

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

Inquiry Regarding the Commission's Policy      )      Docket No. PL19-4-000  
for Determining Return on Equity      )

**COMMENTS OF THE MISO TRANSMISSION OWNERS**

The MISO Transmission Owners<sup>1</sup> submit the following comments in response to the Federal Energy Regulatory Commission's ("Commission" or "FERC") Notice of Inquiry<sup>2</sup> issued in this docket. The NOI seeks comments on whether, and if so how, the Commission should modify its policies concerning the determination of the base rate of return on equity ("ROE") in jurisdictional rates charged by public utilities. As explained below, the MISO Transmission Owners have provided responses to many of the Commission's questions in two pending complaint proceedings before the Commission. These comments reiterate the MISO Transmission Owners' general support for the four-

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<sup>1</sup> The MISO Transmission Owners for this filing consist of: ALLETE, Inc. for its operating division Minnesota Power (and its subsidiary Superior Water, L&P); Ameren Services Company, as agent for Union Electric Company d/b/a Ameren Missouri, Ameren Illinois Company d/b/a Ameren Illinois, and Ameren Transmission Company of Illinois; American Transmission Company LLC; Cleco Power LLC; Duke Energy Corporation for Duke Energy Indiana, Inc.; Entergy Arkansas, LLC; Entergy Louisiana, LLC; Entergy Mississippi, LLC; Entergy New Orleans, LLC; Entergy Texas, Inc.; Indianapolis Power & Light Company; International Transmission Company d/b/a ITC~~Transmission~~; ITC Midwest LLC; Michigan Electric Transmission Company, LLC; MidAmerican Energy Company; Montana-Dakota Utilities Co.; Northern Indiana Public Service Company; Northern States Power Company, a Minnesota corporation and Northern States Power Company, a Wisconsin corporation, subsidiaries of Xcel Energy Inc.; Northwestern Wisconsin Electric Company; Otter Tail Power Company; Southern Indiana Gas & Electric Company (d/b/a Vectren Energy Delivery of Indiana); and Wolverine Power Supply Cooperative, Inc.

<sup>2</sup> *Inquiry Regarding the Commission's Policy for Determining Return on Equity*, Notice of Inquiry, 166 FERC ¶ 61,207 (2019) ("NOI").

model approach the Commission suggests in the NOI (and originally proposed in the recent MISO Transmission Owners Briefing Order<sup>3</sup> and *Coakley* Briefing Order<sup>4</sup>), with certain changes to that approach.<sup>5</sup>

## **I. EXECUTIVE SUMMARY**

The MISO Transmission Owners generally support the Commission adopting, with slight modifications, the four-model approach for determining electric utility base ROEs outlined in the MISO Transmission Owners and *Coakley* Briefing Orders, while also committing to evaluate each ROE under consideration to ensure it meets the statutory requirement of a just and reasonable rate.<sup>6</sup> The Commission’s proposed four-model approach represents a substantial improvement in the way the Commission evaluates electric utility ROEs. While the MISO Transmission Owners urge the Commission to make certain minor changes to the proposed methodology and the MISO Transmission Owners Briefing Order’s calculations, for several reasons, the proposal is preferable to the Commission’s previous, exclusive reliance on the discounted cash flow (“DCF”) model.

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<sup>3</sup> *Ass’n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 165 FERC ¶ 61,118 (2018) (“MISO Transmission Owners Briefing Order”).

<sup>4</sup> *Coakley v. Bangor Hydro-Elec. Co.*, 165 FERC ¶ 61,030 (2018) (“*Coakley* Briefing Order”).

<sup>5</sup> The MISO Transmission Owners originally presented their proposed modifications to the Commission’s proposed methodology in their supplemental briefs in Docket Nos. EL14-12-003 and EL15-45-000 in response to the MISO Transmission Owners Briefing Order. These comments reiterate those proposals; however, the MISO Transmission Owners respectfully request that the Commission take official notice of, and make part of the record in this proceeding, the MISO Transmission Owners’ briefs and supporting affidavits submitted in compliance with the MISO Transmission Owners Briefing Order.

<sup>6</sup> The NOI further requests comments on whether any change to its policies regarding ROEs for public utilities should be applied to interstate natural gas and oil pipelines. The MISO Transmission Owners do not address this aspect of the NOI.

First, reduced reliance on the DCF model is prudent because recent cases (including Docket Nos. EL14-12 and EL15-45) have shown the model currently to be an unreliable indicator of investor expectations, particularly in atypical capital market conditions.<sup>7</sup> The Commission itself acknowledges that, recent experience “demonstrates the presence of unusual capital market conditions such that we have less confidence that the central tendency of the DCF zone of reasonableness (the midpoint in this case) accurately reflects the equity returns necessary to meet *Hope* and *Bluefield*.”<sup>8</sup> Dr. Roger A. Morin expresses a similar view in his treatise, *New Regulatory Finance*: “by relying solely on the DCF model at a time when the fundamental assumptions underlying the DCF model are tenuous, a regulatory body greatly limits its flexibility and increases the risk of authorizing unreasonable rates of return.”<sup>9</sup> Thus, the Commission’s transition away from exclusive reliance on the DCF model to determine ROEs for public utilities is a positive development.

Second, the proposed new approach will utilize three additional, empirically useful tools for determining zones of reasonableness and fixing new base ROEs: the Risk Premium method, the Capital-Asset Pricing Model (“CAPM”), and an Expected Earnings

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<sup>7</sup> See *Ass’n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 551, 156 FERC ¶ 61,234, at P 119 (2016), *reh’g pending*; *Coakley v. Bangor Hydro-Elec. Co.*, Opinion No. 531, 147 FERC ¶ 61,234, at P 145, *order on paper hearing*, Opinion No. 531-A, 149 FERC ¶ 61,032 (2014), *order on reh’g*, Opinion No. 531-B, 150 FERC ¶ 61,165 (2015), *vacated & remanded sub nom. Emera Me. v. FERC*, 854 F.3d 9 (D.C. Cir. 2017), *order on remand sub nom. ISO New Eng. Inc. v. Bangor Hydro-Elec. Co.*, 161 FERC ¶ 61,031 (2017), *reh’g pending*.

<sup>8</sup> Opinion No. 551 at P 119 (noting the requirements in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (“*Hope*”) and *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923) (“*Bluefield*”).

<sup>9</sup> Roger A. Morin, *New Regulatory Finance* 28 (2006).

analysis,<sup>10</sup> rather than relying on the single, inflexible DCF model. These three analytical tools are widely relied upon by investors,<sup>11</sup> and present transparent cost-of-capital estimates.<sup>12</sup> Moreover, the Commission already has acknowledged each of them to be a useful tool for evaluating utilities' cost-of-equity capital.<sup>13</sup> Throughout the MISO Transmission Owners' and the New England Transmission Owners' ("NETOs") recent ROE complaint proceedings, transmission owners have advocated using all three of these models as benchmarks to check the veracity of the Commission's preferred DCF methodology.<sup>14</sup> Accordingly, the MISO Transmission Owners also endorse the Commission's proposal to incorporate these three well-established methods into the Commission's determinations of utilities' ROEs.

Third, the Commission's new approach adopts a method for the evaluation and selection of base ROEs within the traditional zone of reasonableness that both retains the Commission's preference for reliance on points of central tendency and appropriately accounts for the risk profile of the utility or utilities under consideration. Unlike the Commission's earlier approach of setting ROEs in anomalous capital market conditions at a measure of central tendency in the upper half of the traditional zone of reasonableness, the Commission's new method sets a base ROE at the measure of central tendency

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<sup>10</sup> MISO Transmission Owners Briefing Order at PP 17–18.

<sup>11</sup> See Opinion No. 551 at P 236; Opinion No. 531 at P 147.

<sup>12</sup> See Opinion No. 531 at P 147 (describing the straightforward process for deploying each of the four analytical methods).

<sup>13</sup> See Opinion No. 551 at P 135 (“[W]e find that these analyses are informative . . . .”); Opinion No. 531 at P 146 (“[W]e find the risk premium analysis, the CAPM, and expected earnings analyses informative . . . .”).

<sup>14</sup> See, e.g., Opinion No. 551 at P 135; *Ark. Elec. Coop. Corp. v. ALLETE, Inc.*, 155 FERC ¶ 63,030, at PP 346–47 (2016); Opinion No. 531 at P 131.

reflective of returns appropriate for utilities with a similar risk profile.<sup>15</sup> This approach appears to be fully consistent with the United States Supreme Court’s requirement that a utility’s ROE “should be commensurate with returns on investments in other enterprises *having corresponding risks*.”<sup>16</sup>

Fourth, the Commission’s proposed rebuttable presumption (i.e., that an existing base ROE that falls within the range of returns commensurate with the subject utility’s risk profile remains just and reasonable)<sup>17</sup> provides an objective and much-needed mechanism for evaluating ROE complaints under section 206<sup>18</sup> of the Federal Power Act (“FPA”). The MISO Transmission Owners expect this aspect of the proposed new methodology will give all market participants a useful tool for evaluating potential success before filing or responding to a future ROE complaint, and should also reduce and simplify the Commission’s already significant administrative caseload.

## II. COMMENTS<sup>19</sup>

### **Role and Objectives of the Commission’s Base ROE Policy**

- A.1. Adopting the ROE methodology described in the MISO Transmission Owners and *Coakley* Briefing Orders will increase the predictability of ROE determinations and reduce litigation costs.

The ROE methodology described in the MISO Transmission Owners and *Coakley* Briefing Orders would increase the predictability of ROE determinations in two key ways.

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<sup>15</sup> See MISO Transmission Owners Briefing Order at PP 29–30.

<sup>16</sup> *Hope*, 320 U.S. at 603 (emphasis added).

<sup>17</sup> MISO Transmission Owners Briefing Order at P 17.

<sup>18</sup> 16 U.S.C. § 824e.

<sup>19</sup> For ease of reference, the MISO Transmission Owners include the question numbers from the NOI in the headings.

