

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

**Inquiry Regarding the Commission’s Policy for
Determining Return on Equity**

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Docket No. PL19-4-000

COMMENTS OF EXELON CORPORATION

Exelon Corporation (Exelon) appreciates the opportunity to submit comments in response to the Federal Energy Regulatory Commission’s (Commission) Notice of Inquiry Regarding the Commission’s Policy for Determining Return on Equity.¹ A robust and resilient transmission system provides significant benefits to our customers, and the single most effective way to incent utilities to invest in needed transmission facilities is for the Commission to ensure that they have the opportunity to earn a fair and predictable return on those investments. With certain clarifications and modifications, the proposed framework for evaluating returns on equity (ROE) that the Commission set forth in the *Coakley* and MISO Briefing Orders² (proposed ROE framework) can provide just such an opportunity. The proposed ROE framework is largely workable, and the regulatory certainty that its adoption is expected to bring will facilitate needed transmission investment and reduce prolonged litigation.

This Notice of Inquiry, however, seems inconsistent with the regulatory certainty that the *Coakley* and MISO Briefing Orders otherwise seemed to provide. The mere range of questions

¹ *Inquiry Regarding the Commission’s Policy for Determining Return on Equity*, Notice of Inquiry, 166 FERC ¶ 61,207 (2019) (ROE Policy NOI).

² *Martha Coakley v. Bangor Hydro-Elec. Co.*, 165 FERC ¶ 61,030 (2018) (*Coakley* Briefing Order); *Ass’n of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 165 FERC ¶ 61,118 (2018) (MISO Briefing Order).

in the ROE Policy NOI, which extend well past the few implementation details left unresolved by the proposed ROE framework in the *Coakley* and MISO Briefing Orders, seemingly indicate that the Commission may be completely reconsidering how it should evaluate ROEs. The potential that the Commission could adopt an entirely new framework in this proceeding will erode utilities' and investors' certainty and confidence as to how the Commission will ultimately evaluate ROE. Given the importance of establishing fair and predictable ROEs to support transmission investment, the Commission should expeditiously close this proceeding and adopt the proposed ROE framework set forth in the *Coakley* and MISO Briefing Orders and refine that framework consistent with clarifications and modifications as recommended herein.

I. INTRODUCTION

On March 21, 2019, the Commission issued the ROE Policy NOI, setting forth a range of questions for comment to “help the Commission explore whether, and if so how, it should modify its policies concerning the determination of the [ROE] to be used in designing jurisdictional rates charged by public utilities.”³ Specifically, the Commission seeks further information as it reevaluates its ROE policies following the *Emera Maine* decision,⁴ acknowledging the potentially significant and widespread effect on public utilities (including those that are not parties thereto) of the ROE policies that it adopted in response to that decision.⁵ The NOI seeks comments on the following topics: (1) the role of base ROE in

³ ROE Policy NOI, 166 FERC ¶ 61,207 at P 1.

⁴ *Emera Maine v. FERC*, 854 F.3d 9 (D.C. Cir. 2017) (*Emera Maine*). In *Emera Maine*, the U.S. Court of Appeals for the District of Columbia Circuit (D.C. Circuit) reversed and vacated a Commission opinion finding the New England Transmission Owners' ROE to be unjust and unreasonable and establishing a new just and reasonable ROE. Following *Emera Maine*, the Commission issued the *Coakley* and MISO Briefing Orders, in which it set forth a new framework for evaluating ROEs. Under its proposed ROE framework, the Commission would rely on three financial models to produce a composite zone of reasonableness for use in its analysis under the first prong of Federal Power Act (FPA) section 206, 16 U.S.C. § 824e (2012), and four financial models to establish a new just and reasonable ROE when it has found that the existing base ROE is unjust and unreasonable. See *Coakley* Briefing Order; MISO Briefing Order.

⁵ ROE Policy NOI, 166 FERC ¶ 61,207 at P 3.

investment decision-making and the objectives that should guide the Commission's approach to it, (2) the appropriateness and advisability of uniform application of the Commission's ROE policies across the electric, interstate natural gas pipeline, and oil pipeline industries, (3) the performance of the discounted cash flow (DCF) model, (4) the scope of proxy groups, (5) the financial models that the Commission includes in its analysis, (6) the mismatch between market-based ROE determinations and book value rate base, (7) the Commission's approach to determining whether an existing ROE is unjust and unreasonable under the first prong of FPA section 206, and (8) the mechanics and implementation of each financial model.⁶

As both a transmission owner and a customer taking service on jurisdictional transmission facilities and interstate natural gas pipelines, Exelon has a substantial interest in this proceeding. Exelon is a holding company, headquartered at 10 South Dearborn Street, Chicago, Illinois, with operations and business activities in 48 states, the District of Columbia, and Canada. Exelon owns Atlantic City Electric Company (Atlantic City Electric), Baltimore Gas and Electric Company (BGE), Commonwealth Edison Company (ComEd), Delmarva Power & Light Company (Delmarva Power), PECO Energy Company (PECO), and Potomac Electric Power Company (Pepco). Together Atlantic City Electric, BGE, ComEd, Delmarva, PECO, and Pepco own electric transmission and distribution systems that deliver electricity to approximately 10 million customers in the District of Columbia (Pepco), northern Delaware and the Delmarva Peninsula (Delmarva Power), southern New Jersey (Atlantic City Electric), Northern Illinois (ComEd), Maryland (BGE and Pepco), and southeastern Pennsylvania (PECO). In addition, BGE distributes natural gas to over 600,000 customers in central Maryland and also operates a liquefied natural gas facility for the liquefaction and storage of natural gas, as well as associated

