IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Association of Businesses Advocating Tariff Equity Coalition of MISO Transmission Customers Illinois Industrial Energy Consumers Indiana Industrial Energy Consumers, Inc. Minnesota Large Industrial Group Wisconsin Industrial Energy Group American Municipal Power, Inc. Cooperative Energy Hoosier Energy Rural Electric Cooperative, Inc. Mississippi Public Service Commission Missouri Public Service Commission Missouri Joint Municipal Electric Utility Commission Organization of MISO States, Inc. Southwestern Electric Cooperative, Inc. Wabash Valley Power Association, Inc. Petitioners, v. Federal Energy Regulatory Commission, Respondent.	)	Case No. 20-1251

PETITION FOR REVIEW

Pursuant to Section 313 of the Federal Power Act, 16 U.S.C. § 825l and Rule 15(a) of the Federal Rules of Appellate Procedure ("FRAP"), the Association of Businesses Advocating Tariff Equity, Coalition of MISO Transmission Customers, Illinois Industrial Energy Consumers, Indiana Industrial Energy Consumers, Inc., Minnesota Large Industrial Group, Wisconsin Industrial Energy Group, American

Municipal Power, Inc., Cooperative Energy, Hoosier Energy Rural Electric Cooperative, Inc., Mississippi Public Service Commission, Missouri Public Service Commission, Missouri Joint Municipal Electric Utility Commission, Organization of MISO States, Inc., Southwestern Electric Cooperative, Inc., and Wabash Valley Power Association, Inc. (collectively, "Petitioners"), hereby petition the Court for judicial review of the following orders issued by Respondent, Federal Energy Regulatory Commission ("Commission"):

1. *Ass'n of Bus. Advocating Tariff Equity, et al., v. Midcontinent Indep. Sys. Operator, Inc., et al.*, Opinion No. 551, Order on Initial Decision, Docket No. EL14-12-002, 156 FERC ¶ 61,234 (Sept. 28, 2016) ("Opinion No. 551");

2. *Ass'n of Bus. Advocating Tariff Equity, et al., v. Midcontinent Indep. Sys. Operator, Inc., et al.*, Opinion No. 569, Order on Briefs, Rehearing, and Initial Decision, Docket Nos. EL14-12-003, EL15-45-000, 169 FERC ¶ 61,129 (Nov. 21, 2019) ("Opinion No. 569"); and

3. *Ass'n of Bus. Advocating Tariff Equity, et al., v. Midcontinent Indep. Sys. Operator, Inc., et al.*, Opinion No. 569-A, Order on Rehearing, Docket Nos. EL14-12-004 and EL15-45-013, 171 FERC ¶ 61,154 (May 21, 2020) ("Opinion No. 569-A").

Copies of Opinion No. 551, Opinion No. 569, and Opinion No. 569-A are attached hereto as **Exhibit A**, **Exhibit B**, and **Exhibit C**, respectively.

The Court should note that on June 22, 2020, Petitioners timely filed a request for rehearing of Opinion No. 569-A, which included certain clarifications and

modifications of Opinion No. 569.[1] Petitioners acknowledge that the law of this Circuit states that Petitioners' request for rehearing of Opinion No. 569-A – which remains pending before the Commission[2] – may render this Petition for Review ("Petition") premature and subject to dismissal without prejudice.[3]

This Petition is filed out of an abundance of caution, because precedent followed in at least one other Circuit allows judicial review following final agency action on each "discrete issue,"[4] and because review of the subject orders could ultimately occur in another Circuit. Based on this Court's previous guidance,[5]

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[1] *Norwood v. FERC*, 906 F.2d 772, 775 (D.C. Cir. 1990).

[2] *See Allegheny Def. Project v. FERC*, 17-1098, *et al*., Slip Op. at 27 (D.C. Cir. June 30, 2020) ("Section 717r(a) says in straightforward terms that the Commission's failure to act on a rehearing application within 30 days means that rehearing can be deemed denied and the applicant can obtain judicial review."); *see also id.* at 28 (explaining that the Federal Power Act is a "close relative of the Natural Gas Act" and citing *City of Clarksville v. FERC*, 888 F.3d 477, 484 (D.C. Cir. 2018) ("Because the [Natural gas Act] is modeled substantively after the [Federal Power Act], they are interpreted similarly.")).

[3] *See, e.g., Clifton Power Corp. v. FERC*, 294 F.3d 108 (D.C. Cir. 2002); *Tenn. Gas Pipeline Co. v. FERC*, 9 F.3d 980 (D.C. Cir. 1993) (pur curiam).

[4] *See, e.g., Cal. Dept. of Water Res. v. FERC*, 361 F.3d 517 (9th Cir. 2004); *Steamboaters v. FERC*, 759 F.2d 1382, 1387-88 (9th Cir. 1985).

[5] "We have advised parties that are unsure whether a rehearing order has made a significant change to an underlying license to follow the 'safer course' by filing a protective petition for review." *American Rivers v. FERC*, 895 F.3d 32, 43 n.1 (D.C. Cir. 2018); *see also Eagle-Picher Indus. v. EPA*, 759 F.2d 905, 909 (D.C. Cir. 1985) ("[P]etitioners who delay filing requests for review on their own assessment of when an issue is ripe for review do so at the risk of finding their claims time-barred."); *Miss. Valley Gas Co. v. FERC*, 68 F.3d 503, 510 (D.C. Cir. 1995) (where FERC reaches its decisions incrementally, the parties before it "face[] a terrible dilemma in

Petitioners will defer to this Court for a determination of whether judicial review is premature. Because a final order finding that the current petition is premature would be controlling in any future appeals, Petitioners would not oppose dismissal, provided that dismissal is granted without prejudice to a subsequent petition for review.

Respectfully submitted,

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having to decide when to seek review of the FERC orders," making it "prudent" to file a petition even though it may be dismissed as unripe).

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Dated: July 17, 2020

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA

Association of Businesses Advocating Tariff Equity	)	
Coalition of MISO Transmission Customers	)	
Illinois Industrial Energy Consumers	)	
Indiana Industrial Energy Consumers, Inc.	)	Case No. _____
Minnesota Large Industrial Group	)	
Wisconsin Industrial Energy Group	)	
American Municipal Power, Inc.	)	
Cooperative Energy	)	
Hoosier Energy Rural Electric Cooperative, Inc.	)	
Mississippi Public Service Commission	)	
Missouri Public Service Commission	)	
Missouri Joint Municipal Electric Utility Commission	)	
Organization of MISO States, Inc.	)	
Southwestern Electric Cooperative, Inc.	)	
Wabash Valley Power Association, Inc.	)	
Petitioners,	)	
v.	)	
Federal Energy Regulatory Commission, Respondent.	)	

CORPORATE DISCLOSURE STATEMENTS

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure ("FRAP") and D.C. Circuit Rule 26.1, Petitioners hereby submit their respective corporate disclosure statements. Petitioners represent a broad array of consumer-side stakeholders, including state commissions, official state consumer advocates, cooperatives, municipals, and industrials located within the service territory of the Midcontinent Independent System Operator, Inc. ("MISO"). Petitioners were active

participants in the Commission proceedings in which the orders subject to review were issued and sought rehearing of the Commission's Opinion No. 569-A. Petitioners are subject to, and will be affected by, the orders under review.

CORPORATE DISCLOSURE STATEMENT OF ASSOCIATION OF BUSINESSES ADVOCATING TARIFF EQUITY

Association of Businesses Advocating Tariff Equity ("ABATE") is a voluntary association of large industrial businesses that are located in and doing business in the state of Michigan. ABATE has been formed for the express purpose of participating in regulatory proceedings to protect the interests of businesses in connection with energy and utility matters. Members of ABATE consume substantial quantities of electricity and natural gas, and, in Michigan alone, their combined gas and electric bills are approximately $1.2 billion per year. ABATE has no parent companies, and there are no publicly held companies that have a 10% or greater ownership interest in ABATE.

CORPORATE DISCLOSURE STATEMENT OF
COALITION OF MISO TRANSMISSION CUSTOMERS

Coalition of MISO Transmission Customers ("CMTC") is a continuing *ad hoc* association of large industrial and commercial end-users of electricity in the Midwest operated for the purposes of representing the interests of industrial energy consumers before regulatory and legislative bodies. CMTC members have facilities throughout the MISO region, and CMTC is a MISO member. CMTC has no parent companies, and there are no publicly held companies that have a 10% or greater ownership interest in CMTC.

CORPORATE DISCLOSURE STATEMENT OF ILLINOIS INDUSTRIAL ENERGY CONSUMERS

Illinois Industrial Energy Consumers ("IIEC") is an association of large industrial customers in the State of Illinois. They are eligible to choose a retail supplier other than their electric utility under Illinois law and eligible for transmission service under the applicable Regional Transmission Organization ("RTO") and Independent System Operator ("ISO") tariffs. They consume approximately 13 billion kilowatt-hours ("kWh") of electricity and employ approximately 90,000 people in the State of Illinois. They have members served by Ameren Illinois, a member of MISO. They also have manufacturing facilities located within MISO. IIEC has no parent companies, and there are no publicly held companies that have a 10% or greater ownership interest in IIEC.

CORPORATE DISCLOSURE STATEMENT OF INDIANA INDUSTRIAL ENERGY CONSUMERS, INC.

Indiana Industrial Energy Consumers, Inc. ("INDIEC") is a not-for-profit 501(C)(6) corporation incorporated and doing business in the State of Indiana. INDIEC was formed to provide large energy users an independent voice in regulatory and legislative matters that impact utility rates and energy policies. INDIEC's 22 member companies' electric spend is over $566.6 million annually. INDIEC has no parent companies, and there are no publicly held companies that have a 10% or greater ownership interest in INDIEC.

CORPORATE DISCLOSURE STATEMENT OF MINNESOTA LARGE INDUSTRIAL GROUP

Minnesota Large Industrial Group ("MLIG") is a continuing *ad hoc* consortium of large industrial end-users of electricity in Minnesota, consuming more than 6.5 billion kWh of electricity each year and functioning to represent large industrial interests before regulatory and legislative bodies. MLIG has no parent companies, and there are no publicly held companies that have a 10% or greater ownership interest in MLIG.

CORPORATE DISCLOSURE STATEMENT OF WISCONSIN INDUSTRIAL ENERGY GROUP

Wisconsin Industrial Energy Group ("WIEG") is a voluntary member association consisting of large industrial and commercial customers in the State of Wisconsin. As key drivers of economic growth and development throughout the state, WIEG members collectively employ approximately 50,000 people in Wisconsin and consume approximately 3.6 billion kWh of electricity each year. WIEG has no parent companies, and there are no publicly held companies that have a 10% or greater ownership interest in WIEG.

CORPORATE DISCLOSURE STATEMENT OF AMERICAN MUNICIPAL POWER, INC.

American Municipal Power, Inc. ("AMP") is a non-profit Ohio corporation organized in 1971. AMP has 135 members, including 134 member municipal electric systems in the states of Ohio, Pennsylvania, Michigan, Virginia, Kentucky, West Virginia, Indiana, and Maryland, and the Delaware Municipal Electric Corporation, a joint action agency with nine members that is headquartered in Smyrna, Delaware. AMP provides wholesale energy supply and related services to its members. AMP issues no stock, has no parent corporation, and is not owned in whole or in part by any publicly held corporation.

CORPORATE DISCLOSURE STATEMENT OF COOPERATIVE ENERGY

Cooperative Energy is an incorporated, non-profit cooperative electric power association, organized and operating under and pursuant to Chapter 184, Mississippi Laws of 1936, as amended; Section 5463, *et seq.*, Vol. 4A Recompiled, Mississippi Code of 1942; and is a public utility under the laws of the State of Mississippi. Cooperative Energy is owned and controlled by its members, which are distribution rural electric power associations, serving rural areas in Mississippi at retail. Cooperative Energy is a transmission-owning member of MISO and its operations are integrated into MISO. Cooperative Energy has no parent corporation, and no publicly held corporation has any ownership interest in Cooperative Energy.

CORPORATE DISCLOSURE STATEMENT OF HOOSIER RURAL ELECTRIC COOPERATIVE, INC.

Hoosier Energy Rural Electric Cooperative, Inc. ("Hoosier") is a member-owned generation and transmission cooperative organized under the laws of the state of Indiana. Hoosier's purpose is to provide generation and transmission service to its eighteen distribution cooperative members in Indiana and Illinois. Hoosier is a non-profit electric generation and transmission cooperative organized pursuant to Indiana law. Hoosier has no parent corporation, and issues no stock. Accordingly, no publicly held corporation owns 10% or more of Hoosier's stock.

CORPORATE DISCLOSURE STATEMENT OF MISSISSIPPI PUBLIC SERVICE COMMISSION

Pursuant to Federal Rule of Appellate Procedure 26.1, the Mississippi Public Service Commission is not required to, and does not provide, a Corporate Disclosure Statement, because it is a governmental entity organized under the laws of the state of Mississippi.

CORPORATE DISCLOSURE STATEMENT OF MISSOURI PUBLIC SERVICE COMMISSION

Pursuant to Federal Rule of Appellate Procedure 26.1, the Missouri Public Service Commission is not required to, and does not, provide a Corporate Disclosure Statement, because it is a governmental entity organized under the laws of the state of Missouri.

CORPORATE DISCLOSURE STATEMENT OF
MISSOURI JOINT MUNICIPAL ELECTRIC UTILITY COMMISSION

Missouri Joint Municipal Electric Utility Commission is a joint action agency and a political subdivision of the State of Missouri authorized by legislation to construct, operate, and maintain jointly owned transmission and generation facilities for the production and transmission of electric power for its members, to purchase and sell electric power and energy, and to enter into agreements with any person for transmission of electric power. Missouri Joint Municipal Electric Utility Commission is not a nongovernmental corporate party nor does it issue any stock, thus it is not subject to the corporate disclosure statement requirement of Rule 26.1 of the Federal Rules of Appellate Procedure.

CORPORATE DISCLOSURE STATEMENT OF SOUTHWESTERN ELECTRIC COOPERATIVE, INC.

Southwestern Electric Cooperative, Inc. ("SWEC") is an electric distribution cooperative that serves rural consumers in Bond, Clinton, Effingham, Fayette, Macoupin, Madison, Marion, Montgomery, Shelby, and St. Clair counties in the State of Illinois. Located approximately 45 miles east of St. Louis, Missouri and 85 miles south of Springfield, Illinois, SWEC serves over 20,000 members and operates over 3,500 miles of energized electric line. SWEC is a MISO transmission customer located within the Ameren Illinois Company rate zone. SWEC has no parent companies, and there are no publicly held companies that have a 10% or greater ownership interest in SWEC.

CORPORATE DISCLOSURE STATEMENT OF ORGANIZATION OF MISO STATES, INC.

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure and Rule 26.1 of the Circuit Rules of this Court, the Organization of MISO States, Inc. ("OMS") hereby submits this Corporate Disclosure Statement.

The OMS is a Non-Profit Domestic Corporation (under the Indiana Nonprofit Corporation Act of 1991), and is a self-governed, member-based organization comprised of representatives from entities with regulatory jurisdiction over utilities participating in the MISO region.

The purpose of the OMS is to promote the public interest and social welfare by providing means for its members to act in concert when deemed to be in the common interest of their affected publics.

The OMS does not issue securities to the public and is not owned by any publicly held company.

CORPORATE DISCLOSURE STATEMENT OF WABASH VALLEY POWER ASSOCIATION, INC.

Wabash Valley Power Association, Inc. ("Wabash Valley") is a not-for-profit generation and transmission cooperative formed in 1963 under Indiana law to enable its member cooperatives to obtain reliable long-term all-requirements power at least-cost, stable cost-based rates as part of a not-for-profit enterprise that the Members owned and controlled. Wabash Valley's twenty-five Members are both owners and customers of Wabash Valley. Twenty-three Members are not-for-profit distribution electric cooperatives that provide electric energy to their members at retail across the States of Indiana, Illinois, and Missouri.[6] The other two Members are a Wabash Valley subsidiary, Wabash Valley Energy Marketing, Inc., and J. Aron & Company, Inc., neither of which has retail load-serving obligations. Wabash Valley is a transmission owner and transmission customer of MISO, a transmission customer of PJM Interconnection, L.L.C. ("PJM"), and a market participant in both MISO and PJM. Wabash Valley has no parent companies, and there are no publicly held companies that have a 10% or greater ownership interest in Wabash Valley.

[6] Wabash Valley's 23 not-for-profit distribution cooperatives are: Boone REMC, Carroll White REMC, Citizens Electric Corporation, Corn Belt Energy, EnerStar Electric Cooperative, Fulton County REMC, Heartland REMC, Hendricks Power Cooperative, Jasper County REMC, Jay County REMC, Kankakee Valley REMC, Kosciusko REMC, LaGrange County REMC, M.J.M. Electric Cooperative, Marshall County REMC, Miami-Cass REMC, Newton County REMC, Ninestar Connect, Noble REMC, Parke County REMC, Steuben County REMC, Tipmont REMC, and Warren County REMC.

Respectfully submitted,

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Dated: July 17, 2020

CERTIFICATE OF SERVICE

I hereby certify that on July 17, 2020, a copy of the foregoing Protective Petition for Review was served by e-mail upon each person designated on the official service list maintained by the Secretary of the Federal Energy Regulatory Commission in the proceedings below. A file-stamped copy of the Protective Petition for Review will be served upon Respondent, pursuant to 18 C.F.R. § 385.2012 (1995), as follows:

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Dated: July 17, 2020

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EXHIBIT A

156 FERC ¶ 61,234
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Norman C. Bay, Chairman;
Cheryl A. LaFleur, and Tony Clark.

Association of Businesses Advocating Tariff Equity
Coalition of MISO Transmission Customers
Illinois Industrial Energy Consumers
Indiana Industrial Energy Consumers, Inc.
Minnesota Large Industrial Group
Wisconsin Industrial Energy Group

Docket No. EL14-12-002

v.

Midcontinent Independent System Operator, Inc.
ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

OPINION NO. 551

ORDER ON INITIAL DECISION

(Issued September 28, 2016)

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1. This order addresses briefs on and opposing exceptions to an Initial Decision issued on December 22, 2015 by the presiding Administrative Law Judge (Presiding Judge) in the captioned proceedings.[1] The Initial Decision set forth the Presiding Judge's findings concerning a complaint filed pursuant to section 206 of the Federal Power Act (FPA)[2] challenging the Midcontinent Independent System Operator, Inc. (MISO) Transmission Owners' (TOs) base return on equity (ROE) reflected in MISO's Open Access Transmission, Energy and Operating Reserve Markets Tariff (Tariff). In this order, we affirm the Initial Decision.

I. Background

2. On September 23, 2002, the Commission affirmed an initial decision that approved a base ROE of 12.38 percent for MISO TOs, but the Commission modified the initial decision to include an upward adjustment of 50 basis points for turning over operational control of transmission facilities.[3] On remand from the U.S. Court of Appeals for the District of Columbia Circuit, among other things, the Commission vacated its prior order concerning the 50 basis point adder and stated that MISO TOs may make filings under section 205 of the FPA to include an incentive adder.[4] The 12.38 percent base ROE continues to be the applicable ROE under Attachment O of the MISO Tariff used by all MISO TOs except for American Transmission Company, LLC (ATC).[5]

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[1] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. System Operator, Inc.*, 153 FERC ¶ 63,027 (2015) (Initial Decision).

[2] 16 U.S.C. § 824e (2012).

[3] *Midwest Indep. Transmission Sys. Operator, Inc.*, 100 FERC ¶ 61,292 (2002), *order denying reh'g*, 102 FERC ¶ 61,143 (2003).

[4] *Midwest Indep. Transmission Sys. Operator, Inc.*, 111 FERC ¶ 61,355 (2005).

[5] ATC's base ROE of 12.2 percent was established as part of a settlement agreement that was filed with the Commission on March 26, 2004. In Docket No. ER04-108-000, the Commission approved the uncontested settlement. *Am. Transmission Co. LLC*, 107 FERC ¶ 61,117 (2004).

3. On November 12, 2013, Complainants[6] filed a complaint (Complaint) alleging that the current base ROE is unjust and unreasonable. Additionally, Complainants argued that the capital structures of certain MISO TOs feature unreasonably high amounts of common equity and that MISO TOs' capital structures should be capped at 50 percent common equity. Finally, Complainants contended that the ROE incentive adders received by ITC Transmission for being a member of a regional transmission organization (RTO) and by both ITC Transmission and Michigan Electric Transmission Company, LLC (METC) for being independent transmission owners were unjust and unreasonable and should be eliminated.

4. On October 16, 2014, the Commission set for hearing the issue of whether MISO TOs' base ROE is unjust and unreasonable and established the refund effective date at November 12, 2013.[7] The Commission denied the Complaint with respect to the capital structure issue, finding that Complainants had neither demonstrated that such existing capital structures are not just and reasonable nor cited any precedent for capping, for ratemaking purposes, the level of common equity in such capital structures for individual utilities, much less groups of utilities.[8] The Commission also denied the Complaint with respect to ROE incentive adders.

5. On July 21, 2016, the Commission generally denied requests for rehearing and clarification of the Hearing Order.[9] However, the Commission clarified that non-public utility transmission owners are subject to the outcome of this proceeding. Therefore, the Commission stated that, if the Commission find that MISO TOs' existing base ROE is unjust and unreasonable and requires them to amend their Attachment Os. Accordingly, the Commission will also require those non-public utility transmission owners that incorporate the existing base ROE in their rates to amend their Attachment Os to incorporate the just and reasonable base ROE on a prospective basis. However, the

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[6] Complainants, a group of large industrial customers, are: Association of Businesses Advocating Tariff Equity; Coalition of MISO Transmission Customers; Illinois Industrial Energy Consumers; Indiana Industrial Energy Consumers, Inc.; Minnesota Large Industrial Group; and Wisconsin Industrial Energy Group.

[7] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.* 149 FERC ¶ 61,049, at P 188 (2014) (Hearing Order).

[8] *Id.* P 190.

[9] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 156 FERC ¶ 61,060 (2016) (Rehearing Order).

Commission stated that the MISO non-public utility transmission owners would only be subject to any refund obligations imposed in this proceeding to the extent they have voluntarily committed to make such refunds in prior FPA section 205 proceedings relating to the inclusion of the transmission revenue requirement in MISO's jurisdictional rates.[10]

6. On February 12, 2015, in Docket No. EL15-45-000, a different set of complainants filed a second complaint challenging the public utility MISO TOs' base ROE. By order dated June 18, 2015, the Commission set this matter for hearing and established a refund effective date of February 12, 2015, the day after the expiration of the refund period established by the Hearing Order. That refund period expired May 11, 2016.[11]

7. On December 22, 2015, in this proceeding, the Presiding Judge issued the Initial Decision finding, *inter alia*, that MISO TOs' existing 12.38 percent base ROE is unjust and unreasonable and should be reduced to 10.32 percent. The Presiding Judge also prescribed refunds, with interest, for the period from November 12, 2013 through February 11, 2015.[12] In the Initial Decision, the Presiding Judge explained that the 10.32 percent base ROE represents the midpoint of the upper half of the zone of reasonableness (upper midpoint) of 7.23 percent to 11.35 percent.[13]

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[10] *Id.* PP 47-48.

[11] *Arkansas Elec. Coop. Corp. v. ALLETE, Inc.*, 151 FERC ¶ 61,219, at P 1 (2015) (Second Complaint Hearing Order).

[12] Initial Decision, 153 FERC ¶ 63,027 at P 491.

[13] *Id.* P 110.

8. Joint Customer Intervenors,[14] Complainants, MISO TOs,[15] Resale Power Group of Iowa (Iowa Group), and Trial Staff each filed briefs on exception and opposing exceptions to the Initial Decision. Organization of MISO States (OMS) filed a brief on exceptions and jointly filed, with Joint Consumer Advocates, a brief opposing exceptions.[16]

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[14] Joint Customer Intervenors consist of Arkansas Electric Cooperative Corporation, Mississippi Delta Energy Agency and its members, Clarksdale Public Utilities Commission of the City of Clarksdale, Mississippi and Public Service Commission of Yazoo City, Mississippi, Hoosier Energy Rural Electric Cooperative, Inc., South Mississippi Electric Power Association, and Southwestern Electric Cooperative.

[15] MISO TOs for the purpose of this order refers to: 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, Inc.; Entergy Louisiana, LLC; Entergy Gulf States Louisiana, L.L.C.; Entergy Mississippi, Inc.; Entergy New Orleans, Inc.; Entergy Texas, Inc.; Indianapolis Power & Light Company; International Transmission Company d/b/a ITC Transmission; ITC Midwest LLC; METC; 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. Intervenor Xcel Energy Services Inc. did not join certain of the MISO Transmission Owners' pleadings in this proceeding, but generally supports this brief on behalf of respondents Northern States Power Company, a Minnesota corporation, and Northern States Power Company, a Wisconsin corporation. *See* MISO TOs Brief on Exceptions at n.1.

[16] On February 10, 2016, Joint Consumer Advocates also filed a brief on exceptions, which were due on January 21, 2016. Because of its lateness, we do not consider this brief part of the record in this proceeding. *See* 18 C.F.R. § 385.711(a)(1)(i) (2016).

II. Overview of the Commission's Determinations in this Order

9. In this order, we affirm the conclusions of Initial Decision. We find the Presiding Judge correctly determined that there were anomalous capital market conditions, such that we have less confidence that the midpoint of the zone of reasonableness produced by a mechanical application of the Discounted Cash Flow (DCF) methodology satisfies the capital attraction standards of *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia*[17] and *Federal Power Commission v. Hope Natural Gas Co.*[18] We affirm that, in these circumstances, the Presiding Judge reasonably considered evidence of alternative methodologies for determining ROE and the ROEs approved by state regulatory commissions, for purposes of deciding whether the MISO TOs' ROE should be set at a point above the midpoint of the DCF zone of reasonableness. That evidence corroborates our determination that an ROE above the midpoint is necessary to satisfy *Hope* and *Bluefield*. Accordingly, we find that the just and reasonable ROE for the MISO TOs should be set at the central tendency of the upper half of the zone of reasonableness. We agree with the Presiding Judge that, as a result of this analysis, the appropriate base ROE for MISO TOs is 10.32 percent. We find that the Presiding Judge correctly applied the DCF methodology, including its inclusion of TECO Energy, Inc. (TECO) in the DCF proxy group. As discussed below, we also find that MISO TOs correctly employed the expected earnings alternative, though this finding does not affect the Initial Decision's conclusion.

10. We agree with the Presiding Judge that the base ROE should not be reduced for certain MISO TOs based on their capital structure or the use of transmission formula rates. We also reject Complainants' proposed "quartile approach," as discussed below. Except where specifically mentioned herein, we affirm the determinations in the Initial Decision.

III. Discussion

A. Burden of Proof

1. Initial Decision

11. The Presiding Judge explained that, to modify a rate under FPA section 206, the Commission or complainant has the burden of showing that the existing rate is unjust and

[17] 262 U.S. 679, 692-93 (1923) (*Bluefield*).

[18] 320 U.S. 591, 603 (1944) (*Hope*).

unreasonable. He also explained that a "complainant shows that a Base ROE is unjust and unreasonable by establishing that it is higher than is necessary to meet the requirements set forth in [*Hope* and *Bluefield*]."[19] The Presiding Judge further explained that *Bluefield* dictates that the return should be "equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties."[20] Additionally, the Presiding Judge noted that the return should be "commensurate with returns on investments in other enterprises having corresponding risks."[21]

12. The Presiding Judge continued, 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."[22] That is, the return should be "sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital."[23]

13. Finally, the Presiding Judge stated that a base ROE that "authorized a utility to collect more than is necessary to satisfy the requirements of *Hope* and *Bluefield* would exploit consumers and, therefore, would be unjust and unreasonable," so "Complainants and other participants seeking reduction of MISO TOs' Base ROE . . . have the burden of proving that MISO TOs' Base ROE exceed that level."[24] The Presiding Judge further stated that "[i]f the evidence establishes that MISO TOs exceed [the zone of reasonableness], [Complainants] will have met their burden."[25]

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[19] Initial Decision, 153 FERC ¶ 63,027 at P 19.

[20] *Bluefield*, 262 U.S. at 693.

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

[22] *Bluefield*, 262 U.S. at 693.

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

[24] Initial Decision, 153 FERC ¶ 63,027 at P 24.

[25] *Id.* P 26.

2. Briefs on Exceptions

14. Joint Customer Intervenors argue that the Initial Decision is ambiguous and could be interpreted to mean that, in order to meet their burden, Complainants and aligned parties must establish that the ROE exceeds the zone of reasonableness.[26] Joint Customer Intervenors assert that, while such a showing would suffice to meet their burden, the ROE may also be unjust and unreasonable even if it is not outside the zone of reasonableness. Joint Customer Intervenors argues that, to find otherwise would be incorrect and inconsistent with *Martha Coakley, Mass. Attorney Gen. v. Bangor Hydro-Electric Company*,[27] and Joint Customer Intervenors take exception to the extent that the Initial Decision held an ROE must be outside the zone of reasonableness to be unjust and unreasonable.[28]

3. Briefs Opposing Exceptions

15. MISO TOs challenge Joint Customer Intervenors' claim. MISO TOs argue that the Presiding Judge did not need to "delve into the nuances of the burden of proof . . . and neither should the Commission."[29]

4. Commission Determination

16. We affirm that FPA section 206 does not require complainants or the Commission to demonstrate that an existing ROE falls outside the zone of reasonableness in order for that ROE to be considered unjust and unreasonable. The Commission disagreed with MISO TOs' identical argument in the Rehearing Order in this proceeding.[30] Moreover,

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[26] Joint Customer Intervenors Brief on Exceptions at 9 (citing Initial Decision, 153 FERC ¶ 63,027 at P 26).

[27] Opinion No. 531, 147 FERC ¶ 61,234, at P 12, Opinion No. 531, Opinion No. 531-A, *order on paper hearing*, 149 FERC ¶ 61,032 (2014), Opinion No. 531-B, *order on reh'g*, 150 FERC ¶ 61,165 (2015) (citing *RITELine Ill., LLC*, 137 FERC ¶ 61,039, at P 68 (2011); *N. Pass Transmission LLC*, 134 FERC ¶ 61,095, at P 46 (2011); *S. Cal. Edison Co.*, 131 FERC ¶ 61,020, at P 51 (2010)).

[28] Joint Customer Intervenors Brief on Exceptions at 9-10.

[29] MISO TOs Brief Opposing Exceptions at 49.

[30] *See* Rehearing Order, 156 FERC ¶ 61,060 at P 17.

as the Commission has previously concluded, not all points within the zone of reasonableness necessarily satisfy the just and reasonable standard.[31]

B. Proxy Group and DCF Analysis

17. In order to determine the just and reasonable ROE for public utilities, the Commission applies the DCF model to a proxy group of comparable companies. The Commission uses the following standards to select the proxy group: (1) a national group of companies considered electric utilities by Value Line Investment Survey (Value Line); (2) the inclusion of companies with credit ratings no more than one notch above or below the utility or utilities whose rate is at issue; (3) the inclusion of companies that pay dividends and have neither made nor announced a dividend cut during the six-month study period; (4) the inclusion of companies with no major merger activity during the six-month study period; and (5) companies whose DCF results pass threshold tests of economic logic.[32]

18. With simplifying assumptions, the formula for the DCF model reduces to: P = D/k-g, where "P" is the price of the common stock, "D" is the current dividend, "k" is the discount rate (or investors' required rate of return), and "g" is the expected growth rate in dividends. For ratemaking purposes, the Commission rearranges the DCF formula to solve for "k", the discount rate, which represents the rate of return that investors require to invest in a company's common stock, and then multiplies the dividend yield by the expression (1+.5g) to account for the fact that dividends are paid on a quarterly basis. Multiplying the dividend yield by (1+.5g) increases the dividend yield by one half of the growth rate and produces what the Commission refers to as the "adjusted dividend yield." The resulting formula is known as the constant growth DCF model and can be expressed as follows: k=D/P (1+.5g) + g. Under the Commission's two-step DCF methodology, the input for the expected dividend growth rate, "g," is calculated using both short-term and long-term growth projections.[33] Those two growth rate estimates are averaged, with the short-term growth rate estimate receiving two-thirds

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[31] *Id.*

[32] Opinion No. 531, 147 FERC ¶ 61,234 at P 92.

[33] *Id.* PP 15-17, 36-40, *order on paper hearing*, Opinion No. 531-A, 149 FERC ¶ 61,032 at P 10.

weighting and the long-term growth rate estimate receiving one-third weighting.[34] The Commission generally conducts the DCF analysis based on the most recent six months of financial data in the record.[35]

19. In this case, the Presiding Judge determined that the DCF Study Period for calculating the zone of reasonableness should be the most recent six-month period for which there is financial data in the record, January to June 2015.[36] He rejected MISO TOs' argument that the Commission should not include data subsequent to the November 12, 2013 to February 10, 2015 refund period unless the data are "reasonably representative of the refund period."[37] While the study period utilized in Opinion No. 531 roughly coincided with the refund period, the Presiding Judge noted that that similarity is not an "essential element" of the Commission's decision to consider data outside of the refund period.[38] In any case, the Presiding Judge observed, the overlap between the study period and the refund period in Opinion No. 531 was not much greater than it is here. Lastly, the Presiding Judge noted that any ROE established as part of this proceeding is likely to apply for "an appreciable period of time outside of the Refund Period."[39] Accordingly, the best course of action is to fashion a base ROE based on the most recent data in record.

20. In order to establish a proxy group, the Presiding Judge reviewed the DCF-determined cost of equity for 42 companies. The Presiding Judge determined that 37 of those companies should be included in the proxy group. Of those companies, the lowest cost of equity was Public Service Enterprise Group's 7.23 percent and the highest cost was TECO's 11.35 percent.[40] As described in more detail below, the Presiding Judge rejected contentions that TECO should be excluded from the proxy group because of certain Merger and Acquisition (M&A) Activity. However, following Opinion No. 531,

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[34] Opinion No. 531, 147 FERC ¶ 61,234 at PP 17, 39.

[35] *Id.* P 160.

[36] Initial Decision, 153 FERC ¶ 63,027 at PP 56, 61.

[37] *See* Opinion No. 531, 147 FERC ¶ 61,234 at P 64.

[38] Initial Decision, 153 FERC ¶ 63,027 at P 58.

[39] *Id.* P 61.

[40] *Id.* P 63.

the Presiding Judge excluded three companies — Edison International, FirstEnergy Corporation (FirstEnergy), and Entergy Corporation (Entergy) — because their ROEs were less than 5.65 percent, which is 100 basis points above the average yield for public utility bonds rated Baa by Moody's.[41] The Presiding Judge also excluded Madison Gas and Electric Energy, Inc. because it did not have a credit rating from either Moody's Investors Service or S&P and, therefore, could not be shown to have a credit rating of not more than one notch above or below MISO TOs, as required by Opinion No 531.[42] In addition, the Presiding Judge also excluded Unitil Corporation (Unitil) from the proxy group because it is not one of the companies covered by Value Line and because, unlike the companies in Value Line, Unitil has a capitalization of less than $1 billion.[43]

21. For short-term growth rates, the Presiding Judge adopted the five-year growth rates proposed by Complainants' witness, Mr. Gorman, and, for companies not included in Mr. Gorman's sample, five-year growth rates proposed by Joint Consumer Advocates' witness, Mr. Hill. Both provided projected Institutional Brokers' Estimate System (IBES) growth estimates published by *Yahoo! Finance* obtained on July 13, 2015.[44] For the long-term growth rate, the Presiding Judge adopted the 4.39 percent Gross Domestic Product (GDP) growth rate proposed by Trial Staff witness, Mr. Keyton, reasoning that his method of calculating the growth rate most closely paralleled the method that the Commission used in Opinion No. 531.[45]

22. The parties' briefs on exceptions raise two issues with respect to the Presiding Judge's rulings with respect to the proxy group and the DCF analysis of each member of the proxy group. These are: (1) whether TECO should have been excluded from the proxy group and (2) whether in future cases short-term growth projections could be based on Value Line data. We address these issues below.

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[41] *Id.* PP 66-67.

[42] *Id.* PP 70, 72 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 106).

[43] *Id.* PP 74-75, 77.

[44] *Id.* P 49.

[45] *Id.* P 44.

1. Inclusion of TECO in the Proxy Group

23. As explained in Opinion No. 531, the Commission's practice is "to eliminate from the proxy group any company engaged in M&A activity significant enough to distort the [company's] DCF inputs" — i.e., the company's "stock prices, dividends, or growth rates."[46] TECO is the only company whose M&A activity is at issue here. We first summarize TECO's M&A activity before turning to the Initial Decision, the briefs on and opposing exceptions, and our decision whether to include TECO in the proxy group.

24. TECO engaged in two M&A activities that could potentially require its exclusion from the proxy group. First, on September 2, 2014, nearly four months before the beginning of the updated the study period, TECO completed its acquisition of New Mexico Gas Company (New Mexico Gas).[47] The record reveals that, several months later, during the January 2015 to June 2015 study period, analysts were still assessing the impact of the New Mexico Gas acquisition on TECO earnings. For example, the May 22, 2015 issue of Value Line noted that the acquisition should increase TECO's earnings, although the acquisition was just one of several factors, including strong customer growth and impending rate increases, that Value Line identified to support the projected increase in TECO's earnings for 2015 and 2016.[48]

25. Second, on October 20, 2014, roughly a month after closing the New Mexico Gas acquisition, TECO announced an agreement to sell its coal mining subsidiary, TECO Coal Corporation (TECO Coal) to Cambrian Coal Corp. (Cambrian) for $120 million and a contingent payment of up to $50 million, depending on coal prices.[49] TECO's stock price rose approximately 8 percent in the month following news of the sale. A few months later, in February 2015, TECO announced an amendment to the terms of the agreement that lowered the purchase price to $80 million, but increased the maximum contingent payment to $60 million.[50] Later in February, a securities analyst at UBS upgraded TECO from "neutral" to "buy," noting the potential sale of TECO Coal as one of the reasons for the upgrade. Throughout this period in early 2015, IBES's growth

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[46] Opinion No. 531, 147 FERC ¶ 61,234 at P 114.

[47] Exh. S-4 at 12.

[48] Initial Decision, 153 FERC ¶ 63,027 at P 91; Exh. S-6 at 161.

[49] *Id.* P 98; Exh. S-3.

[50] *Id.* P 98. The terms of the sale were amended again in mid-April 2015.

projections for TECO increased from 6.43 percent in January to 7.08 percent in February and all the way up to 9.20 percent by March 2015, even as at least one analyst expressed skepticism that TECO would complete the sale of TECO Coal.[51]

26. In April 2015, TECO announced that it was considering selling TECO Coal to other potential buyers in the event that the deal with Cambrian fell through.[52] As it happened, TECO announced in June 2015, the last month of the study period, that the deal with Cambrian had not closed as scheduled, but that it had received a non-binding offer for TECO Coal from an undisclosed buyer. The IBES growth projections remained steady at 9.20 percent throughout April, May, and June, notwithstanding the multiple reports casting doubt on TECO's ability to complete the sale of TECO Coal.[53] In early July 2015, TECO announced that it had failed to reach an agreement with the undisclosed buyer, but that a sale of TECO Coal to Cambrian remained a possibility. A week later, on July 13, 2015, IBES's growth projection for TECO declined to 7.68 percent.[54] The Presiding Judge used the 7.68 percent IBES growth projection in his DCF analysis of TECO.

a. Initial Decision

27. The Presiding Judge rejected the contentions of Complainants, Joint Customer Intervenors, Iowa Group, and Trial Staff that TECO should be excluded from the proxy group.[55] The Presiding Judge concluded that neither the acquisition of New Mexico Gas nor the attempted sale of TECO Coal was sufficient to "distort" the DCF inputs.[56] Beginning with the New Mexico Gas acquisition, the Presiding Judge concluded that any earnings distortion caused by the acquisition was insufficient to exclude TECO. As an

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[51] *Id.* P 101; Exh. S-4 at 15; S-6 at 147, 171.

[52] Initial Decision, 153 FERC ¶ 63,027 at P 99.

[53] *Id.* P 101; Exh.S-6 at 149, 151.

[54] Initial Decision, 153 FERC ¶ 63,027 at P 101. The Presiding Judge's Order Establishing Procedural Schedule provided that the cut-off date for data to be used by any party in updates of ROE studies would be July 13, 2015. Exh. JCA-22. *See also infra* note 88.

[55] Initial Decision, 153 FERC ¶ 63,027 at PP 79, 81.

[56] *Id.* PP 81, 96, 106.

initial matter, the Presiding Judge noted that Mr. Gorman, the "principal advocate" of excluding TECO on the basis of its acquisition of New Mexico Gas, did not advocate that position in his original testimony in February 2015, but altered his position to advocate exclusion of TECO in his updated testimony in July 2015.[57] The Presiding Judge, however, concluded that the updated information on which Mr. Gorman relied did not suggest that TECO should be excluded from the proxy group. In particular, the Presiding Judge determined that Mr. Gorman was "incorrect" to suggest that TECO's IBES growth rate had increased 280 basis points between his original and updated testimony. The Presiding Judge observed that, although it was true that the IBES growth rate estimate increased from 6.43 percent in January 2015 to 9.20 percent in June 2015, that number had declined to 7.68 percent by the time of Mr. Gorman's updated testimony, meaning that the actual increase in the growth rate was just 125 basis points, less than half of the 280-basis-point increase to which Mr. Gorman testified.[58]

28. In addition, the Presiding Judge determined that Mr. Gorman's characterization of the May 2015 Value Line report was also "inaccurate."[59] The Presiding Judge noted that TECO's acquisition of New Mexico Gas was just one of many factors that led Value Line to increase its projection for TECO's 2015 earnings. As the Presiding Judge explained, Value Line also emphasized the strong growth prospects for TECO's Florida utilities and an anticipated reduction in TECO's cost of debt. The Presiding Judge also noted that Value Line's increased earnings projections for 2016 were not based on the acquisition of New Mexico Gas. Instead, the Presiding Judge concluded that that increase was based on a pending rate increase for one of TECO's Florida utilities and on New Mexico Gas's own growth projections, whose sustainability was not called into question by the evidence in the record.[60] The Presiding Judge also concluded that, because the acquisition's effect on earnings was limited to 2015, there was no reason to conclude that the acquisition would have an effect on the IBES "Next 5 Years" of growth projections, which is the basis for the DCF analysis.[61] The Presiding Judge rejected arguments that the purchase of New Mexico Gas had decreased short-term earnings expectations relative

[57] *Id.* P 82.

[58] *Id.* P 90.

[59] *Id.* P 91.

[60] *Id.* PP 94-96.

[61] *Id.* PP 95-96.

to the long-term expectations to the point of "distort[ing]" the DCF input, as the Commission to exclude a proxy company on the basis of merger activity.[62]

29. The Presiding Judge also declined to exclude TECO on the basis of its attempted sale of TECO Coal. Although concluding that the "efforts to sell TECO Coal affected investors' perceptions of TECO," the Presiding Judge nevertheless concluded that this effect did not rise to the level of a distortion.[63] The Presiding Judge noted that, throughout the study period, TECO's projected growth rate increased even as the prospects of completing the sale of TECO Coal diminished. The Presiding Judge thus concluded that the growth projections for TECO "do not appear to have been related in any way to" the efforts to sell TECO Coal.[64] In addition, the Presiding Judge recognized that, in the months after the agreement to sell TECO Coal to Cambrian, TECO's stock price increased 20 percent while the industry average decreased 2 percent.[65] Based on that divergence, the Presiding Judge concluded that the potential sale of TECO Coal "may have distorted [TECO's] dividend yield downward during the study period."[66] However, the Presiding Judge declined to exclude TECO, reasoning that, because TECO was at the upper end of the zone of reasonableness and because the divestiture efforts appeared to have lowered TECO's cost of equity, to exclude TECO would have the effect of correcting a distortion that lowered the upper bound of the zone of reasonableness by *further lowering* the upper bound of the zone.[67] That result, the Presiding Judge concluded, would make the DCF analysis a "less reliable" guide to determining TECO's cost of equity.[68] Finally, the Presiding Judge also asserted that the sale of a business unit — or, in this case, an attempted sale — is neither a merger nor an acquisition and, therefore, should not be a reason to exclude a company based on M&A activity.

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[62] *Id.* PP 90-95.

[63] *Id.* PP 100, 106.

[64] *Id.* P 103.

[65] *Id.* P 104.

[66] *Id.* P 106.

[67] *Id.* P 107.

[68] *Id.* P 108.

b. Briefs on Exception

30. Complainants, Joint Customer Intervenors, and Trial Staff contend that the Presiding Judge should have excluded TECO. Joint Customer Intervenors contend that the Presiding Judge erred when he decided not to exclude TECO on the basis that it was at the top of the zone of reasonableness and that the M&A activity appeared to depress TECO's dividend yield. Joint Customer Intervenors also argue that Commission precedent requires the exclusion of any company that engages in significant M&A activity, regardless of its position in the zone of reasonableness or what effect that activity appeared to have on the DCF inputs, including the dividend yield.[69] Joint Customer Intervenors also contend that the Presiding Judge erred to the extent that he declined to exclude TECO on the basis that "[a] sale of a unit (much less an attempted sale) is neither a merger nor an acquisition."[70] Joint Customer Intervenors aver that a sale is a form of M&A activity—since some company is acquiring the asset being sold—and that it "defies logic" to exclude a company that purchases an asset from the proxy group, but not exclude the company that sells it.[71] Similarly, Joint Customer Intervenors argue that the fact that the sale was not completed is irrelevant as the Commission has "routinely" excluded companies from the proxy group based on contemplated or attempted merger or acquisition activity.

31. Complainants contend that the Presiding Judge erred to the extent that he declined to exclude TECO in part because TECO's acquisition of New Mexico Gas occurred several months before the beginning of the January-June 2015 updated study period on which the Initial Decision relied.[72] Complainants defend Mr. Gorman's decision to include TECO based on the original study period, but exclude TECO based on the updated study period. They argue that, although TECO both acquired New Mexico Gas and announced the agreement to sell TECO Coal during the initial study period, which covered July-December, 2014, those activities "were perceived by investors as having only a modest impact on TECO's earnings" during that period and, therefore,

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[69] Joint Customer Intervenors Brief on Exceptions at 12; Trial Staff Brief on Exceptions at 13-14.

[70] Joint Customer Intervenors Brief on Exceptions at 12; Trial Staff Brief on Exceptions at 14-15 (observing that a sale was sufficient to trigger a company's exclusion in Opinion No. 531).

[71] Complainants Brief on Exceptions at 14.

[72] *Id.* at 13.

Mr. Gorman reasonably decided to include TECO in the proxy group.[73] Complainants contend that during the updated study period, by contrast, there was evidence that the acquisition would have a more significant impact on TECO's earnings. In particular, Complainants point to the fact that Value Line stated that TECO's earnings were likely to increase "considerably" and listed the New Mexico Gas acquisition as one of the reasons for that prediction.[74] Complainants contend that this change in earnings expectations justified Mr. Gorman's decision to change course and exclude TECO from the proxy group. In addition, Complainants take exception to how the Presiding Judge interpreted Value Line's discussion of the factors affecting TECO's earnings. Although Complainants acknowledge that there were multiple factors contributing to TECO's growth estimates, they assert that these additional factors affecting the growth do not nullify the effect of the acquisition, which they argue is sufficient to exclude TECO.[75]

32. In addition, Complainants argue that the Presiding Judge erred by concluding that Value Line's earnings forecast limited the impact of the New Mexico Gas acquisition to 2015.[76] They contend that, although Value Line discussed the acquisition's impact on 2015 earnings, it never stated that that the effects of the acquisition were limited to 2015. Complainants further contend that Value Line's discussion of the factors contributing to earnings growth in 2016 were "additional factors"—i.e., over and above those affecting the 2015 earnings—that is, they were not the only factors affecting the 2016 earnings projections. In any case, Complainants argue, the Presiding Judge wrongly concluded that the 2015 earnings projections were not included in the IBES five-year growth projections. Consequently, they contend, the Presiding Judge erred in concluding that the New Mexico Gas acquisition did not affect the IBES five-year growth projections used in the DCF analysis.[77]

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[73] *Id.* at 13-14.

[74] *Id.* at 15-17. Complainants also briefly suggest that TECO should have been excluded on the basis of its attempts to sell TECO Coal. They note that TECO's stock price increased 8 percent when it announced the sale of TECO Coal. Trial Staff makes a similar point. Trial Staff Brief on Exceptions at 13.

[75] Complainants Brief on Exceptions at 20-21.

[76] *Id.* at 18.

[77] *Id.* at 19-20.

33. Finally, Complainants assert that the Presiding Judge erroneously discounted Mr. Gorman's testimony on the basis that the IBES growth rate projection for TECO had increased only 125 basis points, rather than the 277 basis points that Mr. Gorman testified to. Complainants contend that Mr. Gorman's calculation was correct as of July 13, 2015, when he downloaded the information from *Yahoo! Finance* and, therefore, and that the Initial Decision was wrong to conclude that the projected growth rate had increased only 125 basis points. In any case, they argue, a 125-basis-point increase still represents a meaningful change in TECO's estimated growth rate.

34. Trial Staff echoes many of these arguments regarding TECO Coal. In particular, Trial Staff contends that the Presiding Judge failed to adequately justify the conclusion that changes in TECO's stock price, estimated growth rate, and other investment measures were not related to the sale of TECO Coal.[78]

c. Briefs Opposing Exception

35. MISO TOs contend that the Presiding Judge properly included TECO in the proxy group. They argue that the Commission's screening criteria require a company's exclusion on the basis of M&A activity only when (1) that activity takes place during the study period and (2) that activity is sufficient enough to distort the inputs for the DCF analysis.[79] Because the acquisition of New Mexico Gas took place outside the updated study period, MISO TOs assert that it does not meet the first criterion for being excluded on the basis of M&A activity. In addition, MISO TOs contend that there were several factors affecting TECO's estimated growth rate and, therefore, it is not clear whether the effects of the New Mexico Gas acquisition had a significant effect on the estimated growth rates. MISO TOs also contend that the Presiding Judge correctly concluded that the change in TECO's estimated growth rate was 125 basis points, not the 280 basis points that Mr. Gorman testified to.[80] In any case, they argue, investors did not react significantly to this information and the stock price remained within "a narrow band" during the study period.[81]

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[78] Trial Staff Brief on Exceptions at 13.

[79] MISO TOs Brief Opposing Exceptions at 38.

[80] *Id.* at 41.

[81] *Id.* at 42.

36. Turning to the sale of TECO Coal, MISO TOs contend that any distortion associated with the attempted sale would have occurred when the sale was first announced, which was before the updated study period.[82] In addition, they state that there was little variation between TECO's stock prices and those of the Dow Jones Utility Average, suggesting that whatever effect the attempted sale had on TECO's stock price was minimal.[83] MISO TOs also assert that the Presiding Judge correctly determined that the attempted sale did not significantly affect TECO's IBES growth rates or Value Line's earnings per share (EPS) estimates—a result that MISO TOs contend is not surprising given that TECO Coal accounts for less than 1.5 percent of TECO's market capitalization.[84]

d. Commission Determination

37. We affirm the Presiding Judge's decision to include TECO in the proxy group. As explained in Opinion No. 531, it is the Commission's "practice . . . to eliminate from the proxy group any company engaged in M&A activity significant enough to *distort* the DCF inputs."[85] We do not exclude a company simply because it has engaged in any M&A activity or that activity may cause changes in the DCF inputs.[86] Rather, we exclude a company if the M&A activity may cause temporary changes in DCF inputs that are not sustainable or representative of longer-term investor expectations for the company. For the reasons that follow, we conclude that neither TECO's acquisition of New Mexico Gas nor TECO's attempted sale of TECO Coal constitutes M&A activity sufficient to distort the DCF inputs.

38. We begin with New Mexico Gas. As noted, TECO's acquisition of New Mexico Gas was completed on September 2, 2014, nearly four months before the beginning of the

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[82] *Id.* at 43.

[83] *Id.* at 44-45.

[84] *Id.* at 47.

[85] Opinion No. 531, 147 FERC ¶ 61,234 at P 114 (emphasis added).

[86] *Bangor Hydro-Elec. Co.*, Opinion No. 489, 117 FERC ¶ 61,129, at PP 67-68 (2006) ("We also reject [the] . . . argument that Commission precedent supports, in every instance, the exclusion from a proxy group of any utility engaged in merger activity."), *order on reh'g*, 122 FERC ¶ 61,265, *order on clarification*, 124 FERC ¶ 61,136 (2008).

updated study period, which covered January-June, 2015.[87] As such, speculation about whether the acquisition would be completed could not have affected, much less distorted, the stock price or the other DCF inputs during the updated study period. Nevertheless, Complainants contend that TECO should be excluded on the grounds that the acquisition of New Mexico Gas created a temporary and unsustainable increase in TECO's expected earnings. We disagree. As an initial matter, we find that, over the course of the updated study period, the IBES growth estimates increased 125 basis points, not 280 basis points that Mr. Gorman testified to.[88] However, as illustrated by the July 13, 2015 *Yahoo! Finance* data included along with the testimony of Mr. Hill, the actual growth projected earnings growth for TECO at the end of the updated study period used in the parties' DCF analysis was 7.68 percent, 125 basis points above the 6.43 percent at the beginning of the study period.

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[87] Initial Decision, 153 FERC ¶ 63,027 at PP 80, 84.

[88] Exh. JC-22 at 7. Complainants contend that there is a disputed issue of fact regarding the appropriate growth rate for TECO at the end of the updated study period. Complainants Brief on Exceptions at 21-22. They assert that Mr. Gorman's testimony, in which he states that TECO's growth rate increased by 280 basis points from its 6.43 percent level in January 2015, implies a growth rate of 9.20 percent as of the end of the study period, while Join Consumer Advocates' witness, Mr. Hill, stated that he used a growth rate of 7.68 percent. *Id.* We affirm the Presiding Judge's decision to rely on Mr. Hill's 7.68 percent growth rate. Mr. Hill's testimony states clearly that he relied upon the numbers from *Yahoo! Finance* on July 13, 2015, the cut-off date for ROE data used in the updated study period, to evaluate TECO's merger activity. *See* Exh. JCA-22; Order Establishing Procedural Schedule, Docket No. EL14-12, at 3 (Jan. 23, 2015). Mr. Gorman, by contrast, does not state when he compiled the growth rate data on which he relied in deciding to exclude TECO. Exh. JC-22 at 7. Although, later in his testimony, Mr. Gorman stated that he used data taken from *Yahoo! Finance* on July 13, 2015 to perform the DCF analysis, *id.* at 8, that analysis did not include TECO, as Mr. Gorman had already determined to exclude TECO from the proxy group. *See* Exh. JC-25; Exh. JC-22 at 7. As a result, there is nothing in Mr. Gorman's testimony that suggests that he used July 13, 2015 IBES data – and not data from earlier in the study period, when the IBES growth rate was 9.20 percent, Exh. S-4 at 15 – when deciding whether to exclude TECO from the proxy group. Accordingly, we agree with the Presiding Judge that the 7.68 percent growth rate used by Mr. Hill represents the more reliable figure and more clearly represents "the most recent record evidence of the growth rates actually expected by the investment community." Opinion No. 531, 147 FERC ¶ 61,234 at P 89.

39. We conclude that there is no evidence in the record suggesting that the New Mexico Gas acquisition caused a significant and unsustainable increase in TECO's earnings expectations during the updated study period. The May 22, 2015 Value Line report suggests that the acquisition will increase earnings "over and above" the savings TECO will realize from no longer paying transaction costs associated with the acquisition. There is nothing suggesting that the additional increase is unsustainable. After all, all other things being equal, an earnings increase is what we would expect when a company increases its regulated gas and electric customers by 50 percent, as TECO did in acquiring New Mexico Gas.[89] In any case, the acquisition was just one of many factors, along with rate increases for TECO's Florida utilities and an anticipated reduction in TECO's cost of debt, that supported Value Line's increased earnings projections.[90] The Value Line report thus is not evidence suggesting that the acquisition distorted TECO's expected growth rate based on temporary, short-term developments that are unlikely to continue.

40. Turning to TECO's attempts to sell TECO Coal, we similarly conclude that there is no evidence suggesting that those efforts "distorted" the DCF inputs. Unlike the acquisition of New Mexico Gas, the efforts to sell TECO extended into the updated study period and, therefore, it is possible that speculation related to the potential merger could have affected TECO's DCF inputs. Nevertheless, we conclude that any effect was either too small or too attenuated to rise to the level of a distortion requiring TECO's exclusion from the proxy group.

41. We find that the record does not show that the attempted sale of TECO Coal distorted TECO's expected earnings. We first note that TECO Coal represents less than 1.5 percent of TECO's total market capitalization.[91] The sale of such a relatively small

[89] *See* Joint Customer Intervenors Brief on Exceptions at 12. To the extent that the parties suggest that TECO should be excluded because its earnings outlook improved because it is no longer incurring the transaction cost associated with the acquisition, we reject their argument. Adopting that position would require that the Commission exclude companies for a year after almost any major merger or acquisition as the savings from no longer incurring the transaction costs materialize in annual earnings. That result is not the purpose of the M&A screen.

[90] Initial Decision, 153 FERC ¶ 63,027 at P 91.

[91] Exh. MTO-23 at 99 (valuing TECO Coal using the most recent non-contingent purchase price for the attempted sale to Cambrian). Although it is of course possible that the expected earnings growth rate would have further increased during this period were it not for the eroding chances of a successful sale of TECO Coal, we conclude that there is

(continued...)

asset is, as a general matter, not the type of input-distorting transaction that the M&A screen is intended to address. Additionally, many of the public utilities, especially relatively large companies that make a good comparison for TECO, are regularly engaged in potential mergers or acquisitions of small business units or subsidiaries. Excluding such companies from the proxy group on the basis of any small purchase or sale would unnecessarily shrink the group of representative companies, thereby making the proxy group, and the resulting DCF analysis, a less reliable tool for ensuring that the allowed ROE satisfies the requirements of *Hope* and *Bluefield*.

42. In this case, the evidence confirms that TECO's potential sale of its underperforming asset, TECO Coal, had little impact on its projected growth rates or stock prices. As the Presiding Judge observed, IBES's projected growth rates for TECO steadily increased throughout the first five months of the six-month study period, even as the prospects for selling TECO Coal steadily deteriorated.[92] If the potential sale of TECO Coal was a significant factor affecting TECO's DCF inputs, we would anticipate at least some decline in the expected growth rate as the prospects for a sale deteriorated between February and June, 2015. Instead, as noted, TECO's expected growth rate first increased between February and March and then held steady through June.[93] In short, the record simply does not suggest that the potential sale had much, if any, effect on the growth rate used in the DCF analysis.

43. Similarly, we conclude that there is no evidence in the record that the attempted sale of TECO Coal caused a distortion in TECO's stock price. The comparison of TECO's stock price versus the Dow Jones Utility Average submitted by Dr. Avera[94] shows that the two moved in near lockstep from November 2014 through April 2015, which significantly overlaps with the study period. In any case, Dr. Avera's graph shows that TECO outperformed the industry average by an even greater amount for much of March and April, 2015, when the chances of a successful sale appeared to be diminishing.[95] Once again, if the potential sale of TECO Coal was affecting TECO's

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no evidence in the record suggesting that the decreasing likelihood of a sale provided any such drag on TECO's earnings expectations.

[92] Initial Decision, 153 FERC ¶ 63,027 at P 103.

[93] *Id.* P 101.

[94] Exh. MTO-23 at 99.

[95] The Presiding Judge did not rely on Dr. Avera's chart because the y-axis for TECO's stock price was smaller relative to the y-axis for the industry average, which,

(continued...)

DCF inputs in any significant way, we would not expect to see TECO's stock price performing well relative to the industry average even as the prospects for the sale declined. Although it might be argued that looking at relative performance is somewhat misleading, and that TECO's stock would have performed consistently worse relative to the industry average were it not for the potential sale, there is no evidence in the record suggesting that that is the case here and our M&A screen does not require a company's exclusion from the proxy group on so speculative a basis.[96]

2. Short-term Growth Projection

a. Initial Decision

44. The Presiding Judge adopted IBES short-term growth rates published by *Yahoo! Finance* obtained on July 13, 2015 for each proxy company that was included in the proxy group of at least one participant.[97] The Presiding Judge further stated that the Commission has "long relied on IBES growth projections as evidence of the growth rates expected by the investment community" and that since the discontinuation of the IBES Monthly Data Book in 2008, it has consistently used the IBES growth rate estimates published by *Yahoo! Finance* as the source of analysts' consensus growth rates.[98]

45. Additionally, the Presiding Judge stated that he did not need to address the arguments MISO TOs made in support of use of Value Line growth rates because "one can only use one set of growth rates" and the "decision . . . based on the most recent data

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according to the Presiding Judge, caused Dr. Avera's chart to underrepresent the variation in TECO's stock price. That observation does not require us to change our conclusion, which rests in part on the fact that TECO's performed better relative to the industry average when the prospects for the sale dimmed, than when the sale appeared most likely to occur.

[96] Although there is evidence in the record that some analysts viewed TECO Coal as "a drag on shares" of TECO, Initial Decision, 153 FERC ¶ 63,027 at P 100, that evidence does not suggest that the increasingly dim prospect of eliminating that "drag" was sufficient to "distort" the DCF inputs, especially given the absence of any apparent correlation between the DCF inputs and the prospects for a successful sale of TECO Coal.

[97] Initial Decision, 153 FERC ¶ 63,027 at P 44.

[98] *Id.* P 46.

available actually dictates the use of IBES growth rates" because they were the only data presented for the DCF study period.[99]

b. Briefs on Exceptions

46. MISO TOs do not except to the Presiding Judge's use of IBES short-term growth projections in his DCF analysis of the companies included in the proxy group in this proceeding. However, they argue that the Commission should confirm that, in future proceedings as warranted by the surrounding facts and circumstances, the growth projections published by Value Line constitute an acceptable and comparable source of short-term earnings growth estimates that may be considered for use in the two-step DCF analysis.

47. MISO TOs state that MISO TOs' witness, Dr. Avera offered alternative two-step DCF studies using the IBES short-term growth estimates, as published by *Yahoo! Finance* and Value Line short-term estimates.[100] MISO TOs state that Dr. Avera's studies relied exclusively on data from the six-month period ending on January 31, 2015 (the Refund Period). All other DCF studies entered into evidence by opposing parties, whether developed for the Refund Period or the updated six-month period ending in June 2015, used IBES growth forecasts. Hence, the record contains no Value Line short-term growth estimates for the updated six-month period ending in June 2015, which the Presiding Judge used for his DCF analysis.[101] For this reason, MISO TOs state that the Presiding Judge found that his decision to evaluate the base ROE using the updated DCF study period "actually dictates use of IBES growth rates," given the record's absence of Value Line growth rates for the Update Period.[102]

48. MISO TOs request that the Commission unequivocally announce that the Initial Decision includes no merits determination regarding the appropriateness of using Value Line growth estimates in the two-step DCF methodology in public utility cases.[103] In the alternative, MISO TOs conditionally except to this aspect of the Initial Decision to ensure

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[99] *Id.* PP 48-49.

[100] MISO TOs Brief on Exceptions at 13.

[101] *Id.* at 13.

[102] *Id.* at 14 (citing Initial Decision, 153 FERC ¶ 63,027 at P 49).

[103] *Id.* at 14.

that this case is not interpreted as disqualifying comparable sources of short-term growth rates, including Value Line, in future proceedings.[104]

49. In support, MISO TOs argue that, as recently as Opinion No. 531, the Commission has stated that "there may be more than one valid source of growth rate estimates" and stated that, in applying the two-step DCF methodology, the "short-term growth estimate will be based on the five-year projections reported by IBES (or a comparable source)."[105] MISO TOs argue that a number of witnesses challenged the comparability of Value Line but that the Initial Decision did not address these arguments given that no party introduced Value Line data into the proceeding to determine the short-term growth rate for the Update Period.[106]

50. MISO TOs also argue that record evidence demonstrates the comparability of Value Line growth data as both IBES and Value Line projections are expressed on an EPS basis and neither "can be endorsed as systematically more reliable than the other."[107] Additionally, MISO TOs argue that no party disputes that Value Line's growth rate estimates: (1) have a wide financial community circulation; (2) reflect projections from reputable financial analysts that develop short-term growth rate estimates; (3) are reported to investors on a timely basis; and (4) are used by institutions and other investors. For these reasons, MISO TOs argue that Value Line's forecasts satisfy the comparability requirement articulated in Opinion No. 531.[108]

51. Furthermore, MISO TOs argue that previous applications of the DCF Formula using IBES growth estimates do not preclude the future use of Value Line growth estimates or undercut their reliability. In support of this position, MISO TOs point out that Value Line is a "trusted and reputable source for investment data" because it is a "widely-followed, independent investor service."[109] Additionally, MISO TOs argue that the record discredits any attempt to disqualify Value Line growth estimates as "not

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[104] *Id.* at 14.

[105] *Id.* at 15.

[106] *Id.* at 15-16.

[107] *Id.* at 16.

[108] *Id.* at 18 (citing Opinion No. 531 at P 102).

[109] *Id.* at 18-19.

strictly forward looking."[110] They further argue that the Value Line user guide explains that Value Line's projections are "of growth for each item for the coming 3 to 5 years" and that it is not a detriment to inform investors of Value Line's starting point for measuring the rate of change.[111]

52. MISO TOs state that opposing parties' suggest that the Commission disqualified Value Line growth data for use in the two-step DCF methodology when, in prior proceedings, the Commission rejected proposals to use estimates from different sources for different proxy companies and/or to average IBES data with Value Line growth estimates.[112] MISO TOs argue that these cases do not involve the explicit issue that MISO TOs hope to clarify here. MISO TOs also dispute the claim that the Value Line's EPS estimates are attributable to a single analyst. They point out that, in Opinion No. 531-B, the Commission stated that it would not rely on "an analyst head-count" to evaluate the relative reliability of data sources.[113]

53. MISO TOs also dispute opposing parties' attempts to show that Value Line's estimates are less current than IBES's, arguing instead that Value Line reports its estimates on a timely basis and updates them regularly.[114] MISO TOs also ask the Commission to make explicit that the EPS growth forecasts published by Value Line and IBES are presumed to be comparable, and that the source of short-term growth data to be used in any future application of the two-step DCF model will be determined on a case-by-case basis.[115]

c. Briefs Opposing Exceptions

54. Complainants, OMS/Joint Consumer Advocates, Joint Customer Intervenors, Iowa Group, and Trial Staff agree with the Presiding Judge's adopting IBES as the source of short-term growth rate data for this case. Complainants argue that the Presiding Judge's

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[110] *Id.* at 19.

[111] *Id.* at 19-20.

[112] *Id.* at 21.

[113] *Id.* at 22.

[114] *Id.* at 22-23.

[115] *Id.* at 23.

adoption of the five-year IBES growth rate presented by Mr. Gorman's analysis, as supplemented by the IBES data from Mr. Hill's DCF analysis, relies on the Commission's rationale for adopting IBES growth rate projections, as outlined in Opinion No. 531. Complainants state that the Commission has "long relied on IBES growth rate projections as evidence of the growth rates expected by the investment community."[116]

55. Complainants also disagree with MISO TOs' argument that neither IBES nor *Value Line* should be presumed more reliable than the other.[117] Complainants ask the Commission to dismiss this argument as moot because Value Line growth data was absent for the time period adopted by the Initial Decision. Similarly, Joint Customer Intervenors argue that addressing MISO TOs' exception here would have no impact on this proceeding, and would only influence what may or may not be appropriate in future scenarios with different facts and circumstances.[118]

56. In a similar vein, OMS/Joint Consumer Advocates state that what MISO TOs really seek is in the nature of a declaratory order, i.e., a Commission pronouncement applicable to unspecified future cases.[119] OMS/Joint Consumer Advocates state that the Commission's rules provide other more suitable vehicles for parties to request such broad statements of generic policy, including Rule 207(a)(2), which authorizes the filing of petitions for "[a] declaratory order . . . to . . . remove uncertainty."[120] Iowa Group also characterizes the MISO TOs' request for clarification as a collateral attack on Opinion Nos. 531 and 531-B.[121]

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[116] Complainants Brief Opposing Exceptions at 5 (citing Initial Decision, 153 FERC ¶ 63,027 at P 46).

[117] *Id*. (citing MISO TOs Brief on Exceptions at 16-18).

[118] Joint Customer Intervenors Brief Opposing Exceptions at 17-18.

[119] OMS/Joint Consumer Advocates Brief Opposing Exceptions at 14 (citing MISO TOs Brief on Exceptions at 23).

[120] *Id.* at 14 (citing 18 C.F.R. § 385.207(a)(2) (2016)).

[121] Iowa Group Brief Opposing Exceptions at 8 (citing MISO TOs Brief on Exception at 14).

57. OMS/Joint Consumer Advocates further state that MISO TOs are disingenuous in suggesting that the Presiding Judge rejected reliance on Value Line's short-term earnings growth rates only out of necessity, rather than based on a finding that the IBES growth rates were shown to be preferable on the merits. OMS/Joint Consumer Advocates contend that the latest Value Line reports for the adopted study period were in fact in the record for all relevant companies,[122] and, if it had been appropriate, the Presiding Judge would have used those reports' short term EPS growth rates as DCF inputs.[123] OMS/Joint Consumer Advocates state that the Commission should reject MISO TOs' request that the Commission declare that "the EPS growth forecasts published by Value Line and IBES, if available for all proxy companies, are presumed to be comparable."[124] OMS/Joint Consumer Advocates and Joint Customer Intervenors assert that Value Line's short-term earnings growth rates are patently not comparable to IBES growth rates, in multiple respects.[125] For example, OMS/Joint Consumer Advocates and Joint Customer Intervenors state that, unlike the IBES forecasts, the Value Line EPS forecasts "consist[] of an earnings estimate of only one analyst."[126] OMS/Joint Consumer Advocates also state that IBES short-term growth projections are based on analysts' independent evaluation of prospective growth and not inherently tied to past performance. By contrast, OMS/Joint Consumer Advocates state that Value Line forecasts start from an earnings baseline that starts more than three years in the past.[127] Trial Staff also state that the "ANNUAL RATES" section Value Line data used by MISO TOs' witness, Dr. Avera, are plainly from a past three-year period to a future three-year period.[128]

[122] OMS/Joint Consumer Advocates Brief Opposing Exceptions at 11 (citing Exh. S-6 at 9-55).

[123] *Id.*

[124] *Id.* at 15 (citing MISO TOs Brief on Exceptions at 23).

[125] Joint Customer Intervenors Brief Opposing Exceptions at 5.

[126] OMS/Joint Consumer Advocates Brief Opposing Exceptions at 15 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 72 n.145; Joint Customer Intervenors Brief Opposing Exceptions at 5 (citing Exh. JCI-4 at 21:10-14).

[127] OMS/Joint Consumer Advocates Brief Opposing Exceptions at 16 (citing Exh. JCA-11 at 10-12; Exh. JCI-4 at 19-20; Exh. S-1 at 79-82).

[128] Trial Staff Brief Opposing Exceptions at 8 (citing Tr. 622:10; Exh. S-1 at 80-81).

OMS/Joint Consumer Advocates state that, because Value Line's EPS forecasts are derived from an historical three-year baseline, those estimates will be an especially poor predictor of future EPS growth.[129] In addition, OMS/Joint Consumer Advocates state that IBES updates its consensus forecast whenever there is a change in the forecast of one of its polled analysts, whereas Value Line publishes its estimates on a fixed schedule (once every three months).[130] OMS/Joint Consumer Advocates argue that at any given point in time, the IBES consensus forecast is more likely to reflect the most up to date information.[131]

58. Additionally, OMS/Joint Consumer Advocates state that Value Line's forecasts are not consistent with the Commission's decision in Opinion No. 531 to "change the way DCF analyses are conducted in public utility cases to use *the same methodology* as the Commission uses in natural gas and oil pipeline cases."[132] OMS/Joint Consumer Advocates state that Value Line's partially retrospective growth rate is not used in pipeline cases, where the precedents specifically reject using Value Line reports to test the reasonableness of projected growth rates.[133]

59. OMS/Joint Consumer Advocates and Trial Staff oppose MISO TOs' request for a case-by-case determination of the short-term growth rate forecast data source.[134] According to OMS/Joint Consumer Advocates and Iowa Group, MISO TOs' proposal would enable litigants to select whichever source of short-term growth rate data is most advantageous for a given study period.[135] Joint Customer Intervenors go further,

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[129] OMS/Joint Consumer Advocates Brief Opposing Exceptions at 16.

[130] *Id.* (citing Exh. JCI-4 at 21:17 – 22:3).

[131] *See also* Joint Customer Intervenors Brief Opposing Exceptions at 5-6 (citing Exh. JCI-4 at 21:10-14; Opinion No. 531, 147 FERC ¶ 61,234 at P 88).

[132] OMS/Joint Consumer Advocates Brief Opposing Exceptions at 17 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 32 (emphasis supplied)).

[133] *Id.*

[134] *Id.* at 18 (citing Initial Decision, 153 FERC ¶ 63,027 at P 48); Trial Staff Brief Opposing Exceptions at 43-44.

[135] OMS/Joint Consumer Advocates Brief Opposing Exceptions at 19 (citation

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arguing that MISO TOs chose the Value Line growth rates because they were the most advantageous source of short-term growth rates.[136]

60. In addition, OMS/Joint Consumer Advocates state that, if the Commission grants the relief that MISO TOs request, the Commission should put some boundaries around the data source debate in the future.[137] Specifically, OMS/Joint Consumer Advocates state that the Commission should provide guidance as to how it will apply the new rules in future cases.[138] Joint Customer Intervenors also argue that, while MISO TOs portray IBES as just one among many potential sources of growth rate estimates, it is only appropriate to use a comparable source of short-term growth estimates where IBES growth rate estimates are not available.[139] Iowa Group offers that in Opinion No. 531 the Commission applied exactly the same two-step DCF model that it has used for twenty years to set returns on equity for gas and oil pipelines to electric transmission utilities. Iowa Group explains that in doing so, the Commission relied on oil and gas pipeline precedent that established its preference for IBES short-term growth rates.[140]

61. Trial Staff states that it is not the Initial Decision that states IBES estimates are "preferable" – it is the Commission's statements and actions over many years that indicate that preference.[141] Trial State further contends that the Commission has never for any purpose used the particular data from the "ANNUAL RATES" section of the Value Line company reports, which are the basis of Dr. Avera's earnings growth input.[142]

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omitted); Iowa Group Brief Opposing Exceptions at 11; *see also* Joint Customer Intervenors Brief Opposing Exceptions at 7.

[136] *Id.* at 7-8.

[137] Joint Customer Intervenors also express concern about the lack of boundaries here by pointing out that MISO TOs propose no criteria for judging whether a particular source is comparable. *Id.* at 7.

[138] OMS/Joint Consumer Advocates Brief Opposing Exceptions at 20.

[139] Joint Customer Intervenors Brief Opposing Exceptions at 7.

[140] Iowa Group Brief Opposing Exceptions at 8-9.

[141] Trial Staff Brief Opposing Exceptions at 6.

[142] *Id.* at 8 citing Tr. 621:20-622:2.

d. Commission Determination

62. We reject MISO TOs' request for clarification that the growth projections published by Value Line constitute an acceptable and comparable source of short-term earnings growth estimates that may be considered for use in the two-step DCF analysis. In Opinion No. 531, the Commission held that "in future public utility cases, the Commission will adopt the same two-step DCF methodology it uses in natural gas and oil pipeline cases."[143] While the Commission has refrained from mandating the exclusive use of IBES data in its natural gas and oil pipeline rate of return cases, the Commission has stated that "IBES data is the preferred data source for computing the short-term growth rate."[144] The Commission has explained that the "IBES data is a compilation of projected growth rates from various knowledgeable financial advisors within the investment community."[145] As such, the IBES short-term growth estimates generally represent consensus growth rate estimates by a number of analysts. By contrast, the Commission has rejected the use of Value Line growth estimates in gas pipeline ROE cases, because they are the estimates of a single analyst and thus do not constitute such consensus estimates.[146]

63. MISO TOs suggest that, despite the Commission's refusal to use Value Line short-term growth estimates in natural gas and oil pipeline ROE cases, the Commission intended in Opinion No. 531 to permit the use of Value Line estimates in public utility ROE cases. They rely heavily on the Commission's statement in Opinion No. 531 that

[143] Opinion No. 531, 147 FERC ¶ 61,234 at P 39.

[144] *Nw. Pipeline Corp.*, 92 FERC ¶ 61,287, at 62,002 (2000). *See also Nw. Pipeline, Corp.*, 79 FERC ¶ 61,309, at 62,385 (1997) (finding that "[t]he IBES figures should be used for the short-run growth rate of reach of the proxy companies.").

[145] *See, e.g.*, *Northwest Pipeline Corp.*, 87 FERC ¶ 61,266, at 62,058-62,059 (1999); *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260, at P 234 (2002).

[146] *Northwest Pipeline Corp.*, 87 FERC at 62,058-62,059; and *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260 at P 234. *See* Opinion No. 531-B, 150 FERC ¶ 61,165 at n.145, stating that the Value Line data "for any company consists of an earnings estimate from only one analyst, rather than consensus estimates."

the "short-term growth estimate will be based on the projections reported by IBES (or comparable source)."[147] Opinion No. 531 provided a more extensive discussion of short-term growth rates after the general statement relied on by the MISO TOs. There, the Commission stated that the "growth rates used in the DCF model should be the growth rates expected by the market" and that the Commission "has long relied on IBES growth projections as evidence of the growth rates expected by the investment community."[148] The Commission also addressed a proposal by Trial Staff to use Reuters Estimates Database (RED) growth projections published by *reuters.com* for those companies in the proxy group for which the IBES growth projection only reflected the view of one analyst.[149] Trial Staff argued the RED growth projections should be used because they were consensus estimates reflecting the views of more than one analyst. The Commission, however, rejected this proposal because Trial Staff had not provided RED growth projections for all the companies in the proxy group, while IBES data for all the proxy companies was available in the record.[150] While the Commission stated that it is willing to allow the substitution of "comparable data," the Commission explained that "an alternative source of growth rate data should only be used when that source can be used for the growth projections of all of the proxy group companies" because using different sources could "produce skewed results, because those sources may take different approaches to calculating growth rates."[151] For this reason, the Commission emphasized that it has "consistently used a single investor service such as IBES for the investment analysts' growth rate estimates."[152]

64. Thus, consistent with the discussion in Opinion No. 531, the Commission is willing to use short-term growth data published by a source comparable to IBES. However, because the Commission requires the use of analysts' consensus growth rates

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[147] Opinion No. 531, 147 FERC ¶ 61,234 at P 39.

[148] *Id.* PP 89-90.

[149] *Id.* P 90.

[150] *Id.*

[151] *Id.* (citing to *ISO New England, Inc.*, 109 FERC ¶ 61,147, at P 205 (2004) (finding that a presiding judge is not precluded from finding candidates for inclusion in the proxy group for which comparable data can reasonably be substituted for the growth rate data reported by IBES or Value Line)).

[152] *Id.*

as the short-term growth rate input in the DCF methodology, only data sources that publish analysts' consensus growth rate estimates, such as the RED growth forecasts at issue in Opinion No. 531, can be considered comparable to IBES.[153] Value Line does not publish such consensus growth rate estimates. We believe that investors, particularly larger institutional investors such as mutual funds and pension funds, are far more likely to rely upon published consensus estimates than they are to rely on Value Line. In addition, published consensus estimates sourced from investment analysts, e.g., IBES's growth rate estimates, are updated on a rolling basis, sometimes as frequently as daily, and are therefore superior to Value Line's growth rate estimates, which are updated only on a lagging, quarterly basis.[154] We therefore decline to grant MISO TOs' request that we presume that the short-term growth forecasts published by Value Line and IBES to be comparable.

65. Accordingly, we affirm the Presiding Judge's holdings concerning the proxy group and the DCF analysis of each proxy company. We therefore affirm the Presiding Judge's finding that the zone of reasonableness for establishing MISO TOs' ROE is from 7.23 percent to 11.35 percent. We now turn to the issue of where within that range to set the MISO TOs' ROE.

C. Placement of the Base ROE within the Zone of Reasonableness

66. The Commission has typically set the base ROE in RTO/ISO cases at the midpoint of the zone of reasonableness.[155] However, in Opinion No. 531, the Commission found that, because of the presence of anomalous capital market conditions in that case, the central tendency of the zone of reasonableness produced by a mechanical application of the DCF methodology would not satisfy the requirements of *Hope*[156] and *Bluefield*.[157]

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[153] *See, e.g.*, *id.* P 89.

[154] While we find that Value Line's *growth rate estimates* are not acceptable as the short-term consensus growth rate input for the two-step DCF model, we 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.

[155] *See S. Cal. Edison Co.*, 131 FERC ¶ 61,020 at P 91, remanded on other grounds sub nom. *S. Cal. Edison Co. v. FERC*, 717 F.3d 177 (2013).

[156] *Hope*, 320 U.S. 591.

[157] *Bluefield*, 262 U.S. at 693.

Opinion No. 531 corroborated that finding by reference to several alternative methodologies for determining the cost of equity. The Commission accordingly concluded that the just and reasonable ROE in that case should be set at the midpoint of the upper half of the zone of reasonableness.

67. Below, we first consider whether the Presiding Judge correctly held that there are anomalous capital market conditions in this case that would justify setting MISO TOs' ROE above the midpoint produced by a mechanical application of the DCF analysis. Because we affirm the Presiding Judge's conclusion that there were anomalous market conditions, we proceed to consider whether the relevant alternative methodologies corroborate that the mechanical application of the DCF analysis does not result in an ROE consistent with *Hope* and *Bluefield*. Based on the record in this case, including the presence of unusual capital market conditions, we conclude that the just and reasonable base ROE for MISO TOs should be set at the midpoint of the upper half of the zone of reasonableness.[158] Based on the DCF study adopted by the Presiding Judge, we affirm the Presiding Judge's finding that the just and reasonable base ROE for MISO TOs is 10.32 percent.

1. Anomalous Market Conditions

a. Initial Decision

68. The Presiding Judge determined that it is MISO TOs' burden to show that anomalous capital market conditions justify selecting an ROE above the midpoint of the zone of reasonableness.[159] The Presiding Judge explained that this showing required evidence that (1) anomalous conditions make it difficult to determine whether an ROE set at the midpoint of the zone of reasonableness reflects the risks facing MISO TOs and (2) other points of comparison, including credible alternative valuation models and the ROEs allowed by state public utility commissions support an ROE above the midpoint of the zone.

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[158] We calculate the midpoint of the upper half of the zone as follows: (1) calculate the midpoint of the full zone of reasonableness; (2) define the upper half of the zone of reasonableness as the range of cost of equity estimates that are bounded, on the low end, by the midpoint of the full zone of reasonableness and, on the high end, by the highest cost of equity result among the proxy group companies; and (3) calculate the midpoint of the cost of equity results in that upper range, inclusive of the endpoints.

[159] Initial Decision, 153 FERC ¶ 63,027 at P 120.

69. The Presiding Judge determined that anomalous market conditions existed during the study period and that these conditions complicated the task of assessing whether an ROE at the midpoint of the zone of reasonableness accurately reflected the risks facing MISO TOs.[160] The Presiding Judge determined that the Federal Reserve's "unprecedented" purchases of debt securities were the primary factor driving the reduction in short-term interest rates and, as a result, causing a reduction in the dividend yields of public utility stocks. The Presiding Judge concluded that these circumstances are unique and, in all likelihood, unsustainable and temporary because they depend on the Federal Reserve's actions to depress interest rates. The Presiding Judge also found that investors expected the Federal Reserve to allow interest rates to "normalize."[161]

70. The Presiding Judge concluded that these conditions—and the depressed interest rates in particular—had rendered the DCF model less reliable. The Presiding Judge explained that the DCF model assumes that, under normal conditions, an investor will evaluate a stock by considering the anticipated flow of future dividends, discounted for risk, that would accrue to owners of that stock.[162] However, the Presiding Judge concluded that, during the study period, investors were not abiding by the DCF model's assumptions. Instead, the Presiding Judge determined that the Federal Reserve's actions had reduced the returns on debt securities to a level that investors "find unacceptable," causing them to move their money into other classes of assets, including electric-utility stocks.[163]

71. The Presiding Judge concluded that these investors were basing their purchasing decisions "solely [on] the current yields of those stocks" and not on the present value of future dividends, as the DCF model assumes. The Presiding Judge further concluded that investors were making these decisions notwithstanding their belief that the expected rise in interest rates would inevitably cause these stocks to decline in value. The Presiding Judge further concluded that these "hot money," short-term investors would, therefore, liquidate their positions in these stocks once they "sense" that the Federal Reserve has begun to allow conditions to normalize, causing a significant decline in their price.[164] As

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[160] *Id.* P 219.

[161] *Id.* P 224.

[162] *Id.* P 226.

[163] *Id.* P 227.

[164] *Id.* PP 192, 228.

a result, the Presiding Judge concluded that, during the study period, the interest of hot money investors had caused electric-utility stock prices to become inflated to a level that did "not reflect the risks that investment in these securities entails."

72. As a result of these findings, the Presiding Judge determined that the MISO TOs met their burden to show that "the evidence calls into question the reliability of the DCF analysis in this proceeding" and, by extension, whether the midpoint of the zone of reasonableness is the just and reasonable ROE for MISO TOs. Accordingly, the Presiding Judge determined that Opinion No. 531 required the consideration of alternative valuation methods and the ROEs recently authorized by state public utility commissions.[165]

b. Briefs on Exceptions

73. Complainants argue that the Presiding Judge erred in finding that anomalous market conditions existed during the relevant study period. Complainants state that Opinion No. 531 does not articulate a standard for identifying "anomalous market conditions" and that the record in this proceeding also lacks such a standard. Complainants note that the Presiding Judge, even absent evidence, extrapolates this to mean "unprecedented" and "unsustainable." Complainants contend that the Presiding Judge is unable to meet his own "unprecedented" standard because the actions of the Federal Reserve were known to investors prior to the study period.[166]

74. Complainants contend that the record does not demonstrate that current market conditions impacted DCF inputs, focusing on the impact of Federal Reserve actions on investor behavior. Complainants state that the Presiding Judge implies that the Federal Reserve's actions are not reflected in financial market data, a theory which conflicts with the DCF analysis' assumption of efficient market theory.[167] Complainants argue that there is no basis to dispute that the Federal Reserve's policies are relevant information that is known to investors. Rather, current market conditions are already reflected in the DCF and have no impact on MISO TOs' capital attraction capabilities.[168]

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[165] *Id.* PP 229-230.

[166] Complainants Brief on Exceptions at 28-29.

[167] *Id.* at 30 (citing Initial Decision, 153 FERC ¶ 63,027 at P 225).

[168] *Id.* at 31; *see also* Trial Staff Brief on Exceptions at 33 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 201-205).

75. Complainants contend that the Presiding Judge interprets *Hope* and *Bluefield's* capital attraction standard as applying only to long-term investors, an interpretation that is both unsubstantiated and without legal precedent.[169] Complainants also argue that the evidence in this proceeding demonstrates that such a distinction is unnecessary because the DCF model accounts for both long- and short-term investors.[170] According to Complainants, even if short-term investors do not purchase and hold, the sale price of the shares they sell remains based on the long-term cash flow expectations of that security.

76. Complainants argue that the record does not demonstrate that current market conditions negatively impacted MISO TOs' ability to attract capital. The Federal Reserve's policies, Complainants contend, have not resulted in increases to the current low capital cost environment.[171] Complainants assert that, given the indications by the Federal Reserve of gradual systematic change, no significant impact on capital markets is expected, as shown in an August 2015 *Bloomberg Businessweek* article.[172] Complainants argue that there is no immediate impetus for the Federal Reserve to modify or terminate its monetary policy such that the impact of Quantitative Easing will remain in effect for the foreseeable future.[173] Consequently, MISO TOs will continue to have access to low-cost capital for the foreseeable future. Complainants also contend that the record, including statements by the Federal Reserve, undermines the Presiding Judge's finding that investors expect significant interest rate increases in the future.[174] Complainants also cite financial publications showing that investors expect interest rates to rise only gradually.[175]

77. Complainants contend that rather than relying on assertions about the actions of "hot money," the ROE should be based on the two-stage DCF analysis, without

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[169] Complainants Brief on Exceptions at 31-32 (citing Initial Decision, 153 FERC ¶ 63,027 at P 207).

[170] *Id.* at 32-33 (citing Exh. JCA-11 at 25).

[171] *Id.* at 33 (citing Exh. JC-9 at 7).

[172] *Id.* at 33-34 (citing Exh. OMS-23 at 1).

[173] *Id.* at 34 (citing Exh. JC-9 at 34).

[174] *Id.* at 35 (citing Exh. S-15 at 10).

[175] *Id.* at 36 (citing Exh. OMS-22 at 2).

adjustments for anomalous market conditions. Complainants state that if capital market costs increase in the future such that MISO TOs' base ROE is insufficient, they may propose adjustments under section 205 of the FPA.

78. Trial Staff asserts that, while long-term interest rates are indeed low when compared to those prevailing in the recent past, they are not anomalously low when properly viewed in a longer historical context.[176] According to Trial Staff, Mr. Keyton noted that interest rates are subject to long-term cycles that can last for decades.[177] Trial Staff asserts that interest rates on 10-year U.S. Treasury bonds were under three percent during 1953, 1954 and 1955 and generally increased for almost 30 years, reaching a peak of 13.92 percent in 1981 and then receded to a level below three percent again in 2011, where they remain today.[178] Trial Staff further states that interest rates on *Moody's* Baa bonds reached a peak of 9.38 percent during the Great Depression in 1933 and generally fell for a period of 13 years, reaching a low of 3.03 percent in 1946.[179] Then, according to Trial Staff, similar to the pattern found with Treasury debt, interest rates on *Moody's* Baa bonds increased in a secular manner until reaching a peak of 16.60 percent in 1981, and subsequently began a long and steady decline, falling below five percent in 2012, where they have remained ever since.[180] Trial Staff argues that, when viewed in the context of a historical period that is long enough to capture the entirety of an interest rate cycle, a view not available to the Commission in the Opinion No. 531 proceeding, the interest rates on long-term bonds during the DCF study periods in this proceeding are neither unusual nor demonstrably anomalous.

79. Trial Staff asserts that the Presiding Judge erred in relying on Paragraph 50 of Opinion No. 531-B[181] to reject Trial Staff's argument that, if MISO TOs' cost of equity increases in the future and long-term investors in utility stocks begin to perceive more favorable risk-adjusted investment alternatives, MISO TOs are free to file for a return that will allow them to retain the confidence of investors willing to commit funds to

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[176] Trial Staff Brief on Exceptions at 20.

[177] *Id.* at 20 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 123-141; 222).

[178] *Id.* at 20-21 (citing Exh. S-2, Schedule No. 1).

[179] *Id.* (citing Exh. S-2, Schedule No. 2).

[180] *Id.* at 21.

[181] *Id.* at 40 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 204-205).

ensure their creditworthiness and long-term financial integrity. Although Paragraph 50 assumes that the DCF inputs have been distorted by economic abnormalities, Trial Staff states that, in this instance, the only DCF input at issue, current dividend yield, has fallen in line with declining interest rates as a result of market forces, consistent with an economic relationship that has been long accepted by the Commission. Trial Staff explains that the decline in interest rates, to a greater or lesser extent driven by policies of the Federal Reserve, as well as other market forces, has resulted in a decline in dividend yield and in the cost of equity capital. Trial Staff further explains that the current level of dividend yield on utility stocks simply reflects the decline in the cost of equity, rather than some amorphous and unexplained distortion in measuring it. Trial Staff concludes that, given the absence of credible evidence that either of the DCF inputs, current dividend yield or earnings growth has been distorted by purportedly anomalous capital market conditions, placement of MISO TOs' base ROE at the midpoint of the DCF zone of reasonableness automatically ensures that the capital attraction standards of *Hope* and *Bluefield* will be met.[182]

80. Trial Staff avers that while the Federal Reserve's Quantitative Easing programs undoubtedly helped the Treasury Department finance the large federal deficits following the 2008 financial crisis and necessarily had some impact on lowering yields on Treasury debt,[183] other actors in the financial community besides the Federal Reserve, both public and private, were acquiring Treasury debt at historically low yields. Trial Staff asserts that after the Federal Reserve's third round of Quantitative Easing program ended in October 2014, the market interest rate on long-term Treasury debt continued to decline.[184] Trial Staff asserts that this fact implies that the participation of private investors contributed meaningfully to interest rates on Treasury debt, and that resulting rates were less the result of Federal Reserve intervention than the product of private capital market activity responding to prevailing market conditions.[185]

81. Trial Staff notes that, on several occasions in his Initial Decision, the Presiding Judge dismissed assertions concerning other structural reasons for the low interest rates during the DCF study period and appeared to adopt the MISO TOs' position that

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[182] *Id.* at 41.

[183] *Id.* at 25 (citing Exh. S-1 at 107:20-108:10).

[184] *Id.* (citing Exh. S-7).

[185] *Id.* at 25-26.

intervention by the Federal Reserve was the sole or central cause.[186] For example, Trial Staff states that the Presiding Judge rejected arguments by Trial Staff and other participants that the current level of long-term interest rates and their potential future trajectory is due in part to investors' expectations concerning future inflation.[187] Furthermore, Trial Staff contends that the Initial Decision presents a distorted analysis of the array of relevant economic forces impacting the capital markets during the DCF study period.

82. Trial Staff states that, while the Presiding Judge acknowledges present circumstances, he does not concede that low interest rates, low dividend yields, and high equity prices reflect low equity costs.[188] Trial Staff asserts that this is conceptually incorrect and contrary to the Commission's accepted position and may have led the Presiding Judge to make subsequent findings that are also inconsistent with the factual record and accepted economic logic.

