

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

Docket No. PL19-4-000

**INITIAL COMMENTS OF CONNECTICUT AND
MASSACHUSETTS STATE AGENCIES**

Connecticut and Massachusetts State Agencies (State Agencies)¹ provide their initial comments in response to the Commission's "Notice of Inquiry" (NOI) regarding the policies it uses to set the "base" return on equity (ROE) in transmission rates.²

The NOI seeks comment on whether, and if so how, the Commission should modify its base ROE-setting practices following the decision of the U.S. Court of Appeals for the District of Columbia Circuit in *Emera Maine v. Federal Energy Regulatory Commission*, 854 F.3d 9, 23 (D.C. Cir. 2017). As explained in the NOI, the Commission responded to this decision by issuing separate orders in pending ROE proceedings involving transmission providers in New England³ and the Midcontinent Independent System Operator (MISO) footprint.⁴ The Commission proposed "to change its approach to determining base ROE by giving equal weight to four financial models

¹ The Connecticut and Massachusetts State Agencies are: Connecticut Public Utilities Regulatory Authority (CT PURA), Connecticut Department of Energy and Environmental Protection (CT DEEP), Connecticut Office of Consumer Counsel (CT OCC), the Connecticut Office of the Attorney General (CT AG), the Massachusetts Office of the Attorney General (Mass AG), and Massachusetts Department of Public Utilities (MA DPU).

² *Inquiry Regarding the Commission's Policy for Determining Return on Equity*, 166 FERC ¶ 61,207 (2019) (NOI).

³ *Coakley v. Bangor Hydro-Elec. Co.*, 165 FERC ¶ 61,030 (2018) (*Coakley Order*).

⁴ *Ass'n of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 165 FERC ¶ 61,118 (2018) (*MISO Order*).

instead of primarily relying on the DCF [Discounted Cash Flow] methodology.” NOI at

P 24. The NOI seeks comment on the Commission’s proposal to

rely on three financial models that produce zones of reasonableness—the DCF model, CAPM [Capital Asset Pricing Model] model, and Expected Earnings model—to establish a composite zone of reasonableness. The zone of reasonableness produced by each model would be given equal weight and averaged to determine the composite zone of reasonableness. The Commission explained that the Risk Premium model produces a single numerical point rather than a range; therefore, it cannot be used with the other three financial models in establishing a composite zone of reasonableness. The Commission proposed a framework for using that composite zone of reasonableness in evaluating whether an existing base ROE remains just and reasonable.

NOI, P 25 (footnotes omitted).

All but one of the State Agencies is an active participant in the four complaint dockets addressed in the *Coakley Order*, and have submitted “principal” initial and reply briefs as well as docket-specific initial and reply briefs in each proceeding.⁵ These briefs have presented in detail State Agencies’ concerns with the approach to the calculation of the base ROE proposed by the Commission in the NOI.⁶ In addition, CT PURA, CT OCC, and CT DEEP addressed the application of the ROE calculation methodology proposed by the Commission in the NOI in a supplemental initial brief filed on April 19,

⁵ CT PURA, CT OCC, and the Mass AG are all part of the “Consumer-Aligned Parties” group that submitted “Principal” initial and reply briefs and docket-specific initial and reply briefs in the four pending complaint proceedings addressed in the *Coakley Order*: (1) *Coakley v. Bangor Hydro-Elec. Co.*, Docket No. EL11-66-000; (2) *ENE (Env’t Ne.) v. Bangor Hydro-Elec. Co.*, Docket No. EL13-33-000; (3) *Att’y Gen. of Mass. v. Bangor Hydro-Elec. Co.*, Docket No. EL14-86-000; and (4) *Belmont Mun. Light Dep’t v. Cent. Me. Power Co.*, Docket No. EL16-64-000. Citations to these briefs are provided in the attached Appendix.

⁶ As noted in the NOI, the Commission established a paper hearing in the *Coakley* proceeding and “directed the participants in those proceedings to submit briefs regarding this proposed new approach and how to apply it to those proceedings.” NOI at P 27. CT PURA’s briefs were filed in response to this directive.