First, the new four-model approach will help minimize the impact of distortions of any one model's results due to unusual market conditions, because there will be three other models, each of which uses different data inputs, to offset such distortions.<sup>20</sup> Second, the new approach's institution of a presumptively just and reasonable quartile of potential returns within the larger composite zone of reasonableness will aid in the predictability of outcomes for market participants.<sup>21</sup> This aspect of the Commission's proposed new approach will enable market participants to perform calculations that will indicate whether a current base ROE is likely to withstand scrutiny if a complaint is filed.

The Commission's new zone-of-reasonableness/quartile approach to ROE also may allow it to resolve ROE complaints more quickly, thereby reducing the likelihood that a second complaint will be filed prior to the conclusion of a complaint that challenges an existing ROE. This new framework may provide less incentive and opportunity to "game" the administrative process with serial complaints in order to secure stacked refund periods. These aspects of the new approach will assist with predictability because utilities will have less concern about whether their current ROE is likely to remain in effect.<sup>22</sup> The benefits of increased predictability of ROEs and reduced need for litigation should reduce litigation costs for utilities and potential complainants and intervenors alike, while also easing the

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<sup>20</sup> Supplemental Initial Brief of MISO Transmission Owners, Docket No. EL14-12-003, at 17–18 (Feb. 13, 2019) ("EL14-12 MISO TOs Supplemental Initial Brief"); Supplemental Initial Brief of MISO Transmission Owners, Docket No. EL15-45-000, at 32–33 (Feb. 13, 2019) ("EL15-45 MISO TOs Supplemental Initial Brief").

<sup>21</sup> Supplemental Reply Brief of MISO Transmission Owners, Docket No. EL14-12-003, at 69 (Apr. 10, 2019) ("EL14-12 MISO TOs Supplemental Reply Brief"); Supplemental Reply Brief of MISO Transmission Owners, Docket No. EL15-45-000, at 68 (Apr. 10, 2019) ("EL15-45 MISO TOs Supplemental Reply Brief").

<sup>22</sup> EL14-12 MISO TOs Supplemental Reply Brief at 69; EL15-45 MISO TOs Supplemental Reply Brief at 68.

administrative burden on the Commission. As discussed in more detail below, the MISO Transmission Owners also encourage the Commission to reexamine its approach to pancaked complaints. Doing so would provide additional rate certainty to transmission-owning utilities.

The Commission's proposed four-method approach to setting electric utility ROEs is a substantial improvement from sole reliance on a DCF analysis chiefly because of the potential for anomalous inputs to the DCF to produce ROE estimates that are not just and reasonable. However, the MISO Transmission Owners' support for the Commission's proposed approach should not be read as an endorsement of the new approach as the only reasonable approach to estimating a just and reasonable ROE. As with other estimation tools that rely on empirical data, the Commission's proposed four-method approach may someday produce anomalous or unreasonable results. For this reason, and because the Commission must always fulfill its mandate to ensure electric utility rates are just and reasonable, the MISO Transmission Owners encourage the Commission to adopt its four-method approach (with the modifications suggested herein and in the MISO Transmission Owners' recent briefs in Docket Nos. EL14-12 and EL15-45), while also acknowledging that *Hope* and *Bluefield* require the Commission to analyze the results of such approach in each future proceeding to confirm whether the four-method approach has produced a just and reasonable result *in that case*. Thus, in each case, benchmarks such as state-authorized ROEs or other financial data or models should also be considered.

## **Proxy Groups**

D.2. and D.2.a. The Commission should retain its existing approach to proxy group selection.

The MISO Transmission Owners support the Commission’s approach to proxy group selection in the MISO Transmission Owners and *Coakley* Briefing Orders. For purposes of placement within the zone of reasonableness, the Commission and its administrative law judges have properly rejected arguments in the MISO and New England ROE proceedings that transmission operations are somehow less risky than state-regulated retail utility operations.<sup>23</sup> The Commission should continue to recognize that transmission operations are riskier than retail utility service.

The Commission should not require additional proxy company screening for the CAPM, Risk Premium, or Expected Earnings approaches, and should employ the same screening process for those estimation methods as for the DCF method. The MISO Transmission Owners encourage the Commission to continue the approach to proxy group selection it used in the MISO Transmission Owners Briefing Order and the *Coakley* Briefing Order. However, as explained in more detail below, the MISO Transmission Owners support certain modifications to the low-end, high-end, and “natural break” tests for potential outlier results after a proxy group has been identified.

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<sup>23</sup> See Opinion No. 551 at P 250; *Ark. Elec. Coop.*, 155 FERC ¶ 63,030, at P 572; *Ass’n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 153 FERC ¶ 63,027, at PP 402–03 (2015); Opinion No. 531 at PP 148–49.



- D.4. A low-end screen appropriately linked to utility bond yields is warranted, but there is no basis for a high-end screen tied to the median value of a range of estimates.

Low-End Test:

The MISO Transmission Owners support the continued use of a low-end outlier test, but emphasize that any low-end outlier test employed should be one that respects the significance of the inverse relationship between equity risk premiums and bond yields.<sup>24</sup> Yields on Baa-rated public utility bonds may be a useful indicator for evaluating cost-of-equity estimates residing at the low end of an estimate's range. However, the Commission should reconsider its proposal to use a fixed risk premium of 100 basis points to establish the threshold for excluding low-end results from the DCF, CAPM, and Expected Earnings models in the Commission's new four-model approach or in applying any other method for estimating the cost of capital.<sup>25</sup>

The Commission historically has relied on a 100 basis point spread over Baa utility bond yields as a test of whether an estimate is low enough that investors would consider the corresponding utility stock to yield essentially the same return as debt. However, reliance on such a static test overlooks the significance of the inverse relationship between equity risk premiums and bond yields.<sup>26</sup> The Commission repeatedly has acknowledged this relationship.<sup>27</sup> As Mr. McKenzie explained in his affidavits supporting the MISO

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<sup>24</sup> Affidavit of Adrien M. McKenzie, CFA on Behalf of the MISO Transmission Owners at 28:12–20 (“EL14-12 McKenzie Supplemental Initial Affidavit”) (Appendix 2 to the EL14-12 MISO TOs Supplemental Initial Brief).

<sup>25</sup> The Risk Premium model produces a single result rather than a range; thus any low-end or high-end test will not apply to that estimation model.

<sup>26</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 28:12–20.

<sup>27</sup> See Opinion No. 531 at P 147 (noting that “[t]he link between interest rates and risk premiums provides a helpful indicator of how investors’ required returns on equity

Transmission Owners' recent briefs following the MISO Transmission Owners Briefing Order, a fixed premium of 100 basis points over Baa public utility bond yields significantly understates investors' low-end threshold for returns on equity investments in utilities.<sup>28</sup>

The Commission adopted its 100 basis point risk premium threshold for low-end outliers in several ROE cases that used data from 2007 and 2008.<sup>29</sup> Recent bond yields have been substantially lower, indicating that the equity risk premium now is substantially larger.<sup>30</sup> The MISO Transmission Owners' evidence verifies that the inverse relationship between equity risk premiums and bond yields calls for a considerable upward adjustment to the Commission's risk premium threshold for low-end outliers.<sup>31</sup>

*High-End Outlier Test:*

The MISO Transmission Owners oppose the use of any high-end outlier test that implements a high-end limit measuring from a median value, or which assumes without

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have been impacted by the interest rate environment.”); Opinion No. 551 at P 197 (rejecting criticisms of the inverse relationship between bond yields and equity risk premiums and noting that “for every percentage drop of the BBB-rated bond yields, the risk premium increased approximately 77.07 basis points”).

<sup>28</sup> See EL14-12 McKenzie Supplemental Initial Affidavit at 29:8–13; Affidavit of Adrien M. McKenzie, CFA on Behalf of the MISO Transmission Owners at 25:8–13 (“EL15-45 McKenzie Supplemental Initial Affidavit”) (Appendix 2 to the EL15-45 MISO TOs Supplemental Initial Brief).

<sup>29</sup> See *S. Cal. Edison Co.*, 131 FERC ¶ 61,020, at PP 55, 56 (2010), *order on reh'g & clarification*, 137 FERC ¶ 61,016 (2011), *aff'd & remanded in part*, 717 F.3d 177 (D.C. Cir. 2013); *Pioneer Transmission, LLC*, 126 FERC ¶ 61,281, at PP 93–94 (2009); *S. Cal. Edison Co.*, 92 FERC ¶ 61,070, at 61,266 (2000); see also *Kern River Transmission Co.*, 117 FERC ¶ 61,077, at P 140 & n.227 (2006).

<sup>30</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 29:16 – 30:2; EL15-45 McKenzie Supplemental Initial Affidavit at 25:16 – 26:2.

<sup>31</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 30:2–12; EL15-45 McKenzie Supplemental Initial Affidavit at 26:2–12. This threshold value may change in future proceedings if bond yields rise or fall relative to the pertinent bond yields.

basis that higher-end values result from atypical circumstances that somehow make that high-estimate utility's risk profile unrepresentative of an "average company's" risk.<sup>32</sup>

The MISO Transmission Owners also oppose application of a high-end outlier test to a two-stage DCF analysis. The use of a long-term growth rate component already moderates the DCF model's estimated cost of equity, rendering a high-end outlier test unnecessary.<sup>33</sup>

The Commission's proposed "natural break" test is arbitrary and unjustifiable.

The MISO Transmission Owners oppose the so-called "natural break" test proposed in the MISO Transmission Owners and *Coakley* Briefing Orders to identify high-end outliers. The proposal described in those orders would subject the upper and lower ends of the ranges of returns produced by the DCF, CAPM, and Expected Earnings models to a "natural break" analysis based on the difference between individual values and the next lowest (in the case of the high-end) or highest (in the case of the low-end) estimate.<sup>34</sup>

The Commission should not adopt this type of "natural break" test. The size of the difference between one value and another in the range of estimated proxy returns provides no relevant information for the evaluation of the reasonableness of estimates at the high end of the ranges produced by the DCF, CAPM, or Expected Earnings models. Not only

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<sup>32</sup> See EL14-12 MISO TOs Supplemental Initial Brief at 12–16; EL15-45 MISO TOs Supplemental Initial Brief at 29–32.

