UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

COMMENTS ON BEHALF OF THE CITIES OF ANAHEIM, AZUSA, BANNING, COLTON, PASADENA, AND RIVERSIDE, CALIFORNIA

Pursuant to the Commission's March 21, 2019 Notice of Inquiry in the above-captioned proceeding,[1] the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California (collectively, the "Six Cities") hereby submit their comments on the Commission's Notice of Inquiry concerning the Commission's policy for determining return on equity ("ROE") to be used in Commission-jurisdictional rates.

I. DESCRIPTION OF THE SIX CITIES

The Six Cities own and operate municipal electric systems located within the California Independent System Operator Corporation ("CAISO") Balancing Authority Area, and all six Cities participate in the CAISO's markets as both purchasers and sellers. The Six Cities are transmission customers of the CAISO and Participating Transmission Owners ("TOs") in the CAISO. The issues raised by the Notice of Inquiry will have an impact on the Transmission Revenue Requirements of Participating TOs within the CAISO, which are a component of the access charges paid by CAISO transmission

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

customers. As transmission customers of the CAISO, the Six Cities have a direct and substantial interest in the Commission's ROE policies and, in particular, in the issues identified in the Notice of Inquiry.

II. COMMENTS

In *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923) ("*Bluefield")*, and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) ("*Hope*"), the Supreme Court established standards for determining allowable rates of return on common equity capital for regulated entities. In *Hope*, the Supreme Court observed that "[t]he rate-making process . . . i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests."[2] The Supreme Court held that achieving a balance between investors' and consumers' interests requires: (1) the ROE to be sufficient to sustain the financial integrity of the utility and its ability to raise the capital necessary to perform its duties;[3] and (2) protection for consumers from "exploitation at the hands of" the utility.[4] Thus, the Commission must determine "the minimum amount that one must pay new investors . . . to offer the utility the money it needs for investment," which should "pay[]

[2] *Hope*, 320 U.S. at 603.

[3] *See, e.g., Bluefield*, 262 U.S. at 693 (stating that the "return should be 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 the money necessary for the proper discharge of its public duties").

[4] *Hope,* 320 U.S. at 612.

investors a 'fair return,' *but no more*, while obtaining for the company the capital that it needs."[5]

The best way to satisfy the standards of *Hope* and *Bluefield* is to apply the Commission's two-step Discounted Cash Flow ("DCF") methodology to a proxy group of comparable electric utilities selected based on a corporate credit rating screen, among other selection criteria. Indeed, this approach represents the Commission's longstanding policy regarding the determination of public utilities' ROEs. However, in the event that the Commission determines that ROE for electric utilities should be based upon a composite of multiple analytical methodologies, then the ROE should be set according to the results of the two-step DCF methodology, a Capital Asset Pricing Model ("CAPM"), and the Risk Premium analysis.[6] If these three methods are to be used, they should not be weighted equally, but, rather, the results of the two-step DCF methodology should be accorded greater weight in forming the composite results.[7] The Expected Earnings Analysis is inappropriate for use in setting electric utility ROEs and should not be factored into the composite zone of reasonableness or incorporated into a composite analysis to select the point estimate used to set the ROE.

---

[5] *Boston Edison Co. v. FERC*, 885 F.2d 962, 965 (1st Cir. 1989) (internal quotations omitted) (emphasis supplied); *see also Anaheim, et al. v. FERC*, 669 F.2d 799, 803 (D.C. Cir. 1981).

[6] Mr. Mac Mathuna proposes specific applications of both the CAPM and Risk Premium methods, which are summarized below.

[7] Specifically, Mr. Mac Mathuna supports alternate approaches to weighting, depending upon whether the Risk Premium method is included, which Mr. Mac Mathuna generally does not support. *See Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 62:13-63:7

In support of the positions set forth in these comments, the Six Cities provide the attached affidavit of Breandan Mac Mathuna of GDS Associates, Inc., designated as Exhibit No. CIT-0001. The Mac Mathuna Affidavit comprehensively addresses a number of the issues raised by the Commission in the NOI. The Six Cities respectfully request that the Commission consider Mr. Mac Mathuna's affidavit in determining the appropriate policy to apply in setting the base ROE for electric utilities subject to the Commission's jurisdiction. The Six Cities' comments below briefly summarize the principal points that are more fully addressed by Mr. Mac Mathuna.