⁶ ROE Policy NOI, 166 FERC ¶ 61,207 at P 29.

propane facilities. Delmarva Power distributes natural gas to over 122,000 consumers in northern Delaware. PECO distributes natural gas to over 500,000 consumers in the suburban Philadelphia area. Exelon Generation Company (ExGen) is one of the largest competitive power generators in the U.S., with approximately 33,000 megawatts of owned capacity comprising one of the nation's cleanest and lowest-cost power generation fleets, located in a number of organized markets. Constellation, an ExGen business unit consisting of subsidiaries and divisions of ExGen, is one of the nation's leading marketers of electricity and natural gas and related products in wholesale and retail markets. These businesses serve approximately 2.5 million residential and business customers in various markets throughout the United States.

Below, Exelon offers comments on a number of the questions included in the ROE Policy NOI.⁷

II. COMMENTS

A. Role and Objectives of the Commission's Base ROE Policy

At its core, transmission investment is driven by the benefits that a robust transmission system provides to customers. Society depends on reliable and affordable electric service; it is essential to our health, security, prosperity, and comfort. Adequate investment in transmission infrastructure is key to the continued provision of that service to our customers. For example, investments to replace and upgrade existing transmission infrastructure are becoming increasingly important to maintaining reliable service as our nation's transmission system ages and the demands placed on it evolve.⁸ Investments in new transmission facilities and upgrades

⁷ We do not provide responses to every question, but reserve the right to comment on these issues in this and future proceedings. Moreover, silence on a particular issue does not indicate agreement with the propositions set forth in any of the questions.

⁸ In PJM, nearly two-thirds of all transmission system assets are more than 40 years old; over one-third are more than 50 years old. *The Benefits of the PJM Transmission System*, PJM Interconnection, L.L.C., at 5, 55-56 (Apr. 16, 2019), <https://www.pjm.com/-/media/library/reports-notices/special-reports/2019/the-benefits-of-the-pjm-transmission-system.ashx?la=en> (PJM Transmission System Benefits Report). Replacing and modernizing these

to existing transmission facilities to enhance the reliability and resilience of the transmission system provide better service to customers, reducing the frequency and duration of outages and hardening the system against a range of threats (e.g., severe weather and physical and cyber security threats). Such investments can also reduce congestion, facilitating the delivery of lower cost power to loads.⁹ Moreover, transmission investments can support a range of public policy goals, including greater access to location-constrained intermittent, renewable resources¹⁰ and emissions reductions.¹¹ And these benefits will likely increase as our electricity system continues to evolve – indeed, a robust, flexible, and smarter transmission system will be increasingly necessary to support our nation’s transition towards the grid of the future, including greater electrification of the transportation industry (among other sectors), microgrids, and increased penetration of distributed energy resources.

The need for continued investment in transmission infrastructure is clearly essential, but how can the Commission best support such investment? As Exelon maintains in its comments in response to the Commission’s Notice of Inquiry Regarding the Commission’s Electric Transmission Incentives Policy,¹² the Commission should focus on providing regulatory certainty through fair, timely, and flexible performance of its statutory duties in its ordinary course of business. Ensuring that public utilities have the opportunity to earn a fair and predictable ROE on their transmission investments (one of the Commission’s foundational statutory duties) is the most effective means of encouraging such investments.

assets has a number of benefits for customers, including lower maintenance costs, reduced risk of outages associated with deteriorating transmission facilities, and the deployment of more technologically advanced equipment that has greater capabilities than the equipment it replaces. *Id.* at 55.

⁹ *See Id.* at 49-52. As PJM explains in its report, a robust transmission system not only facilitates more economic power transfers within regions, but also between regions.

¹⁰ *See Id.* at 30-33.

¹¹ *See Id.* at 33-34.

¹² *Inquiry Regarding the Commission’s Electric Transmission Incentives Policy*, Notice of Inquiry, 166 FERC ¶ 61,208 (2019) (Incentives NOI).

Based on long-standing Supreme Court precedent, the Commission must evaluate whether a proposed or existing ROE is fair and adequate to support ongoing capital investment. Recognizing that the ratemaking process “involves a balancing of the investor and the consumer interests,” the Court found in *Hope* that “the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks [and] sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.”¹³ Similarly, the Court found in *Bluefield* that a “public utility is entitled to such rates as will permit it to earn a return” that is “reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise capital necessary for the proper discharge of its public duties.”¹⁴ This same standard continues to apply today – the framework that the Commission uses to establish ROEs for public utilities must produce ROEs that allow utilities to raise the capital necessary to fund the investments needed to provide reliable service to their customers.

The proposed ROE framework set forth in the *Coakley* and MISO Briefing Orders largely achieves this result; with certain clarifications and modifications, the framework presents a sensible path for moving forward on ROE matters that will reduce the potential for pancaked complaints and prolonged litigation, and, if an existing ROE is found unjust and unreasonable, increase predictability as to the new ROE – all of which improves regulatory certainty. Thus, the Commission should focus its efforts on clarifying and refining that framework to finish its work towards providing needed regulatory certainty. Specifically, as presented in section II.B.2 below, the Commission should clarify that once it establishes a proxy group that reflects

¹³ *FPC v. Hope*, 320 U.S. 591, 603 (1944) (*Hope*).