<sup>33</sup> See Opinion No. 531 at P 118; EL14-12 McKenzie Supplemental Initial Affidavit at 36:9–14; EL15-45 McKenzie Supplemental Initial Affidavit at 32:21 – 33:2.

<sup>34</sup> MISO Transmission Owners Briefing Order at PP 52, 54; *Coakley* Briefing Order at PP 51, 53.

is such a test unnecessary, but it also is completely subjective.<sup>35</sup> Although the Commission has deployed a variation of the “natural break” test for low-end outliers, it rejected such a criterion for the high end of a range of returns in Opinion No. 531-B:

Petitioners next argue that, if the Commission eliminates PSEG as a low-end outlier, it must also eliminate UIL Holdings as a high-end outlier because UIL Holdings’s DCF result is 112 basis points above the next highest DCF result, and the Commission must apply the same “natural break” analysis in both the low-end and high-end outlier tests. We disagree. The low-end outlier test and the high-end outlier test serve very different purposes: the low-end outlier test is intended to screen out companies whose ROE estimates are low enough that an investor would consider the stock to yield essentially the same return as debt, whereas the high-end outlier test is intended to screen out companies whose growth rates are unsustainably high and therefore fail a threshold test of economic logic.<sup>36</sup>

At its core, using a “natural break” analysis to eliminate outliers in a range of cost-of-equity estimates is based on a false premise that evaluating cost-of-equity estimates for the relevant proxy group is akin to sampling.<sup>37</sup> It is not.

Sampling involves selecting a subset of data from within a larger population that facilitates a researcher making statistical inferences about unknown qualities of the population.<sup>38</sup> This is an empirically valuable analytical method, but one completely

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<sup>35</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 38:4–6; EL15-45 McKenzie Supplemental Initial Affidavit at 34:10–12.

<sup>36</sup> Opinion No. 531-B at P 79 (citation omitted).

<sup>37</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 38:28–30; EL15-45 McKenzie Supplemental Initial Affidavit at 35:6–8.

<sup>38</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 39:2–7; EL15-45 McKenzie Supplemental Initial Affidavit at 35:10–15.

irrelevant to evaluating a range of cost-of-equity estimates calculated from a DCF, CAPM, or Expected Earnings model.<sup>39</sup>

At least for purposes of determining ROEs for public utilities, evaluating cost-of-equity estimates for the proxy group does not involve sampling. To the contrary, the Commission’s proxy group criteria are designed to identify the *entire population* of utilities deemed to be of comparable risk to the relevant transmission owners.<sup>40</sup> In other words, as a statistical matter, the breadth of separation between individual estimates within the proxy group range is not a valid test of whether a particular estimate is credible.<sup>41</sup> Mr. McKenzie provided a more in-depth analysis and statistical example in his affidavits in the recent supplemental briefing in Docket Nos. EL14-12 and EL15-45 to illustrate these principles.<sup>42</sup>

Additionally, the goal of evaluating the results of the DCF, CAPM, and Expected Earnings methods is not to exclude mere “outliers,” but to exclude estimates that are clearly illogical for use as a basis for establishing the zone of reasonableness.<sup>43</sup> To rely simply on the magnitude of a “natural break” between two high-end estimates to identify an “outlier” is arbitrary and capricious.

To the extent the Commission decides to apply a “natural break” standard to its low-end outlier test, the Commission should not use the “natural break” threshold to

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<sup>39</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 39:7–10; EL15-45 McKenzie Supplemental Initial Affidavit at 35:15–18.

<sup>40</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 39:11–16; EL15-45 McKenzie Supplemental Initial Affidavit at 35:19–24.

<sup>41</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 39:19–21; EL15-45 McKenzie Supplemental Initial Affidavit at 36:1–3.

<sup>42</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 39:24 – 41:4; EL15-45 McKenzie Supplemental Initial Affidavit at 36:6 – 37:11.

<sup>43</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 41:5–8; EL15-45 McKenzie Supplemental Initial Affidavit at 38:1–4.

include companies that the low-end outlier threshold indicates investors would ignore as unrepresentative of acceptable equity returns. The sole purpose of the low-end outlier threshold is to exclude low-end estimates that an investor would disregard as essentially equivalent to bond yields. Thus, it would be illogical and unreasonable to deploy a “natural break” analysis to include low-end results that a valid bond yield threshold would screen out. Accordingly, a “natural break” analysis should only be used on the low end of a range of cost-of-equity estimates to assess whether the bond-yield threshold may have failed to exclude an illogical result.

D.4.b. The Commission should apply the same approach to outliers to each of the relevant financial models comprising its new approach to ROE.

The MISO Transmission Owners’ points regarding low-end and high-end screens of proxy values apply equally to the DCF, CAPM, and Expected Earnings models. However, rejection of a high-end outlier test for DCF results is further justified by the fact that a two-stage DCF analysis already incorporates a long-term growth rate. This long-term factor in the Commission’s preferred DCF model is expressly intended to moderate DCF results, and thus negates any perceived need for a high-end outlier test for a DCF range.

Please also refer to the MISO Transmission Owners’ response to Question D.4 above.

D.10. The Commission’s rationale for adopting the midpoint for establishing Regional Transmission Organization (“RTO”)-wide ROEs remains valid.

The MISO Transmission Owners support reliance on the midpoint ROE estimate as the appropriate measure of central tendency for evaluating the ROE for RTO-wide groups of utilities, and oppose the use of median values for that purpose. The MISO Transmission Owners and *Coakley* Briefing Orders correctly proposed to set any new base

ROE for the MISO Transmission Owners by application of the Commission’s proposed four-model approach. The proposed new methodology leads to setting a new base ROE equal to the average of four values: the Risk Premium point estimate and the midpoints of the DCF, CAPM, and Expected Earnings methods. Nothing about the MISO Transmission Owners and *Coakley* Briefing Orders or the Commission’s new approach has implications for the Commission’s long-held position that the midpoint is the appropriate measure of central tendency to use for a group of utilities.

The MISO Transmission Owners Briefing Order states “[t]he Commission will continue to use the midpoint of the zone of reasonableness as the appropriate measure of central tendency for a diverse group of average risk utilities.”<sup>44</sup> This is consistent with the Commission’s treatment of base ROEs for groups of utilities—including the MISO Transmission Owners—for more than fifteen years.<sup>45</sup> In rejecting the use of the median in favor of the midpoint for the MISO Transmission Owners in 2004, the Commission held that, “the midpoint is the most appropriate measure for determining a single ROE for all Midwest ISO [Transmission Owners], since it fully considers th[e] range” of reasonable returns derived for the proxy group.<sup>46</sup> The Commission explained:

The median may be a more refined measure for a utility facing average risk, but it places more weight on the middle values, thus,

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<sup>44</sup> MISO Transmission Owners Briefing Order at P 18 n.40; *see Coakley* Briefing Order at P 17 n.46; *see also S. Cal. Edison Co.*, 131 FERC ¶ 61,020, at P 91, *aff’d & remanded in part*, 717 F.3d at 183–87.

<sup>45</sup> *See Midwest Indep. Transmission Sys. Operator, Inc.*, 100 FERC ¶ 61,292 (2002) (setting MISO Transmission Owners’ base ROE at the midpoint of the zone of reasonableness), *reh’g denied*, 102 FERC ¶ 61,143 (2003), *order on remand*, 106 FERC ¶ 61,302, at PP 10-11 (2004) (providing additional rationale on remand for use of midpoint for the MISO Transmission Owners’ base ROE), *aff’d in part sub nom. Pub. Serv. Comm’n of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005).

<sup>46</sup> *Midwest Indep. Transmission Sys. Operator*, 106 FERC ¶ 61,302, at P 10.

potentially producing a value that is not appropriate for application to a diverse group of utilities. While a simple average evenly weighs each number in the proxy group, the midpoint relies on the high and low values to take into account the widest range of results. Relying on the midpoint to calculate the ROE is appropriate in this case, since the ROE applies to a diverse group of [transmission owners].<sup>47</sup>

This rationale has been sustained throughout the Commission's repeated rulings that the median is an appropriate measure for single-utility ROEs, but the midpoint is the appropriate measure for diverse groups of utilities. "[U]sing the median recognizes important differences in the purpose of the analysis that the Commission conducts when it sets an ROE for an individual utility rather than for a group comprising all of the utilities within an ISO."<sup>48</sup>

The goal of setting a base ROE for an individual utility is to reflect most accurately the risk of that particular utility.<sup>49</sup> In contrast, the goal of setting a base ROE for a regional group of utilities is to estimate a central tendency, while also reflecting the diverse nature of the group.<sup>50</sup> Thus, when setting the base ROE for a regional group of utilities, the Commission is "not seeking the most refined measure of central tendency, which might be achieved with the median, because it [is] not establishing an ROE for a single company of average risk."<sup>51</sup> Instead, the Commission has noted regarding the MISO Transmission Owners specifically, "[g]iven that the ROE will apply across-the-board to all members of

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<sup>47</sup> *Midwest Indep. Transmission Sys. Operator*, 106 FERC ¶ 61,302, at P 11.

<sup>48</sup> *S. Cal. Edison Co.*, 144 FERC ¶ 61,145, at P 8 (2013).

<sup>49</sup> *Id.*

<sup>50</sup> *S. Cal. Edison*, 131 FERC ¶ 61,020, at P 91 ("[T]he median places more weight on the middle values of a range of values than does the midpoint, and thus, it potentially produces a value that is not appropriate for a diverse group of utilities.").