2019, in *Constellation Mystic Power, LLC*, FERC Docket No. ER18-1639-000.⁷ Mass AG separately filed its initial brief in that proceeding on April 19, 2019.⁸ The Commission directed the parties to file supplemental briefs on the appropriate base ROE to be used in calculating charges for services provided by Mystic under a cost cost-of-service agreement governing the continued operation of the Mystic 8 and 9 natural gas-fired generating units.⁹

State Agencies will not repeat here all of the detail contained in these briefs, but ask that the Commission consider the positions taken in those briefs as part of their deliberations in this proceeding. We here briefly highlight some of the positions taken in those filings, which are also responsive to certain questions posed in the NOI. Most fundamentally, these questions include Nos. G1 (“How should the Commission determine if existing ROEs are just and reasonable?”); and G2 (“Is the quartile approach

⁷ Initial Supplemental Brief of the Connecticut Public Utilities Regulatory Authority, the Connecticut Department of Energy and Environmental Protection, and the Connecticut Office of Consumer Counsel, *Constellation Mystic Power, LLC*, Docket No. ER18-1639-000 (Apr. 19, 2019), eLibrary No. 20190419-5189. The reply brief in *Constellation Mystic* is due on July 18, 2019.

⁸ Initial Paper Hearing Brief Of Massachusetts Attorney General Maura Healey, *Constellation Mystic Power, LLC*, Docket No. ER18-1639-000 (Apr. 19, 2019), eLibrary No. 20190419-5131.

⁹ The Commission explained:

While the proposed new methodology is a proposal and not a final policy, the Commission stated that the “new approach reflects the Commission’s proposed policy for addressing this issue *in the future, including in the proceedings currently pending before the Commission.*” Accordingly, consistent with our approach in other pending ROE proceedings, we direct the participants to address *Coakley’s* proposed new methodology in the context of this proceeding, including the merits of the proposed methodology and how to apply the proposed new methodology to the facts of this proceeding.

Order Accepting Agreement, Subject to Condition, and Directing Briefs, *Constellation Mystic Power, LLC*, 165 FERC ¶ 61,267, P 33 (2018) (footnote omitted), *reh’g pending*.

that the Commission proposed in the *Coakley* [Order] . . . appropriate? If not, how should the Commission revise this methodology?”¹⁰

Consistent with the arguments advanced and the positions taken in our prior briefs, State Agencies’ position is that the proposed methodology presented by the Commission in the NOI (and at issue in the *Coakley* proceedings) is unjust and unreasonable and should not be adopted. We likewise object to the suggestion that the base ROEs of utilities of “average risk” should be treated as presumptively just and reasonable if they fall within the “quartile of the zone of reasonableness centered on the central tendency of the overall zone of reasonableness.”¹¹

Specifically, and as reviewed in detail in State Agencies’ briefs:

- A transmission provider’s base ROE¹² should be set at “[the] cost of equity,” meaning “the return that the utility must provide its shareholders in order to induce them to invest their capital in that utility.”¹³
- In identifying the appropriate cost of equity, the Commission should continue to rely heavily on the central value indicated by DCF studies of risk-representative proxy groups, using its longstanding DCF model, including its recognition that long-term Gross Domestic Product (GDP) growth constrains long-term growth of earnings and dividends.

¹⁰ The NOI also poses questions concerning the specific methodologies under consideration, including: (1) DCF (Question Nos. H.2.a.1–H.2.a.6); (2) CAPM (Question Nos. H.2.b1–H.2.b.3); (3) Risk Premium (Question Nos. H.2.d.1–H.2.d.3); and (4) Expected Earnings (Question Nos. H.2.c.1– H.2.c.2).

¹¹ NOI P 36.

¹² The base ROE does not include any incentive adders. If and so far as they may be appropriate, incentive adders should be addressed through transparently separate ROE additions. *See, e.g., Atl. Grid Operations A LLC*, 135 FERC ¶ 61,144, PP 88, 94 (2011).

¹³ *Coakley Order*, at n.73.

- The Commission’s proposed “quartile approach,” under which base ROEs are treated as presumptively just and reasonable so long as they do not exceed the level five-eighths of the way up a composite range, is neither just nor reasonable.¹⁴ Doing so would leave excessive ROEs presumptively un-remedied, unless they are extra-excessive by an arbitrarily wide margin. The Commission’s foundational policy that base ROEs should track the cost of equity¹⁵ cannot be squared with one under which complaints would face dismissal unless the existing ROE, having been shown to exceed the cost of equity, is also shown to exceed it by an arbitrarily wide margin. A challenger to an allowed base ROE should be required to show only that it is above the subject utility’s cost of equity.
- The Commission’s proposed presumption would introduce an unfair asymmetry between FPA Sections 205 and 206. Regulated utilities filing under Section 205 apparently can continue to obtain approval of a proposed ROE increase if they show that the cost of equity exceeds the existing ROE by *any* amount. But under the proposed presumption, customers filing under Section 206 would have to show that cost of equity is so far below the existing ROE that their difference exceeds the “shield” margin.