¹⁴ *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm’n*, 262 U.S. 679, 693 (1923) (*Bluefield*).

companies with similar risk profiles (as measured through a utility's credit rating), there is a rebuttable presumption that the utility whose ROE is at issue is of average risk within that proxy group for purposes of placement within one of the three quartiles. The burden falls on the utility or intervenors to demonstrate that the utility's risk profile is either above or below average. In terms of modifications to the proposed ROE framework, Exelon recommends a few discrete changes, including expanding the quartiles to thirds (see section II.D.2) and applying the same measure of central tendency to all utilities (see section II.D.4).

Many of the questions that the Commission poses in the ROE Policy NOI, however, suggest that the Commission is completely rethinking the ROE framework that it proposed in the *Coakley* and MISO Briefing Orders. For example, the breadth of the NOI questions suggests that everything on ROE is unsettled and that the NOI could result in the proposal of a yet another entirely new framework for determining ROE. Such action generates a level of uncertainty that is not conducive to transmission investment, especially in the wake of the prolonged uncertainty concerning the sustainability of the Commission's ROE framework that has persisted since Opinion No. 531.¹⁵ The *Coakley* and MISO Briefing Orders went a long way towards resolving this uncertainty. The ROE framework proposed in those orders is (with certain clarifications and modifications) generally reasonable. And the Commission direction indicated that the ROE framework in those orders would apply generally in all ROE cases going forward.¹⁶ The Commission should therefore take the information that it gains in this proceeding and quickly narrow its inquiry to the few key issues that remain outstanding from the *Coakley* and MISO

¹⁵ *Coakley, Mass. Attorney Gen. v. Bangor Hydro-Elec. Co.*, Opinion No. 531, 147 FERC ¶ 61,234, *order on paper hearing*, 149 FERC ¶ 61,032 (2014) (Opinion No. 531), *order on reh'g*, 150 FERC ¶ 61,165 (2015) (Opinion No. 531-A). Specifically, the extended litigation that followed Opinion No. 531 and the resulting *Emera Maine* decision created significant uncertainty about the framework that the Commission will use to determine whether an existing ROE is just and reasonable and, if it is found to be unjust and unreasonable, to establish a just and reasonable replacement ROE.

¹⁶ See, e.g., *Constellation Mystic Power, LLC*, 165 FERC ¶ 61,267, at P 33 (2018).

Briefing Orders. Otherwise, the Commission risks undermining the ROE framework that it set forth in the *Coakley* and MISO Briefing Orders, fueling greater uncertainty and hindering (rather than supporting) needed transmission investment.

1. Predictability of ROE under the ROE Framework Proposed in the *Coakley* and MISO Briefing Orders

In Questions A1 and A2, the Commission asks whether the ROE framework proposed in the *Coakley* and MISO Briefing Orders will affect the predictability of ROEs and the results of ROE-related litigated proceedings. As a general matter, Exelon believes that the proposed ROE framework (with certain clarifications and modifications) will provide greater predictability in the Commission's ROE determinations, whether under FPA section 205 (16 U.S.C. § 824(d) (2012)) or FPA section 206.¹⁷ By clarifying the financial models that the Commission will use to make ROE determinations, the proposed ROE framework will provide both utilities and intervenors with greater predictability about the outcome of ROE proceedings that come before the Commission (i.e., under FPA section 205, whether the proposed ROE is just and reasonable, and under FPA section 206, whether the Commission will grant a complaint and, if it does, the just and reasonable replacement ROE). The four financial models used under the proposed ROE framework are generally well-known, text book methodologies on which investors regularly rely.¹⁸ Utilities and intervenors can apply these models on their own, which will provide them with a reasonable estimate of the just and reasonable ROE that will result. This predictability is

¹⁷ The *Coakley* Briefing Order specified that the proposed ROE framework “reflects the Commission’s proposed policy for addressing [whether an existing ROE remains just and reasonable] in the future, including in the proceedings currently pending before the Commission.” *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 19. We assume for purposes of these comments that the Commission intends to use the proposed ROE framework to evaluate ROEs that public utilities propose pursuant to FPA section 205 as well. If that is not the case, the Commission should clarify its intent.

¹⁸ *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 34.

the regulatory certainty that utilities, stakeholders, and the investment community require to support needed transmission development.

Moreover, the proposed ROE framework is likely to reduce the potential for possibly time-consuming litigation (which only prolongs uncertainty) in both FPA section 205 and FPA section 206 proceedings. In individual rate cases filed pursuant to FPA section 205, the proposed ROE framework sets forth clear guidance on the financial models that the Commission will use to assess the just and reasonableness of a proposed ROE, providing all parties involved with a better understanding of the Commission's policies and the likely outcome of the proceeding. As a result, utilities are less likely to propose ROEs that the Commission will ultimately find unjust and unreasonable or set for hearing, while intervenors will have more certainty about whether pursuing litigation is a reasonable course of action.

