the FERC's current policies have produced a large variety in the level of ROEs awarded over time among the electric transmission and gas pipeline companies contrary to the public interest.

Other factors, including the frequency with which a utility seeks an adjustment to its ROE, contributes to the variety in ROEs. The FERC has permitted approximately 80 utilities

nationwide to utilize formula rates.⁵⁷ Over time, the ROE contained within the formula will become stale and may be overstated. Unless the utility voluntarily seeks to modify its formula rate, the only recourse is a complaint initiated under FPA Section 206, which can be extremely difficult and burdensome for a party such as the NJBPU or the NJRC. Where utilities have “stated” transmission rates, they will not return to the regulator for an ROE adjustment if earnings are more than sufficient to cover the cost of service. For example, when JCP&L filed for its formula rate, before settling for a stated rate, it had been 18 years since they’d come to the Commission with a rate case.⁵⁸ Texas Eastern Transmission, L.P., which is currently in a rate case, has gone as much as 30 years between rate cases.⁵⁹ With such a long duration in between rate cases, ratepayers will have to brace themselves for the anticipated rate shock.

To avoid long lags between proceedings, and increase transparency, the Commission’s recent practice with the FERC Form 501-G may be a good example. The Form 501-G compliance filing triggered considerable rate activity for pipeline companies. The requirement of filing the financial Form 501-G documents provided parties an opportunity to evaluate the financials of companies who, otherwise, would not have revealed their robust financial positions. Transparency of financial positions of regulated utilities or pipelines are critical for the impacted parties because the costs of service as well as the healthy ROEs are being paid by the ratepayers. Based on this experience, the NJ Parties recommend that the FERC establish a requirement for electric utilities and pipeline companies to submit a similar compliance filing every three years. This requirement will allow transparency for the parties to review the financials of companies

⁵⁷ *Transmission Ratemaking in the PJM Interconnection*, S&P GLOBAL MARKET INTELLIGENCE (Aug. 1, 2017), <https://www.spglobal.com/marketintelligence/en/news-insights/research/transmission-ratemaking-in-the-pjm-interconnection>.

⁵⁸ See *PJM Interconnection, L.L.C., Jersey Central Power & Light Co.*, Transmittal Letter at 3, Docket No. ER17-217 (Oct 28, 2016).

⁵⁹ See *Texas Eastern Transmission, LP Section 4 Rate Case Filing*, Transmittal Letter at 2, Docket No. RP19-343 (Nov. 30, 2018).

without conducting a full rate case. This filing requirement can also serve as an opportunity for the parties to file a protest and/or seek clarification of any line items that raise concerns or seem unjust and unreasonable. Simultaneously, it can allow any electric utility or pipeline the chance to initiate a full rate case filing based on the financial position revealed through the compliance filing. A regulatory mandate for utilities and pipelines to provide an accounting update every three years will make the rate-making process more transparent, constructive and valuable for all parties.

F. The Commission Should Consider Revisions to its Black Box Settlement Policies.

Question B2. The Risk Premium methodology approved in Opinion Nos. 531 and 551 relied to a large extent on ROEs set forth in numerous settlements involving public utility formula rates approved by the Commission over the preceding 15 or 20 years. Natural gas and oil pipelines have stated rates and settlements of their rate cases are typically “black box” settlements that do not specify an agreed-upon ROE. How could the Risk Premium methodology be implemented in natural gas or oil pipeline rate cases where there is no history of ROE settlements from which to develop a risk premium study of the type used in Opinion Nos. 531 and 551?

The Commission should consider revisions to its “black box” settlement policies. In “black box” settlements at the FERC, parties agree to a specific revenue requirement rather than use of a particular methodology to derive that amount. The settlement typically only provides the revenue requirement figure and does not state the rate of return or identify any of its components. Although allowing parties to engage in “black box” settlements has certain advantages, the FERC should not be left lacking historical data, such as the history of ROE in settlements. The Commission can remedy this dilemma by requiring that certain data inputs be made available in the rate case settlement filing. The NJBPU requires public disclosure of certain inputs even in black box settlements. For instance, RECO’s 2017 distribution rate case

concluded with a “black box” settlement where specific inputs from the settlement were made public. Some of the inputs from RECO’s 2017 distribution rate case, include the test year, revenue requirement and rate adjustment, rate base, ROE, and depreciation/net salvage.⁶⁰ Furthermore, RECO included its ROE in the 2017 transmission rate increase application.⁶¹ The FERC should consider establishing requirements and a standard similar to that used by the NJBPU for all “black box” settlements before the Commission. This requirement will add the much-needed transparency in these proceedings post settlement. It will also serve to eliminate the current issue at hand, i.e. a lack of ROE data from the “black box” settlements, in order to inform future policy decisions.