83. Trial Staff asserts that the record lacks evidence that long-term investors in utility stocks, with at least a partial focus on the anticipated return offered by a potentially increasing stream of future dividend payouts, are deserting utility stocks. Trial Staff states that the Presiding Judge's speculation that the "Total Returns"[189] provided by an investment in utility stocks may currently be unsatisfactory to long-term investors whose participation is necessary to maintain their financial integrity and creditworthiness[190] is contradicted by long-term investors' continued investment in those stocks. Trial Staff states that, while investment by "hot money" investors in utility stocks may have contributed to an increase in utility stock prices and reduced total returns provided by them by reducing current dividend yield, this merely reflects a decline in the overall market cost of debt and equity capital in an efficient market.

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[186] *Id.* at 27 (citing, *e.g.*, Initial Decision, 153 FERC ¶ 63,027 at PP 170-180, 221-223).

[187] *Id.* at 27 (citing, *e.g.*, Initial Decision, 153 FERC ¶ 63,027 at PP 169, 189 n.249).

[188] *Id.* at 34 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 137, 215, 216).

[189] *Id.* at 37.

[190] *Id.* at 37-38 (citing Initial Decision, 153 FERC ¶ 63,027 at P 218).

84. Trial Staff further argues that the Presiding Judge accepted MISO TOs' position that interest rates are likely to rise significantly in the future while virtually ignoring other evidence that this is unlikely to happen. Trial Staff points to the fact that Dr. Avera proffers a claim almost identical to that which he has been making since his testimony in the Opinion No. 531 proceeding,[191] that the existence of "widespread expectations in the investment community are for interest rates to rise significantly as the Federal Reserve moves to normalize its monetary policies and the economy moves toward a more normal pattern of growth."[192] Trial Staff counters that interest rates have gone down rather than up since that time, as shown in Exhibit No. S-7.[193] Finally, Trial Staff offers the example that, while the Presiding Judge gave decisional weight to predictions of increases in interest rates by sources cited by Dr. Avera, he dismissed the views of other observers on this same issue.[194] According to Trial Staff, under these circumstances, there is no basis to refer to alternative methodologies to inform placement of MISO TOs' cost of equity within the DCF zone.

85. Iowa Group states that MISO TOs failed to sustain their burden of proving that alleged anomalous market conditions had skewed the DCF inputs.[195] Iowa Group argues that the Presiding Judge erred by reinterpreting *Hope* and *Bluefield* to classify investors on the basis of their investment intent or motivation. Iowa Group asserts that Ms. Lapson did not quantify any impact that "hot money" investors might have on the price or prices of any particular proxy group, observing that the retreat of "hot money" would drive proxy group prices down and dividend yields up.[196]

86. Iowa Group also asserts that the evidentiary record does not establish that a utility's financial stability and growth is irrelevant (or of far less interest) to short-term investors. It further states that *Hope* and *Bluefield* require that a utility's ROE be: (1) fair to *all* shareholders, regardless of the weight a shareholder places on the growth or yield of a particular stock; and (2) fair to consumers as well, meaning protecting them

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[191] *Id.* at 30 (citing Exh. NET-300 at 12-14; Tr. 616:17-618:11).

[192] *Id.* at 30 (citing Exh. MTO-23 at 103:15-17).

[193] *Id.* at 30.

[194] *Id.* at 30-31 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 189, 223).

[195] Iowa Group Brief on Exceptions at 11.

[196] *Id.* at 13 (citing Initial Decision, 153 FERC ¶ 63,027 at P 210).

from exorbitant rates[197] or as Congress opined when it enacted the FPA, from deficient markets.[198] Iowa Group states that if the Presiding Judge's classification of shareholders is correct, the possibility of overcompensating investors rises significantly.

87. Iowa Group argues that the Presiding Judge also erred in finding that (1) short-term investors are supporting the proxy group utilities' stock prices, inflating share values and depressing dividend yields, and that this "fact" provides "no assurances that these utilities' Total Returns are sufficient to satisfy the requirements of the long-term investor,"[199] as well as (2) low interest rates set by the Federal Reserve Bank had distorted DCF calculations by driving down the yields of Baa Bonds and thereby skewing the 100-basis point screen.[200]

88. Additionally, Iowa Group states that the Presiding Judge excluded Edison International, FirstEnergy, and Entergy from the proxy group because their estimated ROEs (4.38 percent, 5.01 percent, and 5.36 percent, respectfully) either fell below the average Baa Bond yield (4.65 percent) or exceeded it by less than 100 basis-points. Iowa Group asserts that if, as the Presiding Judge found, short-term investors purchase utility shares only to obtain their dividend yield, it follows that such investors would purchase FirstEnergy shares because the higher adjusted dividend yield they would receive from such purchases (3.99 percent) would equal, or exceed, the yield they would receive from two of the 39 proxy group companies. Iowa Group further asserts that the same would be true for Entergy, which, according to Appendix A, has an adjusted dividend yield of 4.23 percent. Iowa Group offers that if the Presiding Judge is correct, then short-term investors would be purchasing Entergy shares since that yield exceeds the yields they would earn on the shares of 29 out of the 37 final proxy group companies.[201]

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[197] *Id.* at 15 (citing *American Pub. Power Assoc. v FPC*, 522 F. 2d 142, 147 (D.C. Cir. 1975) (Bazelon, J. concurring) and *Washington Gas Light Co. v. Baker*, 188 F. 2d 11, 15 (D.C. Cir. 1950) (referencing U. S. Supreme Court cases dating back to 1890)).

[198] *Id.* at 15 (citing *Morgan Stanley Capital Group, Inc. v. Pub. Util. District No. 1*, 554 U.S. 527, 564 (2008) (Ginsburg, J. concurring)).

[199] *Id.* at 15-16 (citing Initial Decision, 153 FERC ¶ 63,027 at P 210).

[200] *Id.* at 18-19 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 155-157).

[201] *Id.* at 17.

89. Iowa Group argues that this evidence indicates that either the Presiding Judge is correct in finding all estimated ROEs below 5.65 percent (to use Dr. Avera's word) illogical and FirstEnergy and Entergy must be excluded from the final proxy group *or* it is correct in finding that short-term investors are purchasing equity only for dividend yield and FirstEnergy and Entergy should be included in the final proxy group. Iowa Group states that these findings are mutually exclusive.

90. Iowa Group states that the Presiding Judge erred when it found that low interest rates set by the Federal Reserve distorted DCF calculations by driving down the yields of Baa Bonds and thereby skewing the 100-basis point screen.[202] Iowa Group argues that the 257 basis point fluctuation in average Baa bond yields over the six and a half years after 2008 that the Presiding Judge highlighted in the Initial Decision does not prove that the DCF's low-end outlier screen was distorted.[203] In fact, Iowa Group points out that the magnitude of this fluctuation pales in comparison to other six-year periods shown on the same exhibit.[204] Iowa Group avers that the fact that a small variance in Baa bond yields coincided with Federal Reserve Bank's implementation of an economic stabilization and stimulus policy is hardly the foundation for finding a distortion in DCF calculations. Moreover, Iowa Group states that even if the "low-end outlier" screen were increased to its 2008 level of 8.22 percent and applied to the DCF results shown in the Initial Decision's Appendix B, the resulting Base ROE would be lower than that set by the Initial Decision. Iowa Group also states that this screen produces a zone of reasonableness that extends from an estimated return of 8.32 percent for SCANA Corporation to the 11.35 percent estimated return for TECO. Iowa Group asserts that, having corrected the effect of the alleged anomalous market conditions on the DCF inputs by raising the bottom of the zone, MISO TOs' new base ROE would not exceed the midpoint, which is 9.835 percent.[205]

91. Iowa Group asserts that the Commission has adjusted a base ROE up or down from the midpoint when there is substantial evidence to do so.[206] Iowa Group states

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[202] *Id.* at 18-19 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 155-157).

[203] *Id.* at 19 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 157).

[204] *Id.* (citing Exh. S-5 at 2).

[205] *Id.* at 19-20.

[206] *Id.* at 20-21 (citing *S. Cal. Edison Co.*, 92 FERC ¶ 61,070, at 61,266 (2000); *Consumers Energy Co.*, 85 FERC ¶ 61,100, at 61,363-61,364 (1998). Iowa Group explains that both of these cases involved adjusting the utility's ROE above the DCF

(continued...)

that, given the lack of evidence to adjust a base ROE here, three options are available: (1) acknowledge the absence of evidence and set the base ROE at the midpoint; (2) re-open the record to allow the parties to submit proof as the extent of the effect; or, (3) consider Opinion No. 531's placement of the base ROE to be a default placement unless the record supports another quantification method. Iowa Group states that the Presiding Judge chose the last option, which constitutes clear error.[207] Iowa Group asserts that under the Administrative Procedure Act, the Presiding Judge was required to "articulate a rational connection between the facts found and the choices made."[208] Iowa Group further asserts that the Presiding Judge's punting of the quantification issue by defaulting to Opinion No. 531's Base ROE placement does not establish such a connection.

92. Iowa Group asserts that the Presiding Judge's utilization of a default quantification is particularly inappropriate in this case because it assumes, without proof, that the alleged anomalous market conditions affected the DCF inputs for each of the proxy companies to exactly the same extent. Iowa states that the Commission's practice of setting RTO-wide Base ROEs at the DCF midpoint rests on the assumption (upheld by the courts) that when setting the Base ROE for a diverse set of transmission companies, the midpoint of the proxy group's DCF zone of reasonableness is reasonably representative of the range of risks experienced by the RTO members. Iowa further explains that in other words, the midpoint, by taking into account the highest and lowest results, assures that the Base ROE accurately reflects the risk experienced by companies analogous to the RTO members.[209] Iowa Group states that there is no such assurance in this case. In fact, Iowa Group avers that there is no evidence in this case as to whether the Presiding Judge's 103 basis point upward adjustment is reasonably representative of the effect of the economic anomalies on MISO TOs' Base ROE. Iowa Group concludes

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midpoint because, based upon the record evidence, the Commission found that the utility's risk profile differed from that of the proxy group. In the case at hand, MISO TOs did not present any evidence to support a finding that they were riskier than the ID's proxy group. Iowa Group Brief on Exceptions at n.60.

[207] *Id.* at 21.

[208] *Id.* at 22 (citing *Pub. Serv. Comm'n v. Fed. Energy Reg. Comm'n*, 397 F.3d 1004, 1008 (D.C. Cir. 2005)).

[209] *Id.* (citing *S. Cal. Edison v. Fed. Energy Reg. Comm'n*, 717 F.3d 177, 183 (D.C. Cir. 2013); *City of Charlottesville v. Fed. Energy Reg. Comm'n*, 661 F.2d 945, 950-51 (D.C. Cir. 1981)).

that without such evidence, the Presiding Judge's placement of the Base ROE at the midpoint of the zone of reasonableness's upper quartile does not constitute reasoned decision-making.[210]

93. Iowa Group asserts that the Presiding Judge's upward adjustment of the DCF zone of reasonableness's midpoint constitutes nothing more than an adjustment to normalize the DCF results so that they reflect the results that would be produced under "normal" financial market conditions. However, according to Iowa Group, the Commission has held that it does not make such adjustments as evidenced by its findings in *Portland Natural Gas Transmission System*.[211] Iowa Group states that the Commission instead explicitly rejected the argument that DCF data from the immediately preceding time period would be more appropriate and found that the cost of capital for the pipeline was representative of the time period in issue, measured by the DCF methodology without special consideration to the underlying turmoil in the financial markets. Iowa Group further states that when the same pipeline underwent another rate review in an immediately subsequent time period, the DCF results reflected those changes.[212] Iowa Group asserts that it is therefore not impermissible or problematic for the Commission to measure the cost of capital on the basis of prevailing capital markets, whether they be favorable or unfavorable to equity investors on the one hand, or consumers on the other. Iowa Group avers that the Commission should not make a practice of "normalizing" Base ROE allowances to take account of unusual or idiosyncratic conditions in the financial markets, especially here, where, as Ms. Lapson testified, the process of normalizing markets could last up to 30 years and the exact extent of alleged anomalies on the DCF model's inputs for the proxy companies is completely unknown.[213]

94. Iowa Group asserts that the expansive character of the generalizations relied upon in the Initial Decision to justify its upward adjustment of the DCF zone of reasonableness's midpoint, combined with their amorphous evidentiary connections to

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[210] *Id.* at 22.

[211] *Id.* at 23-24 (citing *Portland Nat. Gas Transmission System*, Opinion No. 510-A, 142 FERC ¶ 61,198, at PP 219-220 (2013), *aff'g in relevant part*, Opinion No. 510, 134 FERC ¶ 61,129 (2011)).

[212] *Id.* at 24 (citing *see* Opinion No. 510, 134 FERC ¶ 61,129 at P 225; *Portland Nat. Gas Transmission System*, Opinion No. 524, 142 FERC ¶ 61,197, at PP 6, 290, and 323 (2013)).

[213] *Id.* at 24.

the DCF inputs and the lack of data quantifying the extent of the alleged economic anomalies impacts on those inputs, provide fertile ground for future claims for similar adjustments. Iowa Group argues that avoiding this result requires the Commission to reject the Presiding Judge's upward adjustment of the Base ROE on the ground that it does not withstand the rigorous scrutiny emphasized by Commissioner Honorable in Opinion No. 531-B.[214]

95. Joint Customer Intervenors assert that the current capital market conditions are neither "unprecedented" nor "unsustainable," and do not deviate from what is normal, but are instead evidence of a new and consistent normal.[215] Joint Customer Intervenors state that the capital market conditions cited in Opinion No. 531 have lasted at minimum four years and therefore have been shown to be sustainable. Joint Customer Intervenors refer to Mr. Solomon's analysis, which demonstrates that "[t]he consistency and persistence of the levels of capital costs over that . . . period demonstrate that current bond yields cannot be considered aberrational, but rather reflect a new and consistent normal."[216] Joint Customer Intervenors state that the current bond yields appear to be "part of a long-term decline in yields that began in the early 1980s."[217] Joint Customer Intervenors assert that former Federal Reserve Board Chairman, Dr. Benjamin Bernanke, has stated that "[l]ow interest rates are not a short-term aberration, but part of a long-term trend" and that "ten-year government bond yields in the United States were relatively low in the 1960s, rose to a peak above 15 percent in 1981, and have been declining ever since."[218]

96. Joint Customer Intervenors contend that the Presiding Judge's focus on the actions of the Federal Reserve, rather than on the actual market conditions such as the relatively low level of interest rates and inflation, appears to have contributed to the determination that anomalous market conditions existed.[219] Joint Customer Intervenors state that

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[214] *Id.* at 24-25.

[215] Joint Customer Intervenors Brief on Exceptions at 17-18 (citing Exh. JCI-1 at 27:16-19).

[216] *Id.* at 18 (citing Exh. JCI-1 at 27:16-19).

[217] *Id.* at 19 (citing Exh. JCI-4 at 27:5-7).

[218] *Id.* at 20-21 (citing Exh. JCI-6 at 1).

[219] *Id.* at 23.

the Federal Reserve acted to stimulate the economy after the Great Recession, which Joint Customer Intervenors argue would tend to increase economic activity, inflation, and the opportunity cost of capital.[220] Joint Customer Intervenors assert that the Presiding Judge's reliance on the actions of the Federal Reserve as the cause of the alleged anomalous market conditions is unfounded because, without the actions of the Federal Reserve, inflation and the cost of capital could have been lower.[221]

97. According to Joint Customer Intervenors, Mr. Solomon demonstrated that, despite MISO TOs' claim that Federal Reserve bond purchases had made bond investments unavailable to investors interested primarily in yield, federal debt as a percentage of annual GDP has doubled since 2008.[222] Joint Customer Intervenors state that the Presiding Judge dismissed Mr. Solomon's exhibit because the questions raised therein were highly technical and there was a lack of expert testimony.

98. Joint Customer Intervenors also state that the Presiding Judge erred by holding that *Hope* and *Bluefield* require the Commission to distinguish between short- or long-term investors, and by finding that the evidence demonstrates that MISO TOs are only attracting short-term investors.[223] According to Joint Customer Intervenors, the Presiding Judge determined that an ROE can be considered too low if the capital made available to the company comes from the wrong type of investors. Joint Customer Intervenors assert, however, that a short-term investor selling its stock has to accept a price based on the expected long-term cash flow to be derived from the stock.[224]

99. Joint Customer Intervenors also point out that "[r]ates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid."[225] Joint Customer Intervenors state that the Initial Decision appeared to take a

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[220] *Id.* at 24 (citing Exh. JCA-1 at 6:9-15, 7:10-12; Exh. JCA-11 at 24:10-12.).

[221] *Id.* at 24.

[222] *Id.* at 25 (citing Exh. JCI-7).

[223] *Id.* at 26.

[224] *Id.* at 27 (citing *Williston Basin Interstate Pipeline Co.*, 81 FERC ¶ 61,033, at P 61,175 (1997) (*Williston Basin*) ("even a short-term investor would be concerned about long-term growth . . . .")).

[225] *Id.* at 27 (citing *Hope*, 320 U.S. 605).

different view by acknowledging that "the cost to electric utilities of raising capital by issuing stock is also low" but nevertheless holding that "this does not mean that the [cost of equity] is low."[226] According to Joint Customer Intervenors, the Presiding Judge thereby found that an ROE set at the DCF midpoint would enable MISO TOs to raise capital, yet would be insufficient to attract long-term investors and thus would fail to comply with the Initial Decision's interpretation of *Hope* and *Bluefield*. Joint Customer Intervenors contend that the Presiding Judge failed to support the theory that the cost of equity is higher than the cost of raising capital, and assert that this theory is contrary to existing precedent.[227]

100. Joint Customer Intervenors also argue that the Presiding Judge erred by concluding that MISO TOs would not attract a sufficient number of long-term investors if the ROE were set at the midpoint of the DCF range of reasonableness. According to Joint Customer Intervenors, the Initial Decision suggested that a period of six years and eight months may qualify as short-term.[228] Joint Customer Intervenors argue that, if six years and eight months qualifies as short-term, the Presiding Judge effectively held that the midpoint of the DCF can only be relied upon when evidence demonstrates that most investors plan to hold their securities for at least seven years. Joint Customer Intervenors assert, however, that no court or regulatory agency has ever required such a showing.[229]

101. According to Joint Customer Intervenors, the Presiding Judge assumed that the supposed prevalence of short-term investors among utility stockholders is significant because short-term investors are likely to sell their stock as soon as the allegedly anomalous conditions change. Joint Customer Intervenors state that this assumption relied on Ms. Lapson's belief that it is anomalous for investors to buy and hold yield-producing securities when they expect interest rates to rise.[230] Joint Customer Intervenors argue, however, that the forecasts cited in the Presiding Judge predict interest rates to rise

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[226] *Id.* at 27-28 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 215-216).

[227] *Id.* at 28 (citing *Boston Edison Co. v. FERC*, 885 F.2d 962, 965 (1st Cir. 1989) (holding that the DCF asks "what is the minimum amount that one must pay new investors . . . to offer the utility the money that it needs for investment")).

[228] *Id.* (citing Initial Decision, 153 FERC ¶ 63,027 at P 177).

[229] *Id.* at 29.

[230] *Id.* at 35 (citing Initial Decision, 153 FERC ¶ 63,027 at P 146).

by 2019 and that it is hardly anomalous for investors to expect interest rates and other capital market parameters to change over the ensuing several years. Furthermore, Joint Customer Intervenors note that the Presiding Judge stated that "the Federal Reserve's calibration of its increase in the federal-funds target rate . . . may delay the rate impact of normalization, but will not prevent the suddenness of that impact once short-term rates start to provide acceptable yield."[231] Joint Customer Intervenors argue that, even if the Presiding Judge is correct and a sudden selloff of utility stocks by short-term investors leaves MISO TOs with difficulty raising capital, MISO TOs have the right under FPA section 205 to file for increased rates and to put those increased rates into effect after 60 days. Joint Customer Intervenors contend that the Presiding Judge would effectively require customers to pay excessive rates for years to avoid the possibility that MISO TOs might collect insufficient rates for 60 days. Joint Customer Intervenors, therefore, assert that the Initial Decision thus failed to engage in "a balancing of the investor and the consumer interests."[232]

102. Joint Customer Intervenors also argue that the Presiding Judge erred in finding that the reliability of the DCF analysis in this proceeding should be called into question.[233] Joint Customer Intervenors assert that the Commission's two-step DCF methodology, when properly implemented, correctly measures the market cost of capital. Joint Customer Intervenors explain that the Commission's DCF methodology is based on three major components: the dividend, the price of common stock, and the expected dividend growth rate.[234] Joint Customer Intervenors state that the dividend is published by the company and the price of common stock is determined in the competitive marketplace, while growth rate forecasts are developed and published by independent entities that generally are relied on by investors in forming their future outlook. Joint Customer Intervenors assert that, as the DCF methodology is forward-looking and based on the expectations of investors, the DCF results reflect the reality of the capital markets and the actual market cost of equity capital.[235]

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[231] *Id.* at 35-37 (citing Initial Decision, 153 FERC ¶ 63,027 at P 199).

[232] *Id.* at 29-30 (citing *Hope*, 320 U.S. 345).

[233] *Id.* at 21 (citing Initial Decision, 153 FERC ¶ 63,027 at P 228).

[234] *Id.* at 21-22 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 15).

[235] *Id.* at 22-23.

103. According to Joint Customer Intervenors, the Presiding Judge relied heavily on the finding of anomalous capital market conditions in Opinion No. 531, yet failed to recognize that the record established in the instant proceeding differs from that before the Commission in Opinion No. 531 and compels the conclusion that capital market conditions cannot be considered anomalous in the relevant period.[236] Joint Customer Intervenors assert that the Presiding Judge considered arguments that were not found in Opinion No. 531 in support of MISO TOs' contention that conditions were anomalous, but dismissed arguments that conditions were not anomalous because the Commission had not accepted such arguments in Opinion No. 531.[237]

104. Joint Customer Intervenors contend that the record in the instant proceeding includes the following factors that, in contrast to the finding of anomalous market conditions in Opinion No. 531, indicate that economic conditions have not been aberrational: (1) the six-month average ten-year U.S. Treasury bond yield was above two percent by 28 basis points; (2) the unemployment rate dropped substantially to below six percent; (3) the economy expanded and the stock market was strong; (4) the Federal Reserve had substantially wound down its Quantitative Easing initiative; and (5) inflation remained below the Federal Reserve's Open Market Committee's two percent target level.[238] Joint Customer Intervenors argue that the Presiding Judge did not closely examine these conditions or explicitly reject the evidence that the market conditions do not warrant an upper-midpoint ROE for MISO TOs and thus erred in finding that market conditions were anomalous.[239]

105. Joint Customer Intervenors argue that the evidence presented in the hearing failed to demonstrate a correlation between the ROE and the level of transmission investment. They state that MISO TOs' witness, Mr. Kramer, was not able to say whether a base ROE greater than 12.38 percent would have resulted in the construction of more new projects.[240] Joint Customer Intervenors also claim that Mr. Kramer was unable to provide evidence of whether a lower base ROE would have resulted in the same level of

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[236] *Id.* at 15-16 (citing Opinion No. 531, 147 FERC ¶ 61,234 at PP 115, 116, 119).

[237] *Id.* at 16 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 205).

[238] *Id.* at 17 (citing Exh. JCI-1 at 26:12-23).

[239] *Id.*

[240] *Id.* at 52-53 (citing Exh. JCI-14 at 1).

benefits.[241] Joint Customer Intervenors also argue that the Presiding Judge relies upon the statements of MISO TOs' witness, Ms. Lapson, asserting that an ROE reduction would result in a reduction in earnings and cash flow, and that credit ratings might be affected.[242] Joint Customer Intervenors claim, however, that no party provided evidence to suggest that the base ROE that Joint Customer Intervenors argue for would impair transmission investment in MISO.[243]

106. Joint Customer Intervenors also argue that the capital market conditions during the study period in the instant proceeding were similar to those addressed in the May 12, 2015 Entergy Initial Decision,[244] in which the Presiding Judge found that capital market conditions were not anomalous. Therefore, Joint Customer Intervenors argue that the Presiding Judge erred in finding such conditions were anomalous here.[245]

107. OMS states that evidence submitted by Trial Staff showing historical bond yields going back to the year 1919 leads to the conclusion that the low bond yields seen during the study period in this docket are not unprecedented.[246] OMS also states that the Presiding Judge essentially found that capital market conditions are "anomalous" because they are unsustainable, and they are unsustainable because either interest rates will go up or investors will stop expecting them to go up. OMS states that the simple fact is that market conditions change over time because the market forces that shape those conditions change over time. Furthermore, OMS contends that whether or not investors perceive the Federal Reserve's accommodative monetary policy as temporary is beside the point because, it can credibly be argued, *all* market forces are temporary.[247] OMS argues that

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[241] *Id.* at 53 (citing Exh. JCI-13 at 1).

[242] *Id.* at 54 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 463-470).

[243] *Id.*

[244] *Entergy Ark., Inc.*, 151 FERC ¶ 63,008, at P 89 (2015) (Entergy Initial Decision).

[245] Joint Customer Intervenors Brief on Exceptions at 24-25.

[246] OMS Brief on Exceptions at 13-14 (citing Exh. S-1 at 12).

[247] *Id.* at 16 (emphasis supplied).

what actually matters is whether investors expect that the eventual ending of the Federal Reserve's current program of accommodative actions will significantly impact their investments, such as by causing interest rates and bond yields to spike. OMS contends that the answer is far less certain than the Initial Decision suggests.

108. OMS also states that the record evidence casts considerable doubt on the extent to which Federal Reserve policies actually affect the inputs to a DCF study. For example, OMS contends that the record includes an article written by Dr. Bernanke questioning the Federal Reserve's ability to affect interest rates over the long-term, and stated that real interest rates are determined by a broad array of economic factors (including prospects of economic growth), not solely by Federal Reserve actions.[248] In addition, OMS states that the Presiding Judge agrees with MISO TOs' contention that Federal Reserve policy decreased yields on long-term U.S. Treasury bonds by increasing the demand for (and prices of) those securities, but it ignores the *supply* side of that equation.[249] OMS states that overlapping in time with Quantitative Easing, but swamping it in magnitude, large Federal deficits were being financed by the issuance of new federal debt securities, to the extent that Federal debt as a share of Gross Domestic Product more than doubled after 2008.[250] OMS argues therefore that even if Quantitative Easing bond purchases exerted a downward pressure on bond yields (by pulling down the supply of U.S. Treasury bonds, driving up their price and pushing down yields), new Federal bond issuances to finance the growing deficit had the opposite effect; by adding to the supply of Federal debt securities, prices were pushed down and yields were driven up.

109. OMS states that the Presiding Judge found that, as a result of falling interest rates and dividend yields, the cost to electric utilities of raising capital by issuing stock is low.[251] OMS states, however, that the Presiding Judge erred by rejecting the conclusion that logically follows from the finding – namely, that the costs of common equity for utilities is also low. OMS argues that the Presiding Judge's findings in this regard rely on the premise that the cost of equity must satisfy the total return requirements of a long-term investor to satisfy *Hope* and *Bluefield*.[252] OMS states that none of the testimonies

[248] *Id.* at 23 (citing Exh. JCI-6 at 2).

[249] *Id.* at 24 (citing Initial Decision, 153 FERC ¶ 63,027 at P 123 (emphasis supplied)).

[250] *Id.* (citing Exh. JCI-7 at 84, figure 1).

[251] *Id.* at 25 (citing Initial Decision at P 215).

[252] *Id.* at 25-26 (citing Initial Decision, 153 FERC ¶ 63,027 at P 210).

prepared by MISO TOs' expert witnesses' distinguish between the required returns of long-term versus short-term investors to satisfy the standards in *Hope* and *Bluefield*. Rather, OMS states that the distinction was first included in the record during the hearing as part of the Presiding Judge's clarification question to Ms. Lapson. OMS contends that Complainants and supporting intervenors had no opportunity to include expert testimony in the record to address this new distinction and whether it is at all relevant to determining the cost of equity of MISO TOs. OMS states that Complainants and supporting intervenors could not have anticipated such issues being raised during the hearing because: (1) the DCF does not distinguish between "short-term" and "long-term" investors; and (2) there is no Commission precedent discussing the proposition that there is a difference between the results of the DCF study and the true cost of equity.

110. OMS states that the finding that the DCF analysis does not reflect the true cost of equity because it does not satisfy the requirements of the long-term investors was developed by the Presiding Judge who, according to OMS, appears to be uncertain himself about the validity of this theory.[253] OMS states that the Commission should not affirm rulings that rely on such equivocal findings. OMS states that there is no credible evidence in the record showing that investors no longer care about dividend growth and continue to invest in the utility stock just for the yield. Moreover, OMS contends that if the Presiding Judge's theory is credited, then the Presiding Judge contradicted himself in discarding as illogical two low-end results that exceeded the study-period Baa utility bond yield of 4.65 percent, but did so by less than 100 basis points.[254] OMS states that the basis of the standard 100 basis point screen is a finding that investors in utility stocks require appreciably more yield than utility bonds provide.[255]

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[253] *Id.* at 27 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 216 (the total returns of proxy companies "are not necessarily" equivalent to their cost of equity), 218 (expectations of dividend growth "may" not be guiding investment decisions; investors "may" be purchasing stock only for the current yield; the proxy group stock prices "may" not reflect long-term investors satisfaction)).

[254] *Id.* at 27-28 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 65, 158).

[255] *Id.* at 28 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 122 ("The purpose of the low-end outlier test is to exclude from the proxy group those companies whose ROE estimates are below the average bond yield or are above the average bond yield but are sufficiently low that an investor would consider the stock to yield essentially the same return as debt.")).

111. OMS states that investor behavior belies any expectation of sharply increased interest rates. OMS states that MISO TOs' case is grounded on the proposition that investors are (and, during the study period, were) expecting an impending end to the capital market conditions that have prevailed for the past several years, once the Federal Reserve begins to normalize its post-recession monetary policies.[256] OMS states that MISO TOs also contend that investors expect a sharp rise in interest rates and bond yields – an expectation that renders the current conditions "anomalous." OMS argues that, while the Initial Decision accepts both premises of MISO TOs' case, there is a significant flaw in MISO TOs' theory. OMS contends that a fundamental assumption of the DCF method is that investors are rational actors who manifest their knowledge and expectation about the market through the prices they are willing to pay for stock. OMS states that if investors in utility stocks are expecting an imminent jump in interest rates due to Federal Reserve policy normalization, their rational response would be for them to sell those stocks before the increases in interest rates begin. If the expectation were sufficiently widespread and enough investors pursue the path of rational self-interest, OMS contends that utility stock prices would fall as shares are sold into the market, which would cause the dividend yields on those stocks to increase. But, OMS argues that the record evidence shows that simply has not happened. According to OMS, that yields on utility stocks have not increased implies that investors have elected not to sell their shares, a decision that can only mean that investors expect that the normalization of Federal Reserve monetary policy will be gradual and have little to no adverse impacts on the value of their holdings.[257]

112. OMS states that the Presiding Judge's finding that, during the study period, "many investors have expected that the Federal Reserve will normalize current market-capital conditions, and that interest rates will rise significantly over the next few years," is contradicted by evidence in the record.[258] OMS contends that the record demonstrates that, since the Federal Reserve ended its Quantitative Easing Program in October 2014, bond yields and interest rates changed very little.[259] OMS states that, contrary to the Presiding Judge's findings, the record shows that during the study period there was no clear consensus within the investment community as to what specific actions the normalization of Federal Reserve policy would entail, or what impact those actions might

[256] *Id.* at 20 (citing Initial Decision, 153 FERC ¶ 63,027 at P 222).

[257] *Id.* at 19-20.

[258] *Id.* at 16-17 (citing Initial Decision, 153 FERC ¶ 63,027 at P 222).

[259] *Id.* at 17 (citing Exh. S-1 at 63:21-22; Exh. JCI-1 at 27:9-14).

have on interest rates and bond yields. OMS states that, prior to or within the study period, the Federal Reserve reassured the investment community that any change in its accommodative monetary policy would not be drastic. OMS states the January 2015 minutes to the Federal Open Market Committee, cited by Ms. Lapson and included in the record, include a resolution to maintain the Federal Reserve policy of reinvesting principal payments from its holdings of agency debt and agency mortgage backed securities because maintaining a sizable level of long-term securities "should help maintain accommodative financial conditions."[260] OMS contends that, although the Presiding Judge interpreted the Federal Open Market Committee minutes to support a finding that investors expect interest rates to rise because the minutes indicate that "normalization" could start at any time, the minutes can just as easily be understood to say that, even if investors believed that a change in the Federal Reserve's accommodative monetary policies was a certainty and that it would lead to higher interest rates, investors also knew that any such policy changes (1) could take some time to implement, and (2) would likely be carefully measured (not dramatic or sudden) because the Federal Reserve also was charged with pursuing a set of important economic objectives that were tied to promoting recovery from the recent recession.

c. Brief Opposing Exceptions

113. MISO TOs argue that the record demonstrates the existence of anomalous capital market conditions affecting DCF inputs and results and ask the Commission to affirm the Initial Decision's finding of anomalous market conditions.[261] MISO TOs point to the fact that the Federal Reserve holds "massive amounts" of U.S. Treasury bonds and mortgage-backed securities. They argue that these holdings cause bond prices to spike and yields to decline and suppress the short-term federal funds target rate, which leads fixed-income investors to seek yield in higher risk assets, such as electric utility stocks. MISO TOs state that these circumstances result in utility equity price increases and yield decreases.[262] In response to arguments that investors were aware of the Federal Reserve's policies during the relevant period and that the capital market has effectively settled into a "new normal" and cannot be considered anomalous, MISO TOs argue that these arguments conflate the duration of anomalies with the existence of anomalies.[263]

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[260] *Id.* at 19-20 (citing Exh. S-10 at 20).

[261] MISO TOs Brief Opposing Exceptions at 7-8.

[262] *Id.* at 8.

[263] *Id.* at 9-10.

Further, MISO TOs assert that the fact that these conditions have persisted longer than anticipated does not undercut the Presiding Judge's conclusion that investors expect the Federal Reserve to normalize and for interest rates to eventually rise.[264]

114. MISO TOs further argue that the DCF model is not infallible and dispute arguments that the DCF model accurately estimates the cost of equity capital irrespective of prevailing capital market conditions. MISO TOs argue that, in Opinion No. 531-B, the Commission stated that "all methods of estimating the cost of equity are susceptible to error when the assumptions underlying them are anomalous."[265] MISO TOs argue that accepting the opposing parties' contrary arguments here would disregard the Commission's explicit instruction in the Hearing Order that the participants' evidence and DCF analyses conform to Opinion No. 531.[266]

115. Moreover, MISO TOs argue that the Presiding Judge demonstrated how anomalies can undermine a model's ability to accurately estimate a utility's cost of equity and raised sufficient doubt about the DCF results' reliability to compel examination of alternative benchmarks.[267] In response to arguments that the Presiding Judge's analysis "failed to prove distortion of DCF inputs or quantify their impact," MISO TOs argue that Opinion Nos. 531 and 531-B require no such standard of proof, only sufficient evidence to question the reliability of the DCF midpoint.[268] MISO TOs further state that the Presiding Judge noted that the DCF midpoint will not be just and reasonable if it does not appropriately represent utilities' risks.[269]

116. MISO TOs further note that the Presiding Judge's analysis clearly links capital market conditions and the DCF model and explains that *Hope* and *Bluefield*'s dual standards can only "be rationally applied" in the context of long-term investment decisions, since short-term investors have less interest in a utility's financial integrity and

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[264] *Id.* at 10.

[265] *Id.* at 11 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 50).

[266] *Id.* at 12 (citing Hearing Order, 149 FERC ¶ 61,049 at P 186).

[267] *Id.* at 12.

[268] *Id.* at 12.

[269] *Id.* at 13.

creditworthiness.[270] MISO TOs contend that the Presiding Judge found credible testimony that capital market anomalies have caused investors to deploy capital in ways inconsistent with the objectives and assumptions underlying *Hope* and *Bluefield* and the DCF model. This evidence attested that historically low interest rates available from conventional long-term investments are driving investors to better yielding, riskier alternatives, such as utility equities.[271] MISO TOs assert that, consequently, utilities' stock prices have risen and associated yields have declined.[272]

117. MISO TOs also respond to arguments that the Presiding Judge's analysis reflects an interpretation of *Hope* and *Bluefield* that is improperly applied to the DCF and arguments that the Presiding judge's findings cannot "be squared" with the correlation between the cost of debt and equity and the direction relationship between low interest rates, low dividend yields, high equity prices, and a low cost of equity.[273] MISO TOs argue that, in the context of establishing returns for regulated transmission owners, the concepts of capital attraction and financial integrity only have meaning in the long-term horizon as transmission assets take years to plan and construct and are often in service for decades.[274]

118. MISO TOs also take issue with attempts to marginalize the testimony of Ms. Lapson, arguing against the use of the midpoint DCF value by citing to opposing parties' own witnesses who acknowledge the effect of current capital market conditions on DCF inputs. MISO TOs argue, in short, that there is clear evidence that the Federal Reserve's historically unprecedented monetary policies have altered normal investment behavior.[275]

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[270] *Id.* at 14.

[271] *Id.* at 14.

[272] *Id.* at 14.

[273] *Id.* at 15 (citing Trial Staff Brief on Exceptions at 33-35).

[274] *Id.* at 16.

[275] *Id.* at 17.

d. Commission Determination

119. We affirm the Presiding Judge's conclusions, though we do not adopt the totality of his reasoning, concerning anomalous capital market conditions. For the reasons discussed below, we conclude that the record in this proceeding 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*.

120. As the Commission found in Opinion No. 531, the DCF methodology, like all cost of equity estimation methodologies, "may be affected by potentially unrepresentative financial inputs" as a result of unusual economic conditions.[276] As Roger A. Morin states in his treatise, *New Regulatory Finance*,[277] "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." Therefore, it is reasonable, under those conditions, to consider the results of alternative methods for estimating the cost of equity when determining whether a mechanical reliance on the central tendency of the DCF-produced zone of reasonableness produces a just and reasonable ROE.[278] Our finding of anomalous market conditions does not, by itself, justify awarding an ROE above the central tendency of the DCF-produced zone of reasonableness. Rather, that finding supports a consideration of other cost of equity estimation methodologies in determining whether mechanically setting the ROE at the central tendency satisfies the capital attraction standards of *Hope* and *Bluefield*.

121. The record in this proceeding raises the same concerns regarding capital market conditions that the Commission identified in Opinion No. 531. Bond yields remained at historically low levels during the study period. For example, the yield on 10-year U.S. Treasury bonds, which the Commission noted in Opinion No. 531[279] was below

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[276] Opinion No. 531, 147 FERC ¶ 61,234 at P 41. *See also* Opinion No. 531-B, 150 FERC ¶ 61,165 at P 50 ("all methods of estimating the cost of equity are susceptible to error when the assumptions underlying them are anomalous").

[277] *New Regulatory Finance* 28 (Public Utilities Reports, Inc. 2006).

[278] *See, e.g.*, Opinion No. 531, 147 FERC ¶ 61,234 at P 145, *order on reh'g*, Opinion No. 531-B, 150 FERC ¶ 61,165 at P 50.

[279] Opinion No. 531, 147 FERC ¶ 61,234 at n.285.

two percent in that case and had not been below three percent since the 1950s, was at 2.07 percent[280] during the study period. Also, the yield on short-term U.S. Treasury bonds was historically low, ranging from zero to 0.25 percent.[281] Additionally, we note that, while the Federal Reserve has ended the Quantitative Easing program under which it was purchasing unprecedented levels of U.S. Treasury bonds and mortgage-backed securities,[282] the Federal Reserve continues to hold approximately $4.25 trillion[283] of those bonds, a level only slightly below recent record highs, and is reinvesting the principal payments from those holdings to purchase approximately $16 billion of mortgage-backed securities per month and rolling over the U.S. Treasury bonds at auction.[284] This record evidence is indicative of the same type of unusual capital market conditions that the Commission found concerning in Opinion No. 531. Parties point out that certain capital market conditions have changed since Opinion No. 531, including the winding down of Quantitative Easing, the slight increase in U.S. Treasury bond yields, the lower unemployment rate, and strong stock market performance. Though the Commission noted certain economic conditions in Opinion No. 531, the principal argument was based on low interest rates and bond yields, conditions that persisted throughout the study period. Consequently, we find that capital market conditions are still anomalous as described above, and, therefore, we disagree with Iowa Group's assertion that there is not substantial evidence to justify a potential adjustment.

122. Because the evidence in this proceeding indicates that capital markets continue to reflect the type of unusual conditions that the Commission identified in Opinion No. 531, we remain concerned that a mechanical application of the DCF methodology would result in a return inconsistent with *Hope* and *Bluefield*.[285] We conclude that the fact that these

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[280] *See* Exh. S-5 at 8.

[281] *See* Exh. MTO-16 at 22-23.

[282] *See id.* at 17-20.

[283] *See id*. at 18, 23.

[284] *See* Exh. MTO-1 at 22.

[285] Opinion No. 531 states:

> There is 'model risk' associated with the excessive reliance or mechanical application of a model when the surrounding conditions are outside of the normal range. 'Model risk' is the risk that a theoretical model that is used to value real-world transactions fails to

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conditions have persisted over the approximately two years since the end of the study period adopted in Opinion No. 531 does not, in and of itself, mean that these conditions are not anomalous. Ms. Lapson describes the model risk associated with the reliance on mechanical application of a model and discusses how it is necessary to test model outcomes against other investment benchmarks as a check.[286] As the Commission found in Opinion No. 531, under these circumstances, we have less confidence that the midpoint of the zone of reasonableness in this proceeding accurately reflects the equity returns necessary to meet the *Hope* and *Bluefield* capital attraction standards.[287] We therefore find it necessary and reasonable to consider additional record evidence, including evidence of alternative methodologies and state-commission approved ROEs, to gain insight into the potential impacts of these unusual capital market conditions on the appropriateness of using the resulting midpoint.

123. Complainants and intervenors make a number of arguments against the Presiding Judge's determination that anomalous market conditions justify examining alternative methodologies and state-commission approved ROEs to assess whether the ROE should be placed in the upper half of the zone of reasonableness. Such arguments, discussed in more detail below, largely pertain to the Presiding Judge's reasoning, such as the distinction between short-term and long-term investors, reasoning that we do not adopt even though we reach the same conclusions. Additionally, because we base our conclusion on a different rationale than the Presiding Judge, we need not consider arguments regarding the Presiding Judge's consideration of evidence on which we do not rely.

124. Parties argue that the record does not support the Presiding Judge's finding that capital market conditions during the study period are anomalous, either generally or based on the Presiding Judge's definition of anomalous as "unprecedented and unsustainable." We do not adopt that definition so we do not need to consider those arguments here. As described above, evidence in the record regarding historically low interest rates and Treasury bond yields as well as the Federal Reserve's large and persistent intervention in markets for debt securities are sufficient to find that current capital market conditions are anomalous. Although the record indicates that there was a

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predict or represent the real phenomenon that is being modeled.

147 FERC ¶ 61,234 at n.6.

[286] *See* Exh. MTO-16 at 30-31.

[287] Opinion No. 531, 147 FERC ¶ 61,234 at P 145.

past period of similarly low interest rates, it occurred more than sixty years ago. Similarly, while Complainants provide evidence that interest rates have been trending downwards, the current levels may be so low as to cause irregularities in the outputs of the DCF. Despite such yields remaining low for several years, we find that they are anomalous and could distort the results of the DCF model.

125. Parties also argue that MISO TOs have not presented evidence that the actions of the Federal Reserve directly affected DCF methodology results. Specifically, Trial Staff argues that there is no credible evidence that any of the DCF inputs have been distorted by purportedly anomalous capital market conditions. As described above, we find that the relevant anomalous capital market conditions cited in Opinion No. 531 are still present in this proceeding. Moreover, because the analytical approach we use here, and which we used in Opinion No. 531, gives us confidence that the resulting ROE satisfies the requirements of *Hope* and *Bluefield*, a direct causal analysis linking specific capital market conditions to particular inputs or assumptions in the DCF model is not necessary. Consistent with Opinion No. 531, we find that the DCF methodology is subject to model risk of providing unreliable outputs in the presence of unusual capital market conditions.[288] The Commission has not required a mathematical demonstration of how each anomalous capital market condition specifically distorts the DCF analysis and it is uncertain whether such an analysis is even possible given the complexities of capital markets and how various phenomena could affect the DCF methodology results.[289] For that reason, in the presence of anomalous capital market conditions, the Commission examines other evidence, namely the results of alternative methodologies and state-commission approved ROEs to assess the reasonableness of the results of the DCF methodology. We find that the record contains sufficient evidence of anomalous capital market conditions.

126. We also disagree with arguments regarding the lack of effect of Federal Reserve's actions, including OMS' assertion that the effect on capital market conditions of

[288] Opinion No. 531, 147 FERC ¶ 61,234 at n.286.

[289] While we do not adopt the Presiding Judge's rationale concerning the specific causal link between the anomalous capital market conditions and the results of the DCF model, we acknowledge that the Presiding Judge's rationale might have merit and our determination here is without prejudice to that rationale. However, given the difficulty of establishing a causal relationship between complex capital market conditions and the results of any particular financial model, we are not persuaded that the record evidence in this proceeding is adequate to definitively conclude that the Presiding Judge's rationale explains how the current capital market conditions are impacting the DCF model.

increases in the Federal Reserve's holdings of U.S. Treasury bonds has been more than counteracted by large increases in federal debt outstanding during the same period. OMS has provided no evidence showing that increases in the amount of U.S. Treasury bonds directly counteract and nullify the effect of direct capital market interventions by the Federal Reserve.[290] Similarly, no party has shown that other global events or investor behavior caused the anomalous capital market conditions. Again, the fact remains that capital market conditions are anomalous, such that mechanical application of the DCF methodology could produce unreasonable results.

127. Parties raise numerous objections to the Presiding Judge's distinction between short-term and long-term investors in finding that the midpoint ROE produced by the application of the DCF methodology is insufficient. Because we do not adopt this element of the Presiding Judge's reasoning, we need not respond to these objections. Instead, we find that where anomalous market conditions give us reason to have less confidence in DCF methodology outputs, it is reasonable to consider alternative methodologies and state-commission approved ROEs in determining a just and reasonable ROE. Our not adopting this reasoning also renders moot assertions regarding a contradiction between finding that short-term investors require lower returns and maintaining the 100-basis point low end screen in the DCF methodology.

128. Complainants are correct that the record does not contain evidence that economic conditions have "negatively impacted" the ability of MISO TOs to raise capital.[291] MISO TOs have been raising capital successfully with a 12.38 percent ROE, which we determine here is excessively high. However, MISO TOs bear no obligation to demonstrate difficulty raising capital in excess of the ROE adopted by the Initial Decision. Furthermore, there is record evidence that a decrease in ROE of that magnitude – a 309 basis point reduction from 12.38 percent to 9.29 percent –could undermine the ability of MISO TOs to attract capital for new investment in electric transmission.[292]

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[290] Further, we note that, even if more U.S. Treasury bonds are available, the low interest rates in the record are equally applicable to those bonds.

[291] Complainants Brief on Exceptions at 33.

[292] Exh. MTO-1 at 7. For example, Ms. Lapson pointed out a June 11, 2013 Wolf Research paper that stated "Material reductions in the base ROE could lower the quality of and divert capital away from the transmission business, given its generally riskier profile than that for state-regulated utility businesses, such as distribution and generation. Moreover, investors could deploy capital to infrastructure projects with higher allowed

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129. Parties also argue that, because the impending rise of interest rates will not happen suddenly or soon, the returns provided by the midpoint of the DCF analysis are sufficient. They also argue that rational investors would not invest in assets that are assumed to be likely to lose value soon. Such arguments are inapplicable to the rationale adopted in this order. Our reasoning, unlike the Presiding Judge's, does not rely on assessing investor expectations of the specific timing of potential interest rate increases that could affect utilities' future ability to raise capital. We do not find that the ROE needs to be sufficient for when interest rates increase. Similarly, we are not finding that investors are necessarily making investments without considering the potential effects on stock valuation of likely future interest rate increases. Rather, we find that current capital market conditions may cause the mechanical application of the DCF methodology to produce an ROE that does not meet the requirements of *Hope* and *Bluefield*.

130. Similarly, we disagree with Iowa Group's argument that any upward adjustment represents an improper attempt to "normalize" the DCF results to reflect normal capital market conditions. Any finding of anomalous capital market conditions and subsequent adjustments represents an attempt to counteract imprecision in the DCF model caused by capital market conditions and not a results-oriented attempt to raise the ROE to what it more typically is.

131. Trial Staff and others also argue that, if and when capital market conditions change, MISO TOs can request an increase in their effective ROE. As described above, anomalous market conditions may skew the current outputs of the DCF methodology, such that the mechanical application of the DCF methodology could provide an unjust and unreasonable ROE. Subsequent requests for rate increases would not address this shortcoming. The Commission also addressed this argument in Opinion 531-B where it found that transmission owners' "ability to subsequently request a rate increase if economic conditions change does not excuse the Commission from establishing an ROE under FPA section 206 that meets the requirements of *Hope* and *Bluefield*."[293]

132. We also disagree with arguments that the DCF methodology fully incorporates available information and investor expectations such that capital can be raised as inexpensively as the DCF results suggest. We find that such an outcome may not be the case due to model risk inherent in the DCF methodology in the presence of unusual market conditions. The finding that mechanical application of the DCF methodology

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returns, such as Commission-regulated natural gas pipelines, or to other industries generally."

[293] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 50.

may produce results inconsistent with *Hope* and *Bluefield* in certain circumstances is not inconsistent with the efficient market theory underlying the typical application of the DCF methodology in normal circumstances. Thus, consistent with the rationale explicated in Opinion No. 531, we disagree with Joint Customer Intervenors' assertion that the Presiding Judge erred in questioning the reliability of the DCF methodology in this proceeding based on the sources of information employed by this methodology.

133. We disagree with Joint Customer Intervenors' contention that the findings of the Presiding Judge in the Entergy Initial Decision are relevant to the ROE determination in this proceeding. Regardless of the timing of the study period in that proceeding, the findings in an initial decision, unless affirmed by the Commission, are not precedential.

134. We also disagree with Iowa Group's contention that any finding of anomalous capital market conditions and potential subsequent upward adjustment of the ROE is a "default" policy. In each proceeding, the Commission will evaluate the facts during the relevant period to determine whether capital market conditions are unusual and, if so, the Commission will consider alternative benchmark methodologies and state commission-approved ROEs as additional evidence that might suggest that a mechanical application of the DCF results in an ROE insufficient to satisfy the requirements of *Hope* and *Bluefield*.[294] We also disagree with Iowa Group's assertion that there is no evidence that anomalous market conditions apply equally to DCF inputs from each member of the proxy group. This argument implies that MISO TOs would need to provide detailed studies of the effects of capital market conditions for each member of the proxy group, which would be unduly burdensome, if not impossible. Moreover, such a showing is unnecessary since capital market conditions apply across the entire economy and are not specific to individual utilities.

135. MISO TOs presented three alternative methodologies for estimating the cost of equity in this proceeding: a risk premium analysis, a capital asset pricing model (CAPM) analysis, and an expected earnings analysis. These alternative methodologies are the same ones that the Commission relied upon in Opinion No. 531 to corroborate the Commission's determination that a mechanical application of the DCF methodology results in an ROE that does not satisfy *Hope* and *Bluefield*. MISO TOs' risk premium analysis based upon Commission-authorized ROEs indicates that the Operating Companies' cost of equity is 10.36 percent.[295] MISO TOs' CAPM analysis produces a midpoint cost of equity estimate of 10.06 percent once an adjustment for the effect of

[294] *See* Opinion No. 531, 147 FERC ¶ 61,234 at P 145.

[295] Exh. MTO-29 at 1.

firm size is made.[296] MISO TOs' expected earnings analysis produces a midpoint ROE range of 11.99 percent. Thus, all three alternative methodologies produce cost of equity estimates substantially in excess of the 9.29 percent midpoint of the zone of reasonableness produced by the DCF analysis in this case. As the Commission did in Opinion No. 531, we find that these analyses are informative and corroborate our decision to place MISO TOs' ROE at the central tendency of the upper half of the zone of reasonableness produced by our DCF analysis of the proxy group companies, rather than the midpoint.

136. In addition, the record indicates that all of the current state ROEs exceeded the 9.29 percent midpoint of the DCF zone of reasonableness in this case. The midpoint of the current state ROEs is 9.95 percent.[297] As the Commission explained in Opinion No. 531, in situations where our DCF methodology produces ROEs below those approved at the state level, for functions that are riskier than the state-regulated functions, such a relationship might indicate that a mechanical application of the DCF methodology with the use of the central tendency of the resulting zone of reasonableness will not satisfy the requirements of *Hope* and *Bluefield*.

137. As the Commission found in Opinion No. 531, in considering these other methodologies and the ROEs allowed by state commissions, we do not depart from our use of the DCF methodology; rather, due to the presence of unusual capital market conditions, we find it appropriate to look to other record evidence to inform the just and reasonable placement of the ROE within the zone of reasonableness produced by the DCF methodology.[298] Below, we address the participants' arguments against each of MISO TOs' alternative ROE methodologies.

2. CAPM

138. Investors use CAPM analysis as a measure of the cost of equity relative to risk.[299] The CAPM methodology is based on the theory that the market-required rate of return for a security is equal to the risk-free rate, plus a risk premium associated with the specific

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[296] *See* Exh. MTO-1 at 95:9-18.

[297] Exh. MTO-42 at 1-2. *See* Exh. MTO-16 at 52-56. Ms. Lapson eliminated a Base ROE of 10.95 percent as an outlier.

[298] Opinion No. 531, 147 FERC ¶ 61,234 at P 146.

[299] *Id.* P 147.

security. Specifically, the CAPM methodology determines the cost of equity by taking the "risk-free rate" and adding to it the "market-risk premium" multiplied by "beta."[300] The risk-free rate is represented by a proxy, typically the yield on 30-year U.S. Treasury bonds.[301] Betas, which are published by several commercial sources, measure a specific stock's risk relative to the market. The market risk premium is calculated by subtracting the risk-free rate from the expected return. The expected return can be estimated either using a backward-looking approach, a forward-looking approach, or a survey of academics and investment professionals.[302] A CAPM analysis is backward-looking if the expected return is determined based on historical, realized returns.[303] A CAPM analysis is forward-looking if the expected return is based on a DCF study of a large segment of the market.[304] Thus, in a forward-looking CAPM analysis, the market risk premium is calculated by subtracting the risk-free rate from the result produced by the DCF study.[305]

139. In this proceeding, MISO TOs submitted a forward-looking CAPM analysis of each company in the proxy group using the 2.7 percent 30-year U.S. Treasury bond yield for the risk-free rate, beta values for each proxy company reported by Value Line, and a market risk premium based on a DCF study of all dividend-paying companies in the S&P 500.[306] In that DCF study, MISO TOs added the weighted average dividend of those companies (2.4 percent) to the average of the weighted average growth rates projected for the companies by IBES and Value Line (8.9 percent). This resulted in a uniform cost of equity for the dividend-paying companies in the S&P 500 of 11.3 percent. The MISO TOs then subtracted from that figure the 2.7 percent risk-free rate to obtain a risk premium of 8.6 percent. The MISO TOs multiplied this risk premium by the beta listed for each proxy company by Value Line and added the risk-free rate to that

[300] Roger A. Morin, *New Regulatory Finance* 150 (Public Utilities Reports, Inc. 2006).

[301] *Id.* at 151.

[302] *Id.* at 155-162.

[303] *Id.* at 155-156.

[304] *Id.* at 159-160.

[305] *See id.* at 150, 155.

[306] Exh. MTO-1 at 97-98.

product. This CAPM analysis produces an unadjusted ROE range of 7.86 percent to 10.87 percent for the proxy group, with a midpoint value of 9.37 percent.

140. However, after adjusting for the effect of each proxy company's size, MISO TOs' CAPM analysis produced an ROE range of 7.50 percent to 12.61 percent, with a midpoint value of 10.06 percent.[307] MISO TOs' witness, Dr. Avera, explained that the "size adjustment reflects the fact that differences in investors' required rate of return that are related to firm size are not fully captured by beta."[308] Dr. Avera based his size adjustments on data contained in a table published in Morningstar Inc.'s (Morningstar) "2015 Ibbotson SBBI Market Report." The table adjusts each proxy company's cost of equity based on its size, reducing the unadjusted cost of equity of larger companies, while increasing those of smaller companies.[309]

a. Initial Decision

141. The Presiding Judge determined that the CAPM model offered by Dr. Avera was credible and supported allowing MISO TOs to earn a base ROE above the 9.29 percent midpoint of the zone of reasonableness.[310] The Presiding Judge explained that Dr. Avera's model was "substantially similar" to the CAPM that the Commission found useful in determining the placement of the base ROE in Opinion No. 531. The Presiding Judge rejected Mr. Gorman's contention that the growth rate used for the DCF analysis in Dr. Avera's CAPM was unsustainable and should be based, at least in part, on long-term growth rates, noting that the Commission had rejected this argument in Opinion No. 531-B on the grounds that the long-term growth rate does not necessarily apply to a curated set of large companies, like those included in the S&P 500. The Presiding Judge also rejected Mr. Gorman's arguments that Morningstar does not make size adjustments for companies with betas of less than 1.0, including public utilities, concluding that these arguments were not born out by the Morningstar data.[311]

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[307] Initial Decision, 153 FERC ¶ 63,027 at P 264 (citing Exh. MTO-30 at 1).

[308] Exh. MTO-1 at 98.

[309] Exh. MTO-30 at 1.

[310] Initial Decision, 153 FERC ¶ 63,027 at P 313.

[311] *Id.* PP 268-269.

142. The Presiding Judge also rejected Mr. Gorman's contention that, based on the utility industry's low beta, Morningstar also makes a downward "industry premium" adjustment that offsets any upward adjustment for size.[312] Mr. Gorman contended that Morningstar's SBBI 2013 Valuation Yearbook recommends an industry premium, as well as a size adjustment. Mr. Gorman stated that Morningstar recommends a negative industry premium adjustment for the electric-utility industry of between 3.4 percent and 4.09 percent. However, the Presiding Judge found that, on cross-examination, Mr. Gorman admitted that the Morningstar industry premium to which he referred was used for its "buildup method" of estimating cost of equity, and is not used to develop a CAPM.

143. The Presiding Judge also rejected the CAPM analysis advanced by Mr. Gorman and Mr. Hill, noting that it differed in several material respects from the CAPM that Commission relied upon in Opinion No. 531. The Presiding Judge noted, for instance, that this analysis did not use forward-looking data for its risk premium, nor did it use the 30-year U.S. Treasury bonds as its proxy for the risk-free rate of return, and that this analysis made no effort to adjust for the capitalization of the companies considered.[313]

144. The Presiding Judge also rejected, as inconsistent with Opinion Nos. 531 and 531-B, arguments by Mr. Hill that Dr. Avera's model was invalid because it considered historical data and because it did not consider long-term growth rates.[314] The Presiding Judge also rejected Mr. Hill's criticism of Dr. Avera's size-based adjustments to the risk premium, concluding that they "fail[ed] to grasp, much less address, the rationale underlying the size adjustment."[315] The Presiding Judge also elected not to rely on Mr. Hill's CAPM on the grounds that it was partly backward looking, in contrast to the CAPM relied upon by the Commission in Opinion No. 531, and also because it addressed stock price appreciation rather than earnings growth and failed to adjust for the companies' market capitalization, which, as noted, is required by the CAPM model.[316]

145. The Presiding Judge also rejected the Joint Consumer Advocates' critiques of Dr. Avera's methodology, which were based largely on the testimony of Mr. Solomon,

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[312] *Id.* PP 270-271.

[313] *Id.* PP 280-283.

[314] *Id.* PP 284-286.

[315] *Id.* P 290.

[316] *Id.* PP 294-297.

concluding that they were inconsistent with the Commission's reliance on a CAPM model in Opinion Nos. 531 and 531-B. In particular, the Presiding Judge noted that Mr. Solomon's critiques would have excluded companies that the Commission in Opinion No. 531-B found appropriate to include in the CAPM model.[317]

146. Finally, the Presiding Judge rejected Mr. Keyton's critiques of Dr. Avera's CAPM. The Presiding Judge concluded that Mr. Keyton's arguments regarding the sustainability of the growth the rates and the measure of a risk-free return used by Dr. Avera were effectively rejected by the Commission in Opinion No. 531-B, substantially for the reasons stated above.

b. Briefs on Exceptions

147. Complainants and other parties contend that the Presiding Judge erred by accepting Dr. Avera's CAPM analysis despite evidence demonstrating that flaws in the analysis render the results unreliable.[318] Complainants explain that Mr. Gorman proposed certain adjustments to correct Dr. Avera's CAPM analysis, such as replacing the size premium adjustment with an industry premium adjustment.[319] Complainants explain that the Presiding Judge stated that "Mr. Gorman failed to demonstrate that [the Morningstar] analysis is inappropriate for utilities."[320] Complainants state that the Presiding Judge appears to have misunderstood Mr. Gorman's proposal, which argues that Morningstar recognized that there are differences in risk that are not captured by the beta attributable to the industry in which a company operates.[321]

148. Complainants state that the Presiding Judge misunderstands Opinion No. 531 and Morningstar's methodology. Complainants aver that the Opinion No. 531 proceeding did not include evidence involving the industry risk premium and Morningstar's broad

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[317] *Id.* PP 298-303.

[318] Complainants Brief on Exceptions at 48-51; Joint Customer Intervenors Brief on Exceptions at 43-47; OMS Brief on Exceptions at 33-37; Trial Staff Brief on Exceptions at 42-44.

[319] Complainants Brief on Exceptions at 48 (citing Exh. JC-9 at 20-22 (stating that an industry premium adjustment for the electric utility industry would be negative)).

[320] *Id.* at 49 (citing Initial Decision, 153 FERC ¶ 63,027 at P 281).

[321] *Id.* (citing Exh. JC-9 at 20-21).

variation of the CAPM model to reflect firm size and industry risk. Complainants argue that Morningstar does not limit its risk return criteria to only a size adjustment, and instead uses all available and applicable information to accurately adjust the CAPM to reflect investment risk.[322] Complainants state that the Presiding Judge erred by concluding that the buildup method is not a variation of CAPM, and assert that Morningstar undertakes multiple adjustments from the base CAPM to account for both a size adjustment and an industry risk premium.[323]

149. Trial Staff states that Dr. Avera's CAPM calculation arrives at the weighted average growth rates projected for all dividend-paying companies on the S&P 500 through the use of both IBES and Value Line. Trial Staff further states that the Presiding Judge found that in Opinion No. 531, "the Commission found a CAPM using a format substantially similar to that used by Dr. Avera in this case to be a useful guide in determining the placement of the Base ROE," and that "Dr. Avera's CAPM is credible and supports allowing the MISO TOs' to collect a Base ROE above the Midpoint."[324] Trial Staff asserts, however, that this finding is in error because Dr. Avera's CAPM calculation in the Opinion No. 531 proceeding used only IBES growth rate projections.[325] Trial Staff states that Dr. Avera's CAPM calculation in the instant proceeding is contrary to the Commission's stated preference, which the Presiding Judge acknowledges in his Initial Decision, to use IBES as the source for growth rates and to use only one source for growth rates in a given calculation.[326] Trial Staff asserts that Opinion No. 531 leaves no doubt that it is "inappropriate to use estimates from different sources for different proxy group companies."[327] Trial Staff asserts that Dr. Avera's use of both IBES and Value Line data contradicts the Presiding Judge's finding in the Initial Decision that use of

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[322] *Id.* at 49-50 (citing Exh. JC-9 at 21-22).

[323] *Id.* at 49-50.

[324] Trial Staff Brief on Exceptions at 42 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 310-311).

[325] *Id.* (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 110 ("The growth rate in the NETOs' CAPM analysis is based on IBES data, which the Commission has long relied upon as a reliable source of growth rate data")).

[326] *Id.* at 43 (citing Initial Decision, 153 FERC ¶ 63,027 at P 43).

[327] *Id.* at 44 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 90).

IBES alone is appropriate for growth rate projections used in the Commission's DCF analysis in this proceeding.[328]

150. Trial Staff argues that the Presiding Judge incorrectly concluded that (1) the beta component of the CAPM risk-premium calculation "serves to mitigate any differences" between the divergent growth rates used in Dr. Avera's CAPM and DCF analyses, and (2) the beta component of the CAPM "serves the same purpose as the long-term growth rate component" of the DCF.[329] Trial Staff argues that beta measures risk (i.e., the variability of expected returns) and is a different concept than a sustainable growth rate, which measures a firm's long-term expansion. Trial Staff, therefore, asserts that it is not possible for beta to mitigate an unsustainable growth rate or serve the same purpose as the long-term growth rate.[330]

151. Joint Customer Intervenors state that Dr. Avera used a 9 percent market risk premium instead of the independently-published Morningstar market risk premium of 6.2 percent.[331] Joint Customer Intervenors assert that had Dr. Avera used Morningstar's 6.2 percent market risk premium, his midpoint unadjusted ROE would have been just 7.5 percent.[332]

152. Joint Customer Intervenors assert that Dr. Avera inappropriately adjusted the theoretical construct based on his contentions that "financial research indicates that the CAPM does not fully account for observed differences in rates of return attributable to firm size" and that "empirical tests of the CAPM have shown that low-beta securities earn returns somewhat higher than the CAPM would predict, and high-beta securities earn somewhat less than predicted."[333] According to Joint Customer Intervenors,

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[328] *Id.* at 43-44.

[329] *Id.* at 44 n.84 (citing Initial Decision, 153 FERC ¶ 63,027 at P 305).

[330] *Id.* n.84.

[331] Joint Customer Intervenors Brief on Exceptions at 44 (citing Exh. MTO-1 at 97).

[332] *Id.* (citing Exh. JCI-4 at 45:11-13).

[333] *Id.* at 44-45 (citing Exh. MTO-1 at 113).

Dr. Avera's adjustments increased the CAPM-derived midpoint ROE from 9.53 percent to 10.24 percent.[334]

153. Joint Customer Intervenors state that Mr. Solomon noted that the Commission has previously rejected the use of the CAPM methodology because its beta does not fully capture and differentiate risks of common stocks, and argued that CAPM results are thus unreliable and should not be used. Joint Customer Intervenors assert that the Presiding Judge did not address the merit of this argument.[335]

154. Joint Customer Intervenors note that the Presiding Judge found that Dr. Avera's "decision to include only . . . short-term growth components inevitably skews his zone of reasonableness upward."[336] Joint Customer Intervenors contend that this finding indicates that for a DCF study of non-utility companies to produce a reasonable result, a second-stage growth rate must also be included. Joint Customer Intervenors argue, however, that Dr. Avera failed to apply a second-stage growth rate, which the Commission found necessary in Opinion No. 531. Joint Customer Intervenors state that the Presiding Judge recognized that the Commission reasoned in Opinion No. 531-B that "[w]hile an individual company cannot be expected to sustain high short-term growth rates in perpetuity, the same cannot be said for a stock index like the S&P 500 that is regularly updated to contain only companies with high market capitalization."[337] Joint Customer Intervenors argue, however, that Dr. Avera's CAPM analysis did not use a stock index; rather it used a fixed portfolio of approximately 400 stocks picked *ex ante*. Moreover, Joint Customer Intervenors assert that the Presiding Judge effectively conceded that each company in that portfolio will see its growth trend towards the long-term GDP growth rate and, therefore, the portfolio as a whole must likewise trend towards the long-term GDP growth rate. Joint Customer Intervenors explain that the beta component of CAPM is a measure of stock volatility, and disagree with the Presiding Judge's finding that the "beta component serves the same purpose of the long-term growth-rate . . . ."[338]

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[334] *Id.* at 45 (citing Exh. JCI-4 at 45:17-19; Exh. MTO-7 at 1).

[335] *Id.* at 44 (citing Exh. JCI-4 at 45:22-46:11).

[336] *Id.* at 45-46 (citing Initial Decision, 153 FERC ¶ 63,027 at P 328).

[337] *Id.* at 46 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 267 & 304; Opinion No. 531-B, 150 FERC ¶ 61,165 at P 113).

[338] Joint Customer Intervenors Brief on Exceptions at 46-47 (citing Initial

(continued...)

155. Joint Customer Intervenors state that Dr. Avera's approach relies on a DCF analysis of approximately 400 dividend-paying companies culled from the S&P 500. Joint Customer Intervenors contend that, if the Commission has concerns about the accuracy of the DCF methodology employing a proxy group of electric utilities, it makes even less sense to depend on an aggregation of dividend-paying companies in the S&P 500. According to Joint Customer Intervenors, dividends are less important and less reliable for S&P 500 companies when compared to electric utilities, which have been known as relatively low risk, income-producing investments.[339]

156. OMS states that Dr. Avera's CAPM study for the instant proceeding, which incorporates Value Line growth estimates, differs materially from his CAPM study cited in Opinion No. 531, which relied on growth rates taken from Yahoo! Finance's reporting of IBES estimates.[340] OMS asserts that Value Line growth estimates are substantially backward-looking, and notes that the Initial Decision found Value Line to be inferior in a separate passage.[341]

157. OMS argues that the Presiding Judge erred by treating beta as a substitute for second-stage growth. OMS states that beta is a measure of volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole.[342] OMS states that, while the beta for utility stock consistently averages well below 1.0, exceptions in which a utility stock's beta exceeds 1.0 and thus increases that proxy's CAPM result, are Common.[343] OMS states that the second-stage growth rate, on the other hand, is

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Decision, 153 FERC ¶ 63,027 at P 305).

[339] *Id.* at 45.

[340] OMS Brief on Exceptions at 37 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 110; Exh. MTO-30 at 1, note (b)).

[341] *Id.* (citing Initial Decision, 153 FERC ¶ 63,027 at PP 48-49).

[342] OMS Brief on Exceptions at 36 (citing Andrew J. Cueter, *Using Beta* (Oct. 2012), http://www.valueline.com/Tools/Educational_Articles/Stocks/Using_Beta.aspx#.Vp5VhZorJaQ).

[343] *Id.* at 36 (citing Richard A. Michelfelder and Panayiotis Theodossiou, *Public Utility Beta Adjustment and Biased Costs of Capital in Public Utility Rate Proceedings* (Nov. 2013), at 60, 66 (showing in Figure 1 that the top decile of utility betas exceeded 1.0 for some years and the highest utility beta exceeded 1.0 in most years)).

necessary to incorporate the effect of changes in the general economy (as represented by GDP growth) in forecasting the long-term growth of an individual company or group of companies. According to OMS, the second-stage growth rate is part of getting to a reliable number for the expected long-term return on a fully diversified equity portfolio – an essential ingredient for a CAPM study to produce any sort of useful result. OMS argues that to equate beta and the second-stage growth rate because in this particular instance "[e]ach serves to lower the top of the zone of reasonableness" is not well-reasoned.[344]

158. OMS states that the growth component of the portfolio return calculation used by Dr. Avera weighted short-term growth rates forecasted by IBES and Value Line at 100 percent, thereby assuming that the growth rates over the next five years will continue forever. OMS asserts that this premise is implausible and flies in the face of the Commission's determination in Opinion No. 531 to use a weighted average of short and long-term growth rates in its two-step DCF analysis. OMS states that the failure to incorporate a blended growth rate is the precise reason the Presiding Judge rejected Dr. Avera's DCF study of non-utility companies, wherein the Presiding Judge observed that "[Dr. Avera's] decision to include only dividend yields and short-term growth components inevitably skews his zone of reasonableness upward."[345] OMS argues that it is arbitrary and capricious for the Initial Decision to reject one of Dr. Avera's studies for its failure to incorporate long-term growth rates, while adopting another that suffers from precisely the same flaw.[346]

159. OMS acknowledges that Opinion No. 531-B rejected arguments that the Commission erred by adopting a CAPM formulation that failed to include a second-stage growth rate. OMS states that, consistent with Opinion No. 531-B, the Presiding Judge held that "[w]hile an individual company cannot be expected to sustain high short-term growth rates into perpetuity, the same cannot be said for a stock index like the S&P 500 that is regularly updated to contain only companies with high market capitalization."[347]

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[344] *Id.* at 36-37 (citing Initial Decision, 153 FERC ¶ 63,027 at P 305).

[345] OMS Brief on Exceptions at 34 (citing Initial Decision, 153 FERC ¶ 63,027 at P 328).

[346] *Id.*

[347] *Id.* at 35 (citing Initial Decision, 153 FERC ¶ 63,027 at P 304 (quoting Opinion No. 531-B, 150 FERC ¶ 61,165 at P 113)).

OMS contends, however, that such reasoning makes no more sense in the Initial Decision than it did before.[348]

160. OMS states that, in rejecting Dr. Avera's non-utility DCF analysis for its failure to incorporate a second-stage growth factor, the Presiding Judge implicitly recognized that, over time, each individual company in Dr. Avera's portfolio will see its growth rate trend downward toward the long-term GDP growth rate. OMS asserts that, if each company in the portfolio will see its growth rate trend toward the GDP growth rate, so also will the portfolio as a whole. OMS, therefore, contends that the CAPM calculation is illogical and indefensible.[349]

161. OMS asserts that the rationale, as stated in Opinion No. 531 and adopted by the Initial Decision, simply does not apply. OMS explains that the portfolio Dr. Avera used in his CAPM study was not the S&P 500 itself, with a constantly updated cast of high-capitalization companies; rather, it was a fixed portfolio of 400 stocks. OMS stresses that the 400 stock portfolio will not be "regularly updated" to include only companies with high market capitalizations.[350]

c. Briefs Opposing Exceptions

162. MISO TOs contend that the Presiding Judge correctly accepted Dr. Avera's CAPM analysis and correctly found that this analysis supports establishing a base ROE above the midpoint. MISO TOs argue that the arguments raised by Complainants, Joint Customer Intervenors, and OMS were all considered and rejected in Opinion No. 531-B and thus were appropriately rejected, implicitly or explicitly, in the Initial Decision.[351] MISO TOs state that Opinion No. 531-B analyzed and found meritless arguments critical of Dr. Avera's CAPM analysis because Dr. Avera (1) performed a DCF study on the S&P 500, (2) employed a size adjustment, (3) did not employ a long-term growth component, and (4) relied on betas based on historical data as a risk measure.[352]

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[348] *Id.*

[349] *Id.* at 35-36.

[350] *Id.* at 35.

[351] MISO TOs Brief Opposing Exceptions at 28.

[352] *Id.* at 28-29.

163. MISO TOs argue that Complainants' advocacy for Mr. Gorman's CAPM analysis does not withstand scrutiny because Mr. Gorman's CAPM market premium is not based on a DCF analysis or any other forward-looking approach. MISO TOs assert that Mr. Gorman's use of Morningstar's buildup method is distinct from, and not used in, the CAPM methodology.[353] Furthermore, MISO TOs state that the publication on which Mr. Gorman relied only applies an industry-based adjustment factor to the buildup method of estimating risk premiums and not to the well-established CAPM that Dr. Avera employed and that the Commission accepted in Opinion No. 531.[354]

164. With regard to Trial Staff's objections to Dr. Avera's use of both IBES and Value Line growth rate estimates in his CAPM analysis, MISO TOs assert that the Presiding Judge cited Dr. Avera's CAPM analysis for the limited purpose of informing placement of the base ROE within the zone of reasonableness. MISO TOs argue that the Presiding Judge did not explicitly find that only IBES growth rate data are acceptable for purposes of applying the DCF model.[355]

d. Commission Determination

165. We affirm the Presiding Judge's findings that the MISO TOs' witness, Dr. Avera, properly performed his CAPM analysis and that the CAPM methodology supports the Commission's determination that the mechanical application of the DCF methodology results in an ROE that is inconsistent with *Hope* and *Bluefield*.

166. With regard to MISO TOs' size premium adjustment, the Commission stated in Opinion No. 531-B that the use of such an adjustment was "a generally accepted approach to CAPM analyses."[356] The Commission explained that "[t]he purpose of the . . . size adjustment is to render the CAPM analysis useful in estimating the cost of equity for companies that are smaller than the companies that were used to determine the market risk premium in the CAPM analysis."[357] Moreover, Mr. Gorman acknowledged that Morningstar proposes to add a size premium adjustment to the CAPM return because

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[353] *Id.* at 29 (citing Complainants Brief on Exceptions at 48-51).

[354] *Id.* at 29-30 (citing Initial Decision, 153 FERC ¶ 63,027 at P 271).

[355] *Id.* at 31.

[356] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 117.

[357] *Id.* P 117.

research suggests that systematic risk for small companies may not be completely reflected in the company's beta.[358] While Mr. Gorman asserted that Morningstar uses portfolios with a beta greater than one and the national proxy group has a beta less than one,[359] he does not explain how or why that fact would produce overstated results that would bar MISO TOs from making a size premium adjustment. Indeed, nothing in the record supports the notion that there is a correlation between beta and the size premium adjustment used by MISO TOs. As such, we are not persuaded by Complainants' and Joint Customer Intervenors' assertions that the size premium adjustment that is used by Morningstar cannot be used by MISO TOs.[360] For these reasons, we reject Complainants' argument that the size premium adjustment is flawed.

167. With regard to Complainants' proposed industry premium adjustment, the primary issue is whether it should be included in CAPM analyses or it should be limited to Morningstar's buildup method of determining the cost of equity. Complainants assert that the buildup method is a variation of CAPM. However, a thorough examination of Morningstar's buildup method reveals that the underlying formula differs from the generally accepted CAPM formula.[361] Indeed, the buildup method formula used by Morningstar does not consider beta, a fundamental input used in CAPM analyses. Therefore, as an initial matter, we affirm the Presiding Judge's conclusion that Mr. Gorman has failed to demonstrate that Morningstar's use of an industry premium adjustment in its buildup method has any relevance to CAPM analyses.[362]

168. Nevertheless, Complainants assert that an industry premium adjustment to the CAPM analysis is necessary. Therefore, they bear the burden of demonstrating that the inclusion of this adjustment is appropriate. Morningstar explains that the industry premium "measures how risky the industry is in relation to the market as a whole,

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[358] Exh. JC-9 (corrected) at 20-21.

[359] *Id.* at 20.

[360] *See* Initial Decision, 153 FERC ¶ 63,027 at P 281.

[361] Exh. MTO-59 at 6 (the buildup method formula used by Morningstar is as follows: Cost of Equity Estimate = Riskless Rate + Equity Risk Premium + Industry Risk Premium + Size Premium). For comparison, the CAPM formula is as follows: Required return = Risk-free Rate + Beta x (Expected Return – Risk-free Rate). *See* Initial Decision, 153 FERC ¶ 63,027 at P 259 (citing Exh. JC-9 at 41:2-10).

[362] *See* Initial Decision, 153 FERC ¶ 63,027 at P 271.

regardless of size."[363] As discussed above, beta, like the industry risk premium, is a measure of risk relative to the market. We note that every company in the national proxy group has a beta of less than one.[364] From that, we conclude that the betas already reflect the fact that the proxy group companies are low risk relative to the market generally. Accordingly, because the betas already reflect the relative risk of the industry, we conclude that it would be inappropriate to add an industry risk premium to the CAPM analyses.

169. Trial Staff argues against the use of Value Line growth rates in MISO TOs' CAPM analysis. While the Commission has found that Value Line's growth rate estimates are not acceptable as the short-term consensus growth rate input for the two-step DCF model, the Commission has nevertheless found that Value Line is a valid source of general financial data. In the instant CAPM analysis, the Value Line data is used in conjunction with IBES data and both are averaged over a 400-company data set. This use of growth rate data is fundamentally different from how growth rate data is used in our DCF model, because it is intended to provide a less precise cost of equity estimate than the DCF model. Although we require more precision from our DCF model—as the primary financial model that we use, and have used for decades, to determine public utility ROEs—that same degree of precision is less essential in the CAPM analysis because that analysis is but one of multiple pieces of evidence corroborating the results of our DCF analysis. Furthermore, no party demonstrated that the Value Line growth rate estimates for dividend-paying S&P 500 companies are unreasonably high or low, or that reliance on IBES growth rate estimates alone would produce a materially different CAPM result using data from the study period. For these reasons, we conclude that MISO TOs' use of both IBES and Value Line growth rate estimates in their CAPM analysis is reasonable for purposes of corroborating the results of the DCF analysis.

170. While we agree with Trial Staff, Joint Customer Intervenors, and OMS that beta does not serve the same function as the long-term growth rate component of the DCF,[365] we note that a long-term growth rate component is not required in the DCF study used to develop the market risk premium for MISO TOs' CAPM analysis. As the Commission explained in Opinion No. 531-B, the rationale for requiring a two-step DCF methodology that incorporates a long-term growth rate input when conducting a DCF study on a specific group of public utilities does not necessarily apply when conducting a DCF study

[363] Exh. MTO-59 at 4.

[364] *See* Exh. MTO-30 at 1-2.

[365] Trial Staff Brief on Exceptions at 44 n.84.

of the companies in the S&P 500. While it is often unrealistic and unsustainable for high short-term growth rates for an individual company to continue in perpetuity, the S&P 500 is regularly updated to only include companies with high market capitalization.[366] Joint Customer Intervenors and OMS argue that this rationale does not apply because MISO TOs did not rely on the S&P 500 index, but instead studied approximately 400 dividend-paying companies culled from the S&P 500. We disagree. MISO TOs did not arbitrarily select companies; they selected every dividend-paying stock included in the S&P 500, a group that is regularly updated.[367] As such, it is indisputable that each company selected by MISO TOs had a high market capitalization at that time. Therefore, consistent with Opinion No. 531-B, we find that the DCF study of the approximately 400 dividend-paying stocks selected by MISO TOs need not include a two-step DCF methodology that incorporates a long-term growth rate input.

171. Joint Customer Intervenors assert that MISO TOs' CAPM analysis should have used the Morningstar market risk premium of 6.2 percent, which was based on the arithmetic average difference between stocks and Treasury bills from 1926 to 2013.[368] However, the Morningstar market risk premium relies on historical data and, therefore, any CAPM analyses using the Morningstar market risk premium would be backward-looking.[369] Joint Customer Intervenors, therefore, request that the Commission accept a backward-looking CAPM analysis despite the fact that the Commission has historically accepted forward-looking CAPM analyses and rejected backward-looking CAPM analyses.[370] Accordingly, we reject Joint Customer Intervenors' requested use of the Morningstar market risk premium because doing so would result in a CAPM analysis that is not representative of the capital market conditions present during this proceeding.[371]

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[366] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 113.

[367] *See* Initial Decision, 153 FERC ¶ 63,027 at P 260. Non-dividend paying S&P companies must be excluded from the DCF analysis, because a DCF analysis cannot be performed for a non-dividend paying company.

[368] Exh. JCA-1 at 21:21-27.

[369] *See* Opinion No. 531-B, 150 FERC ¶ 61,165 at P 108 (citing Roger A. Morin, *New Regulatory Finance* 155-156 (Public Utilities Reports, Inc. 2006)).

[370] Initial Decision, 153 FERC ¶ 63,027 at PP 279-280 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 147 n.292).

[371] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 118 (finding that a CAPM study

(continued...)

172. For the reasons stated above, we affirm the Presiding Judge's acceptance of the CAPM analysis to be used as corroborative evidence, in determining whether the midpoint of the zone of reasonableness produced by the Commission's DCF analysis provides a return that satisfies the requirements of *Hope* and *Bluefield*.[372]

3. Risk Premium

173. The risk premium methodology, in which interest rates are a direct input, is "based on the simple idea that since investors in stocks take greater risk than investors in bonds, the former expect to earn a return on a stock investment that reflects a 'premium' over and above the return they expect to earn on a bond investment."[373] As the Commission found in Opinion No. 531, investors' required risk premiums expand with low interest rates and shrink at higher interest rates. The link between interest rates and risk premiums provides a helpful indicator of how investors' required returns on equity have been impacted by the interest rate environment.

174. Multiple approaches have been advanced to determine the equity risk premium for a utility.[374] For example, a risk premium can be developed directly, by conducting a risk premium analysis for the company at issue, or indirectly by conducting a risk premium analysis for the market as a whole and then adjusting that result to reflect the risk of the company at issue.[375] Another approach for the utility context is to "examin[e] the risk premiums implied in the returns on equity allowed by regulatory commissions for utilities over some past period relative to the contemporaneous level of the long-term U.S. Treasury bond yield."[376]

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is reliable and sufficiently representative of capital market conditions if it is prospective and does not pre-date the Great Recession).

[372] *See* Initial Decision, 153 FERC ¶ 63,027 at P 311.

[373] Opinion No. 531, 147 FERC ¶ 61,234 at P 147 (citing Roger A. Morin, New Regulatory Finance 108 (Public Utilities Reports, Inc. 2006).

[374] *See generally* Roger A. Morin, *New Regulatory Finance* 107-130 (Public Utilities Reports, Inc. 2006).

[375] *Id.* at 110.

[376] *Id.* at 123.

175. MISO TOs' witness, Dr. Avera, followed a variation of the latter approach, developing a risk premium study by analyzing the ROEs allowed by this Commission for the period from 2006 through 2014, relative to the contemporaneous level of the yield of BBB-rated bonds, to calculate equity risk premiums for each year during that period.[377] Dr. Avera then averaged these annual risk premiums to determine an average risk premium for the entire 2006-2014 period of 4.77 percent.[378]

176. Dr. Avera next adjusted this risk premium to reflect the tendency of risk premiums to rise as interest rates fall. Dr. Avera stated that the average yield of bonds rated BBB by S&P during the period 2006 to 2014 was 5.90 percent. However, the average yield of bonds rated Baa by Moody's during the January-June 2015 period used for the DCF analysis in this case was 4.55 percent, a difference of 1.35 percent.[379] This difference reflects the extent to which current bond yields have fallen below the 2006-2014 average. Based on MISO TOs' regression analysis of the annual equity risk premiums he calculated for each of the nine years from 2006 to 2014, the risk premium during that period increased by approximately 77.07 basis points for each percentage drop of the BBB-rated bond yields.[380] By applying the 77.07 basis point coefficient to the 1.35 percent reduction in bond yields, Dr. Avera calculated a risk premium adjustment of 1.04 percent, which Dr. Avera added to the 4.77 percent average risk premium for the 2006-2014 period to calculate an adjusted risk premium for the six-month DCF study period of 5.81 percent. Finally, Dr. Avera added the 5.81 percent adjusted risk premium to the 4.55 percent Baa-rated bond yield during the six-month DCF study period to calculate a risk premium-based cost of equity of 10.36 percent.[381]

a. Initial Decision

177. The Presiding Judge determined that the risk premium model offered by Dr. Avera was valid and supports awarding MISO TOs a base ROE above the midpoint of the zone

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[377] Exh. MTO-29 at 3; *see also* Exh. MTO-29 at 3.

[378] Exh. MTO-1 at 101:18-19.

[379] Exh. MTO-29 at 1. MISO TOs treated BBB and Baa rate bonds as having equivalent yields.

[380] *See* Exh. MTO-29 at 6.

[381] Exh. MTO-29 at 1; *see also* Initial Decision, 153 FERC ¶ 63,027 at PP 233-235.

of reasonableness. The Presiding Judge noted that the Commission in Opinion No. 531 accepted Dr. Avera's risk-premium analysis and that he had supported his contention that the risk premium rises as the interest rates fall with numerous authorities.[382] The Presiding Judge rejected Mr. Gorman's risk premium model, observing that it was "appreciably different" from the analysis used by the Commission in Opinion No. 531 and that Mr. Gorman did not justify these differences. The Presiding Judge also noted that Mr. Gorman did not address the inverse relationship between bond yields and the risk premium that the Commission "endorsed" in Opinion No. 531.

178. The Presiding Judge also rejected the criticisms of the risk premium model advanced by various witnesses, noting that, although they might be a reason not to rely on the risk premium model in lieu of a DCF analysis, they did not demonstrate that it shouldn't be used as a check on the DCF model.[383] Relying on the Commission's determinations in Opinion No. 531-B, the Presiding Judge also rejected arguments that risk premium model suffered from regulatory lag—the idea that bond yields were not contemporaneous with the various study periods—and that the risk premium analysis was flawed because many of the included ROEs were set by settlement. Finally, the Presiding Judge rejected critiques of Dr. Avera's sample size and statistical methodology, noting that they were equivalent or superior to those that the Commission accepted and relied upon in Opinion No. 531.

b. Briefs on Exceptions

179. Complainants argue that Dr. Avera's risk premium analysis, which the Initial Decision adopted, is inconsistent with the finding of anomalous market conditions. Complainants contend that, because the Initial Decision found that current market conditions are unsustainable, it is inappropriate to accept Dr. Avera's risk premium model, which Complainants assert is based on an unsustainable relationship between equity returns and bond yields during a period of unsustainable capital market conditions.[384]

180. Complainants assert that Dr. Avera's risk premium analysis is flawed because the regression study is based on only nine observations (the annual equity risk premiums for each year from 2006 to 2014). Complainants note that, rather than looking at the

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[382] Initial Decision, 153 FERC ¶ 63,027 at P 260.

[383] *Id.* P 241.

[384] Complainants Brief on Exceptions at 37-39.

individual company-authorized ROEs, Dr. Avera made simplifying assumptions that likely increased the results.[385] Complainants also allege that, rather than relying on independent market participants' projected Baa-rated bond yield, Dr. Avera developed his own projected utility bond yield.[386] Complainants further assert that Dr. Avera's adjustments to the data produce excessive ROEs based on today's current capital market environment.[387] Complainants also cite to arguments from Mr. Solomon and Mr. Hill regarding flaws in the risk premium analysis.[388]

181. Complainants state that Dr. Avera's risk premium analysis should be disregarded and that Mr. Gorman's risk premium analysis should be considered.[389] According to Complainants, unlike Dr. Avera's risk premium analysis, Mr. Gorman's risk premium analysis is based on two estimates of equity return over the period of 1986 to 2015 to account for variations of the risk premium based on market conditions and investor risk perceptions.[390] Complainants explain that Mr. Gorman's risk premium analysis using U.S. Treasury bonds resulted in a range of 8.25 percent to 10.57 percent, his risk premium analysis using Baa-rated bonds resulted in a range of 7.53 percent to 10.13 percent, and the two analyses together resulted in a range of 7.53 percent to 10.57 percent with a midpoint of 9.05 percent.[391]

182. Complainants state that the current A-rated utility-bond yield to U.S. Treasury bond yield spread is approximately 116 basis points, while the 36-year average A-rated utility-bond yield spread is 152 basis points. Complainants further state that the current Baa-rated utility-bond yield to U.S. Treasury bond yield spread is approximately equal to

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[385] *Id.* at 45-46 (citing Exh. JC-9 at 27). Mr. Gorman seems to have argued that Dr. Avera erred by relying on the average authorized returns for each year, thereby weighing each of the eight authorized returns from 2013 less than each of the five authorized returns from 2014.

[386] *Id.* at 46 (citing Exh. JC-9 at 28).

[387] *Id.* at 46 (citing Exh. JC-9 at 28-29).

[388] *Id.* at 46-47 (citing Exh. JCI-4 at 41, Exh. JCA-11 at 36-42).

[389] *Id.* at 47.

[390] *Id.* at 39-40 (citing Exh. JC-9 at 47).

[391] *Id.* at 42-43 (citing Exh. JC-22 at 17).

the 36-year average utility-bond yield spread. According to Complainants, the utility-bond yield spreads are evidence that the market considers electric utilities to be relatively low-risk investments and that utilities continue to have strong access to capital markets.[392]

183. Joint Customer Intervenors contend that several witnesses demonstrated flaws in Dr. Avera's risk premium analysis. Joint Customer Intervenors assert that the Initial Decision improperly rejected the identification of flaws in Dr. Avera's regression analysis on the basis that the Commission accepted the methodology in Opinion No. 531. Joint Customer Intervenors argue, however, that MISO TOs broadened the limited purpose for which the alternative analyses were used in Opinion No. 531 and that the flaws identified in the instant proceeding were not considered in Opinion No. 531.[393]

184. Joint Customer Intervenors argue that Dr. Avera's risk premium analysis was flawed because it relied completely on historical data, inconsistent with the Commission's long-established policy that the ROE methodology must be forward-looking.[394] Joint Customer Intervenors contend that the use of a historical risk premium analysis in conjunction with a forward-looking DCF analysis amounts to an unreliable mismatch.[395]

185. Joint Customer Intervenors contend that the Initial Decision dismissed their witness Mr. Solomon's arguments without addressing them.[396] First, Joint Customer Intervenors assert that Dr. Avera's risk premium analysis lacked a direct equity market input, thereby producing an unreliable and inflated estimate of the current cost of common equity capital. Second, Joint Customer Intervenors also assert that Dr. Avera's risk premium analysis' use of interest rates and risk premiums as the only inputs in its

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[392] *Id.* at 42.

[393] Joint Customer Intervenors Brief on Exceptions at 39-43.

[394] *Id.* at 40 (citing Exh. JCI-4 at 41:15-16; *S. Cal. Edison Co.*, Opinion No. 445, 92 FERC ¶ 61,070 (2000)).

[395] *Id.*

[396] *Id.* at 40-42 (citing Initial Decision, 153 FERC ¶ 63,027 at P 255; *NorAm Gas Transmission Co. v. FERC*, 148 F.3d 1158, 1165 (D.C. Cir. 1998)).

regression analysis failed to consider other factors that influence risk premiums and thus cannot account for historical volatility in risk premiums.[397]

186. According to Joint Customer Intervenors, Mr. Solomon demonstrated that more recent data indicates that Dr. Avera's analysis was upwardly and improperly biased. Joint Customer Intervenors state that Dr. Avera's risk premium analysis calculated a 5.62 percent risk premium for the DCF study period during the first half of 2015, which Joint Customer Intervenors point out is 27 basis points above the 5.35 percent risk premium Dr. Avera observed for 2014.[398]

187. Joint Customer Intervenors also state that Dr. Avera's risk premium analysis calculated that, for every 1 percent drop in utility bond yields, the cost of equity capital goes down by just under 23 basis points. Joint Customer Intervenors note, however, that Dr. Avera concluded in a separate state commission-based risk premium analysis that ROEs declined over 57 basis points for every 1 percent reduction in the average utility bond yield. Joint Customer Intervenors argue that the disparity between the two analyses further supports placing no reliance on the results of such historical analyses.[399]

188. OMS asserts that Dr. Avera's risk premium study is fatally flawed by the inclusion of at least one data point that is demonstrably invalid and results in a grossly excessive risk premium. OMS states that one of the Base ROE decisions that Dr. Avera included in his data set can in no way be considered a cost of equity determination and, therefore, had no place in the data set of historic risk premiums.[400] OMS states that *ITC Holdings* was merely a docketing order insofar as ROE is concerned; it established that litigation of a just and reasonable ROE for the Entergy Operating Companies' transmission assets would be determined prospectively in the instant proceeding, rather than in the Entergy transmission rate docket. OMS argues that, by treating *ITC Holdings* the same as other orders where the Commission actually calculated a just and reasonable return for a company, Dr. Avera grossly inflated the historical risk premium.[401]

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[397] *Id.* at 41 (citing Exh. JCI-4 at 51:17-20, 42:1-15).