With respect to complaints pursuant to FPA section 206, the proposed ROE framework will reduce the likelihood of unsubstantiated complaints and attendant protracted litigation and will encourage settlement when an existing ROE is found to be unjust and unreasonable, thereby further enhancing the timeliness and predictability of the Commission's ROE determinations. By establishing a more formulaic test for determining whether an existing ROE remains just and reasonable that reflects a range of values rather than a single point (as was the case in Opinion No. 531), the proposed framework reduces the need for the Commission to set an existing ROE for hearing unless it is truly merited, reducing costs for all. And prospective complainants will be less likely to file unsuccessful complaints when they have a better understanding of their likelihood of success, both promoting regulatory certainty and reducing costs for intervenors. Similarly, parties are more likely to settle when they have better information about whether the Commission will find a disputed ROE to be just and reasonable, reducing litigation costs for all

parties. More timely decisions on complaints will in turn reduce the likelihood of successive (i.e., pancaked) complaints (which only create greater uncertainty for all participants in the litigation).

The quicker resolution of complaints and reduced likelihood of pancaked complaints under the Commission's proposed ROE framework hinges on the new rebuttable presumption that if a utility's ROE falls within the relevant quartile, it is just and reasonable; the burden is on the complainant to prove otherwise.¹⁹ Without such a rebuttable presumption, the proposed ROE framework will undermine the regulatory certainty that the Commission is attempting to provide. And a rebuttable presumption is appropriate; under FPA section 206, the complainant has the burden to demonstrate that an existing ROE is unjust and unreasonable. The formulaic test that the Commission sets forth in the proposed ROE framework to determine whether an existing ROE is unjust and unreasonable is consistent with statutory requirements and should not present a barrier to justifiable complaints, nor should it deprive a utility of the opportunity to demonstrate that its ROE is just and reasonable despite falling outside of the presumptively just and reasonable range.²⁰

¹⁹ *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 28. Specifically, the Commission stated that:

Pursuant to this framework, a finding that the existing ROE of an average risk utility falls within the applicable range of presumptively just and reasonable ROEs (in the case of an average risk utility, the middle quartile of the newly-calculated zone of reasonableness) will support a holding that the existing ROE has not been shown to be unjust and unreasonable under the first prong of FPA section 206, at least absent evidence to the contrary. By the same token, a finding that the existing ROE of an average risk utility falls outside that range may support a holding that that [*sic*] the ROE has become unjust and unreasonable.

Id. (footnote omitted). If the Commission did not mean this language to create a rebuttable presumption that a utility's ROE is just and reasonable if it falls within the relevant quartile, the Commission should clarify its intent.

²⁰ Even with a rebuttable presumption, the Commission can consider evidence that a complainant provides to demonstrate that an existing ROE that falls within the relevant quartile is, in fact, unjust and unreasonable, as well as evidence that a utility provides to demonstrate that its ROE is just and reasonable even though it falls outside of the relevant quartile.

2. Variations in ROEs among Public Utilities

In Question A3, the Commission asks whether it should apply the same ROE to all utilities in regions with regional transmission organizations and independent system operators (RTOs/ISOs) based on the most recent ROE proceeding. As a threshold matter, such an approach is statutorily impermissible. Under FPA section 206, the Commission cannot modify a utility's ROE on its own initiative absent a finding that the utility's existing ROE is unjust and unreasonable.²¹ Imposing the same ROE on all utilities in RTOs/ISOs based on the outcome of the most recent ROE proceeding without such a showing would thus violate the FPA. And *Emera Maine* indicates that the Commission cannot rely on the fact that a utility's ROE is not equal to the result of the Commission's ROE analysis to find that it is *per se* unjust and unreasonable.²² Thus, as legal matter, the variation in ROEs seen today based on the timing of an FPA section 205 or 206 proceeding does not necessarily render those ROEs unjust and unreasonable.²³

There are also practical considerations that support allowing ROE differences among utilities and that counsel against a standardized policy. Variations in ROEs among the utilities

²¹ See *Atlantic City Electric Co. v. FERC*, 295 F.3d 1, 10 (D.C. Cir. 2002) (“In order to make any change in an existing rate or practice, FERC must first prove that the existing rates or practices are ‘unjust, unreasonable, unduly discriminatory or preferential.’” (quoting 16 U.S.C. § 824e(a))) (*Atlantic City*). In *Atlantic City*, the Court also stated that “[t]he courts have repeatedly held that FERC has no power to force public utilities to file particular rates unless it first finds the existing filed rates unlawful.” *Id.* (internal citations omitted).

²² See *Emera Maine*, 854 F.3d 9 at 26. Specifically, the D.C. Circuit found that:

FERC's decision – that a single ROE analysis generating a new just and reasonable ROE necessarily proved that Transmission Owners' existing ROE was unjust and unreasonable – relied on its assumption that all ROEs other than the one FERC identifies as the utility's just and reasonable ROE are *per se* unlawful in a section 206 proceeding. But, as we have explained, the zone of reasonableness creates a broad range of potentially lawful ROEs rather than a single just and reasonable ROE...

Id. (internal citations omitted).

²³ While Exelon does not support forcing a standardized ROE on all utilities in an RTO/ISO or broader region, that does not mean that utilities should not be allowed to voluntarily seek such treatment.

that are transmission-owning members of RTOs/ISOs may be the result of differing risks among utilities. For example, within the same RTO, some utilities may operate in dense urban areas (as compared to more rural areas), may be subject to different financial demands, etc. Imposing the ROE that reflects the risk of the utility with the most recent rate case on all other utilities, regardless of their individual risks relative to that reference utility, would ignore those differences. Doing so could create a mismatch between the ROE that a utility has an opportunity to earn and its relative risk, in some cases producing ROEs that are too high (when the reference utility is relatively riskier than the other utilities in the RTO/ISO) and in other cases producing ROEs that are too low (when the reference utility is relatively less risky than the other utilities in the RTO/ISO). The former situation may result in the misallocation of capital, while in the latter situation, utilities may be unable to effectively raise the capital they need to fund adequate transmission investment. Finally, such a policy would create excessive volatility in utilities' ROEs, undermining the certainty on which investors rely to make their investment decisions and on which utilities rely to prioritize their capital spend.