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

As explained above, the role and objective of the Commission's ROE policies are stated in its precedents. Specifically, the Commission's role is to equitably balance what are often competing interests in ensuring that utilities have access to needed capital in order to maintain the financial integrity of their businesses, while ensuring that customers are not charged rates that are higher than necessary to accomplish this objective.

The Six Cities reserve their right to further address the issues raised by these questions in reply comments.

B. ROEs for Different Commission-Regulated Industries

The Six Cities do not take a position on whether the policies and methodologies that are applicable to electric utilities should be expanded to other regulated industries.

C. Performance of the DCF Model

The DCF model used by the Commission in setting electric utility ROEs has performed accurately and consistently with its assumptions, and it remains a valid model

for use in setting base ROE. *See generally Mac Mathuna Affidavit,* Exh. No. CIT-0001 at 8:15 – 14:18. As described in Mr. Mac Mathuna's affidavit, utility stocks have performed consistent with the theory underlying the DCF model. *See id*. at 8:20-23. Per the assumptions of the DCF model, projected proxy company earnings have increased in a manner that, in concert with other changes in the market, would justify increases in their stock prices over the same period. There are other variables – such as expected opportunity costs or returns, changes in risk perception, and real interest rates, among others – that impact stock price and the required rate of return, such that "[i]t is not correct that, under the DCF theory, increases in a company's actual earnings or projected growth in earnings would ordinarily be required to justify an increase in the company's stock price." *Id*. at 10:32 – 11:2. Based on the foregoing, Mr. Mac Mathuna concludes that "the underlying theory of the DCF methodology has performed consistently over the last 10 to 20 years." *See id*. at 14:16-18. Thus, it is appropriate to continue using the DCF model to determine electric utility cost of equity.

D. Proxy Groups

The Commission should continue to apply its DCF methodology to a proxy group of electric utilities[8] companies with comparable risk. *See generally Mac Mathuna Affidavit,* Exh. No. CIT-0001 at 14-35. Among other screening criteria, the proxy group should be screened for comparable risk characteristics through the application of a credit

[8] Non-electric utilities should not be included in a proxy group for determining and electric utility ROE. *See Mac Mathuna Affidavit,* Exh. No. CIT-0008 at 15:24 – 17:3.

rating screen, rather than including all investment grade utilities in the proxy group. *See id*. at 26:5-13. As noted by Mr. Mac Mathuna, "credit ratings provide an objective means to identify a proxy group of comparably risked electric utilities, and the Commission has traditionally relied upon a credit rating band to develop a risk-comparable proxy group." *Id*. at 31:16-19. Including all investment-grade utilities in the group would "fail to achieve the goal of developing a proxy group of risk comparable electric utilities," and "would be a significant departure from the *Hope* and *Bluefield* standards." *Id*. at 26:8-13. Retaining the credit rating screen, on the other hand, "ensure[s] the proxy group only consists of electric utilities that are of comparable risk to the utility whose rates are at issue." *Id*. at 27:3-5. Thus, the Commission should continue to screen proxy group companies by including only those "companies with credit ratings no more than one notch above or below the utility or utilities whose ROE is at issue," using "both Standard and Poor's corporate credit ratings and Moody's issuer ratings when both are available."[9]

While the Commission has the discretion to consider risk in the placement of the just and reasonable ROE within the zone of reasonableness, adjustment away from the median to another point within the zone should not be "routine." *See Mac Mathuna Affidavit,* Exh. No. CIT-0008 at 33:6-9. The proponent of an upward adjustment to the ROE above the median result of the range should continue to bear a substantial burden to show that its particular circumstances justify a change to the placement of the ROE and, importantly, that the resulting rates are just and reasonable. Satisfying this burden

[9] *See Martha Coakley, Attorney Gen. of the Commonwealth of Mass., et al. v. Bangor Hydro-Elec. Coop., et al.*, 165 FERC ¶ 61,030 (2018) at P 49 and n.106. ("Coakley Order Directing Briefs").

appropriately includes demonstrating, based upon "a comparison between the risk level of the subject company and the risk level of each of the proxy group companies," that the applicant utility is demonstrably riskier than the companies in the proxy group. *El Paso Natural Gas Company*, 145 FERC ¶ 61,040 at P 698 (2013) ("Opinion No. 528"), *order on reh'g,* 154 FERC ¶ 61,120 (2016) ("*El Paso"*); *see also Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 33:12-14. If – and only if – this showing has been made should the Commission authorize an ROE that is above the median of the range of reasonableness.