G. Offset the Increased Burden by Establishing a Standard Database

Revising the ROE policy may minimize the alleged anomalous market conditions, but it will also result in an added burden for the Commission, the utility, and the intervening parties who wish to meaningfully challenge the ROE. Under the current policy, the zone of reasonableness can be determined by calculating the ROE for each company within the proxy group based on the analysis of a single model, the DCF.⁶² If the revised methodology is adopted, determining the zone of reasonableness will require first calculating the DCF analysis followed by up to three additional ROE calculations using the alternative models for each proxy company as reference checks. It is important to emphasize that the proxy group size is subjective and it appears there are no limitations for how large or small a proxy group can be. For example, in the ROE analysis conducted in support of a 2014 Complaint against the PHI Companies, Mr.

⁶⁰ In the Matter of the Verified Petition of Rockland Electric Company for Approval of Changes in Electric Rates, its Tariff for Electric Service, and its Depreciation Rates; Approval of an Advanced Metering Program; and for Other Relief – NJBPU Docket No. ER16050428, 2017 N.J. PUC LEXIS 42 (Feb. 22, 2017).

⁶¹ *Rockland Electric Co.*, Transmittal Letter, Docket No. ER17-856 (Jan. 26, 2017).

⁶² *Id.* at PP 4-5.

Matthew Kahal computed a list of 37 national proxy companies based on the FERC's general screening criteria to establish a proxy group of companies with comparable risks.⁶³ Determining the zone of reasonableness was already more complicated because of Opinion No. 531, which enhanced the DCF methodology to include a second stage that reflects the long-term forecast rate of growth.⁶⁴ Mr. Kahal conducted the analysis for each company in line with the Commission's revised two-step DCF methodology to determine a zone of reasonableness.⁶⁵ The NJ Parties acknowledge that having to conduct the analysis based on the additional models as a reference check to arrive at an ROE for each of the 37 proxy companies and then determine a zone of reasonableness will become significantly more complex.

The added burden of the revised policy can be minimized by establishing a FERC-sanctioned database for proxy companies. The database would include detailed data for each company that can be derived from approved rate cases as well as various investment resources, such as, the Value Line Investment Survey. The database would allow immediate access to inputs such as the risk profile, dividend data, credit rating, stock price data, cost of equity calculation, earnings per share growth rate, etc. It would also include data related to the assumptions underlying the various methodologies, which can be utilized to allow parties to create a zone of reasonableness based on a list of select proxy group companies that reflect the risk profile of the utility filing the rate case. As recommended above, the Commission should standardize its ROE policies across all industries, which would make the database an invaluable tool. To remain useful on an on-going basis, the database will require regular updates, such as on a monthly basis. Furthermore, the Commission should allow state regulatory agencies and

⁶³ *Delaware Division of the Public Advocate, et al. v. Baltimore Gas and Electric Co., et al.*, Complaint Challenging Base Return on Equity and Motion to Consolidate at 18, Docket No. EL15-27 (Dec. 8, 2014).

⁶⁴ *Id.* at 14.

⁶⁵ *Id.* at 17.

other parties access to the database. A proxy database can be an essential tool to expedite the analysis process in a rate case, reduce regulatory lag and help both agencies make informed decisions.

III. Conclusion

The New Jersey Board of Public Utilities and the New Jersey Division of Rate Counsel respectfully request that the Commission accept these Comments.

Respectfully submitted,

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Dated: June 26, 2019
Newark, New Jersey

CERTIFICATE OF SERVICE

I hereby certify that, on this 26th day of June, 2019, I have caused the foregoing document to be served upon each party designated on the official service list compiled by the Secretary in this proceeding, by email.

/s/ *Peter Van Brunt*

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