3. Fixed ROEs

In Questions A4, A4.a, and A4.b, the Commission questions whether the ROE for a transmission investment should reflect the costs of capital at the time of that investment, suggesting a “vintage approach” (potentially with a national default ROE for all transmission investments made in that year). Exelon has concerns with such an approach. First, as explained in section II.A.2 above, such an approach is inconsistent with the FPA – the Commission can only impose a new rate on a utility if it has first established that the existing rate is unjust and unreasonable.²⁴ And, as the D.C. Circuit has found, the Commission cannot rely solely on the

²⁴ See *Atlantic City Electric Co. v. FERC*, 295 F.3d 1 at 10.

fact that an existing ROE is not equal to the single value that its contemporary analysis would produce to demonstrate that an existing ROE is unjust and unreasonable.²⁵ Thus, the Commission does not have the authority to adopt a “vintage approach” unless it first demonstrates that each individual utility’s ROE is unjust and unreasonable, a task that would require significant time and resources on the part of the Commission, utilities, and interested parties. And even if such time resources were readily available, such an effort may prove unfruitful if the evidence does not support the necessary showing.

Depending on the design of a “vintage approach” (e.g., resetting ROEs annually, every three years, etc.), it could be impractical to implement. If the proceedings to establish ROEs for each vintage period were frequent, it could increase the time and resources that the Commission, utilities, and interested parties must expend to participate in ROE proceedings before the Commission, and in turn the costs that they incur in such litigation. Transmission rates would be more difficult for stakeholders and investors to understand given that investments from each vintage period would have a separate ROE, and utilities would have to carefully track the vintage year of their assets (which may be challenging for construction that is in progress when an ROE changes). A “vintage approach” could lead to perverse incentives undermining transmission investment, such as postponing transmission investments when the vintage period ROE is perceived to be low.

Finally, to incent investment, the ROE must compensate investors for their opportunity costs (in this case, the returns that they could earn by investing in other companies of similar risk). This opportunity cost may not be reflected in the ROE that was in place when a utility

²⁵ See *Emera Maine*, 854 F.3d 9 at 27 (“To satisfy its dual burden under section 206, FERC was required to do more than show that its single ROE analysis generated a new just and reasonable ROE and conclusively declare that, consequently, the existing ROE was per se unjust and unreasonable.”).

invested in a particular transmission facility included in its rate base; rather, it is reflected in the contemporary ROE, which accounts for the returns that an investor could make if it invested in other utilities with similar risk profiles. Equity is fungible – an investor in a utility can always sell its equity at any time and will do so if it can earn a higher return. As a result, the simplest way to ensure that a utility can attract the capital it needs to support the transmission investments that it must make to reliably serve its customers is to establish a single ROE that applies to a utility’s entire rate base and reflects contemporary market conditions (i.e., an ROE that accounts for the ROE that utilities with similar risk profiles earn on their investments). Relying on the ROE in place when a utility invested in a particular transmission facility could result in the misallocation of capital – when the “vintage” ROE is higher than the contemporary ROE, investors will be incentivized to provide more capital than the utility needs and when the “vintage” ROE is lower than the contemporary ROE, the utility may be unable to attract the capital needed to support its investments. For these reasons, Exelon cautions the Commission against adopting a “vintage approach.”

B. Proxy Groups

1. Sufficiency of the Size of Proxy Groups

In Question D1.b, the Commission asks whether proxy groups are sufficiently large given consolidation in the industry. Exelon urges the Commission to avoid being overly rigid in defining proxy groups, especially if the current trend of consolidation in the electric industry continues. The Commission’s current practice is to include in the proxy group those companies with credit ratings that are no more than one notch above or below that of the utility (or utilities) whose ROE is at issue.²⁶ While this approach may be reasonable as the default, there may be

²⁶ See Opinion No. 531, 147 FERC ¶ 61,234 at P 107; *see also* Coakley Briefing Order, 165 FERC ¶ 61,030 at P 49.

cases in which it produces too small of a proxy group. Such an outcome is problematic because it renders the Commission's ROE analysis less robust – a business risk or opportunity unique to a single utility is more likely to significantly affect the results, potentially influencing the resulting ROE excessively high or excessively low. Consequently, the Commission should expand the proxy group when necessary to establish a just and reasonable ROE, perhaps to include all companies with credit ratings that are no more than two notches above or below that of the utility (or utilities) whose ROE is at issue.²⁷

2. Consideration of Risk under the Proposed ROE Framework

In Question D2, the Commission questions whether risk should be considered in both the proxy group selection and in the placement of the ROE within the zone of reasonableness. It is imperative that the Commission clarify the proposed ROE framework with respect to this matter. From the discussion in the *Coakley* and MISO Briefing Orders, Exelon's understanding is that under the proposed ROE framework, the Commission will account for the relative risk of a utility through its selection of the proxy group. Absent a demonstration to the contrary, the Commission will then deem the utility to be average risk given that all of the companies in the proxy group have similar credit ratings and thus, generally, have similar levels of risk. This effectively creates a rebuttable presumption that the utility is of average risk relative to the other companies included in the proxy group, and that its ROE should be placed at the measure of the central tendency for the middle quartile. The burden of proof that the utility should be in a different quartile falls on the utility and intervenors. As a result, the upper quartile and lower quartile will only come into play in the Commission's analysis if the Commission finds that a party has successfully overcome the rebuttable presumption that the utility is of average risk.