¹⁴ The “just and reasonable” standard of Federal Power Act (FPA) Sections 205 and 206 is meant to “afford consumers a complete, permanent and effective bond of protection from excessive rates and charges,” *Atl. Refining Co. v. Pub. Serv. Comm’n*, 360 U.S. 378, 388 (1959), and permits “not even ‘a little unlawfulness.’” *Consumer Fed’n of Am.*, 515 F.2d 347, 358 n.64 (D.C. Cir. 1975) (quoting *FPC v. Texaco, Inc.*, 417 U.S. 380, 399 (1974)).

¹⁵ See, e.g., *Coakley Order*, P 36 & n.73.

- *Emera Maine* held that although there is a broad range within which an existing ROE *potentially* remains just and reasonable, at any given time, and for the particular circumstances of each case, there is ultimately a *single* level that *is* just and reasonable.¹⁶ Nothing in *Emera Maine* contemplates a presumption that a broad range of base ROEs—extending well above the central estimated equity cost value—are all *finally* reasonable for use in setting cost-based transmission rates, such that an existing ROE anywhere in that range should be presumptively immunized against change.
- To the extent the Commission chooses to rely on CAPM study results to set base ROEs, those studies should use a realistic market risk premium, such as one that recognizes long-term GDP growth as a normalizing constraint on the perpetual continuation of near-term forecasts of earnings growth.
- Estimates of expected earnings on book equity should play no role in identifying the just and reasonable base ROE, as such estimates do not measure the return that investors require to be induced to invest in market-priced utility equities.
- Base ROE determinations should be based on the medians, not the midpoints, of whatever proxy groups are identified. Reliance on medians will remove the low and high-end ranges of proxy results properly from

¹⁶ The court in *Emera Maine* had no issue with the Commission “eventually reduc[ing] the zone of reasonableness to a single ROE.” *Emera Me. v. FERC*, 854 F.3d 9, 26 (D.C. Cir. 2017).

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playing any decisional role. Doing so should result in many of the issues raised in the NOI and perpetually litigated in case-specific proceedings, such as proxy group composition and the tests for excluding high and low results outliers, taking on appropriately diminished significance.

In addressing the questions raised in the NOI, State Agencies ask that the Commission consider both the highlighted points, and, even more important, the detailed support for them presented in our briefs in related proceedings.

Respectfully submitted,

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APPENDIX

- CAPS' Paper Hearing Principal Initial Brief, *Coakley v. Bangor Hydro-Elec. Co.*, Docket No. EL11-66-001 (Jan. 11, 2019), eLibrary No. [20190111-5238](#), and Errata to Ex. No. CAP-500 (Feb. 28, 2019), eLibrary No. [20190228-5368](#).
- CAPS' Paper Hearing Principal Reply Brief, *Coakley v. Bangor Hydro-Elec. Co.*, Docket No. EL11-66-001 (Mar. 8, 2019), eLibrary No. [20190308-5263](#).
- CAPS' Paper Hearing Initial Brief As To First Complaint, *Coakley v. Bangor Hydro-Elec. Co.*, Docket No. EL11-66-001 (Jan. 11, 2019), eLibrary No. [20190111-5239](#).
- CAPS' Paper Hearing Reply As To First Complaint, *Coakley v. Bangor Hydro-Elec. Co.*, Docket No. EL11-66-001 (Mar. 8, 2019), eLibrary No. [20190308-5263](#).
- CAPS' Paper Hearing Initial Brief As To Second Complaint, *ENE (Env't Ne.) v. Bangor Hydro-Elec. Co.*, Docket No. EL13-13-000 (Jan. 11, 2019), eLibrary No. [20190111-5240](#).
- CAPS' Paper Hearing Reply Brief As To Second Complaint, *ENE (Env't Ne.) v. Bangor Hydro-Elec. Co.*, Docket Nos. EL13-13-000 *et al.* (Mar. 8, 2019), eLibrary No. [20190308-5263](#).
- CAPS' Paper Hearing Initial Brief As To Third Complaint, *Att'y Gen. of Mass. v. Bangor Hydro-Elec. Co.*, Docket No. EL14-86-000 (Jan. 11, 2019), eLibrary No. [20190111-5241](#).
- CAPS' Paper Hearing Reply Brief As To Third Complaint, *Att'y Gen. of Mass. v. Bangor Hydro-Elec. Co.*, Docket No. EL14-86-000 (Mar. 8, 2019), eLibrary No. [20190308-5263](#).
- CAPS' Paper Hearing Initial Brief As To Fourth Complaint, *Belmont Mun. Light Dep't v. Cent. Me. Power Co.* (Jan. 11, 2019), eLibrary No. [20190111-5242](#).
- CAPS' Paper Hearing Reply Brief As To Fourth Complaint, *Belmont Mun. Light Dep't v. Cent. Me. Power Co.* (Mar. 8, 2019), eLibrary No. [20190308-5263](#).

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