[398] *Id.* at 41-42 (citing Exh. MTO-6 at 3).

[399] *Id.* at 43 (citing Exh. MTO-10).

[400] OMS Brief on Exceptions at 31 (citing *ITC Holdings Corp.*, 143 FERC | ¶ 61,257 (2013), *order on reh'g*, 146 FERC ¶ 61,111, at P 25 (2014) (*ITC Holdings*)).

[401] *Id.*

189. OMS states that it is a straightforward matter to correct the errors committed by Dr. Avera. OMS states that the Commission may take administrative notice of its past decisions and those decisions' underlying bases to the extent necessary to consider OMS' corrected version of Exhibit No. MTO-29.[402] OMS states that, by limiting the data points to actual base ROE determinations, its corrected version of Exhibit No. MTO-29 produces a value significantly lower than 10.32 percent.[403]

c. Briefs Opposing Exceptions

190. MISO TOs argue that the Presiding Judge correctly accepted Dr. Avera's risk premium analysis, and that his analysis simply serves as a check on the midpoint of the DCF range, and not the cost of capital model used to set the authorized ROE. MISO TOs assert that the Commission has previously accepted Dr. Avera's approach for its limited purpose.[404] MISO TOs state that the Presiding Judge properly concluded that Mr. Gorman's alternate risk premium analysis was "unreliable and produced cost of equity estimates that were unrepresentatively low."[405] MISO TOs disagree with OMS' characterization of the Commission's decision in *ITC Holdings* as "merely a docketing order insofar as ROE is concerned."[406] MISO TOs assert that the Commission found the current 12.38 percent ROE to be just and reasonable for Entergy as a MISO transmission owner, and rejected arguments for a different ROE.[407]

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[402] *Id.* at Attachment 1 (removing or revising various data points from the list compiled by MISO TOs).

[403] OMS Brief on Exceptions at 32-33. OMS proposes a risk premium cost of equity of 9.94 percent. *Id.*, Attachment 1.

[404] MISO TOs Brief Opposing Exceptions at 24 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at PP 97-101).

[405] *Id.* at 26.

[406] *Id.* (citing OMS Brief on Exceptions at 31); *see ITC Holdings*, 146 FERC ¶ 61,111.

[407] MISO TOs Brief Opposing Exceptions at 27 (citing *ITC Holdings*, 146 FERC ¶ 61,111 at P 60).

d. Commission Determination

191. We affirm the Presiding Judge's findings that the MISO TOs' risk premium study is valid and supports awarding the MISO TOs a base ROE above the midpoint. We disagree with Complainants' assertion that risk premium analyses cannot be relied upon during a period of anomalous capital market conditions. The Commission has already considered this question. In Opinion No. 531, the Commission stated that alternative methodologies serve as additional evidence to gain insight into the potential impacts of unusual capital market conditions on the appropriateness of using the resulting midpoint. The Commission found the risk premium analysis to be informative, and used it and other alternative methodologies to inform the placement of the just and reasonable ROE within the zone of reasonableness established by the DCF methodology.[408] Consistent with this precedent, we find that, as a general matter, it is appropriate to rely on risk premium analyses as corroborative evidence during periods of anomalous capital market conditions.

192. With regard to assertions regarding the number of observations in MISO TOs' regression analysis, we find that the nine-year period is sufficiently large to inform a risk premium study. Since the issuance of Order No. 679, when the Commission commenced setting "up-front ROEs," a substantial amount of ROE data points became available. Moreover, MISO TOs' regression analysis covers a period both before and after the financial crisis, and considers approximately 80 Commission-accepted ROE data points over the nine-year period.[409] Neither Complainants nor Complainant-aligned parties provided additional Commission-accepted ROE data points for the years preceding 2006, so we have no evidence that doing so would substantially impact MISO TOs' regression analysis.[410]

193. While Complainants suggest that each ROE data point should be its own observation in the regression analysis, we are not persuaded that doing so would be

[408] Opinion No. 531, 147 FERC ¶ 61,234 at PP 145-146.

[409] Exh. MTO-29 at 4-5.

[410] Complainants' risk premium analysis considers state commission-accepted ROEs for the period from 1986 through March 2015. *See* Exh. JC-19. The Commission rejected the results of a similar risk premium study due to the risk differential between state-regulated distribution and Commission-regulated interstate transmission. Opinion No. 531-B, 150 FERC ¶ 61,165 at P 99. Accordingly, we reject Complainants' risk premium analysis.

superior to MISO TOs' regression analysis, based on the nine annual equity premiums during the years 2006-2014. Complainants' proposal would require each ROE data point to be matched with the bond yield that existed on the date of the Commission's acceptance of that data point.[411] However, Complainants have not demonstrated why the bond yield on that specific date is more representative of the interest rate environment than the average annual bond yields used by MISO TOs. Indeed, there is no fixed relationship – and there is a lag – between dates of the relevant study period and the date on which the Commission adopts an ROE, with the variation depending on the facts of the case. Therefore, it seems that assigning the bond yield on one specific date to each data point would add an unnecessary amount of volatility to the regression analysis. Furthermore, the Commission already held in Opinion No. 531-B that assigning approximate dates to the cost of equity determinations is often unavoidable and does not undermine the relevance of risk premium analyses. For these reasons, we find that the methodology used by MISO TOs in their regression analysis is appropriate.

194. We also reject Complainants' argument that MISO TOs should have relied on independent market participants' projected Baa-rated bond yield. The Presiding Judge held that projected yields used in risk premium analyses are speculative and less reliable than historical yields, and rejected Dr. Avera's use of projected Baa-rated bond yields. As an initial matter, we agree with the Presiding Judge and, for that reason, reject Complainants' argument.

195. With regard to Joint Customer Intervenors' argument that MISO TOs' risk premium analysis was flawed because it relied completely on historical data, we note that the risk premium analysis accepted in Opinion No. 531-B was based on "empirical observations and regression analysis of bond yields and Commission-allowed ROEs"—i.e., forms of historical data.[412] In any event, because the risk premium analysis uses regulated ROEs, it would be inappropriate to attempt to project what such ROEs would be. Moreover, despite Joint Customer Intervenors' assertion that MISO TOs' risk premium analysis is inconsistent with the Commission's policy that the ROE methodology must be forward-looking, we are not relying on the risk premium analysis to set the ROE itself. Instead, we find that MISO TOs' risk premium analysis is sufficiently reliable to corroborate our decision to place MISO TOs' base ROE above the midpoint of the zone of reasonableness produced by the DCF analysis.[413]

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[411] Exh. JC-9 (corrected) at 27.

[412] Opinion No. 531-B, 150 FERC ¶ 61,165 at PP 97-101.

[413] *Id.* P 98.

196. We disagree with Joint Customer Intervenors' assertion that MISO TOs' risk premium analysis is flawed because it lacks a direct market input and fails to consider other factors that influence risk premiums. MISO TOs' risk premium analysis is similar to the risk premium analysis accepted in Opinion No. 531-B. Therefore, in order to demonstrate that MISO TOs' risk premium analysis is flawed, Joint Customer Intervenors must either raise and reasonably support new arguments that were not considered in the Opinion No. 531 proceeding, or differentiate between the two risk premium analyses. Joint Customer Intervenors fail to do either. For example, Joint Customer Intervenors generically claim that MISO TOs' risk premium analysis is lacking, but do not propose specific factors that should be considered. As a result, we have no basis to conclude that any further considerations are necessary. Moreover, while Joint Customer Intervenors claim that MISO TOs' risk premium analysis cannot account for historical volatility, they fail to demonstrate that this purported historical volatility would result in materially different risk premium results.[414]

197. Joint Customer Intervenors disagree with MISO TOs' regression analysis and its result: for every percentage drop of the BBB-rated bond yields, the risk premium increased approximately 77.07 basis points and, therefore, the cost of equity capital would decrease by approximately 22.93 basis points. We note, however, that the 77.07 basis point coefficient proposed by MISO TOs is substantially less than the 93 basis point coefficient in the analysis that the Commission relied upon in Opinion No. 531-B.[415] Furthermore, despite Joint Customer Intervenors' arguments to the contrary, the Commission held in Opinion No. 531-B that it was not persuaded by arguments that the results of a Commission-based risk premium analysis "are invalid simply because they differ from the inferred rate relationship reflected in historical state commission-approved ROEs, particularly where anomalous capital market conditions exist that may impact the inferred relationship between risk premiums and interest rates."[416]

198. As for OMS' argument that MISO TOs included data points in their risk premium analysis that should not have been considered, the Commission dismissed similar arguments in Opinion No. 531-B by concluding that "whether the regulatory decision involved a settlement agreement or the application of a cost of equity that was calculated in the past, e.g., the 12.38 percent ROE established for the MISO region, does not affect

[414] *See* Opinion No. 531-B, 150 FERC ¶ 61,165 at P 98.

[415] *Id.* P 99.

[416] *Id.* P 99.

the reliability of a risk premium analysis."[417] Accordingly, we reject OMS' arguments that *ITC Holdings* and other data points should be removed from MISO TOs' risk premium analysis.

199. OMS also proposes revisions to the dates of several data points included in MISO TOs' risk premium analysis. Although we agree with OMS that any necessary corrections should be made, OMS has not demonstrated that its proposed date corrections would materially affect the results of MISO TOs' risk premium analysis.[418] Therefore, we find that these discrepancies do not undermine the usefulness of MISO TOs' risk premium analysis as corroborative evidence.

200. For the reasons stated above, we find that MISO TOs' risk premium analysis is sufficiently reliable to corroborate the results of the DCF analysis in this proceeding. We, therefore, affirm the Presiding Judge's acceptance of the risk premium analysis to be used as corroborative evidence, in determining whether the midpoint of the zone of reasonableness produced by the Commission's DCF analysis provides a return that satisfies the requirements of *Hope* and *Bluefield*.[419]

4. Expected Earnings

201. A comparable earnings analysis is a method of calculating the earnings an investor expects to receive on the book value of a particular stock. The analysis can be either backward looking using the company's historical earnings on book value, as reflected on the company's accounting statements, or forward-looking using estimates of earnings on book value, as reflected in analysts' earnings forecasts for the company.[420] The latter approach is often referred to as an "expected earnings analysis" and is the approach that MISO TOs used in this proceeding. As the Commission explained in Opinion No. 531-B, "returns on book equity help investors determine the opportunity cost of

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[417] *Id.* P 98. In *ITC Holdings*, the Commission approved the Entergy Operating Companies' use of the 12.38 percent ROE established for the MISO region. *ITC Holdings*, 146 FERC ¶ 61,111 at P 25.

[418] While OMS calculated a risk premium cost of equity of 9.94 percent, OMS' analysis revised dates for several data points *and* removed approximately 15 data points from MISO TOs' risk premium analysis. OMS Brief on Exceptions, Attachment 1.

[419] *See* Initial Decision, 153 FERC ¶ 63,027 at P 258.

[420] *See* Opinion No. 531-B, 150 FERC ¶ 61,165 at P 125.

investing in that particular utility instead of other companies of comparable risk" and, as a result, an expected earnings analysis can be useful for corroborating whether the results produced by the DCF model may have been skewed by the anomalous capital market conditions reflected in the record.[421]

202. MISO TOs' forward-looking expected earnings analysis uses the same proxy group used in their two-step DCF analysis. MISO TOs' witness, Dr. Avera, started with the return on book equity that Value Line forecasts for each proxy company for the period 2017 to 2019.[422] He then multiplied each of those returns by an adjustment factor to determine each utility's average return, rather than its year-end return. After the elimination of one outlier result,[423] Dr. Avera's analysis produced an adjusted ROE range of 7.61 percent to 16.37 percent, with a midpoint value of 11.99 percent. As with the other alternative methodologies accepted herein, this midpoint value exceeds the 9.29 percent midpoint value of the Commission's two-step DCF analysis.[424]

a. Initial Decision

203. The Presiding Judge declined to rely on Dr. Avera's forward-looking expected earnings analysis. While acknowledging that the Commission in Opinion No. 531 relied upon an expected earnings analysis "identical in all material respects" to Dr. Avera's, the Presiding Judge observed that the Commission was not aware of a critique by Dr. Morin—on whose authority the Commission relied in accepting the expected earnings analysis in Opinion No. 531—that such analysis should be based on a sample of unregulated, rather than regulated, companies. Because Dr. Avera's analysis relied on the regulated companies in the proxy group, and because of "Dr. Avera's inability to address [Dr. Morin's] rejection" of the use of regulated companies in an expected earnings analysis, the Presiding Judge elected not to rely on Dr. Avera's analysis.[425]

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[421] *Id.* PP 128-129.

[422] Ex. MTO-31.

[423] Dr. Avera eliminated Dominion Resources' adjusted return on common equity of 18.38 percent.

[424] *See* Initial Decision, 153 FERC ¶ 63,027 at P 118.

[425] *Id.* P 325.

b. Briefs on Exceptions

204. MISO TOs ask the Commission to reverse the Initial Decision and instead find that the expected earnings analysis provides a useful and probative benchmark for purposes of evaluating DCF results when anomalous capital market conditions justify consideration of alternative estimates of the cost of equity.[426] MISO TOs refer to the Presiding Judge's conclusion that Dr. Avera failed to follow the approach in Dr. Morin's *New Regulatory Finance*.[427]

205. MISO TOs assert that Dr. Avera's study was the same analysis submitted and accepted in Opinion No. 531 and, although the Presiding Judge argues that the Commission was not aware of Dr. Morin's statement that proxy groups should be made up of unregulated companies, the record in neither proceeding supports this inference.[428] MISO TOs assert that *New Regulatory Finance* does not mandate exclusive reliance on unregulated companies.[429] MISO TOs argue that Dr. Morin's critique of using regulated companies relates entirely to the application of the comparable earnings approach using historical data, which reflects in part past actions of other regulators and historical conditions. MISO TOs argue that this is distinct from the forward-looking expected earnings approach relied upon by the Commission in Opinion No. 531, which MISO TOs contend is no more susceptible to concerns over regulatory influence than the analysts' EPS growth rates that are used to apply the DCF model.[430]

206. MISO TOs argue that the critical inquiry for assessing the merits of an expected earnings analysis is whether the studied companies are of comparable risk to the utilities whose rates are at issue, not whether they are regulated.[431] MISO TOs further state that, although Dr. Avera conceded that expected earnings of non-regulated companies may

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[426] MISO TOs Brief on Exceptions at 2.

[427] *Id.* at 24 (citing Initial Decision, 153 FERC ¶ 63,027 at P 323).

[428] *Id.* at 25 (citing Initial Decision, 153 FERC ¶ 63,027 at P 323).

[429] *Id.* (citing Roger A. Morin, *New Regulatory Finance* 381 (Public Utilities Reports, Inc. 2006) (stating that "[t]he reference group is usually made up of unregulated industrial companies.")).

[430] *Id.* at 25-26.

[431] *Id.* at 26.

also provide a logical benchmark for evaluating a just and reasonable ROE, this does not preclude consideration of other electric utilities' expected earnings. MISO TOs argue that *Principles of Public Utilities Rates* supports Dr. Avera's assertion that an analysis of comparable earnings may be conducted for "utilities or nonregulated firms."[432]

207. Finally, MISO TOs argue that the Presiding Judge failed to credit Dr. Avera's testimony regarding the use of the expected earnings model by the Virginia State Corporation Commission (Virginia Commission), which is required by statute to consider the earned returns on book value of electric utilities in its region and has established allowed ROEs based on earned returns on book value for peer groups of other electric utilities.[433] MISO TOs argue that Dr. Avera's point was to show that regulators do not consider the expected earning analysis to be useful only when applied to unregulated enterprises and that there is no reason to assume that the Virginia Commission's rationale for its practice is different than the rationale offered by Dr. Avera and Mr. Bonbright – that an expected earnings study of comparable enterprises can provide useful estimates of investor expectations.[434]

c. Briefs Opposing Exceptions

208. Complainants and other parties contend that the Commission should affirm the Presiding Judge's rejection of Dr. Avera's expected earnings analysis.[435] Complainants point out that Dr. Avera's methodology departs from Dr. Morin's prescribed method of composing a proxy group by using a group of electric utilities, rather than a group of unregulated companies.[436] Complainants argue that Dr. Avera was unable to justify this

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[432] *Id.* (citing James C. Bonbright *et al.*, Principles of Public Utility Rates 329 (2d ed. 2006)).

[433] MISO TOs Brief on Exceptions at 27.

[434] *Id.*

[435] Complainants Brief Opposing Exceptions at 7-11; Trial Staff Brief Opposing Exceptions at 9-16; Iowa Group Brief Opposing Exceptions at 11-16; Joint Customer Intervenors Brief Opposing Exceptions at 8-17; OMS/Joint Consumer Advocates Brief Opposing Exceptions at 21-24.

[436] Complainants Brief Opposing Exceptions at 7 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 315-316, 323).

departure from Dr. Morin's expected earnings methodology such that their arguments should be rejected.[437]

209. Complainants assert that MISO TOs' arguments that the Commission was aware of Dr. Morin's statement that proxy group should be made up of unregulated companies are unpersuasive and made up of circumstantial evidence.[438] Complainants also disagree with MISO TOs' argument that this departure from Dr. Morin's expected earnings approach is permissible given the Commission's recognition of Dr. Morin as an authority on the expected earnings analysis.[439] According to Complainants, the record in this proceeding is lacking evidence that justifies such a departure. Complainants state that a plain reading of Opinion No. 531 demonstrates that the Commission was unaware of the proxy group flaw in the expected earnings analysis. Complainants assert that Dr. Avera's expected earnings results in circular ratemaking,[440] problems of which the Commission has recognized.[441]

210. Complainants contend that the Presiding Judge's rejection of Dr. Avera's expected earnings analysis was based on the record in this proceeding and represents reasoned decision making. According to Complainants, the Presiding Judge's rejection of Dr. Avera's expected earnings analysis does not affect the Presiding Judge's ultimate ROE recommendation and, by taking exception, MISO TOs are seeking what is effectively an inappropriate advisory opinion from the Commission.[442]

211. Complainants disagree with MISO TOs' argument regarding the Virginia Commission's use of a similar expected earnings methodology.[443]

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[437] *Id.* at 8.

[438] *Id.* (citing MISO TOs Brief on Exceptions at 25-26).

[439] *Id.* at 8-9 (citing Initial Decision, 153 FERC ¶ 63,027 at P 315).

[440] *Id.* at 9 (citing Exh. S-1 at 97-98).

[441] *Id.* (citing *Minnesota Power and Light Co.*, Opinion No. 12, 3 FERC ¶ 61,045, at 61,132 (1978)).

[442] *Id.* at 9-10.

[443] *Id.* at 10 (citing MISO TOs Brief on Exceptions at 27).

Complainants assert that a mere description of a state Commission's purported use of this method is not sufficient to justify Dr. Avera's departure from Dr. Morin's guidance.[444]

212. Complainants also argue that the record demonstrates other flaws in Dr. Avera's expected earnings analysis. Complainants state that the non-regulated assets of MISO TOs can affect the expected return on their consolidated operations. Complainants also state that the earned return on book equity does not describe the return investors currently require to make an investment in the National Proxy Group of companies and, therefore, it does not establish what the current market cost of equity is for these companies.[445] Complainants note that, in addition to Mr. Gorman, the following witnesses testified that Dr. Avera's expected earnings study is fundamentally flawed and consequently produces unreliable results: Mr. Hill, Iowa Group's witness Mr. Parcel, Mr. Solomon, and Mr. Keyton.[446]

213. Trial Staff notes that the Presiding Judge relied on Mr. Keyton's observations that both the Commission, in Opinion Nos. 531 and 531-B, and Dr. Avera, in his testimony, referred extensively to Roger Morin's *New Regulatory Finance*.[447] Trial Staff argues, however, that Dr. Avera failed to follow the specific three step methodology outlined by Dr. Morin, and instead repeated the type of expected earnings analysis that he used in the Opinion No. 531 proceeding.[448]

214. Trial Staff objects to the use of utility book rates of return as data inputs for an expected earnings study, and asserts that doing so introduces an element of circularity into the analytical process. Trial Staff states that limiting the data field to regulated utilities perpetuates established allowed ROEs rather than estimating the current market costs of equity.[449] Despite MISO TOs' argument that circularity concerns have been

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[444] *Id.* at 10 (citing Initial Decision, 153 FERC ¶ 63,027 at P 321).

[445] *Id.* at 10-11 (citing Exh. JC-9 at P 17).

[446] *Id.* at 11.

[447] Trial Staff Brief Opposing Exceptions at 10 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 315-323).

[448] *Id.* (citing Roger A. Morin, *New Regulatory Finance* 383 (Public Utilities Reports, Inc. 2006)).

[449] *Id.* at 11 (citing Exh. S-1 at 98).

obviated by Dr. Avera's use of projected Value Line rates of return on book equity,[450] Trial Staff contends that Dr. Avera's use of projected book rates of return intensifies rather than ameliorates the noted defect. Trial Staff states that if utilities are awarded an ROE on the basis of what Value Line expects them to earn, there is a clear likelihood that they will converge in the future.[451]

215. According to Trial Staff, Dr. Avera used the Value Line data for the period from 2017 to 2019 when shorter-term projections were also available.[452] Trial Staff argues that, given that the expected accuracy of predictive estimates decline as their temporal horizon increases, it would have been preferable for Dr. Avera to average the three available Value Line earned rate of return projections instead of relying solely on the most distant one.[453]

216. Trial Staff disagrees with MISO TOs' contention that the methodology used by Dr. Avera is analytically identical to the one the Commission accepted in Opinion No. 531. Trial Staff acknowledges that, in Opinion No. 531, the Commission cited Dr. Morin's treatise in support of use of this methodology as a check on DCF results.[454] However, according to Trial Staff, the general discussion of this issue in Opinion No. 531 can hardly be read as an endorsement of the particular calculations performed by Dr. Avera on the data he selected for his study. Trial Staff argues that, as with the case of the Commission's inadvertent use of Dr. Avera's dividend yield calculation in Opinion No. 531, the Commission cannot be held to have approved an expected earnings methodology that it had not substantively examined.[455]

217. Regarding MISO TOs' contention that other authorities, such as the Virginia Commission, find comparable earnings studies relying on regulated utility data to be

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[450] *Id.* at 14 (citing MISO TOs Brief on Exceptions at 25-26 (noting that Dr. Morin generally discusses the use of historical data in his discussion of the comparable earnings methodology)).

[451] *Id.* at 14.

[452] *Id.* at 11-12 (citing Exh. S-1 at 100-101).

[453] *Id.* at 12 (citing Exh. S-1 at 100-101).

[454] *Id.* at 13 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 147).

[455] *Id.* at 13-14.

acceptable, Trial Staff states that MISO TOs do not attempt to defend or even explain the rationale underlying that choice.[456] Furthermore, Trial Staff states that the Commission has expressly ruled on this issue, indicating its preference for the use of nonregulated firms in conducting a comparative earnings analysis.[457] Trial Staff asserts that neither Dr. Avera nor MISO TOs' brief on exception explain the rationale for the Virginia Commission's ROE determinations.[458]

218. Iowa Group asserts that an expected earnings analysis on regulated utilities produces a rate-making circularity that perpetuates allowed returns on equity rather than measuring the actual cost of capital. Iowa Group asserts that the authorities cited by MISO TOs each recognize and discuss this limitation.[459]

219. According to Iowa Group, the purpose of regulation is to produce the same result that would occur in an unregulated market and, therefore, focusing on regulated returns does not produce a reliable measure of the cost of equity for an unregulated firm.[460] Iowa Group states that conducting an expected earnings analysis based on a proxy group consisting solely of regulated utilities involves allowed returns on equity and requires setting a utility's return based on other utilities' returns. Iowa Group, therefore, states that a utility-based expected earnings study will reflect a regulated marketplace over time and that such a result is contrary to one of the fundamental economic principles of utility regulation. Iowa Group asserts that a historical versus forward-looking distinction is meaningless in this context, since both rely on regulated returns. [461]

220. Joint Customer Intervenors assert that Dr. Avera's expected earnings analysis was invalid because it was applied to regulated utilities, while his primary authority,

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[456] *Id.* at 15.

[457] *Id.* at 15 (citing Opinion No. 12, 3 FERC at 61,132).

[458] *Id.* at 15 (citing Initial Decision, 153 FERC ¶ 63,027 at P 321.

[459] Iowa Group Brief Opposing Exceptions at 14-15 (citing James C. Bonbright, Principles of Public Utility Rates 329-330 (Public Utilities Reports, Inc. 2006); Roger A. Morin, *New Regulatory Finance* 383 (Public Utilities Reports, Inc. 2006); David C. Parcell, The Cost of Capital: A Practitioner's Guide 118-119 (2010)).

[460] *Id.* at 14.

[461] *Id.* at 16.

New Regulatory Finance, states that the comparable earnings approach should only be applied to a comparable risk group of unregulated companies.[462] Joint Customer Intervenors contend that MISO TOs cannot be permitted to rely on a source as a standard for analysis and then disregard that source at will.[463]

221. Joint Customer Intervenors object to MISO TOs' citation to *Principles of Public Utility Rates*, arguing that MISO TOs cite to this source for the first time in their brief on exceptions. Joint Customer Intervenors also note that MISO TOs omitted statements in *Principles of Public Utility Rates* that suggest that the issue of circularity is raised if the comparable earnings approach is applied to regulated utilities.[464]

222. Joint Customer Intervenors contend that MISO TOs' argument is anecdotal and without explanation for why or how the Virginia Commission applied its approach. Joint Customer Intervenors assert that MISO TOs failed to justify departure from the methodology that both Dr. Avera and the Commission have cited as the principal authority on the expected earnings model.[465]

223. In response to MISO TOs' argument that Opinion No. 531's cite to *New Regulatory Finance* demonstrates that the Commission was aware of Dr. Morin's prohibition on the use of regulated utilities in the expected earnings analysis, Joint Customer Intervenors assert that the prohibition was not discovered or brought to the Commission's attention in that proceeding.[466]

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[462] Joint Customer Intervenors Brief Opposing Exceptions at 9-10 (citing Dr. Roger A. Morin, *New Regulatory Finance* 381-382 (Public Utilities Reports, Inc. 2006); Initial Decision, 153 FERC ¶ 63,027 at P 316).

[463] *Id.* at 13.

[464] *Id.* at 11 (citing MISO TOs Brief on Exceptions at 26; James C. Bonbright, Principles of Public Utility Rates 239-330 (Public Utilities Reports, Inc. 2006)).

[465] *Id.* at 12.

[466] *Id.* at 13-14 (citing MISO TOs Brief on Exceptions at 25).

224. Joint Customer Intervenors assert that MISO TOs' reference to Dr. Morin's statement that "[t]he reference group is *usually* made up of unregulated industrial companies" is without context, does nothing to refute Dr. Morin's conclusion and rationale for excluding regulated utilities, and fails to recognize the multiple additional instances where Dr. Morin cautions against the use of regulated utilities.[467]

225. Joint Customer Intervenors assert that MISO TOs' claim that Dr. Morin's prohibition on the use of regulated utilities does not apply to forward-looking analyses amounts to a conclusory statement. Joint Customer Intervenors argue that this claim is refuted by Dr. Morin's recognition of the use of the projected comparable earnings approach, and by the absence of any statement by Dr. Morin that the projected comparable earnings approach ameliorates the issue of circularity.[468]

226. Joint Customer Intervenors note that Mr. Solomon explained that Dr. Avera's expected earnings analysis was not based on market data, but on projected returns on book equity, and that the Commission has historically rejected the comparable earnings method.[469] According to Joint Customer Intervenors, the Commission has recognized that the allowed rate of return shall be set "at the rate of return investors require on their investment" and that "when the price-to-book ratio is greater than one, the rate of return investors expect to earn on common equity is greater than the rate of return investors require from their investment in common stock."[470] Joint Customer Intervenors note that Dr. Avera's expected earnings analysis shows a midpoint of 11.44 percent and that the average price-to-book ratio for the proxy group is 1.79.[471]

227. Joint Customer Intervenors assert that an investor willing to pay more than the book value for a utility's expected earnings expects to earn something less than the expected earned rate of return on book value on that investment. Joint Customer

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[467] *Id.* at 14 (citing MISO TOs Brief on Exceptions at 25 & n.67; Dr. Roger A. Morin, *New Regulatory Finance* 381-382 (Public Utilities Reports, Inc. 2006)).

[468] *Id.* at 14-15 (citing MISO TOs Brief on Exceptions at 26; Dr. Roger A. Morin, *New Regulatory Finance* 385 (Public Utilities Reports, Inc. 2006)).

[469] *Id.* at 15 (citing Exh. JCI-4 at 49:14-20).

[470] *Id.* at 15 (citing *Orange and Rockland Utilities, Inc.*, 44 FERC ¶ 61,253, at 61,952 (1988) (*Orange and Rockland*)).

[471] *Id.* at 16 (citing Exh. JCI-4 at 50:14-17).

Intervenors contend that the range for investors' required ROE should be bracketed by the-earnings-to-price ratio and the expected earned rate on return on book value. Joint Customer Intervenors assert that the midpoint of that range is below the 9.29 percent midpoint of the Presiding Judge's DCF range.[472]

228. OMS/Joint Consumer Advocates state that Dr. Avera's inclusion of regulated utilities in his expected earnings sample group creates an inescapable circularity. According to OMS/Joint Consumer Advocates, a regulatory commission's actions necessarily will affect a utility's future earnings, a forecast of which, in turn, then becomes a factor in establishing the ROE in the next regulatory decision, which itself will then affect future earnings and forecasts thereof. OMS/Joint Consumer Advocates state that excluding regulated utilities from the sample group, as indicated to be necessary by the very source on which Dr. Avera relied,[473] is essential if such circularity is to be avoided.[474]

229. OMS/Joint Consumer Advocates state that MISO TOs give no indication in their brief on exceptions that the base ROE adopted in the Initial Decision would be any different had Dr. Avera's expected earnings study been accepted, nor would any such claim be plausible. OMS/Joint Consumer Advocates state that MISO TOs, therefore, seek nothing more than a request for Commission guidance about how the expected earnings method should be applied in other proceedings in the future. OMS/Joint Consumer Advocates contend that there are other avenues, more appropriate for the task, for obtaining generic guidance of that sort from the Commission.[475]

d. Commission Determination

230. We reverse the Presiding Judge's rejection of MISO TOs' expected earnings analysis. Complainants and Complainant-aligned parties assert that MISO TOs' expected

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[472] *Id.* at 16-17.

[473] OMS/Joint Consumer Advocates Brief Opposing Exceptions at 22 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 315, 320, and 323).

[474] *Id.* (citing Opinion No. 12, 3 FERC at 61,132 (stating that "while the comparative earnings technique can be helpful in determining whether an allowed rate of return is commensurate with the return on investments in other enterprises, if the comparison is only with regulated companies, there is a certain circularity.")).

[475] *Id.* at 23.

earnings analysis is flawed for a variety of reasons. As discussed in more detail below, we disagree with these assertions and find that the results of MISO TOs' expected earnings analysis corroborates our determination that MISO TOs should be awarded an ROE above the midpoint of the zone of reasonableness produced by the DCF analysis.[476]

231. The Presiding Judge's rejection of MISO TOs' expected earnings analysis relies on the premise that Dr. Morin's guidance in *New Regulatory Finance* precludes the inclusion of regulated companies in expected earnings proxy groups.[477] MISO TOs argue that *New Regulatory Finance* does not mandate exclusive reliance on unregulated companies in forward-looking expected earnings analyses. We agree. In particular, we note that that conclusion is consistent with Dr. Morin's analysis in *New Regulatory Finance*:

> In defining a population of comparable-risk companies, care must be taken not to include other utilities in the sample, since the rate of return on other utilities depends on the allowed rate of return. The *historical* book return on equity for regulated firms is not determined by competitive forces but instead reflects the *past* actions of regulatory commissions. It would be circular to set a fair return based on the *past* actions of other regulators, much like observing a series of duplicative images in multiple mirrors. The rates of return earned by other regulated utilities may well have been reasonable under historical conditions, but they are still subject to tests of reasonableness under current and prospective conditions.[478]

Dr. Morin's recommendation to avoid other utilities in the sample is based on his concern that the use of historical book ROE would be based on past actions of regulatory commissions and, therefore, reliance on those past actions to set an ROE would raise issues of circularity. However, MISO TOs' expected earnings analysis is forward-looking and based on Value Line forecasts, adjusted to reflect each utility's average return.[479] As the Commission explained in Opinion

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[476] Our analysis below does not rely on the arguments regarding the Virginia Commission's use of expected earnings analyses; therefore, we dismiss such arguments as moot.

[477] *See* Initial Decision, 153 FERC ¶ 63,027 at P 323.

[478] Dr. Roger A. Morin, *New Regulatory Finance* 383 (Public Utilities Reports, Inc. 2006) (Emphasis supplied).

[479] *See* Initial Decision, 153 FERC ¶ 63,027 at P 314.

No. 531-B, an expected earnings analysis, in contrast to a comparable earnings analysis, is sound when it is forward-looking and based on a reliable source of earnings data.[480]

232. Moreover, while Complainants and Complainant-aligned parties refer to various other excerpts from Dr. Morin's *New Regulatory Finance*, each appears to refer to comparable earnings analyses that are based on historical earnings on book value.[481] Thus, even if the Commission did not consider Dr. Morin's statement that proxy groups for comparable earnings analyses should be made up of unregulated companies, that statement alone does not invalidate MISO TOs' expected earnings analysis.

233. We disagree with Complainant-aligned parties' assertions that MISO TOs' expected earnings analysis will nevertheless raise issues of circularity or lead to the convergence of Commission-approved ROEs and the Value Line projections. MISO TOs' zone of reasonableness, in which Commission-approved ROEs are placed, is established by the results of the DCF study. The expected earnings analysis, like the other alternative methodologies accepted herein, is merely used as corroborative evidence. Therefore, we are not persuaded that our acceptance of the expected earnings analysis, which at most can corroborate the Commission's decision to place an ROE above the midpoint of the zone of reasonableness, will raise issues of circularity or lead to a convergence of Commission-approved ROEs to the Value Line projections.

234. We also disagree with Complainants' contention that MISO TOs' expected earnings analysis is flawed because the return on book value does not establish the current market cost of equity for proxy group companies.[482] 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

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[480] Opinion No. 531-B, 150 FERC ¶ 61,165 at PP 125-126. *See, e.g.*, *Southern California Edison Co.*, Opinion No. 445, 92 FERC ¶ 61,070, at 61,263 (2000) (finding it necessary to adjust Value Line's forecasted returns on book equity to reflect average returns rather than year-end returns); *see also* Roger A. Morin, *New Regulatory Finance* 305-306 (Public Utilities Reports, Inc. 2006).

[481] *See, e.g.*, Dr. Roger A. Morin, *New Regulatory Finance* 382 (Public Utilities Reports, Inc. 2006) (providing the three steps required to implement a comparable earnings analysis).

[482] This appears to be another way of saying that MISO TOs' expected earnings analysis did not consider market-to-book ratios.

upon expected earnings analysis for this purpose without attempting to convert that opportunity cost into the current market cost of equity.[483] Therefore, consistent with Opinion No. 531-B, we find MISO TOs' expected earnings analysis reliable as corroborative evidence in this proceeding, notwithstanding the lack of a market-to-book adjustment in their analysis. Furthermore, even assuming *arguendo* that a market-to-book adjustment was appropriate, we are not persuaded that Joint Customer Intervenors' approach would accurately estimate the utility's market cost of equity.[484]

235. We also disagree with Joint Customer Intervenors' reliance on *Orange & Rockland* in crafting their argument that the expected earnings analysis cannot be relied upon because the market-to-book ratio of the proxy group exceeds one.[485] As the Commission explained in Opinion No. 531-B, *Orange & Rockland* did not involve a comparable earnings analysis; it involved a proposal to alter the DCF model by adjusting the dividend yield to reflect the expected earnings of the company whose rates were at issue in that proceeding.[486] MISO TOs do not make such a proposal. Instead, MISO TOs have submitted an expected earnings analysis based on their national proxy group of utilities with comparable risk profiles to MISO TOs. Therefore, unlike *Orange & Rockland*, where the Commission rejected a proposal that would have had the effect of setting the base ROE at the company's own expected ROE, MISO TOs' expected earnings analysis is only relevant to the determination of whether the midpoint of the DCF-produced zone of reasonableness provides a market cost of equity sufficient to meet the requirements of *Hope* and *Bluefield*.[487] The returns on book equity that investors expect to receive from a group of companies with risks comparable to those of a particular utility are relevant to determining that utility's market cost of equity, because those returns on book equity help investors determine the opportunity cost of investing in that particular utility instead of other companies of comparable risk. Such a calculation is consistent with the requirement in *Hope* that "the return to the equity owner should be

[483] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 132.

[484] *See* Joint Customer Intervenors Brief Opposing Exceptions at 16.

[485] *Id.* at 15 (citing *Orange and Rockland*, 44 FERC ¶ 61,253 at 61,952 (*Orange and Rockland*)).

[486] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 127.

[487] *Id.* P 128.

commensurate with returns on investments in other enterprises having corresponding risks."[488]

236. As the Commission explained in Opinion No. 531-B,[489] investors rely on both the market cost of equity and the book return on equity in determining whether to invest in a utility, because investors are concerned with both the return the regulator will allow the utility to earn *and* the company's ability to actually earn that return. If, all else being equal, the regulator sets a utility's ROE so that the utility does not have the opportunity to earn a return on its book value comparable to the amount that investors expect that other utilities of comparable risk will earn on their book equity, the utility will not be able to provide investors the return they require to invest in that utility. Thus, all else being equal, an investor is more likely to invest in a utility that it expects will have the opportunity to earn a comparable amount on its book equity as other enterprises of comparable risk are expected to earn. Because investors rely on expected earnings analyses to help estimate the opportunity cost of investing in a particular utility, we find this type of analysis useful in corroborating whether the results produced by the DCF model may have been skewed by the anomalous capital market conditions reflected in the record.

237. We are also not persuaded by Trial Staff's assertion that MISO TOs should have also considered shorter term Value Line projections than the 2017-2019 projects they used. While Trial Staff asserts that shorter term projections were available to MISO TOs, it is unclear if those shorter term projections would have resulted in materially different results. Therefore, we are not persuaded that MISO TOs' reliance on Value Line projections for 2017-2019 undermined the usefulness of MISO TOs' expected earnings analysis as corroborative evidence.

238. We also reject the arguments that MISO TOs' exception to the Presiding Judge's rejection of their expected earnings analysis has no relevance on this proceeding and is effectively an attempt to receive general guidance from the Commission. While it is true that, despite his rejection of MISO TOs' expected earnings analysis, the Presiding Judge elected to set the ROE at the upper midpoint of the DCF-produced zone of reasonableness, the placement of the ROE was disputed by Complainants and Complainant-aligned parties in their briefs on exceptions. Given that the expected earnings analysis can further corroborate our finding that a mechanical application of the

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[488] *Hope*, 320 U.S. at 603; *see also Petal Gas Storage, L.L.C.*, 496 F.3d 695 (D.C. Cir. 2007).

[489] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 129.

DCF methodology does not satisfy *Hope* and *Bluefield*, MISO TOs' exception to the Presiding Judge's rejection of their expected earnings analysis is appropriate.

239. For the reasons stated above, we reverse the Presiding Judge's rejection of MISO TOs' expected earnings analysis.[490] We find that MISO TOs' expected earnings analysis is sufficiently reliable to be used as corroborative evidence that the midpoint of the zone of reasonableness produced by the mechanical application of the DCF methodology does not result in a return that satisfies the requirements of *Hope* and *Bluefield*.

5. State ROEs

240. MISO TOs' witness, Ms. Lapson, presented evidence that all state-authorized ROEs during the period April 1, 2013 through March 31, 2015 for integrated electric utilities providing generation, transmission, and distribution services ranged from 9.5 percent to 10.4 percent.[491] In addition, 87.34 percent of state-authorized ROEs for both integrated electric utilities and distribution-only electric utilities during that period were within this range. Ms. Lapson also testified that investing in Commission-regulated electric transmission involves significant risks that investment in other utilities does not and that setting MISO TOs' ROE at a level generally below state-authorized ROEs will make investment in interstate electric transmission less attractive than investment in conventional electric utility activities.

a. Initial Decision

241. The Presiding Judge determined that the state-authorized ROEs in the record support setting MISO TOs' base ROE above the midpoint of the DCF zone of reasonableness. The Presiding Judge observed that the midpoint of the DCF zone of reasonableness is lower than all of the state-authorized ROEs for integrated electric utilities and two-thirds of the state-authorized ROEs for distribution-only utilities. The Presiding Judge noted that MISO TOs face risks that are at least as great as the risks facing both categories of companies.[492] The Presiding Judge rejected arguments regarding the data used to identify the state-authorized ROEs, noting that, consistent with Opinion Nos. 531 and 531-B, this data reflected the most recent data in the record.[493]

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[490] *See* Initial Decision, 153 FERC ¶ 63,027 at P 323.

[491] Exh. MTO-42 at 1-2.

[492] Initial Decision, 153 FERC ¶ 63,027 at PP 454-456.

[493] *Id.* PP 366-367.

The Presiding Judge also rejected the argument that the 50 basis point incentive ROE adder should be considered in setting the base ROE, noting that the Commission flatly rejected this argument in Opinion No. 531.[494] Finally, the Presiding Judge rejected a host of arguments contending that differences in the risk profile of the state-regulated utilities rendered base ROE comparisons inapt.

b. Briefs on Exceptions

242. OMS states that the Presiding Judge interpreted Opinion No. 531-B as requiring that he give more weight to the fact that the average state-authorized ROE exceeded the DCF midpoint than to the demonstrated downward trajectory in state-authorized ROEs.[495] OMS argues that, in this regard, the Presiding Judge misconstrues Opinion No. 531-B. According to OMS, the Commission did not, in that instance, consider and dismiss a proven downward movement in state ROEs; rather, it simply found that the record lacked proof of such a downward trend.[496] OMS states that the record evidence clearly shows a downturn in state-authorized ROEs over the past decade continuing through the DCF study period. It further contends that the failure of Ms. Lapson's study to account for this trend is a "fatal flaw" that disqualifies the study for use as support for setting the base ROE above the midpoint.[497] Furthermore, OMS contends that the downward trend in state-authorized ROEs should alleviate concerns about capital being shifted away from transmission investments into distribution investments.

243. OMS further argues that, in Opinion No. 531, the Commission compared the investment risks of electric infrastructure with those of electric distribution infrastructure and concluded that the Commission-approved ROE for transmission assets should be higher than the state-authorized ROEs for distribution assets.[498] OMS avers that the basis for this finding was the Commission's determination that investing in transmission carries greater risk than investing in distribution. However, OMS states that Ms.

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[494] *Id.* P 380.

[495] OMS Brief on Exceptions at 38-39 (citing Initial Decision, 153 FERC ¶ 63,027 at P 363).

[496] *Id.* at 39 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at n.176).

[497] *Id.*

[498] *Id.* at 40 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 149).

Lapson's analysis is based solely on state-authorized ROEs for integrated utilities, and that Ms. Lapson consciously avoided using data from distribution-only companies.[499]

244. OMS states that the Presiding Judge found that the mean, median, and midpoint of the state-authorized ROEs for distribution-only utilities (9.45 percent, 9.55 percent, and 9.41 percent, respectively) are above the midpoint of the DCF analysis adopted in the Initial Decision (i.e., 9.29 percent).[500] OMS contends, however, that the mean and the midpoint of the state-authorized ROE numbers for distribution-only utilities are below the base ROE of 9.54 percent recommended by Mr. Gorman and that the median is only 0.01 percent above Mr. Gorman's proposed ROE for MISO TOs.[501] OMS states that, to the extent that state-authorized ROEs for distribution-only utilities are a meaningful consideration in setting transmission ROEs, the base ROE proposed by the Complainants in this proceeding is reasonable and sufficient.

245. OMS also asserts that the Commission should reject the Presiding Judge's finding that investing in MISO TOs' Commission-regulated electric transmission entails risks that are at least as great as the risks of investing in the integrated electric utilities analyzed by Ms. Lapson, and therefore it would be illogical to award a base ROE for MISO TOs that is below the state-authorized ROEs of these integrated electric utilities.[502] OMS states that there is no evidence in the record that supports the proposition that the risks assumed by MISO TOs, or by transmission companies in general, are at least as great as those of the integrated utilities studied by Ms. Lapson. On the contrary, OMS states that evidence presented by Mr. Hill indicates that the risks of transmission service are less than the risks of integrated utility operations, which include the risks of competitive operations.[503] Joint Customer Intervenors similarly argue assert that the Presiding Judge failed to consider evidence demonstrating that the formula rate-based transmission service at issue here is less risky than the integrated generation and distribution service regulated by the state commissions.[504]

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[499] *Id.* (citing Exh. MTO-16 at 54:5-14 and OMS Reply Brief at 31).

[500] *Id.* at 41 (citing Initial Decision, 153 FERC ¶ 63,027 at P 400).

[501] *Id.* (citing Exh JC-1 at 2:13; Exh. JC-9 at 32:7-8).

[502] *Id.* (citing Initial Decision, 153 FERC ¶ 63,027 at P 453).

[503] *Id.* at 41-42 (citing Exh. JCA-1 at 35:17-22).

[504] Joint Customer Intervenors Brief on Exceptions at 47-48 (citing Exh. JCI-4 at

(continued...)

246. OMS also states that, should the Commission find that MISO TOs are largely or predominantly integrated or that MISO TOs have risks "at least as great" as those of integrated utilities, an upward adjustment from the DCF midpoint based on comparing utilities having similar risk profiles would not be supportable here. OMS reiterates its Reply Brief argument that an upward adjustment of the base ROE in reliance on Ms. Lapson's state ROE benchmark would not compensate investors by an amount that is in any way linked to the risks that purportedly exceed those associated with distribution companies. Rather, according to OMS, it would simply confer on investors in transmission infrastructure a premium, but one that has no nexus to the risks it is meant to address.[505] OMS states that over-compensating investors for transmission risks is not without its own adverse impacts, including potentially reducing the amount of capital available for other necessary electric infrastructure investments.

247. Joint Customer Intervenors state that the Commission, prior to Opinion No. 531, had long held that wholesale ROE determinations should not be influenced by state-authorized ROEs.[506] Joint Customer Intervenors also argue that incentives should be taken into consideration when comparing the base ROEs awarded to MISO TOs in this proceeding to the state-awarded ROEs. Joint Customer Intervenors assert that it is inappropriate to compare state-awarded ROEs that do not include incentives to Commission-awarded ROEs that do not include incentives.[507]

248. Joint Customer Intervenors explain that Mr. Solomon presented an analysis by SNL Financial that demonstrated that the overwhelming majority of electric utilities are not able to earn their state-awarded ROEs, while MISO TOs' transmission formula rates provide assurance that MISO TOs are able to earn their Commission-awarded ROE. Joint Customer Intervenors state that the utilities in the SNL Financial study earned ROEs that were, on average, 120 basis points below their state-awarded ROEs. Joint Customer Intervenors therefore argue that MISO TOs' ROE should not be compared to

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32:21-36:2).

[505] OMS Brief on Exceptions at 42 (citing OMS Reply Brief at 32).

[506] Joint Customer Intervenors Brief on Exceptions at 47 (citing *Middle S. Services, Inc.*, Opinion No. 124, 16 FERC ¶ 61,101, at 61,221 (1981); *Boston Edison Co.*, Opinion No. 411, 77 FERC ¶ 61,272, at 62,172 (1996); *Jersey Cent. Power & Light Co.*, Opinion No. 408, 77 FERC ¶ 61,001, at 61,009 (1996)).

[507] *Id.* at 48-49.

state-awarded ROEs but should instead be compared to the ROEs that utilities can reasonably be expected to earn under those state-awarded ROEs.[508]

c. Briefs Opposing Exceptions

249. MISO TOs argue that the Presiding Judge properly credited Ms. Lapson's state ROE evidence and correctly found that wholesale transmission is at least as risky as an integrated electric utility and more risky than a distribution-only electric utility.[509] MISO TOs agree that Ms. Lapson's study supports allowing MISO TOs to collect a base ROE above the midpoint, as the DCF midpoint is lower than all the state-authorized ROEs for integrated utilities and lower than two-thirds of the distribution-only electric utilities' state-authorized ROEs.[510] MISO TOs argue that, given "the clear Commission precedent support consideration of state-authorized" ROEs, the Presiding Judge correctly discredited the arguments made in Joint Customers' and OMS's exceptions, which MISO TOs assert, were previously rejected in Opinion Nos. 531 and 531-B.[511] In particular, MISO TOs contend that the Presiding Judge correctly disregarded arguments that the downward trend in state ROEs undermined the usefulness of Ms. Lapson's evidence. Additionally, MISO TOs argue that it is equally unpersuasive for Joint Customers to argue that the Presiding Judge erred by excluding from consideration any ROE incentives awarded under FPA section 219.[512]

d. Commission Determination

250. We agree with the Presiding Judge that the state-authorized ROE study by Ms. Lapson corroborates the finding that a mechanical application of the DCF methodology does not satisfy *Hope* and *Bluefield*. We do so because the 9.29 percent midpoint calculated by the Presiding Judge's DCF study is lower than all of the state-authorized ROEs of integrated electric utilities and most of the distribution-only utilities in that study and because investing in MISO TOs' Commission-regulated electric transmission entails risks that are "at least as great" as those faced by investors in

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[508] *Id.* at 49-50 (citing Exh. JCI-7 at 110-113).

[509] MISO TOs Brief Opposing Exceptions at 31.

[510] *Id.* at 32.

[511] *Id.* at 32-33 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 353-81).

[512] *Id.* at 33.

integrated electric utilities.[513] In Opinion No. 531, the Commission found that record evidence of state commission-approved ROEs supported adjusting the New England transmission owners' base ROE above the midpoint of the zone of reasonableness. In that decision, the Commission stated that it was not "using state commission-approved ROEs to establish the . . . ROE" but that the Commission found that "the discrepancy between state ROEs and the . . . midpoint serve[d] as an indicator that an adjustment to the midpoint . . . is necessary to satisfy *Hope* and *Bluefield*."[514] In Opinion No. 531-B, the Commission further explained that "the Commission merely relied on the state commission-authorized ROEs – in conjunction with evidence that interstate transmission is riskier than state-level distribution – as evidence that the . . . midpoint of the . . . zone of reasonableness was insufficient to satisfy . . . *Hope* and *Bluefield*."[515] We find that the rationale employed there justifies our adoption of the Presiding Judge's finding with regard to Ms. Lapson's study.

251. We also find that OMS's and Joint Customer Intervenors' claims about a downward trend in overall state-authorized ROEs from 10.54 percent in 2005 to 9.58 percent during the first six months of 2015, are not enough, in and of themselves, to overcome the fact that the midpoint is below the vast majority of state-authorized ROEs that became effective during the April 1, 2013 through March 31, 2015 period of Ms. Lapson's study.[516] As noted above, the relevance of the study is to examine whether a survey of state-authorized ROEs might support making an upward adjustment to the Commission-allowed ROE. A study demonstrating that the vast majority of state-authorized ROEs studied exceed the midpoint of the zone of reasonableness suggests that the midpoint of that zone may be too low, and the asserted downward trend in state-authorized ROEs does not, in and of itself, counter this suggestion. First, irrespective of any downward trend in overall state commission-approved ROEs, the fact remains that every single state commission-approved ROE for a vertically integrated utility in the April 1, 2013 through March 31, 2015 study period exceeded the midpoint of the Presiding Judge's DCF study, including those in the first three months of 2015. Mr. Gorman's study, which asserted that the average of state-authorized ROEs declined to 9.58 percent during the first six months of 2015, included distribution-only electric

[513] Initial Decision, 153 FERC ¶ 63,027 at P 455.

[514] Opinion No. 531, 147 FERC ¶ 61,234 at P 148.

[515] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 84.

[516] Initial Decision, 153 FERC ¶ 63,027 at P 353.

utilities, as well as integrated electric utilities.[517] In addition, Mr. Gorman's 9.58 percent figure is still above the 9.29 percent midpoint of the DCF zone of reasonableness. Moreover, Mr. Gorman excluded base ROEs authorized by the Virginia Commission. As the Presiding Judge pointed out, inclusion of the Virginia Commission-authorized ROEs would have raised the average of the state-authorized ROEs approved in the first half of 2015 to 10.09 percent,[518] 80 basis points above the 9.29 percent midpoint of the DCF zone of reasonableness.

252. We further disagree with OMS that Ms. Lapson's analysis is "based solely on state-authorized ROEs for *integrated* utilities" and that "she consciously avoided using data from distribution-only companies."[519] As the Presiding Judge noted, Ms. Lapson's study includes data from distribution-only utilities.[520] Additionally, OMS makes arguments comparing the mean and midpoint of the state-authorized ROE numbers for distribution-only utilities to the 9.54 percent base ROE recommended by Mr. Gorman. Again, we note that the Ms. Lapson's study's only relevance is to determine whether state-authorized ROEs are higher than the midpoint of the DCF zone of reasonableness. The study does not prescribe where in the zone of reasonableness the base ROE should be established. Ms. Lapson's study clearly indicates that the 9.29 percent midpoint is lower than all of the state-authorized ROEs of integrated electric utilities in the study and lower than two-thirds of all of the state-authorized ROEs of distribution-only electric utilities in the study.[521]

253. We also disagree with arguments that the record does not contain evidence that MISO TOs and other transmission companies face risks that are at least as great as the risks of investing in integrated electric utilities. Ms. Lapson's study contains an extended discussion of the risks faced by MISO TOs and transmission owners in general.[522] For instance, Ms. Lapson explains that developing interstate electric transmission is subject to "controversy and public opposition" and "subject to the requirements of multiple

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[517] Exh. JC-26 at 1.

[518] Initial Decision, 153 FERC ¶ 63,027 at P 370.

[519] OMS Brief on Exceptions at 40.

[520] *See, e.g.*, Initial Decision, 153 FERC ¶ 63,027 at PP 338, 401, 402.

[521] Initial Decision, 153 FERC ¶ 63,027 at PP 455-56.

[522] *See id.* PP 340-48.

jurisdictions," which can increase project complexity and force transmission developers to "make economic concessions to . . . gain approvals."[523] Furthermore, Ms. Lapson states that transmission-owning utilities face "execution risks in completing the project and the risk that parties may seek to disallow rate recovery of any cost overruns."[524] Lapson also notes that medium or small utilities, such as "quite a few of the MISO [TOs]" require external funding, a consideration which creates uncertainty associated with capital market conditions and access to the debt and equity markets.[525]

254. Ms. Lapson also asserts that MISO TOs have capital expenditure (capex) commitments higher than most electric utilities and observes that utilities with high capex are exposed to execution or implementation risks associated with large capital investment, risks associated with the fact that "nearly all of the MISO TOs are invested in capex in excess of their internal cash from operations," and risks associated with the need for external financing.[526] Additionally, we note, and agree with, the Presiding Judge's conclusion that "investment in electric transmission poses a number of unique risks that investment in integrated electric utilities does not" and that investment in "MISO TOs' transmission entails additional risks due to the owners' high capex requirements."[527]

255. We also disagree with Joint Customer Intervenors' argument that "failing to consider the incentives included in state-awarded ROEs and then comparing them to FERC-awarded ROEs that do not include incentive adders is inappropriate on its face."[528] Ms. Lapson stated that she removed all incentive adders from the state-authorized ROEs included in her study, and the Presiding Judge found that the other parties had not provided evidence to show that any of the state-authorized ROEs included in her study

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[523] Exh. MTO-39 at 40:14, 18-22.

[524] *Id.* at 40: 22-24.

[525] *Id.* at 41:1-6.

[526] Initial Decision, 153 FERC ¶ 63,027 at PP 342-347 (citing Exh. MTO-16 at 40:4-5, 13-15.

[527] Initial Decision, 153 FERC ¶ 63,027 at P 397 (citing Exh. MTO-16 at 35, Table 3, 40:4-19, 41:10-42:12; Moody's Rating Methodology, Regulated Electric and Gas Utilities, December 23, 2013 at 24).

[528] JCI Brief on Exceptions at 49.

did include such incentives.[529] It is appropriate to compare state-authorized ROEs that do not include incentive adders with FERC-approved ROEs that also do not include incentive adders, as Ms. Lapson did. As the Commission explained in Opinion No. 531, "[a]lthough section 219 of the FPA gives [the Commission] authority to provide incentives above the base ROE, nothing in section 219 relieves [the Commission] from first setting the base ROE at a place that meets *Hope* and *Bluefield*."[530] Since the base ROE must therefore not include incentives, it would be equally inappropriate to compare state-authorized ROE data that includes state-awarded ROE incentives.

256. Joint Customer Intervenors also argue that the Commission should not compare MISO TOs' ROE to state-awarded ROEs, but should instead compare MISO TOs' ROE to the state-awarded ROEs that utilities can expect to actually earn. Again, Ms. Lapson's conclusions serve as one indicator among several suggesting that the 9.29 percent midpoint of the DCF-produced zone of reasonableness is insufficient to satisfy *Hope* and *Bluefield*. That is, these conclusions, along with the other alternative methodologies described above have convinced us to set the base ROE above the midpoint in this proceeding. The survey does not, and should not, serve to prescribe the Commission's placement of the base ROE at any particular point within the zone of reasonableness. Additionally, we find that evidence that Joint Customer Intervenors provide to argue that not all utilities can expect to actually earn the state-authorized ROE they are permitted earn is both incomplete and not wholly supportive of their argument here.[531]

6. Impact of Base ROE on Planned Investment

a. Initial Decision

257. The Presiding Judge concluded that setting MISO TOs' base ROE at the midpoint of the zone of reasonableness "could undermine their ability to attract capital for new investment in electric transmission."[532] The Presiding Judge reviewed the evidence provided by Mr. Kramer, observing, in particular, that the 2014 MISO Transmission Expansion Plan (MTEP) contemplated roughly $20 billion of investment in transmission facilities. The Presiding Judge recounted how Ms. Lapson explained that MISO TOs'

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[529] Exh. MTO-16 at 52. Initial Decision, 153 FERC ¶ 63,027 at P 374.

[530] Opinion No. 531, 147 FERC ¶ 61,234 at P 153.

[531] Exh. JCI-4 at 34:1-12.

[532] Initial Decision, 153 FERC ¶ 63,027 at P 480.

ROE was one of their primary sources of cash flow, which they used to fund investment in new transmission facilities.[533] In addition, she noted that this cash flow also helped to demonstrate MISO TOs' financial health to investors. Too large a reduction in base ROE would thus both cut off their cash flow as a significant source of investment capital and make it more difficult for MISO TOs to attract reasonably priced capital. Limited access to capital could, in turn, force MISO TOs to divert investment from projects contemplated in the MTEP and instead toward transmission projects for local reliability, which they are obligated to build.[534] In addition, the Presiding Judge also noted Ms. Lapson's observation that a large ROE reduction could create continued uncertainty, reducing investor interest in transmission-owning entities more generally.[535]

258. In reaching those conclusions, the Presiding Judge rejected the argument that the fact that the MISO TOs had not yet cancelled or deferred any transmission projects, even though they expected some reduction in base ROE, demonstrated that an ROE reduction was unlikely to reduce their investment in transmission infrastructure. The Presiding Judge explained that Ms. Lapson's testimony indicated that too large an ROE reduction would impair new investment, not that any reduction whatsoever would have that effect.[536] The Presiding Judge explained that, in Opinion No. 531, the Commission relied on evidence showing that a 175 basis-point reduction in ROE "*could*" reduce transmission investment. The Presiding Judge therefore concluded that Opinion No. 531 was consistent with the conclusion that reducing MISO TOs' base ROE from its current level to the midpoint of the zone of reasonableness, a 310-basis-point reduction, could undermine their ability to attract new capital to invest in transmission infrastructure.[537]

b. Briefs on Exception

259. Joint Customer Intervenors argue that the evidence did not demonstrate a correlation between the ROE and the level of transmission investment. According to Joint Customer Intervenors, Mr. Kramer stated that "he does not know what would have happened" when asked whether the amount of new projects would have exceeded

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[533] *Id.* PP 465-466.

[534] *Id.* PP 468-469.

[535] *Id.* P 471.

[536] *Id.* PP 473-475.

[537] Initial Decision, 153 FERC ¶ 63,027 at PP 476-477.

the levels he cited if the Commission had allowed a return higher than the current 12.38 percent ROE.[538] Joint Customer Intervenors also claim that Mr. Kramer was unable to provide "evidence that indicates whether or not the same benefits would or would not have been achieved . . . under the suggested hypothetical of a lower base ROE."[539] Joint Customer Intervenors further argue that Ms. Lapson's statements, while relied upon by the Initial Decision, merely assert that a reduction in ROE would result in a reduction in earnings and cash flow, and that credit ratings might be affected.[540] Joint Customer Intervenors assert that there is no evidence in the record suggesting that their proposed base ROE would do any harm to transmission investment in the MISO region.[541]

c. Briefs Opposing Exception

260. MISO TOs argues that Joint Customers wrongly suggest that the Presiding Judge was required to quantify the precise ROE necessary to sustain transmission investment, as such precision is not required by the FPA.[542] Additionally, MISO TOs argue that the Presiding Judge "cited ample record support" to support his conclusion that setting the DCF at the midpoint of zone of reasonableness would have placed MISO TOs' base ROE below the ROE available for comparable or less risky investments, thereby impairing MISO TOs ability to compete for capital.[543] In particular, they note that the Presiding Judge adequately responded to the contention that federally regulated transmission mission facilities are less risky than those subject to state regulation and, therefore, that the federally regulated entities could still adequately attract capital, even if they are receiving a lower ROE.

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[538] Joint Customer Intervenors Brief on Exceptions at 52-53 (citing Ex. JCI-14 at 1).

[539] *Id.* at 53 (citing Ex. JCI-13 at 1).

[540] *Id.* at 54 (citing Initial Decision, 153 FERC ¶ 63,027 at PP 463-470).

[541] *Id.*

[542] MISO TOs Brief Opposing Exceptions at 37.

[543] *Id.*

d. Commission Determination

261. We affirm the Presiding Judge's conclusion that setting MISO TOs' base ROE at the midpoint of the zone of reasonableness could impair investment in transmission facilities. As the Commission explained in Opinion No. 531, adequate transmission investment supports the Commission's responsibility to ensure that rates are just and reasonable because new transmission facilities help to "promote efficient and competitive electricity markets, reduce costly congestion, enhance reliability, and allow access to new energy resources, including renewables."[544] We continue to find that this is the case, including for the $20 billion of transmission investment contemplated by the 2014 MTEP.[545]

262. We find that reducing MISO TOs ROE to the midpoint of the zone of reasonableness could, as Ms. Lapson and Mr. Kramer explained, put at risk the MTEP investments as well as those in other beneficial transmission facilities. By reducing MISO TOs' cash flow, an overly large ROE reduction will reduce MISO TOs' ability to fund new transmission investment with the profits from their existing operations. In addition, an overly large ROE reduction could cause MISO TOs' credit ratings and/or other measures of financial health to deteriorate, impairing their ability to raise external capital to fund new transmission facilities. In particular, as Ms. Lapson explained, a "radical reduction" in MISO TOs ROE could cause investors to shift their capital to state-regulated utilities, which may have a similar risk to MISO TOs and, as discussed above, may earn an ROE greater than the midpoint of the zone of reasonableness, making them significantly more attractive investments. As she explained, a recent UBS report identified a "perception" that "investors were already beginning to react to the potential for lower [b]ase ROEs by shifting their investment capital to [state-regulated] electric and gas retail distribution investments and away from wholesale electric transmission."[546]

263. We conclude that reducing MISO TOs' ROE to the midpoint of the zone of reasonableness could be sufficient to bring about those results. As the Presiding Judge explained, in Opinion No. 531, the Commission concluded that a 175-basis-point ROE reduction—from an ROE of 11.14 to an ROE of 9.39—could put transmission investment at risk.[547] The same is true here. Based on the evidence in this proceeding, we conclude

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[544] Opinion No. 531, 147 FERC ¶ 61,234 at P 150.

[545] Initial Decision, 153 FERC ¶ 63,027 at PP 459, 461.

[546] *Id.* P 350 (citing Exh. MTO-44).

[547] *Id.* P 479 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 150).

that a base ROE reduction nearly twice as large as the Commission considered in Opinion No. 531 — that is, a reduction from an ROE of 12.38 to an ROE of 9.29 — is at least as likely to put transmission investment at risk as was the reduction contemplated in Opinion No. 531. Thus, as in Opinion No. 531, we find that the potential for reduced transmission investment counsels against a mechanical application of the DCF.[548]

264. Joint Customer Intervenors' arguments do not require a contrary conclusion. In particular, we note that the Commission has never required a demonstrated correlation between a particular ROE level and a particular level of transmission investment or that a reduction in ROE will cause particular harms to customers within MISO. Further, the Commission, in Opinion No. 531, concluded that evidence that a certain ROE reduction "could" imperil transmission investment militated against imposing such a reduction.[549] For the reasons discussed, we conclude that the evidence in the record suggests that setting MISO TOs' base ROE at the midpoint of the zone of reasonableness could impair their ability to invest in new transmission infrastructure.

265. Based on the presence of anomalous capital market conditions and informed by the returns indicated by the CAPM, expected earnings, and risk premium analyses discussed above, we find that the ROE for MISO TOs should be above the midpoint of the zone of reasonableness established by the DCF analysis. We now turn to the issue of precisely where in the upper half of the zone of reasonableness to set MISO TOs' ROE.

7. Placement of the Base ROE above the Midpoint

a. Initial Decision

266. The Presiding Judge concluded that the presence of anomalous market conditions justified an ROE above the midpoint of the zone of reasonableness. The Presiding Judge concluded that, consistent with Opinion No. 531, it was appropriate to set the base ROE at the midpoint of the upper half of the zone of reasonableness.[550]

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[548] *See* Opinion No. 531, 147 FERC ¶ 61,234 at P 150.

[549] *Id.*

[550] Initial Decision, 153 FERC ¶ 63,027 at PP 118-119, 491.

b. Briefs on Exceptions

267. Joint Customer Intervenors contend that, to the extent that capital market conditions were anomalous and such conditions justified a return higher than the midpoint of the zone of reasonableness, the appropriate point would be the 75th percentile of the zone of reasonableness. They state that their witness, Mr. Mr. Solomon testified that the 75th percentile is the point in the zone of reasonableness at which 25 percent of the proxy companies have higher ROEs and 75 percent of the proxy companies have lower ROEs. Joint Customer Intervenors argue that, while the Initial Decision stated that the Commission has thus far selected either the midpoint or the upper midpoint to be the base ROE applicable to multiple transmission owners, there is no Commission policy mandating the choice of the upper midpoint following a decision to choose a point above the midpoint or median.[551] Joint Customer Intervenors note that the Commission has chosen a point other than the midpoint or upper midpoint.[552] Joint Customer Intervenors argue that, even if the Commission had never chosen a point other than the midpoint or upper midpoint, the Commission has never declared that only those two points may be considered and, therefore, other points could be considered.[553]

268. OMS states that, should the Commission find that anomalous market conditions existed during the study period, the Commission need not (and should not) default to placing the Base ROE at the upper midpoint. OMS states that the Commission's charge in cases such as this is to set the new Base ROE at a level sufficient for MISO TOs to attract capital on reasonable terms, but no higher, and that to comply with that mandate, the Commission must have the flexibility to set the Base ROE anywhere between the DCF midpoint and the upper midpoint. OMS notes that, in Opinion No. 531-B, the Commission rejected a proposal to allow a Base ROE at the 75th percentile of the zone of reasonableness on the grounds that Commission precedent supported use of the "central tendency" to determine an appropriate return in cases involving the placement of the Base ROE for a region-wide group of utilities.[554] OMS states that Opinion No. 531-B

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[551] Joint Customer Intervenors Brief on Exceptions at 50-51 (citing Initial Decision, 153 FERC ¶ 63,027 at P 118).

[552] *Id.* at 51 (citing *Sw. Pub. Serv. Co.*, Opinion No. 421, 83 FERC ¶ 61,138, at 61,637-38 (1998)).

[553] *Id.*

[554] OMS Brief on Exceptions at 28 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 55).

also rejected arguments that Commission precedent requires the Commission to consider distribution of results within the proxy group when determining where in the upper half of the zone the Base ROE should be placed.[555]

269. OMS contends that the Presiding Judge only evaluated the alternative benchmarks to determine if a higher ROE should be used than the midpoint. OMS argues that the Presiding Judge erred by finding irrelevant the relationship between the ROE values from the alternative benchmarks and the upper midpoint, which would support a value lower than the upper midpoint. [556]

270. OMS argues that the Commission should not bind itself to an "either-or" choice between the DCF midpoint and the Upper Midpoint; rather, it must be able to set the Base ROE at other points of central tendency within the upper-half of the zone of reasonableness, such as the mean or the median of the upper-half of the zone. OMS states that the Commission could also set the Base ROE at any point of central tendency within a range between the midpoint of the DCF zone of reasonableness and the Upper Midpoint (i.e. between 9.29 percent and 10.32 percent). OMS argues that the Commission should take care to preserve maximum flexibility in establishing the new base ROE for MISO TOs, and reject the notion that it is limited to a binary choice between the DCF midpoint and the upper midpoint, where capital market conditions have been proven "anomalous."[557]

271. Complainants contend that the Initial Decision erred in failing to consider their proposed four quartile approach for placement of the ROE.[558] Complainants state that, even though the Commission typically considers the midpoint to be the best embodiment of the central tendency within the zone of reasonableness for the base ROE for multiple utilities, the Commission has expressed concern that this approach gives undue weight to the two extreme values in that range.[559] Complainants state that, to mitigate this

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[555] *Id.* (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 55).

[556] *Id.* at 9.

[557] *Id.* at 29.

[558] Complainants Brief on Exceptions at 23 (citing Complainants Initial Brief at 40-43; *see also* Complainants Reply Brief at 28-29).

[559] *Id*. (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 144 (citing *S. Cal. Edison Co*., 131 FERC ¶ 61,020, at P 91 (2010), *remanded on other grounds sub. nom. S. Cal. Edison Co. v. FERC*, 717 F.3d. 177 (D.C. Cir. Ct. 2013) and *S. Cal. Edison Co*.,

(continued...)

shortcoming, Mr. Gorman separated the DCF estimates within his original zone of reasonableness (i.e., 6.75 to 11.01 percent) into four quartiles and redefined the upper and lower bounds of the zone by using the medians of the upper and lower quartiles, resulting in a zone of reasonableness from 8.60 to 9.56 percent. Mr. Gorman then recommended a base ROE situated at the 9.08 percent midpoint between these outer bounds, which he recommended for MISO TOs that have common equity ratios of 55 percent or less.[560] Complainants contend that this approach is appropriate because of the distortive effect of the extreme values, as demonstrated by the effect of their removal.[561]

c. Briefs Opposing Exceptions

272. MISO TOs argue that the placement of the new base ROE at the upper half midpoint is consistent with Opinion No. 531 and produces reasonable results supported by alternative benchmarks and state ROEs.[562] In support of this argument, MISO TOs argue that nothing in Opinion Nos. 531 or 531-B requires the Presiding Judge to calibrate the precise increment by which the DCF midpoint is affected by anomalous capital market conditions and such "exactitude is neither practical nor necessary to satisfy" the FPA.[563] MISO TOs note that the Presiding Judge relied on Opinion No. 531 to inform his zonal placement because this precedent represents the Commission's "most current explication of its approach to zonal placement," and the issues decided in Opinion No. 531 "were substantively identical" to the questions at issue here.[564]

273. MISO TOs argue that, while in deviating from midpoint values in the past, the Commission has typically relied upon comparative risk assessment, this fact does not preclude consideration of ROE adjustments based on other factors, including demonstrated infirmities in DCF inputs and results.[565] MISO TOs also argue that there is

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131 FERC ¶ 61,020 at P 86 (citing *Northwest Pipeline Corp.*, 99 FERC ¶ 61,305 at 62,276 (2002)).

[560] *Id*. at 24 (citing Ex. JC-1, pp. 33-37; *see also* Ex. JC-22, pp. 18-19).

[561] *Id*. at 24-25.

[562] MISO TOs Brief Opposing Exceptions at 19.

[563] *Id.* at 20.

[564] *Id.* at 21.

[565] *Id.* at 21.

no requirement that the Presiding Judge examine every conceivable zonal point within the DCF range or quantify the exact basis-point impact of the documented capital market anomalies. They further argue that the upper-half midpoint is "consistent with the Commission's preference for the central tendency."[566]

274. MISO TOs also state that the Presiding Judge did not need to explicate his reasons for not adopting Complainants' quartile approach, because such approach is "arbitrary and contrived merely to constrict the zone of reasonableness."[567] Additionally, they state that Mr. Gorman articulated the rationale for his proposal and the Presiding Judge rightly rejected this approach.[568]

d. Commission Determination

275. In the Initial Decision, the Presiding Judge determined that, consistent with Commission precedent, in the presence of anomalous capital market conditions, the base ROE should be established at the upper midpoint of the zone of reasonableness. The Presiding Judge stated that, when determining the base ROE applicable to multiple transmission owners, "the only two places within the zone of reasonableness that have thus far proved consistent with the Commission's preference of the central tendency" are the midpoint and upper midpoint, which the Presiding Judge determined to be 9.29 percent and 10.32 percent, respectively.[569] In this proceeding, we adopt the Presiding Judge's finding that the upper midpoint of the zone of reasonableness represents the just and reasonable base ROE for the MISO transmission owners.

276. We are unpersuaded by contentions that, if the Commission concludes that MISO TOs' base ROE should be set above the midpoint of the zone of reasonableness, the base ROE should be placed at the true 75th percentile of the zone of reasonableness, rather than at the 10.32 percent midpoint of the upper half of the zone. As the Commission explained in Opinion No. 531-B,[570] the Commission has traditionally used measures of central tendency to determine an appropriate return in ROE cases and, in cases involving

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[566] *Id.* at 22 (citing Initial Decision at P 118).

[567] *Id.* n.50.

[568] MISO TOs Brief Opposing Exceptions at n.50.

[569] Initial Decision, 153 FERC ¶ 63,027 at P 118.

[570] Opinion No 531-B, 150 FERC ¶ 61,165 at P 55.

the placement of the base ROE above the central tendency of the zone of reasonableness, the Commission has used the central tendency of the top half of the zone. Our decision to utilize the midpoint of the upper half of the zone is based on the record evidence in this proceeding and is consistent with the Commission's established policy of using the midpoint of the ROEs in a proxy group when establishing a central tendency for a region-wide group of utilities.[571]

277. We also disagree with the assertion that there is no evidence to support the specific upward adjustment. Such exactitude has never been required in determining the appropriate placement of ROEs within the zone of reasonableness or for determining the appropriate size of incentives. The Commission maintains discretion to use its judgment in weighing factors specific to a given proceeding to determine where within the zone of reasonableness the final base ROE should be placed.

278. The Commission has held that the midpoint is the appropriate measure of the central tendency for groups of utilities.[572] That determination is not altered by the use of the midpoint of the upper half of the zone of reasonableness.

279. In response to Joint Customer Intervenors, while anomalous market conditions reduce the Commission's confidence in the establishment of the ROE at the midpoint of the zone of reasonableness, the Commission has not required a precise correlative relationship between a particular ROE and a desired level of transmission investment. Additionally, while we disagree with Complainants' proposed quartile approach, we also find that Joint Customer Intervenors failed to convince us that the 75th percentile of the zone of reasonableness reflects the appropriate base ROE here.

280. We disagree with OMS' argument that the Presiding Judge erred in not considering that the alternative benchmarks indicate that the ROE should be lower than the upper midpoint. MISO TOs' risk premium and expected earnings analyses, which the Commission accepts as discussed above, featured respective midpoint ROEs of 10.36 and 11.99 percent, both of which *exceed* the upper midpoint, indicating that the upper midpoint is not generally higher than the ROEs produced by the alternative benchmarks.

281. Finally, we reject the Complainants' proposal to set MISO TOs' ROE at 9.08 percent based on their four quartile approach. A base ROE of 9.08 percent would be

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[571] *SoCal Edison*, 131 FERC ¶ 61,020 at P 92, *aff'd in relevant part, S. Cal. Edison Co. v. FERC*, 717 F.3d at 185-87.

[572] *See, e.g.*, S. *Cal. Edison Co.*, 131 FERC ¶ 61,020 at P 91.

below the 9.29 percent midpoint of the DCF zone of reasonableness in this case. The Complaints' proposal is thus contrary to our holding above that MISO TOs' ROE should be set at a point above the midpoint of the zone of reasonableness.

D. Other Issues

1. Capital Structure

a. Initial Decision

282. At hearing, Complainants and JCA both propose that whatever base ROEs are approved in this proceeding be reduced for all MISO TOs with equity ratios of 55 percent or higher. Mr. Gorman contends that the base ROEs of these utilities should be lowered by 20 basis points.[573] Mr. Hill recommends that the allowed base ROEs of MISO TOs that have common equity ratios of 55 percent or above should be adjusted downward five basis points for every one percent difference between the ratemaking common equity ratio and 49 percent (the average common equity ratio of what he refers to as "the electric utility sample group"). Conversely, he recommends that the base ROEs of firms with equity ratios at or below 45 percent should be adjusted upward five basis points for every one percent difference between the ratemaking common equity ratio and 49 percent.[574] Both Complainants/Joint Consumer Advocates contended that a utility with a higher equity ratio is less risky than comparable utilities with lower equity ratios, and that its base ROE should be lowered to reflect that rate differential.[575]

283. The Presiding Judge rejected proposals to adjust MISO TOs' base ROE based on their equity ratios. The Presiding Judge determined that these arguments amounted to a collateral attack on the Commission's rejection in the Hearing Order of an argument that it should cap MISO TOs' actual or hypothetical capital structure at 50 percent equity. The Presiding Judge concluded that lowering the base ROE for utilities with an equity ratio greater than 50 percent would "do indirectly what the Commission said it would not do directly."[576] The Presiding Judge further noted that the Commission's approach to

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[573] Exh. JC-1 at 36:13-17.

[574] Exh. JCA-1 at 43:27–44:9; Exh. JCA-11 at 63-64.

[575] Exh. JC-1 at 20-21; Exh. JCA-11 at 45.

[576] Initial Decision, 153 FERC ¶ 63,027 at P 483.

setting the base ROE already incorporates measures of the utilities' risk, obviating the need to account for the effect of capital structure on risk.

b. Briefs on Exceptions

284. Complainants argue that the Presiding Judge erred in rejecting Complainants' recommended capital structure-based ROE adjustments as a collateral attack on the Hearing Order. Complainants argue that the Hearing Order did not foreclose consideration of all issues related to MISO TOs' capital structure for evaluating the base ROE such that their argument warrants consideration.[577] Specifically, the Commission found that issues regarding capital structures "are best addressed with respect to that ROE, which the Commission is setting for hearing."[578] Complainants state that an equity-heavy capital structure increases costs to ratepayers and recommends a 20 basis point reduction to the base ROE of MISO TOs whose common equity structure exceeds 55 percent to account for their lower risk.[579]

c. Briefs Opposing Exceptions

285. MISO TOs also argue that the Presiding Judge correctly rejected Complainants' collateral attack on the Hearing Order's rejection of a cap on common equity ratios.[580]

d. Commission Determination

286. We disagree with Complainants' argument that the Commission should reduce the base ROEs of utilities with capital structures featuring at least 55 percent equity by 20 basis points. Although this proposal is not beyond the scope of this proceeding, as it is distinct from Complainants' request to prohibit equity-rich capital structures, it is insufficiently supported and inconsistent with the Commission's methodology for determining where in the DCF zone of reasonableness to place a specific public utility. While the Commission has indeed adjusted a company's base ROE above or below the

[577] Complainants Brief on Exceptions at 51.

[578] *Id.* at 51-52 (citing Hearing Order, 149 FERC ¶ 61,049 at P 199).

[579] Complainants Brief on Exceptions at 52 (citing Complainants Initial Brief at 90; *see also* Complainants Reply Brief at 39-41).

[580] MISO TOs Brief Opposing Exceptions at 49-51.

central tendency of the zone of reasonableness based on the relative risk analysis,[581] it does so only after a full evaluation of all relevant factors including both business and financial risk.[582] This is because lower financial risk may be offset by higher business risk or vice versa. Complainants have provided no such complete evaluation of any of the MISO TOs' relative risk versus the proxy group. Rather, they seek a risk adjustment based upon a single factor, an alleged equity-rich capital structure, without consideration of any other risk factor. This is contrary to Commission policy.

287. Moreover, although equity-rich capital structures may reduce utility risk Complainants have not attempted to justify or provide quantitative support for presumably arbitrary 55 percent threshold for this penalty. Additionally, Complainants' observation that their proposed 20 basis-point reduction is approximately one third of the difference between the spread between A and Baa utility bond yields for the six months ending December 2014,[583] lacks quantitative support such that it does not make the choice of this threshold any less arbitrary. Complainants provide no evidence of how much a higher return correlates with a higher credit rating. Complainants also do not justify why their proposed ROE reduction should apply to all utilities with equity percentages above 55 percent, regardless of what the equity percentage is.

288. In any event, Complainants' position fails to take into account the fact that our criteria for selecting members of the proxy group are intended to produce a proxy group made up of companies of similar risk. Those criteria include screens to ensure that the proxy group contains only utilities with similar credit ratings to the utility at issue. To the extent that a higher percentage equity in the capital structure reduces a utility's risk, as Complainants and Joint Consumer Advocates assert, then the utility's credit rating would be correspondingly higher than that of a utility with a typical capital structure. The resulting higher credit ratings of members of the proxy group would reduce the calculated ROE, because higher-rated companies generally have lower ROEs. Consequently, additional reductions to the ROEs that are proposed by Complainants essentially reduce the ROE twice for featuring equity-rich capital structures.

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[581] *See, e.g.*, *Williston Basin Interstate Pipeline Co. v. FERC*, 165 F.3d at 57 ("Once the Commission has defined a zone of reasonableness [using the DCF model], it then assigns the pipeline a rate within that range to reflect specific investment risks associated with that pipeline as compared to the proxy group companies").

[582] *See, e.g.*, *El Paso Natural Gas Co.*, Opinion No. 528-A, 154 FERC ¶ 61,120 at PP 302-340 (2016) (Opinion No. 528-A).

[583] *See* Exh. MTO-1 at 36.

289. Furthermore, as a policy matter, the Commission does not directly incentivize utilities' to adjust their preferred capital structures. The Commission has not previously directly encouraged utilities to feature more debt in their capital structure. We find that it would be inappropriate to encourage additional debt leveraging of utilities, many of which are undertaking large investments or do not have high credit ratings.

2. Formula Rate ROE Adjustments

a. Initial Decision

290. The Presiding Judge rejected the arguments of Joint Consumer Advocates and Joint Customer Intervenors that MISO TOs' formula rates reduce their business risks, at least relative to state-regulated utilities. The Presiding Judge observed that, although the parties appeared to "agree that formula rates reduce the risk of under-recovery, but deny the utility the benefits of over-recover[y]," the record did not indicate which effect was likely to predominate, making it impossible to determine the net effect of formula rates on a company's risk profile.[584] The Presiding Judge also concluded that the record did not contain evidence that the formula rates gave MISO TOs a significant advantage in more rapidly recovering their costs relative to state-regulated electric utilities.[585] In addition, the Presiding Judge distinguished a series of earlier Commission cases, in which the Commission appeared to adopt the proposition that formula rates reduced a utility's business risk. The Presiding Judge explained that those cases involved generators that had contracted to sell electricity to corporate affiliates that agreed to purchase all of the generators' output and the generator had a formula rate that provided for the recovery of all its expenses — circumstances that the Presiding Judge determined were not present for MISO TOs.[586] Finally, the Presiding Judge also noted that "a formula rate . . . appears to best serve the public interest" and, therefore, that lowering a public utility's ROE on the basis that it receives a formula rate could run counter to Commission objectives.[587]

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[584] Initial Decision, 153 FERC ¶ 63,027 at P 419.

[585] *Id.* PP 429-430, 432.

[586] *Id.* PP 435-443.

[587] *Id.* PP 449-450.

b. Briefs on Exceptions

291. Joint Customer Intervenors assert that the Presiding Judge failed to consider evidence demonstrating that the formula rate-based transmission service at issue here is less risky than the integrated generation and distribution service regulated by the state commissions.[588] OMS states that the Commission has explained that, in determining the ROE for public utilities, its evaluation of investment focuses on the two major sources of uncertainty to a company: the business risk and financial risk. OMS reiterates the arguments that Attachment O to the MISO Tariff – a comprehensive formula rate transmission rate – substantially mitigates the business risk faced by MISO TOs, and that this reduction in risk must be considered and given effect in determining a just and reasonable ROE for MISO TOs.[589] OMS states that the Presiding Judge rejected those arguments, citing three reasons why the availability of formula rates should not be a factor in the ROE determination. OMS contends that each of the three reasons relied upon by the Presiding Judge is erroneous.

292. First, OMS states that the Presiding Judge appears to have adopted MISO TOs' contention that formula rates are a double-edge sword; they eliminate the need for utilities to file rate cases when costs are increasing, but do not eliminate the risk of retroactive downward adjustments to rates when the formula has operated to over-recover costs.[590] OMS states that the inability to enjoy a windfall when costs are declining is not a factor that should be thought to balance out the mitigation of business risk formula rates provide in an increasing-cost environment.

293. Second, OMS states that the Presiding Judge found that formula rates serve the "public interest" because they ensure that a utility earns no more or less than its authorized Base ROE.[591] OMS states that this interest would be adversely affected, according to the Presiding Judge, if base ROEs were reduced to reflect the lower business risk faced by a company with a formula rate.[592] OMS argues that the Initial Decision's

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[588] Joint Customer Intervenors Brief on Exceptions at 47-48 (citing Exh. JCI-4 at 32:21-36:2).

[589] OMS Brief on Exceptions at 44 citing OMS Initial Brief at 34-35.

[590] *Id.* (citing Initial Decision, 153 FERC ¶ 63,027 at P 446).

[591] *Id.* at 45 (citing Initial Decision, 153 FERC ¶ 63,027 at P 447).

[592] *Id.* (citing Initial Decision, 153 FERC ¶ 63,027 at P 448).

finding in this regard misses the point that was argued by OMS and others because it focuses on the pros and cons of formula rates from the point of view of utilities, not from the perspective of investors. OMS states that investors care more about the certainty of cost recovery over time than they do about the opportunity for short-term windfalls, and therefore investors require less of a return from companies that offer a certainty of cost recovery than they do from companies offering instead the remote chance for an occasional windfall.[593] OMS contends that, by failing to give effect to this fact, the Presiding Judge confers a Base ROE that is higher than the actual risk-adjusted cost of equity for companies with full-cost recovery formula rates.

294. Finally, OMS states that the Presiding Judge relies on the fact that "the Commission has recently ignored without comment contentions that it should reduce a utility's Base ROE based on its utilization of allegedly less risky formula rates."[594] OMS argues that the Commission's silence in *PATH* cannot be construed as a determination on the merits of the question, and the Commission made clear in a more recent incarnation of the *PATH* proceedings that "silence is not evidence of Commission policy."[595] Furthermore, OMS contends that in *PATH* and the other orders to which the Initial Decision alludes[596] (save one), the Commission declined to expressly recognize the risk-mitigating effects of formula rates in the context of considering ROE *incentives*, not in the context of determining a just and reasonable, properly risk-adjusted *base* ROE. That the Commission did not expressly give effect to the risk-mitigating impact of formula rates in ROE adder cases, according to OMS, says nothing about the ability of formula rates to mitigate the risks that are relevant in Base ROE cases. OMS states that the only case cited by the Presiding Judge that specifically addressed a utility's base ROE is *Virginia Electric & Power Company*, where the Commission reduced the requested base ROE without expressly addressing, one way or the other, the argument that formula rates

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[593] *Id.* n.155 ("It is well-established in the financial literature that investors are generally 'risk-averse.' This means that the required return for an investment that has symmetric expectations of gains and losses is greater than the required return for an investment with certainty of no gains or losses.").

[594] *Id.* at 46 (citing Initial Decision, 153 FERC ¶ 63,027 at P 445 (citing *Potomac-Appalachian Transmission Highline, L.L.C.*, 122 FERC ¶ 61,188 (2008) (*PATH*))).

[595] *Id.* (citing *Potomac-Appalachian Transmission Highline, L.L.C.*, 153 FERC ¶ 61,308, at P 13 (2015)).

[596] *Id.* at 46 (citing Initial Decision, 153 FERC ¶ 63,027 at n.570).

mitigate risks.[597] OMS asserts that since silence is not evidence of Commission policy, the Initial Decision's reliance on these orders is not well-founded.

c. Briefs Opposing Exceptions

295. MISO TOs state that the Commission has previously found that formula rate tariffs do not fully mitigate the cost recovery risk of federally-regulated transmission or render public utilities less risky than state-regulated enterprises.[598]

296. In support of this argument, they state that the Commission has previously found that formula rate tariffs do not fully mitigate the cost recovery risk of federally-regulated transmission or render public utilities less risky than state-regulated enterprises.[599] Additionally, in response to OMS's argument that the Presiding Judge wrongly discounted Mr. Hill's comparable risk evidence, MISO TOs claim that OMS documented no errors in the Presiding Judge's finding that such evidence was outdated, inapplicable, incomplete, or inconsistent with testimony offered by other witnesses.[600] MISO TOs also argue that the Presiding Judge rightly determined that Mr. Solomon's testimony was incomplete, tangentially relevant, or not supportive of Mr. Solomon's position.[601]

d. Commission Determination

297. We affirm the Presiding Judge's determination that the use of formula rates does not warrant a lower base ROE. To the extent that formula rates reduce risk, they would, similar to the use of more equity in the capital structure, improve utility credit ratings. This would in turn affect the DCF proxy group based on screens requiring a group of similarly-rated utilities, diminishing the ROE produced by the DCF analysis. Additionally, nearly all electric utilities feature transmission formula rates. Consequently, the use of such formula rates is reflected in the proxy group within the DCF analysis.

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[597] *Id.* at 46-47 citing *Virginia Elec. & Power Co.*, 123 FERC ¶ 61,098, at P 58 (2008).

[598] MISO TOs Brief Opposing Exceptions at 35.

[599] *Id.*

[600] *Id.* at 35-36.

[601] *Id.* at 36.

298. Finally, as the Commission previously explained in Opinion No. 531, "when a public utility's ROE is changed, either under section 205 or section 206 of the FPA, that utility's total ROE, inclusive of transmission incentive ROE adders, should not exceed the top of the zone of reasonableness produced by the two-step DCF methodology," which in this case, would be 11.35 percent.[602] We therefore find that MISO TOs' total or maximum ROE, including transmission incentive ROE adders, cannot exceed 11.35 percent.[603]

The Commission orders:

(A) MISO TOs' base ROE is hereby set at 10.32 percent with a total or maximum ROE including incentives not to exceed 11.35 percent, effective on the date of this order, as discussed in the body of this order.

(B) MISO and MISO TOs are hereby directed to submit compliance filings with revised rates to be effective the date of this order reflecting a 10.32 percent base ROE and a total or maximum ROE not exceeding 11.35 percent (inclusive of transmission incentive ROE adders), within thirty (30) days of the date of this order, as discussed in the body of this order.

(C) MISO and MISO TOs are hereby directed to provide refunds, with interest calculated pursuant to 18 C.F.R. § 35.19a (2016), within thirty (30) days of the date of this order, for the 15-month refund period from November 13, 2013 through February 11, 2015, as discussed in the body of this order.

(D) MISO and MISO TOs are hereby directed to file a refund report detailing the principal amounts plus interest paid to each of their customers within forty-five (45) days of the date of this order.

By the Commission. Commissioner Honorable is not participating.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

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[602] Opinion No. 531, 147 FERC ¶ 61,234 at P 165.

[603] *See* Opinion No. 531-A, 149 FERC ¶ 61,032 at P 11.

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EXHIBIT B

169 FERC ¶ 61,129
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Neil Chatterjee, Chairman;
Richard Glick and Bernard L. McNamee.

Association of Businesses Advocating Tariff Equity
Coalition of MISO Transmission Customers
Illinois Industrial Energy Consumers
Indiana Industrial Energy Consumers, Inc.
Minnesota Large Industrial Group
Wisconsin Industrial Energy Group

Docket No. EL14-12-003

v.

Midcontinent Independent System Operator, Inc.
ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

Arkansas Electric Cooperative Corporation
Mississippi Delta Energy Agency
Clarksdale Public Utilities Commission
Public Service Commission of Yazoo City
Hoosier Energy Rural Electric Cooperative, Inc.

Docket No. EL15-45-000

v.

ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

OPINION NO. 569

ORDER ON BRIEFS, REHEARING, AND INITIAL DECISION

(Issued November 21, 2019)

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1. On November 15, 2018, the Commission issued an Order Directing Briefs in the above-captioned proceedings.[1] The Briefing Order directed the participants in the above-captioned proceedings to submit briefs regarding: (1) a proposed framework for determining whether an existing base return on equity (ROE) is unjust and unreasonable under the first prong of Federal Power Act (FPA) section 206;[2] and (2) a revised methodology for determining just and reasonable base ROEs under the second prong of FPA section 206.[3] As discussed below, we will adopt the proposal in the Briefing Order, with certain revisions. Principally, we will not adopt the use of the expected earnings (Expected Earnings) and risk premium (Risk Premium) models in our ROE analyses under the first and second prongs of section 206, and instead will use only the discounted cash flow (DCF) model and capital-asset pricing model (CAPM) in our ROE analyses under both prongs of section 206.