²⁷ At the same time, Exelon does not support expanding the proxy group so broadly to include all investment grade utilities, as discussed further below.

We believe that this interpretation is consistent with the *Coakley* and MISO Briefing Orders.²⁸

If the Commission does not agree with this interpretation, it should clarify its approach to considering risk under the proposed ROE framework. The *Coakley* and MISO Briefing Orders provide little explanation of how the Commission will determine, once it has established the proxy group, whether the utility whose ROE is at issue is below average risk, average risk, or above average risk. And the Commission already accounts for the credit risk of a utility when establishing the proxy group, so it would be redundant to again consider credit risk to determine the appropriate quartile in which to place a utility's ROE. Exelon believes its rebuttable presumption interpretation to be a reasonable interpretation of the *Coakley* and MISO Briefing Orders, but Commission clarification that it is accurate would be helpful in ensuring the benefits that the proposed ROE framework would otherwise provide.

3. Expansion of the Proxy Group

In Question D6, the Commission inquires about the impact of modifying the credit rating screen to include all investment-grade utilities in the proxy group. Exelon does not support such an approach as it would effectively dilute one measure of risk calibration in the ROE analysis. In other words, a broad proxy group may fail to align the investment risk of the utility at issue with other utilities of similar risk.

To the extent that the Commission decides to adopt such an approach, it must clarify how

²⁸ See *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 25. In the *Coakley* Briefing Order, the Commission stated:

The Commission historically has accounted for a utility's risk profile in two ways. First, it has attempted to compare that utility to other utilities facing similar risks by establishing a proxy group of comparable risk companies.... Second, recognizing that, nevertheless, the particular circumstances facing a utility may differ from some or all of the proxy group companies, the Commission has adjusted the ROE within the zone of reasonableness derived from the proxy group.

The Commission further stated that “[these] longstanding determinations will form the basis of the Commission’s approach to evaluating whether an existing ROE may be found unjust and unreasonable.” *Id.* P 26.

it will consider risk in the ROE analysis. As noted, under its current practice, the Commission limits the proxy group to companies with a credit rating similar to that of the utility whose ROE it is evaluating.²⁹ This practice ensures that all of the companies in the proxy group are of similar credit risk, such that it is reasonable to presume that the utility whose ROE is at issue is of average risk within the proxy group (see discussion in section II.D.2 above); in this way, relative credit risk is factored into the ROE computation. If the Commission were to expand the proxy group to include all investment-grade utilities, it is unclear how the Commission would consider credit risk in the analysis. For example, would credit risk be factored in when determining whether to place a utility's ROE in the lower quartile, middle quartile, or upper quartile (i.e., whether the utility is below average risk, average risk, or above average risk)? Without clarity on this issue, it is uncertain what effect expanding the proxy group to all investment-grade utilities would have.

4. Adjustment of ROE within the Zone of Reasonableness

In Question D9, the Commission asks what circumstances or factors, if any, warrant an adjustment from the midpoint/median to other points within the zone of reasonableness (e.g., lower or upper midpoint/median). Utilities always have the right under FPA section 205 to file proposed changes to their rates,³⁰ and Exelon believes that there are circumstances and factors that may warrant adjustment from the measure of central tendency of the middle quartile of the composite zone of reasonableness. However, rather than attempting to create a complete list of such circumstances and factors in advance, Exelon urges the Commission to consider the specific circumstances and factors in individual cases to determine whether to adjust the ROE. Such

²⁹ See *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 25.

³⁰ See *Atlantic City Electric Co. v. FERC*, 295 F.3d 1 at 9 (holding that “[s]ection 205 of the Federal Power Act gives a utility the right to file rates and terms for services rendered with its assets”) (citing 16 U.S.C. § 824d).

case-by-case flexibility will provide the Commission with the discretion necessary to address changing industry and market conditions, as well as the specific circumstances of individual utilities, when warranted.

C. Financial Model Choice

1. Performance of Financial Models

In Questions E1 through E8 and E11, the Commission poses a number of questions concerning which financial models it should use in its ROE analysis, including their sensitivity to different capital market conditions. To a degree, the Commission's questions on this topic suggest that the Commission is searching for a single financial model that will perform well under all types of market conditions. It is important to keep in mind the nature of financial models – they are, by definition, simplified representations of the real world that will not function perfectly under all market conditions. That does not render them useless. Their results may not be perfectly accurate, but they are reliable enough to help inform the Commission's ROE determinations.