<sup>51</sup> *Id.*



[MISO], rather than to a single company of average risk, we must consider their full range of risks and business profiles,” and “[b]ecause the ROE in this case will apply to a diverse group of companies, the entire range of results” yielded by the proxy group is relevant.<sup>52</sup> Reviewing courts have upheld the Commission’s approach of relying on the midpoint for regional groups, even as it applies the median for individual utilities.<sup>53</sup> The Commission therefore should continue to use the midpoint for establishing RTO-wide ROEs as the appropriate measure of central tendency for each cost of capital methodology that produces a range of potentially reasonable returns.

D.10.a. Employing the Commission’s proposed four-model ROE framework does not alter the reasoning that supports reliance on midpoint values for RTO-wide ROEs.

While the four-method approach proposed in the MISO Transmission Owners and *Coakley* Briefing Orders incorporates two new range-producing methods, CAPM and Expected Earnings, in addition to the DCF model, proxy groups are composed for these methods the same way as they historically have been assembled for the Commission’s DCF approach.<sup>54</sup> Therefore, in cases involving groups of utilities, the midpoints of the CAPM and Expected Earnings ranges are the appropriate measure of central tendency derived

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<sup>52</sup> *Midwest Indep. Transmission Sys. Operator*, 106 FERC ¶ 61,302, at PP 9, 10; *see also id.* at P 10 (“Thus, we find that using the midpoint is the most appropriate measure for determining a single ROE for all Midwest ISO TOs, since it fully considers that range. Selecting the most refined measure of central tendency, as might be achieved with use of the median, is not the Commission’s goal in this case, given that we are not selecting a ROE for a single utility of average risk.”).

<sup>53</sup> *See S. Cal. Edison Co.*, 717 F.3d at 186; *Pub. Serv. Comm’n of Ky.*, 397 F.3d at 1011.

<sup>54</sup> *See* MISO Transmission Owners Briefing Order at P 50; *Coakley* Briefing Order at P 49.

from those models for the same reasons the midpoint is the most relevant central tendency derived from a DCF analysis.<sup>55</sup>

Reliance on the midpoint for DCF, CAPM, and Expected Earnings models alongside a Risk Premium model is appropriate even though the Risk Premium method does not produce a range of returns. This conclusion is not altered when the result of averaging the Risk Premium estimate with the midpoints of the DCF, CAPM, and Expected Earnings methods deviates from the midpoint of a composite zone of reasonableness produced as proposed in the MISO Transmission Owners and *Coakley* Briefing Orders. The Commission has found the Risk Premium method, as well as the models that provide ranges of estimates, to be a useful benchmark for estimating the cost of equity capital. Simply because incorporating the Risk Premium result might cause the resulting ROE estimate to diverge from the central tendencies of the composite zone of reasonableness provided by the other three models is not an error in the Commission's approach. Instead, it merely ensures that all four appropriate methods have a role in setting a replacement base ROE.

For additional discussion of why the midpoint is still the appropriate measure of central tendency for RTO-wide ROEs, please refer to the MISO Transmission Owners' response to Question D.10 above.

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<sup>55</sup> Reply Affidavit of Adrien M. McKenzie, CFA on Behalf of the MISO Transmission Owners at 124:11–22 (“EL14-12/EL15-45 McKenzie Supplemental Reply Affidavit”) (Appendix 2 to the EL14-12 and EL15-45 MISO TOs Supplemental Reply Briefs).

## **Financial Model Choice**

E.1. and E.5. The Commission’s four-method approach avoids distortion due to unusual capital market conditions.

There is ample basis to infer that investors rely on the DCF, Risk Premium, Expected Earnings, and CAPM methods, as well as state ROEs, to evaluate utility equities.<sup>56</sup> The MISO Transmission Owners reserve the question of whether other models might also be used.

In composing the composite zone of reasonableness under the MISO Transmission Owners and *Coakley* Briefing Orders, the Commission proposed to average the highest and lowest values produced by each of the DCF, CAPM, and Expected Earnings models. Averaging each of the ranges produced by each of the three models, of itself, mitigates some of the potential for an “unsustainable” estimate from any single model to skew the overall result of the Commission’s proposed methodology, whatever the market conditions may be.<sup>57</sup>

E.6. and E.7. The Commission’s proposed four-method hybrid approach properly factors multiple models into a single estimate.

The MISO Transmission Owners generally support implementation of the four-model approach proposed in the MISO Transmission Owners and *Coakley* Briefing Orders, subject to the modifications proposed in the MISO Transmission Owners’ briefs in Docket Nos. EL14-12 and EL15-45, as a just and reasonable approach to evaluating base ROE. The MISO Transmission Owners supported considering CAPM, Expected Earnings, and

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<sup>56</sup> See Opinion No. 531 at P 147.

<sup>57</sup> See EL14-12 MISO TOs Supplemental Initial Brief at 17–18; EL15-45 MISO TOs Supplemental Initial Brief at 32–33.

Risk Premium throughout those proceedings, and provided evidence of the deep shortcomings of the Commission's DCF method.<sup>58</sup> However, the MISO Transmission Owners know of no basis for reaching a conclusion that any one of the four methods—DCF, CAPM, Expected Earnings, and Risk Premium—is definitively the “best” method in all circumstances. Thus, the MISO Transmission Owners do not support the selection of any one method that should apply in all circumstances.

The MISO Transmission Owners supported the Commission's proposal to weigh the DCF, CAPM, Expected Earnings, and Risk Premium models equally when using one or more of them in tandem in a multi-method approach in the MISO Transmission Owners' ROE complaint proceedings in Docket Nos. EL14-12 and EL15-45. The evidentiary records in those proceedings leave little doubt that there is no single approach to estimating the cost of equity that is fundamentally superior or foolproof.<sup>59</sup> Each benchmark offers unique features that make it preferable to others in certain respects, but less so in other respects.<sup>60</sup> Thus, in those proceedings, because no method is perfect and it would add an additional and unnecessary level of complexity to weigh the four methods asymmetrically, the MISO Transmission Owners argued it was reasonable to weigh all methods equally. However, the MISO Transmission Owners encourage the Commission to remain open to proposals for alternative weighting schemes in future proceedings should the relevant evidence so warrant. This approach is consistent with the Commission's policy of reviewing evidence on a case-by-case manner in evidentiary proceedings.

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<sup>58</sup> See, e.g., Opinion No. 551 at PP 115–18, 120, 139–40, 175–76, 202; *Ark. Elec. Coop.*, 155 FERC ¶ 63,030, at PP 126–54, 267, 276, 346–49, 391–406, 473–78, 490, 494.

<sup>59</sup> EL14-12/EL15-45 McKenzie Supplemental Reply Affidavit at 115:13 – 116:2.

<sup>60</sup> *Id.* at 112:20 – 113:3.

E.9. and E.10. The Commission should consider evidence of state ROEs on a case-by-case basis consistent with current Commission policy.

The Commission should continue to consider state-authorized ROEs as evidence of expected investor returns, and should evaluate the evidence presented in each proceeding on a case-by-case basis. Probative evidence in Docket Nos. EL14-12 and EL15-45 demonstrates that investors look to state-authorized ROEs when evaluating what investments, if any, to make in transmission utilities.<sup>61</sup> The Commission previously concluded in Opinion No. 531-B that the proper use of state-authorized ROEs is to compare the “significant number of state commission-authorized ROEs to the midpoint produced” by the Commission’s ROE methodology, and to determine whether “their levels, relative to each other, were illogical in light of the record evidence concerning the comparative risks of state-level electric distribution and interstate electric transmission.”<sup>62</sup> This approach continues to be appropriate. Thus, state-authorized ROEs are properly considered in the context of how the risk profile of a state-regulated utility compares to the risk profile of jurisdictional utilities’ transmission operations.

Most importantly, the records in Docket Nos. EL14-12 and EL15-45 demonstrate that there are material risk differences between state-regulated retail distribution and integrated utilities and interstate transmission operations regulated by the Commission, and transmission is generally considered to present higher risks.<sup>63</sup> State ROE data nevertheless

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<sup>61</sup> See, e.g., Opinion No. 551 at PP 240, 249–50; *Ark. Elec. Coop.*, 155 FERC ¶ 63,030, at PP 535–58, 610–12.

<sup>62</sup> Opinion No. 531-B at P 88.

<sup>63</sup> See Opinion No. 531 at PP 148–49; see also EL14-12 Exhibit No. MTO-16 (Lapson) at 46:12–20, 54:3–14, 59:8 – 60:3; EL15-45 Exhibit No. MTO-16 (Lapson) at 12:5–16.

has been and can be a useful benchmark in reviewing investor expectations and evaluating cost of equity estimates within the larger market context.<sup>64</sup>

**Purported Mismatch Between Market-Based ROE Determinations and Book-Value Rate Base**

F.5. The Commission should not adjust ROEs to account for market-to-book ratios above or below one.

There is no sound rationale for adjusting ROEs based on market-to-book ratios. Although some critics may contend that Expected Earnings calculations (or other ROE estimates) are unreliable when utilities' market-to-book ratios are greater than one,<sup>65</sup> the Commission rejected this contention in Opinion No. 551:

As the Commission explained in Opinion No. 531-B, investors rely upon the return on book equity to determine the opportunity cost of investing in a particular company, and investors rely upon expected earnings analysis for this purpose without attempting to convert that opportunity cost into the current market cost of equity.<sup>66</sup>

In his reply affidavit submitted in response to the MISO Transmission Owners Briefing Order, Mr. McKenzie provided additional analysis demonstrating that arguments in favor of adjusting ROEs based on market-to-book ratio erroneously conflate cost of equity theory with market reality.<sup>67</sup> Mr. McKenzie also observed that Dr. Roger Morin, author of *New*

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<sup>64</sup> See EL14-12/EL15-45 McKenzie Supplemental Reply Affidavit at 61:7–9.