In determining the appropriate proxy group, tests of economic logic, including low- and high-end outlier tests, should be applied. Mr. Mac Mathuna proposes a high-end outlier test that would eliminate any model results "that are more than two standard deviations from the median of each model's ROE array prior to testing for low- and high-end outliers." *Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 20:19-22. Mr. Mac Mathuna does not advocate for modifications to the Commission's low-end outlier test.

After eliminating high- and low-end outliers, the Commission should apply an objective standard for determining where there is a natural break between proxy companies. Under Mr. Mac Mathuna's proposed standard, which would identify natural breaks occurring at either the high-end or the low-end of the array, additional companies that are "close to the threshold level that applies prior to considering natural breaks" and "relatively far from the neighboring proxy value that would be retained." *Id*. at 23:3-11. Mr. Mac Mathuna has developed objective criteria for measuring these factors, which are described in his affidavit. *Id*. If the Commission adopts an ROE methodology that uses the results of multiple frameworks, the outlier tests, including the natural break standard,

should be applied independently to the array of ROEs resulting from each framework. *Id*. at 25:10-11.

E. Financial Model Choice

When evaluating utility equities, investors use the DCF, CAPM, and Risk Premium, each of which are market-based models, to estimate the required rate of return or cost of equity. *See Mac Mathuna Affidavit,* Exh. No. CIT-0001 at 37:5-7. Mr. Mac Mathuna provides detailed descriptions of each of these methodologies and their appropriate application in his affidavit. *See id*. at 39:9 – 41:11 (describing the DCF method); 41:12 – 50:15 (describing the CAPM method, including variants using historical and projected market risk premiums); and 50:16 – 51:5 (describing the Risk Premium method). While the Commission has raised for consideration the potential use of the Expected Earnings method for setting utilities ROEs,[10] this method "is devoid of capital market input," "has been thoroughly discredited," and is not considered by investors. *Id*. at 37:7-9. If the Commission determines that it should base the ROE on a composite set of analyses, it should consider and give varying degrees of weight to the DCF, CAPM, and Risk Premium methodologies, which are market-oriented methods for measuring cost of equity. The Commission should not rely on the Expected Earnings methodology.

[10] *See* Coakley Order Directing Briefs at P 16, and *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 165 FERC ¶ 61,118, at P 17 (2018) ("MISO Order Directing Briefs").

While continued reliance solely on the DCF methodology is both theoretically sound and consistent with longstanding Commission policy, if the DCF, CAPM, and Risk Premium methodologies each are used, they should not be weighted equally. Rather, in light of the Commission's decades-long use of the DCF method[11] and the continued viability of the DCF as a measure of investors' expected returns for electric utilities, the DCF results should be weighted more heavily than the results produced by either the CAPM or Risk Premium models. *See Mac Mathuna Affidavit*, Exh No. CIT-0001 at 63:3-6. Specifically, if the Commission chooses to use multiple models, then it should consider the following two alternatives:

Alternative 1: If the Commission decides not to rely upon the Risk Premium methodology at all in establishing the ROE, then, for determining both the zone of reasonableness and the appropriate ROE, the DCF results should be weighted at 60% and the CAPM results should be weighted at 40%.

Alternative 2: If the Commission decides to use the Risk Premium methodology, then, in determining the zone of reasonableness, the DCF should

[11] *See Generic Determination of Rate of Return on Common Equity for Pub. Utils.*, Order No. 489, FERC Stats. & Regs. ¶ 30,795 (1988). Order No. 489 is not the first time that the Commission recognized the DCF methodology as a useful analytical framework for estimating the rate of return required by investors to invest their capital with a company. For example, the Commission "first took cognizance of the DCF methodology in public utility cases as far back as the 1970's." *See Coakley v. Bangor Hydro-Elec. Co.*, 147 FERC ¶ 61,234, at P 14 n.26 (2014) ("Opinion No. 531"), *order on paper hearing*, Opinion No. 531-A, 149 FERC ¶ 61,032 (2014) ("Opinion No. 531-A"), *reh'g denied*, Opinion No. 531-B, 150 FERC ¶ 61,165 (2015) ("Opinion No. 531-B"), *vacated and remanded sub nom. Emera Maine v. FERC*, 854 F.3d 9 (D.C. Cir. 2017) (*citing Minn. Power & Light Co.*, 3 FERC ¶ 61,045, at 61,132-33 (1978) ("We are interested in forward looking analyses of the market's required rates of return. The Commission seeks to have before it estimates of the opportunity cost of equity capital in capital markets to use in making rate of return determinations. Market oriented techniques, including the DCF approach, are useful in this regard.")).

be weighted at 60% and the CAPM at 40%, while the ROE would be fixed based upon a 50% weighting for the DCF median, a 30% weighting for the CAPM median, and a 20% weighting for the Risk Premium result. *See id*. at 63 Table 3.