I. Background

A. Opinion No. 531 *et seq.*

2. In Opinion No. 531, the Commission adopted certain changes to its use of the DCF methodology for evaluating and setting the Commission-allowed ROE for the New England transmission owners (New England TOs). In particular, the Commission elected to replace the "one-step" DCF model, which considers only short-term growth projections for a public utility, with a "two-step" model that considers both short- and long-term growth projections.[4] The Commission also departed from its typical practice of setting the just and reasonable ROE of a group of utilities at the midpoint of the zone of reasonableness. The Commission explained that evidence of "anomalous" capital market conditions, including "bond yields [that were] at historic lows," made the Commission "less confiden[t] that the midpoint of the zone of reasonableness . . . accurately reflects the [ROE] necessary to meet the *Hope* and *Bluefield* capital attraction

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[1] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 165 FERC ¶ 61,118 (2018) (Briefing Order).

[2] 16 U.S.C. § 824e (2018).

[3] Briefing Order, 165 FERC ¶ 61,118 at PP 13-14.

[4] *See generally, Coakley Mass. Attorney Gen. v. Bangor Hydro-Elec. Co.*, Opinion No. 531, 147 FERC ¶ 61,234, at PP 8, 32-41, *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), *rev'd, Emera Maine v. FERC*, 854 F.3d 9 (D.C. Cir. 2017) (*Emera Maine*).

standards."[5] The Commission therefore looked to four alternative benchmark models: three financial models—the Risk Premium model, CAPM, and Expected Earnings model[6]—as well as a comparison with the ROEs approved by state public utility commissions.[7] In considering those models, the Commission emphasized that it was not departing from its long-standing reliance on the DCF model, but rather relying on those models only to "inform the just and reasonable placement of the ROE within the zone of reasonableness established . . . by the DCF methodology."[8] Based on these alternative models, the Commission determined that an ROE of 10.57 percent, the midpoint of the upper half of the zone of reasonableness produced by the two-step DCF model, would be just and reasonable. Because that figure differed from the New England TOs' existing 11.14 percent ROE, the Commission concluded that the existing base ROE had become unjust and unreasonable and it therefore set New England TOs' base ROE at 10.57 percent, pending a paper hearing concerning the long-term growth projection to use in the DCF analysis. Following that hearing, in Opinion No. 531-A the Commission reaffirmed its conclusion that 10.57 percent was the just and reasonable ROE and that New England TOs' existing ROE was unjust and unreasonable. The Commission required New England TOs to submit a compliance filing to implement their new ROEs effective October 16, 2014—the date of Opinion No. 531-A.

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[5] Opinion No. 531, 147 FERC ¶ 61,234 at PP 144-145 & n.285. "*Hope*" and "*Bluefield*" refer to a pair of U.S. Supreme Court cases that require the Commission "to set a rate of return commensurate with other enterprises of comparable risk and sufficient to assure that enough capital is attracted to the utility to enable it to meet the public's needs." *Boroughs of Ellwood City, Grove City, New Wilmington, Wampum, & Zelienople, Pa. v. FERC*, 731 F.2d 959, 967 (D.C. Cir. 1984) (citing *FPC v. Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944) (*Hope*) and *Bluefield Waterworks Improvement Co. v. Pub. Serv. Comm'n of W.V.*, 262 U.S. 679 (1923) (*Bluefield*)).

[6] As discussed further below, the Risk Premium model and CAPM estimate cost of equity using the premium that investors expect to earn on a stock investment over and above the return that they expect to earn on a bond investment, and the Expected Earnings model is a method of calculating the earnings that an investor expects to receive on the book value of a particular stock.

[7] Opinion No. 531, 147 FERC ¶ 61,234 at PP 147-149.

[8] *Id.* P 146.

B. Opinion No. 551 *et seq.*

3. On November 12, 2013, multiple complainants[9] filed a complaint (First Complaint) in Docket No. EL14-12-000 pursuant to FPA section 206, alleging, among other things, that the Midcontinent Independent System Operator, Inc.'s (MISO) transmission-owning members' (MISO TOs) base ROE reflected in MISO's Open Access Transmission, Energy and Operating Reserve Markets Tariff (Tariff) was unjust and unreasonable.[10] At the time of the First Complaint, MISO TOs had a base ROE of 12.38 percent (except for the ATCLLC zone which had a 12.20 percent ROE),[11] and their total ROE—i.e., the base ROE plus any ROE adders approved by the Commission—was not permitted to exceed 15.96 percent. The Commission established the MISO TOs'

[9] The complainants consist of a group of large industrial customers: Association of Businesses Advocating Tariff Equity (ABATE); Coalition of MISO Transmission Customers (Coalition of MISO Customers); Illinois Industrial Energy Consumers (IIEC); Indiana Industrial Energy Consumers, Inc. (INDIEC); Minnesota Large Industrial Group (MLIG); and Wisconsin Industrial Energy Group.

[10] The following MISO transmission owners were named in the First Complaint: ALLETE, Inc. for its operating division Minnesota Power (and its subsidiary Superior Water, L&P); Ameren Services Company, as agent for Union Electric Company, Ameren Illinois Company, and Ameren Transmission Company of Illinois; American Transmission Company LLC (ATC); Cleco Power LLC; Duke Energy Corporation for Duke Energy Indiana, Inc.; Entergy Arkansas, Inc.; Entergy Louisiana, LLC; Entergy Gulf States Louisiana, L.L.C.; Entergy Mississippi, Inc.; Entergy New Orleans, Inc.; Entergy Texas, Inc.; Indianapolis Power & Light Company; International Transmission Company; ITC Midwest LLC; METC; 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; and Wolverine Power Supply Cooperative, Inc. Intervenor Xcel Energy Services Inc. did not join certain of the MISO Transmission Owners' pleadings in this proceeding, but generally supports this brief on behalf of respondents Northern States Power Company, a Minnesota corporation, and Northern States Power Company, a Wisconsin corporation.

[11] For the sake of clarity, we refer to this ROE of the MISO TOs as 12.38 percent in this order, without separately identifying that the ATCLLC zone had a 12.20 percent ROE. Our discussion and decisions with respect to the MISO TOs' 12.38 percent ROE also apply to the 12.20 percent ATCLLC ROE.

preexisting 12.38 percent ROE in a 2002 decision.[12] That ROE was based on a DCF analysis using financial data for the six-month period ending February 2002.[13] On October 16, 2014, the same date that the Commission issued Opinion No. 531-A, it set the First Complaint for hearing before an Administrative Law Judge and established a refund effective date of November 12, 2013.[14]

4. Following the hearing, the Presiding Judge issued an Initial Decision,[15] and the Commission subsequently issued Opinion No. 551.[16] In Opinion No. 551, the Commission calculated the just and reasonable ROE using the two-step DCF methodology from Opinion No. 531 and financial data for the period January 1 through June 30, 2015. The Commission affirmed the conclusions of Initial Decision (I), finding that the Presiding Judge correctly applied the two-step DCF analysis required by Opinion No. 531.[17] The Commission also affirmed the Presiding Judge's determination that, as in Opinion No. 531, there were anomalous capital market conditions such that the Commission had less confidence that the midpoint of the zone of reasonableness produced by a mechanical application of the DCF methodology satisfied the capital

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[12] *See Midwest Indep. Transmission Sys. Operator, Inc.*, 99 FERC ¶ 63,011, *initial decision affirmed as to base ROE*, 100 FERC ¶ 61,292 (2002), *reh'g denied*, 102 FERC ¶ 61,143 (2003), *order on remand*, 106 FERC ¶ 61,302 (2004). The ATCLLC zone base ROE of 12.20 percent was established as part of a settlement agreement that was filed with the Commission on March 26, 2004. In Docket No. ER04-108-000, the Commission approved the uncontested settlement. *Am. Transmission Co. LLC*, 107 FERC ¶ 61,117 (2004).

[13] *Midwest Indep. Transmission Sys. Operator, Inc.*, 99 FERC ¶ 63,011, App. A.

[14] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 149 FERC ¶ 61,049, at P 188 (2014) (MISO I Hearing Order), *order on reh'g*, 156 FERC ¶ 61,060 (2016) (MISO I Rehearing Order). In the MISO I Rehearing Order, the Commission denied requests for rehearing and clarification of the MISO I Hearing Order and clarified that non-public utility transmission owners are subject to the outcome of that proceeding. MISO I Rehearing Order, 156 FERC ¶ 61,060 at PP 47-48.

[15] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 153 FERC ¶ 63,027 (2015) (Initial Decision (I)).

[16] *Ass'n of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 551, 156 FERC ¶ 61,234 (2016) (affirming Initial Decision (I), 153 FERC ¶ 63,027).

[17] *See generally* Opinion No. 551, 156 FERC ¶ 61,234 at P 9.

attraction standards of *Hope* and *Bluefield*.[18] The Commission found that the Presiding Judge reasonably considered evidence of alternative methodologies for determining the ROE and the ROEs approved by state regulatory commissions, for purposes of deciding to set the ROE at the central tendency of the upper half of the zone of reasonableness, setting the base ROE for MISO TOs at 10.32 percent.[19] The Commission required MISO TOs to submit a compliance filing to implement their new ROEs effective September 28, 2016, the date of Opinion No. 551, and to provide refunds for the November 12, 2013-February 11, 2015 refund period. Following the issuance of Opinion No. 551, numerous parties submitted requests for rehearing.

C. Second Complaint Against MISO TOs' ROE

5. On February 12, 2015, a new set of complainants[20] filed a complaint (Second Complaint) also alleging that the MISO TOs' base ROE of 12.38 percent was unjust and unreasonable.[21] Relying on an updated two-step DCF analysis, the Second Complaint

[18] *Id.*

[19] *Id.*

[20] Complainants for the Second Complaint consist of: Arkansas Electric Cooperative Corporation (Arkansas Electric Cooperative); Mississippi Delta Energy Agency and its two members, Clarksdale Public Utilities Commission of the City of Clarksdale, Mississippi and Public Service Commission of Yazoo City of the City of Yazoo City, Mississippi; and Hoosier Energy Rural Electric Cooperative, Inc. (Hoosier Cooperative).

[21] The following MISO transmission owners were named in the Second Complaint: ALLETE, Inc. (for its operating division Minnesota Power, Inc. and its wholly-owned subsidiary Superior Water Light, & Power Company; Ameren Illinois Company; Union Electric Company (identified as Ameren Missouri); Ameren Transmission Company of Illinois; ATC; Cleco Power LLC; Duke Energy Business Services, LLC; Entergy Arkansas, Inc.; Entergy Gulf States Louisiana, LLC; Entergy Louisiana, LLC; Entergy Mississippi, Inc.; Entergy New Orleans, Inc.; Entergy Texas, Inc.; Indianapolis Power & Light Company; International Transmission Company, ITC Midwest LLC, and Michigan Electric Transmission Company, LLC; MidAmerican Energy Company; Montana-Dakota Utilities Co., Northern Indiana Public Service Company; Northern States Power Company-Minnesota; Northern States Power Company-Wisconsin; Otter Tail Power Company; and Southern Indiana Gas & Electric Company.

complainants argued that the base ROE should be no higher than 8.67 percent.[22] On June 18, 2015, the Commission established hearing procedures and set a refund effective date of February 12, 2015.[23]

6. Parties filed requests for rehearing of the MISO II Hearing Order, and on July 21, 2016, the Commission generally denied these rehearing requests.[24] Following the MISO II Hearing Order, the Presiding Judge issued the Initial Decision on June 30, 2016.[25] The Presiding Judge adopted a zone of reasonableness of 6.75 percent to 10.68 percent based on financial data for the period July 1, 2015 through December 31, 2015. The Presiding Judge also determined that the anomalous market conditions identified in Opinion No. 531 persisted and, after considering the alternative benchmark methodologies, that the just and reasonable ROE was 9.70 percent—halfway between the midpoint and the upper bound of the zone of reasonableness. The participants filed briefs on and opposing exception, which are currently pending before the Commission.

D. ***Emera Maine***

7. On April 14, 2017, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) issued its *Emera Maine* decision, vacating and remanding Opinion No. 531 *et seq*. As an initial matter, the D.C. Circuit was not persuaded by New England TOs' argument that an ROE within the DCF-produced zone of reasonableness could not be deemed unjust and unreasonable. The D.C. Circuit explained that the zone of reasonableness established by the DCF is not "coextensive" with the "statutory" zone of reasonableness envisioned by the FPA.[26] Accordingly, the D.C. Circuit concluded that the fact that New England TOs' existing ROE fell within the zone of reasonableness

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[22] *Ark. Elec. Coop. Corp. v. ALLETE, Inc.*, 151 FERC ¶ 61,219, at P 1 (2015) (MISO II Hearing Order), *order on reh'g*, 156 FERC ¶ 61,061 (2016) (MISO II Rehearing Order).

[23] MISO II Hearing Order, 151 FERC ¶ 61,219 at P 1.

[24] *See* MISO II Rehearing Order, 156 FERC ¶ 61,061.

[25] *Ark. Elec. Coop. Corp. v. ALLETE, Inc.*, 155 FERC ¶ 63,030 (2016) (Initial Decision (II)).

[26] *Emera Maine*, 854 F.3d at 22-23.

produced by the DCF did not necessarily indicate that it was just and reasonable for the purposes of the FPA.[27]

8. Nevertheless, the D.C. Circuit found that the Commission had not adequately shown that the New England TOs' existing ROE was unjust and unreasonable. The D.C. Circuit explained that the FPA's statutory "zone of reasonableness creates a broad range of potentially lawful ROEs rather than a single just and reasonable ROE" and that whether a particular ROE is unjust and unreasonable depends on the "particular circumstances of the case."[28] Thus, the fact that New England TOs' existing ROE did not equal the just and reasonable ROE that the Commission would have set using the current DCF inputs did not necessarily indicate that New England TOs' existing ROE fell outside the statutory zone of reasonableness.[29] As such, the D.C. Circuit concluded that Opinion No. 531 "failed to include an actual finding as to the lawfulness of [New England TOs'] existing base ROE" and that its conclusion that their existing ROE was unjust and unreasonable was itself arbitrary and capricious.[30]

9. The D.C. Circuit also found that the Commission had not adequately shown that the 10.57 percent ROE that it set was just and reasonable. Although recognizing that the Commission has the authority "to make 'pragmatic adjustments' to a utility's ROE based on the 'particular circumstances' of a case," the D.C. Circuit nevertheless concluded that the Commission had not explained why setting the ROE at the upper midpoint was just and reasonable.[31] The D.C. Circuit noted, in particular, that the Commission relied on the alternative models and state-regulated ROEs to support a base ROE *above* the midpoint, but that it did not rely on that evidence to support an ROE *at* the upper midpoint.[32]

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[27] *Id.* at 23.

[28] *Id.* at 23, 26.

[29] *Id.* at 27 ("To satisfy its dual burden under section 206, FERC was required to do more than show that its single ROE analysis generated a new just and reasonable ROE and conclusively declare that, consequently, the existing ROE was per se unjust and unreasonable.").

[30] *Id.*

[31] *Id.* (quoting *FPC v. Nat. Gas Pipeline Co. of America*, 315 U.S. 575, 586 (1942)).

[32] *Id.* at 29 ("FERC's reasoning is unclear. On the one hand, it argued that the alternative analyses supported its decision to place the base ROE above the midpoint, but

Similarly, the D.C. Circuit noted that the Commission had concluded that a base ROE of 9.39 percent—the midpoint of the zone of reasonableness—might not be sufficient to satisfy *Hope* and *Bluefield* or to allow the utility to attract capital, but that the Commission had not similarly explained how a 10.57 percent base ROE was sufficient to meet either of those conditions. Because the D.C. Circuit found that the Commission had not pointed to record evidence supporting the specific point at which it set New England TOs' ROE, the D.C. Circuit held that the Commission had not articulated the "rational connection" between the evidence and the rate that the FPA demands.[33]

10. Based on the D.C. Circuit's conclusion that the Commission had not met its burden either under the first or the second prong of FPA section 206, it vacated and remanded Opinion No. 531 *et seq.*[34] Thus, the current state of affairs concerning the MISO TOs' ROE is this: There are two currently pending complaints against their ROE, both of which have been fully litigated before a Presiding Judge. The D.C. Circuit vacated the Commission's determinations in Opinion No. 531, upon which the Commission relied extensively in its order on the First Complaint (i.e., Opinion No. 551), meaning that Opinion No. 531 is no longer precedential,[35] even though the Commission remains free to re-adopt those determinations on remand as long as it provides a reasoned basis for doing so.[36] In the meantime, MISO TOs are continuing to collect their 10.32 percent ROE, although the Commission has broad remedial authority to correct its legal error in order to make whatever ROE it sets on rehearing effective as of the date of Opinion No. 551.[37]

E. Briefing Orders

11. On October 16, 2018, the Commission issued an order proposing a methodology for addressing the issues that were remanded to the Commission in *Emera Maine* and

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on the other hand, it stressed that none of these analyses were used to select the 10.57 percent base ROE.").

[33] *Id.* at 28-30.

[34] *Id.* at 30.

[35] *ISO New England Inc. v. Bangor Hydro-Electric Co.*, 161 FERC ¶ 61,031, at P 28 (2017).

[36] *Emera Maine*, 854 F.3d at 30.

[37] *See ISO New England Inc. v. Bangor Hydro-Electric Co.*, 161 FERC ¶ 61,031 at PP 24, 34.

establishing a paper hearing on whether and how this methodology should apply to the four complaint proceedings concerning the New England TOs' ROE.[38] In the *Coakley* Briefing Order, the Commission proposed to change its approach to determining base ROE by giving equal weight to four financial models, instead of primarily relying on the DCF methodology. The Commission stated that evidence indicates that investors do not rely on any one model to the exclusion of others. Therefore, relying on multiple financial models makes it more likely that our ROE determination will accurately reflect how investors make their investment decisions.

12. Specifically, the Commission proposed to rely on three financial models that produce zones of reasonableness—the DCF model, CAPM, 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.[39]

13. The Commission also proposed a framework for using the composite zone of reasonableness in evaluating whether an existing base ROE remains just and reasonable. The Commission proposed that, in order to find a utility's existing ROE unjust and unreasonable under the first prong of FPA section 206, its ROE must be outside a range of presumptively just and reasonable ROEs for a utility of its risk profile, absent additional evidence to the contrary. In other words, the Commission would dismiss an ROE complaint if the targeted utility's existing ROE falls within the range of presumptively just and reasonable ROEs for a utility of its risk profile unless that presumption is sufficiently rebutted. The Commission explained that, by the same token, a finding that the existing ROE of a utility falls outside that range would support a holding that the ROE has become unjust and unreasonable, absent additional evidence to the contrary.[40]

14. The Commission explained that it is appropriate to calculate the applicable ranges of presumptively just and reasonable ROEs based on a utility's risk profile because a utility's risk profile remains the "particular circumstance[]" most relevant to determining whether a point within a zone of reasonableness is a just and reasonable ROE for that utility.[41] The Commission further concluded that the "principal consideration for

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[38] *Coakley v. Bangor Hydro-Elec. Co.*, 165 FERC ¶ 61,030 (2018) (*Coakley* Briefing Order).

[39] *See id.* PP 16, 30.

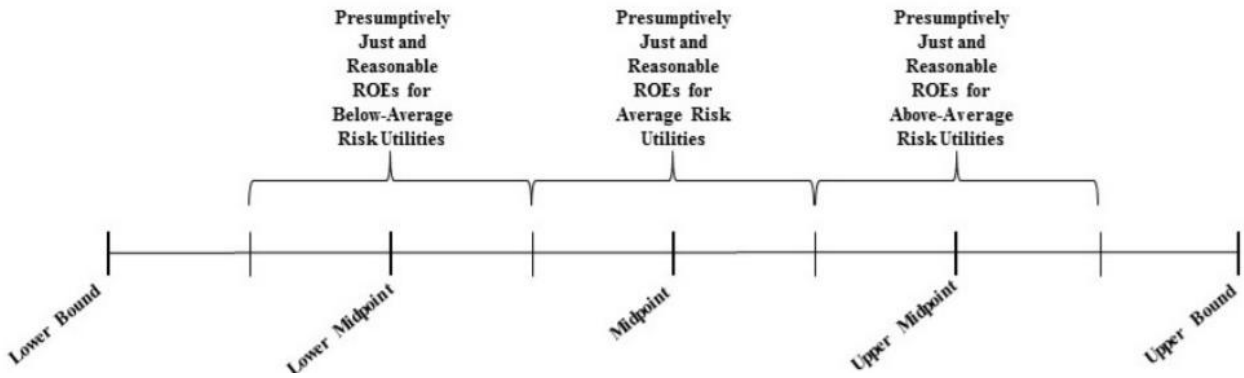
[40] *See id.* PP 16, 28.

[41] *Id.* P 24 (quoting *Emera Maine*, 854 F.3d at 23).

determining whether an existing ROE within the overall zone of reasonableness has become unjust and unreasonable is the risk profile of the utility or utilities for which the Commission is setting the ROE."[42]

15. The Commission proposed that the applicable range of presumptively just and reasonable ROEs for a utility should correspond to those points that are closer to the ROE that the Commission should set for that utility than to the ROE for a utility of a different risk profile.[43] For example, the Commission explained that it typically would be unjust and unreasonable for an average risk utility to receive an ROE that is closer to the ROE that would be just and reasonable for a utility of above- or below-average risk.[44] In particular, for average risk utilities, the Commission proposed that the presumptively just and reasonable range would be the quartile of the zone of reasonableness centered on the central tendency of the composite zone of reasonableness. For below average risk utilities, the Commission proposed that such range would be the quartile of the zone of reasonableness centered on the central tendency of the lower half of the zone of reasonableness. For above average risk utilities, the Commission proposed that such range would be the quartile of the zone of reasonableness centered on the central tendency of the upper half of the zone of reasonableness.[45] The Commission illustrated how these presumptively just and reasonable quartile ranges would be divided as follows:

Figure 1: Zone of Reasonableness Quartiles



16. For purposes of establishing a new just and reasonable base ROE when the existing base ROE has been shown to be unjust and unreasonable, the Commission proposed using the above three models, plus the Risk Premium model. The Risk

[42] *Id.* P 28.

[43] *Id.* P 27.

[44] *Id.* P 26.

[45] *Id.*

Premium model produces a single numerical point rather than a range; therefore the Commission did not propose to use it to establish a composite zone of reasonableness. The Commission proposed to determine a new just and reasonable ROE for average risk utilities by determining the midpoint/medians of each zone of reasonableness produced by the DCF, CAPM, and Expected Earnings models and averaging those ROEs with the Risk Premium ROE, giving equal weight to each of the four figures. The Commission proposed to use the midpoint/medians of the lower and upper halves of the zones of reasonableness to determine ROEs for below average and above average risk utilities, respectively, and average those ROEs with the Risk Premium ROE.[46]

17. On November 15, 2018, the Commission issued the Briefing Order in these proceedings. In that order, the Commission similarly established a paper hearing on whether and how the methodology proposed in the *Coakley* Briefing Order should apply to the two proceedings pending before the Commission involving MISO TOs' ROE.[47]

II. Overview

18. As discussed below, we adopt the revised base ROE methodology proposed in the Briefing Order, with certain revisions. The Commission will use this methodology to determine whether an existing base ROE is unjust and unreasonable under the first prong of section 206, and for determining a new just and reasonable replacement base ROE under the second prong of section 206 when an existing ROE has been shown to be unjust and unreasonable. However, we will not use the Expected Earnings model or Risk Premium model in our revised base ROE methodology, for the reasons we discuss below. As a result, we will use the DCF model and CAPM in our determinations under the first and second prongs of section 206, as we discuss further below. These models are the two methods most commonly used by investors for estimating the cost of equity.[48] We will also use the ranges of presumptively just and reasonable ROEs in our analysis under the first prong of section 206, as the Commission proposed in the Briefing Order.

19. In this order, we also make other, more specific findings regarding the implementation of these models in our revised base ROE methodology. In particular, in the DCF model, we will use a two-step DCF analysis that incorporates a long-term growth rate, use the short-term growth rate to calculate the (1+.5g) adjustment to dividend yield, and use only the Institutional Brokers' Estimate System (IBES) as the source of short-term earnings growth estimates. In the CAPM, we will: (1) estimate the

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[46] *Id.* P 17.

[47] *See* Briefing Order, 165 FERC ¶ 61,118 at P 1.

[48] Trial Staff Initial Br. (I) at 8 (citing *In re Connect Am. Fund*, 28 FCC Rcd. 7123, 7148 (2013)); Trial Staff Initial Br. (II) at 7 (citing same).

CAPM expected market return using a forward-looking approach; (2) use a one-step DCF model without any long-term growth projection for the DCF analysis within the CAPM; (3) use only IBES as the source of short-term earnings growth estimates in the DCF analysis within the CAPM; (4) screen from the CAPM analysis S&P 500 companies with growth rates that are negative or in excess of 20 percent; and (5) include a size premium adjustment. In addition, we also adopt a revised low-end outlier test that eliminates DCF and CAPM proxy group ROE results that are less than the yields of generic corporate Baa bonds plus 20 percent of the CAPM risk premium.

20. Applying this revised base ROE methodology to the facts of the First Complaint, we review the MISO TOs' 12.38 percent ROE that was the existing ROE reviewed in Opinion No. 551, which is pending on rehearing before us here. Under the revised base ROE methodology, the composite zone of reasonableness in the First Complaint proceeding is from 7.52 percent to 12.24 percent.[49] As discussed below, we find that MISO TOs are of average risk, therefore the applicable quartile range of presumptively just and reasonable ROEs for MISO TOs in the First Complaint proceeding is from 9.29 percent to 10.47 percent.[50] Accordingly, MISO TOs' 12.38 percent ROE is not treated as presumptively just and reasonable and in fact, is higher than the 12.24 percent top of the overall zone of reasonableness. As discussed below, in light of this and the other circumstances of the case, we find that MISO TOs' 12.38 percent is unjust and unreasonable. Having found that MISO TOs' existing 12.38 percent ROE is unjust and unreasonable, we then find that the just and reasonable replacement ROE for the MISO TOs in the First Complaint proceeding is 9.88 percent because MISO TOs are of average risk and the midpoint of the composite zone of reasonableness is 9.88 percent.[51] Accordingly, we grant rehearing of Opinion No. 551 in part to require the MISO TOs to adopt a 9.88 percent ROE effective September 28, 2016, the date Opinion No. 551 required the MISO TOs to adopt a 10.32 percent ROE, and provide refunds, with interest for the applicable refund period, as discussed below.

21. As discussed further below, in the Second Complaint proceeding, the ROE to be reviewed is the 9.88 percent ROE established in the First Complaint proceeding that is effective prospectively from September 28, 2016. Under the revised base ROE methodology, the composite zone of reasonableness in the Second Complaint proceeding is from 7.78 percent to 11.66 percent.[52] As discussed below, we continue to find that

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[49] *See* Appendix C.

[50] *See id.*

[51] *See id.*

[52] *See id.*

MISO TOs are of average risk in the Second Complaint proceeding; therefore the applicable quartile range of presumptively just and reasonable ROEs for MISO TOs in that proceeding is from 9.23 percent to 10.20 percent.[53] The 9.88 percent ROE that the Commission is reviewing for purposes of the Second Complaint proceeding falls within that range; therefore, the Commission presumes it to be just and reasonable. As discussed below, we find that this presumption has not been rebutted by the evidence in the Second Complaint proceeding. Accordingly, we affirm in part and reverse in part the Initial Decision (II) in the Second Complaint proceeding, dismiss the Second Complaint, and find that no refunds should be issued as a result of the resolution of that complaint.

III. Use of Multiple Models Generally

A. Background

22. As noted above, in the Briefing Order, the Commission proposed to change its methodology for analyzing base ROEs under section 206 to rely on multiple financial models instead of primarily relying on only the DCF model. Specifically, the Commission proposed to rely on the three financial models that produce zones of reasonableness—the DCF, CAPM, and Expected Earnings models—in its ROE analysis under the first prong of section 206, and to rely on four financial models—the Risk Premium model, in addition to those used in the first prong analysis—in its ROE analysis under the second prong of section 206.[54]

23. The Commission explained that changing its base ROE methodology to rely on these multiple financial models is appropriate because investors do not rely on any single financial model to make their investment decisions, but instead rely on these models and other methods to varying degrees. The Commission reasoned that, therefore, a more accurate estimate of what ROE is needed to induce investors to invest in a utility—i.e., what ROE a utility must offer in order to attract capital—would be provided by relying on multiple financial models because that is what investors do when making investment decisions.[55] The Commission further explained that relying on multiple financial models is appropriate because any one model has the potential for errors or inaccuracies and

[53] *See id.*

[54] *See* Briefing Order, 165 FERC ¶ 61,118 at PP 17-18.

[55] *See id.* PP 37-49.

relying on multiple models together reduces the risks that errors or inaccuracies in any one model will produce an inaccurate cost of equity estimate.[56]

B. CAPs

24. Complaint-Aligned Parties (CAP)[57] argue that the Commission should continue to rely on the DCF as the primary, if not exclusive, model in its ROE analyses. CAPs assert that the DCF method still remains the most robust and instructive market-based method to use in the determination of just and reasonable ROEs.[58] CAPs contend that the Commission's concerns about continuing to rely on only the DCF model are misplaced.[59]

25. CAPs argue that, to the extent the Commission adopts an ROE methodology that relies upon the CAPM model, it must be implemented properly and that CAPs' witness

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[56] *See id.* PP 38-40.

[57] For purposes of the CAPs briefs in the First Complaint proceeding, CAPs include the following entities: American Municipal Power, Inc. (AMP); ABATE, Coalition of MISO Customers, IIEC, INDIEC, MLIG, and Wisconsin Industrial Group (WIEC) (collectively, Joint Complainants); Joint Consumer Advocates, including Indiana Office of Utility Consumer Counselor, Iowa Office of Consumer Advocate, Michigan Citizens Against Rate Excess, Minnesota Department of Commerce, and Citizens Utility Board of Wisconsin; Joint Customers, including Arkansas Electric Cooperative, Cooperative Energy, and Hoosier Cooperative; Organization of MISO States, Inc. (OMS); Mississippi Public Service Commission (MS PSC), Missouri Public Service Commission (MO PSC) and Missouri Joint Municipal Electric Utility Commission (MJMEUC) (collectively, Missouri-Mississippi Parties or MOMs); and Southwest Electric Cooperative, Inc. (SWEC). For purposes of the CAPs briefs in the Second Complaint proceeding, CAPs include Industrial Consumer Groups (ICG), comprising ABATE, Coalition of MISO Customers, IIEC, INDIEC, MLIG, and WIEC; Joint Consumer Advocates, comprising Illinois Citizens Utility Board, Indiana Office of Utility Consumer Counselor, Iowa Office of Consumer Advocate, Michigan Citizens Against Rate Excess, Minnesota Department of Commerce, and Citizens Utility Board of Wisconsin; Joint Complainants and Intervenor (JCI), comprising Arkansas Electric Cooperative, Cooperative Energy, and Hoosier Cooperative; OMS; Missouri-Mississippi Parties; and SWEC.

[58] CAPs Initial Br (I) at 12-14; CAPs Initial Br. (II) at 11-14; CAPs Reply Br. (I) at 6-9; CAPs Reply Br. (II) at 21-24.

[59] CAPs Initial Br. (I) at 14-22; CAPs Initial Br. (II) at 14-22.

Mr. Gorman provides a CAPM analysis that "produces reliable results."[60] CAPs similarly assert that, if the Commission uses the Risk Premium model in its ROE methodology, it should be revised in the manner recommended by CAPs and "Mr. Gorman addresses the correct approach for conducting a Risk Premium study that produces a reliable cost-of-equity estimate."[61] CAPs oppose the use of the Expected Earnings model in the Commission's ROE methodology, arguing that it should receive no weight.[62] CAPs contend that, at the most, the Expected Earnings model should be given significantly less weight than market-based models.[63]

C. MISO TOs

26. MISO TOs support the Commission's proposal to use multiple financial models in its ROE methodology, asserting that the multiple model approach is a significant improvement over the approach of relying on only the DCF model.[64] MISO TOs assert that the additional three models which the Commission proposes to use are widely relied upon by investors and present transparent cost-of-capital estimates.[65] MISO TOs propose certain modifications to the DCF, CAPM, and Expected Earnings models and urge the Commission to apply the Risk Premium model in the same manner in this proceeding as the Commission proposed in the New England TOs' ROE complaint proceedings.[66]

D. Trial Staff

27. Trial Staff proposes various adjustments to the DCF, CAPM and Risk Premium models, but does not oppose the Commission using them in its ROE methodology in general.[67] Trial Staff argues that the Expected Earnings model should not be included in

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[60] CAPs Initial Br. (I) at 27-28; CAPs Initial Br. (II) at 27.

[61] CAPs Initial Br. (I) at 34-35; CAPs Initial Br. (II) at 34-35.

[62] CAPs Initial Br. (I) at 14; CAPs Initial Br. (II) at 14.

[63] CAPs Initial Br. (I) at 46; CAPs Initial Br. (II) at 46.

[64] MISO TOs Initial Br. (I) at 1-2; MISO TOs Initial Br. (II) at 5; MISO TOs Reply Br. (I) at 5-19; MISO TOs Reply Br. (II) at 5-19.

[65] MISO TOs Initial Br. (I) at 4; MISO TOs Initial Br. (II) at 6.

[66] MISO TOs Initial Br. (I) at 6-7; MISO TOs Initial Br. (II) at 24.

[67] *See* Trial Staff Initial Br. (I) at 2; Trial Staff Initial Br. (II) at 2; Trial Staff Reply Br. (I) at 8-19; Trial Staff Reply Br. (II) at 8-19.

the Commission's ROE methodology. Trial Staff asserts that the Commission has used market-based models for over 30 years to determine the cost of equity, but the Expected Earnings model is not a market-based method for estimating the cost of equity. Trial Staff also asserts that there is little evidence that the Expected Earnings approach is widely used by investors.[68]

E. LPSC

28. The Louisiana Public Service Commission (LPSC) contends that the Commission should require certain changes to the Risk Premium model and CAPM if those models are used in the Commission's ROE methodology, but does not oppose the use of those models in general.[69] LPSC argues that the Expected Earnings model should not be used in the Commission's ROE methodology, arguing, among other things, that the model has no legitimate relationship to investors' required return on equity.[70] LPSC argues that, if the Commission decides to use the Expected Earnings model, then it should adjust the analysis for market-to-book ratios.[71]

F. RPGI

29. Resale Power Group of Iowa (RPGI) argues that the Commission should "reaffirm the primacy of the DCF model" and continue to use a DCF-based approach for setting ROEs.[72] RPGI contends that, if the Commission uses multiple financial models in its ROE methodology, then the Commission should make changes to the CAPM and Risk Premium models, but it does not oppose the use of these two financial models in general.[73] RPGI endorses Trial Staff's proposal to exclude the Expected Earnings model from the Commission's ROE methodology.[74]

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[68] Trial Staff Initial Br. (I) at 2-3; Trial Staff Initial Br. (II) at 2-3.

[69] LPSC Initial Br. at 5-9, 29-42.

[70] *Id.* at 1-5, 13-29.

[71] *Id.* at 29.

[72] RPGI Initial Br. (I) at 5-7, 11-20; RPGI Initial Br. (II) at 12-23.

[73] RPGI Initial Br. (I) at 26-37; RPGI Initial Br. (II) at 29-40.

[74] RPGI Reply Br. (I) at 8; RPGI Reply Br. (II) at 7.

G. Alliant

30. Alliant supports Trial Staff's proposal to exclude the Expected Earnings model from the Commission's ROE methodology.[75] Alliant does not oppose the use of the DCF, CAPM or Risk Premium models in the Commission's ROE methodology.

H. Commission Determination

31. We will expand our methodology for determining whether an existing base ROE is unjust and unreasonable under the first prong of section 206, and for determining a new just and reasonable replacement base ROE under the second prong of section 206 when an existing ROE has been shown to be unjust and unreasonable, to rely on multiple financial models. Specifically, we will use the DCF model and CAPM in our ROE methodology, but not the Expected Earnings or Risk Premium models. As discussed further below, we find that expanding our methodology to use the CAPM model in addition to the DCF model will better reflect how investors make their investment decisions. This should result in our ROE analyses producing cost of equity estimates that more accurately reflect what ROE a utility must offer in order to attract capital. As discussed in sections VI and VIII below, we find that, on balance, the Expected Earnings and Risk Premium models would not improve our ROE determinations sufficiently to justify using those models, in light of their flaws and the potential inaccuracies and complexity that they could introduce into our ROE analyses.

32. As an initial matter, the D.C. Circuit has repeatedly observed that the Commission is not required to rely upon the DCF methodology alone or even at all.[76] Accordingly, the Commission may "change its past practices," such as relying exclusively on the DCF model, "with advances in knowledge in its given field or as its relevant experience and expertise expands," provided that it supplies "a reasoned analysis indicating that prior

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[75] Alliant Reply Br. at 5-7.

[76] *Tenn. Gas Pipeline Co. v. FERC*, 926 F.2d 1206, 1211 (D.C. Cir. 1991) (explaining that the Commission is free to reject the DCF methodology, provided that it adequately explains its reasons for doing so); *Elec. Consumers Res. Council v. FERC*, 747 F.2d 1511, 1514 n.6 (D.C. Cir. 1984) ("[N]either statutes nor decisions of this court require that the Commission utilize a particular formula or a combination of formulae to determine whether rates are just and reasonable."); *NEPCO, Mun. Rate Comm. v. FERC*, 668 F.2d 1327, 1345 (D.C. Cir. 1987) ("FERC is not bound 'to the service of any single formula or combination of formulas.'" (quoting *FPC v. Nat. Gas Pipeline Co.*, 315 U.S. at 586)); *see also Emera Maine*, 854 F.3d at 27 (noting that the Commission has authority to make "'pragmatic adjustments' to a utility's ROE" based on the facts of the particular case (quoting *FPC v. Nat. Gas Pipeline Co.*, 315 U.S. at 586)).

policies and standards are being deliberately changed, not casually ignored."[77] Our existing ROE methodology relies on the DCF model exclusively for purposes of determining the zone of reasonableness that is used under the first and second prongs of section 206. However, we find that now, in light of our expanded experience with ROE determinations under various market conditions and the court's guidance in *Emera Maine*, expanding our ROE methodology to include the CAPM, as well as the DCF model, will better reflect how investors make their investment decisions and result in more accurate cost of equity estimates.

33. In *Hope*, the Supreme Court held that "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[78] Thus, a key consideration in determining just and reasonable utility ROEs is determining what ROE a utility must offer in order to attract capital, i.e., induce investors to invest in the utility in light of its risk profile.[79] As the Commission stated in Opinion No. 414-B,[80] "the cost of common equity to a regulated enterprise depends upon what the market expects not upon precisely what is going to happen."[81] Thus, in determining what ROE to award a utility, we must look to how investors analyze and compare their investment opportunities.

34. Investors have varying preferences as to which of the various methods for determining cost of equity they may use to inform their investment decisions. As Dr. Roger Morin states, "Investors do not necessarily subscribe to any one method, nor does the stock price reflect the application of any one single method by the price-setting

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[77] *Nuclear Energy Inst., Inc. v. EPA*, 373 F.3d 1251, 1296 (D.C. Cir. 2004) (per curiam) (internal citations and quotation marks omitted).

[78] *Hope*, 320 U.S. at 603. *See also Canadian Ass'n of Petroleum Producers v. FERC*, 254 F.3d 289, 293 (D.C. Cir. 2001) ("In order to attract capital, a utility must offer a risk-adjusted expected rate of return sufficient to attract investors.").

[79] *See Bluefield*, 262 U.S. at 692-693 (discussing factors an investor considers in making investment decisions).

[80] *Transcontinental Gas Pipe Line Corp.*, Opinion No. 414-B, 85 FERC ¶ 61,323 (1998).

[81] *Id.* at 62,268. *See also Kern River Gas Transmission Co.*, Opinion No. 486-B, 126 FERC ¶ 61,034, at P 120 (2009).

investor. There is no monopoly as to which method is used by investors."[82] As discussed further below, the record in this proceeding demonstrates that the CAPM model is one of the primary methods investors use to measure the cost of equity, along with the DCF model.[83] Moreover, like the DCF model, the CAPM model is market-oriented and produces a zone of reasonableness. Accordingly, we find that cost of equity estimates based on both models will provide a more reasonable measure of investor expectations, since they are among the information that investors rely upon when making investment decisions.

35. We also find that the expansion of our ROE methodology to use the CAPM in addition to the DCF model will help address the issues that led the court to remand Opinion No. 531 in *Emera Maine*. In that proceeding involving New England TOs' base ROE, the Commission found that it had "less confidence that the midpoint of the zone of reasonableness" produced by the DCF model "accurately reflect[ed] the equity returns necessary to meet the *Hope* and *Bluefield* capital attraction standards."[84] Because of this concern, the Commission considered "'additional record evidence, including evidence of alternative benchmark methodologies" to inform the placement of ROE within the DCF-produced zone of reasonableness.[85] The Commission found that that evidence "supported a finding that an upward adjustment from the midpoint was warranted."[86] The

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[82] Roger A. Morin, *New Regulatory Finance* 429 (Public Utilities Reports, Inc. 2006) (Morin) at 429.

[83] *See, e.g.*, Trial Staff Initial Br. (I), Keyton Aff. at 11 ("the DCF, CAPM, and Risk Premium methods which are widely used by investors."); Trial Staff Initial Br. (II), Keyton Aff. (II) at 10 (stating same); MISO TOs Initial Br. (I) at 4 (explaining that the CAPM is "widely relied upon by investors"); MISO TOs Initial Br. (II) at 6 (explaining same); Trial Staff Reply Br. (I) at 5 ("'There are three broad generic methods available to measure the cost of equity: DCF, Risk Premium, and CAPM. All three of these methods are accepted and used by the financial community and firmly supported in financial literature.'" (quoting San Diego Gas & Electric Company, Prepared Direct Testimony of Dr. Roger A. Morin on behalf of San Diego Gas & Electric Company, Docket No. ER19-221-000, at 16-17 (filed Oct. 30, 2018))); Michael C. Ehrhardt and Eugene F. Brigham, *Financial Management: Theory and Practice* 253 (13th ed. 2011) ("the basic CAPM is still the most widely used method for thinking about required rates of return on stocks.").

[84] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 49 (quoting Opinion No. 531, 147 FERC ¶ 61,234 at P 145).

[85] Opinion No. 531, 147 FERC ¶ 61,234 at P 145.

[86] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 37.

Commission then set the New England TOs' ROE at the 10.57 percent midpoint of the upper half of the DCF zone of reasonableness. In taking this action, the Commission emphasized that it was "'not depart[ing] from [its] use of the DCF methodology.'"[87]

36. In *Emera Maine*, the court held that the Commission "failed to explain how any evidence demonstrated that 10.57 percent was a just and reasonable base ROE."[88] The court found that this omission was particularly troublesome in light of the Commission concerns over the reliability of the DCF zone of reasonableness. The court also stated that "FERC never explained how 10.57 percent was just and reasonable when the alternative benchmarks and additional record evidence it used to justify a departure merely pointed to a base ROE somewhere above 9.39 percent." The court also stated that "[o]n the one hand, [the Commission] argued that the alternative analyses supported its decision to place the base ROE above the midpoint, but on the other hand, it stressed that none of these analyses were used to select the 10.57 percent base ROE."[89]

37. We find that if the most useful types of additional record evidence that the Commission relied upon in Opinion No. 531, namely the CAPM analysis, are more directly incorporated into the formal ROE methodology and construction of the zone of reasonableness, then that evidence will be directly "used to select" a just and reasonable ROE and we will not make ROE decisions because evidence "merely point[s] to a base ROE somewhere" that is different than a given base ROE, but because that evidence will be directly used to calculate a specific cost of equity estimate. This will help ensure that our ROE determinations are directly connected to, and supported by justifications in the record evidence. Our new ROE methodology will do this by averaging the top and bottom of the DCF and CAPM zones of reasonableness to produce a composite zone of reasonableness and then setting the ROE of average risk utilities at the central tendency midpoint of that zone.

38. Moreover, any methodology has the potential for errors or inaccuracies. Therefore, relying exclusively on any single methodology increases the risk that the Commission could authorize an unjust and unreasonable ROE. There is significant evidence indicating that combining estimates from different models is more accurate than relying on a single model.[90] For example, in discussing "model risk," Mr. McKenzie

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[87] Opinion No. 531, 147 FERC ¶ 61,234 at P 146.

[88] *Emera Maine*, 854 F.3d at 28.

[89] *Id.* at 28-29.

[90] *See, e.g., In re. Connect Am. Fund*, 28 FCC Rcd. 7123, 7147 (2013) ("As the cost of equity reflects the uncertain expectations of investors, there is potential for introducing significant errors into the estimates, and no single model can be counted on

explained that "when conditions associated with a model are outside of the normal range, there is a risk . . . that the theoretical model will fail to predict or represent the real phenomenon that is being modeled."[91] Similarly, Ms. Ellen Lapson testified on behalf of MISO TOs that "it is wise to consider a broader set of evidence from alternate models and methods of estimating investors' cost of equity . . . Although all such methods are potentially subject to error, the use of multiple models that are based on different underlying assumptions provides a check on the reasonableness of the results of the DCF model and the placement of the [MISO TOs'] base ROE with the DCF range."[92]

39. As discussed further below, we find that the CAPM and DCF models most accurately reflect how investors make their investment decisions, therefore providing a more accurate cost of equity estimate and helping to minimize model risk to the greatest extent possible.

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exclusively to provide a precise estimate of the cost of equity."); *Use of a Multi-Stage Discounted Cash Flow Model in Determining the Railroad Industry's Cost of Capital*, STB Ex Parte No. 664 (Sub-No. 1), 2009 WL 197991, *11 (S.T.B. Jan. 23, 2009) ("As the Federal Reserve Board noted in its testimony in STB Ex Parte No. 664, academic studies had demonstrated that using multiple models will improve estimation techniques when each model provides new information. In addition, there is robust economic literature confirming that, in many cases, combining forecasts from different models is more accurate than relying on a single model.") (citations omitted); EL15-45-000, Ex. MTO-1 at 28 ("Rather, reference to the results of a number of well accepted methodologies provides greater clarity regarding the extent to which DCF results may be distorted, and the use of multiple benchmarks is useful in guiding the determination of a just and reasonable ROE within the zone of reasonableness.").

[91] Docket No. EL15-45-000, Ex. MTO-22 at 18-19 (citations omitted). *See also* Morin at 428 ("Reliance on any single method or preset formula is inappropriate when dealing with investor expectations because of possible measurement difficulties and vagaries in individual companies' market data."); *id.* at 429-30 ("If a regulatory commission relies on a single cost of equity estimate or on a single methodology, that commission greatly limits its flexibility and increases the risk of authorizing unreasonable rates of return. The results from one methodology . . . are likely to contain a high degree of measurement error and may be distorted by short-term aberrations.").

[92] Docket No. EL14-12-001, Ex. MTO-39 at 37.

IV. Presumptively Just and Reasonable ROE Ranges for Determining if an Existing ROE is Unjust and Unreasonable under Prong One of Section 206

A. Background

40. As noted above, in the Briefing Order, the Commission proposed to use ranges of presumptively just and reasonable ROEs in determining whether an existing ROE is unjust and unreasonable under the first prong of section 206.[93] As described below, CAPs and the RPGI oppose the Commission's proposed approach of using ranges of presumptively just and reasonable ROEs while MISO TOs support the proposal.

1. CAPs

41. CAPs contend that the Commission's proposed approach of establishing a range of presumptively just and reasonable ROEs would: (a) contravene the customer protection principles embodied in the FPA; (b) improperly tilt the balancing of interests under *Hope* and *Bluefield* in favor of industry over customers; (c) introduce an unlawful asymmetry between the treatment of FPA sections 205 and 206 filings; and (d) violate complainants' due process rights. In addition, they argue that the proposal to establish ranges of presumptively just and reasonable ROEs is arbitrary and capricious because it fails to provide a reasoned explanation for the risk profile.[94]

42. CAPs assert that *Emera Maine* did not hold or imply that the Commission must accept a range of ROEs as just and reasonable. They contend that, instead, it held that the Commission had not provided a sufficiently clear explanation of what made it unreasonable to retain a prior ROE that exceeded the newly re-determined cost of equity. In addition, they argue that the mere fact that the existing ROE was higher than the ROE determined to be just and reasonable was not the basis for the Commission's decisions in Opinion No. 551 and Initial Decision (II). They point out that both Opinion No. 551 and Initial Decision (II) found that the MISO TOs' existing 12.38 percent ROE was outside the DCF zone of reasonableness. CAPs accordingly argue that any concerns in *Emera Maine* with respect to the Commission's application of the first prong of section 206 where the existing ROE is within the DCF zone of reasonableness are not present in these proceedings.[95]

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[93] *See* Briefing Order, 165 FERC ¶ 61,118 at PP 24, 28-30.

[94] CAPs Initial Br. (I) at 67; CAPs Initial Br. (II) at 67.

[95] CAPs Initial Br. (I) at 68-69; CAPs Initial Br. (II) at 68-69.

43. CAPs argue that the Briefing Order presents its proposal to use ranges of presumptively just and reasonable ROEs as a response to the court's observation in *Emera Maine* that there exists a "broad range of potentially lawful ROEs."[96] CAPs contend that, however, nothing in *Emera Maine* requires the Commission to create ranges of presumptively just and reasonable ROEs. CAPs assert that the court held that the Commission was correct in noting that "rates within the zone of reasonableness are not *per se* just and reasonable" and that "the fact that a rate falls within the zone of reasonableness does not establish that the rate is *the* just and reasonable rate for the utility at issue."[97] CAPs contend that the *Emera Maine* court's reference to the "broad range of potentially lawful ROEs" was to the full breadth of the DCF range and that the court specifically affirmed that this range is not a zone of immunity from rate reductions under FPA section 206.[98]

44. In addition, CAPs assert that the proposal to use ranges of presumptively just and reasonable ROEs violates the Commission's statutory duty to protect customers from excessive rates because it would presume ROEs within the zone to be lawful even when the preponderance of the evidence points to a lower ROE. They argue that the just and reasonable standard of FPA sections 205 and 206 permits not even a little unlawfulness and that "the primary aim of the [FPA is] to guard the consumer against excessive rates."[99] CAPs contend that, accordingly, the customer protection purpose of section 206 requires the Commission to reduce existing rates that are shown to have become unjust, unreasonable, or unduly discriminatory, which conflicts with the use of ranges of presumptively just and reasonable ROEs.[100]

45. CAPs further argue that the use of ranges of presumptively just and reasonable ROEs would create an unlawful asymmetry between rate increases sought by utilities under FPA section 205 and rate reductions sought by consumers under FPA section 206. They contend that this would be the case because utilities filing under section 205 can continue to obtain approval of a proposed ROE increase if they show that the cost of

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[96] CAPs Initial Br. (I) at 70 (quoting *Emera Maine*, 854 F.3d at 26); CAPs Initial Br. (II) at 69 (quoting *Emera Maine*, 854 F.3d at 26).

[97] CAPs Initial Br. (I) at 70 (quoting *Emera Maine*, 854 F.3d at 23); CAPs Initial Br. (II) at 70 (quoting *Emera Maine*, 854 F.3d at 23).

[98] CAPs Initial Br. (I) at 71 (quoting *Emera Maine*, 854 F.3d at 23); CAPs Initial Br. (II) at 71 (quoting *Emera Maine*, 854 F.3d at 23) (emphasis added).

[99] CAPs Initial Br. (I) at 72; CAPs Initial Br. (II) at 72.

[100] CAPs Initial Br. (I) at 72-73; CAPs Initial Br. (II) at 72-73.

equity exceeds the existing ROE by any amount, but under the proposed presumption, customers filing complaints under section 206 would have to show that the existing ROE is so high that it is above the applicable range of presumptively just and reasonable base ROEs. CAPs assert that this treatment is contrary to the *Mobile*[101] and *Sierra*[102] cases and the 1988 Regulatory Fairness Act, all of which indicate that section 205 rate increase filings and section 206 complaints seeking rate decreases should be treated similarly. CAPs further contend that the use of ranges of presumptively just and reasonable ROEs will create an asymmetry between sections 205 and 206 by heightening the burden of proof faced by complainants under section 206.[103]

46. In addition, CAPs argue that the proposal creates a conclusive presumption that violates customers' due process rights. They contend that this is the case because the use of ranges of presumptively just and reasonable ROEs could allow an ROE to be considered presumptively just and reasonable even if the existing ROE exceeds the central value of all of the financial models that the Commission proposes to use. CAPs assert that the central values of the financial models are the best evidence of the cost of equity and if an ROE can exceed all of those values and still be considered presumptively just and reasonable, then the presumption is a conclusive presumption that violates customers' due process rights. CAPs argue that, while the Commission's Briefing Order indicates that the presumption can be rebutted with additional evidence to the contrary such as changes in capital market conditions, such changes in capital market conditions will already be reflected in the financial models and it is doubtful that customers will be able to produce additional evidence that is more effective than the collective evidence of the financial models. CAPs assert that the presumption is therefore effectively conclusive.[104]

47. CAPs also contend that the proposal to use ranges of presumptively just and reasonable ROEs is arbitrary and capricious. They argue that this is the case first because the proposed presumption is not inferred from proven facts, as is required by court precedent,[105] but rather from the erroneous conclusion that each of the MISO TOs is of average risk, combined with a logical fallacy. CAPs go on to contend that the

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[101] *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956).

[102] *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956).

[103] CAPs Initial Br. (I) at 73-76; CAPs Initial Br. (II) at 73-75.

[104] CAPs Initial Br. (I) at 76-78; CAPs Initial Br. (II) at 76-78.

[105] CAPs Initial Br. (I) at 79 (citing *U.S. v. Gainey*, 380 U.S. 63, 78-79 (1965)); CAPs Initial Br. (II) at 78 (citing same).

Commission has not explained how the "broad range of potentially lawful ROEs" contemplated by *Emera Maine* becomes a range of presumptively just and reasonable ROEs. CAPs then assert that the Commission's rationale appears to be that an existing ROE is reasonable even if it exceeds (or is below) the risk-appropriate just and reasonable ROE as long as it is closer to the risk-appropriate ROE than to an appropriate ROE for a utility of a different risk profile.[106] They contend that this is arbitrary and capricious because the fact that an ROE lies closer to the just and reasonable ROE than to an appropriate ROE for a utility of a different risk profile does not render that ROE just and reasonable in light of court precedent that does not permit "even a little unlawfulness."[107] CAPs also argue that the proposal contradicts the court's rulings in *Emera Maine* that "[w]hether a rate, even one within the zone of reasonableness, is unlawful depends on the particular circumstances of the case" and that "the fact that a rate falls within the zone of reasonableness does not establish that the rate is the just and reasonable rate for the utility at issue."[108]

48. In addition, CAPs argue that it is arbitrary and capricious to assume that all utilities fall into one of only three risk groups—low risk, average risk, and high risk. They contend that the Commission has previously set ROEs at a wide variety of locations within the distribution of proxy results, not only at the upper or lower midpoint. CAPs suggest that the Commission could establish a greater number of more granular risk groups.[109]

2. MISO TOs

49. MISO TOs support the Commission's proposal in the Briefing Order to use the composite zone of reasonableness to identify a range of presumptively just and reasonable ROEs for utilities of similar risk profiles as an evidentiary tool to evaluate complaints under section 206 of the FPA. MISO TOs argue that 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. They note that, in *AEP Marketing*,[110] the Commission described its authority to establish a new policy, including a new rebuttable

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[106] CAPs Initial Br. (I) at 79-80; CAPs Initial Br. (II) at 79.

[107] CAPs Initial Br. (I) at 80; CAPs Initial Br. (II) at 79-80.

[108] CAPs Initial Br. (I) at 80 (citing *Emera Maine*, 854 F.3d at 23); CAPs Initial Br. (II) at 80 (citing same).

[109] CAPs Initial Br. (I) at 82-83; CAPs Initial Br. (II) at 82-83.

[110] *AEP Power Mktg., Inc.*, 107 FERC ¶ 61,018 (2004) (*AEP Marketing*).

presumption, as part of adjudication of a case-specific proceeding.[111] MISO TOs further state that the Commission adopted a rebuttable presumption that a "price squeeze" indicates that a wholesale rate is unduly discriminatory in violation of section 206 of the FPA[112] and the D.C. Circuit upheld this presumption.[113]

50. MISO TOs argue that it is immaterial whether the court in *Emera Maine* specifically mandated that the Commission use ranges of presumptively just and reasonable ROEs. They assert that the court in *Emera Maine* directed the Commission to provide a more complete explanation why the New England TOs' base ROE was unjust and unreasonable and that the Commission's adoption of ranges of presumptively just and reasonable ROEs is a logical step in analyzing whether an existing base ROE may no longer be just and reasonable under the first prong of FPA section 206. MISO TOs state that the Commission's adoption of a rebuttable presumption that a base ROE within a portion of the zone of reasonableness is consistent with *Emera Maine* and other ROE precedents which provide that there may be more than one just and reasonable return, even though the Commission ultimately must fix a single, just and reasonable rate.[114]

51. MISO TOs contend that the Commission's adoption of ranges of presumptively just and reasonable ROEs does not contravene the Regulatory Fairness Act. They assert that the Regulatory Fairness Act sought to add symmetry between FPA sections 205 and 206 by adding a refund obligation to FPA section 206 where previously there was none in order to match more closely the refund obligation in FPA section 205, but did not broadly require a uniform symmetry between sections 205 and 206 beyond what already existed between the two provisions. MISO TOs further argue that CAPs assume without basis that the Commission's ranges of presumptively just and reasonable ROEs will not apply in section 205 proceedings and that if the Commission does apply those ranges in section 205 proceedings, CAPs' concerns about symmetry between sections 205 and 206 are moot.[115]

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[111] MISO TOs Reply Br. (I) at 59-60 (citing *AEP Marketing*, 107 FERC ¶ 61,018 at PP 199, 201).

[112] MISO TOs Reply Br. (I) at 60 (citing *Conn. Light & Power Co.*, 8 FERC ¶ 61,187, at 61,655 (1979)).

[113] MISO TOs Reply Br. (I) at 60 (citing *Anaheim v. FERC*, 941 F.2d 1234, 1241, 1249 (D.C. Cir. 1991)).

[114] MISO TOs Reply Br. (I) at 61-63; MISO TOs Reply Br. (II) at 61-62.

[115] MISO TOs Reply Br. (I) at 64-65; MISO TOs Reply Br. (II) at 63-64.

52. MISO TOs also assert that CAPs erroneously attempt to characterize the presumption as conclusive or irrebuttable. MISO TOs state that CAPs purport to support their claim by arguing that the only evidence customers could possibly use to show a base ROE is unjust and unreasonable would be already incorporated into the Commission's calculation of the composite zone of reasonableness and the zone of presumptively just and reasonable ROEs. MISO TOs disagree and state that, for example, evidence that is not already incorporated in those zones could include risk premium data, which is used in the formulation of a new base ROE in prong two of FPA section 206 but not for calculation of the zone of reasonableness, non-utility stock prices and investor expectations for non-utility stocks, various types of bond yields, investor testimony and testimony of customer hardship.[116]

53. MISO TOs further argue that nothing about the approach of using ranges of presumptively just and reasonable ROEs contravenes the customer protection purpose of section 206. They contend that the approach will promote the Commission's compliance with its mandate to reduce existing rates only when they are shown to be unjust, unreasonable, or unduly discriminatory by providing an objective benchmark against which to measure existing rates. In addition, MISO TOs note that the rebuttable presumption provides value to customers and utilities alike, not only utilities as CAPs suggest. MISO TOs assert that a zone of presumptively just and reasonable ROEs is also a useful tool for making a *prima facie* case that an existing base ROE may no longer be just and reasonable, which will benefit consumers that file complaints.[117]

54. MISO TOs request that the Commission clarify that, just as a base ROE falling within the applicable quartile of the composite range of returns that is commensurate with the utility's risk profile creates a rebuttable presumption that such base ROE remains just and reasonable, a base ROE outside of the same quartile is only rebuttably presumed to be no longer just and reasonable.[118]

3. RPGI

55. RPGI argues that the proposed approach of using ranges of presumptively just and reasonable ROEs effectively shields existing ROEs from modification absent a showing that the ROE is outside the applicable range. RPGI asserts that no such margin applies to any other existing cost of service component of a formula rate like those employed by most transmission utilities under current Commission practice. RPGI contends that, if the cost of furnishing regulated service declines, it is subject to adjustment and true-up on an

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[116] MISO TOs Reply Br. (I) at 67-68; MISO TOs Reply Br. (II) at 66-67.

[117] MISO TOs Reply Br. (I) at 68-69; MISO TOs Reply Br. (II) at 67-68.

[118] MISO TOs Initial Br. (I) at 6; MISO TOs Initial Br. (II) at 7-8.

annual basis under formula rates. RPGI contends that it is arbitrary and unfair to consumers to allow a zone of protection within which changes to a base ROE allowance will be disregarded, given the magnitude of the costs at issue. RPGI also contends that the Commission does not indicate that it intends to determine whether to dismiss a complaint and whether to grant a complaint on the basis of the same process. In addition, RPGI asserts that the Commission should clarify how it intends to resolve factual issues raised by the process in which a complaint and answer are filed. RPGI contends that, if the Commission anticipates that it will be in a position to resolve all factual issues instrumental to denying a complaint, then it should follow that it can resolve all issues relating to the establishment of a just and reasonable replacement ROE allowance where it finds that a complainant has satisfied that same standard.[119]

56. RPGI argues that the Commission should not clarify, as MISO TOs request, that if a base ROE falls outside the applicable quartile zone of presumptively just and reasonable ROEs, it is only rebuttably presumed to be no longer just and reasonable. RPGI contends that this would unfairly benefit utilities by giving them additional procedures to defend an existing ROE and would delay adjudication of just and reasonable rates.[120]

B. Commission Determination

1. Use of Presumptively Just and Reasonable ROE Ranges Generally

57. In *Emera Maine*, the court found that our prior practice of using "a single ROE analysis" to demonstrate both: (1) that an existing ROE is unjust and unreasonable under the first prong of FPA section 206; and (2) that a new ROE is just and reasonable under the second prong is contrary to the FPA.[121] In response to that decision, we adopt a new framework for evaluating whether an existing ROE remains just and reasonable for purposes of the first prong of FPA section 206. Specifically, we adopt the use of ranges of presumptively just and reasonable ROEs based on the risk profile of a utility or group of utilities to inform our decision of whether an existing ROE has become unjust and unreasonable, as proposed in the Briefing Order.[122] We reiterate that, for average risk utilities, the presumptively just and reasonable range is the quartile of the overall composite zone of reasonableness centered on the central tendency of the overall zone of

[119] RPGI Initial Br. (I) at 40-41; RPGI Initial Br. (II) at 43-44.

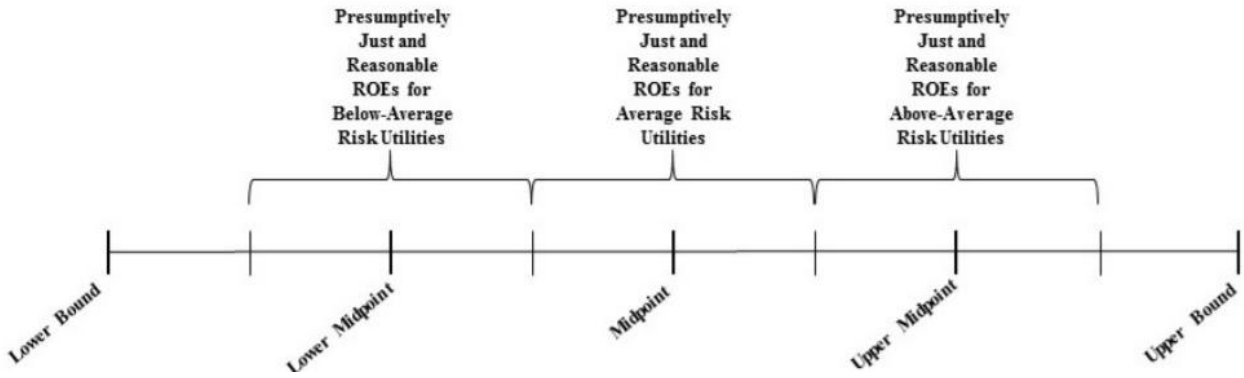
[120] RPGI Reply Br. (II) at 24-26.

[121] *Emera Maine*, 854 F.3d at 27.

[122] *See* Briefing Order, 165 FERC ¶ 61,118 at PP 17, 24, 28-30.

reasonableness; for below average risk utilities, that range is the quartile of the zone of reasonableness centered on the central tendency of the lower half of the zone of reasonableness; and for above average risk utilities, that range is the quartile of the zone of reasonableness centered on the central tendency of the upper half of the zone of reasonableness. These ranges of presumptively just and reasonable located within the overall composite zone of reasonableness are again illustrated below.

Figure 1: Zone of Reasonableness Quartiles



58. We recognize that this facet of our new ROE methodology departs from our prior policy and precedent. As courts have held, "[t]he Commission can depart from a prior policy or line of precedent, but it must acknowledge that it is doing so and provide a reasoned explanation."[123] The D.C. Circuit has explained that

> [a]n agency is free to discard precedents or practices it no longer believes correct. Indeed we expect that any agency may well change its past practices with advances in knowledge in its given field or as its relevant experience and expertise expands. If an agency decides to change course, however, we require it to supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored.[124]

[123] *La. PSC v. FERC*, 772 F.3d 1297, 1303 (D.C. Cir. 2014) (citing *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009); *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 57 (1983)).

[124] *Nuclear Energy Inst., Inc. v. EPA*, 373 F.3d 1251, 1296 (D.C. Cir. 2004) (per curiam) (internal citations and quotation marks omitted).

That same court has affirmed the Commission's departure from prior policy when the Commission has "explained how changed circumstances justified a new policy."[125] Similarly, agency action has been upheld where "to the extent the agency departed from precedent, it offered a reasonable explanation for doing so."[126]

59. We find that this change to our prior methodology for determining whether an existing ROE is unjust and unreasonable is necessary to ensure that our ROE determinations under section 206 satisfy the requirements of the *Emera Maine* decision. In that case, the court found that the Commission's decision that "a single ROE analysis generating a new just and reasonable ROE necessarily proved that the Transmission Owners' existing ROE was unjust and unreasonable" is contrary to the FPA.[127] The court found that this decision "relied on [the Commission's] assumption that all ROEs other than the one FERC identifies as the utility's just and reasonable ROE are per se unlawful in a section 206 proceeding."[128] However, the court held that, because "the zone of reasonableness creates a broad range of potentially lawful ROEs rather than a single just and reasonable ROE," a finding that a particular ROE is just and reasonable, "standing alone, 'does not amount to a finding that every other rate of return'" is not just and reasonable.[129] Rather, the Commission must explain what circumstances render an existing ROE unjust and unreasonable in order to satisfy its burden of proof under the first prong of FPA section 206.[130]

60. As discussed in detail later in this order, the Commission has long based its decisions concerning just and reasonable ROEs for public utilities on the "current market cost of equity."[131] Accordingly, the starting point for determining whether a public utility's existing ROE has become unjust and unreasonable must be a consideration of

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[125] *ANR Pipeline Co. v. FERC*, 205 F.3d 403, 407 (D.C. Cir. 2000).

[126] *Busse Broad. Corp. v. FCC*, 87 F.3d 1456, 1458 (D.C. Cir. 1996).

[127] *Emera Maine*, 854 F.3d at 26.

[128] *Id.*

[129] *Id.* (quoting *Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950, 857 (D.C. Cir. 1983)).

[130] *Id.*

[131] *Generic Determination of Rate of Return on Common Equity for Public Utilities*, Order No. 420, FERC Stats. & Regs. ¶ 30,644 at 31,367 (1985) (cross-referenced at 31 FERC ¶ 61,168).

whether the current market cost of equity has changed since the existing ROE was established. For this purpose, we intend to use the DCF and CAPM financial models to establish a composite zone of reasonableness reflecting the current market cost of equity, as discussed below. However, neither of those models "conclusively determines or estimates the expected return for an individual firm. Each methodology possesses its own way of examining investor behavior, its own premises, and its own set of simplifications of reality. Each method proceeds from different fundamental premises that cannot be validated empirically."[132]

61. Accordingly, while the results of these models "inform" our determination whether an existing ROE has become unjust and unreasonable, the models are too imprecise to "rigidly . . . determine" that issue.[133] The models can, at best, produce a general estimate of the current cost of equity. As a result, there is no single percentage current cost of equity that we can select from the zone of reasonableness that will demonstrate that all other ROEs within the zone of reasonableness are per se unjust and unreasonable. Put another way, as the court held in *Emera Maine*, the mere fact that the financial models now produce a cost of equity that is somewhat lower than the existing ROE is, "without any further explanation," insufficient to satisfy our burden under FPA section 206 to "prove that Transmission Owners' existing base ROE was unlawful."[134] Rather, the court requires that we explain the "particular circumstances" that support an explicit finding that the existing ROE has become unjust and unreasonable.[135]

62. Given the imprecise tools available to us for estimating the current cost of equity, we find that our explanation in such circumstances must include a showing that the existing ROE is now outside some range of potentially just and reasonable ROEs within the zone of reasonableness for the public utility at issue, in light of our estimate of the current market cost of equity, or alternatively, that other evidence convincingly demonstrates that the existing ROE is unjust and unreasonable despite it falling within that range. Given the Court's explanation that there is "'a substantial spread' of potentially reasonable rates,"[136] we believe that a range of potentially just and reasonable ROEs will likely be the best evidence of what is a just and reasonable ROE for the utility

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[132] Morin at 429.

[133] *Emera Maine*, 854 F.3d at 26.

[134] *Id.*

[135] *Id.* (quoting *Montana-Dakota Utilities Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251 (1951)).

[136] *Id.*

at issue. Therefore, we find that it is appropriate to treat an ROE that falls within that range as presumptively just and reasonable, unless other evidence is sufficient to rebut that presumption. We also find that the circumstance most relevant to determining that range is the utility's risk profile. As the Supreme Court explained in *Hope*, when describing what has become the standard for evaluating whether an ROE is just and reasonable under the FPA, a utility's ROE "should be commensurate with returns on investments in other enterprises *having corresponding risks*."[137] Indeed, the D.C. Circuit has explained that failing to consider a utility's risk profile, at least relative to the proxy group companies, can itself be arbitrary and capricious.[138] By the same token, an ROE—even one within the zone of reasonableness—that is *not* commensurate with the returns on investments in other enterprises having "corresponding risks" will not be just and reasonable. Accordingly, we find that, in order to explain the "particular circumstances" that support an explicit finding that the existing ROE has become unjust and unreasonable, we must determine the relevant utility's risk profile and then identify a range of presumptively just and reasonable ROEs within the overall zone of reasonableness for that utility based on its risk profile.

63. Consistent with the Commission's well-established policy on relative risk analysis, we find that the measure of central tendency for the entire zone of reasonableness should be the starting point for identifying the range within the overall zone of reasonableness that represents presumptively just and reasonable ROEs for utilities with an average risk profile.[139] Similarly, the starting points for identifying the ranges within the overall zone of reasonableness that represent presumptively just and reasonable ROEs for utilities with above or below average risk profiles should be the measures of central tendency of the upper and lower halves of the zone of reasonableness, respectively.[140] Logic dictates that the end points of those ranges should not be closer to the starting points for the ranges of

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[137] *Hope*, 320 U.S. at 603 (emphasis added); *Petal Gas Storage, L.L.C. v. FERC*, 496 F.3d 695, 698 (D.C. Cir. 2007) (discussing this standard in the context of whether rates are just and reasonable).

[138] *Petal Gas*, 496 F.3d at 700.

[139] *See, e.g.*, *Emera Maine*, 854 F.3d at 27 (citing *Tenn. Gas Pipeline Co. v. FERC*, 926 F.2d 1206, 1213 (D.C. Cir. 1991)) ("We have noted that the midpoint is a good 'starting place' for the placement of the ROE.").

[140] *See, e.g.*, *id.* at 30 (citing *Tenn. Gas Pipeline*, 926 F.2d at 1213) (where "the utility at issue was riskier than the proxy group . . . the midpoint of the upper half was 'an obvious place to begin.'"); *Potomac-Appalachian Transmission Highline, LLC*, 158 FERC ¶ 61,050, at PP 270, 273 (2017) (setting ROE at the "measure of central tendency of the lower half of the zone of reasonableness . . . Given [the utility's] low level of risk as compared to the proxy group.").

utilities with different risk profiles than they are to their own starting point. Applying those principles, we find that the range within the overall zone of reasonableness that best represents presumptively just and reasonable ROEs for average risk utilities is the quartile of the zone of reasonableness centered on the central tendency of the entire zone of reasonableness, while the ranges within the overall zone of reasonableness that best represent presumptively just and reasonable ROEs for above- and below- average utilities are the quartiles centered on the central tendencies of the upper and lower halves of the zone of reasonableness, respectively.

64. This is the reasoning underlying how we constructed the ranges of presumptively just and reasonable ROEs proposed in the Briefing Order. We are now changing our ROE methodology to incorporate these ranges of presumptively just and reasonable ROEs into our analysis of whether an existing ROE is just and reasonable. We do so in order to satisfy the court's requirements in *Emera Maine* that our section 206 analysis produce an "actual finding as to the lawfulness" of an existing ROE and that we "explain what circumstances" led to that finding. Along with the prevailing market conditions, a utility's risk profile is the most important circumstance to be considered in determining whether an existing ROE is unjust and unreasonable. Using the ranges of presumptively just and reasonable ROEs objectively and automatically incorporates risk profile into our ROE analysis so that we can ensure that we explain how this most important circumstance factors into our ROE determinations under section 206, as the court required in *Emera Maine*.

65. While previous Commission determinations under section 206 regarding ROEs may have made "actual finding[s] as to the lawfulness" of existing ROEs and sufficiently "explain[ed] what circumstances" led to those findings without the use of ranges of presumptively just and reasonable ROEs as we are adopting herein, we find that using such ranges is now necessary to ensure that our determinations meet the requirements of the court in the *Emera Maine* decision and is well within the Commission's "'considerable latitude in developing a methodology responsive to its regulatory challenge.'"[141] We believe that using such ranges incorporates a utility's risk profile into our ROE analysis in a concrete and objective way that will establish a direct connection between the most important circumstance of the case—a utility's risk profile—and our ultimate determination as to whether an existing ROE is unjust and unreasonable. In addition, because our determination of a utility's risk profile will lead to a rebuttable presumption of lawfulness or unlawfulness, our reasoning underlying that determination will largely "explain what circumstances" support our "actual finding as to the lawfulness" of the existing ROE. That is because, if the presumption is not rebutted, the reasoning underlying our risk profile determination will support our finding as to

[141] *Emera Maine*, 854 F.3d at 20 (citations and internal quotation marks omitted) (citing *S.C. Pub. Serv. Auth. v. FERC*, 762 F.3d 41, 55 (D.C. Cir. 2014)).

lawfulness and, if the presumption is rebutted, we will have to explicitly explain how the other evidence rebuts the presumption and leads to our finding as to unlawfulness.

66. Moreover, while using ranges of presumptively just and reasonable ROEs is necessary to ensure that our ROE determinations under section 206 meet the requirements of the *Emera Maine* decision, we believe that it will also provide more general benefits to consumers and utilities. Specifically, "[r]atemaking . . . is not a science"[142] and the overall composite zone of reasonableness that is calculated under the revised methodology will still "create[] a broad range of potentially lawful ROEs rather than a single just and reasonable ROE."[143] In addition, it remains true under the new ROE methodology, as it did under our prior policy and precedent, that "[w]hether a rate, even one within the zone of reasonableness, is unlawful depends on the particular circumstances of the case."[144] Accordingly, while the overall composite zone of reasonableness informs the Commission's assessment of whether an existing ROE is unjust and unreasonable under section 206, potential complainants and respondents still face a substantial amount of uncertainty as to whether an existing ROE is unjust and unreasonable in light of the particular circumstances of the case.

67. We believe that using ranges of presumptively just and reasonable ROEs will provide additional certainty and predictability to parties because it will provide an additional objective indicator of whether an existing ROE may be unjust and unreasonable under section 206. This additional guidance should help potential complainants assess whether an existing ROE may be unjust and unreasonable and avoid expending time and resources on complaints that are not likely to succeed. Similarly, utilities will be able to better assess whether their existing ROEs are likely to be found unjust and unreasonable under section 206 and, if so, proactively file to reduce their ROEs in advance of complaints.

68. At the same time, we recognize that whether an existing ROE is unjust and unreasonable, even one that falls within the applicable range of presumptively just and reasonable ROEs, still "depends on the particular circumstances of the case."[145] Accordingly, if an existing ROE falls within the applicable range of presumptively just and reasonable ROEs, the presumption that the ROE is just and reasonable is a rebuttable presumption. Therefore, other evidence regarding the particular circumstances of the case can demonstrate that an existing ROE is unjust and unreasonable even if falls within

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[142] *Boston Edison Co. v. FERC*, 885 F.2d 962, 969–70 (1st Cir. 1989).

[143] *Emera Maine*, 854 F.3d at 26.

[144] *Id.* at 23.

[145] *Id.*

the applicable range of presumptively just and reasonable ROEs, such as evidence regarding non-utility stock prices, investor expectations for non-utility stocks, various types of bond yields and their relation to stock prices, investor and other expert testimony, and testimony regarding the effects of rates on customers. We believe that employing a rebuttable presumption will provide additional certainty and transparency to parties while also not restricting the Commission's ability to consider the particular circumstances of the case, as required by applicable precedent.

2. Arguments Opposing the Use of Presumptively Just and Reasonable ROE Ranges

69. We are not persuaded by the arguments opposing the use of ranges of presumptively just and reasonable ROEs as proposed in the Briefing Order. CAPs argue that the court's holding in *Emera Maine* did not require that we "must accept a range of ROEs as just and reasonable."[146] CAPs' argument on this point is inapposite. If an existing ROE falls within the applicable range of presumptively just and reasonable ROEs, it does not mean that we "must accept" that ROE as just and reasonable nor do such ranges establish that every ROE within that range "must" be just and reasonable. As we discuss further below, if an existing ROE falls within the applicable range of presumptively just and reasonable ROEs, then it is only rebuttably presumed to be just and reasonable. That presumption may be rebutted by other evidence regarding the particular circumstances of the case and the Commission may find that an existing ROE is unjust and unreasonable even if it falls within the applicable range of presumptively just and reasonable ROEs.

70. CAPs further assert that the court in *Emera Maine* only held that the Commission "was required to do more than show that its single ROE analysis generated a new just and reasonable ROE and conclusively declare that, consequently, the existing ROE was per se unjust and unreasonable."[147] It is true that the court held this, but it further held that the Commission's analysis did not satisfy section 206 because it "failed to include an actual finding as to the lawfulness of Transmission Owners' existing base ROE"[148] and explained that such a finding should "explain what circumstances rendered Transmission Owners' existing rate unlawful."[149] The court also stated that the Commission's decision

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[146] CAPs Initial Br. (I) at 68; CAPs Initial Br. (II) at 68.

[147] CAPs Initial Br. (I) at 68 (citing *Emera Maine*, 854 F.3d at 15); CAPs Initial Br. (II) at 68 (citing same).

[148] *Emera Maine*, 854 F.3d at 27.

[149] *Id.* at 26.

"relied on its assumption that all ROEs other than the one FERC identifies as the utility's just and reasonable ROE are *per se* unlawful in a section 206 proceeding",[150] but explained that this reasoning was insufficient because "the zone of reasonableness creates a broad range of potentially lawful ROEs rather than a single just and reasonable ROE, meaning that FERC's finding that 10.57 percent was a just and reasonable ROE, standing alone, 'did not amount to a finding that every other rate of return was not.'"[151] Similarly, the court explained that finding that a just and reasonable ROE would be a "'a numerical value below the existing numerical value'"[152] was "without any further explanation . . . insufficient to prove that Transmission Owners' existing base ROE was unlawful."[153] Thus, CAPs' quote of the *Emera Maine* case is accurate but incomplete. In light of this more complete context of the court's holding, we find that using ranges of presumptively just and reasonable ROEs in our ROE methodology is necessary in order to ensure that our ROE determinations under section 206 meet the requirements of the court's holding in *Emera Maine*.

71. In particular, using such ranges will produce a specific result from our risk profile determination—a rebuttable presumption—and then we will make an explicit finding as to whether the other evidence presented by the parties in the case has rebutted that presumption. This analysis will allow the Commission to "explain what circumstances" support our "actual finding as to the lawfulness" in a structured manner. Moreover, because risk profile is the particular circumstance most relevant to determining whether an existing ROE is unjust and unreasonable, using ranges of presumptively just and reasonable ROEs based on a utility's risk profile will ensure that the risk profile determination has a clear and significant connection to our ultimate finding as to lawfulness. We find that the use of ranges of presumptively just and reasonable ROEs in our ROE methodology ensures that our determinations satisfy the requirements of the *Emera Maine* decision.

72. CAPs also argue that using ranges of presumptively just and reasonable ROEs violates the Commission's statutory duty to protect customers from excessive rates because it would presume ROEs within the range to be lawful even when the

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[150] *Id.*

[151] *Id.* (citing *Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950, 952–53 (D.C. Cir. 1983)).

[152] *Id.* (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 32).

[153] *Id.*

preponderance of the evidence points to a lower ROE.[154] RPGI makes a similar argument, asserting that the use of these ranges effectively shields existing ROEs from modification absent a showing that they fall outside of the applicable range.[155] We disagree. Using ranges of presumptively just and reasonable ROEs will not hinder the Commission's ability to protect customers from excessive rates or necessarily require a showing that the relevant ROE falls entirely outside of the applicable range. As explained above, we will use the range of presumptively just and reasonable ROEs as an additional tool to help inform our ROE analyses. The range of presumptively just and reasonable ROEs will provide an initial indication of whether an existing ROE may be unjust and unreasonable which we will consider along with all of the other evidence in the applicable record, including evidence addressing the particular circumstances of the case. The presumption that will apply if an existing ROE falls within the applicable range of presumptively just and reasonable ROEs is rebuttable. Accordingly, the Commission can still find that the ROE is unjust and unreasonable based upon the preponderance of the evidence, even if it falls within the applicable range of presumptively just and reasonable ROEs. Moreover, as the court held in *Emera Maine*, the mere fact the financial models now produce a cost of equity that is somewhat lower than the existing ROE is, "without any further explanation," insufficient to satisfy our burden under FPA section 206 to "prove that Transmission Owners' existing base ROE was unlawful."[156] Thus, contrary to CAPs' assertion, even if the evidence points to a lower ROE, this alone "without any further explanation" is insufficient to support a finding that the existing ROE is unjust and unreasonable.

73. In opposing our use of presumptively just and reasonable ROEs, CAPs contend that we should take the approach that the *Emera Maine* court specifically rejected. CAPs assert that the court in *Emera Maine* held that "at any given time and for the particular circumstances of each case, there is ultimately a *single ROE* level that *is* just and reasonable."[157] On the contrary, the court explicitly held that there is a "broad range of potentially lawful ROEs rather than a single just and reasonable ROE"[158] and reversed the Commission's finding that an existing ROE was unjust and unreasonable because it exceeded the single just and reasonable ROE that the Commission would have set. CAPs similarly argue that ranges of presumptively just and reasonable ROEs are unlawful

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[154] CAPs Initial Br. (I) at 72-73; CAPs Initial Br. (II) at 72-73.

[155] RPGI Initial Br. (I) at 40; RPGI Initial Br. (II) at 43.

[156] *Emera Maine*, 854 F.3d at 26.

[157] CAPs Initial Br. (I) at 71-72 (emphasis in original); CAPs Initial Br. (II) at 71 (emphasis in original).

[158] *Emera Maine*, 854 F.3d at 26.

because the Commission cannot allow returns "that exceed the cost-based level." However, the court in *Emera Maine* found that the Commission must do more than simply determine what the cost-based ROE is and then determine if the existing ROE is unjust and unreasonable based on whether it exceeds that cost-based level. Accordingly, we disagree with CAPs' apparent position that the Commission should continue to follow the approach that was reversed in *Emera Maine* of identifying the cost of equity and then finding that an existing ROE is unjust and unreasonable under prong one of section 206 if it exceeds that cost of equity.

74. CAPs also argue that our use of ranges of presumptively just and reasonable ROEs will create an unlawful asymmetry between rate increases sought by utilities under FPA section 205 and rate reductions sought by consumers under FPA section 206. According to CAPs, utilities filing under section 205 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 complaints under section 206 would have to show that the existing ROE is so high that it is above the applicable range of presumptively just and reasonable base ROEs.[159] We disagree that the use of ranges of presumptively just and reasonable ROEs will create any unlawful difference between our treatment of filings under section 205 and section 206. As an initial matter, "[t]he purpose of section 206 is 'quite different' from that of section 205"[160] and "[s]ection 206's procedures are 'entirely different' and 'stricter' than those of section 205."[161] As the D.C. Circuit has further explained, "[i]n contrast to section 206, section 205 'is intended for the benefit of the utility,'"[162] and the Commission "plays 'an essentially passive and reactive' role under section 205."[163] The court in *Emera Maine* further explained that "A utility filing a rate adjustment under section 205 must show that the adjustment is *lawful*. The proponent of a rate change under section 206, however, bears 'the burden of proving that the existing rate is *unlawful*.'"[164] We find that there is nothing unlawful about using ranges of

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[159] CAPs Initial Br. (I) at 73-75; CAPs Initial Br. (II) at 73-74.

[160] *Emera Maine*, 854 F.3d at 24 (quoting *City of Winnfield, La. v. FERC*, 744 F.2d 871, 875 (D.C. Cir. 1984)).

[161] *Id.* (quoting *City of Anaheim, Cal. v. FERC*, 558 F.3d 521, 525 (D.C. Cir. 2009)).

[162] *Id.* (quoting *City of Winnfield v. FERC*, 744 F.2d at 875).

[163] *Id.* (quoting *Atl. City Elec. Co. v. FERC*, 295 F.3d 1, 10 (D.C. Cir. 2002)).

[164] *Id.* (emphasis in original) (quoting *Ala. Power Co. v. FERC*, 993 F.2d 1557, 1571 (D.C. Cir. 1993)).

presumptively just and reasonable ROEs to inform our analysis of whether an existing ROE has been shown to be unlawful under section 206. The showing that is required under section 206 differs from the showing that is required under section 205. Using ranges of just and reasonable ROEs will not change this fact. It remains the case that demonstrating that a proposed rate change is lawful under section 205 and demonstrating that an existing rate is unlawful under section 206 are two different standards. CAPs frame their argument as opposing the use of ranges of presumptively just and reasonable ROEs, but they are in fact taking issue with the different standards that apply to section 205 filings and section 206 complaints. We lack the authority to change those standards and our modification of the Commission's ROE methodology to use ranges of presumptively just and reasonable ROEs adheres to those standards.

75. In addition, we reiterate that customers filing complaints under section 206 do not necessarily have to show that the existing ROE is so high that it is above the applicable range of presumptively just and reasonable base ROEs in order to demonstrate that an existing ROE is unjust and unreasonable. As noted above, the presumption is a rebuttable one and whether an existing ROE falls within the applicable range is just one piece of evidence that the Commission will consider along with all of the evidence in a particular case.

76. In support of their argument, CAPs point to court precedent ruling that "[t]he statutory 'just and reasonable' standard is the same under section 205 and section 206."[165] However, the same court in *Emera Maine*, citing that same case, clarified that "while '[t]he just and reasonable lodestar is no loftier under section 206 than under section 205,' the showing required of FERC to exercise its section 206 authority to change an existing rate differs from anything required for FERC to approve a utility's proposed rate adjustment under section 205."[166] Therefore, precedent does not require the Commission's analysis under sections 205 and 206 to be the same. On the contrary, the statutes themselves *require* different showings and thus a different analysis by the Commission. The Commission's use of ranges of presumptively just and reasonable ROEs in reviewing complaints under section 206 will help it determine if an existing rate has been shown to be unjust and unreasonable and that does not create any unlawful asymmetry with its analysis under section 205.

77. CAPs' contention that the Commission's use of such ranges also contravenes the Regulatory Fairness Act, which modified FPA section 206(b) to provide the Commission

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[165] CAPS Initial Br. (I) at 74 (citing *FirstEnergy Serv. Co. v. FERC*, 758 F.3d 346, 353 (D.C. Cir. 2014)); CAPS Initial Br. (II) at 74 (citing same).

[166] *Emera Maine*, 854 F.3d at 24 (quoting *FirstEnergy*, 758 F.3d at 353) (internal quotation marks omitted).

some refund authority, is also unavailing. CAPs assert that this is the case because the Regulatory Fairness Act was intended to add symmetry between the Commission's treatment of section 205 rate increase filings and section 206 complaints seeking rate decreases.[167] However, a step to "add symmetry" between the sections does not mean that they are completely symmetrical. In fact, as discussed above "[s]ection 206's procedures are 'entirely different' and 'stricter' than those of section 205."[168]

78. The fact that the Commission's analysis under section 206 differs from its analysis under section 205 is not only consistent with the Regulatory Fairness Act but also mandated by the statutory language of sections 205 and 206. CAPs further assert that *Mobile* and *Sierra* support their argument because those cases provide that a rate increase filing made and suspended under FPA section 205 and a rate decrease complaint filed under FPA section 206 are both subject to the same "character" and "scope."[169] We are not persuaded by this contention because, as discussed above, "while '[t]he just and reasonable lodestar is no loftier under section 206 than under section 205,' the showing required of FERC to exercise its section 206 authority to change an existing rate differs from anything required for FERC to approve a utility's proposed rate adjustment under section 205."[170] It is consistent with *Mobile* and *Sierra* for the Commission to employ one analysis to determine if the required showing that an existing ROE is unjust and unreasonable has been made under the first prong of section 206 and a somewhat different analysis to determine if a showing has been made under section 205 that a proposed ROE is just and reasonable.

79. CAPs also argue that using ranges of presumptively just and reasonable ROEs heightens the burden of proof faced by complainants, thereby creating an unlawful asymmetry between the burden of proof that utilities must meet to raise rates under FPA section 205, and the burden of proof that customers must meet to obtain lower rates under FPA section 206.[171] We disagree. The change to our ROE methodology to utilize ranges of presumptively just and reasonable ROEs does not change the burden of proof that

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[167] CAPS Initial Br. (I) at 74-75; CAPS Initial Br. (II) at 74.

[168] *Emera Maine*, 854 F.3d at 24 (quoting *City of Anaheim v. FERC*, 558 F.3d at 525).

[169] CAPs Initial Br. (I) at 74 (citing *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 341 (1956); CAPs Initial Br. (II) at 74 (citing same).

[170] *Emera Maine*, 854 F.3d at 24 (quoting *FirstEnergy*, 758 F.3d at 353) (internal quotation marks omitted).

[171] CAPs Initial Br. (I) at 75-76; CAPs Initial Br. (II) at 75.

parties face under section 205 or section 206. It is merely an objective benchmark that will be used in our overall analysis of base ROEs to help determine if an existing rate has been shown to be unjust and unreasonable under section 206. It remains the case, as it was before implementing this modification to our ROE methodology, that "[a] utility filing a rate adjustment under section 205 must show that the adjustment is *lawful*" while "[t]he proponent of a rate change under section 206, however, bears 'the burden of proving that the existing rate is *unlawful*.'"[172] The use of ranges of presumptively just and reasonable ROEs does not change these burdens. Those ranges will merely serve to inform our assessment of ROEs. The fact that our use of those ranges will involve employing a rebuttable presumption does not change the burdens that apply. As MISO TOs note, the Commission has previously adopted a rebuttable presumption in the context of section 206. For example, in *AEP Marketing*,[173] the Commission adopted a rebuttable presumption that a utility does not possess market power in generation if it passes two market power screens and a rebuttable presumption that a utility does have market power if it fails either screen.[174] The Commission explained that "[f]ailure of a screen will provide the basis for instituting a section 206 proceeding and will establish a rebuttable presumption of market power in the section 206 proceeding."[175] This presumption is now incorporated in the Commission's regulations.[176] The Commission also previously adopted a rebuttable presumption that a "price squeeze" indicates a wholesale rate is unduly discriminatory in violation of section 206 of the FPA.[177] Indeed, the use of rebuttable presumptions in the context of section 206 analyses does not create an unlawful asymmetry with section 205 as CAPs suggest. Complainants continue to bear the burden of proving that the existing rate is unlawful and this burden is unchanged regardless of whether the rebuttable presumption is triggered. The addition of the ranges of presumptively just and reasonable ROEs merely provides additional detail regarding

[172] *Emera Maine*, 854 F.3d at 24 (emphasis in original) (quoting *Ala. Power Co. v. FERC*, 993 F.2d at 1571).

[173] *AEP Power Mktg.*, 107 FERC ¶ 61,018.

[174] *See id.* P 37.

[175] *Id.* P 201.

[176] *See* 18 C.F.R. §35.37(c)(1) (2019).

[177] *See Conn. Light & Power Co.*, 8 FERC at 61,655 ("Based on the above, we conclude that given the establishment of a prima facie case of price discrimination and competition, it is reasonable from an administrative point of view to presume that there is a reasonable probability of an anticompetitive effect. The utility, of course, will have an opportunity to rebut this presumption.").

how a complainant must approach its effort to satisfying that burden. As MISO TOs note, the Commission has broad discretion over what weight to give evidence presented to it,[178] and our use of ranges of presumptively just and reasonable ROEs merely provides additional detail as to our evidentiary expectations for complainants' satisfying the burden of proof under prong one of FPA section 206.