<sup>65</sup> Initial Paper Hearing Brief of the MISO Complainant-Aligned Parties, Docket No. EL14-12-003, at 42–43 (Feb. 13, 2019); Initial Paper Hearing Brief of the MISO Complainant-Aligned Parties, Docket No. EL15-45-000, at 42 (Feb. 13, 2019); Brief on Behalf of the Louisiana Public Service Commission, Intervenor, Submitted for the Purpose of Addressing Return on Equity Methods and Applications, Docket No. EL14-12-003, at 26–29 (Feb. 13, 2019) (“EL14-12 LPSC Brief”).

<sup>66</sup> Opinion No. 551 at P 234.

<sup>67</sup> EL14-12/EL15-45 McKenzie Supplemental Reply Affidavit at 79:13 – 87:22. As noted, the Commission need not and should not consider the Louisiana Public Service Commission’s (“LPSC”) belated attempt to show an inconsistency in the

*Regulatory Finance*, soundly rejects any notion that regulators' ROE decisions should consider market-to-book ratios.<sup>68</sup>

### **First Prong of an FPA 206 ROE Determination**

- G.1. The MISO Transmission Owners and *Coakley* Briefing Orders' framework for evaluating whether an existing base ROE remains just and reasonable is generally appropriate, but the Commission should adopt the MISO Transmission Owners' proposed modifications.

The MISO Transmission Owners generally agree with the MISO Transmission Owners and *Coakley* Briefing Orders' framework for evaluating whether an existing base ROE remains just and reasonable.<sup>69</sup> The Commission should rely on the composite zone of reasonableness produced by the CAPM, DCF, and Expected Earnings models;<sup>70</sup> the assignment of relative risk to the three points of central tendency within such zone; and the quartiles centered on such points to evaluate whether a utility's existing base ROE remains just and reasonable. The MISO Transmission Owners support the Commission's proposal that existing base ROEs that fall within the quartile of returns associated with the subject

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testimony Dr. William E. Avera presented in Docket No. ER13-1508 (*see* EL14-12 LPSC Brief at 15–16, 28–29). Mr. McKenzie nevertheless establishes that LPSC's claim has no merit. EL14-12/EL15-45 McKenzie Supplemental Reply Affidavit at 90:5–16.

<sup>68</sup> *Id.* at 86:3 – 87:2 (quoting *New Regulatory Finance* at 377–78).

<sup>69</sup> *See Coakley* Briefing Order at PP 19–31; MISO Transmission Owners Briefing Order at PP 21–33.

<sup>70</sup> However, as the MISO Transmission Owners have explained above and in response to the MISO Transmission Owners Briefing Order, the Commission should make certain changes its proposed methodology to ensure that the new approach is consistent with investors' expectation, and statutorily and procedurally sound. *See supra* Section D.4; EL14-12 MISO TOs Supplemental Initial Brief at 6–22.

utility's risk profile should be subject to a rebuttable presumption that the ROE remains just and reasonable.<sup>71</sup>

Such a rebuttable presumption is consistent with the *Emera Maine* court's holding that the Commission may not rely on a finding that a single base ROE is just and reasonable to conclude that all other base ROEs, including all others within the statutory zone of reasonableness, are not.<sup>72</sup> The Commission's sensible response to this holding is to adopt a range of potential base ROEs that is substantially narrower than the full zone of reasonableness, but broad enough to include multiple base ROEs that it potentially and justifiably may find to be just and reasonable. The Commission's proposal to recognize a discrete zone of presumptively just and reasonable returns is also consistent with its and the courts' long-held view that there may be more than one just and reasonable return, even though the Commission ultimately must fix a single, just and reasonable rate.<sup>73</sup> Thus, the Commission's adoption of a rebuttable presumption in favor of a base ROE within a portion of the zone of reasonableness is consistent with *Emera Maine* and other precedents.

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<sup>71</sup> See *Coakley* Briefing Order at P 16; MISO Transmission Owners Briefing Order at P 17.

<sup>72</sup> 854 F.3d at 26.

<sup>73</sup> See *Midwest Indep. Transmission Sys. Operator, Inc.*, 127 FERC ¶ 61,109, at P 20 (2009) ("It is well established that there can be more than one just and reasonable rate"); *Am. Elec. Power Serv. Corp. v. Midwest Indep. Transmission Sys. Operator, Inc.*, 122 FERC ¶ 61,083, at P 88 ("As the courts have found, on the same set of facts there can be 'multiple just and reasonable rates' and the resolution may depend on whether the proceeding is initiated under section 206." (citing "*Complex*" *Consol. Edison Co. of N.Y., Inc. v. FERC*, 165 F.3d 992, 1000–02 (D.C. Cir. 1999))), *order on reh'g*, 125 FERC ¶ 61,210 (2008).



Further, by establishing such a rebuttable presumption, the Commission will provide the industry an objective mechanism for evaluating ROE complaints.<sup>74</sup> This will provide a useful tool for evaluating potential success before filing (or responding to) a future ROE complaint, and it will also reduce and simplify the Commission's review and disposition of ROE-based complaints. That is, a range of presumptively reasonable returns can help potential complainants evaluate their chances of success, and help respondent utilities evaluate the merits of their potential defenses to a complaint.<sup>75</sup> As a result, the narrow zone of presumptively just and reasonable returns will not only facilitate making a *prima facie* case that an existing base ROE may no longer be just and reasonable, but it will also aid in a defense that a base ROE remains just and reasonable. Therefore, the Commission's proposed rebuttable presumption provides fair guidance to the industry and the public, and is consistent with due process because it provides benefits to both sides of the consumer/utility balance.

However, the MISO Transmission Owners propose one clarification. The Commission should also provide that existing base ROEs that fall within the composite range of returns, but outside the quartile associated with the subject utility's risk profile, are rebuttably presumed to be unjust and unreasonable, and not unjust and unreasonable as a matter of law. Such a corollary rebuttable presumption is consistent with the framework

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<sup>74</sup> It is well established that the Commission has the authority to adopt a rebuttable presumption to assist it in deciding whether or not to grant a complaint. *See, e.g., AEP Power Mktg., Inc.*, 107 FERC ¶ 61,018, at P 199 (2004).

<sup>75</sup> Of course, both sides also have the opportunity to present additional evidence, in the case of complainants to demonstrate a base ROE is unjust and reasonable despite residing within the presumptively reasonable zone, and in the case of respondent utilities to demonstrate a base ROE remains just and reasonable despite residing outside the presumptively reasonable zone.

the Commission offered in the MISO Transmission Owners and *Coakley* Briefing Orders. The Commission stated it may also consider “other indications of a change in capital market conditions since the existing ROE was established,” because “[a] utility’s cost of equity is determined at least in part, by comparison with other potential investments.”<sup>76</sup> Thus, it is appropriate to allow a utility to demonstrate that its base ROE remains just and reasonable, although its existing base ROE may fall outside the quartile associated with its risk profile, based on a holistic review of market data and other relevant evidence. Such clarification will provide utilities with a meaningful opportunity, as due process requires, to defend their existing ROEs under their own specific circumstances.

G.2. The Commission’s quartile approach, as proposed in the MISO Transmission Owners and *Coakley* Briefing Orders is appropriate, so long as the Commission adopts the MISO Transmission Owners’ modifications.

As discussed above, the Commission’s quartile approach, based on the composite zone of reasonableness with the modifications proposed by the MISO Transmission Owners, is appropriate to evaluate whether an existing base ROE remains just and reasonable.

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<sup>76</sup> MISO Transmission Owners Briefing Order at P 31; *Coakley* Briefing Order at P 29. The Commission listed prime interest rates, bond yields, and changes to the expected ROEs for other enterprises with similar risk profiles as other factors that may bear on whether the existing base ROE is just and reasonable. MISO Transmission Owners Briefing Order at P 31; *Coakley* Briefing Order at P 29.

- G.3. Overlapping or “pancaked” complaints are unlawful, but to the extent the Commission determines otherwise, complainants should bear the burden of a *prima facie* showing of changed circumstances from the prior complaint to substantiate the need for a subsequent (and continued) investigation into a utility’s ROE.

As the MISO Transmission Owners have previously demonstrated, pancaked complaints are not permitted under the FPA.<sup>77</sup> However, the Commission has found otherwise.<sup>78</sup> To the extent the Commission continues to allow such complaints going forward, complainants prosecuting any pancaked complaint (i.e., a complaint filed while a complaint on the same issue is pending before the Commission) should be required to make, with specific facts, a *prima facie* showing of sufficient change in market conditions to substantiate the need for a subsequent (and continued) investigation into a utility’s ROE. As demonstrated below, requiring complainants to make at least such a *prima facie* demonstration, in addition to showing the ROE is outside of the presumptively just and reasonable ROE range, is sound administrative policy, would avoid unnecessary proceedings, and would preserve scarce resources.

*Pancaked complaints must demonstrate changed circumstances as part of a prima facie case.*

In essence, pancaked complaints seek to continue litigating a utility’s (or group of utilities’) base ROE even though the Commission will set a just and reasonable base ROE at the conclusion of a preceding complaint. Given that the Commission will determine a

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<sup>77</sup> See, e.g., Answer to Complaint of the MISO Transmission Owners, Docket No. EL15-45-000, at 44–46 (Mar. 11, 2015) (“EL15-45 MISO TOs Answer to Complaint”); EL15-45 MISO TOs Supplemental Initial Brief at 15–20.

<sup>78</sup> See, e.g., *Belmont Mun. Light Dep’t v. Cent. Me. Power Co.*, 156 FERC ¶ 61,198, at PP 39–40 (2016), *reh’g denied*, 162 FERC ¶ 63,035 (2018); *ENE (Environment Northeast) v. Bangor Hydro-Elec. Co.*, 147 FERC ¶ 61,235, at P 27 (2014), *reh’g denied*, 151 FERC ¶ 61,125 (2015).

just and reasonable base ROE in response to the first complaint, absent some justification, there is no need to continue to litigate that issue. Accordingly, complainants filing a pancaked complaint should be required to identify, with specificity, material changes in market conditions relative to when the initial complaint was presented. The simple passage of time is insufficient grounds for the Commission to open a new investigation into an ROE that is or recently has been under investigation. That is why Commission policy requires a showing of changed circumstances to prevent unnecessary relitigation of issues.<sup>79</sup> ROE should be no different.