Alternative 1 does not include application of the Risk Premium analysis because, as described in Mr. Mac Mathuna's affidavit, there are "significant concerns regarding the most common application of the Risk Premium method" (*see id*. at 62:16-18), which he discusses in detail at pages 134 through 144 and are summarized below.

As is further described in the Mac Mathuna Affidavit, there are valid methodological reasons for the Commission to consider adopting a modification to its previously-proposed approach for forming the ROE range of reasonableness and the median and midpoint estimates when relying on a composite of several analytical methodologies. *See generally Mac Mathuna Affidavit*, Exh No. CIT-0001 at 63:8 – 65:15. Specifically, rather than taking a simple average of the top and bottom of the zone of reasonableness produced by each methodology, the Commission should consider "develop[ing] a single composite ROE array by calculating a composite ROE for each proxy group electric utility member." *Id*. at 64:8-9. The Commission would accomplish this by averaging the ROEs produced by each methodology for each proxy group member. *Id*. at 64:8-12. As Mr. Mac Mathuna discusses, development of company-specific composite ROE results will have the effect of mitigating results that are illogical or unreasonable that may results from the Commission's proposed approach to developing composite results.

F. Mismatch Between Market-based ROE Determinations and Book-Value Rate Base

In response to a services of questions posed by the Commission in the Notice of Inquiry and as shown in the Mac Mathuna Affidavit, the allowed ROE for an electric utility should be set at the cost of equity based on an estimate of the market-based cost of equity. *See generally Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 70:24 – 83:3. The purported "mismatch" between applying a market-based ROE determination to an electric utility's book value rate base does not create a problem. Rather, applying a market-based ROE determination to a market value rate base suffers from circularity problems. *See id*. at 66:26 – 67:3. Mr. Mac Mathuna describes that multiple industry experts and the Commission have explained why it is not inconsistent to apply a market-based ROE determination to a book value rate base, supporting the conclusion that the Commission should not change its current practice of applying a market-based ROE determination to the book value rate base. *See id*. at 67-73.

With regard to differences between market value and book value of common equity that result in market-to-book ratios greater than 1.0, Mr. Mac Mathuna describes the many reasons why this may occur, including depreciation versus financing policies, regulatory lag, cost trends, factors not under regulatory control, and changes in rate base relative to capacity and output. *See id*. at 75:4-8. However, the simplest conclusion is "that the expected return earned by electric utilities is greater than the investors' required rate of return," which "result[s] in a market value that is greater than book value." *See id*. at 77:6-8.

Based on the foregoing, the allowed ROE for an electric utility should be set at the cost of equity based on a market-based cost of equity estimate using the two-step DCF methodology.

G. First Prong of ROE Determination

The Six Cities do not take a position on the first prong of the Commission's ROE determination at this time. However, the Six Cities reserve their right to comment on these issues in reply comments.

H. Model Mechanics and Implementation

1. General issues/issues that affect multiple models

With regard to the general issues that affect multiple models, the Six Cities only address the choice of growth rate as a proxy for investors' expectations. *See generally Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 80:11 – 84:22. The growth rate reflecting investor consensus should come from a "source that provides a reasonable representation of the growth rate expected by the market." *Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 81:8-9. The growth rates published by Institutional Brokers' Estimate System ("IBES") meet this objective. IBES growth rates are easily accessible in a central location without a fee or subscription requirement, and they provide consensus growth rates, obviating the need for investors to consult multiple sources. *See Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 80:23-26. The Commission also has long relied on IBES growth rates (*see id*. at 81:10-11), and they "offer[] the benefits of predictability, consistency, and objectivity" (*id*. at 84:13-17).