80. CAPs further contend that, at worst, the use of such ranges creates a conclusive presumption that violates customers' due process rights. They argue that this is the case because the central values of the financial models are the best evidence of cost of equity but the ranges of presumptively just and reasonable ROEs would allow an existing ROE to exceed the central values of all of the financial models and still be presumed just and reasonable. CAPs assert that it would violate their due process rights to presume the lawfulness of rates that have been shown to be excessive by the same financial models that are used to establish the range of presumptively just and reasonable ROEs. They argue that this is further true because it is doubtful that customers will be able to produce additional evidence that is more effective than the collective evidence of the financial models.[179] This argument is unavailing. As discussed above, the presumption that will apply if an ROE falls within the applicable range of presumptively just and reasonable ROEs is a rebuttable presumption. Contrary to CAPs' suggestion, there is a wide variety of potential additional evidence that could be used to rebut the applicable presumption. For example, complainants could offer evidence regarding non-utility stock prices, investor expectations for non-utility stocks, various types of bond yields and their relation to stock prices, and investor and other expert testimony, including testimony regarding the effects of rates on customers. Moreover, even if an ROE falls within the applicable range of presumptively just and reasonable ROEs, the relative location of that ROE within the range, and the level of the ROE relative to the central values of the other financial models could be relevant. Accordingly, it is not the case, as CAPs imply, that the central values of the financial models would be ignored merely because an ROE falls within the applicable range of presumptively just and reasonable ROEs. These are just illustrative examples of the types of evidence that could be used to potentially rebut the presumption. There is a wide array of potential evidence that could be used to rebut the presumption and therefore we disagree with CAPs' contention that the presumption is conclusive.

81. CAPs also argue that the proposal to use ranges of presumptively just and reasonable ROEs is arbitrary and capricious because the proposed presumption is not

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[178] *See e.g., Hope*, 320 U.S. at 622 ("The amount of evidence to be admitted on any point was of course in the agency's reasonable discretion, and it was free to give its own weight to these or other factors and to determine from all the evidence its own judgment as to the necessary rates.").

[179] CAPs Initial Br. (I) at 76-78; CAPs Initial Br. (II) at 76-78.

inferred from proven facts. We disagree. The presumption is inferred from proven facts, namely the zones of reasonableness produced by the DCF and CAPM which use verifiable data inputs, the objective calculations of the overall composite zone of reasonableness, where the applicable range of presumptively just and reasonable ROEs is located within that overall zone, the identification of where the relevant existing ROE falls within that overall zone, and the determination of whether it falls within the applicable range of presumptively just and reasonable ROEs.

82. Moreover, we disagree with CAPs' contention that the rationale underlying how the ranges of presumptively just and reasonable ROEs are constructed is flawed. CAPs point to the Commission's statement in the Briefing Order that "for an average risk utility, the 'broad range of potentially lawful ROEs' that the D.C. Circuit contemplated in *Emera* should correspond to those points that are closer to the ROE that the Commission would set for that utility than to the ROE for a utility of a different risk profile,"[180] and then assert that the Commission has not explained how the potentially lawful ROEs contemplated in *Emera Maine* for the DCF zone of reasonableness became presumptively lawful ROEs under its new proposal. As an initial matter, we clarify that the ranges of presumptively just and reasonable ROEs are not coextensive with the "broad range of potentially lawful ROEs" contemplated in *Emera Maine*. As the court explained "the zone of reasonableness creates a broad range of potentially lawful ROEs."[181] The court was referencing the overall zone of reasonableness and we clarify that, under our revised methodology, the composite overall zone of reasonableness will still represent the "broad range of potentially lawful ROEs" for a utility or group of utilities. The ranges of presumptively just and reasonable ROEs are intended to assist the Commission, as well as market participants, in determining whether an ROE that falls within the overall composite zone of reasonableness is just and reasonable because "[w]hether a particular rate within the zone is the just and reasonable rate for the utility at issue depends on a number of factors" and "[t]hus, the fact that a rate falls within the zone of reasonableness does not establish that the rate is the just and reasonable rate for the utility at issue."[182] Accordingly, we clarify that the potentially lawful ROEs contemplated in this language of *Emera Maine* are not coextensive with the applicable range of presumptively just and reasonable ROEs under our revised methodology. As a result, CAPs' argument on this point does not demonstrate any flaw in our methodology.

83. CAPs also point to the Commission's statement in the Briefing Order that the applicable range of presumptively just and reasonable ROEs for a diverse group of

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[180] Briefing Order, 165 FERC ¶ 61,118 at P 29.

[181] *Emera Maine*, 854 F.3d at 26.

[182] *Id.* at 23.

average risk utilities is one quarter of the zone of reasonableness, centered on the midpoint because "[e]very potential ROE within that range is closer to the current just and reasonable ROE for an average-risk utility than the current just and reasonable ROE for a utility of a different risk profile."[183] CAPs counter that the observation that an ROE lies closer to the just and reasonable ROE than to some appropriate ROE for a utility of a different risk profile does not render that ROE just and reasonable. CAPs have misconstrued the point of the statement. Nothing in our rationale asserts the position CAPs describes. The fact that an ROE lies closer to the just and reasonable ROE than to an appropriate ROE for a utility of a different risk profile does not render that ROE just and reasonable, but it does provide some evidence indicating that the ROE may be just and reasonable. That is why our revised methodology uses that information to determine how to construct the ranges of presumptively just and reasonable ROEs, which we will then use as one piece of evidence in our overall assessment of whether an ROE is just and reasonable. Our rationale does not find that this information conclusively establishes that an ROE is just and reasonable, but instead that it is some evidence indicating that the ROE is just and reasonable. Using this information to construct the ranges of presumptively just and reasonable ROEs is the most effective manner in which we can incorporate this information into our ROE methodology.

84. In addition, CAPs argue that the use of only three risk groups (below-average risk, average risk, and above-average risk) in the ranges of presumptively just and reasonable ROEs is arbitrary. They assert that the Commission has previously set ROEs at a wide variety of locations within the distribution of proxy results, not only at the upper or lower midpoint. CAPs suggest that the Commission could establish more granular risk groups, for example using five risk groups of very-low-risk, moderately-low-risk, average-risk, moderately-high-risk, and very-high risk. We are not persuaded by this argument. The quartile approach using three risk groups strikes an appropriate balance between the interests of customers and utilities. We find that the ranges that are produced by this approach are narrow enough to protect customers from unjust and unreasonable ROEs while also providing utilities and all market participants with an additional objective benchmark that the Commission will use to assess whether an ROE is likely unjust and unreasonable. This will provide additional transparency and certainty with respect to our ROE analyses without giving undue preference to a utility's existing ROE or to a challenge of an existing ROE. As noted above, the use of three risk groups is supported by the fact that, under that construct, every ROE within the applicable presumptively just and reasonable range will be closer to the traditional starting place for evaluating the

[183] CAPs Initial Br. (I) at 79-80 (citing Briefing Order, 165 FERC ¶ 61,118 at P 29); CAPs Initial Br. (II) at 79 (citing same).

ROE of a utility with that risk profile[184] than it will be to the corresponding traditional starting place for a utility of a different risk profile. This approach will most effectively identify whether a given ROE is likely more appropriate for a utility of the applicable risk profile than it would be for a utility of a different risk profile, which will help inform our assessment of whether the ROE is unjust and unreasonable in light of all of the particular circumstances of the case. Because "[r]atemaking . . . is not a science,"[185] we could have constructed the ranges of presumptively just and reasonable ROEs using a different number of risk groups or with wider or narrower ranges.[186] However, we find that, in light of the record in these proceedings and our past experience with ROE analyses, the approach we are adopting herein will best balance the interests of consumers and utilities and most effectively allow us to determine if an ROE is unjust and unreasonable.

85. MISO TOs request that the Commission clarify that a base ROE that falls outside of the applicable range of presumptively just and reasonable ROEs is only rebuttably presumed to be no longer just and reasonable, just as an ROE that falls within the zone is only rebuttably presumed to be just and reasonable.[187] RPGI opposes this clarification, arguing that it would unfairly benefit utilities.[188] We clarify that the Commission will apply a rebuttable presumption to both ROEs that fall within the applicable range of presumptively just and reasonable ROEs and those that fall outside of the applicable range. In other words, ROEs that fall within the applicable range will be presumed to be just and reasonable, unless that presumption is rebutted, and those that fall outside of the applicable range will be presumed to be unjust and unreasonable, unless that presumption is rebutted.

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[184] *See, e.g.*, *Emera Maine*, 854 F.3d at 27 ("We have noted that the midpoint is a good 'starting place' for the placement of the ROE.") (citing *Tenn. Gas Pipeline Co. v. FERC*, 926 F.2d 1206, 1213 (D.C. Cir. 1991)); *id.* at 30 (where "the utility at issue was riskier than the proxy group . . . the midpoint of the upper half was 'an obvious place to begin.'") (citing *Tenn. Gas Pipeline*, 926 F.2d at 1213); *Potomac-Appalachian Transmission Highline, LLC*, 158 FERC ¶ 61,050, at PP 270, 273 (2017) (setting ROE at the "measure of central tendency of the lower half of the zone of reasonableness . . . Given [the utility's] low level of risk as compared to the proxy group.").

[185] *Boston Edison Co. v. FERC*, 885 F.2d 962, 969-70 (1st Cir. 1989).

[186] *See, e.g.*, CAPs Initial Br. (I) at 82-83 (proposing five risk groups with sextiles within the composite zone applying to each group).

[187] MISO TOs Initial Br. (I) at 6; MISO TOs Initial Br. (II) at 7-8.

[188] RPGI Reply Br. (II) at 24-26.

86. RPGI requests that the Commission acknowledge that it intends to determine whether to dismiss a complaint and whether to grant a complaint on the basis of the same process under the new ROE methodology. Specifically, RPGI contends that, if the Commission anticipates that it will be in a position to resolve all factual issues instrumental to denying a complaint if the relevant ROE falls within the applicable range of presumptively just and reasonable ROEs and the presumption is not rebutted, then the Commission should apply an equivalent standard for granting complaints.[189] We clarify that we intend to determine whether to dismiss a complaint and whether to grant a complaint on the basis of the same process under the new ROE methodology. The ranges of presumptively just and reasonable ROEs and the other changes to our methodology adopted in this order will apply generally to our overall assessment of existing ROEs under FPA section 206. There will be no difference in how the methodology is applied in the context of potentially dismissing a complaint as opposed to potentially granting a complaint, outside of the differences in the statutory and regulatory burdens and requirements that complainants and respondents face under section 206 which, as noted above, the revised methodology adopted herein cannot and does not change. With respect to RPGI's contention that, if the Commission anticipates that it will be able to resolve all factual issues relevant to denying a complaint, it should also be able to do so with respect to granting a complaint, we clarify that we do not necessarily anticipate that the revised methodology adopted in this order will allow us to resolve all factual issues in every ROE case without additional hearing or settlement procedures. As was the case before this order, there may be cases where we will be able to resolve all factual issues before us and dismiss or grant a complaint without additional procedures. However, there may be other cases where there are issues of material fact in dispute that cannot be resolved based upon the record and will require additional procedures. We will not approach the question of whether there are issues of material fact differently in determining if a complaint will be granted as opposed to if a complaint will be denied, again outside of the differences in the statutory and regulatory burdens and requirements that complainants and respondents face under section 206 which the revised methodology adopted herein does not change.

V. DCF

A. Background

87. The DCF model is based on the premise that an investment in common stock is worth the present value of the infinite stream of dividends discounted at a market rate commensurate with the investment's risk. With simplifying assumptions, the DCF model results in the investor using the following formula to determine share price:

[189] RPGI Initial Br. (I) at 41; RPGI Initial Br. (II) at 44.

P = D/k-g,

where "P" is the price of the common stock, "D" is the current dividend, "k" is the discount rate (or investors' required rate of return), and "g" is the expected growth rate in dividends.

88. Unlike investors, the Commission uses the DCF model to determine the ROE (the "k" component) to be included in the utility's rates, rather than to estimate a stock's value. Therefore, the Commission rearranges the DCF formula to solve for "k", the discount rate, which represents the rate of return that investors require to invest in a company's common stock. The Commission also multiplies the dividend yield by the expression (1+.5g) to account for the fact that dividends are paid on a quarterly basis. Multiplying the dividend yield by (1+.5g) increases the dividend yield by one half of the growth rate and produces what the Commission refers to as the "adjusted dividend yield." Under the resulting formula, ROE equals the adjusted dividend yield plus the expected future growth rate of dividends and can be expressed as follows:

k=D/P (1+.5g) + g.

89. Under the Commission's two-step DCF methodology, the input for the expected future growth rate of dividends, "g," is calculated using both short-term and long-term growth projections.[190] Those two growth rate estimates are averaged, with the short-term growth rate estimate receiving two-thirds weighting and the long-term growth rate estimate receiving one-third weighting, to create a composite growth rate.[191]

B. Dividend Yield

90. In the First Complaint proceeding, all parties, including the MISO TOs, calculated the adjusted dividend yield using the same composite growth rate, including both short- and long-term growth rates, for the (1+.5g) adjustment the Commission uses for the expected future growth rate of dividends. Accordingly, the Presiding Judge in that proceeding, and the Commission in Opinion No. 551, also calculated the adjusted dividend yield using the composite growth rate, and no party sought rehearing of Opinion No. 551 on this issue.

91. Initially, all parties in the Second Complaint proceeding, including the MISO TOs, also proposed to calculate the adjusted dividend yield using the composite growth rate for

[190] Opinion No. 531, 147 FERC ¶ 61,234 at PP 15-17, 36-40; Opinion No. 531-A, 149 FERC ¶ 61,032 at P 10.

[191] Opinion No. 531, 147 FERC ¶ 61,234 at PP 17, 39.

the (1+.5g) adjustment. However, three days after the MISO TOs filed their update testimony in the Second Complaint proceeding, the Commission issued Opinion No. 546 in *Seaway Crude Pipeline Co. LLC*,[192] holding that only a short-term growth projection should be used in calculating the (1+.5g) adjustment to dividend yield. The Commission stated that "the short-term IBES growth rate is far more representative of the growth investors expect over the coming year than is the [composite] growth rate."[193] At the hearing in the Second Complaint proceeding, the MISO TOs presented modified dividend yield calculations consistent with Opinion No. 546, using only short-term growth projections to calculate the (1+.5g) adjustment to dividend yield.[194] However, the Presiding Judge, without discussion, used the same composite growth rate to calculate the adjusted dividend yield as used for the expected future growth in dividends.

1. MISO TOs

92. In their brief on exceptions to Initial Decision (II) in the Second Complaint proceeding and in the initial affidavits of their witness Mr. McKenzie in response to the Briefing Order, MISO TOs argue that only the short-term IBES growth rate should be used to calculate the (1+.5g) adjustment to dividend yield. They point out that the Commission found in Opinion No. 546 that a projected GDP growth rate should not be used in adjusting the dividend yield, because the short-term IBES growth rate is more representative of the growth investors expect over the coming year than a composite growth rate also reflecting GDP growth.[195] In their brief on exceptions, MISO TOs explain that the Commission has long held that "[t]he appropriate dividend figure to use in the DCF equation is the amount which is expected to be received by the investor during the twelve months following the purchase of the stock."[196] MISO TOs assert that the Commission assumes that the dividend will be increased annually and that the next increase will occur on average six months after the stock purchase.[197] Therefore, the

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[192] *Seaway Crude Pipeline Co.*, Opinion No. 546, 154 FERC ¶ 61,070, at PP 198-200 (2016).

[193] *Id*. P 198.

[194] Ex. MTO-140 (II). Tr. 310-311 (II).

[195] MISO TOs Initial Br. (I), App. 2 McKenzie Aff. (I) at 17-18; MISO TOs Initial Br. (II), App. 2 McKenzie Aff. (II) at 18-19; MISO TOs Br. On Exceptions at 38-44.

[196] *Id*. at 42 (quoting *Conn. Light & Power Co.*, Opinion No. 305-A, 45 FERC ¶ 61,370, at 62,168-69 (1988)).

[197] *Id*. at 40 (citing Opinion No. 305-A, 45 FERC at 62,169).

actual dividend yield during the six-month study period must be adjusted upward for the first expected dividend increase. MISO TOs state that, because the adjusted dividend yield is intended to reflect investor expectations during just one year, it is inherently a short-run figure, and therefore the short-term IBES growth projection is the appropriate growth projection to use in making the adjustment.

2. CAPs

93. CAPs oppose MISO TOs recommendation to use only a short-term dividend growth rate, for purposes of the (1+ .5g) adjustment to the dividend yield.[198] Instead, they recommend using a composite growth rate consistent with Opinion Nos. 531 and 551 and Initial Decision (II).

94. CAPs contend that the Commission's longstanding practice has been to use the composite growth rate, not the short-term IBES growth projection, as the "g" in the (1 + .5g) dividend adjustment factor.[199] They state that this practice is appropriate, because the purpose of the adjustment is to account for the quarterly, rather than annual, payment of dividends, and therefore the adjustment requires a projection of growth in dividends, not growth in earnings. CAPs state that projected long-term earnings growth is the best available predictor of near-term dividend growth because: (1) long-term earnings growth funds long-term dividend growth; and (2) utility holding companies moderate their near-term dividend growth in order to avoid cutting dividends when earnings fall. Thus, CAPs claim, "the composite growth rate is a better predictor of near-term dividend yield increases than is the first-stage growth rate."[200] CAPs state that this conclusion is borne out in the record of the Second Complaint proceeding, where, to take one example, OGE Energy's earnings have increased during the last five years by 6.84 percent annually, but its dividends have only increased by 4.5 percent annually.[201]

95. CAPs also reject the MISO TOs' argument that Opinion No. 546 established a new DCF methodology for electric utilities. Rather, CAPs state that Opinion No. 546 concerned an oil pipeline master limited partnership (MLP) and was a "case-specific determination" that the pipeline's DCF study should not be disregarded because of a relatively minor difference related to the dividend adjustment. CAPs point out that the

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[198] CAPs Reply Br. (I) at 22-25; CAPs Reply Br. (II) at 40-44; CAPs Br. Opposing Exceptions at 40-44.

[199] CAPs Reply Br. (I) at 23. CAPs Reply Br. (II) at 42.

[200] CAPs Reply Br. (I) at 23; CAPs Reply Br. (II) at 42.

[201] CAPs Br. Opposing Exceptions at 43.

pipeline had argued that, for MLPs, the short-term earnings growth rate was the best predictor of the coming year's earnings growth, because MLPs distribute most available cash to investors, and therefore near-term dividends growth would be expected to track near-term earnings growth. CAPs assert that this determination in Opinion No. 546 was never meant to apply to electric utilities.[202] In addition, CAPs argue that the MISO TOs' recommended methodology of using different growth rates for future dividends and cash flows would distort the DCF model's results.[203]

3. Trial Staff

96. Trial Staff also opposes using only a short-term dividend growth rate, for purposes of the (1+ .5g) adjustment to the dividend yield. Trial Staff contends that MISO TOs' reliance on Opinion No. 546 is misplaced. Trial Staff states that that case involved an oil pipeline and used a proxy group of only oil pipeline MLPs, which "distribute most available cash to investors."[204] Trial Staff instead asserts that "investors value stable dividends" and that "adjusted dividend yield calculations should be based on expectations of long-term earnings growth, which requires the use of the composite growth rate."[205]

97. Trial Staff also contends that, if the Opinion No. 546 dividend adjustment methodology is applied to public utilities, it is likely to reduce the low-end DCF results and increase the high-end DCF results. That is because proxy companies with high-end DCF results generally have IBES growth rates that are higher than the GDP growth projection, while proxy companies with low-end DCF results have IBES growth projections that are less than the GDP growth projection. However, Trial Staff states that the reduced low-end DCF results are likely to be eliminated by the low-end outlier test, but the high-end results will not be eliminated. As a result, Trial Staff asserts that the Opinion No. 546 methodology is likely to increase the midpoint ROE.[206]

4. Commission Determination

98. The Commission will use the short-term growth rate to calculate the (1+.5g) adjustment to dividend yield. As noted in Opinion No. 305-A,

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[202] *Id.* at 41-42.

[203] CAPs Reply Br. (I) at 22-24; CAPs Reply Br. (II) at 41-43.

[204] Trial Staff Reply Br. (I) at 8; Trial Staff Reply Br. (II) at 8.

[205] Trial Staff Reply Br. (I) at 9; Trial Staff Reply Br. (II) at 9.

[206] Trial Staff Br. Opposing Exceptions at 20-21.

> The appropriate dividend figure to use in the DCF equation is that amount which is expected to be received by the investor during the twelve months following the purchase of the stock. To estimate that amount, we generally make the following two simplifying assumptions: (a) that the dividend rate will be increased annually (this has been the recent practice for electric utilities); and (b) that the next increase will occur, on average, six months after the stock purchase.[207]

Because this first dividend is necessarily paid within the time period covered by the IBES short-term growth projection, that rate is the more appropriate growth rate for calculating the (1+.5g) adjustment to the dividend yield.

99. We are not persuaded by the contention that the Commission should apply Opinion No. 546 only to oil pipeline MLPs. Opinion No. 546 approved use of the short-term IBES growth projection to calculate the (1+.5g) adjustment to dividend yield on the ground that "the short-term IBES growth rate is far more representative of the growth investors expect over the coming year than is the two-stage growth rate."[208] That rationale applies equally to public utilities as to oil pipelines. It does not turn on any unique feature of oil pipeline MLPs, such as their slower expected long-term growth because of the fact MLPs distribute most available cash to investors. We find that the adjusted dividend yield methodology used in Opinion No. 546 should be applied both to electric utilities and pipeline companies. Furthermore, we do not agree that using different growth rates would distort the DCF's results; the adjusted dividend yield, which concerns only the dividend received in the first year after a stock's purchase, is logically distinct from the infinite stream of dividends received from holding the stock in perpetuity.

100. We do not find Trial Staff's assertion that using only the IBES growth rate in calculating the adjusted dividend yield is likely to increase the midpoint ROE to be a basis for requiring the composite growth rate to be used in calculating the adjusted dividend yield. As noted above, the adjusted dividend yield only considers expected growth within the year after a stock's purchase, and so should be calculated using a short-term growth rate. In any event, as the Commission stated in Opinion No. 546, using only the IBES short-term growth projection to make the (1+.g) adjustment to dividend yield has a *de minimis* effect on the outcome of the DCF analysis, increasing proxy company ROEs by only one or two basis points.

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[207] Opinion No. 305-A, 45 FERC ¶ 61,370 at 62,168-69.

[208] Opinion No. 546, 154 FERC ¶ 61,070 at P 198.

C. Short-Term Growth Rate

1. Opinion No. 551

101. In the First Complaint proceeding, the MISO TOs proposed to use earnings growth projections published by *Value Line* as the short-term projection of the future growth in dividends. However, the Presiding Judge adopted the IBES 3 to 5 year growth projections published by *Yahoo! Finance*, stating that the Commission has "long relied on IBES growth projections as evidence of the growth rates expected by the investment community."[209] Additionally, the Presiding Judge stated that the Commission's policy that ROE should be determined using the most recent financial data in the record (i.e., data for the last six months of 2015) dictates use of the IBES growth projections, because the MISO TOs had only provided *Value Line* data from the first half of 2015, whereas the other parties had provided IBES growth projections through July 13, 2015.[210] In their brief on exceptions, MISO TOs stated they were not excepting to the Presiding Judge's use of IBES growth projections in the First Complaint proceeding, because the record did not contain *Value Line* growth estimates from the last half of 2015. However, they requested that the Commission confirm that, in future proceedings, *Value Line* growth projections would constitute an acceptable and comparable source of short-term earnings growth estimates that may be considered for use in the two-step DCF analysis.[211]

102. In Opinion No. 551, the Commission denied MISO TOs' request for clarification that the *Value Line* growth projections constitute an acceptable and comparable source of short-term earnings growth estimates that may be considered for use in the two-step DCF analysis. It stated, that while the Commission has not mandated the exclusive use of IBES data in its natural gas and oil pipeline rate of return cases, the Commission has stated that "IBES data is the preferred data source for computing the short-term growth rate"[212] and explained that "IBES data is a compilation of projected growth rates from

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[209] Initial Decision (I), 153 FERC ¶ 63,027 at PP 44, 46.

[210] *Id.* PP 48-49.

[211] *See* Opinion No. 551, 156 FERC ¶ 61,234 at PP 46-53.

[212] *Nw. Pipeline Corp.*, 92 FERC ¶ 61,287, at 62,002 (2000). *See also Nw. Pipeline Corp.*, 79 FERC ¶ 61,309, at 62,385 (1997) (finding that "[t]he IBES figures should be used for the short-run growth rate of reach of the proxy companies.").

various knowledgeable financial advisors within the investment community."[213] As such, the IBES short-term growth estimates generally represent consensus growth rate estimates by a number of analysts. The Commission stated that, by contrast, it has rejected the use of *Value Line* growth estimates, because they are the estimates of a single analyst and do not constitute such consensus estimates.[214]

103. In response to MISO TOs' argument that the *Value Line* estimates should be considered a comparable source, the Commission cited Opinion No. 531, which states that the Commission "has long relied on IBES growth projections as evidence of the growth rates expected by the investment community."[215] The Commission also noted that Opinion No. 531 states that, while the Commission could conceivably allow the substitution of "comparable data," an "alternative source of growth rate data should only be used when that source can be used for the growth projections of all of the proxy group companies" because using different sources could "produce skewed results, because those sources may take different approaches to calculating growth rates."[216] The Commission confirmed that this is the reason that it has "consistently used a single investor service such as IBES for the investment analysts' growth rate estimates."[217]

104. Thus, the Commission stated that, while it is willing to use short-term growth data published by a source comparable to IBES, because *Value Line* does not publish consensus growth rate estimates, it cannot be considered comparable.[218] The Commission also stated that published consensus estimates sourced from investment

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[213] *See, e.g.*, *Nw. Pipeline Corp.*, 87 FERC ¶ 61,266, at 62,058-59 (1999); *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260, at P 234 (2002).

[214] Opinion No. 551, 156 FERC ¶ 61,234 at P 62 (citing *Nw. Pipeline Corp.*, 87 FERC at 62,058-59; *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260 at P 234; Opinion No. 531-B, 150 FERC ¶ 61,165 at P 72 n.145 (stating that the *Value Line* data "for any company consists of an earnings estimate from only one analyst, rather than consensus estimates")).

[215] *Id.* P 63 (citing Opinion No. 531, 147 FERC ¶ 61,234 at PP 89-90).

[216] *Id.* (citing *ISO New England, Inc.*, 109 FERC ¶ 61,147, at P 205 (2004) (finding that a presiding judge is not precluded from finding candidates for inclusion in the proxy group for which comparable data can reasonably be substituted for the growth rate data reported by IBES or *Value Line*)).

[217] *Id.*

[218] *Id.* P 64.

analysts, e.g., IBES's growth rate estimates, are updated on a rolling basis, sometimes as frequently as daily, and are therefore superior to *Value Line*'s growth rate estimates, which are updated only on a lagging, quarterly basis.[219]

2. MISO TOs' Request for Rehearing of Opinion No. 551

105. MISO TOs sought rehearing of Opinion No. 551 on this issue.[220] MISO TOs argue that nothing in the record suggests that investors are more likely to rely on an earnings forecast if more analysts helped develop the forecast. Additionally, MISO TOs argue that *Value Line*'s growth projections have as much, if not more, influence on investment decision-making as the IBES estimates.[221] Furthermore, they assert that the IBES growth estimates lack transparency regarding the forecast and updating procedures, a defect "not common to *Value Line*'s estimates."[222] As an example of this opacity, MISO TOs point to Mr. Keyton's testimony which, they argue, concedes that there is no way to know how many analysts contribute to any IBES growth estimate.[223] In contrast, MISO TOs contend that Dr. Avera argued that *Value Line*'s short-term growth estimates meet the same objective criteria of IBES's, are widely relied upon by investors, and are based on transparent forecast techniques explained in *Value Line*'s user manual.[224]

106. MISO TOs further contend that the Commission relied on an erroneous assumption about the frequency of IBES updates, as Mr. Solomon stated that the IBES update frequency is indeterminable. Additionally, MISO TOs argue that Dr. Avera explained that *Value Line*'s projections "are updated on a scheduled basis, which removes debate about the potential staleness of the underlying data."[225] MISO TOs argue, therefore, that the record contradicts the Commission's findings about the update frequency of IBES and Value-Line. Nonetheless, MISO TOs argue that update frequency

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[219] *Id.*

[220] MISO TOs Rehearing Request at 5.

[221] *Id.* at 8.

[222] *Id.*

[223] *Id.*

[224] *Id.* at 8-9.

[225] *Id.* at 9.

is irrelevant in light of the fact that the investment community relies on *Value Line*.[226] To this point, they argue that "[w]hat matters is whether" growth estimates are representative of investor expectations, and that investors' "undisputed reliance" on *Value Line* establishes that such estimates are suitable for the DCF model.[227] MISO TOs also argue that the Commission has relied on *Value Line* investment data in other contexts.[228]

107. Furthermore, MISO TOs argue that the Commission erroneously assumed that investors are more likely to rely on a consensus forecast even though the record does not demonstrate that IBES estimates reflect a greater consensus of input than *Value Line* estimates. To this point, they argue that Mr. Keyton stated, and Mr. Solomon confirmed, that there is no way to ascertain the number of IBES analysts contributing to an estimate or if more than one analyst was responsible for any particular forecast.[229] MISO TOs therefore ask the Commission to grant rehearing and leave open the ability of parties to propose appropriate alternatives to IBES, including *Value Line*.[230] Additionally, MISO TOs argue that undisputed record evidence confirms that *Value Line* estimates are reviewed by a committee of peer analysts, which undercuts the worth of the Commission's determination that such estimates are only published under the name of a single analyst.[231] They also argue that, even if IBES provides updates with greater frequency, this is actually a disadvantage because such updates do not adhere to any known schedule or published metrics. In contrast, MISO TOs point out that *Value Line*'s earnings forecasts are updated quarterly in accordance with documented procedures.[232]

108. MISO TOs also argue that the Commission has not rejected the use of *Value Line* growth estimates in natural gas pipeline rate cases based on the fact that they are estimates of a single analyst and do not constitute consensus estimates.[233] They argue

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[226] *Id.* at 10.

[227] *Id.*

[228] *Id.* (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 102 and *Kern River Gas Transmission Co.*, Opinion No. 486-C, 129 FERC ¶ 61,240, at P 50 (2009)).

[229] *Id.* at 11.

[230] *Id.* at 12.

[231] *Id.*

[232] *Id.* at 13.

[233] *Id.* at 14.

that this finding in Opinion No. 551 contradicts the Commission's earlier finding in Opinion No. 531-B, where the Commission concluded that investors' reliance on IBES growth projections does not vary depending upon the "the exact number of analysts contributing to any particular IBES growth projection."[234]

109. Finally, MISO TOs argue that the Commission's categorical rejection of *Value Line* growth projections deprives the Commission of information relevant to the determination of a just and reasonable ROE.[235]

3. Second Complaint Proceeding

110. In the Second Complaint proceeding, the MISO TOs again proposed to use *Value Line* growth projections as the short-term projection of growth in future dividends. The Presiding Judge, however, rejected that proposal and determined that IBES data should be used.[236] The Presiding Judge held that, because the Commission had used IBES data as the short-term growth projection in Opinion No. 531, the MISO TOs had the burden to demonstrate that use of *Value Line* growth projections would be preferable in this case. The Presiding Judge was not persuaded by the MISO TOs' contention that the *Value Line* short-term growth projection should be used, because the resulting DCF midpoint and upper midpoints (9.50 and 10.89 percent) are closer to the result of the alternative methodologies than the DCF midpoint and upper midpoint produced using IBES growth projections (8.72 and 9.70 percent).[237] The Presiding Judge found that the alternative methodologies should not be referred to in deciding what short-term growth projection should be used in a DCF analysis. The Presiding Judge also found that use of the IBES short-term growth projections "better conforms to the Commission's admonition that the DCF model incorporate the most recent data available,"[238] because the IBES projections in the record were obtained as late as January 8, 2016, while the *Value Line* growth projections were obtained for various proxy group companies on October 30, November 30, and December 18, 2015.

111. In its brief on exceptions, MISO TOs argued, among other things, that prior reliance on IBES does not foreclose the use of *Value Line* growth projections, and it

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[234] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 72.

[235] MISO TOs Rehearing Request at 18-19.

[236] Initial Decision (II), 155 FERC ¶ 63,030 at PP 32-45.

[237] *Id*. PP 36-41.

[238] Initial Decision (II), 155 FERC ¶ 63,030 at P 42.

again argued that the *Value Line* DCF is corroborated by the results of its risk premium, CAPM, and expected earnings analyses.[239] MISO TOs contend that a DCF analysis using *Value Line* short-term growth projections produces ROEs close to those produced by the alternative methodologies, such as a DCF analysis using IBES short-term growth projections. MISO TOs also argued that the *Value Line* estimates are at least as current as the IBES estimates. MISO TOs explained that, although the IBES growth projections in the record were in an IBES report published in January 2016, the analyst growth projections reflected in the report may have been made as much as 180 days earlier. MISO TOs cited evidence that *Yahoo Finance* provides no information as to the schedule or frequency of updates to any of the analyst growth projections used to create the consensus IBES growth projection published by *Yahoo Finance*.

112. In their briefs opposing exceptions, CAPs, OMS, RPGI, and Trial Staff all disagree with MISO TOs on this issue.[240] CAPs contend that *Value Line* growth projections are not similar to IBES short-term growth projections for at least three reasons. First, IBES short-term growth projections represent a consensus of the views of multiple analysts, while *Value Line* projections are made by only one analyst. Second, CAPs state that the *Value Line* growth rates are substantially retrospective in contrast to the prospective IBES growth projections. CAPs state that IBES analysts typically start from a single most recent historical year, make adjustments to that base year to remove non-recurring gains or losses, and then project normalized earnings growth over a three to five year period. However, *Value Line* growth rates represent an estimate of growth from a three-year historical period to a three-year forecast period, with the base period starting up to four years before the date of the *Value Line* publication.[241] Third, CAPs assert that the *Value Line* growth rates do not reflect as accurate a normalization of non-recurring base period gains and losses as the IBES projections. They state that the *Value Line* growth rates rely solely on an averaging of the three historical years, whereas IBES participating analysts make adjustments to the most recent year to remove specific non-recurring gains and losses.[242] OMS and Trial Staff also argue that the IBES growth projections are more current, because IBES updates its data base on a daily basis as participating analysts provide new inputs, whereas *Value Line* publishes on a rolling

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[239] MISO TOs Br. on Exceptions at 12-30.

[240] CAPs Br. Opposing Exceptions at 6-32; OMS-JCA Br. Opposing Exceptions at 9-16; RPGI Br. Opposing Exceptions at 4-29; Trial Staff Br. Opposing Exceptions at 6-13.

[241] CAPs Br. Opposing Exceptions at 12-13.

[242] *Id*. at 13.

quarterly basis.[243] Trial Staff and RPGI also oppose MISO TOs' reliance on alternative methodologies to support use of *Value Line* growth rates in the DCF model, asserting that alternative methodologies may only be considered after the DCF analysis has been completed.[244]

4. Briefing Order

113. In the Briefing Order, the Commission stated that, while IBES growth projections represented a consensus in the past, they may not reflect as robust a consensus at this point.[245] The Commission stated that this concern stems from the fact that most investment analysts that make and publish quarterly and annual earnings estimates no longer make and publish three-to-five year short-term projections of earnings growth and that in recent years, the IBES data for many proxy companies have reflected between one and three analysts' short-term growth projections.[246] The Commission further stated that the reduced number of short-term growth projections means that a significant change in a single analyst's growth projection for a particular proxy company can significantly affect that company's DCF analysis result.[247]

5. MISO TOs' Initial Briefs

114. In their brief in the First Complaint proceeding, MISO TOs state that they do not propose reliance on growth rates from a source other than IBES to resolve the First Complaint.[248] However, they ask the Commission to clarify that it is receptive to considering in the future other sources of growth rate estimates that are widely relied

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[243] OMS-JCA Br. Opposing Exceptions at 13-14; Trial Staff Br. Opposing Exceptions at 12.

[244] Trial Staff Br. Opposing Exceptions at 9-11; RPGI Br. Opposing Exceptions at 14.

[245] Briefing Order, 165 FERC ¶ 61,118 at P 48.

[246] *Id.* P 49 (citing *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 47).

[247] *See e.g., id.* P 48 (noting, for example, that one analyst's error involving the growth projection for Portland General Electric Company (Portland General) reduced the overall Reuters consensus projected short-term percentage growth in earnings for Portland General from 10.96 percent to 7.80 percent).

[248] MISO TOs Initial Br. (I) at 22.

upon in the investment community, such as *Value Line*.[249] They argue that, from the earliest application of the two-step DCF, the Commission has neither adopted nor endorsed IBES as the only source of data for developing short-term growth projections.[250] They also state that the Commission has conceded that there is no perfect data source for such estimates and that the order directing briefing questions whether IBES growth rates reflect investor consensus.[251] For these reasons, they ask the Commission to clarify that it is open to considering sources of short-term earnings growth rate estimates other than IBES.[252]

115. In their brief in the Second Complaint proceeding, MISO TOs propose to use the *Value Line* growth estimates they presented at the hearing as the short-term estimate of the future growth in dividends.[253] MISO TOs rely on the same rationale as in their Brief on Exceptions to Initial Decision (II).

6. RPGI Initial Briefs

116. RPGI provides arguments in support of the use of IBES. RPGI contends that the Commission has previously considered and rejected concerns regarding the number of IBES analysts when using such data in the DCF model and the Commission has previously found that calculating the "common equity to a regulated enterprise depends upon what the market expects not upon precisely what is going to happen."[254] RPGI argues that the focus of the analysis in formulating a policy choice among financial models should not be whether the IBES growth estimates are the product of numerous inputs but whether there is "sufficient continuity and regularity over time in the publication of analysts' estimates that investors might reasonably make use of those

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[249] *Id.*

[250] *Id.* at 23 (citing *Ozark Gas Transmission Sys.*, 68 FERC ¶ 61,032, at 61,106 (1994), *order on reh'g*, 71 FERC ¶ 61,138 (1995)).

[251] *Id.* (citing Opinion No. 414-B, 85 FERC at 62,269 (1998)).

[252] *Id.*

[253] MISO TOs Initial Br. (II), App. 2 McKenzie Aff. (II) at 19-20.

[254] RPGI Initial Br. (I) at 22 (citing Opinion No. 414-B, 85 FERC at 62,268-69); RPGI Initial Br. (II) at 26 (citing same).

estimates in evaluating proxy companies' prospects."[255] It argues that there is no evidence to suggest that IBES inputs fail under this analysis.

117. RPGI also states that investors continue to make use of IBES forecasts and thus, the DCF continues to meet the Commission's established criterion for selecting which source to use—that the source is used by investors.[256] It also argues that it is not a defect that IBES forecasts "appear to be published on a basis that excludes estimates made more than six months prior."[257]

7. CAPs Reply Brief

118. CAPs' reply brief in the First Complaint proceeding did not address the issue of what short-term growth projection to use in the DCF model. However, in their reply brief in the Second Complaint proceeding, CAPs oppose use of *Value Line* as the short-term growth projection, repeating the same arguments they made in their brief opposing exceptions in the Second Complaint proceeding.

8. Trial Staff Reply Briefs

119. In reply to MISO TOs' Initial Briefs in both complaint proceedings, Trial Staff reiterates the Commission's arguments about its preference for IBES. It also points to Opinion No. 531-B, where the Commission stated that it is "preferable to use a consistent source of dividend growth projections for all members of the proxy group as provided by IBES, rather than to use different sources of growth projections depending upon the number of analysts contributing to each IBES growth projection."[258] Moreover, Trial Staff states that the Commission has a long history of finding that IBES is the preferred data source for computing the short-term growth rates[259] and that alternate sources should only be used when they are available for the growth projections for all proxy group companies in order to avoid skewed results.[260] Trial Staff also points out that the

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[255] RPGI Initial Br. (I) at 22; RPGI Initial Br. (II) at 26.

[256] RPGI Initial Br. (I) at 23; RPGI Initial Br. (II) at 27.

[257] RPGI Initial Br. (I) at 23; RPGI Initial Br. (II) at 27.

[258] Trial Staff Reply Br. (I) at 15-16 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 72); Trial Staff Reply Br. (II) at 15.

[259] Trial Staff Reply Br. (I) at 16; Trial Staff Reply Br. (II) at 15.

[260] Trial Staff Reply Br. (I) at 17; Trial Staff Reply Br. (II) at 17.

Commission has found that IBES is updated on a rolling basis, sometimes as frequently as daily, while *Value Line*'s growth estimates are updated only on a lagging quarterly basis.[261] Trial Staff therefore recommends that the Commission reject the proposed use of *Value Line*-based short-term growth rates in the future and any alternative source that does not include all proxy group companies.[262]

9. Commission Determination

120. For the reasons discussed below, we deny MISO TOs' request for rehearing of Opinion No. 551's rejection of their request for clarification that *Value Line* growth projections constitute an acceptable source of short-term earnings growth estimates for use in the two-step DCF analysis. We also affirm the Presiding Judge's rejection of the MISO TOs' proposal in the Second Complaint proceeding to use *Value Line* growth projections as the short-term growth projection for purposes of the two-step DCF analysis and therefore we deny MISO TOs' exceptions on this point.

121. In Opinion No. 531, the Commission held that "in future public utility cases, the Commission will adopt the same two-step DCF methodology it uses in natural gas and oil pipeline cases."[263] Although the Commission has refrained from mandating the exclusive use of IBES data in its natural gas and oil pipeline rate of return cases, the Commission has in fact used IBES data for the short-term growth projection in every such case since the Commission initiated the two-step DCF model 25 years ago in *Ozark Gas Transmission System*.[264] For example, when the Commission increased the weighting of the short-term growth projection from one-half to two-thirds in Opinion Nos. 414-A and 414-B,[265] the Commission reaffirmed the use of IBES data for the short-term growth projection and rejected the use of *Value Line* short-term growth projections. Opinion No. 414-B cited testimony that "there is a body of evidence showing that the most reliable measure of investor expected growth is the growth forecasts, such as IBES,

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[261] Trial Staff Reply Br. (I) at 14-15; Trial Staff Reply Br. (II) at 14-15.

[262] Trial Staff Reply Br. (I) at 17-18; Trial Staff Reply Br. (II) at 17.

[263] Opinion No. 531, 147 FERC ¶ 61,234 at P 39.

[264] *Ozark Gas Transmission Sys.*, 68 FERC ¶ 61,032 at 61,106-07. *Nw. Pipeline Corp.*, 79 FERC ¶ 61,309 at 62,384-85.

[265] *Transcon. Gas Pipe Line Corp.*, Opinion No. 414-A, 84 FERC ¶ 61,084 at 61,423-24 (1998), *reh'g denied*, Opinion No. 414-B, 85 FERC at 62,268-69.

published by security analysts."[266] That evidence included the article by Robert Harris, entitled *Using Analysts' Growth Forecasts to Estimate Shareholder Required Rates of Return*,[267] upon which the MISO TOs rely in this case to support their use of a one-step DCF method as part of their CAPM analysis. Opinion No. 414-B stated that article supported the use of IBES growth projections.[268] The Commission also quoted the testimony of the pipeline's witness that "[t]he analysts from which IBES collects forecasts are professionals, exercising their best judgment as to the future growth in earnings of the companies they follow . . . Their analyses are provided as a service to investors and should therefore serve as a good measure of the expectations investors have formed. I believe that IBES and Zacks Investment Research . . . are the best sources. IBES is well known in the investment community, and I believe draws on more professional forecasts than any other similar service except for Zacks."[269]

122. The Commission continued to follow this precedent in subsequent natural gas and oil pipeline rate of return cases.[270] The Commission also rejected proposals to average IBES short-term growth projections with *Value Line* growth estimates, finding that *Value Line* projections are "projections from a single source" and their use would "dilute the industry consensus reflected in the IBES data."[271]

123. Similarly, when the Commission modified its proxy group policies to permit MLPs to be included in natural gas and oil pipeline proxy groups, the Commission held that IBES growth projections should also be used for MLPs, finding that those

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[266] Opinion No. 414-B, 85 FERC at 62,269.

[267] Robert S. Harris, *Using Analysts' Growth Forecasts to Estimate Shareholder Required Rates of Return*, Fin. Mgmt., Spring 1986.

[268] Opinion No. 414-B, 85 FERC at 62,269 n.34.

[269] *Id.* at 62,269

[270] *See, e.g.*, *Nw. Pipeline Corp.*, 87 FERC at 62,058-59 (explaining that the "IBES data is a compilation of projected growth rates from various knowledgeable financial advisors within the investment community"); *Nw. Pipeline Corp.*, 92 FERC at 62,002; and *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260, at P 234 (2002).

[271] *Nw. Pipeline Corp.*, 87 FERC at 62,058-59; *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260 at P 234.

projections remain "the best and most reliable source of growth information available."[272] The Commission again found that investors rely on the IBES growth projections in making investment decisions, because they are widely available and generally reflect the input of a number of financial analysts. The Commission also rejected a proposal to use *Value Line* reports to test the reasonableness of IBES growth projections.[273]

124. MISO TOs have failed to provide a persuasive reason for the Commission to modify this longstanding policy concerning the short-term growth projection to be used in the two-step DCF model. For the reasons we discuss below, we continue to find the use of IBES three-to-five year growth projections preferable to the use of *Value Line* growth projections.

125. MISO TOs point out that, in Opinion No. 531, the Commission stated that the short-term growth projection to be used in the two-step DCF model "will be based on the five-year projections reported by IBES (or a comparable source)."[274] They contend that *Value Line* is a "comparable source," and thus Opinion No. 531 permitted its use. However, we find that *Value Line* is not a comparable source. As we have previously found, the IBES growth projections generally represent consensus growth estimates by a number of analysts.[275] By contrast, the *Value Line* growth estimates represent the growth projection of a single analyst, as Opinion No. 531-B stated.[276] MISO TOs assert that the *Value Line* growth estimates are comparable to consensus estimates, because they "are vetted through internal processes including review by a committee composed of peer analysts."[277] However, regardless of any review process within *Value Line*, the fact remains that the *Value Line* growth projections are projections by a single institution. By

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[272] *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048, at P 75 (2008) (*Proxy Group Policy Statement*).

[273] *Id*. PP 83-84.

[274] MISO TOs Br. on Exceptions at 14 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 39).

[275] Ex. JCI-14 (II) at 27 ("IBES consensus estimates are normally based on the average of multiple analysts, or brokerage or investment firms' estimates.").

[276] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 72 n.145 (stating that the *Value Line* data "for any company consists of an earnings estimate from only one analyst, rather than consensus estimates").

[277] MISO TOs Rehearing Request at 12 (citing Ex. S-1 at 17 and Ex. MTO-1 at 27).

contrast, IBES compiles the growth projections of a number of analysts at different brokerage and investment firms. The IBES growth projections thus generally represent an average of projections made independently of one another by a number of analysts at different institutions.[278] Data sources can reflect investor expectations by being used by large numbers of investors and/or being themselves the results of the analysis of a diverse group of persons in the investment community. Both IBES and *Value Line* growth rates are used by large numbers of investors but only IBES growth rates reflect the analysis of a diverse group of persons in the investment community.

126. Academic research supports the use of consensus forecasts such as those reported by IBES for purposes of the DCF growth projection, rather than the forecast of a single analyst or institution. For example, Roger Morin states,

> Exclusive reliance on a single analyst's growth forecast runs the risk of being unrepresentative of investors' consensus forecast. One would expect that averages of analysts' growth forecasts, such as those contained in IBES or Zacks, are more reliable estimates of investors' consensus expectations likely to be impounded in stock prices. Averages of analysts' growth forecasts rather than a single analyst's forecasts are more reliable estimates of investors' consensus expectations.[279]

The Harris article, *Required Rates of Return*, cited by Opinion No. 414-B, similarly supports the use of a survey of multiple analyst growth projections, such as IBES, for the DCF growth projection. In addition, Harris and Marston concluded in *Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts* that use of IBES growth

[278] As MISO TOs point out, the Commission has recognized that in a few instances an IBES growth projection may be based on the projection of a single analyst. MISO TOs Rehearing Request at 16 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 71-72). However, the fact that a few of the IBES growth projections may not represent the consensus of more than one analyst or institution's growth projection does not justify shifting to a source of growth projections in which none of the growth projections reflect a consensus of more than one analyst or institution's growth projection. For the reasons discussed above, we believe it is appropriate to use as many consensus growth projections as possible, and participants are free to propose alternatives to IBES to the extent they may provide more robust consensus projections.

[279] Morin at 302.

projections offer "a straightforward and powerful aid in establishing required rates of return either for corporate investment decisions or in the regulatory arena."[280]

127. The record in these proceedings includes testimony to the same effect. For example, CAPs' witness, Mr. Gorman, stated, "Because IBES captures a greater number of analysts' growth rate projections, it more likely reflects the information used by investors to form investment decisions."[281] Similarly, Trial Staff's witness, Mr. Keyton, stated, "I believe that IBES growth estimates have a higher potential for representing a broader consensus in the investor community."[282] Thus, we believe it is appropriate to use IBES as the short-term growth projection, not simply because investors use IBES, but also because the consensus growth projection reported by IBES reflects the information which the analysts, brokerage and investments firms contributing to IBES provide to their clients.

128. We also find that the IBES growth projections are generally more timely than the *Value Line* projections. IBES updates its data base on a daily basis as participating analysts revise their forecasts,[283] whereas *Value Line* publishes its projections on a rolling quarterly basis.[284] Thus, the IBES consensus growth projection will immediately reflect any change a contributing analyst makes in its forecast. However, *Value Line* will not reflect such changes until its next quarterly report. MISO TOs suggest that some analyst projections reflected in the IBES consensus projections may be stale, whereas *Value Line*'s quarterly publication schedule guarantees that all analyst projections are updated on a quarterly basis. However, the record indicates that IBES has a policy of retaining each analyst's estimate in its data base for only 180 days.[285] Although some questions have been raised as to whether *Yahoo Finance* always follows this policy, in this case the evidence indicates that the IBES growth projections for the proxy companies are regularly updated. For example, the IBES growth projections of 26 of the 30 companies

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[280] Robert S. Harris & Felicia C. Marston, *Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts*, Fin. Mgmt., Summer 1992, at 6.

[281] Ex. ICG-15 at 10 (II).

[282] Ex. S-1 at 112 (II).

[283] As testified by Mr. Solomon, *Yahoo Finance*, which publishes IBES, "update[s] it daily as any of the growth rates that it accesses changes." Hearing Transcript (II) at 31.

[284] Ex. MTO -22 (II) at 79.

[285] Hearing Transcript (II) at 128.

that are in the proxy groups for both the First and Second Complaint proceedings changed in the course of the six months between the dates when the IBES projections were downloaded.[286]

129. MISO TOs also contend that the Commission has relied on *Value Line* growth forecasts in its public utility rate of return cases in the past.[287] However, in each of the cases cited by MISO TOs, *Value Line* data was used for the purpose of implementing the "br + sv" growth formula[288] which the Commission previously used as part of the one-step DCF model, but the Commission discontinued using that model in Opinion No. 531. The Commission used *Value Line* data, rather than IBES data, for the purpose of implementing the br + sv formula, because not all of the necessary data is published by IBES. In any event, the Commission also consistently used IBES growth projections as a second growth projection as part of its one-step DCF method.[289]

130. MISO TOs suggest that IBES growth projections could be overly optimistic, because analysts contributing to those projections may be selling the stocks that they are reporting on, whereas *Value Line* is an independent research firm not engaged in buying and selling stocks.[290] The Commission disagreed with this contention in Opinion No. 414-B, stating that analysts have a significant incentive to make their analyses as accurate as possible to meet the needs of their clients.[291] Investors will not utilize brokerage firms whose analysts repeatedly overstate the growth potential of companies. Moreover, there is no evidence in these proceedings that analysts contributing to IBES

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[286] Compare the IBES growth projections in the MISO Initial Decision, 153 FERC ¶ 61,027, App. B to the IBES growth projections in Ex. MTO-34 (II) at 1.

[287] MISO TOs Br. on Exceptions at 14 (citing, e.g., *RiteLine Ill., LLC*, 137 FERC ¶ 61,039 (2011), *reh'g denied*, 149 FERC ¶ 61,238 (2014); *N. Pass Transmission LLC*, 134 FERC ¶ 61,095 (2011); *Bangor Hydro-Elec. Co.*, 122 FERC ¶ 61,265 (2008); *So. Cal. Edison Co.*, Opinion No. 445, 92 FERC ¶ 61,070, at 61,263 (2000).

[288] Under that formula, "b" is the expected retention formula, "r" is the expected earned rate of return on common equity, "s" is the percent of common equity expected to be issued annually as new common stock, and "v" is the equity accretion rate.

[289] *See, e.g.*, *RiteLine Ill., LLC*, 137 FERC ¶ 61,039, at P 68; *N. Pass Transmission LLC*, 134 FERC ¶ 61,095, at P 46; *Pub. Serv. Elec. & Gas Co.*, 126 FERC ¶ 61,219, at P 62 (2009); Opinion No. 445, 92 FERC at 61,265.

[290] MISO TOs Rehearing Request at 17 n. 44.

[291] Opinion No. 414-B, 85 FERC at 62,270.

provide more optimistic growth projections, than *Value Line* analysts. In fact, the *Value Line* growth rates tend to be higher than those of IBES. For instance, in the Second Complaint, where the MISO TOs seek to use *Value Line* instead of IBES data, use of the former instead of the later would increase the midpoint of their proposed DCF zone of reasonableness by 77 basis points from 8.73 percent to 9.50 percent.[292]

131. Finally, MISO TOs contend that the Presiding Judge in the Second Complaint proceeding erred in rejecting their contention that the *Value Line* short-term growth projection should be used, because the resulting DCF midpoint and upper midpoints (9.50 and 10.89 percent) are closer to the results of the alternative methodologies than the DCF midpoint and upper midpoint produced using IBES growth projections (8.72 and 9.70 percent).[293] The Commission denies this exception. In this order, we are deciding to use only the DCF and CAPM models to determine public utility ROEs. Therefore, the fact that using *Value Line* growth projections may produce results closer to the ROEs proposed by MISO TOs based on the Expected Earnings and Risk Premium models is irrelevant. More significantly, we find that the DCF and CAPM models should be implemented independently of one another. They are separate models based on different assumptions and inputs. We have no basis to find either model more reliable than the other. Therefore, there is no reason to decide issues concerning the implementation of either model based upon which resolution produces an ROE closest to the ROE produced by the other model.

132. The Commission has discretion in this proceeding to make a determination about available data sources in calculating the DCF. In making this determination, we agree with Trial Staff that it is preferable for the Commission to use a consistent source of dividend growth, such as IBES, for projections for all members of the proxy group.[294] Furthermore, we again note that the Commission has historically relied on IBES as the preferred source for computing short-term growth rates.[295]

133. MISO TOs also ask the Commission to leave open the ability of parties to propose appropriate alternatives to IBES, including *Value Line.* Parties are free to propose whatever data sources they deem appropriate. However, absent compelling reasons why, we will continue to rely exclusively on IBES as the preferred source for short-term growth projections for the purpose of performing the DCF analysis. Moreover, while this order lays out changes to the Commission's method for determining the ROE, wherever

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[292] Ex. MTO-34 (II).

[293] Initial Decision (II), 155 FERC ¶ 63,030 at P 39.

[294] Trial Staff Reply Br. at 15-16 (citing Ex. 531-B at P 72).

[295] Trial Staff Reply Br. at 16.

possible, we seek to provide predictability. Such predictability would be undermined if, in each proceeding, parties cherry pick whichever data best supports their desired results, leaving the Commission to adjudicate which is superior in each proceeding. Although MISO TOs have offered arguments to suggest that *Value Line* is a comparable source, the record in this proceeding still indicates that IBES is more stable and robust because IBES represents the views of multiple analysts and is updated more frequently.

D. Long-Term Growth Projection

134. As described above, the Commission's current policy is to require the DCF analysis of an individual company to include a projection of the long-term growth in dividends based on the growth in gross domestic product (GDP). The long-term growth projection is given one-third weight, with a short-term growth projection given two-thirds weight. For the reasons we discuss below, the Commission reaffirms this policy and will continue to require a long-term growth projection in the DCF analysis.

1. Opinion No. 551

135. During the hearing in the First Complaint proceeding, the MISO TOs, CAPs, and Trial Staff all presented DCF studies that included long-term growth projections based on growth in GDP, consistent with Commission policy. The Presiding Judge approved the 4.39 percent GDP growth projection included in Trial Staff's DCF study, reasoning that its method of calculating the growth rate most closely paralleled that which the Commission used in Opinion No. 531.[296] Thereafter, when the Initial Decision was considered by the Commission, no exceptions were raised by any party regarding the Presiding Judge's rulings concerning the long-term growth projection. The Commission approved the DCF study with a long-term growth projection in Opinion No. 551,[297] and no issue concerning the use of long-term growth projections in the DCF study was raised on rehearing of Opinion No. 551.

2. Second Complaint Proceeding

136. In the Second Complaint proceeding, the participants, including the MISO TOs, again all presented DCF studies that included long-term growth projections based on growth in GDP, and the Presiding Judge again adopted Trial Staff's long-term growth projection of 4.35 percent. No party filed an exception to the Presiding Judge's finding on this issue.

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[296] Initial Decision (I), 153 FERC ¶ 63,027 at PP 51-53.

[297] Opinion No. 551, 156 FERC ¶ 61,234 at P 65.

3. Initial Briefs

137. In their Initial Brief in response to the Briefing Order, MISO TOs assert that, when the Commission adopted the two-step DCF method for electric utilities in Opinion No. 531, the Commission concluded that the long-term growth rate portion of that method moderates the estimated cost of equity, rendering a high-end outlier test unnecessary.[298] MISO TOs accordingly oppose the high-end outlier test proposed in the Briefing Order. However, they state that, if the Commission nevertheless applies a high-end outlier test to the DCF model, then it should employ a single-stage, constant growth DCF, rather than a two-stage DCF, and eliminate the long-term growth projection.[299]

138. The MISO TOs contend that there are significant shortcomings in using GDP growth rates as part of the DCF analysis. MISO TOs' witness, Mr. McKenzie, comments that practical application of the DCF model requires a growth estimate that matches investors' expectations, which he asserts is less than the 30 year horizon for GDP growth estimates.

139. MISO TOs assert that there are no utility-specific, long-term growth projections available to the public. Therefore, although the DCF model is supposed to reflect investor behavior, it includes GDP growth estimates that investors do not use. As a result, this approach gives greater weight to the theory that all firms' growth rates converge to long-term GDP growth over actual investor behavior.[300]

140. MISO TOs assert that GDP growth estimates understate investors' expectations for electric utility growth and fall well short of analysts' estimates of the proxy companies' growth rates during the study periods in these proceedings.[301] Mr. McKenzie asserts that actual historical growth rates for certain individual proxy companies refute the notion that the long-term growth of electric utilities is constrained by GDP. For example, he states that *Value Line* reports included in the First Complaint proceeding record indicate that Alliant Energy and Eversource Energy had a 10-year earnings per share growth rate of 8 percent, while OGE Energy and IDACORP, Inc., had 10-year

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[298] MISO TOs Initial Br. (I) at 16 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 118).

[299] *Id.* at 20 (citing App. 2 McKenzie Aff. (I) at 50-51).

[300] *Id*. at 20-21 (citing App. 2 McKenzie Aff. (I) at 42-43).

[301] *Id*. at 21 (citing App. 2 McKenzie Aff. (I) at 47). MISO TOs Initial Br. (II) at 36 (citing App. 2 McKenzie Aff. (II) at 43-44).

earnings per share growth rates of 8.5 percent and 9.0 percent respectively.[302] Mr. McKenzie also states that *Value Line* reports in the Second Complaint proceeding record indicate that ALLETTE, Eversource Energy, OGE Energy, and IDACORP had 10-year earnings per share growth rates of 7.0 percent, 8.0 percent, 8.5 percent, and 9.0 percent, respectively.[303] MISO TOs explain that Myron Gordon, the founder of the DCF model, believed that it should use growth estimates that correspond to investor expectations, and he was dubious about incorporating long-term growth rates into the DCF model.[304]

141. Also, the MISO TOs state that, according to Mr. McKenzie, the instant case does not present the kind of circumstances that might support using a two-step DCF with long-term growth estimates.[305] Mr. McKenzie states that when the Commission adopted the two-step DCF model for natural gas pipelines, the IBES short-term growth projections for those pipelines were substantially higher than the projected growth in GDP. For example, in *Transcontinental Gas Pipe Line Corp*., the IBES growth rates for the proxy group ranged from 8.0 percent to 15.0 percent and averaged 11.3 percent.[306] However, in the First Complaint proceeding, the IBES growth projections of all but one of the proxy companies are less than 8.0 percent,[307] and in the Second Complaint proceeding the IBES growth projections of all but two of the proxy companies are less than 8.0 percent.[308] Therefore, Mr. McKenzie asserts that there is no evidence in these proceedings that analysts' short-term earnings per share growth projections for electric utilities are characterized by the short-term optimism that led the Commission to adopt the two-step DCF model for natural gas pipelines. Mr. McKenzie also states that evidence presented by CAPs that electric utilities have entered a cycle of significant capital spending on

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[302] MISO TOs Initial Br. (I), App. 2 McKenzie Aff. (I) at 47.

[303] MISO TOs Initial Br. (II), App. 2 McKenzie Aff. (II) at 43-44.

[304] MISO TOs Initial Br. (I) at 21; *id.*, App. 2 McKenzie Aff. (I) at 49 (citing Myron J. Gordon, The Cost of Capital to a Public Utility, 100-01 (MSU Pub. Util. Studies 1974)).

[305] *Id*. at 21 (citing App. 2 McKenzie Aff. (I) at 48-51).

[306] MISO TOs Initial Br. (I), App. 2 McKenzie Aff. (I) at 50 (citing Opinion No. 414-A, 84 FERC ¶ 61,084 at App. A).

[307] MISO TOs Initial Br. (I), App. 2 McKenzie Aff. (I) at 51 n.111.

[308] MISO TOs Initial Br. (II), App. 2 McKenzie Aff. (II) at 48 n.97.

utility infrastructure suggests that GDP growth estimates understate investors' growth expectations for electric utilities.[309]

4. Reply Briefs

142. In their Reply Briefs, CAPs, Trial Staff and RPGI addressed issues raised by the MISO TOs. These three parties oppose MISO TOs' proposal to use a single-stage, constant growth DCF, rather than the two-step DCF method if the Commission applies a screen for high-end outliers.[310] RPGI asserts that over time the Commission has adopted and expanded its preference for the two-step DCF method, including support for the theoretical assumptions of the DCF formula requiring the use of a two-stage growth component.[311] CAPs argue that it is important to use an accurate representation of long-term dividend stream that investors expect, regardless of the tests used to filter outliers. CAPs also argue that, because MISO TOs are not proposing to filter out any DCF high-end results from the study-period analysis in this proceeding, they are essentially conceding that in this case the DCF model should apply a two-step composite growth rate.[312]

143. Moreover, in response to MISO TOs' assertion that the DCF model requires a growth estimate that matches investors' expectations, CAPs assert that this is a reason to use the long-term GDP constraints on analysts' projected rate of near-term growth in earnings per share. CAPs state that rational investors know what Dr. Roger Morin explains in his textbook: that utility holding companies seek to keep dividend growth on a path they can sustain over the long term to avoid having to cut dividends when earnings are down.[313] CAPs comment that the Commission recognized the importance of factoring in long-term growth even before Opinion No. 531,[314] but now MISO TOs are

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[309] MISO TOs Initial Br. (I), App. 2 McKenzie Aff. (I) at 47-48, 51.

[310] *See* CAPs Reply Br. (I) at 9; Trial Staff Reply Br. (I) at 18-19; RPGI Reply Br. (I) at 20-21.

[311] RPGI Reply Br. (I) at 21 (citing *Ozark Gas Transmission Sys.*, 68 FERC at 61,105-07; *Wyoming Interstate Co.*, 69 FERC ¶ 61,259 (1994); *Nw. Pipeline Corp.*, 71 FERC ¶ 61,253, at 61,992 (1995)).

[312] CAPs Reply Br. (I) at 9.

[313] CAPs Reply Br. (I) at 10 (citing Morin at 284).

[314] Opinion No. 531, 147 FERC ¶ 61,234; Opinion No. 531-A, 149 FERC ¶ 61,032; Opinion No. 531-B, 150 FERC ¶ 61,165.

proposing to eliminate consideration of whether the growth projected by analysts for the next three-to-five years is sustainable over the long term. Further, CAPs argue that, consistent with its findings in Opinion No. 531, the Commission factored in a long-term growth projection in Opinion No. 551, and MISO TOs' did not seek rehearing.[315]

144. CAPs comment that Mr. McKenzie does not provide evidence to support his claim that investors do not rely on estimates of GDP growth in evaluating growth expectations for utility stocks.[316] CAPs state that Warren Buffet, who they say may be both the largest and most followed individual investor in U.S. electric utilities, has made clear that he expects stocks' long term earnings growth to be constrained by GDP growth.[317]

145. Further, CAPs dispute MISO TOs' reliance on the fact that in the First Complaint proceeding four of the proxy companies had 10-year earnings per share growth rates averaging 8.4 percent and in the Second Complaint proceeding four proxy companies had 10-year earnings per share growth rates averaging 8.1 percent. CAPs argue that, because the DCF model "turns" on investors' expected stream of dividend receipts, the growth in dividends over the last 10 years is more meaningful than growth in earnings per share. CAPS assert that in the First and Second Complaint proceedings the growth in dividends for the four proxy companies in question averaged less than 3.9 percent and 4.9 percent respectively.[318] Also, CAPs contend that Mr. McKenzie's focus on four proxy companies was cherry-picking. CAPs point out that in the First and Second Complaint proceedings, just looking at the top of the alphabet, one could equally point to the low 10-year earnings per share growth rates of American Electric Power (1.5 percent), Ameren (-2.0 percent), CenterPoint Energy (2.0 percent), and Consolidated Edison (3.5 percent).[319]

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[315] *See* CAPs Reply Br. (I) at 11.

[316] *Id.*

[317] *Id.* (citing Fortune, "Mr. Buffet on the Stock Market," Fortune, November 22, 1999), https://money.cnn.com/magazines/fortune/fortune_archive/1999/11/22/269071/ ("You know, someone once told me that New York has more lawyers than people. I think that's the same fellow who thinks profits will become larger than GDP. When you begin to expect the growth of a component factor to forever outpace that of the aggregate, you get into certain mathematical problems.").

[318] *Id.* at 12; CAPs Reply Br. (II) at 27.

[319] CAPs Reply Br. (I) at 12 (citing Ex. JC-10 at 44, 45, 48, 50). CAPs Reply Br. (II) at 27-28 (citing Ex. JCI-9 at 60, 61, 63 & 65).

146. MISO TOs argue that capital expenditures forecast in 2018 for 2018 imply higher long-term growth. In response, CAPs assert that the Commission should not accept Mr. McKenzie's view that capital investment can generate profit expansions that will long exceed GDP growth.[320] CAPs first argue that the relevance of this report in ascertaining the cost of equity during the study periods in these proceedings is not clear, because the April 2018 Regulatory Research Associates report uses data that post-dates both study periods. In any event, CAPs state that the referenced report indicates that capital expenditures of the covered electric industry holding companies will shrink from 2018 to 2020 to a level below that of 2016. CAPs also state that the Commission's composite-growth method giving two-thirds weight to the IBES short-term growth projection already assumes that near-term growth will continue for decades. Further, CAPs assert that the real focus of the DCF model is the expected rate of growth in dividends per share and that the near-term growth rate is better projected by factoring in long-term GDP growth, because electric utilities seek to keep dividend growth on a path they can sustain over the long run. CAPs argue that the resulting moderation of earnings growth in realized dividend growth can be seen by comparing past earnings per share (EPS) growth projections to actual dividend per share growth.[321]

147. CAPs dispute MISO TOs' reliance upon a 1974 publication expressing skepticism about the use of the two-stage DCF model. They argue that in the intervening decades the DCF model has been widely adopted and refined. They cite to Dr. Morin, author of a text cited by the Commission in the Briefing Order, as supporting "[a] multiple-stage DCF model that better mirrors the patterns of future dividend growth," and recognizing that "[a] transition must occur between the first stage of growth forecast by analysts for the first five years and the company's long-term sustainable growth rate."[322]

148. CAPs disagree with MISO TOs' argument that the two-stage DCF was appropriate in the 1990s when electric utilities were transitioning to non-regulated markets, but that expectations of widespread deregulation no longer exist. CAPs explain that in fact the

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[320] MISO TOs Reply Br. (I) at 12-13 (citing *S&P Global Market Intelligence, RRA Financial Focus – Utility Capital Expenditures Update,* Regulatory Research Associates (Apr. 20, 2018)).

[321] CAPs Reply Br. (I) at 12-14. CAPs witness, Mr. Gorman, provides a comparison of the 2015 projections of three-to-five year EPS growth that are the basis for the composite growth rate used in Opinion No. 551 to the DPS growth rate between then and now. These companies' projected EPS growth rate averaged 5.15 percent, whereas their realized DPS growth rate averaged 3.83 percent. CAP witness Gorman Ex. JC-109 at 1.

[322] CAPs Reply Br. (I) at 14 (quoting Morin at 309).

Commission used a one-stage DCF model for electric utilities during the transitional period,[323] but that in Opinion No. 531, the Commission determined that it was no longer appropriate to consider the transitional period of deregulation as the basis for assuming utility stocks' near-term growth rates would continue indefinitely.[324]

149. CAPs argue that MISO TOs mischaracterize the testimony of Dr. J. Randall Woolridge before the Virginia State Commission as supporting the constant growth DCF model for DCF valuation procedures. CAPs argue that, in fact, Dr. Woodridge opposed basing DCF growth rate solely on analysts' projections of the near-term EPS growth.[325]

150. Trial Staff comments that their expert witness, Mr. Keyton, disagrees with McKenzie's elimination of the long-term growth component in the DCF. Trial Staff cites to the Commission's determination in *Williston Basin Interstate Pipeline Company* and Opinion No. 531 rejecting the one-step or constant growth DCF model in favor of a two-step DCF model.[326] Trial Staff also relies upon Dr. Morin who supports incorporating a long-term growth estimate in the DCF model and who was the Commission's authority for the conclusion that "all company growth rates, especially utility service growth rates, converge to a level consistent with the growth rate of the aggregate economy."[327] Mr. Keyton also notes that Professors Brigham and Ehrhardt support the use of longer term growth rates.[328]

5. Commission Determination

151. We disagree with MISO TOs' contention that the Commission should eliminate the long-term growth projection based on GDP from its DCF analysis of electric utilities. As the Commission held in Opinion No. 531,

> The DCF model is based on the premise that an investment in common stock is worth the present value of the infinite stream of future dividends discounted at a market rate

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[323] *Id.* at 15 (citing Opinion No. 445, 92 FERC at 61,266).

[324] *Id.* (citing Ex. JC-108 at 24).

[325] *Id.* at 16-17. (CAPs question the relevance of this testimony in an unrelated proceeding. *Id.*)

[326] Trial Staff Reply Br. (I) at 18.

[327] *Id.* at 19 (quoting Opinion No. 531, 147 FERC ¶ 61,234 at P 36 n.63).

[328] *Id.*

> commensurate with the investment's risk.[329] Corporations have indefinite lives and therefore will pay dividends for an indefinite period. For that reason, the Commission stated as long ago as 1983, when it first adopted the constant growth DCF model for gas pipeline cases, that 'projections by investment advisory services of growth for relatively short periods of years into the future' cannot be relied on 'without further consideration.' Thus, as the Commission held in *Ozark*, the constant growth DCF model requires consideration of long-term growth projections.[330]

152. MISO TOs have not provided a persuasive basis for us to depart from this policy. Although MISO TOs cite a 1974 article by Myron Gordon arguing that analysts' short-term growth projections may be used without reference to a longer-term projection, more recent academic works support inclusion of a long-term growth projection based on GDP. For example, in *New Regulatory Finance*, Roger Morin recognizes that there is a growing consensus that security analysts' growth projections are "the best place to start" in projecting growth in dividends. However, he continues,

> The problem is that from the standpoint of the DCF model that extends into perpetuity, analysts' horizons are too short, typically five years. It is often unrealistic for such growth to continue into perpetuity. A transition must occur between the first stage of growth forecast by analysts for the first five years and the company's long-term sustainable growth rate . . . It is useful to remember that eventually all company growth rates, especially utility service growth rates, converge to a level consistent with the growth rate of the aggregate economy.[331]

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[329] As the Commission explained, "The DCF model assumes growth for an infinite period of time. This can be approximated as 50 years because the present value of a one dollar dividend received 50 years in the future, discounted at 12 percent, is less than one cent." *Ozark Gas Transmission Sys.*, 68 FERC at 61,105 n.32 (citing Eugene F. Brigham & Louis C. Gapenski, Financial Management 291 (1991)).

[330] Opinion No. 531, 147 FERC ¶ 61,234 at P 33 (quoting *Consol. Gas Supply Corp.*, 24 FERC ¶ 61,046, at 61,105 (1983)) (footnotes omitted).

[331] Morin at 308.

Dr. Morin goes on to state that one way to account for the two stages of growth is to adopt a blended growth rate as the Commission does, giving two-thirds weight to analysts' five-year growth projections and one-third weight to long-range projections of growth in GDP projected for the very long-term.[332]

153. MISO TOs argue that, regardless of the fact that the underlying theory of the DCF model requires a long-term growth projection, as a practical matter investors rely solely on short-term growth projections, such as the IBES three-to-five year growth projections. MISO TOs assert that there are no long-term projections of the growth of public utilities and therefore investors must be limited to using short-term growth projections. However, MISO TOs fail to counter evidence that sophisticated investors do in fact consider long-term economic trends, including long-term growth in GDP, when estimating the future growth in earnings or dividends. For example, CAPs note that Warren Buffet has made clear that he expects firms' long-term earnings growth to be limited by GDP growth, stating,

> You know, someone once told me that New York has more lawyers than people. I think that's the same fellow who thinks profits will become larger than GDP. When you begin to expect the growth of a component factor to forever outpace that of the aggregate, you get into certain mathematical problems.[333]

154. MISO TOs nevertheless assert that GDP does not constrain the growth in earnings of electric utilities, stating that the record in the First Complaint proceeding contains *Value Line* reports showing that four electric utilities had earnings per share growth rates over the previous 10 years of 8 to 10 percent, and the record in the Second Complaint proceeding contains similar *Value Line* reports showing that four electric utilities had earnings per growth rates of 7 to 9 percent. MISO TOs point to the proxy group companies featuring the highest growth rates, while the growth rates of the overall proxy group contradict their position. The First Complaint proceeding record includes *Value*

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[332] *Id*. at 309. In *Corporate Finance, A Focused Approach*, at 279 (Fourth Edition), Ehrhardt and Brigham also state "dividend growth for most mature firms is generally expected to continue in the future at about the same rate as nominal gross domestic product (real GDP plus inflation)," and they also discuss a blended approach for determining the growth projection for the constant growth DCF model when the short-term growth projection is unsustainable. *Id*. at 324.

[333] "Mr. Buffet on the Stock Market," *Fortune*, November 22, 1999.

Line reports showing the average 10-year earnings growth rates for 41 electric utilities.[334] The median 10-year earnings growth rate for all 41 electric utilities was 3.5 percent, which is less than the long-term projected nominal GDP growth rate of 4.39 percent in that proceeding. Similarly, the Second Complaint proceeding record includes *Value Line* reports showing the average 10-year earnings growth rates for 30 electric utilities.[335] The median 10-year earnings growth rate for all 30 of those electric utilities is also 3.5 percent, which is less than the long-term projected nominal GDP growth rate of 4.35 percent in that proceeding. Thus, a review of all the *Value Line* reports in the exhibits cited by the MISO TOs indicates 10-year earnings growth more in line with the growth of the economy as whole.

155. In any event, the fact some electric utilities may maintain earnings growth in excess of GDP for periods of 10 years or more is not inconsistent with the Commission's two-step DCF model. As the Commission has previously explained, our two-step DCF model does not assume that an electric utility's growth rate will immediately drop to the GDP growth rate following the fifth year of the IBES short-term growth projection. "Our decision to give the IBES data two-thirds weight and the long-term projection one-third weight is the equivalent, in a 50-year model, of averaging 33 years at the higher IBES number and 17 years at the lower GDP number."[336] Therefore, the fact some electric utilities may have earnings growth in excess of the growth in GDP for periods of 10 years or more is not inconsistent with our holding that GDP is appropriate as a long-term growth rate given one-third weight.

156. MISO TOs also argue investors may expect public utilities to have earnings and dividend growth in excess of GDP, pointing to several reports that public utility capital expenditures are expected to increase. For example, MISO TOs cite a 2014 S&P report, stating among other things, "[b]eginning in 2017, we expect the industry's generation and overall capital spending needs to pick up significantly, consistently exceeding $100 billion annually."[337] In addition, they cite a 2018 report stating, "[f]orecasted 2018 capital expenditures for the 52 electric and gas utilities in the RRA universe climbed to

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[334] Ex. JCI-109 (I) at 42-86.

[335] Ex. JCI-109 (II) at 58-90.

[336] *Williston Basin Interstate Pipeline Co.*, 87 FERC ¶ 61,264 at 62,004 (1999). *See also Williston Basin Interstate Pipeline Co.*, 84 FERC ¶ 61,081 at 61,384-85 (1998).

[337] Standard & Poor's Corporation, *The Outlook for U.S. Regulated Utilities Remains Stable on Increasing Capital Spending and Robust Financial Performance*, RatingsDirect (Dec. 16, 2014) (2014 S&P Report).

an all-time high of $141.1 billion."[338] MISO TOs' reliance on these reports is unavailing. These reports relate to the public utilities' capital spending in the relatively near future, within a time frame during which, as discussed in the preceding paragraph, the two-step DCF model assumes growth consistent with the IBES growth projection. Therefore, these reports do not undercut the underlying rationale of the two-step DCF model that firms cannot grow faster than GDP over the indefinite long-term. Moreover, the 2018 S&P report was issued over two years after the financial study periods in the two complaint proceedings, the second of which ended on December 31, 2015, and therefore that report could not affect investor expectations during the time periods at issue in these proceedings. In any event, as CAPs point out, the 2018 S&P report indicates that capital expenditures of the covered electric industry holdings companies will shrink from 2018 to 2020 to a level below that of 2016.[339]

157. MISO TOs also seek to distinguish electric utilities from natural gas pipelines with respect to the need for a long-term growth projection. They argue that the IBES short-term growth projections of electric utilities are generally lower than natural gas pipeline IBES growth projections in the cases where the Commission first adopted the two-step DCF model. Opinion No. 531 recognized that the IBES growth projections of electric utilities reflect a different pattern from those of natural gas and oil pipelines. Although pipeline IBES growth projections are consistently higher than the long-term growth of GDP, that is not true of electric utilities.[340] Nevertheless, Opinion No. 531 adopted the two-step DCF model for electric utilities. The Commission pointed out that it had held that giving some effect to the long-term growth projection will aid in normalizing any distortions that might be reflected in short-term data limited to a narrow segment of the economy.[341] Opinion No. 531 concluded that this reasoning applied

> regardless of whether the short-term growth projection is greater or less than the growth of the economy as a whole.

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[338] S&P Global Market Intelligence, *RRA Financial Focus – Utility Capital Expenditures Update*, Regulatory Research Associations (Apr. 20, 2018) (2018 S&P Report).

[339] See 2018 S&P Report, Table 1 ("Total Electric" Cap Ex of $93.6 million in 2016A, $106.6 million in 2018E, and $86.2 million in 2020E, its most distant prediction.).

[340] Opinion No. 531, 147 FERC ¶ 61,234 at P 30 (citing *S. Cal. Edison Co.*, 92 FERC at 61,261).

[341] Opinion No. 531, 147 FERC ¶ 61,234 at P 38 (citing Opinion No. 414-A, 84 FERC at 61,423).

> Over the long-run, a regulated firm may reasonably be expected to grow at the rate of the average firm in the economy; growth either significantly above or below the growth of the economy as a whole is unlikely to continue indefinitely. Using the same long-term growth projection for all public utilities is consistent with this expectation.[342]

158. In any event, regardless of the fact that the IBES growth projections of a number of public utilities are less than or about equal to projected growth in GDP, the IBES growth projections of the public utility proxy companies that set the top of the DCF zone of reasonableness in both proceedings are substantially above projected growth in GDP. In the First Complaint proceeding, TECO Energy (TECO) sets the top of the zone of reasonableness. The IBES short-term growth projection for TECO is 7.68 percent, 329 basis points above the long-term GDP growth projection of 4.39 percent.[343] In the Second Complaint proceeding, PNM Resources, Inc. (PNM) sets the top of the zone of reasonableness. The IBES short-term growth projection for PNM is 9.30 percent, over twice the long-term GDP growth projection in that case of 4.35 percent.[344] Thus, these public utilities present the same circumstances as the pipelines in the cases where the Commission adopted the two-step DCF method – IBES short-term growth projections substantially in excess of GDP growth. Because we determine the central tendency of the zone of reasonableness using the midpoint, it is particularly important that the ROEs of the companies setting the top of the zone be determined consistent with the underlying theory of the DCF model, requiring use of a long-term growth projection.

159. Finally, MISO TOs assert that, if the Commission applies a high-end outlier test to the DCF model, there will remain no rationale for requiring the long-term growth component of the two-step DCF model. The existence of the high-end outlier test is irrelevant to the question of whether a long-term growth projection should be included in a DCF analysis of public utilities. The high-end outlier tests eliminates outlier proxy group members. It does not address the fact that, over the long-term, companies cannot maintain their short-term growth rates and must, to some extent, converge on the growth rate of the overall economy. Furthermore, the high-end outlier test we adopt later in this order does not screen out any of the ROEs produced by the DCF analysis of the proxy groups in these two cases, including the ROE results discussed above that establish the top of the zones of reasonableness in these two cases.

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[342] *Id.*

[343] Initial Decision (I), 153 FERC ¶ 63,027 at App. B.

[344] CAPs Initial Br. (II) at App. I.

E. Has DCF Performed Inconsistently with Underlying Theory

160. In both Opinion Nos. 531 and 551, the Commission found that, because of unusual capital market conditions, the Commission had "less confidence" that the midpoint of the zone of reasonableness determined by the DCF analysis satisfied the *Hope* and *Bluefield* capital attraction standards.[345] For example, in Opinion No. 551, the Commission stated that bond yields remained at historically low levels during the January to June 2015 study period in the First Complaint proceeding. The yield on 10-year U.S. Treasury bonds, which the Commission noted in Opinion No. 531[346] was below two percent in that case and had not been below three percent since the 1950s, was at 2.07 percent during the Opinion No. 551 study period.[347] Also, the yield on short-term U.S. Treasury bonds was historically low, ranging from zero to 0.25 percent.[348]

161. Opinion No. 551 then considered the alternative cost of equity models to corroborate the Commission's determination to set MISO TOs' ROE "at a point above the midpoint" of the DCF analysis' zone of reasonableness, i.e., the midpoint of the upper half of the zone.[349] However, the Commission emphasized that it was not departing from the use of the DCF methodology to determine the zone of reasonableness.[350] At the hearings on the Second Complaint, the participants devoted a substantial portion of their evidentiary presentations to debating whether the continuing low-interest rate capital market conditions should be considered "anomalous" and whether those conditions distort the results of a DCF analysis.[351]

162. In the Briefing Order, the Commission stated that those issues are largely irrelevant under the Briefing Order's proposed approach to determining just and

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[345] Opinion No. 531, 147 FERC ¶ 61,234 at P 145; Opinion No. 551, 156 FERC ¶ 61,234 at P 119.

[346] Opinion No. 531, 147 FERC ¶ 61,234 at P 145 n.285.

[347] Opinion No. 551, 156 FERC ¶ 61,234 at P 121.

[348] *Id.*

[349] *Id.* P 135.

[350] *Id.* P 137.

[351] *See, e.g.*, Exs. JCA-1 at 6-18, JCI-1 at 29-32, 38, ICG-15 at 18-30, MTO-1 at 21-28, 102-105, MTO-16 at 16-38.

reasonable ROEs.[352] The Commission stated that, under this approach, it would average the cost of equity results produced by the DCF model with the results produced by the other proposed models, using the midpoint/medians of the models that produce zones of reasonableness, to get one average figure for the cost of equity. Therefore, the Commission would not be making an adjustment above the midpoint/median as it did in Opinion No. 551. The Commission stated that, as a result, there was no need to find that low-interest rate capital market conditions distort the results of a DCF analysis so as to justify adjusting the ROE for average risk utilities above the midpoint. To the contrary, the Commission's primary reason for proposing to average the results of the DCF analysis with the results of other models is that investors use those models, in addition to the DCF methodology, to inform their investment decisions. The Commission concluded that, under this approach, whether a change in the capital market conditions is anomalous or persistent is of less importance, because relying on multiple financial models makes it more likely that the Commission's decision would accurately reflect how investors are making their investment decisions.

163. Nevertheless, the Commission noted that, in recent years, utility stock prices appear to have performed in a manner inconsistent with the theory underlying the DCF methodology.[353] The Commission stated that, under that 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. However, the Commission stated that, although the Dow Jones Utility Average increased by almost 70 percent from October 1, 2012 through December 1, 2017, there was not an increase in either utility earnings or projected earnings during that period that would justify the substantial increase in stock prices. The Commission stated that this is an example of what MISO TOs have described as "model risk" —the risk that in some circumstances a model will produce results that do not reflect real world experience.[354] The Commission stated that

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[352] Briefing Order, 165 FERC ¶ 61,118 at P 46.

[353] *Id*. P 47.

[354] *Id*. (citing Ex. MTO-16 (II) at 36) ("There is 'model risk' associated with the excessive reliance or mechanical application of a model when the surrounding conditions are outside of the normal range. 'Model risk' is the risk that a theoretical model that is used to value real-world transactions fails to predict or represent the real phenomenon that is being modeled. Although the concept of model risk was originally applied to derivative instruments and hedging transactions, it applies equally to models used to value companies, to manage investment portfolios, to assign credit ratings, or in this case, to determine the ROE that will provide a fair return and encourage investment in critical infrastructure.").

it appears that, for whatever the reason, investors have seen greater value in utility stocks than the DCF methodology would predict. The Commission concluded that this suggests that the ROE estimated by that methodology may be correspondingly inaccurate.

1. CAPs

164. CAPs contest the Briefing Order's suggestion that current capital market conditions, including low bond yields, have affected the reliability of the DCF Model.[355] They contend that the Commission failed to support its assertion that utility stock prices appear to have performed in a manner inconsistent with the theory underlying the DCF model. In particular, they state that the Commission's statement that the DCF model assumes that stock prices increase only when there is an actual or projected increase in earnings/dividends is inaccurate. Rather, their witness, Mr. Bertram, explained that "[t]he theory underlying the DCF method is that stock prices can change not only as a result of expected changes in earnings/dividends ("g"), but also due to changes in investors' required rate of return for investing in a company ("k")."[356] Mr. Solomon states that factors influencing the investor's required rate of return include

> expected returns that might be earned on alternative investments, changes in risk perceptions, changes in risk tolerance, changes in a desire for current income versus longer-term capital gains, expectations about inflation, expectations about real interest rates, expectations about the U.S. economy in general and various sectors of the U.S. economy specifically as well as expectations about the global economy, among others.[357]

165. CAPs also point out that, in Order No. 489, the Commission explained that the DCF model does not assume that stock prices are solely a function of current and projected future earnings, stating the DCF model "shows the relationship between stock prices and dividends, growth rate of dividends, and shareholders' required rate of return."[358] Opinion No. 489 stated that the term "k" in the DCF model, representing

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[355] CAPs Initial Br. (I) at 18-21.

[356] Ex. JCI-100 at 22.

[357] *Id*. at 22-23.

[358] CAPs Initial Br. (I) at 20 (quoting *Generic Determination of Rate or Return on Common Equity for Public Utilities*, Order No. 489, FERC Stats. & Regs. ¶ 30,795 at 30,990 (1988) (cross-referenced at 42 FERC ¶ 61,122)). Ex. JCI-100 at 22-25.

shareholders' required rate of return, reflects a number of factors influencing stock prices, "including expectations about the real interest rates, the expected rate of inflation, and the 'risks' associated with owning a particular stock."[359]

166. CAPs assert that the increase in utility stock prices from 2012 to 2017 likely reflected the historically low interest rates the Commission noted in the Briefing Order, as opposed to "model risk." They contend that this conclusion is consistent with the Commission's own statement, quoted by the D.C. Circuit in *Tennessee v. FERC*, that a "drastic drop in interest rates attract[s] capital away from bonds and into stocks, causing a rise in stock prices and a decline in dividend yields."[360]

2. MISO TOs

167. MISO TOs contend that the Briefing Order properly determined that the limitations of the DCF model justify taking a broader perspective to the examination of ROE.[361] For example, they state that the Briefing Order documented that utility stock prices have trended in a manner inconsistent with the basic theory of the DCF model.

168. MISO TOs' witness, Mr. McKenzie, states that the Briefing Order's observation that utility stock prices rose by almost 70 percent without a corresponding increase in utility earnings during the period 2012 to 2017 is not critical to supporting the Commission's proposal to use multiple financial models to determine ROE. However, Mr. McKenzie states that the Briefing Order's observation illustrates that the behavior of investors in the financial markets can depart significantly from the underlying assumptions of the DCF model.[362] He states that the DCF model assumes dividends, earnings, and stock price growth at the same constant rate to infinity, resulting in a constant price/earnings ratio. Mr. McKenzie states that the Briefing Order's observation that utility stocks increased without a corresponding increase in earnings simply indicates that the price/earnings ratio was not constant, contrary to the DCF model's assumptions. He argues that real-world experience contradicts the DCF assumptions, which he claims illustrates that there is no perfect way to estimate the cost of equity and therefore reliance on multiple modes is fully supported.

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[359] *Id*. at 20 (quoting Order No. 489, FERC Stats. & Regs. ¶ 30,795 at 30,990).

[360] 926 F.2d 1206, 1209 (D.C. Cir. 1991) (quoting *Tenn. Gas Pipeline Co.*, 46 FERC ¶ 61,089, at 61,383 (1989)).

[361] MISO TOs Reply Br. (I) at 13-15.

[362] *Id.*, App. 2 McKenzie Reply Aff. (I) at 17-18.

3. Other Parties

169. RPGI contends that the Briefing Order failed to support its assertion that the increase in utility stock prices from 2012 to 2017 was not accompanied by a commensurate growth in earnings per share.[363] RPGI states that, in support of this assertion, the Briefing Order cited the *Coakley* Briefing Order,[364] and that order in turn cited only a single exhibit from the fourth complaint proceeding concerning the New England TOs' ROE.[365] RPGI states that the cited exhibit only contains information concerning utility stock prices and contains no information concerning earnings or projected earnings of any utilities.[366] RPGI also states that the period 2012 to 2017 extends beyond the 2015 test periods in the two MISO complaint proceedings and after the close of the records in these proceedings.

4. Commission Determination

170. As the Commission stated in the Briefing Order, the issue of whether the low-interest rate capital market conditions during 2015 were "anomalous" or may have distorted the results of the DCF model are not relevant to our revised approach to determining just and reasonable ROEs. In Opinion Nos. 531 and 551, the Commission relied on its finding of anomalous capital market conditions to justify setting the New England TOs' and MISO TOs' ROEs at the midpoint of the upper half of the DCF zone of reasonableness, despite the fact that the transmission owners are of average risk and the Commission ordinarily sets the ROE of average risk utilities at the central tendency of the overall zone of reasonableness. Under our revised approach to determining just and reasonable ROEs, we are averaging the results of the DCF and CAPM models to determine a composite zone of reasonableness and setting the ROE of average risk utilities at the central tendency of that composite zone of reasonableness. We are not making an adjustment above the central tendency of the zone of reasonableness as we did in Opinion Nos. 531 and 551. There is thus no need to find that low-interest rate capital market conditions distort the results of a DCF analysis so as to justify increasing the ROE for average risk utilities above the central tendency, and we make no such finding in this order.

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[363] RPGI Initial Br. (I) at 18-20; RPGI Initial Br. (II) at 20-22.

[364] Briefing Order, 165 FERC ¶ 61,118 at P 47 (citing *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 45).

[365] RPGI Initial Br. (I) at 19 (citing Ex. CAP-65 in Docket No. EL16-64-002); RPGI Initial Br. (II) at 22 (citing same).

[366] RPGI Initial Br. (I) at 19; RPGI Initial Br. (II) at 22.

171. Rather, our revised ROE policy rests on a finding that investors use the DCF and CAPM models to inform their investment decisions. Under this approach, whether a change in capital market conditions is anomalous or persistent is of little importance, because relying on multiple financial models makes it more likely that our decision will accurately reflect how investors are making their investment decisions. Moreover, to the extent that investors in fact rely on a financial model, the fact that that model may have defects does not invalidate its use in determining ROE. A key consideration in determining just and reasonable utility ROEs is determining what ROE a utility must offer in order to attract capital, i.e., induce investors to invest in the utility in light of its risk profile. For this purpose, we must look to the methods investors actually use to analyze and compare their investment opportunities, regardless of any flaws in those methods. As the Commission stated in Opinion No. 414-B, "the cost of common equity to a regulated enterprise depends upon what the market expects not upon precisely what is actually going to happen."[367] As we discuss elsewhere in this order, there is no serious dispute that investors use the DCF and CAPM models in making investment decisions. In any event, the application of the CAPM model mitigates some of the model risk that the DCF model may perform poorly in certain circumstances.

VI. Expected Earnings Model

A. Background

172. A comparable earnings analysis is a method of calculating the earnings an investor expects to receive on the book value of a particular stock. The analysis can be either backward looking using the company's historical earnings on book value, as reflected on the company's accounting statements, or forward-looking using estimates of earnings on book value, as reflected in analysts' earnings forecasts for the company.[368] The latter approach is often referred to as an "Expected Earnings analysis." The Expected Earnings methodology provides an accounting-based approach that uses investment analyst estimates of return (net earnings) on book value (the equity portion of a company's overall capital, excluding long-term debt).