Absent significant changes in capital market conditions or other relevant circumstances, the base ROE established in a pancaked complaint proceeding should not be appreciably different from that established in the initial complaint proceeding. The low probability of a significant change in base ROE in pancaked complaint proceedings without a change in circumstances shows that such proceedings have little utility and waste scarce administrative resources. Indeed, recent ROE proceedings frequently have been lengthy and costly, entailing multiple rounds of witness testimony, a live trial-type evidentiary hearing, briefing, an initial decision by an administrative law judge, and more briefing,

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<sup>79</sup> See, e.g., *EPIC Merchant Energy v. PJM Interconnection, L.L.C.*, 131 FERC ¶ 61,130, at P 20 (2010) (“We dismiss the complaint. This complaint merely seeks to re-litigate the same issues as raised in the prior case citing no new evidence or changed circumstances.”); *Alamito Co.*, 43 FERC ¶ 61,274, at 61,753 (1988) (“The Commission’s long-standing policy against relitigation of issues disposes of Tucson’s motion for reconsideration. The basis for this position is not the doctrine of res judicata, collateral estoppel, stare decisis, or law of the case, but the fact that it is contrary to sound administrative practice and a waste of resources to relitigate issues in succeeding cases once those issues have been fully determined. Absent a showing of significant change in circumstances, the relitigation of an issue is simply not justified. Sound public policy reasons support the Commission’s policy against relitigation of issues.” (footnote omitted)).

before ever reaching the Commission, only to be followed by rehearing requests and judicial review.<sup>80</sup>

The Commission's proposal to compare an existing base ROE against a range of presumptively just and reasonable ROEs is, in fact, a proposal to evaluate whether there are changed circumstances warrant examination of the subject utility's (or utilities') base ROE. However, in a pancaked complaint case, the predicate ROE used in the comparison has not yet been set, rendering the Commission's presumptively reasonable quartile approach unworkable in such cases. Indeed, the inability to even perform the first prong analysis under FPA section 206 makes it impossible for all involved to evaluate the relative merits of a pancaked complaint and inherently requires lengthy proceedings that waste scarce resources. Thus, a policy requiring a showing of changed circumstances would address the fatal flaw of allowing pancaked complaints in the first instance and is a necessary corollary to the Commission's proposed rebuttable presumption for existing ROEs.

Further, such a requirement should apply regardless of when a complaint is filed. The need for a showing of changed circumstances also applies in the case of a successive complaint scenario (i.e., a complaint filed after the issuance of a Commission opinion in

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<sup>80</sup> See, for example, the proceeding in Docket No. EL11-66, the NETOs' first complaint case. There, the proceeding took almost six years from the complaint being filed to judicial review, with the complaint filed on September 30, 2011, evidentiary hearing held in May 2013, initial decision issued in August 2013, Opinion No. 531 issued in June 2014, Opinion No. 531-B (rehearing of Opinion No. 531) issued in March 2015, and the court opinion (*Emera Maine*) issued in April 2017. The case continues today on remand. Parallel to the prosecution of this complaint, the NETOs' have been subjected to *three* other complaints in Docket Nos. EL13-33, EL14-86, and EL16-64, each of which has proceeded through the evidentiary hearing stage as well as supplemental briefing on remand, consuming an extensive amount of time and resources from all parties, including the Commission.

the first complaint, or any other case where the Commission has established a new ROE). In other words, a successive complaint filed after the Commission issues an opinion determining a utility's ROE should have the same initial burden of demonstrating changed circumstances as a pancaked complaint. But, the need for such a demonstration is more acute in the case of pancaked complaints, as the Commission cannot evaluate whether a complaint satisfies the first prong under FPA section 206 until the ROE is determined in the pending complaint proceeding(s).

*In any event, pancaked (or successive) complaints are unlawful.*

In addition, requiring a demonstration of a change in circumstances *before* setting a pancaked complaint for hearing is consistent with the intent of FPA section 206 and the limit of the refund period to fifteen months. This is true even if the complaint makes a showing that the utility's approved ROE falls outside the presumptively just and reasonable quartile. FPA section 206(b) authorizes the Commission to "order refunds of any amounts paid, for the period subsequent to the refund effective date through a date fifteen months after such refund effective date."<sup>81</sup> The plain text of the FPA and the legislative history are clear that this refund authority is limited to the period of fifteen months following the refund effective date.<sup>82</sup>

However, pancaked complaints improperly allow customers to expand this refund period limitation. Congress did not intend such circumvention, as is evident in the text of

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<sup>81</sup> 16 U.S.C. § 824e(b).

<sup>82</sup> See, e.g., *Regulatory Fairness Act: Hearing on S. 1567 and H.R. 2858 Before the S. Comm. on Energy & Nat. Res.*, 100th Cong. 74–76, 85–87, 91–92, 99–100, 107–08, 115–17, 138, 295–97 (1982) (testimony addressing concerns regarding potential open-ended refund liability and emphasizing limits imposed by amended FPA section 206(b) based on fifteen-month refund period).

FPA section 206(b), which confines refunds to “amounts paid . . . in excess of those which would have been paid under the just and reasonable rate . . . which the Commission orders to be *thereafter observed and in force*.”<sup>83</sup> In cases involving pancaked ROE complaints, as in Docket Nos. EL14-12 and EL15-45, it is the resolution of the first complaint (in Docket No. EL14-12) which establishes the just and reasonable, “existing” rate for purposes of resolving the second complaint (Docket No. EL15-45). When, in considering a second complaint, the rate established (or sustained) in a prior proceeding is shown to be just and reasonable, no action by the Commission in response to the subsequent complaint can establish a “thereafter” rate for the simple reason that the Commission will have no basis for changing the rate it *already determined* to be just and reasonable in the first proceeding.

While parties have brought these legal and administrative infirmities to the Commission’s attention, the Commission has so far declined to reconsider its approach to pancaked complaints. Instead, the Commission has maintained its view that serial ROE complaints are properly considered separate proceedings because they target different time periods involving different financial and economic data.<sup>84</sup> The Commission has further opined that, in allowing pancaked complaints, it advances congressional intent in the Regulatory Fairness Act<sup>85</sup> by providing enhanced symmetry between the rate-filing rights

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<sup>83</sup> 16 U.S.C. § 824e(b) (emphasis added).

<sup>84</sup> See, e.g., *Belmont Mun. Light Dep’t*, 156 FERC ¶ 61,198, at PP 39–40; *ENE (Environment Northeast)*, 147 FERC ¶ 61,235, at P 27.

<sup>85</sup> Pub. L. No. 100-473, 102 Stat. 2299 (1988).

afforded utilities under FPA section 205,<sup>86</sup> and the rate-challenging rights available to the Commission and/or potential complainants under FPA section 206.<sup>87</sup>

Neither of these justifications is persuasive, at least insofar as they purport to rationalize refund periods in excess of fifteen months. The notion that “different time periods” may lead to different rates was not lost on Congress when it considered the Regulatory Fairness Act.<sup>88</sup> Yet despite this understanding, Congress adopted an explicit fifteen-month refund limitation, with a single exception for dilatory action by the utility. It logically follows that a pancaked complaint cannot, consistent with FPA section 206(b), extend the refund period from an underlying complaint beyond the statutory fifteen-month limit.

The Commission’s “symmetry” rationale is similarly flawed. While it is true that the Regulatory Fairness Act was intended, in part, to provide greater alignment between FPA sections 205 and 206, the two provisions retain important distinctions. For example, in considering the Regulatory Fairness Act’s amendment to section 206, Congress rejected an original draft proposal that provided for open-ended refund liability, comparable to the refund condition that applies when the Commission accepts, suspends, and makes subject to refund, a utility’s FPA section 205 rate increase.<sup>89</sup> Furthermore, as *Emera Maine* made

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<sup>86</sup> 16 U.S.C. 824d.

<sup>87</sup> See, e.g., *ENE (Environment Northeast)*, 151 FERC ¶ 61,125, at P 28.

<sup>88</sup> 133 Cong. Rec. 29,273 (1987) (statement of Rep. Bruce recognizing that the costs underlying electricity rates are subject to fluctuation over time due to a host of factors); see also *id.* at 21,739–40 (statement of Sen. Bumpers).

<sup>89</sup> See 134 Cong. Rec. 25,128 (1988) (statement of Rep. Moorhead noting that the Senate amended the bill to limit the retroactive effect of a section 206 proceeding); S. Rep. No. 100-491, at 6 (1988) (discussing amendment to House bill placing a fifteen-month refund limitation on section 206 proceedings).



clear, FPA sections 205 and 206 are “related but distinct,” with “entirely different” and “stricter” procedures prescribed by FPA section 206.<sup>90</sup> Thus, whatever “symmetry” the Regulatory Fairness Act’s legislative history may suggest is necessarily cabined by the statute’s unambiguous command that a challenge to a utility’s existing rate shall not create refund liability for more than fifteen months.

The MISO Transmission Owners’ and NETOs’ pancaked ROE complaint proceedings provide clear examples of why the Commission should abandon its permissive approach to pancaked ROE complaints, and should require a showing of a sufficient change in market conditions to warrant further investigating a utility’s (or group of utilities’) ROE. In the MISO Transmission Owners pancaked ROE complaint proceedings, for example, the second complaint (Docket No. EL15-45) was filed on the very last day of the refund period established for the first complaint (Docket No. EL14-12), with the obvious purpose of extending the MISO Transmission Owners’ potential refund liability. But the refund condition established in the second complaint proceeding simply cannot be implemented consistent with the Regulatory Fairness Act’s explicit fifteen-month limitation on refund liability.<sup>91</sup> This is because any refund obligation ostensibly arising from the second complaint would necessarily be based on the ROE determined *in the first complaint*

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<sup>90</sup> *Emera Me.*, 854 F.3d at 21, 24. In the court’s words: “[T]he showing required of FERC to exercise its section 206 authority to change an existing rate is different from anything required for FERC to approve a utility’s proposed rate adjustment under section 205.” *Id.* at 25. In this way, the more demanding rate-change requirements imposed by section 206 provide a “form of ‘statutory protection’ to a utility.” *Id.* at 24 (citing *City of Winnfield v. FERC*, 744 F.2d 871, 875 (D.C. Cir. 1984)).