In fact, the four financial models that the Commission applied under its proposed ROE framework are regularly used by financial professionals and in other regulatory environments.³¹ That said, while helpful in evaluating the return that investors need to provide capital to utilities to support their transmission investment, they are blunt tools, each with their own limitations. Given those limitations, the most accurate representation of reality can be achieved by using the results of a range of financial models rather than relying on a single model. Therefore, the Commission's proposed reliance on a composite zone of reasonableness constructed using three

³¹ See e.g., Supplemental Reply Brief of MISO Transmission Owners, Reply Affidavit of Adrien M. McKenzie, Docket No. EL14-12-003 (filed Apr. 10, 2019) at p. 11 (stating that investors, financial analysts, and regulators customarily consider the results of different approaches).

financial models for the first prong of the Commission’s analysis under FPA section 206 (and four financial models for the second prong) is reasonable. Used together and comparatively, the four financial models included in the proposed ROE framework will provide, in many cases, a reasonable basis for the Commission’s analysis of ROEs.³²

2. Consideration of State ROEs

In Question E9, the Commission asks how, if at all, it should consider state ROEs. Exelon believes that ROEs for transmission system investments should always be higher than state ROEs for distribution system investments. Investment in transmission infrastructure is riskier than investment in distribution infrastructure for a number of reasons, a fact that the Commission has acknowledged in its orders.³³ For example, unlike distribution facilities, transmission lines often span multiple jurisdictions, complicating the siting and permitting process and requiring the transmission owner to negotiate with (and make economic concessions to) a wider range of parties. Moreover, the benefits of distribution facilities are more localized than those of transmission facilities. As a result, there is typically less landowner opposition to siting distribution facilities, and state siting authorities need not engage in any analysis of local versus regional benefits and costs for planned distribution facilities, an important consideration when they evaluate siting applications for transmission facilities. Finally, developing a transmission facility typically involves a larger commitment of funds for a longer timeframe than typically required when developing a distribution facility and thus has a greater financial impact on a utility’s balance sheet.

³² As noted above in section II.B.4, public utilities have the right to file rates in the first instance, and they may propose to use other financial models, data, or considerations to support their filed ROE. *See Atlantic City Electric Co. v. FERC*, 295 F.3d 1 at 9 (“Section 205(d) provides that a public utility may file changes to rates, charges, classification, or service at any time upon 60 days notice.” (citing 16 U.S.C. § 824d(d))).

³³ *See, e.g.*, Opinion No. 531, 147 FERC ¶ 61,234 at P 149 (noting the risks that investors funding electric transmission infrastructure face compared to the risks associated with state-regulated distribution facilities).

Because transmission system investments are riskier than distribution system investments, the Commission should ensure that utilities' transmission ROEs exceed their state-granted ROEs. Otherwise, utilities will have an incentive to overinvest in their distribution systems to the detriment of the nation's transmission infrastructure.

D. First Prong of ROE Determination

1. Commission Analysis of Existing ROEs

In Question G1, the Commission asks how it should determine whether existing ROEs are just and reasonable. As Exelon explains in section II.A.1 above, the proposed ROE framework (with certain clarifications and modifications) is generally reasonable. Consistent with *Emera Maine*, it acknowledges that there is range of potentially lawful ROEs rather than a single just and reasonable ROE.³⁴ It relies on commonly used financial models and should help to facilitate more timely Commission determinations on ROE, reducing the potential for pancaked complaints. Finally, it will provide greater predictability in ROE determinations, reducing the likelihood of litigation by discouraging unsubstantiated complaints and encouraging utilities to engage in settlement discussions when their ROEs are likely to be found unjust and unreasonable.

2. Quartile Approach

In Question G2, the Commission asks whether and, if so, how it should revise the quartile approach that it proposed in the *Coakley* and MISO Briefing Orders. As an initial matter, as discussed in section II.B.2 above, Exelon requests that the Commission clarify that there is a rebuttable presumption that a utility is of average risk within the proxy group for purposes of its

³⁴ See *Emera Maine*, 854 F.3d 9 at 26.

ROE determinations.³⁵ Exelon also recommends that the Commission expand the quartiles, dividing the composite zone of reasonableness into thirds that together cover the entire zone. As under the quartile approach, the lower third would be the presumptive zone of reasonableness for below average risk utilities, the middle third would be the presumptive zone of reasonableness for average risk utilities, and the upper third would be the presumptive zone of reasonableness for above average risk utilities.

Exelon believes that expanding the quartiles into thirds is reasonable. There is no reason to exclude parts of the zone of reasonableness from the Commission's analysis – the Commission already accounts for outliers when it removes outliers from the proxy group and there is no reason to repeat this normalizing step when divvying up the zone of reasonableness. Dividing the composite zone of reasonableness into thirds rather than quartiles will better reflect the full range of ROEs of the comparator companies included in the proxy group. This is a more complete representation of reality than excluding the top eighth and bottom eighth of the composite zone of reasonableness from the Commission's analysis.

3. Standard for Evaluating Pancaked Complaints

In Question G3, the Commission poses a series of questions about how it should evaluate pancaked complaints. The proposed ROE framework should greatly reduce the likelihood of pancaked complaints; thus, the Commission need not adopt a new approach to evaluating such complaints. As discussed in section II.A.1 above, the Commission will be able to more quickly and transparently identify unsupported complaints given the use of a range of presumptively just and reasonable ROEs rather than a single value. Consequently, it is less likely that an unsupported complaint will be set for hearing (resulting in an extended litigation process), such

³⁵ Without such clarification, Exelon cannot comment on the details of the quartile approach because it is uncertain how the Commission will implement it.

that there will be less reason for a complainant to file a pancaked complaint. Where an existing ROE may be unjust and unreasonable, the Commission's proposed ROE framework should allow it to more timely process complaints and establish the just and reasonable replacement rate, again reducing the likelihood of pancaked complaints.