173. In Opinion No. 551, the Commission found that the results of MISO TOs' Expected Earnings analysis corroborated its determination that MISO TOs should be awarded an ROE above the midpoint of the zone of reasonableness produced by the DCF analysis.[369] In doing so, the Commission reversed the Presiding Judge's rejection of

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[367] Opinion No. 414-B, 85 FERC at 62,268.

[368] *See* Opinion No. 531-B, 150 FERC ¶ 61,165 at P 125.

[369] Opinion No. 551, 156 FERC ¶ 61,234 at P 230.

MISO TOs' Expected Earnings analysis. The Presiding Judge rejected the analysis because a critique by Dr. Morin took the position that the Expected Earnings analysis should be based on a sample of unregulated, rather than regulated companies, but MISO TOs' Expected Earnings analysis relied on regulated companies in the proxy group and their expert, Dr. Avera, was unable to sufficiently address Dr. Morin's critique.[370]

174. In Opinion No. 551, the Commission pointed out that Dr. Morin's critique was based on his concern that using the historical book ROE of regulated companies in the analysis would be based on past actions of regulatory commissions and would raise issues of circularity. The Commission found, however, that this concern was not present with respect to MISO TOs' Expected Earnings analysis because it was forward-looking.[371] The Commission further explained that the Expected Earnings analysis was useful in corroborating the results produced by the DCF model because investors rely on both the market cost of equity and the book return on equity in determining whether to invest in a utility.[372] CAPs, OMS, and RPGI request rehearing of Opinion No. 551's decision to consider the MISO TOs' Expected Earnings analysis.[373]

175. In the Initial Decision in the Second Complaint proceeding, the Presiding Judge similarly found that "an expected earnings [analysis] serves as a useful guide to placement of the Base ROE within the DCF-calculated zone of reasonableness to the extent it calculates the earnings on book value investors can expect to earn."[374] CAPs, OMS and JCA, RPGI, and Trial Staff filed exceptions to the Presiding Judge's decision to consider the MISO TOs' Expected Earnings analysis.[375]

176. In the Briefing Order, the Commission proposed to give the Expected Earnings model equal weight, along with the DCF model and CAPM, in establishing a composite zone of reasonableness to be used under the first prong of section 206.[376] For purposes of

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[370] *See* Initial Decision (I), 153 FERC ¶ 63,027 at P 325.

[371] *Id.* PP 231-232.

[372] *Id.* PP 234-236.

[373] *See, e.g.*, CAPs Rehearing Request at 25-41; OMS Rehearing Request at 16-20; RPGI Rehearing Request at 12-15.

[374] Initial Decision (II), 155 FERC ¶ 63,030 at P 515.

[375] *See, e.g.*, CAPs Br. on Exceptions at 79-85; OMS-JCA Br. on Exceptions at 5-6, 47-49; RPGI Br. on Exceptions at 64; Trial Staff Br. on Exceptions at 26-32.

[376] *See* Briefing Order, 165 FERC ¶ 61,118 at P 17.

establishing a new just and reasonable ROE where the existing ROE has been shown to be unjust and unreasonable (i.e., the second prong of the FPA section 206 analysis), the Commission proposed to use the Expected Earnings model, DCF model, CAPM, and Risk Premium model to produce four separate cost of equity estimates and then average the four estimates to produce the just and reasonable ROE.

177. In the briefs filed in response to the Briefing Order, the parties either generally opposed or supported the use of the Expected Earnings model in the Commission's revised ROE methodology. Those arguments and other relevant arguments in the records of these proceedings are summarized and addressed below.

B. Parties Opposing the Use of Expected Earnings

178. CAPs, Trial Staff, LPSC, and Alliant oppose using the Expected Earnings model in the Commission's revised ROE methodology. They all argue that the Expected Earnings model does not accurately reflect a utility's cost of equity because it is an accounting-based measure that does not reflect the rate of return that investors require to invest in the market-priced common equity capital of a utility.[377] CAPs assert that this is because an investor cannot purchase a utility's common stock at book value and must instead pay the prevailing market price for common equity, which means that expected earned return on book value is not indicative of what an investor can expect to earn on an investment in the utility's common stock nor what return an investor requires to invest in the utility's common stock.[378] Similarly, Trial Staff notes precedent in which the Commission found that "[a]ccounting rates of return are not reliable measures of the current market cost of capital, since they do not reflect the current market prices that are determined in competitive capital markets."[379]

179. Trial Staff also argues that the Expected Earnings model is not widely used by investors.[380] Trial Staff notes that Dr. Roger A. Morin's book, *New Regulatory Finance*, addresses a generic comparable earnings method, which is a backward-looking measure that is not the same model as the Expected Earnings model used by the MISO TOs in

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[377] *See, e.g.*, CAPs Initial Br. (I) at 40-44; CAPs Initial Br. (II) at 39-44; Trial Staff Initial Br. (I) at 8-9; Trial Staff Initial Br. (II) at 7-8; LPSC Initial Br. at 15-20; Alliant Reply Br. (I) at 5-6; Alliant Reply Br. (II) at 5-6.

[378] CAPs Initial Br. (I) at 41; CAPs Initial Br. (II) at 41.

[379] Trial Staff Initial Br. (I) at 8 (citing *Generic Determination of Rate of Return in Common Equity for Pub. Utils.*, Order No. 420, FERC Stat. & Regs. at 31,344.

[380] Trial Staff Initial Br. (I) at 6-8; Trial Staff Initial Br. (II) at 5-7.

these proceedings. In addition, Trial Staff points to Dr. Morin's explanation of why multiple models should be used to estimate the cost of equity and notes that he cites Professor Eugene Brigham as stating that the CAPM, DCF, and Risk Premium models "typically are used" but not mentioning the Expected Earnings model.[381] Trial Staff further cites to an observation by Professor Brigham that the comparable earnings method has been "thoroughly discredited" and replaced by the market-oriented DCF, Risk Premium and CAPM models.[382] In addition, Trial Staff cites to a Federal Communications Commission report which explains that the two most commonly used methods for estimating the cost of equity are the DCF and CAPM models.[383] Accordingly, Trial Staff contends that there is little support for the notion that the Expected Earnings approach is widely used by investors.

180. LPSC similarly argues that evidence indicates that the Expected Earnings model is not used by investors. LPSC argues that the comparable earnings approach was grounded in the theory that the rate of return for utilities could be determined by examining the book returns of unregulated firms because their profitability would be limited by the forces of competition. LPSC asserts that, however, this analysis was made impractical because of differences in accounting between regulated and unregulated firms and the difficulty in measuring differences in risk between regulated and unregulated firms. LPSC argues that the alternative of using the comparable earnings of regulated utilities—like the analysis that was accepted in Opinion No. 551—conflicts with the essential premise of the comparable earnings approach because utilities do not operate in competition and therefore such an Expected Earnings analysis is not reliable. LPSC asserts that, if investors consider returns on book value at all, they do not consider it as a direct indication of returns on their investments because they cannot purchase stock at book value unless market price and book value happen to be exactly equal. In addition, LPSC cites to various academic sources which it asserts indicate that the Expected Earnings model is not used because of its flaws.[384] LPSC also asserts that, while

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[381] Trial Staff Initial Br. (I) at 6-7 (citing Morin at 430); Trial Staff Initial Br. (II) at 6 (citing same).

[382] Trial Staff Initial Br. (I) at 6-7 (citing Eugene F. Brigham, Dilip K. Shome & Steve R. Vinson, *Cost of Capital Estimation, The Risk Premium Approach to Measuring a Utility's Cost of Equity* 33 (1985)); Trial Staff Initial Br. (II) at 7 (citing same); LPSC Initial Br. at 1-2 (citing Eugene F. Brigham et al., *The Risk Premium Approach to Measuring a Utility's Cost of Equity*, 14 Financial Management 33, 33 (1985)).

[383] Trial Staff Initial Br. (I) at 8 (citing *In re Connect Am. Fund*, 28 FCC Rcd. 7123, 7148 (2013)); Trial Staff Initial Br. (II) at 7 (citing same).

[384] LPSC Initial Br. at 1-4; 13-24.

Dr. Morin's academic text may explain the Expected Earnings model, he does not use it himself when presenting testimony concerning investor return requirements.[385] LPSC also states that, in proposing to abandon the use of book return to determine carriers' rate of return, the Federal Maritime Commission stated that a firm's accounting rates of return are not equivalent to the firm's true economic rate of return, because accounting and economic concepts of income and value are substantially different.[386] LPSC states that the Federal Maritime Commission adopted a final rule using the DCF model to determine rate of return.

181. CAPs argue that the Expected Earnings model produces an erroneously inflated measure of investors' required level of return for stocks whose market value exceeds their book value. CAPs assert that only when investors bid the stock price of a company to at or near its book value (i.e., a market-to-book ratio at or near 1.0) can the expected earned rates of return on the company's book value be considered a reasonable estimate of its cost of common equity capital, or investors' required return. CAPs further contend that the Expected Earnings model does not measure opportunity cost because the only opportunity cost available to investors is the market price at which they can actually purchase stock.[387]

182. CAPs also assert that the Expected Earnings model should not be used because it is inappropriately circular and potentially self-fulfilling. CAPs contend that this is the case because the *Value Line* projected earnings-to-book ratios are based on past allowed ROEs and therefore the Expected Earnings model's reliance on them will merely serve to perpetuate existing ROEs.[388]

183. RPGI argues that, if the Commission uses the Expected Earnings model in its revised methodology, it must consider market-to-book ratios in order to give the model an element of being a market-based approach. RPGI contends that, if the Commission

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[385] *Id.* at 16 (citing *Okla. Gas and Elec. Co.*, Cause No. PUD201700496 (Okla. Corp. Comm'n), Reb. Test. of Roger A. Morin at 33 (May 29, 2018) ("Q. Do you agree with Mr. Parcell's Comparable Earnings Analysis? A. *Although I myself do not rely on this accounting-based method*, I agree with Mr. Parcell's Comparable Earnings results.") (emphasis added)).

[386] *Id*. at 18-19, citing *Financial Reporting Requirements and Rate of Return Methodology in the Domestic Offshore Trades*, Proposed Rule, 59 Fed. Reg. 16,592 (1994).

[387] CAPs Initial Br. (I) at 41-43; CAPs Initial Br. (II) at 41-43.

[388] CAPs Reply Br. (I) at 37-38; CAPs Reply Br. (II) at 57-58.

does not consider market-to-book ratios then the Expected Earnings model should not be used.[389] LPSC similarly asserts that, if the Commission decides to use the Expected Earnings model, then it should adjust the analysis for market-to-book ratios or screen the group of unregulated firms based on market-to-book ratios.[390]

184. CAPs also argue that, if the Commission decides to use the Expected Earnings model, then it should implement certain adjustments. Specifically, CAPs argue that any Expected Earnings model should use the average of all available projected years' returns on book common equity, rather than just using the *Value Line* projection that is furthest out in time (that for 2018-2020). CAPS state that using all three forward projections provided by *Value Line*, including those for 2015 and 2016 would better reflect long-term expectations of per-book earnings. CAPs further contend that the Expected Earnings model should incorporate actual, realized returns for all available years because this will incorporate a measure of historical realism which will mitigate the risk that projections could reflect only short-run economic conditions that fail to represent long-term expectations.[391] CAPs also assert that an analysis of proxy company market-to-book ratios must be used in combination with the Expected Earnings model.[392] In addition, as discussed further below in section XII, CAPs argue that if the Expected Earnings model is used, then it should be given the least weight among the different financial models.[393]

185. Trial Staff witness, Mr. Keyton, asserts that, if the Commission uses the Expected Earnings model, then it should use the average of all three of the return on book value projections provided by *Value Line* rather than only the most distant projection, because this will moderate the impact of any irregular return on book value estimates that may be obtained from a single estimate.[394] Trial Staff and CAPs also both criticize the fact that

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[389] RPGI Initial Br. (I), Ex. RPG-17 at 25-26; RPGI Initial Br. (II), Ex. RPG-38 at 26.

[390] LPSC Initial Br. at 29.

[391] CAPs Initial Br. (I) at 44-46; CAPs Initial Br. (II) at 44-46; CAPs Reply Br. (I) at 38-39; CAPs Reply Br. (II) at 58-59.

[392] CAPs Reply Br. (I) at 39; CAPs Reply Br. (II) at 59.

[393] CAPs Initial Br. (I) at 46-48; CAPs Initial Br. (II) at 46-47; CAPs Reply Br. (I) at 40; CAPs Reply Br. (II) at 60.

[394] Trial Staff Initial Br. (I) at 18-19 and Keyton Aff. (I) ¶¶ 52-54; Trial Staff Initial Br. (II) at 18 and Keyton Aff. (II) ¶¶ 50-52.

the Expected Earnings model relies solely on *Value Line* growth estimates, which they contend are unreliable because they are made by a single analyst.[395]

C. Parties Supporting the use of Expected Earnings

186. MISO TOs argue that the Expected Earnings model is a useful tool for evaluating utilities' cost of equity[396] and that the Commission should reject all of the parties' arguments against using the Expected Earnings model.[397] MISO TOs note that CAPs cite to Order No. 461[398] for the proposition that *Hope* and *Bluefield* require returns to reflect the market cost of equity and then argue that the Commission has not justified the use of the Expected Earnings model because it is based on accounting rates of return that do not estimate the market cost of capital. MISO TOs argue that CAPs overstate the importance of Order No. 461's reference because the mere fact that the Commission previously found compelling reasons to focus on the market cost of equity does not tie the Commission's hands today. MISO TOs assert that ratemaking is not a science and that the Commission uses models only to inform, not rigidly determine an appropriate ROE. MISO TOs further contend that, in the sentence immediately following CAPs' selected passage in Order No. 461, the Commission stated that it will "take into account non-cost factors in setting an allowed rate of return in an individual case if circumstances warrant."[399]

187. MISO TOs also note CAPs' citation to Opinion No. 429 but assert that, while the Commission declined to rely solely on the comparable earnings method to establish ROE in that case, it did not hold that the FPA forecloses non-market-based methods for developing just and reasonable returns. MISO TOs argue that the Commission only noted that it "*currently* favors market-oriented methodologies (the DCF methodology in

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[395] CAPs Initial Br. (I) at 43; CAPs Initial Br. (II) at 43; Trial Staff Initial Br. (I) at 9-10; Trial Staff Initial Br. (II) at 9.

[396] MISO TOs Initial Br. (I) at 4; MISO TOs Initial Br. (II) at 6; MISO TOs Reply Br. (I) at

[397] MISO TOs Reply Br. (I) at 35-36; MISO TOs Reply Br. (II) at 35-36.

[398] *Generic Determination of Rate of Return on Common Equity for Pub. Utils.*, Order No. 461, 37 FERC ¶ 61,287, FERC Stats. & Regs., Regs Preambles ¶ 30,722 (1986) (Order No. 461), *reh'g denied*, Order No. 461-A, 38 FERC ¶ 61,160 (1987).

[399] MISO TOs Reply Br. (I) at 37 (citing Order No. 461, FERC Stats. & Regs., Regs Preambles ¶ 30,722 at 30,499); MISO TOs Reply Br. (II) at 37 (citing same).

particular)."[400] MISO TOs argue that the Commission is now merely proposing a different, equally legitimate, approach in light of different circumstances.

188. In addition, MISO TOs take issue with LPSC's citation to the Federal Maritime Commission's proposal of a new rule as support for LPSC's argument that the Expected Earnings model does not utilize accepted financial theory. MISO TOs argue that the statement that LPSC cites is irrelevant because courts had in fact previously upheld the Federal Maritime Commission's use of a purely accounting-based, comparable earnings test to determine rates of return under a "just and reasonable" standard akin to that of the FPA.[401] MISO TOs contend that, therefore, the Expected Earnings model's reliance on accounting data does not preclude the Commission from using the model in its ROE methodology.[402]

189. MISO TOs' witness, Mr. McKenzie, similarly asserts that the purpose of the Expected Earnings model is not to derive a market cost of equity. He contends that this is an advantage of the model because it avoids the complexities, controversies, and limitations of capital market methods and instead focuses on expected earned returns on book equity, which are readily available to investors. MISO TOs also assert that the fact that the Expected Earnings model does not rely on market data is, in fact, a sound reason for the Commission to include the model in its ROE determinations. MISO TOs argue that the market-based methods all involve complexities, controversies, and limitations that the Expected Earnings does not share. Mr. McKenzie asserts that, because no single approach can accurately reflect investors' required return, the Commission correctly determined that considering the results of alternative methods provides a more accurate basis on which to determine a just and reasonable ROE and reliance on the Expected Earnings approach is consistent with this logic. Mr. McKenzie further contends that, because regulators establish the allowed return on the book value of a utility's investment—not the return that investors earn in the capital markets—the Expected

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[400] MISO TOs Reply Br. (I) at 38 (citing *Consumers Energy Co.*, Opinion No. 429, 85 FERC ¶ 61,100, at 61,362 (1998) (Opinion No. 429) (emphasis added by MISO TOs)); MISO TOs Reply Br. (II) at 38 (citing same).

[401] MISO TOs Reply Br. (I) at 38-39 (citing *Matson Navigation Co. v. Fed. Mar. Comm'n*, 959 F.2d 1039, 1041, 1043 (D.C. Cir. 1992); MISO TOs Reply Br. (II) at 38-39 (citing same).

[402] MISO TOs Reply Br. (I) at 38-39; MISO TOs Reply Br. (II) at 38-39.

Earnings model provides a direct guide to ensure that the allowed ROE is similar to what other utilities of comparable risk will earn on invested capital.[403]

190. MISO TOs also assert that the circularity criticisms of the Expected Earnings model are meritless. MISO TOs argue that the Expected Earnings model is not circular because it relies on forward-looking, expected returns on book equity, and circularity is an issue only with the comparable earnings model, which relies on historical earnings on book equity. MISO TOs also contend that Trial Staff and LPSC are mistaken in asserting that Dr. Morin does not support use of the Expected Earnings model. MISO TOs argue that they disregard his explanation that the comparable earnings model is highly meaningful. Moreover, MISO TOs contend that, while Trial Staff is correct that Dr. Morin does not explicitly mention "expected earnings," the comparable earnings model that he does discuss is the forward-looking version of the Expected Earnings model. MISO TOs also state that Trial Staff and LPSC ignore the close relationship of the comparable earnings approach to the capital attraction standards of *Hope* and *Bluefield*.[404] Mr. McKenzie states that "virtually every measure of future financial performance—including cash flow measures, profitability, and dividend policies—is impacted by the ROE established by regulators"[405] and concludes that, therefore the Expected Earnings model is no more susceptible to circularity concerns than the DCF.

191. In addition, MISO TOs argue that evidence demonstrates that investors rely on the utilities' expected earnings. MISO TOs assert that investors understand that regulators establish rates of return on book equity and they do not and cannot determine a rate of return on the market value of a utility's equity. MISO TOs contend that the evidentiary records in these proceedings include numerous examples of investment advisories and other publications that provide estimates of utilities' returns on equity, including returns on book value of utilities' assets.[406] They assert that Mr. McKenzie's reply affidavit

[403] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 62-67; MISO TOs Reply Br. (II), App. 2 McKenzie Reply Aff. (II) at 62-67.

[404] MISO TOs Reply Br. (I) at 42-43; MISO TOs Reply Br. (II) at 42-43.

[405] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 72; MISO TOs Reply Br. (II), App. 2 McKenzie Reply Aff. (II) at 72.

[406] MISO TOs Reply Br. (I) at 43-44; MISO TOs Reply Br. (II) at 43-44.

includes additional examples of the investment community's recognition of the relevance of returns on book value.[407]

192. Mr. McKenzie cites an S&P report as demonstrating the relevance of earned returns on book value in highlighting the primary credit considerations in the utility industry. In particular, he points to a statement in the report that "'required rate of return on equity investment is closely linked to a utility company's profitability.'"[408] Mr. McKenzie points to the report's statement that "'the regulator ultimately bases its decision on an authorized ROE,'" but "different factors such as variances in costs and usage may influence the return a utility is actually able to earn, and consequently our analysis of profitability for cost-of- service-based utilities centers on the utility's ability to consistently earn the authorized ROE.'"[409] Mr. McKenzie contends that this demonstrates that S&P's view is that earned return on book value may provide better insight into the financial health of the utility because it reflects the end-result of regulation, not the theoretical outcome implied by an authorized ROE.[410]

193. Mr. McKenzie argues that Moody's also recognizes the relevance of returns on book value in its assessment of a utility's future prospects. He cites a report in which Moody's stated that, while "'[t]he authorized ROE is a popular focal point in many regulatory rate case proceedings,'" it is the case that "'earned ROEs, as reported by

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[407] MISO TOs Reply Br. (I) at 44 (citing MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 69-70); MISO TOs Reply Br. (II) at 43-44 (citing MISO TOs Reply Br. (II), App. 2 McKenzie Reply Aff. (II) at 69-70).

[408] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 69 (citing S&P Global, *Utilities: Key Credit Factors For The Regulated Utilities Industry*, Criteria Corporates (Nov. 19, 2013); https://www.standardandpoors.com/en_US/web/guest/article/-/view/type/HTML/id/2189281); MISO TOs Reply Br. (II), App. 2 McKenzie Reply Aff. (II) at 69 (citing same).

[409] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 69-70 (citing S&P Global, *Utilities: Key Credit Factors For The Regulated Utilities Industry*, Criteria Corporates (Nov. 19, 2013); https://www.standardandpoors.com/en_US/web/guest/article/-/view/type/HTML/id/2189281); MISO TOs Reply Br. (II), App. 2 McKenzie Reply Aff. (II) at 69-70 (citing same).

[410] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 70; MISO TOs Reply Br. (II), App. 2 McKenzie Reply Aff. (II) at 70.

utilities and adjusted by Moody's,' are a key gauge of financial performance."[411] In addition, Mr. McKenzie cites a CFRA publication which he contends "highlighted the relevance of returns on book equity to investors." He cites the following portion of the publication as supporting this contention

> If a utility's ROE is too low, the analyst must determine if it was caused by mild weather or the absence of a needed rate hike – or if the utility is poorly operated. Conversely, an ROE that is too high could cause regulators to seek a rate cut. For firms in the S&P Composite 1500 electric utilities index, the average ROE generally ranges between 10% and 13%, although the average has trended lower in the past few years.[412]

194. As additional evidence that the Expected Earnings model has been recognized as a meaningful ROE methodology, Mr. McKenzie cites to a 1991 survey by the National Association of Regulatory Commissioners (NARUC) in which it reported that 19 regulatory jurisdictions cited the comparable earnings approach as a primary method favored in determining the allowed ROE, while an additional 16 jurisdictions reported that this approach was considered along with the results of other methods.[413] He also notes that the Virginia State Corporation Commission is required by statute to consider the earned returns on book value of electric utilities in its region, which establish lower and upper boundaries for the allowed ROE.[414] In addition, Mr. McKenzie points to a textbook prepared by Mr. Parcell for the Society of Utility and Regulatory Financial

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[411] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 70 (citing Moody's Investors Service, Lower Authorized Equity Returns Will Not Hurt Near-Term Credit Profiles, Sector In-Depth, at 5 (Mar. 10, 2015)); MISO TOs Reply Br. (II), App. 2 McKenzie Reply Aff. (II) at 70 (citing same).

[412] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 70-71 (citing CFRA, Electric Utilities, Industry Surveys 50 (Aug. 2018)); MISO TOs Reply Br. (II), App. 2 McKenzie Reply Aff. (II) at 70-71 (citing same).

[413] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 67-68 (citing Nat'l Ass'n of Regulatory Util. Comm'rs, *Utility Regulatory Policy in the U.S. and Canada, 1995-1996* (Dec. 1996)); MISO TOs Reply Br. (II), App. 2 McKenzie Reply Aff. (II) at 67-68 (citing same).

[414] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 68 (citing Virginia Code § 56-585.1.A.2.a)); MISO TOs Reply Br. (II), App. 2 McKenzie Reply Aff. (II) at 68 (citing same).

Analysts which Mr. McKenzie asserts "observes that the amount of subjective judgment required to implement this method is 'minimal,' particularly when compared to the DCF and CAPM methods."[415]

195. MISO TOs also disagree with LPSC's contention that Dr. Morin says that the Expected Earnings model requires a proxy group of non-regulated companies. MISO TOs assert that, to the contrary, Dr. Morin only observed that the backward-looking, comparable earnings model "usually" uses a sample of unregulated companies. MISO TOs argue that, because Dr. Morin did not even explicitly address the Expected Earnings model, the "usual" application of a different methodology does not indicate any error in the Commission's proposal.[416]

196. MISO TOs further assert that LPSC's claim that the Expected Earnings model reflects the results of inconsistent accounting does not establish that the Expected Earnings model is unreliable. MISO TOs claim that LPSC provides no evidence that any of the data relied upon in the Expected Earnings analyses in these proceedings is inaccurate or unreliable in any way.[417]

197. MISO TOs also dispute that the Expected Earnings model is unreliable when utilities' market-to-book ratios are greater than one. MISO TOs argue that, in Opinion No. 551, the Commission explained that 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.[418] MISO TOs further assert that LSPC fails to mention that Dr. Morin rejects the notion that regulators' ROE decisions should consider market-to-book ratios.[419] MISO TOs' witness Mr. McKenzie contends that market-to-book ratios of greater than one are not unusual and that if, as CAPs and

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[415] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 68 (citing David C. Parcell, *The Cost of Capital: A Practitioner's Guide* 115-16 (1997)); MISO TOs Reply Br. (II), App. 2 McKenzie Reply Aff. (II) at 68 (citing same).

[416] MISO TOs Reply Br. (I) at 44; MISO TOs Reply Br. (II) at 44.

[417] MISO TOs Reply Br. (I) at 45-47; MISO TOs Reply Br. (II) at 45-47.

[418] MISO TOs Reply Br. (I) at 47-48 (citing Opinion No. 551, 156 FERC ¶ 61,234 at P 234); MISO TOs Reply Br. (II) at 47-48 (citing same).

[419] MISO TOs Reply Br. (I) at 48; MISO TOs Reply Br. (II) at 48.

LPSC assert, an appropriate market-to-book ratio for utilities is at or near 1.0, then this would imply that MISO TOs should incur significant capital losses.[420]

198. MISO TOs support the use of *Value Line* estimates in the Commission's proposed Expected Earnings model. MISO TOs dispute CAPs' argument that, because the Commission has declined to use *Value Line*'s estimates in the DCF model, the Commission should not rely upon *Value Line*'s five-year average earnings estimates in the Expected Earnings model. MISO TOs state that the Commission has declined to accept *Value Line* earnings growth rates in its DCF model on the ground that such estimates are created by a single analyst. MISO TOs note that CAPs point to the Commission's observation that its decision to abandon exclusive reliance on the DCF model was based in part on evidence that a single analyst is the source of many IBES earnings estimates. MISO TOs argue that the proper response to this is not to ignore all single-analyst estimates, but to consider additional, multiple estimates, to minimize the risk that unreliable data may distort the results of a particular model. MISO TOs also disagree with CAPs' alternative contention that the Commission should require the Expected Earnings model to average *Value Line*'s shorter-term earnings estimates with the five-year estimates. MISO TOs assert that the Commission rejected this suggestion in Opinion No. 551 and no party has offered any basis for the Commission to revisit that conclusion.[421]

199. In addition, MISO TOs argue that the Commission should reject CAP's proposal to use actual realized returns for all available years to incorporate historical realism in the Expected Earnings model. MISO TOs contend that using estimates of future earnings and book equity, rather than historical data, is what distinguishes the Expected Earnings model from the comparable earnings method and thus historical data should not be used.[422]

D. Commission Determination

200. In the Briefing Order, the Commission proposed to use the Expected Earnings model because the record in these proceedings included the Expected Earnings model as one of the methods that "investors may use to estimate the expected return from an

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[420] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 78-89; MISO TOs Reply Br. (II), App. 2 McKenzie Reply Aff. (II) at 78-89.

[421] MISO TOs Reply Br. (I) at 48-50; MISO TOs Reply Br. (II) at 48-50.

[422] MISO TOs Reply Br. (I) at 50-51; MISO TOs Reply Br. (II) at 50-51.

investment in a company."[423] In Opinion No. 551, the Commission found that the Expected Earnings model was useful in corroborating the results produced by the DCF model[424] and, in the Initial Decision in the Second Complaint proceeding, the Presiding Judge similarly found that the Expected Earnings model was a "useful guide to placement of the Base ROE within the DCF-calculated zone of reasonableness to the extent it calculates the earnings on book value investors can expect to earn."[425] However, we now find that, in light of the record as supplemented after issuance of the Briefing Order, it is not appropriate to use the Expected Earnings model in our new base ROE methodology.

201. In particular, we find that the record does not support departing from our traditional use of market-based approaches to determine base ROE.[426] Under the market-based approach, the Commission sets a utility's ROE to equal the estimated return that investors would require in order to purchase stock in the utility at its current market price. In *Hope*, the Supreme Court explained that "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks."[427] In order to determine this, we must analyze the returns that are earned on "investments in other enterprises having corresponding risks," but investors cannot invest in an enterprise at book value and must instead pay the prevailing market price for an enterprise's equity. As a result, the expected return on a utility's book value does not reflect "returns on investments in other enterprises" because book value does not reflect the value of any investment that is available to an investor in the market, outside of the unlikely situation in which market value and book value are exactly equal. Accordingly, we find that relying on the Expected Earnings model would not satisfy the requirements of *Hope*.

202. The return on book value is also not indicative of what return an investor requires to invest in the utility's equity or what return an investor receives on the equity

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[423] Briefing Order, 165 FERC ¶ 61,118 at P 36.

[424] Opinion No. 551, 156 FERC ¶ 61,234 at P 230.

[425] Initial Decision (II), 155 FERC ¶ 63,030 at P 515.

[426] *Generic Determination of Rate of Return on Common Equity for Public Utilities*, Order No. 489, FERC Stats. & Regs. ¶ 30,795 at 30,993, *reh'g denied*, Order No. 489-A, 42 FERC ¶ 61,390 (1988) ("There is compelling economic justification for relying on the market cost of capital as the standard for rate of return decisions. Furthermore, a market cost of capital approach addresses both the comparable earnings and attraction of capital standards of the *Hope* decision.").

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

investment, because those returns are determined with respect to the current market price that an investor must pay in order to invest in the equity. As CAPs similarly explain, "Because an investor cannot purchase a utility's common stock at book value and must instead pay the prevailing market price for common equity, the utility's expected earned return on book value is indicative of neither what an investor can expect to earn on an investment in the utility's common stock nor what return an investor requires to invest in the utility's common stock."[428] Accordingly, return on book value does not reflect "the return to the equity owner" that we must ensure is "commensurate with returns on investments in other enterprises"; therefore we find that this model is not useful in ensuring that the standards of *Hope* are satisfied.

203. MISO TOs argue that the fact that the Expected Earnings model does not rely on market data is a sound reason for the Commission to include the model in its ROE determinations. MISO TOs assert that the Expected Earnings model avoids the complexities and opportunities for controversy that are implicated by the market-based models. MISO TOs contend that the Expected Earnings model relies on the straight-forward concept that when evaluating two investments of comparable risk, investors will choose the alternative with the higher expected return.[429] To make a similar point, MISO TOs' witness Mr. McKenzie points to a textbook prepared by Mr. Parcell for the Society of Utility and Regulatory Financial Analysts which Mr. McKenzie asserts "observes that the amount of subjective judgment required to implement this method is 'minimal,' particularly when compared to the DCF and CAPM methods."[430]

204. While it may be true that the Expected Earnings model does not involve the same complexities as the market-based approaches, we find that this is because it does not reflect a utility's cost of equity. It is simpler because it does not consider the market price that an investor must pay to make its investment and other factors such as projected growth rates for the subject utility. Factors such as these—in particular the market price that an investor must pay for an investment, which is the basis for determining the return on that investment—are critical to determining a utility's cost of equity. While it may be simpler to use a model that does not consider such factors, doing so renders that model unable to effectively estimate the rate of return that investors require to invest in the market-priced common equity capital of a utility, which is the utility's cost of equity

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[428] CAPs Initial Br. (I) at 41; CAPs Initial Br. (II) at 41.

[429] MISO TOs Reply Br. (I) at 39 and App. 2, McKenzie Reply Aff. (I) at 65; MISO TOs Reply Br. (II) at 39 and App. 2, McKenzie Reply Aff. (II) at 65.

[430] MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 68 (citing David C. Parcell, *The Cost of Capital: A Practitioner's Guide* 115-16 (1997)); MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 68 (citing same).

capital. We find that it is not appropriate to use a model that does not accurately measure the "return to the equity owner" as required by *Hope* merely because it may be simpler to administer. We are cognizant of the administrative burden that is placed on parties to evaluate models that are used in analyzing ROEs, but the mere simplicity of one model as compared to others does not justify using that model if it does not assist us in ensuring that returns to equity owners are just and reasonable.

205. Moreover, we find that the record demonstrates that the Expected Earnings model does not identify investments of comparable risk and which alternatives will have a higher expected return as MISO TOs' witness Mr. McKenzie indicates.[431] In particular, because the Expected Earnings model measures returns on book value, without consideration of what market price an investor would have to pay to invest in the relevant company, it does not accurately measure the investor's expected returns on its investment. In order to assess what return investors will receive, they must know the market price of the equity that they are purchasing. For example, if two companies each have book value of $100 and expected returns on that book value of 10 percent, or $10, over the next year, then they would appear to be equally attractive investments to an investor based on the Expected Earnings model. However, if the market price to purchase the first company's stock is $20 and the market price to purchase the second company's stock is $40, then the first company would obviously be a more attractive investment. Thus, contrary to Mr. McKenzie's characterization, investors in such a situation would not be able to determine what "the alternative with the higher expected return" is with the Expected Earnings model.

206. MISO TOs also argue that the fact that the majority of stocks, including utility stocks, sell substantially above the company's book value supports the use of the Expected Earnings Model.[432] MISO TOs' witness, Mr. McKenzie, points out that *Value Line* reports that approximately 1500 of the roughly 1700 stocks it follows have market-to-book ratios above one, and he cited evidence that utility stocks have an average market-to-book ratio of 2.1.[433] Mr. McKenzie asserts that, in these circumstances, an ROE equal to the current market cost of equity as determined under the DCF model will not produce sufficient earnings to support the utility's current stock price. Mr. McKenzie points out that the Commission calculates the dollar return included in a utility's rate base by multiplying the book value of the rate base by the percentage ROE determined by the

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[431] MISO TOs Reply Br. (I) at 39 and App. 2, McKenzie Reply Aff. (I) at 65; MISO TOs Reply Br. (II) at 39 and App. 2, McKenzie Reply Aff. (II) at 65.

[432] MISO TOs Reply Br. (I) at 47-48; MISO TOs Reply Br. (I) at 47-48.

[433] MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 81-82; MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 81-82.

Commission. He then provides a numerical example that purports to show that, when a utility's market-to-book ratio is above one, this calculation will not produce a sufficient dollar return to allow the utility to continue to pay the same level of dividends and retain the same level of earnings to fund growth as the investor assumed in performing its DCF analysis and evaluating whether to purchase the stock.[434] As a result, according to Mr. McKenzie, the DCF model will not provide a return sufficient to support the utility's current stock price.[435] Mr. McKenzie asserts that, by contrast, the Expected Earnings model calculates the projected returns on the utility's book equity that support the investors' expectations underlying the current market price of the stock. As a result, Mr. McKenzie contends the Expected Earnings model provides a direct guide to ensure that the ROE allowed by the Commission is similar to the returns that investors expect other utilities of comparable risk will earn on the book value of their invested capital.[436]

207. The MISO TOs' concerns about market-to-book ratios in excess of one and maintaining the current stock values of public utilities do not justify use of the Expected Earnings model. The Commission is not obligated to set ROEs so as to maintain current stock values.[437] As the Supreme Court held in *Hope*, the "fair value" of a regulated enterprise "is the end product of the process of ratemaking, not the starting point . . . The heart of the matter is that rates cannot be made to depend on 'fair value' when the value of the going enterprise depends upon earnings under whatever rates are anticipated."[438] Consistent with this holding in *Hope*, the Commission has stated, "The market value of an enterprise or its common stock depends upon its earnings or anticipated earnings,

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[434] MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 83; MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 83.

[435] Mr. McKenzie also cites a 1970 scholarly article raising similar concerns about the DCF model "in the early days before the DCF became a regulatory mainstay." MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 84 (citing Walter A. Morton, *The Investor Capitalization Theory of the Cost of Equity Capital*, Land Econ. 248-63 (Aug. 1970)); MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 84 (citing same).

[436] *Id*. at 83-84.

[437] *Illinois Bell Telephone Co. v. FCC*, 988 F.2d 1254 (D.C. Cir. 1993) (*Illinois Bell*) (affirming the FCC's rejection of the same contention concerning use of the DCF model when market-to-book ratios are above one as the MISO TOs make here, and stating that the FCC "has no obligation to maintain the current market value on investors' property.").

[438] *Hope*, 320 U.S. at 601.

which in turn depend upon the rates allowed. Thus, market value is the result of the ratemaking process and may not properly be the beginning of that process as well."[439]

208. In any event, there is no evidence that the Commission's use of the DCF model to determine ROEs based on the current market cost of capital has provided insufficient returns to support proxy company stock values or had a tendency to drive market-to-book ratios down to one. In fact, market-to-book ratios of the proxy companies have been consistently above one since the 1980s, a period during which the Commission solely used the DCF model to determine ROEs.[440] Moreover, the public utility companies for which the Commission sets rates are not publicly traded and thus do not have any market-determined stock values. Hence, there is no observable market-to-book ratio specifically applicable to the electric transmission business for which we are establishing an ROE. The publicly-traded companies in the proxy group are generally holding companies, which not only have regulated electric transmission business but also other businesses that are not subject to cost-based regulation.[441] Therefore, the proxy company market-to-book ratios may exceed one primarily because of the value investors see in their non-electric transmission businesses.[442] We recognize that, in an environment where the market-to-book ratios of publicly-traded companies are generally above one, it would be unreasonable to adopt an ROE policy that resulted in capital losses for investors in order to drive market-to-book ratios that are currently above one down to one.[443] However, the record before us does not contain evidence that our longstanding policy of determining ROE based on the current market cost of equity is having this effect. In these circumstances, we see no basis to change that policy in order to use the Expected Earnings model.

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[439] Order No. 489, FERC Stats. & Regs. ¶ 30,795 at 30,994; s*ee also Orange and Rockland Utilities, Inc*., Opinion No. 314, 44 FERC ¶ 61,253 at 61,952*, reh'g*, Opinion No. 314-A, 45 FERC ¶ 61,252 (1988).

[440] Morin at 377. The market-to-book ratios of the proxy group companies in the First Complaint proceeding range from 1.17 to 2.55. Ex. JCI-100 at 35. The market-to-book ratios of the proxy group companies in the Second Complaint proceeding range from 1.15 to 3.38. Ex. JCI-200 at 33 n. 47.

[441] CAPs Initial Br. (I), Ex. JCI-100 at 36; CAPs Initial Br. (II), Ex. JCI-200 at 35.

[442] *See Illinois Bell*, 988 F.2d at 1261 (stating that the telephone companies there at issue also had unregulated assets, and appreciations in the value of the unregulated assets could account for the market-to-book ratios above one).

[443] *See* Morin at 376-378.

209. We agree with MISO TOs that the Commission is not necessarily required to rely on only market-based methods to determine ROEs merely because it previously found that such an approach was appropriate. If, for example, facts and circumstances before the Commission change in a manner that would allow the Commission to provide a reasoned explanation for departing from this precedent, then the Commission could depart from this precedent. However, the mere fact that the Commission can depart from precedent such as Order No. 461 and Opinion No. 429 does not necessarily mean that it should. Here, we find that the record does not demonstrate that it is appropriate to rely on the Expected Earnings model in our ROE analysis and we find, consistent with our existing precedent, that it is appropriate to rely on market-based methods in our ROE determinations. Similarly, we agree with MISO TOs that the fact that the Federal Maritime Commission criticized using an accounting-based rate of return method does not preclude this Commission from using such a method. However, the fact that we are not precluded from using an accounting-based method does not mean that we must use such a method. As discussed herein, we find that, on balance, this evidence and the other record evidence in these proceedings demonstrates that the Expected Earnings approach is not appropriate for us to use in our ROE analysis.

210. In the Briefing Order, the Commission noted that the returns on book equity that investors expect to receive "are relevant to determining that utility's cost of equity, because those returns on book equity help investors determine the opportunity cost of investing in that particular utility instead of other companies of comparable risk."[444] The Commission further stated that "Because investors rely on Expected Earnings analyses to help estimate the opportunity cost of investing in a particular utility, we find this type of analysis useful in determining a utility's ROE."[445] In light of the record in these proceedings as supplemented after issuance of the Briefing Order, we find that there is not sufficient record evidence to conclude that investors rely on the Expected Earnings analysis to estimate the opportunity cost of investing in a particular utility as compared to other companies. As parties have noted, investors cannot purchase equity at book value;[446] therefore, although book value and returns on book equity may be useful data points for investors, they do not reflect an opportunity for investment that can be characterized as an opportunity cost. In addressing this point, CAPs' witness Mr. Solomon cites to a similar explanation of the point made by Dr. Morin that "Accounting rates of return are not opportunity costs in the economic sense, but reflect

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[444] Briefing Order, 165 FERC ¶ 61,118 at App.

[445] *Id.*

[446] *See, e.g.*, CAPs Initial Br. (I) at 41, Ex. JCI-100 at 30; CAPs Initial Br. (II) at 41, Ex. JCI-200 at 29.

the average returns earned on past investments and hence reflect past regulatory actions . . . Investors can only purchase new shares of common stock at current market prices and not at book value."[447] Moreover, as we discuss further below, there is insufficient record evidence to demonstrate that investors rely on the Expected Earnings model.

211. Record evidence also provides an example of how returns on book equity fail to reflect the returns that investors require to invest in a given company and thus, fail to reflect the opportunity costs of investing in one company as opposed to others. As CAPs explain, when the market value of a company's equity exceeds its book value—i.e., when its market-to-book ratio exceeds 1.0—this means that investors' required rate of return for investing in the equity is less than the expected earnings on book value for that company.[448] CAPs' witness Mr. Solomon then details the market-to-book ratios for the proxy groups used by Dr. Avera in the First Complaint and Second Complaint proceedings, finding that the ratios ranged from 1.17 to 2.55 for the proxy groups in both proceedings, with 30 of the 39 companies in the First Complaint proxy group having ratios at or above 1.50 (with an average of 1.80) and 23 of the 32 companies in the Second Complaint proxy group having ratios at or above 1.50 (with an average of 1.70).[449] Accordingly, the record demonstrates that investors' required rate of return for investing in the equity of all of the proxy group companies in both of these proceedings is less than the return on the book value of the equity of those companies. Therefore, the return on the book value measured by the Expected Earnings model overstates the investors' required rate of return for investing in the proxy group companies and as a result it does not reflect investors' opportunity cost of investing in one proxy group company as opposed to another.

212. In the Briefing Order, the Commission stated that a primary reason for proposing to average the results of the DCF analysis with the results of the CAPM, Expected Earnings, and Risk Premium analyses is that investors use those models, in addition to

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[447] CAPs Initial Br. (I), Ex. JCI-100 at 31 (citing Morin at 393); CAPs Initial Br. (II), Ex. JCI-200 at 30.

[448] *See* CAPs Initial Br. (I) at 42-43, Ex. JCI-100 at 30-31; CAPs Initial Br. (II) at 42, Ex. JCI-200 at 29-30; Opinion No. 314, 44 FERC at 61,952 ("[W]hen the price-to-book ratio is greater than one, the rate of return investors expect O&R to earn on common equity is greater than the rate of return investors require from their investment in O&R's common stock.").

[449] CAPs Initial Br. (I) at 42-43, Ex. JCI-100 at 35; CAPs Initial Br. (II) at 42-43, Ex. JCI-200 at 34.

the DCF methodology, to inform their investment decisions.[450] Upon review of the record, as supplemented after issuance of the Briefing Order, we find that this statement may not be true with respect to the Expected Earnings model. MISO TOs cite numerous pieces of evidence of "investment advisories and other publications that provide estimates of utilities' returns on equity, including returns on book value of utilities' assets."[451] This evidence cited by the MISO TOs shows that investors examine expected earnings (future profits). However, looking at the future earnings of a company is not the same as determining a company's cost of capital or making investment decisions based on the earnings per book value calculations in the Expected Earnings model. Additionally, there is no evidence that such information is useful to investors in determining their required return from an investment in a particular company independent of the stock price, which the Expected Earnings model ignores. Below we examine the specific evidence that MISO TOs' claim demonstrates that investors use the Expected Earnings model.

213. Exhibit No. MTO-43 in the First Complaint proceeding, a Wolf Research report, discusses Commission and state regulated ROE determinations. Exhibit No. MTO-44 in the First Complaint proceeding, a UBS Global Research brief, also discusses Commission ROE policy without mentioning non-DCF approaches or book value. Exhibit No. MTO-45 in the First Complaint proceeding, another UBS Global Research brief, similarly merely discusses potential changes to the Commission's ROE policy with no mention of use of earnings per book value or other approaches. Although investors are obviously interested in what ROE the Commission may approve in pending rate proceedings, that fact does not support a finding that investors use the Expected Earnings model to determine their required returns on investments in public utilities.

214. Exhibit No. MTO-54 in the First Complaint proceeding, the *Value Line* portion of Exhibit No. S-3 cited by MISO TOs, and pages 41-85 of Exhibit No. JCI-3 in the Second Complaint proceeding—all *Value Line* summary PDFs for proxy group companies—include dozens of financial metrics and brief discussions of major issues surrounding companies. Book value and book value per share are among the information provided, as well as return on total capital. However, total capital in this instance differs from net plant, which is listed separately and is more analogous to book value. In any event, the listing of a relevant metric among dozens does not indicate that investors use it independently to determine their required return on their investments in particular companies. The Barron's report in Exhibit No. S-3 discusses key financial metrics including earnings per share and dividend yield, and explicitly discusses these metrics

[450] Briefing Order, 165 FERC ¶ 61,118 at P 46.

[451] MISO TOs Reply Br. (I) at 43-44; MISO TOs Reply Br. (II) at 43-44.

with respect to the share price that investors see.[452] It does not discuss book value or illustrate that investors determine the cost of equity or make purchase decisions using the Expected Earnings model. Pages 3-4 of Exhibit No. JCI-12 in the Second Complaint proceeding, a Moody's report, examines the impact of Commission proceedings on American Transmission Company. It makes no mention of book value and merely opines on how changes in authorized ROEs could affect future earnings. The information in Exhibit No. JCI-13 in the Second Complaint provides a similar analysis for Ameren Illinois.

215. MISO TOs' witness Mr. McKenzie asserts that an S&P Global report in Exhibit No. MTO-74 in the Second Complaint proceeding indicates that the earned return on book value may provide better insight into the financial health of the utility because it reflects the end-result of regulation, not the theoretical outcome implied by an authorized ROE. He also maintains that Moody's recognizes the relevance of returns on book value when it explains that earned ROEs, rather than authorized ROEs, are a "key gauge of financial performance."[453] However, we agree with Trial Staff that the record lacks evidence that S&P and Moody's use this information to estimate the cost of equity.[454] First, we disagree with MISO TOs that S&P's statement that "different factors [other than ROEs] such as variances in costs and usage may influence the return a utility is actually able to earn, and consequently our analysis of profitability for cost-of-service –based utilities centers on the utility's ability to consistently earn the authorized ROE"[455] indicates that S&P examines earnings per book value. Whether a utility actually earns the authorized ROE can be determined by comparing actual earnings with the earnings implied by the authorized ROE, which is independent of book value. In fact, the only mention of book value in the S&P article is, when explaining the usefulness of earnings before interest, tax, depreciation and amortization, the statement that "the book value of capital does not always reflect true earning potential." Similarly, the Moody's reference

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[452] Ex. S-3 at 1-3.

[453] MISO TOs Reply Br. (I), App. 2, McKenzie Reply Aff. (I) at 70; MISO TOs Reply Br. (II), App. 2, McKenzie Reply Aff. (II) at 70.

[454] *See* Trial Staff Reply Br. (I), Keyton Reply Aff. (I) at 5; Trial Staff Reply Br. (II), Keyton Reply Aff. (II) at 5.

[455] MISO TOs Reply Br. (I), App. 2, McKenzie Reply Aff. (I) at 69-70 (citing S&P Global, *Utilities: Key Credit Factors For The Regulated Utilities Industry*, Criteria Corporates (Nov. 19, 2013), https://www.standardandpoors.com/en_US/web/guest/article/-/view/type/HTML/id/2189281)); MISO TOs Reply Br. (II), App. 2, McKenzie Reply Aff. (II) at 69-70 (citing same).

to the stability of "earned ROEs" as reported by utilities does not clearly indicate that it is earned returns on book value.

216. Even if Mr. McKenzie's inferences regarding the usefulness of earnings as related to book value to assess the financial health of a utility are correct, that fact is not indicative that such information is used by investors independently of price to determine their required returns. As discussed above, the Commission relies on the market cost of capital as the standard for its rate of return decisions. This approach requires us to estimate the return that investors would require in order to purchase stock in the utility at its current market price. We have determined that, for this purpose, we should look to the methods that investors use to determine their required return on an investment in public utilities, including the DCF and CAPM models. However, there is nothing in the S&P and Moody's articles cited by Mr. McKenzie to indicate that investors look to earnings on book value to determine their required return on an investment. Credit rating agencies, who are not investors, may use such information to inform their assessment of utilities' risk or financial strength. As Mr. McKenzie states, S&P uses this metric to assess utilities' "financial health."[456] However, there is no evidence that they use such metrics to determine the cost of capital of utilities or to calculate return on an investment.

217. Looking at earned return on book value is not the same as conducting an Expected Earnings analysis to determine the applicable cost of capital. Investors observe many financial metrics, including metrics such as price to earnings ratios and free cash flow, which are not independently bases for determining an entity's cost of equity or investment decisions. When an investor makes an investment decision, a fundamental consideration is the cost to the investor to make the investment—i.e., the market price that the investor must pay for the investment. The Expected Earnings analysis does not take this fundamental consideration into account and thus it does not reflect how an investor would make an investment decision. MISO TOs' citations to evidence that merely references book value or earnings on book value among various other financial metrics or in the context of credit rating analyses does not demonstrate that investors would use the earnings on book value results of an Expected Earnings analysis to make investment decisions without considering the market price of the investment.

218. The academic literature and testimony by academics cited in the record also indicates that investors do not commonly use the Expected Earnings model to estimate utilities' cost of equity. Trial Staff states that the Briefing Order cites Exhibit No. MTO-1 in the First Complaint proceeding as support for the proposition that investors base their decisions on models that include the Expected Earnings model. Trial Staff argues that, however, that exhibit, which in turn cites Dr. Morin's *New Regulatory*

[456] MISO TOs Reply Br. (I), App. 2, McKenzie Reply Aff. (I) at 70; MISO TOs Reply Br. (II), App. 2, McKenzie Reply Aff. (II) at 70.

Finance, does not support this proposition. Trial Staff asserts that Dr. Morin does not mention the Expected Earnings model used by MISO TOs in this proceeding. Trial Staff contends that, in fact, as support for his contention that financial literature supports the use of multiple methods to estimate the cost of equity, Dr. Morin cites Professor Eugene Brigham who identifies the DCF, CAPM, and Risk Premium models as the "[t]hree methods [that] typically are used . . . when . . . estimating a company's cost of equity"[457] and does not identify the Expected Earnings model. Trial Staff argues that, therefore, Dr. Morin's own source of information on the use of multiple ROE methodologies excludes the Expected Earnings approach as one of the methods typically used. LPSC and CAPs' expert Mr. Solomon also point to Dr. Morin's discussion of the comparable earnings approach which states, among other things, that "Accounting rates of return are not opportunity costs in the economic sense . . . More simply, the Comparable Earnings standard ignores capital markets."[458] MISO TOs counter that these parties "cherry-pick" Dr. Morin's treatise. MISO TOs assert that they disregard Dr. Morin's explanation of the benefits of the approach, which states that "because the investment base for ratemaking purposes is expressed in book value terms, a rate of return on book value . . . is highly meaningful."[459] Trial Staff and LPSC also cite to recent testimony by Dr. Morin in other proceedings that they allege supports excluding the Expected Earnings model. In particular, LPSC cites the following testimony of Dr. Morin in an Oklahoma Corporation Commission proceeding:[460]

> Q. Do you agree with Mr. Parcell's Comparable Earnings Analysis?
>
> A. *Although I myself do not rely on this accounting-based method*, I agree with Mr. Parcell's Comparable Earnings results.[461]

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[457] Trial Staff Initial Br. (I), Keyton Aff. (I) at 12-13 (citing Morin at 430); Trial Staff Initial Br. (II), Keyton Aff. (II) at 11 (citing same).

[458] LPSC Initial Br. at 17 (citing Morin at 393); CAPs Initial Br. (I), Ex. JCI-100 at 31 (citing same); CAPs Initial Br. (II), Ex. JCI-200 at 30 (citing same).

[459] MISO TOs Reply Br. (I) at 42-43 and App. 2, McKenzie Reply Aff. (I) at 69; MISO TOs Reply Br. (II) at 42-43 and App. 2, McKenzie Reply Aff. (II) at 69.

[460] *Okla. Gas and Elec. Co.*, Cause No. PUD201700496 (Okla. Corp. Comm'n).

[461] *Okla. Gas and Elec. Co.*, Cause No. PUD201700496 (Okla. Corp. Comm'n), Reb. Test. of Roger A. Morin at 33 (May 29, 2018).

Trial Staff cites testimony by Dr. Morin in a Commission proceeding in which he identified the methods available to determine cost of equity and did not include the Expected Earnings model.[462]

219. The evidence in the record regarding Dr. Morin's views on the Expected Earnings model, if anything, indicates that the Expected Earnings model is inappropriate in this context. As LPSC and CAPs note, Dr. Morin's *New Regulatory Finance* states that "[a]ccounting rates of return are not opportunity costs in the economic sense" and that the Expected Earnings model's historical-looking analog, the comparable earnings standard, "ignores capital markets." The fact that the accounting-based Expected Earnings approach does not represent opportunity costs and ignores capital markets undermines its ability to estimate "the return to the equity owner [that is] commensurate with returns on investments in other enterprises" because returns on investments depend on what price an investor must pay for the investment in the capital markets. In addition, the fact that Dr. Morin has testified that he does not use the accounting-based comparable earnings method and that the Expected Earnings model is not one of the "methods available to measure the cost of equity" further indicates that the Expected Earnings model is not appropriate to use to estimate cost of equity. MISO TOs' citation to Dr. Morin's statement that "rate of return on book value . . . is highly meaningful" is not sufficient to convince us that the Expected Earnings model is appropriate. The quoted language does not indicate that Dr. Morin believes that rate of return on book value "is highly meaningful" for purposes of determining cost of equity. Rate of return on book value could be highly meaningful for other purposes—e.g., for determining revenues because rate of return is applied to the book value of a utility's rate base—but this does not mean that it is necessarily highly meaningful for determining cost of equity. In light of the other academic literature and testimony evidence in the record, we find that this evidence does not justify using the Expected Earnings model in our ROE analysis.

220. Trial Staff also notes that Professor Brigham has stated that the Expected Earnings model's historical-looking analog, the comparable earnings approach, "has now been thoroughly discredited . . . and it has been replaced by three market-oriented (as opposed to accounting-oriented) approaches: (i) the DCF method, (ii) the bond-yield-plus-risk-

[462] San Diego Gas & Electric Company, Prepared Direct Testimony of Dr. Roger A. Morin on behalf of San Diego Gas & Electric Company, Docket No. ER19-221-000, at 16-17 (filed Oct. 30, 2018) ("There are three broad generic methods available to measure the cost of equity: DCF, Risk Premium, and CAPM. All three of these methods are accepted and used by the financial community and firmly supported in financial literature.").

premium method, and (iii) the CAPM."[463] LPSC cites another article that states that

> Investments in equity shares are made by the purchase of shares at market prices. Therefore, the fairness of the rate of return to the investor must be judged from the investor's point of view in the market place and not on the basis of book value.[464]

LPSC also cites to studies that it claims demonstrate that accounting rates of return like those produced by the Expected Earnings model are unreliable as a measure of economic returns. In particular, LPSC cites a paper that concludes that "the accounting rate of return—after tax as well as before tax—is a misleading measure of the economic rate of return."[465] LPSC further cites an article which observed that, over a 15-year period "We see that the annual rates of return based on book value have fluctuated very little, while the annual rates of return to the investor in the market have fluctuated quite wildly."[466]

221. We find that this evidence does not support using the Expected Earnings model in our ROE analysis. Trial Staff's cited evidence indicates that the similar accounting-based comparable earnings approach has been "thoroughly discredited" and replaced by market-oriented rather than accounting-oriented approaches. As discussed above, this is logical given that the return an investor requires and the return an investor receives are dependent on the market price that investor must pay for the investment, not the accounting book value of the investment. Similarly, the evidence cited by the LPSC demonstrates that accounting rates of return do not reflect the economic rate of return actually received by an investor. *Hope* requires us to ensure that the return to a utility's

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[463] Trial Staff Initial Br. (I) at 7 and Keyton Aff. (I) at 13-14 (citing Eugene F. Brigham, Dilip K. Shome & Steve R. Vinson, *Cost of Capital Estimation, The Risk Premium Approach to Measuring a Utility's Cost of Equity*, Financial Management Spring 1985, at 33); Trial Staff Initial Br. (II) at 7 and Keyton Aff. (II) at 12 (citing same).

[464] LPSC Initial Br. at 18 (citing Alexander A. Robichek, *Regulation and Modern Finance Theory*, 33 Journal of Finance 693, 701 (1978)).

[465] LPSC Initial Br. at 22 (citing Franklin M. Fisher & John J. McGowan, *On the Misuse of Accounting Rates of Return to Infer Monopoly Profits*, 73 American Economic Review 82, 89 (1983)).

[466] *Id.* at 23 (citing Alexander A. Robichek, *Regulation and Modern Finance Theory*, 33 Journal of Finance 693, 701-702 (1978)).

equity owner is "commensurate with returns on investments in other enterprises having corresponding risks" but if an accounting-based model like the Expected Earnings model does not take into account the market price of investments in other enterprises and thus the economic return rate of return on those investments, then it cannot accurately estimate the "returns on investments in other enterprises" that we must analyze in order to assess a utility's ROE. Accordingly, we find that this evidence does not support using the Expected Earnings model in our ROE analysis.

222. As support for using the Expected Earnings model, MISO TOs' witness, Mr. McKenzie, cites to a 1991 NARUC survey in which it reported that 19 regulatory jurisdictions cited the comparable earnings approach as a primary method favored in determining the allowed ROE.[467] He also notes that the Virginia State Corporation Commission is required by statute to consider the earned returns on book value of electric utilities in its region when making ROE determinations.[468] This evidence is insufficient to persuade us that using the Expected Earnings model is appropriate. As an initial matter, the over 30-year old survey that MISO TOs cite addresses the use of the comparable earnings method, which is based on historical book returns and is not the Expected Earnings model that is at issue here.[469] Similarly, the cited Virginia statute relates to past returns on book value, not expected returns like those considered in the Expected Earnings model. Moreover, this is evidence of what regulators consider in making ROE determinations, not necessarily what investors consider in making investment decisions and determining what return they will receive on their investment, which necessarily involves a consideration of the market price that must be paid to make the investment. Accordingly, this evidence does not persuade us that return on book value can be used to estimate the "return to the equity owner" that we must ensure is "commensurate with returns on investments in other enterprises having corresponding risks" under *Hope*.

223. In addition, the application of the Expected Earnings model in the electric utility cost-of-service context could produce illogical results that render use of the model sub-optimal. The simple math of the equation is that the higher the ratio of earnings to book value a given company features, the higher the resulting return from the model. Much of

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[467] MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 67-68 (citing Nat'l Ass'n of Regulatory Util. Comm'rs, *Utility Regulatory Policy in the U.S. and Canada, 1995-1996* (Dec. 1996)); MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 67-68 (citing same).

[468] *See* Va. Code Ann. § 56-585.1.A.2.a (2019).

[469] *See* Trial Staff Reply Br. (I), Keyton Reply Aff. (I) at 4-5; Trial Staff Reply Br. (II), Keyton Reply Aff. (II) at 4-5.

the earnings from regulated utilities comes from the return earned in their cost-of-service rates. In such rates, the higher the percentage of equity in the capital structure, the higher the overall return, and thus earnings, would be, because the cost of equity is higher than the cost of debt. Consequently, holding all else equal, if a utility features an equity-rich capital structure, the Expected Earnings model would produce a higher return than if it featured a less equity-rich capital structure. This is illogical because the latter utility would be riskier than the former given its higher amount of leverage. Thus, the model would imply that less risky companies merit higher returns, when investors would require a lower return from those companies.

224. In addition, book value in the expected earnings calculation, if it follows general accounting conventions, would take the initial value of assets and subtract depreciation (and include any subsequent adjustments like write-downs). This leads to higher returns from the model for utilities that feature older, more-depreciated, assets than newer ones. Again, all else being equal, utilities with more depreciated assets are generally of lower risk, because they have recovered more of their invested capital, and thus they would generally merit a lower return, than utilities with newer assets.

225. Finally, we note that the MISO TOs' Expected Earnings model, unlike the other market-based models, is based solely on projections and features data from a single *Value Line* analyst. Thus the data, even if reviewed by others at *Value Line*, is much less robust and more subject to error than the data underlying the CAPM and DCF models, most of which is historic, easily verifiable, and comes from more than the projections of a single analyst.

226. We recognize that, in Opinion No. 551, the Commission reversed the Presiding Judge's rejection of MISO TOs' Expected Earnings analysis. However, in Opinion No. 551, the Commission only found that "MISO TOs' expected earnings analysis is sufficiently reliable to be used as corroborative evidence that the midpoint of the zone of reasonableness produced by the mechanical application of the DCF methodology does not result in a return that satisfies the requirements of *Hope* and *Bluefield*."[470] The Commission stated that "The expected earnings analysis, like the other alternative methodologies accepted herein, is merely used as corroborative evidence . . . which at most can corroborate the Commission's decision to place an ROE above the midpoint of the zone of reasonableness."[471] Here, the question before the Commission is whether to adopt the proposal in the Briefing Order to directly use the results of the Expected Earnings model in the ROE estimate calculations that are the foundation of our ROE analysis. We find that stronger evidence is required to support a decision to include the Expected Earnings model as a direct input in our ROE methodology than is required to

[470] Opinion No. 551, 156 FERC ¶ 61,234 at P 239.

[471] *Id.* P 233.

merely use it as corroborative evidence for placing an ROE within the zone of reasonableness. We have directed the parties in these proceedings to address the Briefing Order's proposal to use the Expected Earnings model as a direct input in our ROE methodology and, in light of the evidence that they have provided, we find that there is not sufficient support to use the Expected Earnings model as a direct input in our ROE methodology. The question in this proceeding regarding the Expected Earnings model differs from the question that was considered in Opinion No. 551. Accordingly, our decision to exclude the Expected Earnings model from our ROE methodology here is not inconsistent with our determination in Opinion No. 551.

227. Some parties argue that, if the Expected Earnings model is used, the Commission should implement certain modifications to the model.[472] MISO TOs argue against implementing these modifications.[473] We find that these arguments are moot and that it is unnecessary to address them because we will not use the Expected Earnings model as part of our ROE methodology. For the same reason, we find it unnecessary to address the arguments that oppose using the Expected Earnings model on other grounds, such as the LPSC's *Daubert* arguments,[474] and the applicable counterarguments.

228. Because we find that it is not appropriate to use the Expected Earnings model in our ROE methodology, we grant the requests for the rehearing of Opinion No. 551 in the First Complaint proceeding and the exceptions to the Initial Decision in the Second Complaint proceeding that ask the Commission to exclude the Expected Earnings model from its ROE determinations, to the extent those requests for rehearing and exceptions are based on our reasoning discussed above for excluding the Expected Earnings model.

VII. CAPM

A. Background

229. Investors use CAPM analysis as a measure of the cost of equity relative to risk.[475] The CAPM methodology is based on the theory that the market-required rate of return for a security is equal to the risk-free rate, plus a risk premium associated with the specific

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[472] *See, e.g.*, CAPs Initial Br. (I) at 44-46; CAPs Initial Br. (II) at 44-46; Trial Staff Initial Br. (I) at 18-19 and ; Trial Staff Initial Br. (II) at 18; RPGI Initial Br. (I), Ex. RPG-17 at 25-26; RPGI Initial Br. (II), Ex. RPG-38 at 26; LPSC Initial Br. at 29.

[473] *See, e.g.*, MISO TOs Reply Br. (I) at 47-51; MISO TOs Reply Br. (II) at 47-51.

[474] *See, e.g.*, LPSC Initial Br. at 15-20.

[475] Opinion No. 551, 156 FERC ¶ 61,234 at P 138.

security. Specifically, the CAPM methodology estimates the cost of equity by taking the "risk-free rate" and adding to it the "market-risk premium" multiplied by "beta."[476] The risk-free rate is represented by a proxy, typically the yield on 30-year U.S. Treasury bonds.[477] Betas, which are published by several commercial sources, measure a specific stock's risk relative to the market. The market risk premium is calculated by subtracting the risk-free rate from the expected return. The expected return can be estimated either using a backward-looking approach, a forward-looking approach, or a survey of academics and investment professionals. A CAPM analysis is backward-looking if the expected return is determined based on historical, realized returns. A CAPM analysis is forward-looking if the expected return is based on a DCF analysis of a large segment of the market. Thus, in a forward-looking CAPM analysis, the market risk premium is calculated by subtracting the risk-free rate from the result produced by the DCF analysis.[478]

230. In the First Complaint proceeding, MISO TOs submitted a forward-looking CAPM analysis of each company in the proxy group. MISO TOs used the 2.7 percent 30-year U.S. Treasury average historical bond yield for November 2014 to April 2015 for the risk-free rate,[479] beta values for each proxy company reported by *Value Line*, and a market risk premium based on a one-step DCF study of all dividend-paying companies in the S&P 500.[480] In that DCF study, MISO TOs added the weighted average dividend of those companies (2.4 percent) to the average of the weighted average growth rates projected for the companies by IBES and *Value Line* (8.9 percent). MISO TOs did not include a long-term growth projection in its DCF study of the dividend-paying companies in the S&P 500. MISO TOs' DCF study resulted in a uniform cost of equity for the dividend-paying companies in the S&P 500 of 11.3 percent. The MISO TOs then subtracted from that figure the 2.7 percent risk-free rate to obtain a risk premium of 8.6 percent. The MISO TOs multiplied this risk premium by the beta listed for each proxy company by *Value Line* and added the risk-free rate to that product. This CAPM analysis

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[476] *Id.* (citing Morin at 150).

[477] *Id.* P 138.

[478] *See id.* PP 150, 155.

[479] Ex. MTO-30 at 1. MISO TOs also performed a CAPM study using the average projected 30-year U.S. Treasury bond yield for 2016-2020. *Id.* at 2. However, the Presiding Judge rejected that study, finding that projected bond yields are speculative and therefore less reliable for a CAPM study than current Treasury bond yields. Initial Decision (I), 153 FERC ¶ 63,027 at P 309. MISO TOs did not except to this ruling.

[480] Ex. MTO-1 at 97-98.

produces an unadjusted ROE range of 7.86 percent to 10.87 percent for the proxy group, with a midpoint value of 9.37 percent.[481]

231. However, after adjusting for the effect of each proxy company's size, MISO TOs' CAPM analysis produced an ROE range of 7.50 percent to 12.61 percent, with a midpoint value of 10.06 percent.[482] MISO TOs' witness, Dr. Avera, explained that the "size adjustment reflects the fact that differences in investors' required rate of return that are related to firm size are not fully captured by beta."[483] Dr. Avera based his size adjustments on data contained in a table published in Morningstar Inc.'s (Morningstar) "2015 Ibbotson SBBI Market Report." The table adjusts each proxy company's cost of equity based on its size, reducing the unadjusted cost of equity of larger companies, while increasing those of smaller companies.[484]

232. In Opinion No. 551, the Commission affirmed the Presiding Judge's acceptance of MISO TOs' CAPM analysis "to be used as corroborative evidence" in determining where to place MISO TOs' ROE in the DCF zone of reasonableness.[485] The Commission rejected challenges to MISO TOs' calculation of the market risk premium and use of a size adjustment. In their requests for rehearing of Opinion No. 551, CAPs and OMS contend that the Commission erred in approving MISO TOs' CAPM analysis, taking issue with how MISO TOs implemented their CAPM analysis.[486]

233. In the Second Complaint proceeding, MISO TOs submitted a CAPM study using the identical methodology as the CAPM study they presented in the First Complaint proceeding.[487] After the size adjustment, that study produced a zone of reasonableness of

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[481] Opinion No. 551, 156 FERC ¶ 61,234 at P 139.

[482] *Id.* P 140; Initial Decision (I), 153 FERC ¶ 63,027 at P 264 (citing Ex. MTO-30 at 1).

[483] Opinion No. 551, 156 FERC ¶ 61,234 at P 140 (citing Ex. MTO-1 at 98).

[484] *Id.* (citing Ex. MTO-30 at 1).

[485] *Id.* PP 165-172.

[486] *See* CAPs Rehearing Request at 28-29, 49-58; OMS Rehearing Request at 5, 26-34.

[487] *See* Ex. MTO-36.

7.97 percent to 12.12 percent with a midpoint of 10.05 percent.[488] The Presiding Judge rejected most challenges to that study.[489] However, the Presiding Judge found that MISO TOs erred in using both IBES and *Value Line* short-term growth projections in its DCF analysis of the dividend paying companies in the S&P 500, and should have only used IBES growth projections.[490] The Presiding Judge found that revising MISO TOs' CAPM study to use only the IBES growth projections reduced the midpoint from 10.05 percent to 9.67 percent, and he approved MISO TOs' CAPM study with that modification.[491]

234. Although MISO TOs' excepted to the Presiding Judge's rejection of their proposal to use only the *Value Line* short-term growth projections in their two-step DCF analysis of the proxy group,[492] they did not except to the Presiding Judge's rejection of the use of *Value Line* short-term growth projections as part of the DCF analysis of the dividend-paying companies in the S&P 500 for purposes of their CAPM study. However, CAPs, OMS and JCA, and RPGI filed exceptions to the Presiding Judge's approval of MISO TOs' CAPM study, as modified, objecting to the use of a one-step DCF analysis of the dividend-paying companies in the S&P 500 and the size adjustment.[493]

235. In the Briefing Order, the Commission proposed to give the CAPM model equal weight, along with the DCF model and Expected Earnings model, in establishing a composite zone of reasonableness to be used under the first prong of section 206 to determine whether the existing ROE has become unjust and unreasonable.[494] It also proposed to give the CAPM model equal weight, along with the DCF, Expected Earnings, and Risk Premium models, in determining a new just and reasonable ROE, when the existing ROE has been shown to be unjust and unreasonable under the second prong of section 206.[495] The Commission also recognized that the fact it was no longer

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[488] Initial Decision (II), 155 FERC ¶ 63,030 at P 405.

[489] *See id.* PP 392-474.

[490] *Id.* P 412.

[491] *Id.* PP 409, 412, 474.

[492] *See* MISO TOs Br. on Exceptions at 12-30.

[493] *See* CAPs Br. on Exceptions at 69-79; OMS and JCA Br. on Exceptions at 5, 48; RPGI Br. on Exceptions at 57-64.

[494] *See* Briefing Order, 165 FERC ¶ 61,118 at PP 13, 17.

[495] *Id.* P 18.

proposing to use the alternative methodologies only to corroborate setting the ROE above the midpoint of the DCF zone of reasonableness raises the issue of whether there should be any adjustments to how we implement the alternative methodologies, including the CAPM model.[496]

B. Use of CAPM Generally

236. Parties generally do not oppose use of the CAPM in the Commission's ROE methodology, with most parties generally agreeing that proper application of the CAPM model can produce reliable ROE results and that investors use the CAPM model.[497] As noted above, some parties argue that the Commission should continue to exclusively rely the DCF model but those parties do not oppose the use of the CAPM model if the Commission does move to a multiple-model ROE methodology.[498] However, the parties disagree on the proper application of the CAPM model. The record evidence demonstrates that this model is widely used by investors.[499] Academic literature similarly indicates that investors rely on the CAPM.[500] Moreover, the CAPM is directly relevant to

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[496] *Id*. P 41.

[497] *See, e.g.*, CAPs Initial Br. (I) at 28 ("The CAPM analysis, as corrected by Mr. Gorman, produces reliable results.") and Ex. JC-100 at 11; CAPs Initial Br. (II) at 27 and Ex. JC-200 at 10; Trial Staff Initial Br. (I), Keyton Aff. (I) at 11 ("the DCF, CAPM, and Risk Premium methods which are widely used by investors."); Trial Staff Initial Br. (II), Keyton Aff. (II) at 10; LPSC Initial Br. at 8; MISO TOs Initial Br. (I) at 4; MISO TOs Initial Br. (II) at 6. Alliant and OMS neither explicitly support, nor oppose, the use of the CAPM.

[498] *See, e.g.*, RPGI Initial Br. (I) at 11, 25-29; RPGI Initial Br. (II) at 14-15, 29-33; CAPs Initial Br. (I) at 12-25, 27-28; CAPs Initial Br. (II) at 11-25, 27-28.

[499] *See, e.g.*, Trial Staff Initial Br. (I), Keyton Aff. (I) at 11 ("the DCF, CAPM, and Risk Premium methods which are widely used by investors."); Trial Staff Reply Br. (I) at 5 ("'There are three broad generic methods available to measure the cost of equity: DCF, Risk Premium, and CAPM. All three of these methods are accepted and used by the financial community and firmly supported in financial literature.'" (quoting San Diego Gas & Electric Company, Prepared Direct Testimony of Dr. Roger A. Morin on behalf of San Diego Gas & Electric Company, Docket No. ER19-221-000, at 16-17 (filed Oct. 30, 2018))); MISO TOs Initial Br. (II) at 6 (explaining that the CAPM is "widely relied upon by investors.").

[500] *See, e.g.*, Jonathan B. Berk and Jules H. van Binsbergen, *Assessing asset pricing models using revealed preference*, 119(1) Journal of Financial Economics 1, 2 (2016) ("We find that the CAPM is the closest model to the model that investors use to

the Commission's task in this context of assessing what rate of return on equity investors require to invest in a utility.[501] John Graham and Campbell Harvey have explained that "the CAPM is by far the most popular method of estimating the cost of equity capital."[502] Accordingly, we adopt the CAPM as one of the models that the Commission will use in its methodology for assessing whether an ROE is just and reasonable and determining just and reasonable ROEs when existing ROEs have been shown to be unjust and unreasonable. Below we address the parties' arguments regarding how the CAPM model should be implemented.

C. Calculation of Market Risk Premium

1. Risk-Free Rate

237. As noted above, the market risk premium in the CAPM model is calculated by subtracting the risk-free rate from the expected market return. Parties generally support the use of 30-year U.S. Treasury average historical bond yield over a six-month period as the risk-free rate.[503] RPGI proposes using the 20-year U.S. Treasury average historical

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make their capital allocation decisions . . . investors appear to be using the CAPM to make their investment decisions."); Brad M. Barber, et al., *Which Factors Matter to Investors? Evidence from Mutual Fund Flows*, 29(10) The Review of Financial Studies 2600, 2639 (2016) ("[W]hen we ran a horse race between six asset-pricing models, the CAPM is able to best explain variation in flows across mutual funds."); *id.* at 2624 ("[T]he CAPM does the best job of predicting fund-flow relations.").

[501] *See, e.g.*, Michael C. Ehrhardt and Eugene F. Brigham, *Financial Management: Theory and Practice* 253 (13th ed. 2011) ("[T]he basic CAPM is still the most widely used method for thinking about required rates of return on stocks.").

[502] John R. Graham and Campbell R. Harvey, *The theory and practice of corporate finance: Evidence from the field*, 60(2) Journal of Financial Economics 187, 201 (2001).

[503] *See, e.g.*, CAPs Initial Br. (I) at 34 ("The components of a properly implemented forward-looking CAPM methodology include: (1) the use of the actual 30-year U.S. Treasury bond yield during the six-month study period for the risk-free rate") and Ex. JC-100 at 11, 26; Trial Staff Initial Br. (I) at 11 ("Mr. Keyton also accepts the use of the risk-free rate as the yield on the 30-year U.S. Treasury bonds."); LPSC Initial Br. at 38; MISO TOs Reply Br. (I), App. 2 at 28 ("The CAPM applications presented in Mr. Gorman's and Mr. Keyton's affidavits all use an average yield on 30-year U.S. Treasury bonds for the risk-free rate and rely on *Value Line* beta values. I agree with these aspects of their analyses.").

yield over a six-month period as the risk-free rate, but only supports this proposal with a footnote stating that "Use of 20-year Treasury bonds is appropriate as risk-free rate since this is the maturity of bonds used in Morningstar study as measurement of long-term government bonds."[504] We find that the evidence supporting the use of the 30-year U.S. Treasury average historical bond yield over a six-month period as the risk-free rate outweighs the evidence supporting the use of the 20-year U.S. Treasury yield. RPGI is the only party to propose using the 20-year U.S. Treasury yield and the other evidence and precedent provides greater support for using the 30-year U.S. Treasury yield.[505] Accordingly, we adopt use of the 30-year U.S. Treasury average historical bond yield over a six-month period as the risk-free rate.

238. CAPs argue that the six-month period for purposes of determining the risk-free rate should be the same time period as used to produce the DCF study in the applicable proceeding.[506] Other parties do not disagree with this argument and generally use the same time period as used to produce the DCF study or a time period as close as possible to that time period.[507] Accordingly, we adopt the use of the 30-year U.S. Treasury average historical bond yield over a six-month period corresponding as closely as possible to the six-month financial study period as the risk-free rate.

2. Expected Market Return

a. Background

239. As described above, in the CAPM model, the market risk premium is calculated by subtracting the risk-free rate from the expected market return. The expected market return can be estimated either using a backward-looking approach based upon realized

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[504] RPGI Initial Br. (I), Ex. RPG-17 at 11 & n.29; RPGI Initial Br. (II), Ex. RPG 38 at 11 & n.29.

[505] *See, e.g.*, Morin at 151-152 ("[T]he yield on very long-term government bonds, namely, the yield on 30-year Treasury bonds, is the best measure of the risk-free rate for use in the CAPM and Risk Premium methods."); Opinion No. 531-B, 150 FERC ¶ 61,165 at P 114 ("30-year U.S. Treasury bond yields are a generally accepted proxy for the risk-free rate in a CAPM analysis, and are also considered superior to short- and intermediate-term bonds for this purpose.").

[506] *See* CAPs Initial Br. (1), Ex. JC-100 at 26; CAPS Initial Br. (II), Ex. ICG-200 at 25.

[507] *See, e.g.*, MISO TOs Initial Br. (I) at 24-25; Trial Staff Initial Br. (I), Keyton Aff. (I) at 8; RPGI Initial Br. (I), Ex. RPG-38 at 11.

market returns during a historical period, a forward-looking approach applying the DCF model to a representative market index, such as the S&P 500, or a survey of academics and investment professionals.[508]

240. In Order No. 551, the Commission affirmed the Presiding Judge's findings that the MISO TOs' witness, Dr. Avera, properly calculated a forward-looking expected market return, using a one-step DCF analysis of the dividend-paying companies in the S&P 500. The Commission found that Dr. Avera's use of an average of IBES and *Value Line* short-term growth projections as his short-term growth projection and his decision to not include a long term growth projection were acceptable. The Commission stated that, while it has found that *Value Line*'s growth rate estimates are not acceptable for purposes of the two-step DCF model, the Commission has nevertheless found that *Value Line* is a valid source of general financial data.[509] In his CAPM analysis, Dr. Avera uses the *Value Line* data in conjunction with IBES data and both are averaged over a 400-company data set. The Commission held that

> this use of growth rate data is fundamentally different from how growth rate data is used in the DCF model, because it is intended to provide a less precise cost of equity estimate than the DCF model. Although we require more precision from our DCF model—as the primary financial model that we use . . . to determine public utility ROEs—that same degree of precision is less essential in the CAPM analysis because that analysis is but one of multiple pieces of evidence corroborating the results of our DCF analysis.[510]

Furthermore, the Commission stated that no party demonstrated that reliance on IBES growth rate estimates alone would produce a materially different CAPM result.

241. The Commission also found that a long-term growth component is not required in the DCF study when developing a market risk premium for a CAPM analysis.[511] The Commission stated that "the rationale for requiring a two-step DCF methodology that incorporates a long-term growth rate input when conducting a DCF study on a specific group of public utilities does not necessarily apply when conducting a DCF study of the

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[508] Morin at 155-162.

[509] Opinion No. 551, 156 FERC ¶ 61,234 at P 169.

[510] *Id.*

[511] *Id.* P 170.

companies in the S&P 500."[512] Further, over protests from parties that MISO TOs did not use the S&P 500, the Commission explained that MISO TOs selected every dividend-paying stock included in the S&P 500, totaling approximately 400 companies, and that each company selected had a high market capitalization at that time. The Commission determined that, consistent with Opinion No. 531-B, the resulting DCF study of the approximately 400 dividend-paying stocks need not include a two-step DCF methodology that incorporates a long-term growth rate input.[513]

242. In the Second Complaint proceeding, the Presiding Judge in his initial decision, issued before Opinion No. 551, held that MISO TOs erred in using both IBES and *Value Line* short-term growth projections in the DCF analysis of the dividend paying companies in the S&P 500. The Presiding Judge found that, because the Commission does not permit use of *Value Line* growth projections in its regular DCF analyses of public utility and pipeline proxy groups, those growth projections also should not be used as part of the DCF analysis of the dividend paying companies in the S&P 500 for purposes of a CAPM analysis.[514] However, the Presiding Judge did, consistent with Opinion Nos. 531 and 551, find that Dr. Avera properly used a one-step DCF analysis for this purpose.

b. MISO TOs

243. MISO TOs support the Commission's holdings in Opinion No. 551 concerning the DCF analysis of the dividend paying members of the S&P 500 for purposes of determining the CAPM market risk premium. They argue that the Commission properly approved use of an average of *Value Line* and IBES short-term growth projections. MISO TOs state that in Opinion No. 551 the Commission found that "*Value Line* is a valid source of general financial data" and that the "use of growth rate data [in the CAPM] is fundamentally different from how growth rate data is used in our DCF model."[515] MISO TOs argue that Trial Staff does not confront this finding, but instead raises generalized arguments that do not invalidate the reliability of *Value Line*'s growth rate estimates. MISO TOs assert that the Commission has not ruled out consideration of *Value Line* in any and all contexts. MISO TOs add that Trial Staff's claim that IBES growth rates are updated more frequently than *Value Line*'s lacks any empirical support, and in any event, there is no evidence that the frequency of updates has any bearing on

[512] *Id.* (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 113).

[513] *Id.*

[514] *Id.* P 412.

[515] MISO TOs Reply Br. (I) at 27 (citing Opinion No. 551, 156 FERC ¶ 61,234 at P 169); MISO TOs Reply Br. (II) at 27.

investor reliance on either IBES or *Value Line*.[516] MISO TOs conclude that the Commission should continue to allow the use of *Value Line* data in CAPM analyses.

244. MISO TOs also support the Commission's determination in Order No. 551 to use a single stage DCF model to develop the market risk premium for the CAPM analysis, noting that the Commission has already twice rejected CAPs and other parties' arguments that the two-step DCF is required.[517] According to MISO TOs, it is appropriate to use a single stage DCF to evaluate the S&P 500 Index because the "growth rates used in the MISO TOs' CAPM studies are representative of the consensus expectations for the dividend paying firms in the S&P 500 Index *as a whole*."[518] Mr. McKenzie asserts that concerns about the sustainability of such growth rates for a single firm miss the point because the growth rate represents the weighted average of investors' expectations for the dividend paying firms in the S&P 500 Index, not a growth rate for a single firm that is assumed to be constant in perpetuity. MISO TOs' witness Mr. McKenzie states that the S&P 500 includes a broad sample of corporations from widely varied and distinct industries. He states that growth expectations for some firms fall below expected trends in GDP, while projections for other firms are more optimistic. He also points out that the composition of the S&P 500 is not static. As a result, formerly successful firms are supplanted by new firms with potential for high growth, for example Sears is supplanted by Amazon or Blockbuster by Netflix.[519]

245. Mr. McKenzie also asserts that academic research supports the use of a single-step DCF model when performing a DCF analysis of the S&P 500.[520] For example, Mr. McKenzie points out that in *Estimating Shareholder Risk Premia*, Harris and Marston estimate the market-required rate of return by performing a DCF analysis of the

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[516] MISO TOs Reply Br. (I) at 28-29; MISO TOs Reply Br. (II) at 28-29.

[517] MISO TOs Reply Br. (I) at 23; MISO TOs Reply Br. (II) at 23.

[518] MISO TOs Reply Br. (I) at 24 and App. 2 at 26 (emphasis added by MISO TOs); MISO TOs Reply Br. (II) at 24 and App. 2 at 26.

[519] MISO TOs Reply Br. (I), App. 2 at 20 and 26; MISO TOs Reply Br. (II), App. 2 at 20 and 26.

[520] MISO TOs Reply Br. (I), App. 2 at 23-25 (citing Robert S. Harris, *Using Analysts' Growth Forecasts to Estimate Shareholder Required Rates of Return*, Fin. Mgmt., Spring 1986; Robert S. Harris & Felicia C. Marston, *Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts*, Fin. Mgmt., Summer 1992; and Felicia Marston & Robert S. Harris, *Risk and Return: A Revisit Using Expected Returns*, Fin. Rev., Feb. 1993); MISO TOs Reply Br. (II), App. 2 at 23-25 (citing same).

dividend paying companies in the S&P 500. Consistent with the MISO TOs' CAPM approach, Harris and Marston state that "[t]he mean value of the individual analysts' forecasts of five-year growth rates in [earnings per share] will be used as a proxy for g in the DCF model."[521] In addition, Mr. McKenzie points out that Harris and Marston state that "[t]he five-year horizon is the longest horizon over which such forecasts are available from IBES and often is the longest horizon used by analysts."[522] Moreover, Harris and Marston emphasize that their use of a one-step DCF analysis to determine the market-required rate of return "is applied to portfolios of stocks [i.e., the S&P 500], rather than to individual securities, since future growth patterns may be expected to have drastic changes for some specific securities."[523]

246. MISO TOs state that the DCF analysis used to determine an input into the CAPM need not mimic the DCF model used to yield ROE estimates for individual public utilities. "It is a feature . . . that the CAPM and the Commission's DCF rely on different approaches to estimate investors' expected return on equity."[524] They state that reliance on the one-step DCF is consistent with the Briefing Order's approach reducing the risk of misidentifying the ROE through the use of multiple models. Finally, MISO TOs argue that CAPs have not provided any reason for the Commission to revisit its findings on this matter.[525]

c. CAPs

247. In their request for rehearing of Opinion No. 551, brief on exceptions to the Initial Decision in the Second Complaint proceeding, and briefs in response to the Briefing Order, CAPs assert that the Commission's two-step DCF methodology is required to accurately calculate the market risk premium of the CAPM,[526] and assert the MISO TOs'

[521] MISO TOs Reply Br. (I), App. 2 at 23-24; MISO TOs Reply Br. (II), App. 2 at 23-24.

[522] MISO TOs Reply Br. (I), App. 2 at 24; MISO TOs Reply Br. (II), App. 2 at 24.

[523] MISO TOs Reply Br. (I), App. 2 at 26; MISO TOs Reply Br. (II), App. 2 at 26.

[524] MISO TOs Reply Br. (I) at 24; MISO TOs Reply Br. (II) at 24.

[525] MISO TOs Reply Br. (I) at 24; MISO TOs Reply Br. (II) at 24.

[526] CAPs Initial Br (I) at 30-31; CAPs Initial Br. (II) at 30-31.

CAPM study improperly used the one-step DCF.[527] CAPs assert that including only short-term growth rates in this DCF calculation implies that such growth will continue in perpetuity, and assumes that a company can grow faster than the economy for an indefinite period of time.[528] They also comment that such an assumption is both unrealistic and inconsistent with the Commission's prior determinations.[529] CAPs assert that failure to include a second-stage growth rate in the CAPM portfolio DCF calculation runs counter to economic logic.[530]

248. In their request for rehearing of Opinion No. 551, CAPs assert that the record in the First Complaint proceeding shows that the investment community expects corporate earnings growth to track GDP growth.[531] For example, they cite Pacific Investment Management Company (PIMCO's) "Asset Allocation Secular Outlook 2015," in which PIMCO projects a 10-year return on U.S. equities of 4.5 percent.[532] They point out that this is well below the 11.3 percent market return estimated by the MISO TOs' one-step DCF analysis of the dividend paying members of the S&P 500 in the MISO TOs' CAPM study in the First Complaint proceeding. CAPs also observe that PIMCO states that its estimate of "[e]xpected earnings growth is based on per capita real GDP growth estimates."[533] CAPs also state that the PIMCO report calculates a forward-looking equity risk premium of 3.9 percent by comparing the projected 10 year return of the S&P 500 to

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[527] CAPs Initial Br. (I) at 30 (citing Ex. JC-100 at 11-13); CAPs Initial Br. (II) at 30-31 (citing Ex. ICG-200 at 11-13); CAPs Rehearing Request at 49-55; CAPs Br. on Exceptions at 74-78.

[528] CAPs Initial Br. (I) at 30; CAPs Initial Br. (II) at 30.

[529] CAPs Initial Br. (I) at 30 (citing *Generic Determination of Rate of Return in Common Equity for Pub. Utils.*, Order No. 420, FERC Stat. & Regs. at 31,344 & n.39 (finding that inflated equity cost estimates result when analysists estimate risk premiums using "DCF estimates of the investors' required rate of return" on "common stock," because "the use of analysts' short-term forecasts overstate[s] investors' long term growth expectations."); CAPs Initial Br. (II) at 30 (citing same).

[530] CAPs Initial Br. (I) at 31 (citing Ex. JC-100 at 14); CAPs Initial Br. (II) at 31 (citing Ex. ICG-200 at 14).

[531] CAPs Rehearing Request at 54.

[532] *Id.* (citing Ex. S-11 at 6).

[533] *Id.* (citing Ex. S-11 at 7).

inflation protected 10-year treasury bonds. CAPs state that this is less than half the 8.6 percent equity risk premium calculated by the MISO TOs.[534]

249. In addition to the PIMCO report, CAPs state that the American Appraisal Risk Premium Quarterly calculated a forward-looking risk premium of 6.0 percent, and Duff & Phelps calculated a forward-looking risk premium of 5.0 percent.[535] Also, according to CAPs, *Value Line* estimated "that the required equity premium above the yield on ten-year bonds in order to induce investment in corporate equity was about 5.5 percent."[536]

250. CAPs assert that these facts demonstrate that the 11.3 percent market return calculated by MISO TOs using the one-step DCF method, without any long-term GDP growth projection, is "way out of line with forward-looking (and historical) investment-community sources."[537] CAPs conclude that a two-step DCF method must be used to calculate the market return. They state that using a two-step DCF analysis of the dividend paying members of the S&P 500 in the First Complaint proceeding would lower the equity risk premium from 8.6 percent to 7.1 percent and lower the midpoint of the CAPM zone of reasonableness to 8.89 percent.[538] CAPs make similar arguments, relying on similar evidence, in their Brief on Exceptions to the Initial Decision in the Second Complaint proceeding.[539]

251. CAPs challenge MISO TOs' reliance upon three academic papers published between 1986 and 1993 that applied a one-stage DCF in constructing their CAPM models.[540] CAPs explain that these studies estimated that the risk premium of a diversified equity portfolio over long-term U.S. bonds averaged well under seven percent,

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[534] *Id*. (citing Ex. S-11 at 10).

[535] *Id*. (citing Ex. JCI-4 at 46-47).

[536] *Id.* (citing Ex. S-1 at 15).

[537] *Id*. at 54-55.

[538] *Id*. at 55.

[539] CAPs Br. on Exceptions at 75-77.

[540] Robert S. Harris, *Using Analysts' Growth Forecasts to Estimate Shareholder Required Rates of Return*, Fin. Mgmt., Spring 1986; Robert S. Harris & Felicia C. Marston, *Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts*, Fin. Mgmt., Summer 1992; and Felicia Marston and Robert S. Harris, *Risk and Return: A Revisit Using Expected Returns*, Fin. Rev., Feb. 1993.

less than the 8.6 percent and 8.2 percent that Mr. McKenzie applied in his CAPMs for the First Complaint and Second Complaint study periods. CAPs also assert that these studies are not relevant here because they tested whether the cost of equity varied over time and across company risks, not the absolute value of the cost of equity.[541] CAPs posit that the authors did not use a two-stage DCF methodology because long-term growth "was tangential to what they sought to measure."[542]

252. CAPs disagree with Mr. McKenzie's argument that investors can expect long-term dividend growth that exceeds the growth rate of the U.S. economy because the composition of the S&P 500 Index is not static and firms with high growth potential replace firms with low growth potential.[543] CAPs argue that regardless of index composition, the equity market as a whole cannot sustainably grow faster than the economy as a whole. Finally, CAPs assert that the S&P 500 Index does not grow through the substitution of firms, but instead when there is a substitution of firms, the index value is held constant.[544]

253. CAPs contest Mr. McKenzie's argument that the portfolio return must exceed the 9.29 percent that Opinion No. 551 found insufficient for electric utilities.[545] CAPs argue that because Opinion No. 551 is under reconsideration by the Commission, it should not be relied upon here. Further, CAPs argue that the decision in Opinion No. 551 to place the base ROE above the DCF midpoint was based on the fact that CAPM results, if premised on an unsustainable equity portfolio return, pointed above the DCF midpoint. CAPs assert that relying upon that decision to require an equity portfolio return above the DCF midpoint would be untenably circular. Also, they argue that the appropriate comparison would be between the average (or median) composite earnings growth rate used in the utility DCF and the composite earnings growth rate used in the CAPM's portfolio DCF. CAPs explain that the earnings growth rate for the CAPM equity portfolio is substantially higher than that of the utility proxies. CAPs' witness, Mr. Gorman recommended a modification of the DCF-based CAPM portfolio return, with an average composite earnings growth rate of 7.4 percent. CAPs argue that the

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[541] CAPs Reply Br. (I) at 17-18; CAPs Reply Br. (II) at 33-34.