<sup>91</sup> See EL15-45 MISO TOs Answer to Complaint at 44–46; EL15-45 MISO TOs Supplemental Initial Brief at 15–20.

*proceeding*, as that ROE became the “existing” ROE against which the second complaint is evaluated. Thus, the outcome of the first complaint would serve, inappropriately, as the predicate for refund liability for a period of thirty consecutive months. Nothing in the FPA empowers the Commission effectively to double the fifteen-month refund period prescribed by Congress.<sup>92</sup> The Commission should abandon its unsupported, contrary interpretation of the statute.

### **General Issues/Issues that Affect Multiple Models**

H.1.1.1. Institutional Brokers Estimate System (“IBES”) data do not necessarily present consensus estimates, and IBES is not the only acceptable source of such estimates.

While some investors may rely on IBES for growth rate estimates, IBES is not the sole source of such estimates on which investors rely. The MISO Transmission Owners are aware of no evidence to support a notion that a sufficient percentage of investors prefer IBES over other sources to conclude that IBES growth rates alone should be deemed to represent an “investor consensus.”<sup>93</sup> In fact, there is no evidence that IBES estimates are preferred or given greater weight by investors relative to Value Line or other sources of growth estimates.

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<sup>92</sup> What is more, given that the Commission’s current practice imposes no restrictions on the filing or timing of pancaked complaints, the period in which a utility could be subject to refund liability is potentially limitless. A third complaint on the heels of the refund period of a second complaint would extend the utility’s refund liability to forty-five months; a similarly timed fourth complaint would create refund exposure over a sixty-month period, and so on, and so on.

<sup>93</sup> See, e.g., Opinion No. 531 at P 102 (“We accept the *Value Line* industry classifications because *Value Line* is a widely-followed, independent investor service . . .”). In fact, the Commission has relied upon Value Line in numerous other ROE decisions. See, e.g., *RITELine Ill., LLC*, 137 FERC ¶ 61,039 (2011); *N. Pass Transmission LLC*, 134 FERC ¶ 61,095 (2011); *Bangor Hydro-Elec. Co.*, 122 FERC ¶ 61,265 (2008).

The lack of such evidence is consistent with the Commission's long-held recognition that investors rely on a number of sources for investment data, including earnings growth rates. From its earliest application of the two-step DCF method, the Commission has emphasized that it was neither adopting nor endorsing IBES "as the only source of data for developing short-term projections of growth; it is merely one of a variety of sources that may be used for that purpose."<sup>94</sup> In applying both the one-step and two-step DCF methods, the Commission has considered growth rates published by a number of sources, including, among others, IBES, Value Line, and Zack's Investment Research, Inc. ("Zack's").<sup>95</sup> The Commission has observed that "there is no perfect source of data" for short-term growth rate estimates,<sup>96</sup> and as recently as Opinion No. 531, the Commission "reaffirm[ed] that there may be more than one valid source of growth rate estimates."<sup>97</sup>

Accordingly, in each proceeding, the Commission should weigh objectively the merits of other sources of earnings growth estimates for use in applying the Commission's DCF methodology. In other words, the Commission should not adopt a general policy of considering only growth rates from a single, specific source. Rather, the Commission

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<sup>94</sup> *Ozark Gas Transmission Sys.*, 68 FERC ¶ 61,032, at 61,106 (1994).

<sup>95</sup> *See, e.g., S. Cal. Edison Co.*, Opinion No. 445, 92 FERC ¶ 61,070, at 61,263–66 (2000) (relying on Value Line and IBES data); *Sw. Pub. Serv. Co.*, Opinion No. 421, 83 FERC ¶ 61,138, at 61,634, 61,637 & n.69 (1998) (adopting an ROE based on a single-stage DCF using growth rates published by Value Line, and "confirmed" by DCFs using growth rates published by Zack's and IBES); *see also* Opinion No. 421 at 61,636 n.63 ("The Commission did not, however, intend to preclude consideration of contemporaneous growth estimates made by the various investor services companies (e.g., Value Line, [Zack's], [IBES]), as investors rely on these estimates in their decision-making process.").

<sup>96</sup> *Transcon. Gas Pipeline Corp.*, Opinion No. 414-B, 85 FERC ¶ 61,323, at 62,269 (1998).

<sup>97</sup> Opinion No. 531 at P 90.

should consider sources of short-term earnings growth rate estimates relied on by investors other than IBES, as warranted by record facts and circumstances.

Investor reliance on growth rates should be the primary criteria for acceptance, and the Commission should avoid adopting seemingly arbitrary criteria to limit the universe of such data in its proceedings. Just as investors rely on multiple models, investors look to multiple sources of data to evaluate equity investment options. The Commission should be willing to consider data sources relied on by investors other than IBES, as warranted by facts and circumstances established for each case. For example, the records in the ongoing ROE proceedings show that other sources, such as Value Line, provide reliable data on which investors rely.<sup>98</sup> The Commission should be wary of narrowing potential sources of data by adopting criteria that may prove infeasible or arbitrary in practice. Accordingly, the Commission should allow for the consideration of multiple sources in each step of each ROE model, as appropriate and based on the evidence presented in each proceeding.

H.1.1.c. The Commission should not make the number of analysts supporting a particular growth rate a factor in evaluating the credibility of that growth rate.

The Commission should not consider the number and identity of analysts contributing to a given growth rate estimate, or discount an estimate if such information is

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<sup>98</sup> See, e.g., EL14-12 Exhibit No. MTO-23 (Avera) at 72:9–11 (“Value Line is widely regarded as a reliable source for estimates that are reflective of investors’ expectations that has been accepted by the Commission in the past.”); EL15-45 Exhibit No. MTO-1 (McKenzie) at 31:20 – 32:14 (explaining that investors rely on Value Line for estimated growth rates and other financial data); EL14-86 Exhibit No. NET-1300 (Avera) at 99:4–7 (“Value Line is recognized as being the most widely available source of investment information to investors and there are many citations to textbooks and other sources supporting its usefulness as a guide to investors’ expectations.”); see also *New Regulatory Finance* at 71 (“Value Line is the largest and most widely circulated independent investment advisory service, and influences the expectations of a large number of institutional and individual investors.”).

unavailable. While the number of analysts contributing to an estimate may lend credibility to such estimate, many sources of estimates do not publish the number of independent analysts, or only publish the leader of a team of analysts. Relying on such analyst-based information to determine the relative weight of one estimate over another is fraught with problems and would artificially limit the Commission's consideration of sources of relevant market data on which investors may rely.

For example, IBES growth estimates published by *Yahoo! Finance* do not specify the identity or number of contributing analysts.<sup>99</sup> Value Line publishes growth rate estimates that are the product of a committee evaluation, but Value Line identifies only a single analyst by name.<sup>100</sup> By virtue of listing one name, is Value Line inherently more credible than IBES which does not list any names?<sup>101</sup> Such a question is of little value, and the answer is likely no. In any event, the Commission has already found that investors' reliance on IBES growth projections does not necessarily vary depending upon "the exact number of analysts contributing to any particular IBES growth projection."<sup>102</sup> Indeed, it is

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<sup>99</sup> See Opinion No. 531-B at P 72 (acknowledging that IBES "does not publish the number of analyst estimates on which a company's growth rate estimate is based").

<sup>100</sup> See EL14-12 Exhibit No. S-1 (Keyton) at 17:3-6 ("Although the report may have been authored by one individual analyst, *Value Line* analysts interact through a committee that reviews and monitors their analyses and conclusions. The resulting projections are supported by a team, and ultimately reflect more than the views of one individual.").

<sup>101</sup> Taken further, if the Commission were to consider the identity of each analyst supporting a growth rate estimate, each analyst's credibility will become an issue (e.g., How much weight does the industry place in this analyst's forecasts? How accurate has this analyst been in the past? What is the analyst's pedigree (education, work experience)?). This would create an unworkable, time-consuming sideshow, and would not assist the Commission in determining electric utility ROEs.

<sup>102</sup> Opinion No. 531-B at P 72.

likely that investors rely generally on the source of the market data and not the number of analysts behind it.

H.1.5. The Commission should not require growth rates to be based on any specific published source.

Given that investors rely on multiple sources of data, including growth rate estimates, the Commission should allow for the consideration of multiple sources.

### **DCF-Specific Questions**

H.2.a.3. The Commission should use a single-stage constant growth DCF model to set ROEs for electric utilities.

The Commission should use a single-stage constant growth DCF model to set ROEs for electric utilities. The evidence in the MISO Transmission Owners' ROE proceedings does not support a finding that investors' expectations for electric utilities are moderated by the estimated long-term gross domestic product ("GDP") growth rate. Rather, as Mr. McKenzie demonstrated, the long-term cycle of capital investment in electric utilities supports higher long-term growth, and "suggests that GDP growth estimates understate investors' expectations for electric utilities."<sup>103</sup>

Mr. McKenzie demonstrated significant shortcomings in relying on GDP growth rates as part of a DCF analysis, including:

- (1) practical application of the DCF model requires using a growth estimate that matches investors' expectations, which is not the same as the thirty-year horizon for GDP estimates;
- (2) evidence suggests that investors do not reference or rely on estimates of GDP growth in evaluating growth expectations for utility common stocks;

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<sup>103</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 51:18–19; *see id.* at 47:15 – 48:26 (demonstrating that investors' expectations for the utility industry do not support moderating DCF results with a long-term growth rate).