The Commission should continue to require the use of IBES growth rates in ROE analyses, and it should not combine short-term growth rate data from multiple sources. Allowing parties to pick and choose which growth rates to apply in conducting their analyses may result in cherry picking those growth rates that produce the highest (or lowest) ROE. S*ee Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 82:5-10. Combining results from multiple sources could also create "distorted results," because they may use different time periods and/or analysts, and certain sources may not be readily available to all parties. *See id*. at 82:11 – 83:12.

2. Model-Specific Questions

a. DCF

The Commission should continue to apply the two-step DCF methodology to estimate electric utility cost of equity. *See generally Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 86:9-10; *see also id*. at 39:9 – 41:11 (describing the DCF methodology and why it is appropriate for use in setting electric utility ROEs). Alternative models, such as a model using free cash flow rather than dividends or a multi-stage DCF model, require the adoption of uncertain assumptions and are likely to result in unnecessary controversy and dispute. *See id*. at 86:10-12. Further, the DCF methodology is suited for use in determining the cost of equity for electric utilities, because utility stocks reflect steady returns and typically provide consistent dividends. *See id*. at 40:14 – 41:2.

The two-step DCF model is also appropriate for determining base ROE because it incorporates a long-term growth rate (*see generally id*. at 95:8-11), measured by Gross Domestic Product ("GDP"), which reflects the fact that investors consider "projections of

earnings and dividend growth beyond five years" (*id*. at 91:18-19). Indeed, both investors and industry analysts must account for a stock's long-term value. Even if their intention is to hold onto the stock for a short period of time, investors must "account for the remaining expected value of the stock at the end of their investment horizon." *Id*. at 93:13-14. As the Commission has recognized, investors rely on GDP growth when evaluating their expectations for common stock. *Id*. at 96:8-18.

Given these characteristics, the two-step DCF model remains the best tool for determining electric utility cost of equity and should be retained as the primary methodology upon which the Commission bases its ROE determinations.

b. CAPM

The appropriate application of the CAPM for use in determining electric utility cost of equity includes calculating the market risk premium component based on the two-step DCF methodology and using only a standard, single-factor CAPM that is not adjusted based on the Fama-French model or to add a size premium. *See generally Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 107:18 – 108:2.

First, the market risk premium component of the CAPM should be calculated using the two-step DCF methodology, rather than the one-step DCF, which does not incorporate a long-term growth rate. *See generally id*. at 104:15-18. Because companies cannot "grow in perpetuity at a rate above the growth rate of the general economy," limiting their growth rate through application of a long-term growth rate measured by GDP is appropriate when calculating the market risk premium. *Id*. at 97:24-25. With regard to market risk premium, Mr. Mac Mathuna also recommends "that the

Commission place equal weight on ex-post and ex-ante market risk premium methods if it were to no longer solely rely on the two-step DCF method." *Id*. at 107:10-12; *see also id*. at 50:6-15 (explaining that there is no consensus as to whether to use an historical or projected market risk premium and recommending a blended approach). If Mr. Mac Mathuna's recommendation to incorporate both historical and projected market risk premiums is not adopted and the Commission instead elects to use the DCF methodology for purposes of estimating the ex ante market risk premium, then it is critical that the two-step DCF methodology, which includes both short- and long-term growth rates, is used.

Second, Value Line is the appropriate source for the beta value included in the CAPM, as agreed on by multiple industry experts. *See generally Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 105:17-106:1. Value Line computes beta using historical data, which is also consistent with Mr. Mac Mathuna's proposal to blend the historical and projected market risk premium. *Id*. at 106:20-21.

Third, the Commission should not use the Fama-French Model of the CAPM (*see generally id*. at 108:4 – 110:5), which seeks to "identify additional factors not included in the standard CAPM model that purport to better measure and explain stock returns" (*id*. at 108:5-7). The Commission has previously rejected the use of this model, and multiple industry experts raise serious concerns with the Fama-French variant. *See id*. at 108:8 – 110:5. Such concerns include that the model does not perform as well as the standard CAPM, application of the Fama-French model may provide irrational results, and the Fama-French model is more appropriate for assessing portfolios than individual stocks. *See id*. at 109:8 – 110:3.

Finally, the CAPM should not be adjusted to add a size premium, which artificially inflates the model's results. *See generally Mac Mathuna Affidavit* at 117:1-5. Inclusion of a size premium is based on questionable data, and industry experts have questioned its applicability for determining electric utility rates. *See id*. at 116:11-13.

c. Expected Earnings

The Expected Earnings analysis should not be relied on to determine a just and reasonable ROE. As described by Mr. Mac Mathuna, the Expected Earnings analysis is not a market-based approach to determining cost of equity, and it suffers from issues or circularity. *See generally Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 117:17-18; *see also id*. at 51:12 – 58:20 (explaining why the Expected Earnings analysis is inferior to alternative analytical methods for establishing the ROE for electric utilities).