[542] CAPs Reply Br. (I) at 18; CAPs Reply Br. (II) at 34.

[543] CAPs Reply Br. (I) at 19 (citing MISO TOs, McKenzie Reply Aff., Docket No. EL11-66, at 27-28 (filed Mar. 8, 2019)); CAPs Reply Br. (I) at 35-36 (citing same).

[544] CAPs Reply Br. (I) at 19; CAPs Reply Br. (II) at 35-36.

[545] CAPs Reply Br. (I) at 20 (citing MISO TOs, McKenzie Reply Aff., Docket No. EL11-66, at 31 (filed Mar. 8, 2019)); CAPs Reply Br. (II) at 36 (citing same).

earnings growth rate for the CAPM equity portfolio is substantially higher than that of the utility proxies, as expected given the utility proxies' low risk. And, they argue that this difference contradicts the MISO TOs' claim that the growth rate obtained by applying a second-stage growth constraint to portfolio earnings is too low when compared to utility stock financial data.[546]

254. CAPs disagree with Mr. McKenzie's assertion that other regulators rely on a one-stage DCF to find CAPM portfolio returns.[547] They comment that Mr. McKenzie's assertion relied upon testimony that was filed 18 years ago in a state commission proceeding. According to CAPs, in the *Coakley* Briefing Order proceeding, a survey of electric transmission ROE regulation in Australia, Canada, the United Kingdom and Europe showed that when regulators apply CAPM models, they use equity market returns that are typically about 4.75 percent to 6.0 percent above the risk-free governmental security yield.[548]

255. In their request for rehearing of Opinion No. 551, CAPs state that they are not seeking rehearing of the Commission's acceptance of MISO TOs' use of an average of IBES and *Value Line* growth projections as the short-term growth projection in their DCF analysis of the dividend paying members of the S&P 500 in the First Complaint proceeding. CAPs agree with Opinion No. 551's finding that the record in the First Complaint proceeding is insufficient to show that removal of the *Value Line* growth projection would materially affect the results of the MISO TOs' CAPM analysis. However, CAPs state that they support the Presiding Judge's decision in the Second Complaint proceeding to eliminate the *Value Line* growth projection and use only IBES as the short-term growth projection.[549]

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[546] CAPs Reply Br. (I) at 20-21; CAPs Reply Br. (II) at 36-37.

[547] CAPs Reply Br. at 21 (citing MISO TOs, McKenzie Reply Aff., Docket No. EL11-66, at 28-29 (filed Mar. 8, 2019)).

[548] CAPS Reply Br. (I) at 21 (citing Docket No. EL11-66, Ex. CAP-600 at 37-46); CAPS Reply Br. (II) at 37 (citing same).

[549] CAPs Rehearing Request at 55-56 n.193.

d. Trial Staff

256. Trial Staff argues that the DCF component of CAPM should be calculated following the Commission's two-step DCF methodology.[550] Trial Staff asserts that use of the one-step DCF model implies that a company can grow faster than the economy for an indefinite period of time.[551] Trial Staff also comments that such an assumption is both unrealistic and inconsistent with the Commission's prior determinations.[552]

257. In its briefs in both the First and Second Complaint proceedings, Trial Staff also argues that only IBES growth rates should be used as the short-term growth projection in the DCF model employed in a CAPM analysis.[553] Trial Staff states that *Value Line* does not represent consensus earnings growth estimates, but rather the estimate of a single analyst.[554] Trial Staff alleges that IBES growth rates are updated more frequently. Trial Staff's witness, Mr. Keyton, included in the workpapers attached to his affidavit in the First Complaint proceeding the IBES growth projections for the dividend-paying members of the S&P 500 necessary for calculating a short-term growth projection using only IBES growth projections.[555]

258. Trial Staff proposes to remove companies from the CAPM whose short-term IBES growth rates or composite growth rates are less than or equal to zero, and those greater than or equal to 20 percent, as supported by Dr. Morin.[556] Trial Staff argues that the Commission has previously found that zero or negative growth rates are either

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[550] Trial Staff Initial Br. (I) at 13-14; Trial Staff Initial Br. (I) at 12-13 Trial Staff Reply Br. (I) at 10-11; Trial Staff Reply Br. (II) at 11.

[551] Trial Staff Initial Br. (I) at 13-14; Trial Staff Initial Br. (II) at 12-13.

[552] Trial Staff Initial Br. (I) at 14 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 36 n.63 and Morin at 308); Trial Staff Initial Br. (II) at 13 (citing same).

[553] Trial Staff Initial Br. (I) at 11-12; Trial Staff Initial Br. (II) at 11.

[554] Trial Staff Initial Br. (I) at 12. Trial Staff Initial Br. (II) at 11.

[555] Trial Staff Initial Br. (I), Keyton Aff., (I) Attachment B at 8-14; Trial Staff Initial Br. (I), Keyton Aff. (II), Attachment B at 7-12.

[556] Trial Staff Initial Br. (I) at 16-18; Trial Staff Initial Br. (II) at 16-17.

economically illogical or unsustainable.[557] Trial Staff states that, similarly, the Commission has also screened for high-end short-term growth rates.[558] Trial Staff also reasons that employing growth rate screens in both the DCF and the CAPM provides for consistency among methods.[559]

e. Other Parties

259. LPSC argues that the Commission should adopt the two-step DCF to determine the CAPM's market risk premium. They argue that MISO TOs' one-step approach "inflated the yield compared to what would be developed using the two-step approach."[560] LPSC continues that it is inconsistent to match the short-term DCF forecast with the yield on long-term bonds.[561] RPGI argues that the 8.6 percent market risk premium component of the CAPM adopted in the Briefing Order exceeds long-term risk premiums by approximately 6 percent.[562]

f. Commission Determination

260. We continue to find reasonable the MISO TOs' proposal to estimate the CAPM expected market return using a forward-looking approach, based on applying the DCF model to the dividend paying members of the S&P 500. Using a DCF analysis of the dividend-paying members of the S&P 500 is a well-recognized method of estimating the expected market return for purposes of the CAPM model.[563] The DCF analysis must be limited to the dividend-paying members of the S&P 500, rather than using all companies in the S&P 500, because a DCF analysis can only be performed on companies that pay dividends.

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[557] Trial Staff Initial Br. (I) at 17 (citing Opinion No. 531, 147 FERC ¶ 61,234 at PP 38-39); Trial Staff Initial Br. (II) at 16 (citing same).

[558] Trial Staff Initial Br. (I) at 17 (citing *ISO New England, Inc., et al.*, 109 FERC ¶ 61,147, at P 205 (2004) (indicating Commission removal of a company from the proxy group whose short-term growth rate was 13.3 percent)); Trial Staff Initial Br. (II) at 1617 (citing same).

[559] Trial Staff Initial Br. (I) at 17; Trial Staff Initial Br. (II) at 17.

[560] LPSC Initial Br. at 37.

[561] *Id.* at 38.

[562] RPGI Initial Br. (I) at 27; RPGI Initial Br. (II) at 31.

[563] Morin at 160.

261. No participant opposes the use of a DCF analysis of the dividend-paying members of the S&P 500 to estimate the expected market return. However, CAPS, LPSC, and Trial Staff raise several issues with respect to the growth projection used by MISO TOs in their CAPM analyses in both complaint proceedings. These issues include: (1) the use of the one-step DCF model without any long-term growth projection based on GDP; (2) whether S&P 500 companies included in the DCF analysis should be screened for unrealistic growth projections; and (3) the use of an average of IBES and *Value Line* growth projections as the short-term growth projection. For the reasons discussed below, we are not persuaded by CAPs and Trial Staff's arguments in support of a two-step DCF analysis to calculate the CAPM expected market return. However, we agree with CAPs that the *Value Line* growth projections should not be included in the DCF analysis.

262. Financial research supports using a one-step DCF analysis of the dividend paying members of the S&P 500 when determining a forward looking expected market return as part of the CAPM model. For example, in *Estimating Shareholder Risk Premia*, Harris and Marston present estimates of shareholder required rates of return and risk premiums using forward-looking analysts' growth forecasts. They state that "a 'market' required rate of return is calculated using each dividend paying stock in the S&P 500 for which data is available."[564] In describing this process, the authors state, "This expectational approach employs the [DCF model] in which a consensus measure of financial analysts' forecasts . . . of earnings is used as a proxy for investor expectations."[565] They continue that "[t]he mean value of individual analysts' forecasts of five-year growth rate in [earnings per share (EPS)] will be used as a proxy for *g* in the DCF model," and state that the "five-year horizon is the longest horizon over which such forecasts are available from IBES and often is the longest horizon used by analysts."[566] A second study cited by MISO TOs cautions against "the introduction of *ad hoc* assumptions about future growth" beyond the five-year time-frame used by IBES.[567] That study also emphasizes, "[i]mportantly, however, the approach is applied to portfolios of stocks rather than to individual securities, since future growth patterns may be expected to have drastic changes for some specific securities."[568] Thus, these studies support Opinion No. 531-B's holding that a long-term growth projection is not needed when performing a

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[564] *Estimating Shareholder Risk Premia* at 3.

[565] *Id.* at 2.

[566] *Id.*

[567] *Required Rates of Return* at 61.

[568] *Id.*

DCF analysis of a portfolio of stocks, despite the fact such a growth projection is needed when doing a DCF analysis of a single utility.[569] We note that the third study also relies solely upon analysts' five-year IBES growth forecasts.[570]

263. As the Commission found in Opinion No. 531-B, we continue to find that 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 apply when conducting a DCF study of the companies in the S&P 500.[571] The Commission's rationale for incorporating a long-term growth rate estimate in DCF analyses for public utilities is that it is often unrealistic and unsustainable for high short-term growth rates to continue in perpetuity for a particular utility or group of utilities.[572] The purpose of the DCF analysis in the CAPM model differs from the purpose of using the DCF analysis to directly estimate a utility's cost of equity. The purpose of the DCF analysis in the CAPM model is to determine the "required return on the overall market" that will be used to determine the market risk premium—which is based on the difference between the "required return on the overall market" and the risk-free rate.[573]

264. As described above, the required return on the overall market is determined by conducting a DCF study of "a representative market index, such as the Standard & Poor's 500 Index."[574] We find that there are at least two reasons why it is not necessary to include a long-term growth projection based on GDP in a DCF analysis of the dividend paying companies in the S&P 500. First, the S&P 500 is regularly updated to ensure, among other things, that it only includes companies with high market capitalization[575] and that it remain representative of the industries in the economy of the United States. Although the value of the S&P 500 index is held constant when one company is replaced

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[569] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 113.

[570] Ex. EMC-0224 at 3-4.

[571] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 113.

[572] *See* Opinion No. 531, 147 FERC ¶ 61,234 at P 36 n.63.

[573] *See id.* P 113.

[574] Morin at 159.

[575] Currently, in order to be included in the S&P 500, a company must have a market capitalization of at least $8.2 billion, calculated by multiplying outstanding shares of stock by stock price.

by another as CAPs state,[576] the updating of the companies in the index has the general effect of substituting companies with declining stock values and market capitalization with companies with growing stock values and market capitalization. As Mr. McKenzie testified for the MISO TOs, "As a result formerly successful firms are supplanted by new firms with potential for high growth."[577] CAPs contest this reasoning on the ground that, although the companies in the S&P 500 are updated, the MISO TOs performed a DCF analysis of a specific group of about 400 companies, and there is no reason to expect that a group of stocks "will enjoy long-term growth at short-term rates without being affected by changes in the economy as a whole."[578] This argument misses the point. Although the MISO TOs' applied their DCF analysis to the specific companies who happened to be the dividend paying members of the S&P 500 at that point in time, the purpose of the analysis was to determine a required return on the overall market as represented by an investment in the S&P 500, which is regularly updated. Thus, it is reasonable for the inputs used in the DCF analysis, including the growth projections, to be selected based on the assumption that the subject companies will be updated in the manner described above.

265. Second, we find that, because the dividend paying members of the S&P 500 constitute a large portfolio of stocks, they include companies at all stages of growth. Some are relatively young companies with new products that have not yet fully penetrated the markets and thus are likely to have quite high IBES growth rates. However, other companies are mature companies with limited growth potential which are likely to have quite low IBES growth rates. The inclusion of the IBES growth rates of such mature companies in the overall average IBES growth rate of all the dividend paying members of the S&P 500 performs the same role as the inclusion of the long-term GDP growth rate in the DCF analysis of a single utility: it reflects the fact that companies cannot maintain indefinitely the high growth rates of their early years. Thus, using the IBES growth rates of all dividend paying S&P 500 companies, without using a long-term GDP growth projection can reasonably reflect investors' consensus expectations about the S&P 500 Index as a whole.

266. In summary, while it may be unreasonable to expect an individual company to sustain high short-term growth rates in perpetuity, the same cannot be said for a broad representative market index that is regularly updated to include new companies. Put differently, a portfolio of companies behaves differently than an individual company. Accordingly, the rationale for incorporating a long-term growth rate estimate in conducting a two-step DCF analysis of a specific utility or group of utilities for purposes of directly estimating cost of equity does not apply to the DCF analysis of a broad

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[576] CAPs Reply Br. (I) at 19.

[577] MISO TOs Reply Br. (I), App. 2; McKenzie Reply Aff. (I) at 26.

[578] CAPs Rehearing Request at 51.

representative market index with a wide variety of companies that is regularly updated to include new companies for purposes of determining the required return to the overall market.

267. We also accept Trial Staff's proposal to screen from the CAPM analysis S&P 500 companies with growth rates that are negative or in excess of 20 percent. Such screening is consistent with the elimination of outliers elsewhere in our ROE methodology. Such high or low growth rates are highly unsustainable and non-representative of the growth rates of the electric utilities in the proxy groups. For instance, in the Second Complaint proceeding, Helmerich and Payne featured an IBES growth rate of negative 42 percent while Cabot Oil and Gas featured an IBES growth rate of 48.1 percent.[579] Neither growth rate is sustainable for the intermediate, much less long, term and should thus be eliminated from the group of S&P 500 companies examined.

268. Evidence indicates that the use of this growth rate screen is appropriate in the CAPM analysis. For example, in *Principles of Corporate Finance*, Richard A. Brealey and Stewart C. Myers explain that "No firm can continue growing at 20 percent per year forever, except possibly under extreme inflationary conditions."[580] Dr. Morin also separately states that growth rates less than or equal to zero and greater than or equal to 20 percent should be removed from an analysis.[581] In addition, in conducting a DCF analysis of the dividend-paying S&P 500 members to estimate *ex ante* expected returns in the CAPM analysis, Harris, et al. screened out companies "if the standard deviation around the mean [analyst] forecast exceeds 20%."[582] While this screen differs from the one Trial Staff has proposed in this proceeding, it nonetheless indicates that it is appropriate to screen out companies when conducting a DCF analysis of the dividend paying S&P 500 members in the CAPM analysis. The CAPM growth rate screen that is in record evidence before us is the screen proposed by Trial Staff and there is sufficient support to indicate that it will exclude companies with growth rates that are unsustainable. Accordingly, we find that S&P 500 companies with growth rates that are negative or in excess of 20 percent should be excluded from the CAPM analysis because their growth rates are not representative of sustainable growth rates.

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[579] Trial Staff Reply Br. (I) at App. C.

[580] Richard A. Brealey and Stewart C. Myers, *Principles of Corporate Finance* 68 (7th ed. 2003).

[581] Trial Staff Initial Br. (I); Keyton Aff. (I) at 33 (citing Morin at 165).

[582] Robert S. Harris et al., *Ex Ante Cost of Equity Estimates of S&P 500 Firms: The Choice between Global and Domestic CAPM*, Fin. Mgmt., Autumn 2003, at 5.

269. CAPs assert that the Harris and Marston articles cited by the MISO TOs do not support use of the one-step DCF model to determine the market risk premium in these two proceedings. CAPs point out that those studies estimated that the risk premium of a diversified equity portfolio over long-term U.S. bonds averaged well under seven percent,[583] less than the 8.6 percent and 8.2 percent market risk premiums that the MISO TOs used in their CAPM analyses for the First Complaint and Second Complaint study periods. Based upon our holdings in this order, we calculate market risk premiums in the First and Second Complaint proceedings of 9.12 percent and 8.85 percent respectively. The fact that the absolute market risk premiums calculated in the Harris and Marston articles for varying periods between 1982 and 1991 are lower than those we calculate based on financial information for the first and second halves of 2015 does not undercut our reliance on the Harris and Marston articles. In *Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts*, Harris and Marston found that the "market risk premium varies over time. In particular, the equity market premium over government bonds is higher in low interest rate environments."[584] Government bond interest rates were significantly lower during 2015 than during the 1982 to 1991 period.[585] Therefore, the fact that we have found higher market risk premiums of 9.12 percent and 8.85 percent during the first and second halves of 2015, rather than the less than 7.0 percent risk premiums Harris and Marston found during 1982 to 1991 is consistent with the Harris and Marston articles. Indeed, Dr. Morin cites a subsequent 2003 article by Harris, Marston, Mishra, and O'Brien[586] in which they estimate the market risk premium rising to just above 9 percent in 1998, using the same methodology as in the earlier Harris and Marston articles cited by the MISO TOs.

270. CAPs also assert that the Harris and Marston articles are not relevant here because they tested whether the cost of equity varied over time and across company risks, not the

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[583] The first article estimated 1982 average annual risk premiums of 6.16 percent. The second article estimated 1982-1991 average annual risk premiums of 6.47 percent, and the third article estimated 1982-1987 average annual premiums of 5.66 percent.

[584] Robert S. Harris & Felicia C. Marston, *Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts*, Fin. Mgmt., Summer 1992, at 1.

[585] *See, e.g.* St. Louis Federal Reserve, Treasury Constant Maturity Rate Data, https://fred.stlouisfed.org/categories/115.

[586] Morin at 160 (citing Robert S. Harris et al., *Ex Ante Cost of Equity Estimates of S&P 500 Firms: The Choice between Global and Domestic CAPM*, Fin. Mgmt., Autumn 2003, at 51-66).

absolute value of the cost of equity.[587] CAPs posit that the authors did not use a two-stage DCF because long-term growth "was tangential to what they sought to measure."[588] However, as discussed above, in *Using Analysts' Growth Forecasts to Estimate Shareholder Required Rates of Return*, Harris expressly supported using the one-step DCF model when performing a DCF analysis of a portfolio of stocks, such as the S&P 500, as opposed to individual securities. The Harris and Marston articles discuss how the costs of equity calculated by their studies varied over time and across company risks for the purpose of confirming the accuracy of their analyses using a one-step DCF study of the dividend paying members of the S&P 500, not as a separate inquiry.

271. We are not persuaded by Trial Staff's arguments that Dr. Morin supports the two-step DCF analysis for a market risk premium used in a CAPM. In particular, Trial Staff argues that Dr. Morin supports the underlying theory of incorporating a long-term growth estimate in the DCF methodology, citing his statement that "eventually all company growth rates, especially utility service growth rates, converge to a level consistent with the growth rate of the aggregate economy."[589] However, Dr. Morin made this statement in the context of discussing the DCF analysis of a single company or utility, not the market risk premium used in a CAPM. As discussed above, in discussing the application of the DCF model to a representative market index for purposes of estimating a prospective market risk premium for the CAPM, Dr. Morin cited the studies by Marris and Marston and the study by Harris, Marston, Mishra, and O'Brien discussed above.[590]

272. Finally, in their request for rehearing of Opinion No. 551, CAPs contend that the 8.6 percent market risk premium calculated by MISO TOs in the First Complaint proceeding using a one-step DCF analysis to estimate the expected market return is substantially higher than forward-looking market risk premiums calculated by other financial analysts during the same time period. They cite a PIMCO report calculating a forward-looking equity risk premium of 3.9 percent calculated by comparing the projected 10-year return of the S&P 500 to inflation protected 10-year treasury bonds. They also state that the American Appraisal Risk Premium Quarterly calculated a forward-looking risk premium of 6.0 percent, Duff & Phelps calculated a forward-looking risk premium of 5.0 percent, and *Value Line* estimated that the required equity

[587] CAPs Reply Br. (I) at 17-18; CAPs Reply Br. (II) at 33-34.

[588] CAPs Reply Br. (I) at 18; CAPs Reply Br. (II) at 34.

[589] Morin at 308.

[590] *Id.* at 159-164.

premium above the yield on ten-year bonds in order to induce investment in corporate equity was about 5.5 percent.

273. There are a variety of views as to the reasonable market risk premium to include in a CAPM study and what method to use to determine that premium, as is clear from Dr. Morin's summary of academic studies of both historical and prospective market risk premiums. Dr. Morin concludes that "Faced with this myriad, and often conflicting, evidence on the magnitude of the risk premium, a regulator might very well be confused about the correct market risk premium."[591] Although the risk premiums we approve in this order exceed those of certain other analyses, we find that their determination is analytically sound and supported by the evidence in this proceeding. We find, on balance, that the MISO TOs' use of a one-step DCF analysis of the dividend paying members of the S&P 500, in conjunction with Trial Staff's outlier test, to determine the expected market return is reasonable.

274. We now turn to the issue of what short-term growth projection sources to use in the one-step DCF analysis. For the reasons discussed below, we find that only the IBES three to five year consensus growth projections should be used. Thus, we find that MISO TOs erred in averaging the IBES growth projections with single analyst *Value Line* growth projections. This determination is consistent with our determination above to utilize IBES data for the short-term growth projection in the two-step DCF model. In that determination, we held that the record suggests that IBES provides more stable and robust data than *Value Line*, because, among other reasons, the IBES growth projections are consensus projections generally based on projections from a number of independent analysts and brokerage and investment firms, whereas the *Value Line* growth projections are by a single analyst.[592] Moreover, the Commission has rejected proposals to average IBES short-term growth projections with *Value Line* growth estimates, finding that *Value Line* projections are "projections from a single source" and their use would "dilute the industry consensus reflected in the IBES data."[593]

275. In addition, the Marston and Harris articles cited above in support of using a one-step DCF analysis of the dividend paying members of the S&P 500 as part of determining the market risk premium endorse the use of IBES projections as the single growth projection in that analysis. For example, Harris and Marston concluded in *Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts* that the use of IBES data

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[591] *Id.* at 163.

[592] *See, e.g.*, *supra* PP 125-127.

[593] *Nw. Pipeline Corp.*, 87 FERC at 62,058-59; *Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260 at P 234.

"offers a straightforward and powerful aid to establishing required rates of return either for corporate investment decisions or in the regulatory arena." [594]

276. As MISO TOs point out, Opinion No. 551 accepted their proposal to average IBES and *Value Line* growth projections for purposes of the DCF analysis of the dividend paying members of the S&P 500 as part of implementing the CAPM model. However, in doing so, the Commission explained, "Although we require more precision from our DCF model—as the primary financial model that we use, and have used for decades, to determine public utility ROEs—that same degree of precision is less essential in the CAPM analysis because that analysis is but one of multiple pieces of evidence corroborating the results of our DCF analysis."[595] In this order, by contrast, we find that it is appropriate to give equal weight to the DCF and CAPM models in setting just and reasonable ROEs. Accordingly, the CAPM model must be implemented with the same degree of precision as the DCF model. Therefore, having found that use of the IBES growth projections is preferable to the *Value Line* growth projections, we require the sole use of IBES growth projections for the DCF component of the CAPM analysis.

D. Betas and Size Premium

1. CAPs

277. In their initial briefs, CAPs argue that Dr. Avera's CAPM approach improperly includes a size premium adjustment to the base CAPM ROE range. CAPs contend that Dr. Avera's application of the size premium adjustment produces an inflated and unreliable CAPM result due to the use of mismatched betas. As explained below, CAPs assert that the betas used in Dr. Avera's base CAPM are different from, and incompatible with, the betas in the size premium adjustment. Thus, CAPs argue that the adjusted CAPM results accurately reflect neither a security's investment risk nor the market-required return on that investment risk level. CAPs assert that, as Mr. Gorman testifies, the CAPM model produces the most reliable results when it does not include a size premium adjustment.[596]

278. CAPs note that in the base CAPM, Dr. Avera relied on *Value Line*'s adjusted betas. CAPs state that *Value Line* measures a "raw" beta based on a regression of the monthly returns of the individual companies, relative to the New York Stock Exchange

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[594] Robert S. Harris and Felicia C. Marston, *Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts*, Fin. Mgmt., Summer 1992, at 6.

[595] Opinion No. 551, 156 FERC ¶ 61,234 at P 169.

[596] CAPs Initial Br. (I) 31-32; CAPs Initial Br. (II) 31-32.

(NYSE) average, over a five-year period. CAPs note that *Value Line* then adjusts the raw beta for the long-term tendency of beta to converge on the market beta of one over long periods of time. CAPs state that *Value Line*'s adjusted betas represent a raw beta estimate given two-thirds weight and the market beta of one given one-third weight.[597] CAPs also note that *Value Line* publishes its adjusted betas, not its raw betas.[598]

279. CAPs further state Dr. Avera's size premium adjustment relies on Duff & Phelps unadjusted or "raw" betas. CAPs note that Duff & Phelps' raw betas are produced by a regression study of the monthly returns on the stock index that are in excess of a 30-day U.S. Treasury yield over the period 1926 through the most recent period. CAPs state that, unlike *Value Line*, Duff & Phelps does not adjust raw betas for the long-term tendency of betas to converge on the market beta of one over time, and thus, the *Value Line* and Duff & Phelps betas are not measured in the same manner and are incompatible with each other. Additionally, CAPs argue that Duff & Phelps explicitly caution against the use of mismatched betas. CAPs assert that when these two betas are combined, as Dr. Avera has proposed, they do not accurately measure the risk or required return for a security and in fact, inflate the CAPM return estimate.[599]

280. CAPs argue that Mr. Gorman corrects Dr. Avera's CAPM to incorporate raw betas in both the base CAPM analysis and the size adjustment, which makes it evident that the use of mismatched betas inflates the CAPM results. CAPs contend that Mr. Gorman's corrected version of Dr. Avera's base CAPM produces a midpoint value of 8.40 percent and, after applying the size adjustment, a midpoint value of 9.09 percent. Further, CAPs assert that, when a consistent beta methodology is used to measure both the base CAPM and size adjustment, the resulting midpoint of 9.09 percent is reasonably comparable to a base CAPM return using a *Value Line* adjusted beta without a size premium. CAPs argue that the use of unrelated betas involves an apples-and-oranges measurement of risk and return, and therefore the CAPM should not include a size adjustment.[600]

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[597] CAPs Initial Br. (I) at 32 (citing Ex. JC-100 at 17); CAPs Initial Br. (II) at 32 (citing Ex. ICG-200 at 17).

[598] CAPs Initial Br. (I) at 32 (citing Ex. JC-100 at 18-19); CAPs Initial Br. (II) at 32 (citing Ex. ICG-200 at 17).

[599] CAPs Initial Br. (I) at 32-33 (citing Ex. JC-100 at 18-19); CAPs Initial Br. (II) at 32-33 (citing Ex. ICG-200 at 18-19).

[600] CAPs Initial Br. (I) at 33-34; CAPs Initial Br. (II) at 33-34.

2. Trial Staff

281. Trial Staff witness, Mr. Keyton, supports omitting the size premium adjustment. Trial Staff argues the three most important reasons the size premium adjustment should be removed are: (1) it is a questionable method with conflicting support among academics; (2) the data on which the Commission relied to support a size premium adjustment in Opinion No. 551 contradicts the Commission's goal to use forward-looking methods for developing the cost of equity; and (3) Mr. Keyton's regression analysis determined there is no meaningful relationship between forward-looking DCF results and current market capitalizations.[601] Mr. Keyton also notes that several scholars disagree over the use of a size premium adjustment in numerous studies.[602] Trial Staff also argues that in Opinion No. 551, the size premium adjustment was based on historical (rather than forward-looking) data that shows smaller market capitalization companies earn higher returns than larger market capitalization companies.[603]

282. In reply briefs, Trial Staff agrees with CAPs and LPSC that the size premium adjustment is unsupported and may amount to double counting. Trial Staff agrees with LPSC that there is no empirical evidence suggesting the need for a size premium adjustment.[604]

3. Other Parties

283. LPSC also criticizes the MISO TOs' use of the raw beta for determining the size premium adjustment while using the *Value Line* adjusted beta for the CAPM calculation. LPSC also argues that the stock index used to derive beta should be the same as the index used to determine the required return on equity.[605] LPSC states that in Opinion No. 551, the Commission accepted a CAPM analysis that forecasted equity returns and compared them with current long-term bond yields. LPSC argues that MISO TOs' witness Dr. Avera, however, matched a short-term DCF equity return with long-term Treasury bond yields, contrary to the guidance in *New Regulatory Finance*. LPSC argues MISO TOs applied a beta developed by comparing utility stock volatility with that of the New York Stock Exchange, but then applied that beta to dividend-paying firms in the

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[601] Trial Staff Initial Br. (I) at 14; Trial Staff Initial Br. (II) at 13-14.

[602] Trial Staff Initial Br. (I) at 15; Trial Staff Initial Br. (II) at 14.

[603] Trial Staff Initial Br. (I) at 15; Trial Staff Initial Br. (II) at 14-15.

[604] Trial Staff Reply Br. (I) at 10; Trial Staff Reply Br. (II) at 10.

[605] LPSC Initial Br. at 8.

S&P 500, which created a mismatch that conflicts with advice in *New Regulatory Finance*.[606]

284. LPSC argues that the MISO TOs' method incorrectly applied a size premium adjustment to increase the return on equity, on the theory that beta does not fully account for risk differences resulting from the size of firms. LPSC argues that no empirical evidence suggesting the need for a size premium adjustment for utilities was cited and it appears that none exists. LPSC argues the empirical evidence in the record, capitalization amounts and DCF results for the proxy group, shows that size is completely unrelated to the required return on equity.[607] LPSC also points to a regression analysis between company size and the DCF-calculated ROEs to argue that the size premium adjustment is inappropriate, citing the lack of apparent relationship between required return and company size.[608]

285. RPGI opposes the incorporation of a size premium adjustment in CAPM calculations and argues it has been shown through empirical studies to be invalid as applied to utilities. RPGI further notes that Mr. Parcell demonstrated in a study comparing the size of a utility with its risk factors, that there is no significant difference and there is no discernible pattern of increase among the risk indicators of publicly-traded electric utilities of different sizes.[609]

4. MISO TOs

286. In reply briefs, MISO TOs argue there is no rational basis for Mr. Gorman's argument that it is inappropriate to use *Value Line*'s adjusted betas in conjunction with size premium adjustments from Duff & Phelps and that his attempt to interject raw betas into the process simply biases his results downward.[610] MISO TOs contend that Duff & Phelps neither recommends a specific source for beta, nor suggests that adjusted betas are incompatible with their size premia adjustments. MISO TOs argue that Duff & Phelps simply observed that, because there can be differences in the methodologies used by alternative reporting services, it is preferable to use the same, consistent source of betas

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[606] *Id.* at 36.

[607] *Id.*

[608] *Id.* at 40-42.

[609] RPGI Initial Br. (I) at 28-29 (citing Parcell Aff. (I) at 11); RPGI Initial Br. (II) at 32 (citing Parcell Aff. (II) at 10).

[610] MISO TOs Reply Br. (I) at 29-30; MISO TOs Reply Br. (II) at 29-30.

for all companies included in the analysis.[611] Further, MISO TOs argue that there is no inconsistency between the two betas because the beta values reported by *Value Line* are based on an ordinary least-squares analysis, as are the size premium adjustments reported by Duff & Phelps for the firm size deciles.[612]

287. MISO TOs oppose the "build-up method" presented by Mr. Gorman, which they argue is based on historical risk premiums that have been rejected by the Commission and found to be considerably downward-biased.[613] MISO TOs argue that Mr. Gorman confuses the size premium adjustment required by the CAPM with aspects of the build-up method described in a Duff & Phelps publication and that the CAPM and build-up method are not synonymous and in fact are distinct methods for estimating the cost of equity. MISO TOs contend that the industry risk adjustment Mr. Gorman uses in the context of the build-up method is in lieu of the more precise beta risk measure for each firm in the proxy group that is employed in the CAPM. MISO TOs assert that Mr. Gorman's observation that regulated utility companies' industry risk is lower than companies in other industries does not support the use of a generic industry risk adjustment, as risk differences are already reflected in the CAPM through the use of beta. Further, MISO TOs argue the Commission has already rejected Mr. Gorman's build-up method, as well as the related logical errors underlying his contentions regarding the CAPM size premium adjustment and the Commission should continue to do so.[614]

288. MISO TOs assert the Commission should continue to include a size premium adjustment when applying the CAPM. MISO TOs argue that Duff & Phelps conclude in the publication attached to Mr. Gorman's affidavit that observation of the size effect is consistent with a modification of the pure CAPM, that studies have shown the limitations of beta as a sole measure of risk, and that the size premium adjustment is an empirically

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[611] MISO TOs Reply Br. (I) at 30; MISO TOs Reply Br. (II) at 30.

[612] MISO TOs Reply Br. (I) at 30 n.56; MISO TOs Reply Br. (II) at 30 n.56.

[613] MISO TOs Reply Br (I) at 32 (citing *N.Y. Indep. Sys. Operator, Inc.*, 146 FERC ¶ 61,043, at P 105, *reh'g denied*, 147 FERC ¶ 61,148 (2014), *appeal denied sub nom. Cent. Hudson Gas & Elec. Corp. v. FERC*, 783 F.3d 92 (2015)); MISO TOs Reply Br (II) at 32 (citing same).

[614] MISO TOs Reply Br. (I) at 33-34 (citing Opinion No. 551, 156 FERC ¶ 61,234 at PP 142, 166); MISO TOs Reply Br. (II) at 33-34 (citing same).

derived correction to the pure CAPM.[615]

289. MISO TOs argue Mr. Parcell and Mr. Keyton incorrectly place significant weight on a 1993 study by Annie Wong that refutes the need for a size premium adjustment when applying the CAPM to a utility. MISO TOs contend that a closer examination of this research reveals that it is largely inconclusive and inconsistent with CAPM and demonstrates no material difference between utilities and industrial firms with respect to size premiums. MISO TOs argue that her study also finds no significant relationship between beta and returns, which contradicts modern portfolio theory and the CAPM.[616]

290. MISO TOs assert that Mr. Parcell's observation that the majority of publicly traded companies are unregulated and operate in industries that are much riskier than the utility industry says nothing at all about the relevance of a size premium adjustment. MISO TOs argue that the fact that the size premia reported by Duff & Phelps was estimated on an industry-by-industry basis provides no basis to ignore the relationship in estimating the cost of equity for utilities. MISO TOs contend that Mr. Gorman concluded that a size premium adjustment for a regulated utility company should only be considered along with recognizing the low-risk nature of the regulated utility industry and that that is exactly the effect of combining *Value Line*'s beta values for the proxy companies with beta adjusted size premiums reported by Duff & Phelps.[617]

291. In response to Mr. Parcell's claims that a comparison of risk measures for utilities of different size demonstrates that there is no need for a size premium adjustment, MISO TOs argue the size premium adjustment is narrowly tailored to address an inability of beta to fully account for the impact of firm size within the CAPM, and the CAPM did not even figure into Mr. Parcell's simplistic comparison.[618]

292. In response to Mr. Keyton's claims that a regression between DCF estimates for the dividend-paying firms in the S&P 500 index and market capitalization demonstrates there is no need for a size premium adjustment, MISO TOs argue that the size premium does not relate to cost of equity estimates computed using the DCF model, which were the basis for Mr. Keyton's regression. Rather, MISO TOs assert that they are solely intended to address an inability of beta to account for the impact of firm size, and beta did

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[615] MISO TOs Reply Br. (I) at 35-36 (citing Ex. JC-101 at 3); MISO TOs Reply Br. (II) at 35-36 (citing Ex. JC-101 at 3).

[616] MISO TOs Reply Br. (I) at 36; MISO TOs Reply Br. (II) at 36.

[617] MISO TOs Reply Br. (I) at 40; MISO TOs Reply Br. (II) at 40.

[618] MISO TOs Reply Br. (I) at 40; MISO TOs Reply Br. (II) at 40.

not even figure into Mr. Keyton's regression. MISO TOs argue that Trial Staff's calculations have nothing whatsoever to do with the CAPM and say nothing about the relevance of the size premium adjustment.[619] MISO TOs assert that these observations apply equally to the LPSC's regression between DCF estimates and size. Further, MISO TOs contend that the size premium adjustment relates to beta, not the DCF model, and the fact that DCF estimates may not be correlated with market capitalization is unrelated to the size premium adjustment, as applied in the CAPM.[620]

293. MISO TOs argue that Mr. Parcell's historic premium of 6.0 percent is too low and that he incorrectly calculated the equity risk premium using the total return for Duff & Phelps' long-term government bond series. MISO TOs assert that, as a result, his historical equity risk premiums fall far below what his own source reports and Mr. Parcell's CAPM analysis is further compromised. MISO TOs argue that using only the arithmetic mean income component of the long-term government bond return provides a more reliable estimate of the expected risk premium because investors do not anticipate capital losses for a risk-free security.[621]

294. In response to LPSC's arguments that *Value Line* betas cannot be applied to firms in the S&P 500 due to a mismatch, MISO TOs contend that application of the DCF approach to the dividend-paying firms in the S&P 500 Index provides a sound proxy for investors' expected return on the market. MISO TOs assert that similarly, reference to *Value Line*'s published beta values also offer an objective proxy for an unobservable forward-looking beta and that there is no mismatch.[622]

295. MISO TOs argue that LPSC wrongly contends that the size premium adjustment is predicated on a finding that utilities are generally smaller than the companies in the S&P 500 and that size premium adjustments correspond to market capitalization across the spectrum of publicly traded firms.[623]

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[619] MISO TOs Reply Br. (I) at 41; MISO TOs Reply Br. (II) at 41.

[620] MISO TOs Reply Br. (I) at 42; MISO TOs Reply Br. (II) at 42.

[621] MISO TOs Initial Br. (I), App. 2 McKenzie Aff. (I) at 35; MISO TOs Initial Br. (II), App. 2McKenzie Aff. (II) at 35.

[622] MISO TOs Reply Br. (I) at 31; MISO TOs Reply Br. (II) at 31.

[623] MISO TOs Reply Br. (I) at 38 n.85; MISO TOs Reply Br. (II) at 38 n.85.

5. Commission Determination

296. With regard to MISO TOs' size premium adjustment, the Commission stated in Opinion No. 531-B that the use of such an adjustment was "a generally accepted approach to CAPM analyses."[624] We continue to find this to be the case.

297. CAPs argue that it is inconsistent to apply the Ibbotson size adjustment, which is derived based on raw betas, to a CAPM analysis that uses adjusted betas. We continue to find that the *Value Line* adjusted betas are reasonable for use in the CAPM. There is substantial evidence in the record that investors rely on *Value Line* betas.[625] No party objects to use of adjusted betas, which Dr. Morin supports, stating that "the regression tendency of betas to converge to 1.0 over time is very well known and discussed in the financial literature."[626] We acknowledge that there is imperfect correspondence between the size premia being developed with different betas. Nonetheless, we conclude that the size premium adjustments improve the accuracy of the CAPM results and cause it to better correspond to the costs of capital estimates employed by investors.

298. We also find that the application of size premium adjustments based on the NYSE to dividend-paying members of the S&P 500 is acceptable. The use of the NYSE for the size premium calculations enabled Ibbotson to develop a rich data set. There is no evidence that the application to a CAPM methodology using S&P 500 growth rates and dividend yields with a size premium adjustment based on NYSE data is problematic. There is no evidence that companies in the S&P 500 feature different risk premiums than those in the NYSE. Furthermore, the betas and size premia are applied to the calculated cost of equity of individual utilities in the proxy group, regardless of what stock index they may be found in.

299. We find that, though not uniform, a sufficient amount of academic literature exists to indicate that many investors rely on the size premia. Dr. Morin discusses the "size effect" finding that:

> Investment risk increases as company size diminishes, all else remaining constant. Small companies have very different returns than large ones, and on average they have been

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[624] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 117.

[625] *See, e.g.*, MISO TOs Reply Br. (I), App. 2 at 31-32; Robert S. Harris & Felicia C. Marston, *Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts*, Financial Management, Summer 1992 (using betas derived using *Value Line* method).

[626] Morin at 72.

> higher. The greater risk of small stocks does not fully account for their higher returns over many historical periods.[627]

300. Dr. Morin also avers that the higher returns required by investors in small companies than the CAPM would project is well documented in the financial literature.[628] Specifically, Dr. Morin cites to work by Rolf Banz showing that from 1936 to 1975 stocks of small firms earned higher risk-adjusted abnormal returns than those of large firms.[629] Eleswarapu Reinganum found a similar dynamic, looking at the relationship between firm size and PE ratio.[630] Ibbotson Associates, now under Duff & Phelps, has long published a series quantifying this effect for various sizes of firms, pulling from data going back to 1926.

301. We also agree with the Presiding Judge that the financial literature arguing against the continued existence of the size premium or its applicability to utilities is unavailing. Specifically, we do not find persuasive the article cited by Professor Annie Wong that utilities are less risky than industrial stocks and feature betas that do not decrease with firm size.[631] Even if true, which the MISO TOs aver is not the case, the argument in favor of a size premium adjustment is that there are differences in risk and required returns between small and large companies that are not captured in the betas. Consequently, lack of substantial variance in the betas between large and small companies is not indicative that they feature differences in risk and corresponding returns that are the basis for the size premium adjustment. The subsequent endorsement of this phenomenon, by Dr. Morin, lends credence to the view that Professor Wong's conclusions are no longer state of the art. Furthermore, an article reconsiders Professor Wong's evidence and concludes that "new information… indicates that there is a small

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[627] *Id.* at 181.

[628] *Id.* at 181-183.

[629] *Id*. at 181-183 (citing Rolf Banz, *The Relationship between Return and Market Value of Common Stocks* (1981)).

[630] Eleswarapu Reinganum, *Misspecification of Capital Asset Pricing Empirical Anomalies based on Earnings Yields and Market Values*, Journal of Financial Economics, Vol. 9, 1981.

[631] Annie Wong, *Utility Stocks and the Size Effect: an Empirical Analysis* (1993).

firm effect in the utility sector."[632] A more recent article published in *Business Valuation Review* found that "none of the academic papers throughout the last three decades have qualified the [size premium] as a statistical error."[633] Finally, a 2019 National Association of Certified Valuators and Analysts publication supports the use of the size premium adjustment to the CAPM.[634] We thus find that, based on the evidence of this dynamic and that many investors consider it when evaluating companies, it is appropriate to include it in CAPM determinations.

302. We also find unconvincing Mr. Keyton and the LPSC's regression analyses demonstrating that a size premium adjustment is not appropriate for the CAPM. Mr. Keyton and LPSC's regression analyses examine the relationship between forward-looking DCF results and company size. Although DCF results do reflect the cost of capital required by investors, the DCF model is fundamentally different than the CAPM model, which relies on a distinct set of assumptions, inputs, and calculations. This diversity is part of the reason that we are including the CAPM model. By the same rationale, a regression analyses on the reasonableness of CAPM model inputs using the DCF model is unpersuasive, since that model does not consider betas at all.

303. We also find there to be insufficient reason to conclude that the utility industry is unique, as certain intervenors suggest, such that the size premium adjustment is inapplicable. The size premium adjustment is supported by a robust data set. Although the variations in the risk profiles of firms in any industry inevitably vary somewhat, we do not see sufficient evidence in the record to conclude that factors specific to the utility industry insulate smaller utilities from risks such that the CAPM betas sufficiently account for any increased risks and corresponding returns demanded by investors.

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[632] Thomas M. Zepp, *Utility stocks and the size effect—revisited*, 43 Quarterly Review of Economics and Finance 578–82 (2003).

[633] Roger A. Grabowski, *The Size Effect Continues to be Relevant When Estimating the Cost of Capital*, Business Valuation Review, Fall 2018, at 93–109 ("*Grabowski*").

[634] Roger G. Ibbotson & James P. Harrington, *Using a Non-Beta-Adjusted Size Premium in the Context of the CAPM Will Likely Overstate Risk and Understate Value*, Quick Read (Jan. 30, 2019), https://quickreadbuzz.com/2019/01/30/business-valuation-grabowski-harringtonsing-a-nonbeta-adjusted-size-premium/.

VIII. Risk Premium Model

A. Background

304. The risk premium methodology, in which interest rates are also a direct input, is "based on the simple idea that since investors in stocks take greater risk than investors in bonds, the former expect to earn a return on a stock investment that reflects a 'premium' over and above the return they expect to earn on a bond investment."[635]

305. Multiple approaches have been advanced to determine the equity risk premium for a utility.[636] For example, a risk premium can be developed directly, by conducting a risk premium analysis for the company at issue, or indirectly by conducting a risk premium analysis for the market as a whole and then adjusting that result to reflect the risk of the company at issue.[637] Another approach for the utility context is to "examin[e] the risk premiums implied in the returns on equity allowed by regulatory commissions for utilities over some past period relative to the contemporaneous level of the long-term U.S. Treasury bond yield."[638]

306. In Opinion No. 551, the Commission found that "it is appropriate to rely on risk premium analyses as corroborative evidence during periods of anomalous capital market conditions"[639] and that "MISO TOs' risk premium analysis is sufficiently reliable to corroborate the results of the DCF analysis in this proceeding."[640] The Commission concluded that "MISO TOs' risk premium study is valid and supports awarding the MISO TOs a base ROE above the midpoint"[641] and found that "We, therefore, affirm the Presiding Judge's acceptance of the risk premium analysis to be used as corroborative evidence, in determining whether the midpoint of the zone of reasonableness produced by the Commission's DCF analysis provides a return that satisfies the requirements of *Hope*

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[635] Opinion No. 531, 147 FERC ¶ 61,234 at P 147 (citing Morin at 108).

[636] *See generally* Morin at 107-130.

[637] *Id.* at 110.

[638] *Id.* at 123.

[639] Opinion No. 551, 156 FERC ¶ 61,234 at P 191.

[640] *Id.* P 200.

[641] *Id.* P 191.

and *Bluefield*."[642] The Commission also made various determinations regarding specific aspects of how the Risk Premium analysis should be implemented.[643] CAPs, RPGI, and OMS requested rehearing of certain of the Commission's determinations regarding how the Risk Premium analysis was implemented.

307. In the Initial Decision in the Second Complaint proceeding, the Presiding Judge similarly found that MISO TOs' "historical risk premium analysis is valid and supports awarding the MISO TOs a Base ROE above the Midpoint."[644] The Presiding Judge also made various determinations regarding specific aspects of how the Risk Premium analysis should be implemented.[645] CAPs, OMS and JCA, and RPGI took exception to the Presiding Judge's determinations regarding how the Risk Premium analysis was implemented.

308. In the Briefing Order, for purposes of establishing a new just and reasonable ROE where the existing ROE has been shown to be unjust and unreasonable (i.e., the second prong of the FPA section 206 analysis), the Commission proposed to use the Risk Premium model, DCF model, CAPM, and Expected Earnings model to produce four separate cost of equity estimates and then average the four estimates to produce the just and reasonable ROE. For each of the DCF, CAPM, and Expected Earnings models, the Commission proposed to use the central tendency of the respective zones of reasonableness as the cost of equity estimate for average risk utilities and then average those three midpoint/median figures with the sole numerical figure produced by the Risk Premium model to determine the ROE of average risk utilities. The Commission proposed to use the midpoint/medians of the resulting lower and upper halves of the zones of reasonableness to determine ROEs for below or above average risk utilities, respectively.[646] The Commission proposed to omit the Risk Premium model from the analysis under the first prong of section 206 because it does not produce a range which can be used to determine a zone of reasonableness and instead only produces a numerical

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[642] *Id.* P 200.

[643] *Id.* PP 192-199.

[644] Initial Decision (II), 155 FERC ¶ 63,030 at P 391.

[645] *See id.* PP 353-390.

[646] *See* Briefing Order, 165 FERC ¶ 61,118 at P 18.

point. Accordingly, the Commission proposed to use the Risk Premium model output only in the second prong of the FPA section 206 analysis.[647]

B. CAPs

309. CAPs contend that the Commission erred in relying on MISO TOs' Risk Premium analysis, which CAPs argue should have been either rejected or adjusted.[648] CAPs argue that, at a minimum, the Commission should correct MISO TOs' Risk Premium analysis by refining the readings of, and dates attributed to the 81 Commission orders used as inputs in the Risk Premium analysis.[649] CAPs state that the base ROE was not at issue in many of the 81 Commission orders, including those that approved settlements. According to CAPs, by taking appropriate account of the relied upon cases, the result of MISO TOs' Risk Premium analysis would have been materially below the 10.32 percent DCF upper midpoint.[650]

310. CAPs note that nearly all of the Commission outcomes relied upon in MISO TOs' Risk Premium analysis were taken from a period when the Commission applied a one-step DCF methodology that it subsequently found to have been inappropriate. CAPs argue that such reliance unreasonably perpetuates that past error.[651] CAPs also argue that many of these cases involved incentive adders and that previously-determined base ROEs were not at issue.[652]

311. CAPs also explain that, because many of these cases involve Commission settlement and litigation, there is a meaningful disconnect between the dates of Commission orders and the period of time they reflect. CAPs argue that Opinion No. 551 failed to consider that the core of MISO TOs' Risk Premium methodology is the comparison between past findings as to the cost of equity and the contemporaneous cost of debt. CAPs point to the 12.38 percent utility cost of equity as an example. CAPs explain that the 12.38 percent base ROE was based on a study period from August 2001

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[647] *Id.* P 18 n.39.

[648] CAPs Rehearing Request at 41. CAPs state that, prior to Opinion No. 531, the Commission has repeatedly rejected risk premium analyses. *Id.* at 42.

[649] *Id.*at 28, 43.

[650] *Id.* at 41-43.

[651] *Id.* at 42 & n.153.

[652] *Id.* at 43.

through January 2002, and therefore argue that it is arbitrary and capricious for MISO TOs' Risk Premium study to compare it to bond yields in 2011, 2012, and 2013.[653]

312. CAPs state that, with its corrections to MISO TOs Risk Premium study, the resulting cost of equity drops to 9.89 percent.[654] CAPs assert that its 9.89 percent Risk Premium outcome or OMS' 9.94 percent Risk Premium outcome can serve as the representative Risk Premium result for this case.[655]

313. CAPs argue that the Commission, in Opinion No. 551, adopted a deficient Risk Premium study prepared by MISO TOs' witness, Dr. Avera. According to CAPs, MISO TOs' Risk Premium study generates inaccurate and unreliable cost of equity indicators, and should be replaced by CAPs' witness, Mr. Gorman's, Risk Premium study.[656] CAPs also contend that the Presiding Judge, in Initial Decision (II), accepted a flawed Risk Premium study prepared by MISO TOs' witness, Mr. McKenzie.[657]

314. CAPs assert that compiling past Commission findings and attempting to trend them to current market conditions is inferior to directly applying empirical techniques to current market information. CAPs claim that the data set of Commission cases used in MISO TOs' Risk Premium studies consists largely of cases where the Commission expressly declined to make such a substantive cost of capital finding.[658] CAPs assert that, therefore, the ROE in many of these cases do not reflect market costs at the time of the Commission order.[659] CAPs argue that, therefore, the fundamental assumption underlying Dr. Avera's Risk Premium analysis that was accepted in Opinion No. 551 and

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[653] *Id.* at 44-45.

[654] *Id.* at 47. CAPs propose modifications to MISO TOs' Risk Premium study regarding its use of the 12.38 base ROE, as well as its use of several other base ROEs. *Id.* at 46-48.

[655] *Id.* at 48. CAPs also state that, despite being rejected in the Initial Decision, Trial Staff witness Keyton's Risk Premium analysis was well-supported. *Id.* at 26-27.

[656] CAPs Initial Br. (I) at 35; CAPs Initial Br. (II) at 35.

[657] CAPs Initial Br. (II) at 37.

[658] CAPs Initial Br. (I) at 37 (citing Ex. JC-100 at 27-29); CAPs Initial Br. (II) at 37 (citing Ex. ICG-200 at 27, 28-29).

[659] CAPs Initial Br. (I) at 37-38; CAPs Initial Br. (II) at 37.

Mr. McKenzie's Risk Premium analysis that was accepted in Initial Decision (II), is invalid.

315. CAPs also argue that MISO TOs' Risk Premium studies rely too heavily on the inverse relationship between interest rates and risk premiums. According to CAPs, over the last five to six years, the real yield spread between utility stocks and Baa bond yields has been nearly flat.[660] CAPs assert that this shows that interest rate changes are not the sole driver of risk premium changes. Consequently, CAPs recommend applying the following parameters for risk premium determinations: (1) ROE determinations made by the Commission or state commissions at the time of the order; (2) observable market evidence of risk differential, including spreads between A-rated and Baa-rated utility bonds and long-term Treasury bonds; and (3) a comparison of utility stock yields to utility bond yields and Treasury bond yields. Applying such parameters, Mr. Gorman recommends a Risk Premium model ROE range of 8.98 to 9.12 percent in the First Complaint proceeding[661] and of 9.09 to 9.76 percent in the Second Complaint proceeding.[662]

316. CAPs also argue that the risk premium model is inherently less accurate than a well-constructed DCF or CAPM model because it relies on results of market-based methods from past cases, where the DCF and CAPM model rely on primary data. CAPs aver that the Risk Premium model tends to replicate the regulatory lag and "inertial continuation of past returns" affecting past regulatory decisions.[663]

317. In addition, CAPs contend that the MISO TOs' Risk Premium analyses rely on bond yield projections that the Commission has found to be speculative. CAPs state that MISO TOs presented no reason for use of projected bond yields other than to say that this approach is "[c]onsistent with the approach adopted in the *Coakley* Briefing Order."[664] CAPs argue that, however, the *Coakley* Briefing Order used a Risk Premium result based on the actual bond yield. CAPs point out that Initial Decision (I) in the First Complaint

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[660] CAPs Initial Br. (I) at 38 (citing Ex. JC-100 at 31, 33); CAPs Initial Br. (II) at 38 (citing Ex. ICG-200 at 33).

[661] CAPs Initial Br. (I) at 39.

[662] CAPS Initial Br. (II) at 39.

[663] CAPs Reply Br. (I) at 26; CAPs Reply Br. (II) at 46.

[664] CAPs Reply Br. (I) at 27 (citing MISO TOs Initial Br. (I), App. 2 McKenzie Aff. (I) at 27); CAPs Reply Br. (II) at 47 (citing MISO TOs Initial Br. (II), App. 2 McKenzie Aff. (II) at 26 n.46).

proceeding, which ROE the Briefing Order relies on for its Risk Premium figures, rejected use of a projected bond yields as "speculative,"[665] a position affirmed in Opinion No. 551.[666] CAPs contend that, in order to be internally consistent, a Risk Premium study must use projected bond yields to derive the risk premium as well as the yield to which it is added. Additionally, CAPs argue that the projected bond yields do not represent the known and measurable cost of capital and that projected bond yields have proven unreliable.

318. CAPs further argue that MISO TOs' Risk Premium approach includes ROEs from proceedings for which ROEs were not at issue. Consequently, according to CAPs, ROEs from such proceedings are not a valid basis for comparing the cost of equity and cost of debt. CAPs assert that these included two cases which the New England TOs recently admitted did not involve base ROEs.[667]

C. RPGI

319. RPGI notes that MISO TOs' Risk Premium analysis relied on ROEs authorized by the Commission from 2006 through 2014. RPGI questions why, if anomalous market conditions call into question the reliability of the DCF in this case, the same is not true for the Risk Premium analysis, which relies on DCF-produced returns after the onset of the Great Recession.[668]

320. RPGI contends that the MISO TOs have not demonstrated that the Risk Premium model addresses any of the supposed distortions in the DCF model, and thus has no demonstrated superiority over the DCF model.[669]

321. RPGI, in its Initial Brief, states that the Risk Premium methodology the Commission proposes to use is flawed due to: (1) a conceptual flaw in reasoning; (2) a misplaced reliance on research reflecting vastly different financial conditions; and

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[665] CAPs Reply Br. (I) at 27-28 (citing Initial Decision (I) at P 257); CAPs Reply Br. (II) at 47 (citing same).

[666] CAPs Reply Br. (I) at 28 (citing Opinion No. 551, 156 FERC ¶ 61,234 at P 194); CAPs Reply Br. (II) at 47 (citing same).

[667] *See* CAPs Reply Br. (I) at 31 (citing New England TOs, Initial Paper Hearing Brief, at 60 n.222, Docket No. EL11-66-001, *et al.* (filed Jan. 11, 2019)).

[668] RPGI Rehearing Request at 13-14.

[669] RPGI Reply Br. (I) at 9.

(3) flaws in the model's inputs. In order to correct these deficiencies, RPGI recommends an overhaul to the Risk Premium methodology.[670] RPGI states that its Risk Premium model, which corrects the various flaws in the proposed Risk Premium model, results in an 8.68 percent ROE.[671]

322. First, RPGI argues that the Risk Premium model incorporates the same distortions that the Commission has found to warrant a departure from full reliance on the DCF model. RPGI explains that the Risk Premium model uses the same financial data (i.e., interest rates) that the Commission found to be abnormal and unique. According to RPGI, it makes no sense to "carry forward" the same financial market conditions identified as distorting DCF inputs into an alternative model. RPGI states that, unless cured, this case-specific flaw serves as a reason for not using the Risk Premium model at all. RPGI contends that he Commission's stated rational for using other models (i.e., concerns over unusual market capital conditions) is inconsistent with relying on those same capital market conditions on a going-forward basis.[672]

323. Second, RPGI argues that the upward adjustment based on low interest rates contradicts the reasoning used to critique the DCF. RPGI explains that, according to MISO TOs witness, Ms. Lapson, artificially low interest rates have caused investors to migrate from utility bonds to utility stocks.[673] RPGI contrasts this claim with the theory underlying the adjustment included in MISO TOs' Risk Premium study, which is that lower interest rates correlate with an increase in equity risk premiums. RPGI asserts investors cannot be driven to stocks in search of higher returns and simultaneously demand a higher premium than had previously been offered. RPGI states that such investors would not migrate to stocks and take on the additional risk while simultaneously demanding an increase in the risk premium of holding stocks. RPGI contends that, if anything, MISO TOs witness Ms. Lapson's theory would suggest a narrower risk premium than under normal conditions.[674]

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[670] RPGI Initial Br. (I) at 29; RPGI Initial Br. (II) at 33.

[671] RPGI Initial Br. (I) at 37; RPGI Initial Br. (II) at 40.

[672] RPGI Initial Br. (I) at 30-31 (citing Parcell Aff. (I) at 14); RPGI Initial Br. (II) at 34 (citing Parcell Aff. (II) at 14).

[673] RPGI Initial Br. (I) at 31-32 (citing Initial Decision (I) at PP 123-136, 142-158); RPGI Initial Br. (II) at 35 (citing same).

[674] RPGI Initial Br. (I) at 32; RPGI Initial Br. (II) at 35-36.

324. Third, RPGI disputes the reliance on the research from 1985 relied upon to support the adjustment to the Risk Premium model to reflect the inverse relationship between risk premiums and interest rates.[675] RPGI explains that the authors actually found the relationship between interest rates and risk premiums to be volatile. RPGI notes that the statistical correlation between interest rates and risk premiums were actually positive over the time period from 1970 through 1979. RPGI argues that the financial conditions during the article's five-year study period from 1980 through 1984 (i.e., increasing inflationary expectations) have nothing to do with the financial conditions at issue in these proceedings. RPGI asserts that inflation is not a major investment risk, and that no meaningful conclusion can be draw from the 34-year old research.[676]

325. Fourth, RPGI argues that the MISO TOs' Risk Premium model is flawed because it measures risk premiums over a short-term period. Although RPGI concedes that Opinion No. 531 supported the use of a shortened time-period beginning with the enactment of the Energy Policy Act of 2005, RPGI notes that the Risk Premium approach was merely used as a benchmark in Opinion No. 531. RPGI states that the proposal in the Briefing Order faces a higher standard of scrutiny because it is proposed as a source of data for computing a just and reasonable return.[677]

326. Fifth, RPGI argues that the proposed Risk Premium model incorporates a number of dubious choices. RPGI states that input-related flaws include the mismatch between the time period to which the data is attributed and the utility bond yields to which they are compared. RPGI points to the instant proceedings as an example. According to RPGI, the final orders in these proceedings may be issued as many as seven or eight years after the complaints were filed and the relevant data were generated.[678] RPGI also argues that settlements should not be used in the Risk Premium Study. According to RPGI, no meaningful precedent can be drawn from a settlement because the Commission

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[675] RPGI Initial Br. (I) at 33 (citing Eugene F. Brigham et al., *The Risk Premium Approach to Measuring a Utility's Cost of Equity*, 14 Fin. Mgmt. 33, 33-45 (1985)); RPGI Initial Br. (II) at 36.

[676] RPGI Initial Br. (I) at 34-35; RPGI Initial Br. (II) at 37-38.

[677] RPGI Initial Br. (I) at 35-36; RPGI Initial Br. (II) at 38-39.

[678] RPGI Initial Br. (I) at 36. RPGI also appears to question Midwest TDUs' sorting and combining of all ROE-related orders by calendar year. *Id.*

does not approve individual components of a settlement but rather the overall settlement.[679]

D. LPSC

327. LPSC states that risk premiums vary substantially over time, but—in theory—measuring risk premiums over a long period will even out fluctuations and reflect a normal risk premium. LPSC asserts that the nine-year period used by MISO TOs was far too short to reflect a normal risk premium. LPSC argues that a historic risk premium analysis should use the actualized returns on market equity and debt over a long period (i.e., using decades of data).[680] According to LPSC, it is circular and inaccurate to use returns allowed by regulators to determine the risk premium.[681] LPSC states that, in Opinion No. 551, the Commission used its own past allowed returns on equity to reach a decision. LPSC asserts that this methodology is completely circular, and that the circularity concerns cannot be dismissed on the basis that allowed returns presumably reflect market data, because this only mitigates the circularity problem.[682]

328. LPSC argues that the 77 basis point offset for every percentage change in the cost of debt means that the required return on equity is largely unrelated to the cost of debt. LPSC contends that there is no statistically-significant relationship between the cost of debt and investors' return on equity requirements.[683] LPSC acknowledges that MISO TOs' witness, Dr. Avera, found a strong statistical correlation between interest rates and risk premiums. However, LPSC asserts that this simply proved that Commission-allowed ROEs barely changed as bond yields fluctuated, and therefore – because the risk premium is defined as the difference between the ROE and bond yields – risk premiums of course

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[679] RPGI Initial Br. (I) at 36; RPGI Initial Br. (II) at 40.

[680] LPSC Initial Br. at 5-7, 29-31 (citing Morin at 115 (stating that the use of a short period would be defective)).

[681] *Id* at 5.

[682] *Id.* at 6-7 (citing Morin at 125). LPSC notes that Dr. Morin offers the opposite advice with respect to the comparable earnings approach: "[t]he historical book return on equity for regulated firms is not determined by competitive forces but instead reflects the past actions of regulatory commissions." *Id.* at 7, 32 (quoting Morin at 383).

[683] *Id.* at 6. LPSC also note that the 77 basis point offset conflicts with empirical research, which has found an approximately 50 basis point offset. *Id.*

changed in relation to changing bond yields.[684] LPSC argues that a regression of ROEs and bond yields, on the other hand, would show that there is no statistically significant relationship between the two.[685]

329. LPSC asserts that the Risk Premium methodology accepted in Opinion No. 551 substantially mirrors the past. LPSC notes that the returns allowed from 2006 through 2014 are mostly non-litigated cases, many of which involved the settlement of multiple issues, and closely mirrored prior results despite a significant reduction in interest rates. LPSC argues that, given the significant changes in capital markets, this mirror image could not have accurately depicted investor return requirements.[686]

E. OMS

330. OMS argues that the Commission, in Opinion No. 551, erred by relying on MISO TOs' Risk Premium analysis to justify a base ROE of 10.32 percent. OMS argues that a Risk Premium study that assumes a linear relationship between bond yields and cost of equity is incompatible with anomalous market conditions.[687] OMS argues that an analysis that incorporates ROE determinations from a period when the Commission was applying the single-stage DCF methodology, which the Commission no longer accepts, unreasonably perpetuates erroneous results.[688]

331. OMS asserts that, if the Commission nonetheless chooses to rely on a Risk Premium analysis, MISO TOs' Risk Premium analysis should not be used because it is flawed. First, OMS argues that the analysis included 15 cases involving incentive adders that merely reiterated a set of existing base ROEs between 11.14 percent and 12.38

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[684] *Id.* at 32-33. LPSC explains that he results would be even more statistically significant (in fact, the fit would be perfect) if the ROE did not change at all. *Id.* at 33.

[685] *Id.* at 34.

[686] *Id.* at 6. LPSC explains that parties settle for many reasons, such as trade-offs on other issues, cost of litigation, and competing objectives. LPSC asserts that the use of the results of settlements would require objective evidence linking allowed returns to market evidence. *Id.* at 31, 35, 42 (citing *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 43 F.3d 1311, 1317-19 (9th Cir. 1995)).

[687] OMS Rehearing Request at 20-21. OMS notes that Opinion No. 531 found that the relationship between cost of equity and Treasury bond yields has become unreliability in both magnitude. *Id.* at 21 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 159).

[688] *Id.* at 21-22.

percent that had already been approved. According to OMS, relying on these high base ROEs multiple times artificially inflates the results of the analysis. Second, OMS contends that it is improper to include Commission decisions that were the product of settlement or simply mentioned in the context of deciding whether to allow an ROE incentive adder. Third, OMS states that it is particularly troublesome for the Commission to use a Risk Premium analysis that includes the very 12.38 percent base ROE that Opinion No. 551 finds to be unjust and unreasonable. Fourth, OMS points to the lack of synchronism between ROE decisions and the bond yields to which they are compared. OMS explains that synchronizing the data points, by merely correcting the dates to reflect contemporaneous bond yields, has a significant effect on the results of the Risk Premium analysis.[689]

F. Trial Staff

332. Trial Staff explains that its witness Mr. Keyton made adjustments to improve the proposed Risk Premium analysis to ensure that the results are more timely and accurate.[690]First, Trial Staff explains that its witness, Mr. Keyton, removed any Commission-authorized ROE that was not developed using market data contemporaneous with the applicable bond yields. Trial Staff states that, in some cases, the market analysis had taken place years prior to a Commission order assigning an ROE to a utility. Trial Staff notes that, when utilities join an RTO, they are simply given the currently-effective RTO-wide ROE, which is not tied to the risks or cost of equity faced by the utilities at that time. Trial Staff argues that such ROEs do not reflect a cost of equity estimate that is contemporaneous with the bond yields used to calculate the risk premium. Trial Staff explains that, consequently, Mr. Keyton removed observations that were merely reapplication of existing ROEs.[691]

333. Mr. Keyton also contends that using past-authorized ROEs generate erroneous equity risk premiums since their inclusion results in overstated equity risk premiums for more recent years because the vintage ROEs do not reflect the fact that equity costs have fallen as bond yields have fallen. He posits that this contradicts prior Commission findings recognizing the relationship between the cost of equity and bond yields.[692]

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[689] *Id.* at 22-25 (citing App. 1).

[690] Trial Staff Initial Br. (I) at 20-24; Trial Staff Initial Br. (II) at 19-24.

[691] Trial Staff Initial Br. (I) at 22-23 (citing Keyton Aff. (I) at 43-45); Trial Staff Initial Br. (II) at 21-22 (citing Keyton Aff. (II) at 42-43).

[692] Trial Staff Reply Br. (I), Keyton Reply Aff. (I) at 29 (citing Opinion No. 314, 44 FERC at 61,952 n.11, *order on reh'g*, Opinion No. 314-A, 45 FERC ¶ 61,252, *reh'g denied*, 46 FERC ¶ 61,036 (1989) and Order No. 489, FERC Stats. & Regs. ¶ 30,795 at

Mr. Keyton also states that Dr. Morin and Dr. Eugene F. Brigham have both noted the general relationship between interest rates and the cost of equity, which move in the same direction.[693]

334. Second, Trial Staff argues that that the MISO TOs' Risk Premium approach should have removed equity risk premiums between 2008 and 2009 that were impacted by bond yield spikes corresponding to the financial crisis.[694] According to Trial Staff, Mr. Keyton removed the six-month average Moody's Baa bond yields for the months from October to December 2008 and January to August 2009. Trial Staff explains that Mr. Keyton removed the bond yields from October to December 2008 because the yields suddenly rose by 143 basis points, and that he removed the bond yields from January to August 2009 because those yields were in steady decline until they stabilized in September 2009. Trial Staff explains that these removal adjustments were made because a risk premium calculated during a time of bond yield spikes will understate the actual risk premium required by investors.[695] Mr. Keyton notes that Mr. McKenzie acknowledged that there was no indication that a particular Commission-authorized ROE was derived to account for these spikes in bond yields.[696]

335. Trial Staff notes that MISO TOs now support use of a Risk Premium analysis based on both historical and projected bond yields, as apparently supported in the *Coakley* Briefing Order.[697] Trial Staff posits that the use of projected bond yields in the Risk Premium analysis referenced in the *Coakley* Briefing Order was inadvertent. Trial Staff notes that Opinion No. 551 clearly articulated why use of projected bond yields in

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30,993, *reh'g denied*, Order No. 489-A, 42 FERC ¶ 61,390); Trial Staff Reply Br. (II), Keyton Reply Aff. (II) at 24 (citing same).

[693] Trial Staff Reply Br. (I), Keyton Reply Aff. (I) at 29-30 (citing Morin at 383 and Eugene F. Brigham, *Financial Management: Theory and Practice* 21-22 (1979)); Trial Staff Reply Br. (II), Keyton Reply Aff. (II) at 24-25 (citing same).

[694] Trial Staff Initial Br. (I) at 23-24; Trial Staff Initial Br. (II) at 22-23; Trial Staff Reply Br. (I), Keyton Reply Aff. (I) at 28; Trial Staff Reply Br. (II), Keyton Aff. (II) at 23.

[695] Trial Staff Initial Br. (I) at 23-24 (citing Keyton Aff. (I) at ¶¶ 69-72); Trial Staff Initial Br. (II) at 22-23 (citing Keyton Aff. (II) at ¶¶ 69-70).

[696] Trial Staff Reply Br. (I), Keyton Reply Aff. (I) at 28.

[697] Trial Staff Reply Br. (I) at 12 (citing MISO TOs Initial Br. (I) at 24); Trial Staff Reply Br. (II) at 12 (citing MISO TOs Initial Br. (II) at 39-40).

the Risk Premium analysis is inappropriate, finding that "projected yields used in risk premium analyses are speculative and less reliable than historical yields."[698] Trial Staff adds that, for the fluctuations in the cost of equity to be captured by the Risk Premium model, the Commission must eliminate inputs that are speculative, inaccurate, or unreliable.

G. MISO TOs

336. In response to briefs opposing implementation of the MISO TOs' Risk Premium model, MISO TOs observe that the Commission accepted similar use of the Risk Premium analyses in Opinion No. 551 and found it to be similar to the analysis that it accepted in Opinion No. 531-B.[699] MISO TOs aver that opposing parties fail to raise new arguments that were not considered in those orders. Additionally, in response to arguments that their Risk Premium methodology inappropriately relies on settlement agreements, MISO TOs observe that the Commission, in Opinion No. 531-B, found that the use of settlements "do[] not affect that reliability of the risk premium analysis,"[700] and MISO TOs explain that, just as with litigated ROE outcomes, settling parties "rely upon the same market-based methodologies in determining the rates they are willing to accept."[701] MISO TOs further argue that, in each of the cases that other parties criticize, the Commission nonetheless ruled that the ROE at issue resulted in rates that were just and reasonable.[702] MISO TOs also reject arguments that the ROE inputs should align more closely with contemporary bond yields, noting that the Commission already found such precision to be overly difficult.[703]

337. MISO TOs also disagree with criticisms of the inverse relationship between equity risk premiums and interest rates. They note that the Commission, consistent with

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[698] Trial Staff Reply Br. (I) at 13 (citing Opinion No. 551 at P 194); Trial Staff Reply Br. (II) at 13 (citing same).

[699] MISO TOs Reply Br. (I) at 30-31 (citing Opinion No. 551, 156 FERC ¶ 61,234 at PP 191-200); MISO TOs Reply Br. (II) at 30-31 (citing same).

[700] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 98.

[701] MISO TOs Reply Br. (I) at 31-32 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 98); MISO TOs Reply Br. (II) at 31-32 (citing same).

[702] MISO TOs Reply Br. (I), App. 2 at 45; MISO TOs Reply Br. (II), App. 2 at 45.

[703] MISO TOs Reply Br. (I) at 32 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 98); MISO TOs Reply Br. (II) at 32 (citing same).

financial literature, has recognized this relationship.[704] MISO TOs aver that the CAPs offer no empirical evidence or academic literature to support their argument that investment risk differentials reflected in yield spreads have a material effect on the behavior of equity risk premiums. With respect to the LPSC's assertions of the circulatory of this approach, MISO TOs state that Dr. Morin, who the LPSC cites, found that such circulatory concerns are mitigated in the risk premium context because the Commission-approved ROs are "presumably based on the results of market-based methodologies."[705]

338. MISO TOs disagree with Trial Staff's recommendation to remove bond yields associated with periods of volatility. They aver that doing so would ignore relevant observations and undermine the integrity of the risk premium model by enabling analysts to selectively parse monthly bond yield average data. MISO TOs also contend that using annual, averaged Baa utility bond yields, as they propose, washes out some of the monthly volatility.[706]

339. MISO TOs also assert that the Risk Premium model is a traditional method that investors use to estimate the expected return from an investment in a company[707] and that approved ROEs, which are inputs in the Risk Premium model, are closely followed by investors, and provide a direct signal that influences their expectations and required rates of return.[708]

H. Commission Determination

340. Based on full consideration of the record in this proceeding, we will not use the Risk Premium model, as proposed by the MISO TOs, in the Commission's ROE methodology, either for determining the justness of and reasonableness of existing ROEs under the first prong of section 206 or for determining new just and reasonable base ROEs under the second prong of section 206. In light of the evidence in the record regarding the Risk Premium model and the other models that we proposed to use in the

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[704] MISO TOs Reply Br. (I) at 33 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 99; Opinion No. 551, 156 FERC ¶ 61,234 at P 197; Morin at 128); MISO TOs Reply Br. (II) at 33 (citing same).

[705] MISO TOs Reply Br. (I) at 34 (citing Morin at 125); MISO TOs Reply Br. (II) at 34 (citing same).

[706] MISO TOs Reply Br. (I) at 34-35; MISO TOs Reply Br. (II) at 34-35.

[707] MISO TOs Reply Br. (I) at 30; MISO TOs Reply Br. (II) at 30.

[708] MISO TOs Reply Br. (I), App. 2 at 44; MISO TOs Reply Br. (II), App. 2 at 44.

Briefing Order, we conclude that the additional robustness that the Risk Premium model adds to the ROE determination is outweighed by the disadvantages of its deficiencies, as discussed below. Furthermore, we find that the model requires methodological decisions that would likely undermine transparency and predictability in Commission outcomes, which are valued by both investors and customers.

341. As an initial matter, the Risk Premium model is largely redundant with the CAPM. Although they rely on different data sources to determine the risk premium, both models use indirect measures (i.e., past Commission orders in the Risk Premium model and S&P 500 data in the CAPM) to ascertain the risk premium that investors require over the risk-free rate of return. We find that using the Risk Premium model in conjunction with the CAPM model would confer too much weight towards risk premium methodologies. The Commission has long used and, over time, refined the DCF model and we find that it would be inappropriate for variations of the risk premium model to receive twice its weight. In light of the disadvantages of the Risk Premium model discussed below and the similarity of the CAPM and Risk Premium models, we find that it is more appropriate to use only the CAPM to provide a risk premium-based cost of equity estimate.

342. In addition, we agree with CAPs that the Risk Premium model is likely to provide a less accurate current cost of equity estimate than the DCF model or CAPM because it relies on previous ROE determinations, whose resulting ROE may not necessarily be directly determined by a market-based method, whereas the DCF and CAPM methods apply a market-based method to primary data.[709] For example, previous ROE determinations may not involve an explicit determination as to whether an ROE is just and reasonable, but instead focused on whether to allow an ROE incentive adder or were approving a preexisting RTO-wide ROE for a new RTO member. Similarly, many previous ROE determinations used in the Risk Premium model were the product of rate case settlements. Such settlements often involve compromises on a variety of issues present in a rate case, of which the appropriate ROE is only one. Consequently, such settlements could include ROEs that are not representative of the market cost of equity because the ROEs were negotiated above or below that market cost of equity in order to form an overall settlement package, together with negotiated outcomes on other issues, that were acceptable to the parties.

343. While all models, including the DCF, feature some circularity, such circularity is particularly direct and acute with the Risk Premium model because it directly relies on past Commission ROE decisions. MISO TOs' regression analysis, discussed below, accentuates such circularity by largely offsetting the effects of changes in interest rates. As a result, we share the concerns expressed by various parties that the circularity inherent in the Risk Premium model's use of prior ROE determinations would largely

[709] *See* CAPs Reply Br. (I) at 26; CAPs Reply Br. (II) at 46.

continue previously-approved ROEs and reflect past circumstances that influenced the previous ROE decisions.[710]

344. We also question the application of the regression analyses used by MISO TOs in their Risk Premium model. These regressions, which have the impact of increasing the risk premium by 75 basis points for every 100 basis point decline in interest rates,[711] contrast starkly with Dr. Morin's analysis, which made that adjustment 48 basis points. This could be due to the length of time examined by the MISO TOs being less than half of the 18 years of regulatory decisions analyzed by Dr. Morin.[712] We note that, unlike for DCF and CAPM calculations, MISO TOs did not update and add to the data set for ROE proceedings through the end of the test period in June of 2015, further reducing the robustness of the data set. MISO TOs' regression in the first proceeding, by using the average of ROEs from each year, only has nine observations in its regression analysis, which is a low figure for a regression analysis, and therefore could impact the reliability of the results. Regardless of the reason for the high regression results, the MISO TOs' regression creates a dynamic where, regardless of the capital market conditions, the Risk Premium analysis will keep the ROE essentially stable. This defies general financial logic that lower interest rates make it easier to raise capital based on the reduced opportunity cost of bonds and greater availability of revenue to invest due to the opportunity for carry trades where borrowing low-cost debt is used to finance equity purchases. This relationship is evident when the stock market increases or decreases inversely with news regarding Federal Reserve interest rate activity. Additionally, the results of MISO TOs' regression analyses imply that the Federal Reserve's activities following the financial crisis in terms of reducing interest rates and open market operations had virtually no effect on the underlying required return on equity.

345. Additionally, the record contains insufficient evidence to conclude that investors rely on risk premium analyses utilizing historic Commission ROE determinations or settlement approvals to determine the cost of capital and make investment decisions. Investors certainly observe regulatory ROEs and how changes in authorized ROE levels could affect utility earnings, but such considerations differ from the type of analyses employed by the MISO TOs looking back at past decisions to determine the current cost

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[710] *See, e.g.*, CAPs Reply Br. (I) at 26 ("[A] Risk Premium-based finding will tend to replicate the regulatory lag and inertial continuation of past returns that affected past regulatory decisions."); CAPs Reply Br. (II) at 46; LPSC Initial Br. at 6-7; OMS Rehearing Request at 20-21.

[711] MISO TOs Initial Br. (I), App. 2 McKenzie Aff. (I), Attachment 6, at 6.

[712] Morin at 123.

of capital. We recognize that academic literature discusses this methodology, but the record indicates the greater prevalence of other methods.

346. The Risk Premium methodology also entails numerous judgement calls and corresponding points of dispute among parties that would render the model results less predictable and transparent than other models. First, as illustrated in this proceeding, there would likely be vigorous debate on which past ROE determinations the analysis should include. First, there is the issue of how far back such data should go. MISO TOs propose to start their analysis after the Energy Policy Act of 2005. This creates, at least for the time being, a much smaller data set than that which was used by Dr. Morin. We find unpersuasive MISO TOs' arguments that the nature of the industry and the resulting risk premiums changed due to this legislation sufficiently to ignore prior data. FPA section 219 requiring the Commission to provide transmission incentives is not germane to the base ROE determinations, nor are changes to the Public Utility Regulatory Policies Act, Commission enforcement authority, federal citing authority, or other elements of the 2005 Energy Policy Act. With that said, there is no clear initial starting point, which could be subject to debate.

347. In Opinion No. 531, the Commission found that "whether the regulatory decision involved a settlement agreement or the application of a cost of equity that was calculated in the past, e.g., the 12.38 percent ROE established for the MISO region, does not affect the reliability of a risk premium analysis."[713] Upon further review, we find that such application of past ROEs and settlements are not in all cases appropriate. In certain proceedings involving the admittance of new members to RTOs, the pleadings and resulting Commission orders did not reexamine the justness and reasonableness of the existing ROEs. Consequently, it is not reasonable to infer that the ROEs applied in these proceedings are the result of contemporary Commission analysis and representative of the cost of capital at that time. The same rationale applies to certain proceedings involving transmission incentives. In some cases, the Commission has explicitly examined the base ROEs or zones of reasonableness,[714] while in others the Commission has stated that the base ROE is beyond the scope of the proceeding, rendering it hard to argue that the resulting ROEs reflected contemporary risk premiums.[715] Consequently, it is highly debatable, as illustrated in this proceeding, which ROE proceedings the Commission should include in a Risk Premium analysis.

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[713] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 98.

[714] *See Dusqesne Light*, 125 FERC ¶ 61,028 (2008).

[715] *See Pub. Serv. Elec. and Gas Co.*, 147 ¶ FERC 61,142, at P 48 (2014).

348. Order No. 531-B also found that "[g]iven the varying duration of regulatory proceedings, it is difficult, if not impossible, to ensure precise contemporaneity between long-term Treasury bond yields and the cost of equity allowed by a regulator."[716] Although an analysis with such imprecision may have been sufficient for using the Risk Premium model for corroborative purposes, we find that direct use of the model would require actual alignment of the test periods and the dates assigned for purposes of comparing the ROE to the risk free rate of return to determine the risk premium. In particular, orders on initial decision often occur more than a year following the updated test period.[717] It is unclear what test period should be assumed for orders in other types of proceedings, such as those approving transmission incentives. If the Commission were to adopt a precise timing in this proceeding, as a practical matter, such a decision would likely require the Commission to exclude certain proceedings whose test periods predate 2006 and include others, as well as potentially change the dates assigned to yet other proceedings.

349. Other debatable input decisions also bedevil the Risk Premium methodology, such that the Commission would need to resolve numerous implementation questions to enable its use. For instance, what is the risk premium resulting from proceedings resolved by settlements with different ROEs for different parties or time periods? Should multiple ROEs from the same proceeding be given more weight than individual ROEs from other proceedings? Where different ROEs apply to different time periods, should the ROEs be assigned to different times for purposes of the risk premium analysis? Should ROEs from settlements resolving multiple proceedings with the same ROE be counted once or twice? Other methodological decisions include whether to look at the annual average of ROEs and corresponding risk-free rates of return or look at them individually. The former avoids overweighting proceedings from years with many proceedings but greatly reduces precision by muting changes in ROEs and risk free rates of returns within years. Other points of disagreement include the appropriateness of using risk premiums from periods of high bond volatility, and whether to include state ROEs.

350. Such questions illustrate the inherent imprecision and complexity of this approach. We find that, although certain elements of the CAPM and DCF are subject to debate, as discussed above, the Risk Premium model features far more ambiguity and potential for dispute. Although the Commission could provide guidance on some of these matters, others would require ongoing adjudication. As a result, the Risk Premium model would lead to higher costs for participation by interested parties and reduced predictability of results, which both investors and customers value. Additionally, as discussed above, in

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[716] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 98.

[717] *See* Opinion No. 551 which was issued 13 months following the end of the test period.

both proceedings before us here, the parties make numerous arguments supporting and opposing various specific aspects of how the Risk Premium model is implemented. For example, parties dispute whether or not to use settlements as inputs to the Risk Premium model,[718] how the time periods that are used for the comparison of bond yields and allowed ROEs should align,[719] whether to exclude bond yields from periods of high volatility,[720] and whether to use real or nominal bond yields in the Risk Premium analysis.[721]

351. Moreover, as noted in the Briefing Order, the output that the Risk Premium model produces is a single numerical point, and therefore, it does not produce a range which can be used to determine a zone of reasonableness. Accordingly, the Briefing Order proposed to only use the Risk Premium model in the second prong of the section 206 analysis where we determine a specific just and reasonable ROE, but not in the first prong of the analysis, which requires models that produce a range that can be used to determine a zone of reasonableness. This asymmetry in the potential use of the Risk Premium is not ideal and is another disadvantage of the Risk Premium model that weighs in favor of excluding it from the Commission's ROE methodology. We would prefer to use the same models in the prong one and prong two analyses to ensure that our ROE determinations under each prong are based on the same data and models. It would not be logical to use different models and data sources to apply this same standard under the two prongs unless there is some compelling justification for the difference. We find that there is no such compelling justification. We initially proposed to use the Risk Premium model, despite it only being appropriate for use in the second prong analysis, because our initial analysis of the model indicated that it could potentially provide benefits to our ROE methodology that outweighed the disadvantages of only having the model available for use in the second prong analysis. However, in light of the full record in these proceedings before us now, we find that the Risk Premium model does not provide benefits to our ROE methodology that would outweigh the model's disadvantages, such as the disadvantage of only having the model available for use in the second prong analysis.

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[718] *See, e.g.*, CAPs Br. on Exceptions at 65-59; MISO TOs Br. Opposing Exceptions at 57-58; MISO TOs Reply Br. (I) at 31-32.

[719] *See, e.g.*, OMS Rehearing Request at 23-25; RPGI Initial Br. (I) at 36–37; Trial Staff Initial Br. (I) at 21–23; MISO TOs Reply Br. (I) at 32.

[720] *See, e.g.*, Trial Staff Initial Br. (I) at 23-24; MISO TOs Reply Br. (I) at 34-35.

[721] *See, e.g.*, CAPs Br. on Exceptions at 50-52; OMS-JCA Br. on Exceptions at 47-48; MISO TOs Br. Opposing Exceptions at 58-59.

352. As discussed above, we will not use the Risk Premium model in our ROE methodology. Accordingly, we find that the parties' arguments regarding how the Risk Premium model should be implemented are moot and we will not address any such arguments raised in the briefs on and opposing exceptions to Initial Decision (II), requests for rehearing of Opinion No. 551, the initial and reply briefs issued in response to the Briefing Order, or any pleadings in these proceedings. We address some of these implementation issues in the context of discussing our decision to not use the Risk Premium model above, but in light of our decision not to use the model, we find that it is unnecessary to reach determinations on how the model should be implemented. Accordingly, we find that arguments in these proceedings regarding how the Risk Premium model should be implemented are moot.

IX. Potential Consideration of State ROEs

A. Briefing Order Proposal

353. In the Briefing Order, the Commission proposed to not consider the level of state ROEs when determining the composite zone of reasonableness under the first prong of section 206, nor to weight state ROEs equally with the financial models in establishing a new just and reasonable ROE under the second prong of section 206. However, the Commission proposed to consider evidence of state ROEs to the extent that the record adequately demonstrates that investors are using them to inform their investment decisions.[722]

B. CAPs

354. CAPs argue that the Commission's proposal is arbitrary and capricious for several reasons.[723] CAPs contend that the proposal departs from precedent rejecting direct use of state-authorized ROEs in establishing the Commission-jurisdictional return of utilities.[724] They assert that "Commission precedent rejects the direct use of state commissions' return determinations in setting [Commission]-jurisdictional ROEs."[725]

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[722] Briefing Order, 165 FERC ¶ 61,118 at P 37 n.67.

[723] CAPs Initial Br. (I) at 48; CAPs Initial Br. (II) at 48.

[724] CAPs Initial Br. (I) at 49; CAPs Initial Br. (II) at 49.

[725] CAPs Initial Br. (I) at 49 (citing, e.g., *Middle South Services, Inc.*, Opinion No. 124, 16 FERC ¶ 61,101 (1981); *Boston Edison Co.*, Opinion No. 411, 77 FERC ¶ 61,272 (1996); *Jersey Cent. Power & Light Co.*, Opinion No. 408, 77 FERC ¶ 61,001 (1996); *Appalachian Power Co.*, Opinion No. 423, 83 FERC ¶ 61,335 (1998); *Midwest*

CAPs contend that in Opinion Nos. 531 and 531-B the Commission acknowledged and reaffirmed this precedent. They argue that the Commission has not explained "how its proposed use of state-authorized ROEs would be consistent with precedent, or why departure from its precedent would be appropriate."[726] CAPs further assert that "[i]n *Emera Maine*, the D.C. Circuit found it arbitrary and capricious to use state-allowed ROEs to support placement of the New England TOs' ROE at the upper midpoint because state-authorized ROE data pointed to a level below the DCF upper midpoint."[727] CAPs also contend that the Commission does not explain why it may be appropriate to use state-authorized ROEs in the second prong of section 206 proceedings (i.e., to establish the new just and reasonable ROE), but that it is never appropriate to use such data in the first prong of section 206 (i.e., to determine whether the existing ROE of utilities is unjust and unreasonable).[728]

355. CAPs assert that the Commission proposes to disregard considering state-authorized ROEs in the formation of the composite zone of reasonableness at the same time that it is proposing to consider such data in the calculation of a replacement ROE. CAPs argue that, if evidence in the record shows that investors rely on state-authorized ROE data, it follows that investors' return expectations based on this data is as relevant to determining whether the existing ROE is unjust and unreasonable as it is to determining the replacement ROE and the total ROE cap.[729] Hence, CAPs contend that the Commission is proposing an inconsistent application of state-authorized ROE evidence without providing a reasonable explanation for doing so.[730] Further, CAPs argue that the Commission has not explained what weight state-authorized ROEs will be given or what type of evidence could show that investors rely on these ROEs.[731]

356. CAPs comment that the use of state-authorized ROEs by the Commission would not satisfy the comparability standard of *Hope* and *Bluefield*, which requires that a

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Independent Transmission System Operator, Inc., 98 FERC ¶ 61,356, at 62,525 n.15 (2002)); CAPs Initial Br. (II) at 49 (citing same).

[726] CAPs Initial Br. (I) at 50; CAPs Initial Br. (II) at 50.

[727] CAPs Initial Br. (I) at 50; CAPs Initial Br. (II) at 50.

[728] CAPs Initial Br. (I) at 48; CAPs Initial Br. (II) at 48.

[729] CAPs Initial Br. (I) at 51; CAPs Initial Br. (II) at 51.

[730] CAPs Initial Br. (I) at 52; CAPs Initial Br. (II) at 51.

[731] CAPs Initial Br. (I) at 52; CAPs Initial Br. (II) at 51.

utility's return on equity must be "equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties."[732] CAPs argue that state commissions establish ROEs having taken into account a wide range of risk factors that are unique to each state, vary across jurisdictions and change over time. According to CAPs, state ROEs reflect considerations that are completely unrelated to the transmission risks that the base ROE in this case sees to account for.[733]

357. Finally, CAPs assert that, to the extent that the Commission decides to use state-authorized ROE data in its ROE determinations, it should establish generic, transparent criteria to ensure appropriate comparability, and that the state-authorized ROE data should be used in a consistent manner, regardless of whether the data increases or lowers the base ROE.[734]

C. Alliant

358. Alliant argues that the Commission should compare the base ROE resulting from its proposed methodology to retail utility ROEs allowed in states in which transmission facilities owned by each of the MISO TOs are located. Alliant contends that the ROE established by the Commission for unbundled transmission service within a state should be consistent with the ROE permitted by state regulators for retail rates because state regulators also have the obligation to ensure that charges for bundled electric service by retail electric service customers are just and reasonable.[735]

D. MISO TOs

359. In their reply brief, the MISO TOs assert that, contrary to arguments presented by CAPs, the Commission has ample justification in the record of the First and Second Complaint proceedings for considering state-authorized ROEs as evidence of expected investor returns.[736] Further, they endorse the Commission considering state-authorized ROEs in the context of how the risk profile of a state-regulated utility compares to the

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[732] CAPs Initial Br. (I) at 52 (quoting *Bluefield*, 262 U.S. at 692); CAPs Initial Br. (II) at 52 (quoting same).

[733] CAPs Initial Br. (I) at 53; CAPs Initial Br. (II) at 52.

[734] CAPs Initial Br. (I) at 53; CAPs Initial Br. (II) at 53.

[735] Alliant Initial Br. at 10-11.

[736] *See* MISO TOs Reply Br. (I) at 82.

risk profile of the MISO Transmission Owners, and argue that consideration of state-authorized ROEs is consistent with Opinion No. 531-B. MISO TOs also assert that CAPs incorrectly characterizes the ruling in *Emera Maine* regarding the Commission's consideration of data for state-authorized ROEs. MISO TOs argue that the Court did not find error with the Commission's consideration of state ROE data. Rather, the Court determined that the Commission erred when it failed to provide a reasoned explanation relative to the cited state-authorized ROEs and other evidence.[737]

360. In response to CAPs' assertion that the Commission in the First Complaint proceeding did not find that investors had relied upon state-authorized ROE, MISO TOs argue that it is illogical to conclude that there was not a showing that investors relied on such data. MISO TOs argue that the Commission did not need to specifically rely on evidence of state-authorized ROEs in order to present the methodology and findings it proposed in the Briefing Order.[738]

361. MISO TOs comment that CAPs misread the Commission's Briefing Order when they conclude that state-authorized ROEs will not be used in evaluating an existing ROE for justness and reasonableness under prong one of the FPA section 206 analysis.[739] Instead, MISO TOs assert that the Commission explains in the Briefing Order that it will not use state-authorized ROEs in the composition of the composite zone of reasonableness in prong one of PFA section 206, nor as one of the four financial models used to establish a new base ROE in prong two of FPA section 206. Nonetheless, MISO TOs assert that in the Briefing Order the Commission leaves open other purposes for which the Commission could consider state-authorized ROEs in both prongs of the FPA section 206.[740] MISO TOs argue that, contrary to CAP comments, the state ROE data cannot be used to calculate a composite zone of reasonableness because there are material risk differences between utilities regulated at the state level and the transmission utilities regulated at the federal level.[741] Rather, MISO TOs assert that state-authorized ROE data

[737] *Id.* at 83-84.