- (3) the theoretical proposition that growth rates for all firms converge toward long-term GDP growth is not borne out by estimated growth rates for utilities, which can and do exceed GDP growth; and
- (4) there is no evidence that investors' expectations of utility stock growth have begun to converge with overall GDP growth.<sup>104</sup>

In addition, the pioneer of the constant growth DCF approach, Professor Myron J. Gordon, considered including a generic long-term growth rate, like GDP, but found it to be unsupported.<sup>105</sup> Dr. Gordon concluded that, "it is the growth that investors expect that should be used" in applying the DCF model, and the assumption of a single time horizon for a transition to a generic long-term growth rate was highly questionable and failed to reduce error in DCF estimates.<sup>106</sup> Thus, while the DCF model is supposed to reflect investor behavior, including GDP growth estimates incorporates projections that investors do not use. As a result, the two-stage approach gives greater weight to a theoretical concept (i.e., the notion that all firms' growth eventually converges to the average, long-term GDP growth rate) over actual investor behavior.<sup>107</sup> This is unjustified.

Finally, as Mr. McKenzie has testified, the single-stage constant growth DCF model "is the most widely referenced form of the model by financial practitioners and regulatory agencies. As a result, it is highly relevant in any evaluation of investors' required cost of equity for electric utilities."<sup>108</sup> Accordingly, a single-stage constant growth DCF model is the best tool to use in the Commission's ROE determinations.

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<sup>104</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 43:1–13.

<sup>105</sup> Myron J. Gordon, *The Cost of Capital to a Public Utility* 100-01 (MSU Pub. Util. Studies, 1974).

<sup>106</sup> *Id.* at 89.

<sup>107</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 43:24 – 44:6.

<sup>108</sup> *Id.* at 52:11–14.

- H.2.a.4. To the extent the Commission maintains application of the two-stage DCF, the Commission should adopt the MISO Transmission Owners' modifications to the approach laid out in the MISO Transmission Owners and Coakley Briefing Orders.

If the Commission decides to continue application of the two-stage DCF approach for electric utilities, it should not include a high-end outlier test, and should adopt the MISO Transmission Owners' minor modifications to the other approaches for estimating investors' expected ROE. Otherwise, for the reasons stated in section H.2.a.3 above, the Commission should return to its prior approach and use the single-stage constant growth DCF model as the DCF component for the proposed four-model approach for establishing public utilities' ROEs.

#### **CAPM Specific Questions**

- H.2.b.1. A two-stage DCF is inappropriate for determining the market premium in the Commission's CAPM approach.

The Commission has correctly determined that a long-term growth factor is not appropriate for a DCF analysis of a market index. The Commission's rationale for including a long-term growth rate in the DCF analysis—"it is often unrealistic and unsustainable for high short-term growth rates to continue in perpetuity"<sup>109</sup>—does not apply to DCF analyses of a market index because lower performing companies will be rotated out of the index and higher performing companies will rotate in. As the Commission found in Opinion No. 531-B:

The rationale for incorporating a long-term growth rate estimate in conducting a two-step DCF analysis of a specific group of utilities does not necessarily apply when conducting a DCF study of the companies in the S&P 500. That is because the S&P 500 is regularly updated to include only companies with high market capitalization. While an individual company cannot be expected to sustain high short-term growth rates in perpetuity, the same cannot be said for a

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<sup>109</sup> Opinion No. 531-B at P 113.



stock index like the S&P 500 that is regularly updated to contain only companies with high market capitalization, and the record in this proceeding does not indicate that the growth rate of the S&P 500 stock index is unsustainable.<sup>110</sup>

The Commission affirmed this finding in Opinion No. 551.<sup>111</sup> The MISO Transmission Owners are unaware of any new evidence or economic logic that would undermine the Commission's findings.

H.2.b.3. Value Line is an appropriate data source for the beta value.

As discussed, the Commission should not prescribe a one-size-fits-all approach for considering data from multiple sources for all analyses, or even for each step within an analysis. Rather, the Commission should allow for the consideration of multiple sources of data for each step of each ROE model, as appropriate and based on the evidence in each proceeding.

However, to the extent the Commission elects to limit the data sources for the beta value, the Commission should make Value Line a permissible source. The Commission has, in Opinion Nos. 531-B and 551, twice accepted CAPM analyses that relied on Value Line for the beta values.<sup>112</sup> The Commission has often relied on Value Line investment data in various contexts, based on Value Line's reputation as a credible and reliable source

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<sup>110</sup> Opinion No. 531-B at P 113.

<sup>111</sup> Opinion No. 551 at P 170.

<sup>112</sup> Opinion No. 531-B at P 109; Opinion No. 551 at P 165; *see also* Opinion No. 551 at P 64 n.154 (“[W]e reiterate that Value Line is a valid source of general financial data and affirm that Value Line estimates and financial data (e.g., betas) are acceptable as inputs for alternative cost of equity methodologies.”).

of financial information and a source on which investors, in fact, rely.<sup>113</sup> Indeed, the Commission has “found that Value Line is a valid source of general financial data.”<sup>114</sup>

### **Expected Earnings Specific Questions**

H.2.c.2. and H.2.c.2.i. There are no valid circularity concerns with using the forward-looking Expected Earnings analysis in the establishment of base ROEs.

No circularity concerns arise with the forward-looking Expected Earnings approach; rather, such concerns arise with the backward-looking comparable earnings method. As the MISO Transmission Owners understand it, the circularity concern is as follows: using regulated entities’ commission-approved ROEs as the inputs to the analysis allows previously established ROEs to influence ROEs on a going forward basis. Dr. Morin recognized this issue with the comparable earnings approach, and recommended against using regulated utilities in the proxy group for this very reason.<sup>115</sup>

By contrast, the Expected Earnings approach uses projections of returns on each proxy company’s book investment, which are published by reputable sources like Value Line. Thus, Expected Earnings analyses are not susceptible to circularity concerns over

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<sup>113</sup> See, e.g., Opinion No. 531 at P 102 (describing Value Line as “a widely-followed, independent investor service”); *see also Kern River Gas Transmission Co.*, Opinion No. 486-C, 129 FERC ¶ 61,240, at P 91 (2009) (recognizing Value Line as a “major publication used by investors and therefore is probative of the views of investors”), *order on reh’g & compliance*, Opinion No. 486-D, 133 FERC ¶ 61,162 (2010), *order on initial decision*, Opinion No. 486-E, 136 FERC ¶ 61,045 (2011), *order on reh’g*, Opinion No. 486-F, 142 FERC ¶ 61,132, *order on reh’g*, Opinion No. 486-G, 145 FERC ¶ 61,042 (2013).

<sup>114</sup> Opinion No. 551 at P 169.

<sup>115</sup> *New Regulatory Finance* at 383.

the “past actions of other regulators,” and “historical conditions” do not unduly influence going-forward ROEs.<sup>116</sup>

In any event, even if the Expected Earnings approach was susceptible to the asserted circularity concerns, the impact would be muted, because the Commission’s proposed four-model approach prevents Expected Earnings from having an outsized influence on the range of ROEs, or on the ultimate ROE itself. What is more, the proxy utilities’ approved ROEs are adjusted by third-party projections of future earnings. Accordingly, there are no credible circularity concerns with the Expected Earnings approach.

### **Risk Premium Specific Questions**

H.2.d.1. The risk premium analysis should be both historical and forward-looking.

A proper risk premium approach for estimating a utility’s cost of equity can rely on the average of the result of two separate risk premium studies, one using historical bond yields and one using projected bond yields. Both studies utilize the same method under which “[t]he cost of equity is estimated by first determining the additional return investors require to forgo the relative safety of bonds and to bear the greater risks associated with common stock, and by then adding this equity risk premium to the current yield on bonds.”<sup>117</sup> In Opinion No. 531-B, the Commission accepted this risk premium approach,<sup>118</sup>

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<sup>116</sup> *New Regulatory Finance* at 381; *see also* EL15-45 Exhibit No. MTO-22 (McKenzie) at 107:11 – 108:15.

<sup>117</sup> EL14-12 Exhibit No. MTO-1 (Avera and McKenzie) at 99:11–15; *see also id.* at 117:18 – 118:24; EL14-12 Exhibit No. MTO-6 (applying risk premium approach with historical and projected bond yields).

<sup>118</sup> The Commission also accepted this approach in Opinion No. 551 (at P 191).

in part because it “calculate[s] a varying risk premium based on variations in the difference between allowed ROEs and bond yields” over the study period, and avoids the problems of a historical approach that determines a “constant” risk premium.<sup>119</sup> The Commission has explained that a “constant” risk premium is unacceptable because “[t]here is no direct relationship between historical risk premiums and a current cost of equity under constantly changing financial conditions.”<sup>120</sup>

In the *Coakley* Briefing Order, the Commission presented the approach of averaging the results of risk premium analyses using historical and projected bond yields.<sup>121</sup> Such a blended approach makes sense, as Mr. McKenzie has explained in the MISO Transmission Owners’ ROE proceedings.<sup>122</sup> The historical bond yield analysis reflects yields at the time the proxy group ROEs were established, and the projected bond yields provide a risk premium estimate more reflective of investors’ forward-looking expectations.

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<sup>119</sup> Opinion No. 531-B at P 101.

<sup>120</sup> *New Eng. Power Co.*, 31 FERC ¶ 61,378, at 61,841 (1985).

<sup>121</sup> See *Coakley* Briefing Order at P 59 n.115.

<sup>122</sup> EL14-12 McKenzie Supplemental Initial Affidavit at 25:4 – 27:10; EL15-45 McKenzie Supplemental Initial Affidavit at 21:11 – 23:10.

### III. COMMUNICATIONS

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### IV. CONCLUSION

The MISO Transmission Owners respectfully request the Commission consider these comments in making any proposal or policy change relating to base ROE.

Respectfully submitted,

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