As explained in the Mac Mathuna Affidavit, the Expected Earnings analysis "does not measure the rate of return investors require to invest in the common equity capital of a utility," but, rather, "measures expectations of what the utility will earn on the book value of its common equity." *Id*. at 52:9-12. Thus, the methodology lacks market and investor input and cannot measure the rate of return required by the market. *Id*. at 53:10-13.

Further, the Expected Earnings analysis suffers from circularity issues, in that the resultant return is based on the returns set by regulators in the past. *See id*. at 118:1-8. Describing this circularity, Mr. Mac Mathuna refers to the fact that return projections become a self-fulfilling prophecy because "[u]sing the Value Line-projected ROEs as the authorized ROEs would provide the utilities the opportunity to earn those ROEs and

virtually guarantee such earnings when the utility's rates are based on formula rates that use forward projections of investment and costs with true-ups to provide for the recovery of actual costs, including the authorized ROE." *Id*. at 119:5-9. Mitigating the circularity in the Expected Earning analysis would not be beneficial due to the other flaws inherent in the methodology. *See id*. at 120:17-18. Instead, this methodology should simply not be used to determine electric utility cost of equity.

d. Risk Premium

The Six Cities do not recommend use of the Risk Premium analysis when determining electric utility ROEs due to a number of concerns with application of the analysis that render it an unreliable method for determining a just and reasonable ROE. *See generally Mac Mathuna Affidavit*, Exh. No. CIT-0001 at 121:5 – 126:8. However, should the Commission determine that applying the Risk Premium analysis is appropriate, it must also consider the various flaws inherent in the analysis and effectively address them. As Mr. Mac Mathuna explains, this requires a case-by-case review of the data inputs to the Risk Premium analysis to ensure that only inputs fit for determining just and reasonable ROEs are included. *Id*. at 126:6-8.

Many experts in the industry use the "Allowed ROE Risk Premium" methodology, which does not actually reveal the investors' required rate of return, but instead attempts to "measure[s] a relationship between prior ROEs previously-authorized by the Commission and utility bond yields, amounting to a short-hand approach for estimating how changes in yields may have impacted the Commission's allowed-ROEs." *See id*. at 123:11-14. The regression analysis used as part of the Risk Premium analysis

has only limited value, because it does not account for historic volatility in risk premiums, which are influenced by a myriad of other factors. *Id*. at 123:19-124:2. Further, like the Expected Earnings analysis, the Risk Premium suffers from issues of circularity, in that it relies on historical ROEs to determine the implied risk premium, resulting in an inappropriate tying of current ROE determinations to past ROE decisions. *Id*. at 124:12-13. Finally, the Commission has determined that the Risk Premium is only "sufficiently reliable" to corroborate its ROE determination – "not to set the ROE itself."[12] As demonstrated, the Risk Premium analysis should not be used for determining electric utility cost of equity.

[12] Opinion No. 531-B at P 98.

III. CONCLUSION

Wherefore, the Six Cities respectfully request that the Commission consider the foregoing comments and the evidence set forth in the Mac Mathuna Affidavit in evaluating its policies for determining the just and reasonable ROE for inclusion in Commission-jurisdictional rates.

Respectfully submitted,

/s/ *Margaret E. McNaul*

Margaret E. McNaul
Rebecca L. Shelton
Kayla J. Grant
Attorneys for the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California

Law Offices of:

Thompson Coburn LLP
1909 K Street, N.W., Suite 600
Washington, D.C. 20006-1167
202.585.6900
202.585.6969 (facsimile)
June 19, 2019

June 26, 2019

CERTIFICATE OF SERVICE

I hereby certify that I have on this 26th day of June, 2019, caused a copy of the foregoing document to be sent by electronic mail or United States mail to all parties on the list compiled by the Secretary of the Commission in this proceeding.

/s/ Rebecca L. Shelton
Rebecca L. Shelton

Attorney for the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California

Law Offices of:

Thompson Coburn LLP
1909 K Street, N.W.
Suite 600
Washington, D.C. 20006-1167
202.585.6900
202.585.6969 (facsimile)