That said, Exelon emphasizes the importance of timely Commission action on complaints to avoid the potential for complaint pancaking. Complaint pancaking perpetuates uncertainty, discouraging transmission investment. It also results in prolonged litigation that is costly and time-consuming for all parties involved, including the Commission. Exelon recognizes that there are times when the Commission may not be able to act promptly on complaints alleging that a utility's ROE is unjust and unreasonable without additional process. But setting a complaint for hearing should not be the Commission's default action; timely action whenever possible would both support needed transmission investment and reduce the cost associated with participating in ROE proceedings before the Commission.

4. Measure of Central Tendency for Single Utility Rate Cases

In Question G4, the Commission asks whether it is appropriate to use the median as the measure of central tendency in single utility rate cases under the proposed ROE framework. Exelon believes that the Commission should use the same measure of central tendency to establish the ROE for single utilities as it uses to establish an ROE that applies to all of the utilities in an RTO/ISO.

The Commission adopted its reasoning for using the midpoint rather than the median as the measure of central tendency for the MISO transmission owners' ROE. In a 2004 order, the Commission concluded that:

Because the ROE in this case will apply to a diverse group of companies, the entire range of results yielded by the subset is relevant here. Thus, we find that

using the midpoint is the most appropriate measure for determining a single ROE for all [MISO transmission owners], since it fully considers that range.³⁶

In its later rate case, Southern California Edison challenged as unduly discriminatory the Commission's refusal to use the midpoint as the measure of central tendency for a single utility as well. The Commission rejected this argument, finding that "there are important differences in the purpose of the analysis that the Commission conducts when it sets an ROE for such a group rather than for an individual utility."³⁷ Specifically, the Commission stated that its goal in setting an ROE for a group comprising all members of an RTO is not to select the most refined measure of central tendency (as is the case when it sets the ROE for a single utility of average risk), but rather to use the measure of central tendency that produces the most just and reasonable ROE for all of the utilities in the group. It also stated that when setting an ROE for all of the utilities in an RTO, it is not as concerned that the high or low results represent different risks from a single utility because the range only encompasses members of the group.³⁸ Finally, the Commission noted that its decision to use the midpoint rather than the median as the measure of central tendency for the MISO transmission owners' ROE was based on the unique set of circumstances present in that case, and Southern California Edison had not sufficiently supported its argument as to why that policy should be expanded on a generic basis.³⁹ The D.C. Circuit affirmed the Commission's decision, finding that the Commission "explained how its different purposes determine its different approaches when setting the ROE for a single electric utility as opposed to a group of utilities with diverse risk profiles."⁴⁰

³⁶ *Midwest Indep. Transmission Sys. Operator*, 106 FERC ¶ 61,302, at PP 9-10 (2004), *aff'd in relevant part sub nom. Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004, 1010-1011 (D.C. Cir. 2005).

³⁷ *Southern California Edison Co.*, 137 FERC ¶ 61,016, at P 21 (2011), *aff'd in relevant part sub nom. Southern California Edison Co. v. FERC*, 717 F.3d 177, 185-186 (D.C. Cir. 2013).

³⁸ *Southern California Edison Co.*, 137 FERC ¶ 61,016 at P 23 (quoting *Midwest Indep. Transmission Sys. Operator*, 106 FERC ¶ 61,302 at PP 9-10).

³⁹ *Southern California Edison Co.*, 137 FERC ¶ 61,016 at P 24.

⁴⁰ *Southern California Edison Co. v. FERC*, 717 F.3d 177, 185-186.

We urge the Commission to reconsider its position. From an investor's standpoint, the risks associated with a single utility that individually files an ROE are, all else equal, no different from those of a utility that files jointly with all of the other transmission owners in its RTO/ISO to establish a region-wide ROE. And the transmission-owning members of RTOs/ISOs that have their own ROEs are in all other ways similarly situated to the transmission-owning members of RTOs/ISOs that use a region-wide ROE. Thus, it is unduly discriminatory to use different measures of central tendency when determining the ROE for these two types of transmission owners.

E. Model Mechanics and Implementation

1. Model Risk

In Question H.1.2, the Commission questions the extent to which model risk affects all ROE methodologies. As Exelon explains in section II.C.1 above, no financial model is a perfectly accurate representation of the real world. However, relying on the results of a range of financial models rather than a single model helps to reduce the impact of model risk on ROE determinations.

III. CONCLUSION

In conclusion, utilities should have an opportunity to earn fair and predictable ROEs to support needed investments in their transmission facilities – investments that provide significant benefits to their customers. To provide utilities with regulatory certainty that this opportunity will exist, the Commission should expeditiously close this proceeding, adopting the proposed ROE framework set forth in the *Coakley* and MISO Briefing Orders with the clarifications and modifications that Exelon recommends herein. Specifically, the Commission should clarify that under the proposed ROE framework, once it establishes a proxy group that reflects companies

with similar risk profiles (as measured based on a utility's credit rating), there is a rebuttable presumption that the utility whose ROE is at issue is of average risk within that proxy group for purposes of placement within one of the three quartiles. Related to this clarification, the Commission should modify the proposed ROE framework to expand the quartiles into thirds such that they cover the entire composite zone of reasonableness. The Commission should also use the same measure of central tendency to establish the ROE for single utilities as it uses to establish an ROE that applies to all of the utilities in an RTO/ISO.

Respectfully submitted,

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