[738] *Id.* at 84.

[739] *Id.* at 85 (citing Briefing Order, 165 FERC ¶ 61,118 at P 37 n.67).

[740] *Id.* at 85-86.

[741] *Id.* at 86.

has been and can be a useful tool as a benchmark in reviewing investor expectations and evaluations cost of equity estimates within the larger market context.[742]

362. Finally, MISO TOs respond to CAPs request that the Commission adopt a generic and transparent criteria when using data on state-authorized ROEs by asserting that this request seeks a superfluous legal standard that is unnecessary, outside of the scope of this proceeding and would have no discernable benefit.[743]

E. Commission Determination

363. We continue to find that our ROE determination in these proceedings need not consider state-authorized ROEs. As MISO TOs point out, there are material differences between state and Commission ROEs. As an initial matter, state-authorized ROEs may apply to distribution companies, which feature lower risks than transmission companies subject to Commission ROEs. Also, certain states include shared savings, decoupling, or performance-based rates, rendering comparisons between Commission and state ROEs less precise. As a result, we will only consider state-authorized ROEs on a case-by-case basis to the extent that they demonstrate that the results of the Commission's CAPM and DCF analyses are substantially excessive or deficient. We do not expect that the Commission will regularly consider state-authorized ROEs. Rather, they serve as a check given the model risk as we formulate our ROE determinations.

364. We also clarify that state ROE information could inform both prongs of the section 206 ROE analysis. For the first prong, such information could be used to rebut the presumption that a given base ROE is or is not just and reasonable. Such information could also be used to demonstrate, for instance, that the base ROE established under the second prong is substantially excessive or deficient. We also reject Alliant's proposal to use state ROEs where the utility is located. Doing so would potentially tie Commission ROE determinations to state determinations, which could be methodologically very different or apply to utilities featuring different risk profiles than Commission-jurisdictional transmission owners.

X. Proxy Group Construction

365. Both the DCF and CAPM models use proxy groups to determine a range of reasonable returns. In the Briefing Order,[744] the Commission stated that it intends to

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[742] *Id.* at 86.

[743] *Id.* at 86-87.

[744] *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 51.

continue to use the same screens for developing a proxy group as the Commission has used in recent cases, including Opinion Nos. 531[745] and 551.[746] Those five screens are: (1) the use of a national group of companies considered electric utilities by *Value Line*;[747] (2) the inclusion of companies with credit ratings no more than one notch above or below the utility or utilities whose ROE is at issue;[748] (3) the inclusion of companies that pay dividends and have neither made nor announced a dividend cut during the six month study period;[749] (4) the inclusion of companies with no merger activity during the six-month study period that is significant enough to distort the study inputs;[750] and (5) companies whose ROE results pass threshold tests of economic logic, including both a low-end outlier test and a revised high-end outlier test proposed in the Briefing Order.

366. The first four screens listed above evaluate particular characteristics potential proxy group companies. They do not vary depending upon the results of the DCF or CAPM analyses. Accordingly, those screens may be used to develop a starting group of proxy companies eligible for inclusion in the proxy group to be used for the purposes of both the DCF and CAPM analyses. However, the high-end outlier test part of the last screen—whether the company's cost of equity estimate passes threshold tests of economic logic—depends upon the median cost of equity estimate each of the two models produces. Thus, in determining the zone of reasonableness produced by each of these models, the high-end outlier test must be applied separately to each model. Below, we discuss issues raised by the participants with respect to the high-end and low-end outlier tests. By contrast, the low-end outlier test for both models is derived, in part from, the CAPM's risk premium.

A. High End Outlier Test

1. Briefing Order

367. In the Briefing Orders, the Commission recognized that the CAPM model can produce unsustainably high results for a particular proxy company, because, unlike the

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[745] Opinion No. 531, 147 FERC ¶ 61,234 at P 97.

[746] Opinion No. 551, 156 FERC ¶ 61,234 at P 20.

[747] Opinion No. 531, 147 FERC ¶ 61,234 at PP 96, 100-102.

[748] The Commission requires use of both Standard and Poor's corporate credit ratings and Moody's issuer ratings when both are available. *Id.* P 107.

[749] *Id.* P 112.

[750] *Id.* P 114; Opinion No. 551, 156 FERC ¶ 61,234 at PP 37-43.

two-step DCF analysis, it does not include a long-term growth projection based on GDP that would normalize the ROEs produced by the model, similar to that used in the two-step DCF analysis. Moreover, the Commission recognized that in unusual circumstances, the two-step DCF analysis could also produce unsustainably high results. Therefore, the Commission proposed to apply a high-end outlier test to the results of both these models.

368. The Commission proposed to treat as high-end outliers any proxy company whose cost of equity estimated under the model in question is more than 150 percent of the median result of all of the potential proxy group members in that model before any high or low-end outlier test is applied, subject to a "natural break" analysis similar to the approach the Commission uses for low-end DCF analysis results. The Commission stated that this test should identify those companies whose cost of equity under the model in question is so far above the cost of equity of a typical proxy company as to suggest that it is the result of atypical circumstances that are not representative of the risk profile of a more normal utility.

2. CAPs

369. MISO CAPs contend that a high-end outlier test should be used, particularly if the Commission sets the base ROE based mainly on the midpoint rather than the median of the zone of reasonableness. However, CAPs contend that the Commission's proposed high-end outlier test lacks a statistically sound basis and does not appropriately consider information inherent in the underlying array of ROEs produced by each financial model. MISO CAPs recommend the Commission should, instead, exclude as high-end outliers any ROEs produced by each model that are more than two standard deviations[751] above the median of the ROEs produced by that model.[752] MISO CAPs state that MISO TOs'

[751] In statistics, a standard deviation is a measure that is used to quantify the amount of variation or dispersion on a set of values. The smaller the standard deviation, the more values that are expected to be closer to the mean. Conversely, a large standard deviation implies that the data is more widely distributed. Under a normal distribution, only 2.5 percent of observations are expected to be more than two standard deviations above the mean.

[752] CAPS Initial Br. (I) at 60-63, Ex. JCI-100 (Solomon Testimony) at 13-14, CAPS Initial Br. (II) at 60-63, Ex. JCI-200 at 12-13. In reply briefs, MISO CAPS also alternatively endorse use of the Grubbs test, another statistical method for identifying outliers, over MISO TOs' proposals. *See* CAPS Reply Br. (I) at 60.

proposed alternative threshold, which is 150 percent of the highest median return on equity from all three models, has no economic basis.[753]

3. MISO TOs

370. MISO TOs oppose the use of any high-end outlier test.[754] MISO TOs contend that the 150 percent threshold test is arbitrary and not tied to previous Commission policy. MISO TOs specifically assert that there is no support for the contention that an estimate greater than 1.5 times the median of a model's range of estimates must be the result of "atypical circumstances." MISO TOs also contend that there has been no showing that investors generally disregard high-end estimates from any model or rely on the proposed 150 percent test to eliminate high-end results.

371. MISO TOs also oppose CAPs' alternative statistical tests based on a standard deviation. They assert that those tests relate to the practice of sampling, i.e., the selection of a subset of data from within a larger population that allows the researcher to make statistical inferences about unknown qualities of the population. MISO TOs assert that the CAPs' proposed tests are used to determine whether the sampling data represent a random sample from a single normal population. However, MISO TOs contend that, when the Commission selects a proxy group, it is not sampling. Rather, the Commission has identified all of the utilities deemed to be of comparable risk to the MISO TOs. Thus, the array of cost of equity estimates of the proxy companies represent a population, not a sample of the population. As a result, the dispersion of individual values around the population mean is not a valid test of how well a specific estimate reflects investors' expectations.[755] However, MISO TOs contend that, if the Commission does use a high-end outlier test, then it should apply that test to the highest median of the CAPM, Expected Earnings, and DCF models, and apply it only as a rebuttable presumption.

372. Further, MISO TOs contend that the high-end outlier test should not apply to the DCF model.[756] MISO TOs note that, in Opinion No. 531, the Commission stated that including long-term GDP growth in the two-step DCF eliminates the need to screen the results for high-end outliers. MISO TOs also assert that the median of the DCF results does not constitute a meaningful guide to investors' required returns given that the Commission has determined that the central tendency of the DCF zone of reasonableness

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[753] Ex. JCI-107 at 29-30 (Solomon Testimony).

[754] MISO TOs Initial Br. (I) at 12-16.

[755] MISO TOs Initial Br. (I), App. 2 McKenzie Reply Aff. (I) at 100-102.

[756] MISO TOs Initial Br. (I) at 16-18.

may be distorted by anomalous capital market conditions as the Commission found in Opinion Nos. 531 and 551. MISO TOs contend that, if the Commission does apply the high-end outlier test to the DCF model, then it should employ the one-step DCF model without any long-term growth projection.

4. Trial Staff

373. In its reply brief, Trial Staff supports the high-end outlier test proposed in the Briefing Order and opposes the MISO TOs' contention that a high-end outlier test is unnecessary.[757]

5. Other Parties

374. RPGI supports the high-end outlier test proposed by the Briefing Order.[758]

6. Commission Determination

375. We adopt the high-end outlier test proposed in the Briefing Order. Although we have decided not to use the Expected Earnings model, which is more subject to high-end outliers than the other models, or the Risk Premium Model, the other models may produce unsustainably high results for a particular proxy company in unusual situations. Therefore, we find it necessary to apply a high-end outlier test to the results of these methods. As shown with TECO,[759] whose IBES growth estimates changed from 6.43 to 9.2 and back to 7.68 percent during the course of the First Complaint proceeding, financial metrics for individual utilities can fluctuate dramatically, potentially affecting the resulting ROE. Particularly given that the Commission will continue to use the midpoint as the measure of central tendency for region-wide ROEs, as discussed below, we find it appropriate that there be a high-end outlier test to eliminate members of the proxy group whose ROEs are unreasonably high.

376. While parties have proposed alternative high-end outlier tests as being superior because they have a firmer statistical basis, we do not find these arguments persuasive. Statistical methodologies, like the proposed alternative outlier test methodologies, may be based on assumptions such as the distribution of the underlying population being

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[757] Trial Staff Reply Br. (I) at 6-7.

[758] RPGI Reply Br. (I) at 13-18.

[759] As noted above, in the First Complaint proceeding, TECO set the top of the zone of reasonableness.

normal.[760] These underlying assumptions may not always hold for a given proxy group, especially a small proxy group.[761] As stated in the article by Frank Grubbs cited by CAPs, "the rejection of 'outlying' observations may be just as much a practical (or common sense) problem as a statistical one and sometimes the practical or experimental viewpoint may naturally outweigh any statistical contributions in a sample . . . [A]ny test which requires an inordinate amount of calculation seems hardly to be worthwhile."[762] The high-end outlier test proposed in the Briefing Orders has the advantage that it is relatively easy to carry out and places a well-defined upper bound on the proxy group. In addition, because this test only utilizes a percentage differential compared to the median, it can be used with small proxy groups.

377. We also reject MISO TOs' proposal to use 150 percent of the highest median ROE produced by either the DCF or the CAPM model as the high-end outlier test for both models. As Mr. Solomon testified for CAPs, each model is based on different assumptions and thus estimates the cost of equity in different ways. Therefore, the determination of whether each model produces one or more extreme or illogical results is best determined by examining the dispersion of the ROE estimates produced by that model.[763]

378. MISO TOs also assert that, if the Commission applies a high-end outlier test to the DCF model, it should use a one-step DCF model without any long-term growth projection, instead of the two-step DCF model. However, the Commission has already discussed earlier in this order why a DCF analysis of a single utility should include a long-term growth projection. We recognize that the inclusion of a long-term growth projection based on GDP tends to normalize the ROEs produced by the model, and that this minimizes the likelihood that there will be any high-end outlier. Indeed, the high-end outlier test adopted in this order does not exclude any proxy company's DCF ROE in either the First Complaint or Second Complaint proceeding. Nonetheless, it is possible that unusual circumstances with respect to a particular company, if for example, there is an unusually high IBES growth projection as a company bounces back from a unique

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[760] *See, e.g.*, MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 107 ("Under Mr. Solomon's paradigm, where the standard deviation serves as a relevant measure of dispersion, the distribution is assumed to be perfectly normal.").

[761] *See, e.g.*, *Northwest Pipeline Corp.*, 99 FERC ¶ 61,305, at 62,276 (2002) (addressing a case where "the distribution of figures used to calculate Northwest's ROE is negatively skewed.").

[762] Frank Grubbs, Sample Criteria for Testing Outlying Observations, at 30.

[763] Ex. JCI-107 at 29.

setback, could cause the two-step DCF model to produce an illogically high ROE. The high-end outlier test adopted in this order allows such an illogical ROE to be excluded from the proxy group.

B. Low-End Outlier Test

1. Briefing Order

379. Under the Commission's existing low-end outlier test, companies whose ROE fails to exceed the average 10-year bond yield by approximately 100 basis points are excluded from the proxy group on the ground that investors generally cannot be expected to purchase a common stock if debt, which has less risk than a common stock, yields essentially the same expected return.[764] In the Briefing Order, the Commission proposed to continue to use this test for purposes of the CAPM and Expected Earnings analyses as well as the DCF analysis.[765]

2. MISO TOs

380. MISO TOs assert that the Commission adopted its current low-end outlier test in four ROE cases which used financial data for the six months ending November 2007 or the six months ending September 2008.[766] MISO TOs state that Baa bond yields over those two six-month periods averaged 6.69 percent.[767] However, Baa bond yields during the study period for the First Complaint proceeding (the six months ending June 2015) declined by 204 basis points to 4.65 percent,[768] and during the study period for the

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[764] *Pioneer Transmission, LLC*, 126 FERC ¶ 61,281, at P 94 (2009) (*Pioneer*), *reh'g denied*, 130 FERC ¶ 61,044 (2010). *S. Cal. Edison Co.*, 131 FERC ¶ 61,020, at PP 54-56 (2010) (*SoCal Edison*). In *SoCal Edison*, the Commission stated that it also eliminated companies whose ROEs were less than 100 basis points above the Moody's bond yield for that particular rating in *Atlantic PATH 15*, 122 FERC ¶ 61,135 (2008) (*Atlantic PATH*) and in *Startrans IO. L.L.C.*, 122 FERC ¶ 61,306 (2008) (*Startrans*). *Id.* P 54.

[765] Briefing Order, 165 FERC ¶ 61,118 at P 52.

[766] MISO TOs Initial br. (I) App. 2 McKenzie Aff. (I) at 29 (citing *Pioneer*, 126 FERC ¶ 61,281; *SoCal Edison*, 131 FERC ¶ 61,020; *Atlantic PATH*, 122 FERC ¶ 61,135; and *Startrans*, 122 FERC ¶ 61,306).

[767] MISO TOs Initial Br. (I), App. 2 McKenzie Aff. (I) at 29-30.

[768] *Id*. at 31.

Second Complaint study period (the six months ending December 2015) declined by 128 basis points to 5.41 percent.[769] Accordingly, MISO TOs contend that the 100 basis point low-end threshold should be adjusted upwards to account for the inverse relationship between risk premiums and bond yields shown by their risk premium analysis in each case.[770] Under the MISO TOs' proposed method, the low end threshold would be adjusted upwards by 154 basis points[771] from 100 basis points to 254 basis points in the First Complaint proceeding, and by 91 basis points[772] to 191 basis points in the Second Complaint proceeding. Thus, in the First Complaint Proceeding the low-end outlier test would exclude from the proxy group any companies with ROEs of 7.19 percent or less and in the Second Complaint Proceeding the test would exclude companies with ROEs of 7.32 percent or less. MISO TOs contend that this revised test would justify excluding additional companies from the proxy groups used for the DCF analysis. The MISO TOs state that the revised low-end outlier test would not affect the proxy group used for the CAPM analysis.

381. Further, MISO TOs argue that the Commission's practice has been to compare every proxy company's ROE to Baa bond index yields. MISO TOs argue the Commission should continue to use Baa bond index yields for the low-end outlier test because that is the bond rating category closest to the risks of common stock.[773]

3. CAPs

382. CAPs oppose MISO TOs' proposed revision to the low-end outlier test.[774] CAPs point out that the Commission used the 100 basis point low-end outlier test in Opinion No. 551 in the First Complaint Proceeding, and the MISO TOs did not seek rehearing on

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[769] MISO TOs Initial Br. (II), App. 2 McKenzie Aff. (II) at 27.

[770] MISO TOs Initial Br. (I), App. 2 McKenzie Aff. (I) at 28-31; MISO TOs Initial Br. (II), App. 2 McKenzie Aff. (II) at 24-27.

[771] MISO TOs calculate this adjustment by multiplying the 204 basis point decline in interest rate by the 75.34 percent increase in the risk premium determined by its risk premium study in the First Complaint proceeding.

[772] MISO TOs calculate this adjustment by multiplying the 128 basis point decline in interest rate by the 71.56 percent increase in the risk premium determined by its risk premium study in the Second Complaint proceeding.

[773] MISO TOs Reply Br. (I) at 57-58.

[774] CAPs Reply Br. (I) at 48-59; Ex. JC-108 at 29.

that issue. Also, the Presiding Judge in the Second Complaint Proceeding used the 100 basis point low-end outlier test, and the MISO TOs did not file an exception on that issue.

383. CAPs assert that the Commission has explained that the "the purpose of the low-end outlier test is to exclude from the proxy group those companies whose ROE estimates are below the average bond yield or are above the average bond yield but are sufficiently low that an investor would consider the stock to yield essentially the same return as debt."[775] CAPs argue that, for purposes of determining whether a stock would be considered to yield essentially the same return as debt, the 100 basis point threshold is appropriate regardless of changes in interest rates. They assert that yield spreads of utility stock dividends over utility bond yields are relatively stable during most markets. The only notable exception would be during distressed markets when the market demands abnormal risk premiums to invest in securities of greater risk.[776]

384. CAPs also disagree with the MISO TOs' contention that, in applying the low-end outlier test, the ROE of every proxy company should be compared to the Baa bond yield. CAPs argue that the ROE of each proxy company should be compared to the yields of bonds with the same credit rating as the proxy company in question. Thus, if the proxy company has a credit rating of A, its ROE would be compared to A bond yields.[777]

4. Trial Staff

385. Trial Staff argues that MISO TOs' proposed modification to the low-end outlier test, which would require exclusion of companies with ROEs of 7.19 percent or less in the First Complaint Proceeding and companies with ROEs of 7.32 percent or less in the Second Complaint Proceeding, is illogical. Trial Staff contends that no rational investor would consider ROEs of 7.19 percent and 7.32 percent as "essentially the same return" as the contemporary Baa bond yields of 4.65 percent and 5.41 percent respectively.[778] Trial Staff also asserts that the adjustments proposed by MISO TOs rely on an arbitrary choice of time periods for a comparison of interest rates. Trial Staff states that the baseline 6.69 percent Baa bond yield staff used based on study periods in 2007 and 2008 was higher

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[775] CAPs Reply Br. (I) at 53-54 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 122).

[776] Ex. JC-108 at 30-32.

[777] Ex. JCI-100 at 12; Ex. JCI-107 at 8.

[778] Trial Staff Reply Br. (I) at 6 (citing Trial Staff Reply Br. (I), Keyton Reply Aff. (I) at 10-11). *See also* Trial Staff Reply Br. (II) at 5-6 (citing Trial Staff Reply Br. (II), Keyton Reply Aff. (II) at 10-11).

than the calendar year average Baa bond yields for every year since 2002, except for the bond yield spike period of 2008 and 2009.[779] Trial Staff asserts that it is arbitrary to assume that the baseline for the change in interest rates should be constrained to a comparison between the 2007 and 2008 study periods and the study periods for the First and Second Complaint Proceedings.

386. Trial Staff also states that, in applying the low-end outlier test, the ROE of each proxy company should be compared to the yields of bonds with the same credit rating as the proxy company in question.[780]

5. Commission Determination

387. We will adjust the low-end outlier test to include a risk premium instead of the generic 100 basis points proposed in the Briefing Order, as discussed below. In particular, we will adopt a revised low-end outlier test that eliminates proxy group ROE results that are less than the yields of generic corporate Baa bonds plus 20 percent of the CAPM risk premium. The purpose of the low-end outlier test is to eliminate from the proxy group companies with ROEs that are so low that they should not be considered in determining the low end of the zone of reasonableness. Thus, the mere fact a potential proxy company's ROE may be lower than what would be considered reasonable for an average risk, or even a below average risk, utility is not a sufficient reason to exclude the company from the proxy group. Instead, the Commission's standard has been to exclude companies whose ROEs yield "essentially the same expected return" as debt. As MISO TOs have argued, and the Commission has acknowledged, as bond yields decline, the ROE that investors would consider to yield "essentially the same expected return" as a bond is increasingly higher than the corresponding bond yield.[781] Thus, to ensure that the low-end outlier test properly excludes companies whose ROE is indistinguishable from debt, an adjustment accounting for this risk premium is necessary.

388. We find that 20 percent of the risk premium from the CAPM analysis described above is a reasonable risk premium to apply to the low-end outlier test. Because the risk premium that investors demand changes over time, it is imprecise to simply add 100 basis

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[779] Trial Staff Reply Br. (I), Keyton Reply Aff. (I) at 11.

[780] *Id*. at 11-12 (citing *Bangor Hydro-Electric Co*., Opinion No. 489, 117 FERC ¶ 61,129, at PP 56-60 (2006) and Opinion No. 445, 92 FERC at 61,266).

[781] See Morin at 128-129, summarizing empirical research showing that as interest rates decline, the risk premium required by equity investors increases. Morin concludes that the gist of this research is that for every 100 basis point decline in government bond yields, the equity risk premium increases by about 50 basis points.

points to the bond yield. The methodology that we are adopting in this order captures such changes because the risk premium from the CAPM analysis reflects investors' required risk premium under the prevailing market conditions. We find that the 20 percent portion of the risk premium strikes a proper balance by being sufficiently large to account for the additional risk of equities over bonds, but not so large as to inappropriately exclude proxy group members whose return on equity is distinguishable from debt. This raises the low-end outlier threshold in the First Complaint proceeding from 5.65 to 6.47 percent, and it raises the low-end outlier threshold in the Second Complaint proceeding from 6.41 to 7.18 percent.[782] This revision does not result in the exclusion of any additional companies from the proxy group when applied to either the DCF or CAPM analyses in the First Complaint proceeding. However, in the Second Complaint proceeding, the revised low-end outlier test excludes one additional company from the DCF analysis.

389. MISO TOs argue that the low-end outlier test has been and should be based on the average Baa yield, while CAPs argue that the application of the low-end outlier test should be dependent on the bond rating of each company in the proxy group. We note that the Commission has applied this test differently in the past, with the most recent application being to apply the test based on the average Baa yield.[783] Conversely, CAPs contend that the Commission should base the low-end outlier test on Moody's Public Utility Bond index yield for the same rating category proxy utility under consideration. While CAPs argue that this application would be more precise, we find that using the Baa bond yields as the low-end test is consistent with the Commission seeking the proxy group for a diverse group of utilities to be representative of the cost of capital for all of those utilities. Further, using the specific bond yield for each company, in addition to adding complexity to the calculations, renders them (and the resulting ROE) less predictable, as the credit ratings for individual companies are likely more volatile than the generic corporate rate baa credit rating due to company-specific credit rating considerations. As discussed elsewhere in this order, where possible, we seek to provide predictability and transparency to ROE determinations, which is best accomplished by using a single outlier test. We find no reason to adjust the low-end outlier test to be applied to Moody's Public Utility Bond index yield for the same rating category proxy utility under consideration at this time.

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[782] *See* Appendix C. *See also* Opinion No. 551, 156 FERC ¶ 61,234 at P 20; Initial Decision (II), 155 FERC ¶ 63,030 at P 171 and P 174 n.75.

[783] Opinion No. 531, 147 FERC ¶ 61,234 at P 123.

C. Natural Break Analysis

1. Briefing Order

390. In the Briefing Orders, the Commission proposes to apply its low-end and high-end outlier screens, subject to a "natural break" analysis. The natural break analysis determines whether certain proxy group companies screened as outliers, or those almost screened as outliers, truly represent outliers and should thus be removed from the proxy group. Typically this involves examining the distance between that proxy group company and the next closest proxy group company, and comparing that to the dispersion of other proxy group companies.[784]

391. In the Briefing Orders, the Commission did not explicitly define how large of a difference constitutes a natural break, nor did it set forth a specific methodology for determining what constitutes a natural break. In Opinion No. 531, the Commission stated that there was a natural break where an excluded proxy group company had a cost of equity estimate that was 101 basis points above the applicable bond yield and the lowest cost of equity estimate of the included proxy group companies was 242 basis points above the applicable bond yield—or a 141 basis point break between the excluded and lowest included companies.[785] In Opinion 531-B, the Commission indicated that the same natural break analysis need not apply to both the low- and high-end outlier tests because those tests serve different purposes,[786] but did not otherwise define the numerical difference that would constitute a natural break or provide a methodology for determining what constitutes a natural break.

2. CAPs

392. CAPS contend that the natural break analysis should apply to low-end and high-end outliers.[787] However, CAPS argue that the natural break analysis is vague and subjective, and contend the Commission should use a more objective test. Specifically, CAPS propose the Commission use a two-part test that examines whether a proxy value is: (1) close to the threshold level that applies prior to considering natural breaks; and

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[784] *See, e.g.*, *SoCal Edison*, 131 FERC ¶ 61,020 at P 56, applying a natural break analysis to exclude from the proxy group a company whose ROE was 102 basis points above the applicable bond yield.

[785] Opinion No. 531, 147 FERC ¶ 61,234 at P 123.

[786] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 79.

[787] CAPS Initial Br. (I) at 61.

(2) far from the neighboring proxy value that would be retained.[788] MISO CAPS contend that the population argument raised by MISO TOs is undermined by, among other things, the Commission's proxy group selection criteria having changed over time.[789]

3. MISO TOs

393. MISO TOs contend the Commission should not use the natural break analysis. Specifically, MISO TOs contend the test has no economic basis, is illogical, unnecessary, arbitrary, and highly subjective. MISO TOs contend the use of the natural break analysis is based on a false premise that evaluating cost of equity estimates is akin to sampling. Instead, MISO TOs contend that the Commission's proxy group criteria are designed to identify the entire relevant population. Further, the MISO TOs contend that the goal is not to exclude outliers, but to exclude estimates that are illogical for use as a basis for establishing the zone of reasonableness.[790] MISO TOs contend that, if the Commission elects to use a natural break analysis, it only be used on the low end of a cost-of-equity estimate range to determine whether the low-end outlier test may have failed to exclude illogical results.[791]

4. Trial Staff

394. Trial Staff contends a natural break test should be used, and argues that dispersion must be taken into consideration for the midpoint to pass the test of economic logic.[792]

5. Commission Determination

395. We will continue to apply the natural break analysis to our outlier screens. We do not find the arguments raised by MISO TOs against its use availing. As has been noted,

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[788] CAPS Initial Br. (I) at 61-64. The specific test CAPS proposes is detailed in Exhibit JCI-100 at 14-16. Specifically, this test first identifies whether the distance between the outlier threshold and the adjacent proxy value is less than the average jump, or the width of the distribution's range divided by the number of proxies. The test then identifies whether the distance between that lowest or highest proxy value and its neighbor is more than twice the jump separating that neighbor from the next neighbor.

[789] CAPS Reply Br. (I) at 75.

[790] MISO TOs Initial Br. (I) at 9-11.

[791] *Id.* at 11-12.

[792] Trial Staff Reply Br. (I), Keyton Reply Aff. (I) at 29.

the purpose of both the high and low-end outlier tests is to screen for outliers whose inclusion in the proxy group would lead to economically illogical results. Under both tests, as outlined in this order, the Commission will use a formula to calculate a specific numerical guideline for determining whether a particular company's DCF or CAPM ROE should be treated as a high or low-end outlier. However, any such specific numerical guideline must, of necessity, be somewhat arbitrary, given the insignificance of a few basis points difference in ROE. The natural break analysis gives the Commission the flexibility to determine whether a given proxy group company is truly an outlier, or whether it contains useful information, in light of the particular array of ROEs presented by the potential proxy group companies. This is illustrated by the natural break analysis that the Commission performed in both *SoCal Edison*[793] and Opinion No. 531,[794] where the Commission excluded companies whose ROEs were only one and two basis points above the then applicable low-end outlier test, because there was a natural break between those companies' ROEs and the higher ROEs of the companies that the Commission included in the proxy group.

396. We clarify that the Commission will apply such a natural break analysis to both the low-end and high-end outlier tests. We further clarify that the analysis may justify excluding companies whose ROEs are a few basis points above the low-end screen, if their ROEs are far lower than other companies in the proxy group; a similar analysis could also apply with respect to the high-end outlier test. We also clarify that the natural break analysis may justify inclusion of companies in the proxy group despite their failing either the low or high-end outlier test. For instance, a company's ROE could be 152 percent of the median ROE, but, based on this analysis, the Commission may include it in the proxy group if it were not substantially higher than other companies in the proxy group.

397. Further, the Commission has not enumerated a rigid formula, such as specifying how close the company has to be to the next proxy group member to justify inclusion or exclusion from the proxy group, for the application of the natural break analysis, and we decline to do so here. The natural break analysis provides the Commission flexibility to reach a reasonable result based upon the particular array of ROEs presented in a specific case. Although we recognize the value of transparency and predictability, given the number of potential scenarios with respect to outlier proxy group companies, we are not convinced that there is any specific formula that would reach reasonable results in every possible factual situation. In any event, we believe it is appropriate to develop our policy on this issue through case-by-case analysis, rather than adopting a specific formula here.

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[793] 131 FERC ¶ 61,020 at P 56.

[794] 147 FERC ¶ 61,234 at P 123.

XI. Use of Midpoint or Median as Measure of Central Tendency

398. In determining the central tendency of the zone of reasonableness, the Commission has distinguished between cases involving an RTO-wide ROE and cases involving the ROE of a single utility (or pipeline). In cases involving an RTO-wide ROE, the Commission has held that the midpoint is appropriate. The Commission has reasoned that, because an RTO-wide ROE will apply to a diverse set of companies, the range of results becomes as important as the central value, and the midpoint fully considers that range, because it is derived directly from the endpoints of the range. The Commission established this policy in an order on remand in the proceeding establishing the MISO TOs' 12.38 percent ROE.[795] By contrast, in cases involving a single utility, the Commission has held that using the median is appropriate, because the median "is the most accurate measure of central tendency for a single utility of average risk."[796] In the Briefing Order, the Commission proposed to continue this policy.[797]

399. As described below, the CAPs and OMS assert that the Commission should no longer use the midpoint in cases involving an RTO-wide ROE, while MISO TOs defend the current policy. As discussed below, the Commission is retaining its current policy of using the midpoint for determining the central tendency of the zone of reasonableness in cases involving an RTO-wide ROE.

A. CAPs

400. CAPs recommend using the median for setting the base ROE for all MISO TOs, noting that the Commission has found that the "median best represents central tendency" if a distribution is skewed, for companies of average risk.[798] CAPs further assert that "the midpoint is inherently inferior to the median as a measure of central tendency because it depends upon only the two most extreme, unrepresentative observations . . . and ignores

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[795] *Midwest Indep. Transmission Sys. Operator, Inc.*, 106 FERC ¶ 61,302, at PP 9-10 (2004) (*MISO Remand Order*), *aff'd*, *Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005) (*Pub. Serv. Comm'n of Ky. v. FERC*).

[796] *See SoCal Edison*, 131 FERC ¶ 61,020, at P 91, *remanded on other grounds sub nom. S. Cal. Edison Co. v. FERC*, 717 F.3d 177, 183-87 (D.C. Cir. 2013) (*S. Cal. Edison v. FERC*).

[797] Briefing Order, 165 FERC ¶ 61,118 at P18 n.40.

[798] CAPs Initial Br. (I) at 54; CAPs Initial Br. (II) at 53.

the distribution of proxy group results."[799] CAPs contend that the midpoint may be higher than almost all data points in a given distribution, and using the midpoint of such a distribution to establish a base ROE has previously been found arbitrary and capricious.[800]

401. CAPs acknowledge that the Commission previously found in the *MISO Remand Order* that using the midpoint to determine a single ROE for a diverse group of utilities is justified. However, CAPs contend that the *MISO Remand Order* is distinguishable from this proceeding. They contend that the *MISO Remand Order* emphasized that the proxy group used to define the zone of reasonableness in that proceeding was a subset of the MISO TOs to which the ROE would apply. Therefore, the Commission stated that, unlike a case involving a single utility, it was "not as concerned that the high or low results represent different risks from the single company because the range encompasses only publicly traded Midwest ISO TOs. Rather, we must use the measure that produces the most just and reasonable ROE for all of the Midwest ISO TOs."[801]

402. CAPs point out that here, unlike in the *MISO Remand Order*, the zone of reasonableness is based on a national proxy group. They assert that the "risk comparability requirement established in *Bluefield* emphasizes the geographic proximity of proxy companies." However, CAPs state that most of the proxy group companies are national holding companies whose risk profiles include risk unrelated to the MISO TOs' transmission risk, and as a result, the range of costs of equity for this group are fundamentally not comparable to those of the MISO TOs.[802] In particular, CAPs note that the credit ratings for the high and low-end outliers of the national proxy group do not correspond to those of the MISO TOs.[803] Furthermore, CAPs claim that the proxy group companies have, on average, worse credit ratings than the MISO TOs.[804]

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[799] CAPs Initial Br. (I) at 40 (citing Ex. OMS-108 at P 4); CAPs Initial Br. (II) at 60-61 (citing Ex. OMS-208 at P 4).

[800] CAPs Initial Br. (I) at 42; CAPs Initial Br. (II) at 63.

[801] CAPs Initial Br. (I) at 54-55 (citing *MISO Remand Order*, 106 FERC ¶ 61,302 at P 10); CAPs Initial Br. (II) at 54.

[802] CAPs Initial Br. (I) at 55; CAPs Initial Br. (II) at 55.

[803] CAPs Initial Br. (I) at 56; CAPs Initial Br. (II) at 55.

[804] CAPs Initial Br. (I) at 57 (citing Ex. OMS-100 at 11); CAPs Initial Br. (II) at 57 (citing Ex. OMS-200 at 11, Ex. OMS-205 at 1-4).

403. Finally, CAPs argue that the justifications for using the midpoint established in previous proceedings are not applicable here. CAPs point out that the MISO Remand Order stated that the MISO TOs are a "broad group of utilities with diverse risks and business profiles," but the Briefing Order stated that the MISO TOs are of average risk.[805] CAPs contend that, if the MISO TOs as a group can be considered of average risk, then using the median, which emphasizes the central tendency of the range, rather than the midpoint, which emphasizes the impact of the outliers, is consistent with Commission precedent.[806] CAPs also note that averaging the midpoints of the DCF range, CAPM range, Expected Earnings range, and Risk Premium singular value to determine a replacement ROE does not consider whether the outliers' risk profiles for each range are comparable to those of the MISO TOs' outliers. As a result, the replacement ROE "may not correspond to [the costs of equity] of the MISO TOs' outliers."[807]

B. MISO TOs

404. MISO TOs state that CAPs' argument for use of the median relied on Commission decisions addressing single-utility ROEs, which ignores 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 in ISOs/RTOs.[808] MISO TOs state that the goal of setting a base ROE for an individual utility is to reflect most accurately the risk of an individual utility applicant, while 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. MISO TOs argue that, when setting the base ROE for a regional group of utilities, the Commission is not seeking the most refined measure of central tendency, but to consider the full range and risks and business profiles, which is why it would be more appropriate to use the approach of using the midpoint for regional groups.[809]

405. MISO TOs state that CAPs' argument that the Commission's use of a national proxy group warrants the abandonment of the midpoint in favor of the median because

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[805] CAPs Initial Br. (I) at 58 (citing *MISO Order Remand Order*, 106 FERC ¶ 61,302 at P 9).

[806] *Id.*; CAPs Reply Br. (I) at 41; CAPs Initial Br. (II) at 58; CAPs Reply Br. (II) at 61.

[807] CAPs Initial Br. (I) at 58-59; CAPs Initial Br. (II) at 58-59.

[808] MISO TOs Reply Br. (I) at 73; MISO TOs Reply Br. (II) at 70-71.

[809] MISO TOs Reply Br. (I) at 73-74; MISO TOs Reply Br. (II) at 71-72.

the returns identified for outliers have no particular correspondence to the highest and lowest risk profiles is inaccurate. MISO TOs state that Opinion No. 531 recognizes that transmission utilities compete nationally for investors' capital, making the national range of utility returns the most appropriate range from which to derive a just and reasonable base ROE.[810]

406. MISO TOs state that the Commission should reject CAPs' argument that the midpoint would overstate MISO TOs' costs of equity and ignore the distribution of the proxy companies' cost of capital estimates. MISO TOs state that CAPs' argument assumes that the midpoint will generally be higher than the median. However, MISO TOs state that nothing about the midpoint ensures that it will be higher than the median in any particular instance and it is only "pure happenstance" when the midpoint exceeds a median of the same range and vice-versa.[811] MISO TOs state that the Commission should reject CAPs' argument for use of the median instead of the midpoint, and that the midpoints of the CAPM and Expected Earning ranges are the appropriate measure of the central tendency.[812]

407. MISO TOs state that, while CAPs argue that the use of the midpoint is no longer appropriate in light of the Commission's adoption of a hybrid method for estimating the cost of equity, the new approach incorporates two new range-producing methods: CAPM and Expected Earnings. MISO TOs argue that the proxy groups for these methods are composed the same way as they have historically been used in the Commission's DCF approach.[813]

408. MISO TOs state that the Commission's proposal for calculating a new base ROE by averaging the four methods is appropriate because the new base ROE will then be a product of the midpoints of the three range-producing methods and the single result of the Risk Premium approach, and disagrees with CAPs' assertion that the Commission's proposed four-method approach would be calculated without regard to its placement within the new composite zone of reasonableness.[814]

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[810] MISO TOs Reply Br. (I) at 74; MISO TOs Reply Br. (II) at 73-74.

[811] MISO TOs Initial Br. (I) at 76 (citing *S. Cal. Edison v. FERC*, 717 F.3d at 186).

[812] MISO TOs Reply Br. (I) at 75; MISO TOs Reply Br. (II) at 75.

[813] MISO TOs Reply Br. (I) at 76; MISO TOs Reply Br. (II) at 75-76.

[814] MISO TOs Reply Br. (I) at 77; MISO TOs Reply Br. (II) at 76.

C. Commission Determination

409. We will continue to use the midpoint to determine the central tendency of the zone of reasonableness in cases involving an RTO-wide ROE, consistent with the policy set forth in the *MISO Remand Order*. The United States Court of Appeals for the District of Columbia upheld that policy in *Public Service Commission of Kentucky v. FERC*. We find that the CAPs have not presented a compelling reason why that policy should not be applied in this case.

410. The court described the *MISO Remand Order's* rationale for using the midpoint in cases involving an RTO-wide ROE as follows,

> The Commission . . . distinguished between 'cases in which a ROE is set for one gas pipeline or electric utility' and cases where 'applicants proposed setting a single ROE for across-the-board application.' In the latter situation, where 'the ROE will apply to a diverse set of companies,' FERC reasoned that the range of results becomes as important as the central value. The midpoint—unlike the other measures of central tendency—'fully considers that range,' because it is derived directly from the endpoints of the range.[815]

411. This reasoning applies equally in this case. The MISO TOs continue to be "a diverse set of companies." For example, in both the First Complaint and Second Complaint proceedings, the MISO TOs' S&P corporate ratings range from BB- to AA, and their Moody's long-term ratings range from Ba3 to Aa2.[816] This broad range of credit ratings supports a finding that the MISO TOs are a diverse group with a variety of risk profiles, even though we treat the group as a whole as of average risk, consistent with the *MISO Remand Order*.[817]

412. We recognize that the proxy group at issue in the *MISO Remand Order* was limited to MISO TOs, whereas in the First Complaint and Second Complaint proceedings we are using national proxy groups that include some firms with no MISO TO operating companies. However, this does not mean that the high and low ends of the DCF and CAPM zones of reasonableness produced by those proxy groups are unrepresentative of the highest and lowest risk profiles among the MISO TOs. In the First Complaint

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[815] *Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d at 1010.

[816] Ex. MTO-26 at 2. Ex. MTO-32 at 2.

[817] Cross-Answering Testimony of Ellen Lapson in MISO I, Ex. MTO-39 at 46.

proceeding, the high end of the DCF zone of reasonableness is set by TECO.[818] Its S&P corporate rating is BBB+ and its Moody's long-term rating is Baa1.[819] The high-end of the CAPM zone of reasonableness is set by Black Hills Corp.[820] Its S&P corporate rating is BBB and its Moody's long-term rating is Baa1.[821] Thus, the credit ratings of the two companies whose ROEs are averaged together to establish the high end of the composite zone of reasonableness are both within the MISO TOs' S&P corporate ratings range of BB- to AA, and Moody's long-term ratings range of Ba3 to Aa2. The low end of the DCF range of reasonableness is set by Public Service Enterprise Group and IDACORP, Inc.[822] Public Service Enterprise Group's S&P corporate rating is BBB+ and its Moody's long-term rating is Baa2.[823] IDACORP, Inc.'s S&P corporate rating is BBB and its Moody's long-term rating is Baa1.[824] The low-end of the CAPM zone of reasonableness is set by Duke Energy Corp. (Duke) and Southern Company (Southern).[825] Duke's S&P corporate rating is A- and its Moody's long-term rating is A3.[826] Southern's S&P corporate rating is A, and its Moody's long-term rating is Baa1.[827] These credit ratings are also within the ranges of MISO TOs' S&P corporate ratings and Moody's long-term ratings range.[828] Thus, the companies that set the high and low ends of the DCF and CAPM zones of reasonableness in the First Complaint proceeding have similar risk

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[818] *See* Appendix A to this order.

[819] Ex. MTO-26 at 1.

[820] *See* Trial Staff Initial Br. (I), Attachment A to App. 2 at 6, which, as discussed in section XVI of this order, reflects our holdings concerning the appropriate CAPM analysis for the First Complaint proceeding.

[821] Ex. MTO-26 at 1.

[822] Appendix A.

[823] Ex. MTO-26 at 1.

[824] *Id.*

[825] Trial Staff Initial Br. (I), Attachment A to App. 2 at 6. In addition, Duke owns Duke Energy Indiana, Inc., a member of MISO.

[826] Ex. MTO-26 at 1.

[827] *Id.*

[828] *Id.*

profiles to the MISO TOs, and one of those companies is in fact a member of MISO. Similarly, in the Second Complaint proceeding, the high end of the DCF zone of reasonableness is set by PNM Resources.[829] Its S&P corporate rating is BBB+ and its Moody's long-term rating is Baa3.[830] The high-end of the CAPM zone of reasonableness is set by Otter Tail Corp. (Otter Tail).[831] Its S&P corporate rating is BBB and its Moody's long-term rating is Baa2.[832] These credit ratings are both within the MISO TOs' S&P corporate ratings range of BB- to AA, and Moody's long-term ratings range of Ba3 to Aa2. The low end of the DCF zone of reasonableness is set by CenterPoint Energy, Inc.[833] Its S&P corporate rating is A- and its Moody's long-term rating is Baa1.[834] The low-end of the CAPM zone of reasonableness is set by PG&E.[835] Its S&P corporate rating is BBB and its Moody's long-term rating is Baa1.[836] These credit ratings are also within the ranges of MISO TOs' S&P corporate ratings and Moody's long-term ratings. Thus, the companies that set the high and low ends of the DCF and CAPM zones of reasonableness in the Second Complaint proceeding also have similar risk profiles to the MISO TOs, and one of those companies is in fact a member of MISO.

413. We also disagree that the Commission should abandon the midpoint in favor of the median because the proxy group ROEs could be so skewed that the midpoint might be higher than almost all the proxy group ROEs. As the Commission recognized in the MISO Remand Order, the midpoint may be inappropriate in certain circumstances because of egregious distortion by the highest or lowest number. However, here the proxy group ROEs are not so skewed as to render the midpoint inappropriate. In the First Complaint proceeding, the 9.88 percent midpoint of composite zone of reasonableness is only 38 basis points, or four percent, above the 9.50 percent median. In the Second

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[829] *See* Appendix B to this order.

[830] Ex. MTO-32 at 1.

[831] *See* Trial Staff Initial Br. (II), Attachment A to App. 2 at 6, which, as discussed in section XVII of this order, reflects our holdings concerning the appropriate CAPM analysis for the Second Complaint proceeding. Otter Tail is also a member of MISO.

[832] Ex. MTO-32 at 1.

[833] Appendix B.

[834] Ex. MTO-32 at 1.

[835] Trial Staff Initial Br. (I), Attachment A to App. 2 at 6.

[836] Ex. MTO-32 at 1.

Complaint proceeding, the 9.72 percent midpoint of the composite zone of reasonableness is only 4 basis points, or less than one percent, above the 9.68 percent median. The proxy group ROEs in these cases are thus no more skewed than in the *Pub. Serv. Comm'n of Ky. v. FERC* case, where the 12.38 percent midpoint of the zone of reasonableness was 53 basis points, or about 4.5 percent, above the 11.85 percent median. In that case, the court recognized that, although there was some skew, "this is part of the reason FERC used the midpoint in the first place."[837] The same reasoning applies to the current cases.

414. Accordingly, we will determine the central tendency of both the DCF and CAPM zones of reasonableness in the First Complaint and Second Complaint proceedings based on the midpoint, consistent with our policy of using the midpoint in cases involving RTO-wide ROEs.

XII. Weighting of Models

A. Background

415. In the Briefing Order, the Commission proposed to use the DCF model, the CAPM, and the Expected Earnings model to determine whether an existing ROE remains just and reasonable under the first prong of FPA section 206.[838] The Commission then proposed to use the DCF model, the CAPM, the Expected Earnings model, and the Risk Premium model for establishing a new just and reasonable ROE, where the existing ROE has been shown to be unjust and unreasonable (i.e., the second prong of the FPA section 206 analysis).[839] Under each prong, the Commission proposed to give the models to be used equal weight.[840] Below, we discuss issues raised by the participants with respect to the weighting of the various proposed models.

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[837] *Pub. Serv. Comm'n of Ky. v. FERC*, 397 F. 3d at 1003.

[838] Briefing Order, 165 FERC ¶ 61,118 at P 17.

[839] *Id.* P 18.

[840] *See id.* PP 13, 16, 18, 32.

B. CAPs

416. CAPs argue that the Expected Earnings model should be excluded and, if included, should be given the least amount of weight.[841] As described above, CAPs assert that the Expected Earnings model does not accurately estimate a utility's cost of equity, because it is an accounting-based measure that does not reflect the rate of return that investors require in the market-priced common equity capital of a utility.[842] CAPs argue that there is no evidence investors give the Expected Earnings model any weight in informing their investment decisions.[843] If used, CAPs contend that the Expected Earnings model should be weighted significantly less than the market-oriented models (suggested weight of 16.7 percent for prong one and 12.5 percent for prong two),[844] arguing that it distorts and inflates the estimate of investors' required return on market-priced equity.[845]

417. CAPs also assert a number of reasons why the DCF should be weighted more than other models. First, CAPs argue that the Commission has used the DCF method for many years with proven success.[846] Second, CAPs state that, in contrast to other proposed models, the Commission has refined and honed the DCF model over a number of years, making it more accurate.[847] Third, CAPs contend that, because the Commission has used the DCF model for many years, investors are familiar with it and more likely to

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[841] CAPs Initial Br. (I) at 46; CAPs Initial Br. (II) at 46; CAPs Reply Br. (I) at 40, 46; CAPs Reply Br. (II) at 60, 67.

[842] CAPs Initial Br. (I) at 40-44; CAPs Initial Br. (II) at 39-44. CAPs states that the Expected Earnings model may only help predict the stock-issuing company's own rate of return per *its* book equity, not the investor's own rate of return on investment unless adjusted for the market/book ratio. CAPs Reply Br. (I) at 47; CAPs Reply Br. (II) at 67.

[843] CAPs Reply Br. (I) at 46; CAPs Reply Br. (II) at 67.

[844] CAPs Initial Br. (I) at 47; CAPs Initial Br. (II) at 47; Ex. OMS-108 at 8-9; Ex. OMS-208 at 8.

[845] CAPs Initial Br. (I) at 46; CAPs Initial Br. (II) at 46.

[846] CAPs Initial Br. (I) at 46; CAPs Initial Br. (II) at 46; CAPs Reply Br. (I) at 46; CAPs Reply Br. (II) at 66.

[847] CAPs Initial Br. (I) at 46; CAPs Initial Br. (II) at 46; CAPs Reply Br. (I) at 46; CAPs Reply Br. (II) at 66-67.

apply it in the same manner as prescribed the Commission.[848] Fourth, CAPs argue that the DCF model is a superior model for assessing investors' expectations and required returns, because it is the only one that incorporates direct inputs from investors pertaining to the market value of electric utilities' common equity capital (through the "P" term in the DCF equation).[849]

418. CAPs argue that the Commission should exclude the Expected Earnings model, and if it is excluded, that the Commission should use the following weighting for the different models. CAPs assert that for the prong one analysis, the Commission should weight the DCF model at 60 percent and the CAPM at 40 percent; and that for the prong two analysis, the Commission should weight the DCF model at 42.8 percent, the CAPM at 28.6 percent, and the Risk Premium model at 28.6 percent.[850] CAPs contend that, if the Commission includes the Expected Earnings model, the Commission should use the following weighting for the different models. CAPs assert that for prong one, the Commission should weight the DCF model at 50 percent, the CAPM at 33.3 percent, and the Expected Earnings model at 16.7 percent; and that for the prong two analysis, the Commission should weight the DCF model at 37.5 percent, the CAPM at 25 percent, the Expected Earnings model at 12.5 percent, and the Risk Premium model at 25 percent.[851]

C. MISO TOs

419. MISO TOs assert that CAPs' argument to weight the DCF model more heavily than other models is arbitrary and unsupported by evidence.[852] MISO TOs argue in support of weighting all models equally. MISO TOs argue that the methodology is complex as is and that unequal weighting would only result in an extra layer of subjectivity.[853]

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[848] CAPs Reply Br. (I) at 46; CAPs Reply Br. (II) at 67.

[849] CAPs Reply Br. (I) at 46; CAPs Reply Br. (II) at 67.

[850] CAPs Initial Br. (I) at 47-48; CAPs Initial Br. (II) at 46-47; Ex. OMS-100 at 7-8; Ex. OMS-200 at 7-8.

[851] CAPs Initial Br. (I) at 47-48; CAPs Initial Br. (II) at 46-47; Ex. OMS-100 at 7-8; Ex. OMS-200 at 7-8.

[852] MISO TOs Reply Br. (I) at 52; MISO TOs Reply Br. (II) at 51.

[853] MISO TOs Reply Br. (I) at 52; MISO TOs Reply Br. (II) at 51.

420. MISO TOs contend that because there is no evidence that one model is inherently superior to another, weighting them differently is an option unsupported by evidence.[854] MISO TOs argue the Commission has recognized that there is no single approach that is fundamentally superior or foolproof and that each model offers unique features with their own advantages and disadvantages.[855]

421. While MISO TOs generally support weighting all models equally, MISO TOs take particular exception to giving the DCF more weight as compared to other models.[856] MISO TOs state that the evidence submitted during this proceeding indicates that the DCF model fails to meet the *Hope* and *Bluefield* standards, and, therefore, CAPs' argument to weight the DCF model more than the others is particularly flawed.[857]

D. Trial Staff

422. Trial Staff acknowledges that the Commission has proposed to use equal weighting for all models.[858] Trial Staff argues that the Commission should not use the Expected Earnings model for either prong.[859] But if the Commission chooses to use the Expected Earnings model, Trial Staff proposes that, for prong one, the Commission should weight the DCF model, the CAPM, and the Expected Earnings model equally.[860] Additionally, for prong two, Trial Staff proposes that the Commission should weight the

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[854] MISO TOs Reply Br. (I) at 52; MISO TOs Reply Br. (II) at 51-52.

[855] MISO TOs Reply Br. (I) at 52-53; MISO TOs Reply Br. (II) at 51-52.

[856] MISO TOs Reply Br. (I) at 53; MISO TOs Reply Br. (II) at 51-52. MISO TOs also assert there is evidence that investors' decisions are more closely aligned with factors relating to CAPM than other models. MISO TOs argue that this further cuts against CAPs' proposal to rely more heavily on the DCF model. MISO TOs Reply Br. (I) at 53 n.212 (citing Jonathan B. Berk & Jules H. van Binsbergen, *How Do Investors Compute the Discount Rate? They Use the CAPM*, Fin. Analyst J. (2d. Quarter 2017)); MISO TOs Reply Br. (II) at 52 (citing same).

[857] MISO TOs Reply Br. (I) at 53; MISO TOs Reply Br. (II) at 51-52.

[858] Trial Staff Initial Br. (I) at 20; *see* Trial Staff Initial Br. (II) at 18-19.

[859] Trial Staff Initial Br. (I) at 6; Trial Staff Initial Br. (II) at 5.

[860] Trial Staff Initial Br. (I), Keyton Aff. (I) at 39; Trial Staff Initial Br. (II), Keyton Aff. (II) at 37.

DCF model, the CAPM, the Risk Premium model, and the Expected Earnings model equally.[861]

E. RPGI

423. RPGI argues that the Commission should weight the DCF model no less than one-half in proportion to the other models.[862] RPGI states that the Commission has not explained nor justified no longer relying exclusively on the DCF model, rather than utilizing an equally-weighted multiple methodology approach.[863] RPGI argues that, because the Commission has previously observed that the DCF model is statistically superior to alternatives and the Commission has not provided any evidence that the alternative models produce better forecasts, the DCF model should not be weighted equally with the others.[864] RPGI summarizes its arguments in support of the DCF model being weighted at one-half, at the least, by stating that the DCF methodology maintains a preferred status at the Commission and that the Commission has failed to adequately explain its reasoning for adopting a changed course of action.[865]

F. Commission Determination

424. As discussed above in sections VI and VIII, we find that is not appropriate to use the Expected Earnings and Risk Premium models in ROE methodology. Accordingly, the Commission will not give those models any weight in the analysis under either prong one or prong two of FPA section 206. As a result, the arguments proposing alternative weighting of the various models if the Expected Earnings and Risk Premium models are included in the ROE methodology are moot and we will not address them here.

425. In light of our decision not to use the Expected Earnings and Risk Premium models, we will apply only the DCF and CAPM models, giving equal weight to each model. Specifically, the top and bottom of the zones of reasonableness produced by the DCF and CAPM will be given equal weight and averaged to produce a single composite zone of reasonableness that will be used for both the prong one and prong two analysis

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[861] Trial Staff Initial Br. (I), Keyton Aff. (I) at 51; Trial Staff Initial Br. (II), Keyton Aff. (II) at 49.

[862] RPGI Initial Br. (I) at 5, 38; RPGI Initial Br. (II) at 4, 41.

[863] RPGI Initial Br. (I) at 11; RPGI Initial Br. (II) at 15-16.

[864] RPGI Initial Br. (I) at 16, 25; RPGI Initial Br. (II) at 20, 29.

[865] RPGI Initial Br. (I) at 38; RPGI Initial Br. (II) at 41.

under FPA section 206. As discussed in section IV above, in order to determine whether an existing ROE is unjust and unreasonable, we will divide the composite zone of reasonableness into quartiles; the quartile centered on the central tendency[866] of the overall composite zone of reasonableness will represent the range of presumptively just and reasonable ROEs for average risk utilities, and the quartiles centered on the central tendencies of the upper and lower halves of the composite zone of reasonableness will represent the range of presumptively just and reasonable ROEs for above- and below-average utilities, respectively. For purposes of determining just and reasonable ROEs under the second prong of FPA section 206 (and under FPA section 205), we will generally set the ROE of average risk utilities at the central tendency of the overall composite zone of reasonableness, and set the ROEs of above average risk utilities at the central tendency of the upper half of the composite zone of reasonableness and below average risk utilities at the central tendency of the lower half of the composite zone of reasonableness.[867]

426. We find that the record evidence supports giving each model that will be used in the ROE methodology equal weight, as described above. The evidence indicates that neither remaining model is conclusively superior to the other model. Each model has unique aspects, and advantages and disadvantages that make it preferable to the other model in some respects, but not other respects. Parties point out, for example, that the DCF model is the only one that incorporates direct inputs from investors pertaining to the market value of electric utilities' common equity capital;[868] however, parties also argue that investors base their decisions on factors more closely aligned with those contained within the CAPM.[869] Accordingly, we find that, on balance, the evidence does not indicate that there is a clearly superior model for estimating cost of equity that should be given more weight than the others. Moreover, we find that equally weighting the two models will reduce the model risk associated with any particular model more than giving one model greater weight than the other. Therefore we find that the risks associated with

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[866] As noted above in section XI, the 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 and the median as the measure of central tendency for a single utility.

[867] We do not intend by this discussion to foreclose the possibility that a particular utility could be of such high or low risk to justify setting its ROE at the top or bottom of the composite zone of reasonableness.

[868] CAPs Reply Br. (I) at 46; CAPs Reply Br. (II) at 67.

[869] MISO TOs Reply Br. (I) at 53 n.212 (citing Jonathan B. Berk & Jules H. van Binsbergen, *How Do Investors Compute the Discount Rate? They Use the CAPM,* Fin. Analyst J. (2d. Quarter 2017)); MISO TOs Reply Br. (II) at 52 (citing same).

the potential errors or flaws in any one model will be mitigated to the greatest extent by giving each model equal weight.

427. Accordingly, we give equal weight to the CAPM and DCF models for purposes of the analysis under both prong one and two of the FPA, as discussed above.

XIII. Sequencing of Calculations in Determining Composite Zone

A. Background

428. As proposed in the Briefing Order, the calculations for determining the composite zone of reasonableness and applicable range of presumptively just and reasonable ROEs under the first prong of section 206 would be carried out as follows. First, a proxy group would be determined for each model using existing Commission screens. Second, for each model, low and high end outliers would be removed using applicable tests. Third, the models would apply to the proxy groups for each model, which would produce separate zones of reasonableness from each model. Fourth, the top and bottom of the zone of reasonableness produced by each methodology would be averaged to determine a single composite zone of reasonableness. Fifth, the midpoint/median, lower midpoint/median, and upper midpoint/median of that composite zone would be calculated. Sixth, the quartile ranges constituting the ranges of presumptively just and reasonable ROEs would be calculated, with the average risk quartile centered on the midpoint/median of the composite range, the above-average risk quartile centered on the upper midpoint/median of the composite range, and the below-average risk quartile is centered on the lower midpoint/median of the composite range. The Commission would then determine whether the utility, or group of utilities, at issue are of average risk, above-average in risk, or below-average in risk as compared with the proxy companies in order to determine the applicable range of presumptively just and reasonable ROEs. The Commission would then consider any other record evidence that would be relevant to its determination under the first prong of section 206.

429. As proposed in the Briefing Order, if an existing ROE is found to be unjust and unreasonable under the first prong of section 206, then the additional calculations necessary to determine a replacement just and reasonable ROE would be carried out as follows. First, the applicable midpoint/median, or upper or lower midpoint/median, within the zones of reasonableness would be identified for the utility or utilities. Then those applicable midpoint/medians (or upper or lower midpoint/medians) would be given equal weight and averaged to produce a replacement ROE. As proposed in the Briefing Order, the cost of equity estimate produced by the Risk Premium model would also be given equal weight and averaged with the other values. However, as discussed above in section VIII, we find that it is not appropriate to include the Risk Premium model in our ROE methodology. Therefore that part of the calculation will not be included and we need not address it here.

B. CAPs

430. CAPs argue that the Commission should use only the DCF model, but that, if the Commission instead uses multiple financial models, the Commission should use a different sequence of calculations to determine the composite zone of reasonableness and replacement ROE than the sequence proposed in the Briefing Order.[870] CAPs argue that the computational sequence proposed in the Briefing Order increases the potential for errors due to model risk because it treats each model's range as a separate zone of reasonableness, which results in separate results (median or midpoint) that are then averaged to establish the replacement ROE, but each model's median or midpoint carries its own margin of error. CAPs contend that a more appropriate computational sequence is to average the results of each proxy company's DCF and CAPM values, after first addressing any low-end or high-end outliers associated with each methodology.[871]

431. In particular, CAPs' witness, Dr. Berry, proposes to first calculate for each proxy company the average[872] of the DCF and the CAPM results to determine a company-specific cost of equity. Specifically, Dr. Berry proposes to modify the sequence of calculations proposed in the Briefing Order for determining the composite zone of reasonableness and applicable range of presumptively just and reasonable ROEs under the first prong of section 206 to be carried out as follows. First, a proxy group would be determined using existing Commission screens. Second, for each model, low and high end outliers would be removed using applicable tests. Third, a cost of equity *for each proxy group company* would be determined by averaging the DCF and the CAPM results for each company. Fourth, highest and the lowest company-specific composite costs of equity would define the upper bound and the lower bound of the composite zone of reasonableness. Fifth, the Commission would determine whether the utility or utilities are of average risk, above-average risk, or below-average risk as compared with the proxy companies.[873]

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[870] CAPs Initial Br. (I) at 65-66, Ex. OMS-100 at 9, Ex. OMS-108 at 9; CAPs Initial Br. (II) at 65-66, Ex. OMS-200 at 9, Ex. OMS-208 at 9.

[871] CAPs Initial Br. (I) at 65-66; CAPs Initial Br. (II) at 65-66.

[872] We note that Dr. Berry proposes to use a weighted average in calculations based on his proposed alternative weighting of the different models. As discussed above in section XII, we are not adopting Dr. Berry's proposed alternative weighting therefore we need not address that aspect of his proposal in this section.

[873] CAPs Initial Br. (I), Ex. OMS-100 at 10-11; CAPs Initial Br. (I), Ex. OMS-200 at 10-11.

432. Under Dr. Berry's proposal, if an existing ROE is found to be unjust and unreasonable then the applicable median, or upper or lower median, of the composite zone would then be averaged with the Risk Premium model result to calculate a just and reasonable replacement ROE.[874]

433. CAPs provide several reasons in support of this alternative sequencing approach. First, CAPs assert that there is only one just and reasonable return for a given proxy company, though it is not directly observable, and the DCF and the CAPM methods attempt to estimate this unknown cost of equity for each proxy company. CAPs argue that, therefore, the identification of each proxy's equity cost is improved if both methods are combined in identifying *that proxy's* single equity cost.[875] Second, CAPs contend that upper bounds, lower bounds, and midpoints/medians produced by each separate model are susceptible to model risk because they are calculated using only one model. Third, CAPs argue that this alternative sequencing approach reduces model risk by more effectively limiting the inclusion of extreme results in the proxy groups.[876] To illustrate this point, CAPs state that other parties, by implementing the traditional sequencing approach, have engaged in blatant cherry-picking, as evidenced by the fact that each model's proxy groups yielded a different company as the high point.[877] Third, in response to MISO TOs' argument that this alternative sequencing approach washes out the limits of the respective ranges of risk from independent financial models, CAPs argue that the narrowing of the composite zone of reasonableness is appropriate because it enhances the precision of the estimates and excludes the extreme and unrepresentative values that would otherwise be given undue and unreasonable weight.[878] Fourth, CAPs state that any instance where companies may get weighted more or less, simply because they have more or less available financial data, would occur all the same using the traditional sequencing approach.[879] Fifth, CAPs argue that using the alternative

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[874] CAPs Initial Br. (I), Ex. OMS-100 at 11; CAPs Initial Br. (I), Ex. OMS-200 at 11.

[875] CAPs Initial Br. (I), Ex. OMS-100 at 12; Ex. OMS-108 at 9-10; CAPs Initial Br. (II), Ex. OMS-200 at 11-12; Ex. OMS-208 at 9.

[876] Ex. OMS-100 at 13; Ex. OMS-108 at 10; Ex. OMS-200 at 13; Ex. OMS-208 at 10.

[877] Ex. OMS-108 at 10; Ex. OMS-208 at 10.

[878] Ex. OMS-108 at 11; Ex. OMS-208 at 11.

[879] Ex. OMS-108 at 11; Ex. OMS-208 at 11.

sequencing approach to control for outliers leads to results not materially different from the traditional approach.[880]

C. MISO TOs

434. MISO TOs argue that, rather than averaging the cost of equity estimates produced for each individual proxy company across the DCF model and the CAPM, as CAPs support, a separate range and midpoint should be produced for each model as proposed in the Briefing Order.[881] MISO TOs state that the ultimate goal is to specify the broad range of potentially lawful ROEs, and argue that their proposal for a traditional sequencing approach meets that standard.[882]

435. MISO TOs state a number of supporting arguments to claim that CAPs' proposed alternative sequencing approach does not meet this ultimate goal. First, MISO TOs argue that evaluations of the cost of equity typically present the results of alternative models independently, rather than averaging estimates for each individual firm in a proxy group under the separate models.[883] MISO TOs claim that no witnesses for the complainants had previously presented their methodology in this way and that no examples of similar proposals in comparable regulatory proceedings has been presented.[884]

436. Second, MISO TOs state that it is important to compare the results of each methodology against the others, and that, if the Commission followed CAPs' suggested approach, this comparison would be obscured due to a reduction of the results to a single, arithmetic average.[885] Third, MISO TOs argue that CAPs' approach, based on the arithmetic mean of the cost of equity estimates for each proxy company, contradicts the

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[880] Ex. OMS-108 at 12; Ex. OMS-208 at 11.

[881] MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (II) at 112; MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 112.

[882] MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 112; MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 112.

[883] MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 114; MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 114.

[884] MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 114-15; MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 114-15.

[885] MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 113; MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 113.

Commission's precedent of using range and midpoint values.[886] Fourth, MISO TOs state that CAPs' approach does not cancel out model risk or address the impact of extreme results, as CAPs claim, but, rather, just narrows the range by muting out the upper-end estimates.[887] Fifth, MISO TOs argue that the purpose of the proceedings is to arrive at a single ROE that fully considers the range of risks for a diverse group of transmission owners; but, MISO TOs claim that CAPs' approach, instead, determines the average ROE for the average utility, which washes out the limits of the respective ranges of risk from independent financial models.[888]

D. Commission Determination

437. We will use the sequence of calculations proposed in the Briefing Order for the analyses under the first prong and second prong of section 206, with revisions to reflect our decision not to use the Expected Earnings or Risk Premium models, as discussed herein. In particular, we will apply the DCF and CAPM models separately to the applicable proxy group, producing two zones of reasonableness: a DCF zone of reasonableness and a CAPM zone of reasonableness. Then the top of the DCF zone of reasonableness will be averaged with the top of the CAPM zone of reasonableness and the bottom of the DCF zone of reasonableness will be averaged with the bottom of the CAPM zone of reasonableness to determine a single composite zone of reasonableness for use in both the first and second prong analysis under FPA section 206. If an existing ROE is found to be unjust and unreasonable, the replacement ROE will be set at the central tendency of the composite zone or reasonableness or the central tendency of the upper or lower halves of the composite zone of reasonableness depending upon whether the utility is of average, above average, or below average risk, respectively.

438. We will not adopt CAPs' proposed alternative calculation sequence. As noted above, CAPs propose that we determine a cost of equity for each proxy group company by averaging the company-specific DCF and the CAPM results for each company and then using those company-specific composite costs of equity to define the composite zone of reasonableness. We find that the record evidence supports that the DCF and

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[886] MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 113; MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 113.

[887] MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 113; MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 113. MISO TOs point out that a standard outlier test would address OMS's concerns about extreme cost of equity estimates. MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 113 n.266; MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II) at 113 n.266.

[888] MISO TOs Reply Br. (I) App. 2, McKenzie Reply Aff. (I) at 114; MISO TOs Reply Br. (II) App. 2, McKenzie Reply Aff. (II)at 114.

CAPM models that we will use are intended to produce results separately based on the entire applicable proxy group to which the model is applied, without computing averages across multiple methods for a single company, as CAPs propose. There is no record evidence indicating that analysts apply these models in this way or present the results of these models in this way, nor has any party provided an example of these models being applied this way in a comparable regulatory proceeding. There is also nothing in the record to indicate that the assumptions or structures of the DCF and CAPM models contemplate that the result for a specific proxy group company will be isolated and averaged with a company-specific result from a separate model, rather than considered along with the full range of returns for the entire proxy group that the models produce. The sequencing approach that we adopt here allows the models to function as they are designed until they produce their intended end result. CAPs' alternative proposal would interfere in the function of the models before they produce their intended end result and instead take inputs from the models and combine them before the inputs were used as the models intended.

439. Moreover, the purpose of the DCF and CAPM models is to produce a range of returns applicable to the entire span of investment risks for a proxy group of utilities. The purpose is not to provide a specific cost of equity estimate for each proxy group company that can be considered in isolation, outside of the parameters of the model, and then averaged with a company-specific estimate from a separate model. The product of each model is the full range of cost of equity estimates, as calculated within the parameters of the model. There is no evidence to indicate that the DCF and CAPM models would produce superior results if we used the individual data points that form each model's range, before looking at the ranges themselves that are the intended product of the models.

XIV. Use of Group-Wide ROEs as Opposed to Individual Utility ROEs

A. Alliant

440. Alliant argues that the Commission's ROE methodology should allow the base ROE of each individual transmission owner to be different from that established for the group of MISO TOs as a whole. Alliant argues that this is appropriate because the cost of equity may be different among individual transmission owners within a designated group based on company-specific risk factors. Alliant acknowledges the potential administrative burden that would be associated with examining each individual transmission owner's circumstances to determine if a specific transmission owner warrants a different ROE and to mitigate this, proposes to allow stakeholders the

opportunity to provide arguments within the already existing proceeding as to why a specific transmission owner warrants further examination.[889]

B. OMS

441. OMS also argues that the Commission should depart from using RTO-wide ROEs and adopt a more granular approach to examining the risk profiles of utilities in future transmission rate proceedings. OMS contends that the rationale for the original RTO-wide ROE was avoiding unnecessary litigation that could jeopardize formation of MISO, and this rationale no longer applies. OMS asserts that an RTO-wide ROE does not result from proxy groups that appropriately reflect the risk-profile of individual transmission owners based on their own credit rating. OMS contends that the record demonstrates that the MISO TOs feature a wide range of risk profiles and that, for example, a utility with an S&P AA credit rating should not have its rate of return determined using a proxy group that includes companies with an S&P BBB- credit rating. OMS argues that this will over-compensate some transmission owners and under-compensate others. OMS acknowledges that proving that the risks faced by an individual transmission owner (among a group of utilities) are higher or lower than those faced by companies in the proxy group through a comparative risk analysis is difficult. However, OMS does not propose a specific alternative approach but only asks the Commission to pursue a more granular risk analysis of individual transmission owners.[890]

C. MISO TOs

442. MISO TOs argue that the proposals by Alliant and OMS to evaluate MISO TOs' on an individual basis rather than a region-wide group are beyond the scope of these proceedings. MISO TOs assert that at no time prior to the Briefing Order did any complainant, intervenor (including Alliant and OMS), or Commission Trial Staff submit evidence or a brief arguing for evaluation of each MISO TOs' base ROEs on an individual basis. MISO TOs also contend that the complaints in these proceedings challenged the MISO TOs' region-wide base ROE and did not seek a new ROE separately for each transmission owner. MISO TOs also assert that the Commission's orders setting the cases for hearing gave no indication that the possibility of company-specific ROEs was at issue. MISO TOs argue that, accordingly, entertaining these proposals at this stage of the proceedings would deny the MISO TOs due process.[891]

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[889] Alliant Initial Br. (I) at 9-10; Alliant Initial Br. (II) at 9-10.

[890] OMS Initial Br. (I) at 2-8; OMS Initial Br. (II) at 2-8.

[891] MISO TOs Reply Br. (I) at 79-81; MISO TOs Reply Br. (II) at 78-80.

D. Commission Determination

443. We find that the Alliant's and OMS's requests to depart from the use of an RTO-wide ROE are outside the scope this proceeding. The complaints that originated these proceedings asserted that the base ROE for MISO TOs was unjust and unreasonable because it was too high. They did not, however, dispute the use of an RTO-wide ROE for the MISO TOs or contend that each MISO TO's base ROE should be different. Moreover, the Commission did not propose to depart from the use of an RTO-wide ROE for the MISO TOs in its orders in Order No. 551 or in the Briefing Order. Consequently, we find that such arguments are beyond the scope here.

444. Still, even in light of this finding, we note that it is appropriate for MISO, consistent with its historical practice,[892] to retain a single RTO-wide base ROE.[893] The reason is that many of the factors that affect the cost of capital for the MISO TOs are similar due to their MISO membership. For example, MISO administers a regional planning process in which the need for transmission upgrades and expansions within the RTO are established and the MISO TOs are subject to the same requirements with respect to construction of and cost responsibility for the upgrades and expansions identified in the that planning process. In particular, we note that MISO TOs share cost responsibility for some transmission facilities developed pursuant to the MISO Transmission Expansion Plan.[894] In addition, all of the MISO transmission facilities are pooled and operated by MISO and subject to MISO's functional control without distinction as to ownership. Accordingly, the risks faced by the MISO TOs associated with the operation of their transmission facilities will be substantially similar because the facilities will share the same operator and the costs associated with that operation will be shared by the MISO TOs as members of MISO. Furthermore, there is a single OATT for the MISO region and therefore the rules and requirements applicable to the use of those facilities will be similar in many ways. We find that in such circumstances it is reasonable to allow the

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[892] *See MISO Remand Order*, 106 FERC ¶ 61,302 at P 9 ("[H]ere the applicants proposed setting a single ROE for . . . application to all but one of the Midwest ISO TOs. Accordingly, . . . we must calculate a single ROE for application to a broad group of utilities with diverse risks and business profiles") .

[893] *See* Opinion No. 551, 156 FERC ¶ 61,234 at P 2 ("The 12.38 percent base ROE continues to be the applicable ROE under Attachment O of the MISO Tariff used by all MISO TOs except for American Transmission Company, LLC (ATC).").

[894] *See, e.g.*, Midcontinent Independent System Operator, Inc., Compliance Filing Reporting on Multi-Value Project Process Under the Open Access Transmission, Energy and Operating Reserve Markets Tariff, Docket No. ER10-1791-000, at Tab A (filed Apr. 23, 2019) (discussing cost-shared projects in MISO and cost allocations).

use of a single RTO-wide ROE because many of the factors influencing the return that investors would require to invest in the MISO TOs are similar such as operating risks, the potential effects of upgrades and expansions, and the rules and requirements applicable to use of their transmission facilities.

445. Moreover, we find that using a single RTO-wide base ROE will likely promote closer integration among the transmission owners in the MISO region and consistency in MISO planning efforts because the effects of RTO planning and expansion decisions will be more balanced across the various different transmission owners with a single RTO-wide ROE than if those transmission owners earned multiple different ROEs on their respective rate bases.

446. Furthermore, even when a single ROE is used for all of the MISO TOs, the method and the calculation of that ROE accounts for differences between the MISO TOs. For example, the comparable risk band used in forming the proxy groups in these proceedings is based on the credit rating range of all of the MISO TOs.[895] Similarly, the Commission considers the full range of the risks and business profiles of the MISO TOs in setting the single RTO-wide ROE. The Commission has explained that, "Given that the ROE will apply across-the-board to all members of the Midwest ISO, rather than to a single company of average risk, we must consider their full range of risks and business profiles."[896] In addressing the MISO TOs' ROE, the Commission similarly explained that "Here, we are dealing with a group of utilities with differing risks and business rankings. In our view, the differing ROEs in this group fairly brackets the range of reasonableness for all Midwest ISO TOs."[897] For these reasons, we find that it is still appropriate to retain an RTO-wide base ROE for the MISO TOs.

XV. ROE Incentives Cap

A. Background

447. The Briefing Order proposed to cap a utility's total ROE, i.e., its base ROE plus incentive ROE adders, at the top of the overall composite zone of reasonableness produced by the DCF, CAPM, and Expected Earnings models. The Briefing Order

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[895] *See, e.g.*, OMS Initial Br. (I) at 4; OMS Initial Br. (II) at 4.

[896] *MISO Remand Order*, 106 FERC ¶ 61,302 at P 9.

[897] *Id.*

explained that this continued with the Commission's current policy of capping a utility's total ROE at the top of the zone of reasonableness.[898]

B. CAPs

448. CAPs oppose the Commission's proposal, arguing that it is flawed, and assert that the cap on total ROE should be no higher than the top of the zone of reasonableness produced by the DCF model.[899] CAPs contend that the Commission has not provided a reasoned explanation for the proposed departure from Commission precedent of using the DCF zone of reasonableness to set the total ROE cap. CAPs state that the Commission's primary basis for proposing to rely on multiple financial models instead of the DCF alone is that the DCF methodology alone no longer captures how investors view utility returns because investors do not rely on the DCF alone and the other methods used by investors do not necessarily produce the same results as the DCF. CAPs assert that this basis is not founded on reliable record evidence. Accordingly, they assert that the Commission's proposal to use the top of the overall composite zone of reasonableness is not supported.[900]

449. In particular, CAPs argue that inclusion of the Expected Earnings model in the calculation of the overall zone of reasonableness artificially increases the top of the zone in most instances, thereby inflating the total ROE cap and resulting in exploitation of customers.[901] CAPs further contend that, even if the Commission's explanation could support departure from precedent relying on the DCF method, the total ROE cap at the top of the DCF range was established by rulemaking procedures[902] and should continue to apply, unless and until it is changed through a subsequent formal rulemaking.

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[898] Briefing Order, 165 FERC ¶ 61,118 at PP 18, 57.

[899] CAPs Initial Br. (I) at 10; CAPs Initial Br. (II) at 10.

[900] CAPs Initial Br. (I) at 84-85; CAPs Initial Br. (II) at 83-85; CAPs Reply Br. (I) at 76-77; CAPs Reply Br. (I) at 96-97.

[901] CAPs Initial Br. (I) at 84-85; CAPs Br. (II) at 84; CAPs Reply Br. (I) at 76-77; CAPs Reply Br. (II) at 96-97.

[902] CAPs Initial Br. (I) at 85 (citing *Promoting Transmission Investment through Pricing Reform*, Order No. 679, 116 FERC ¶ 61,057, at PP 92-93 (2006), *order on reh'g*, Order No. 679-A, 117 FERC ¶ 61,345 (2006), *clarified*, 119 FERC ¶ 61,062 (2007)); CAPs Initial Br. (II) at 84-85 (citing Order No. 679, 116 FERC ¶ 61,057 at PP 92-93).

450. CAPs assert that, if the Commission does adopt the top of the overall composite zone of reasonableness as the cap on total ROE, it should adopt CAPs' proposed alternative sequence of calculations that would first calculate, for each proxy company, the average of the different financial models that produce zones of reasonableness to determine a company-specific cost of equity, then use the highest and lowest company-specific composite costs of equity define the upper bound and lower bound of the composite zone of reasonableness, and have that upper bound serve as the cap for the total ROE plus incentives.[903]

C. MISO TOs

451. MISO TOs support the Commission's proposal to cap total ROE plus incentives at the top of the overall composite zone of reasonableness. MISO TOs assert that the Commission's proposal is consistent with the Commission's incentives policy. They argue that it would be irrational for the Commission to adopt a multi-method hybrid approach for analyzing cost of equity and then not use the range of returns produced by that multi-method approach to establish the high end of the range as the cap on total ROE. MISO TOs contend that CAPs provide no justification for placing undue weight on the DCF model solely for the purpose of setting the upper bound on total ROE.[904]

D. Commission Determination

452. Our existing policy is to cap a utility's total ROE—i.e., base ROE in addition to all incentive adders— at the top of the zone of reasonableness.[905] Although we are not changing that policy in this order, we must now incorporate our new method of calculating the overall composite zone of reasonableness into our existing policy. As discussed above, we find that calculating the zone of reasonableness using the DCF and CAPM will more accurately reflect a utility's cost of equity, because it will better represent how investors make their investment decisions. Accordingly, we find that it is appropriate to use the upper end of the composite zone of reasonableness as produced by the revised methodology adopted in this order to cap total ROE rather than only the upper end of the zone of reasonableness produced by the DCF methodology, as CAPs argue.

453. CAPs oppose continuing the Commission's policy of using the top of the overall zone of reasonableness to cap total ROE on the basis that the Commission has not justified using multiple models to calculate the zone of reasonableness instead of only the DCF. We address these arguments in this order, specifically in section III, and explain

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[903] CAPs Reply Br. (I) at 43-45; 77-78; CAPs Reply Br. (II) at 63-65; 97-98.

[904] MISO TOs Reply Br. (I) at 81-82; MISO TOs Reply Br. (II) at 80-81.

[905] *See, e.g.*, Order No. 679, 116 FERC ¶ 61,057 at P 93.

why we find that it is no longer appropriate to use only the DCF model to calculate the zone of reasonableness. For those reasons, CAPs' argument on this point is unavailing.

454. CAPs further argue against capping total ROE with the top of the overall zone of reasonableness by asserting that including the Expected Earnings analysis artificially inflates the top of the zone and thus inflates the total ROE cap because it is an outlier that does not reflect to the market cost of equity. As discussed above in section VI, we are not including the Expected Earnings analysis in our calculation of the overall composite zone of reasonableness. Accordingly, CAPs' arguments on this point are inapposite.

455. In addition, CAPs contend that, even if the Commission could support its approach, the total ROE cap at the top of the DCF range was established by rulemaking procedures and should continue to apply, unless and until it is changed through a subsequent formal rulemaking.[906] CAPs cite a case stating that agencies must "use the same procedures when they amend or repeal a rule as they used to issue the rule in the first instance."[907] We find this argument unavailing. We are not amending or repealing our current policy of using the top of the overall zone of reasonableness to cap total ROE. We are continuing that policy, but amending our previous approach to calculating the overall zone of reasonableness. That approach was established via adjudication and therefore we are "us[ing] the same procedures" to change that approach as we did to implement it "in the first instance."

456. Moreover, we find that, even if this constituted a change to our policy of capping total ROE, we could do so in this proceeding. The Commission "has substantial discretion to establish rules of general application by adjudication and need not necessarily employ a separate generic proceeding."[908] We have similarly explained that

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[906] CAPs Initial Br. (I) at 85 (citing Order No. 679, 116 FERC ¶ 61,057 at PP 92-93; *Perez v. Mortg. Bankers Ass'n*, 135 S. Ct. 1199, 1206 (2015) ("the Administrative Procedures Act 'mandate[s] that agencies use the same procedures when they amend or repeal a rule as they used to issue the rule in the first instance.'")); CAPs Initial Br. (II) at 84-85 (citing same).

[907] CAPs Initial Br. (I) at 85 (citing *Perez v. Mortg. Bankers Ass'n*, 135 S. Ct. 1199, 1206 (2015) ("the Administrative Procedures Act 'mandate[s] that agencies use the same procedures when they amend or repeal a rule as they used to issue the rule in the first instance.'")); CAPs Initial Br. (II) at 84-85 (citing same).

[908] *Procedures for Disposition of Contested Audit*, Order No. 675, 114 FERC ¶ 61,178, at P 32 (2006). *See also NLRB v. Bell Aerospace Corp.*, 416 U.S. 267, 294 (1974) ("[A]djudicative cases may and do serve as vehicles for the formulation of agency policies."); *SEC v. Chenery Corp.*, 332 U.S. 194, 203 (1947) ("[T]he choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies

"[o]ur decision to establish new policy in the context of case-specific proceedings is clearly within our authority."[909] Moreover, we stated in the Briefing Order that "we [did] not make any final determinations with respect to the proposed new methodology,"[910] which included our proposal to cap total ROE with the top of the overall zone of reasonableness,[911] and that we would consider briefing regarding "the justness and reasonableness of any aspect of the proposed methodology."[912]

457. In addition, while briefs were being filed in response to the Briefing Order, the Commission issued an NOI that raised questions regarding the Commission's policy on capping total ROE and indicated that any new policy adopted in these proceedings could be modified in the future, and could be incorporated into the Commission's rules through a formal rulemaking.[913] Accordingly, all parties have had ample notice of and opportunity to address the Commission's proposal to continue with its existing policy of capping total ROE at the top of the overall zone of reasonableness.

458. We are also not persuaded by CAPs' arguments that, if we do adopt the top of the overall composite zone of reasonableness as the cap on total ROE, we should adopt

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primarily in the informed discretion of the administrative agency."); *Michigan-Wisconsin Pipeline Co. v. FPC*, 520 F.2d 84, 89 (D.C. Cir. 1975) ("[T]here is no question that the Commission may attach precedential and even controlling weight to principles developed in one proceeding and then apply them under appropriate circumstances in a stare decisis manner."); *Pacific Gas and Electric Co. v. FPC*, 506 F.2d 33, 38 (D.C. Cir. 1974) ("[A]gency may establish binding policy through rulemaking procedures . . . or through adjudications which constitute binding precedents."); *AEP Power Mktg., Inc.*, 108 FERC ¶ 61,026, at P 187 (2004) ("Our decision to establish new policy in the context of case-specific proceedings is clearly within our authority."); *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 103 FERC ¶ 61,349 at P 51 (2003) ("The Commission, moreover, is not limited to notice and comment rulemaking to develop policy. Agencies generally are permitted considerable discretion to choose whether to proceed by rulemaking or by adjudication.").

[909] *AEP Power Mktg.*,107 FERC ¶ 61,018, at P 199.

[910] Briefing Order, 165 FERC ¶ 61,118 at P 10.

[911] *Id.* PP 18, 57.

[912] *Id.* P 20.

[913] *Inquiry Regarding the Commission's Policy for Determining Return on Equity*, 166 FERC ¶ 61,207, at P 46 (2019).

CAPs' proposed alternative sequence of calculations. As discussed above in section XIII we find that this proposed alternative sequence of calculations would not accurately reflect a utility's cost of equity and we do not adopt that proposal.

XVI. Complaint-Specific Results: First Complaint

459. As discussed above, we find that the revised methodology established in this order will better enable us to identify whether an existing ROE is unjust and unreasonable and, if so, what is a just and reasonable ROE. Applying this methodology to the First Complaint, we continue to find that the MISO TOs' existing 12.38 percent ROE for purposes of the First Complaint is unjust and unreasonable. Having addressed the first prong of the Commission's dual burden under FPA section 206 and thus satisfied the "condition precedent"[914] to exercising our authority to change a rate under section 206, we grant rehearing of Opinion No. 551 and find that a just and reasonable replacement ROE for MISO TOs' in the First Complaint is 9.88 percent under the section prong of the Commission's dual burden under FPA section 206.

460. Below we address the "specific findings"[915] as to the "'particular circumstances'"[916] of the First Complaint proceeding that establish "'a rational connection'"[917] between the record evidence in that proceeding and our decisions under both prongs of section 206 herein to establish that we have "'made a principled and reasoned decision supported by the evidentiary record.'"[918] Because the Commission bases its decisions concerning just and reasonable ROEs for public utilities on the most recent information in the record regarding market cost of equity, the starting point for determining whether MISO TOs' existing ROE has become unjust and unreasonable must be a consideration of whether the current market cost of equity has changed since the MISO TOs' existing ROE was established based on financial for the six months ending February 2002. Accordingly, we begin by determining a composite zone of reasonableness using the most recent financial information in the record of the First Complaint proceeding, i.e., data for the first six months of 2015.

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[914] *Emera Maine*, 854 F.3d at 25 (citing *FPC v. Sierra Pac. Power*, 350 U.S. 348, 353 (1956)).

[915] *Id.* at 30.

[916] *Id.* at 27 (citing *FPC v. Nat. Gas Pipeline Co.*, 315 U.S. 575, 586 (1942)).

[917] *Id.* at 28 (citing *FERC v. Elec. Power Supply Ass'n*, 136 S.Ct. 760, 782 (2016)).

[918] *Id.* at 30 (citing *S. Cal. Edison v. FERC*, 717 F.3d at 181).

A. Composition of Starting Proxy Group

461. As described in the Briefing Order,[919] the Commission uses the following screens for developing a proxy group: (1) the use of a national group of companies considered electric utilities by *Value Line*; (2) the inclusion of companies with credit ratings no more than one notch above or below the utility or utilities whose ROE is at issue; (3) the inclusion of companies that pay dividends and have neither made nor announced a dividend cut during the six month study period; (4) the inclusion of companies with no merger activity during the six-month study period that is significant enough to distort the study inputs; and (5) companies whose ROE results pass threshold tests of economic logic, including the low-end outlier test and high-end outlier test adopted in section X of this order. The first four screens listed above evaluate particular characteristics of the companies in question that do not vary depending upon the results of the DCF or CAPM analyses. Accordingly, those screens may be used to develop a starting group of proxy companies eligible for inclusion in the proxy group to be used for the purposes of both the DCF and CAPM models. The low-end and high-end outlier tests must then be applied separately to the results of the DCF and CAPM models to determine the final DCF and CAPM proxy groups. Below, we first address issues concerning the determination of the starting proxy group in the First Complaint proceeding. We then apply the low-end and high-end outlier tests to the results of the DCF and CAPM analyses in order to determine the DCF and CAPM zones of reasonableness.

1. Opinion No. 551

462. The Presiding Judge determined that the DCF Study Period for calculating the zone of reasonableness should be the most recent six-month period for which there is financial data in the record, January to June 2015.[920]

463. In order to establish a proxy group, the Presiding Judge reviewed the DCF-determined cost of equity for 42 companies. The Presiding Judge determined that 40 of those companies should be included in the proxy group, before application of any low or high-end outlier test. Of those companies, the lowest cost of equity was Edison International's 4.38 percent and the highest cost was TECO's 11.35 percent.[921] The Presiding Judge rejected contentions that TECO should be excluded from the proxy group because of certain Merger and Acquisition (M&A) Activity. The Presiding Judge excluded Madison Gas and Electric Energy, Inc. because it did not have a credit rating

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[919] Briefing Order, 165 FERC ¶ 61,118 at PP 50-51.

[920] Initial Decision (I), 153 FERC ¶ 63,027 at PP 56, 61.

[921] *Id.* at App. A.

from either Moody's Investors Service or S&P and, therefore, could not be shown to have a credit rating of not more than one notch above or below MISO TOs, as required by Opinion No 531.[922] In addition, the Presiding Judge also excluded Unitil Corporation (Unitil) from the proxy group because it is not one of the companies covered by *Value Line* and because, unlike the companies in *Value Line*, Unitil has a capitalization of less than $1 billion.[923]

464. Complainants, Joint Customer Intervenors, and Trial Staff excepted to the Presiding Judge's inclusion of TECO in the proxy group.[924] No participant filed exceptions to any of the Presiding Judge's other rulings with respect to the proxy group.

465. In Opinion No. 551, the Commission affirmed the Presiding Judge's decision to include TECO in the proxy group.[925] Citing Opinion No. 531, the Commission explained that "it is the Commission's 'practice . . . to eliminate from the proxy group any company engaged in M&A activity significant enough to distort the [company's] DCF inputs" — i.e., the company's "stock prices, dividends, or growth rates."[926] The Commission stated that it does not exclude a company simply because it has engaged in any M&A activity or that activity may cause changes in the DCF inputs.[927] Rather, the Commission stated that it excludes a company if the M&A activity may cause temporary changes in DCF inputs that are not sustainable or representative of longer-term investor expectations for the company.

466. As noted in Opinion No. 551, TECO engaged in two M&A activities that could potentially require its exclusion from the proxy group. First, on September 2, 2014, nearly four months before the beginning of the updated the study period, TECO completed its acquisition of New Mexico Gas Company (New Mexico Gas). The record reveals that, several months later, during the January 2015 to June 2015 study period,

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[922] *Id.* PP 70, 72 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 106).

[923] *Id.* PP 74-75, 77.

[924] Opinion No. 551, 156 FERC ¶ 61,234 at PP 30-34.

[925] *Id.* PP 37-43.

[926] *Id.* P 23 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 114).

[927] *Id.* (citing Opinion No. 489, 117 FERC ¶ 61,129 at PP 67-68 ("We also reject [the] . . . argument that Commission precedent supports, in every instance, the exclusion from a proxy group of any utility engaged in merger activity."), *order on reh'g*, 122 FERC ¶ 61,265, *order on clarification*, 124 FERC ¶ 61,136 (2008)).

analysts were still assessing the impact of the New Mexico Gas acquisition on TECO earnings.[928] For example, the May 22, 2015 issue of *Value Line* noted that the acquisition should increase TECO's earnings, although the acquisition was just one of several factors, including strong customer growth and impending rate increases, that *Value Line* identified to support the projected increase in TECO's earnings for 2015 and 2016.[929]

467. Second, on October 20, 2014, roughly a month after closing the New Mexico Gas acquisition, TECO announced an agreement to sell its coal mining subsidiary, TECO Coal Corporation (TECO Coal) to Cambrian Coal Corp. (Cambrian) for $120 million and a contingent payment of up to $50 million, depending on coal prices.[930] TECO's stock price rose approximately 8 percent in the month following news of the sale. A few months later, in February 2015, TECO announced an amendment to the terms of the agreement that lowered the purchase price to $80 million, but increased the maximum contingent payment to $60 million.[931] Later in February, a securities analyst at UBS upgraded TECO from "neutral" to "buy," noting the potential sale of TECO Coal as one of the reasons for the upgrade. Throughout this period in early 2015, IBES's growth projections for TECO increased from 6.43 percent in January to 7.08 percent in February and all the way up to 9.20 percent by March 2015, even as at least one analyst expressed skepticism that TECO would complete the sale of TECO Coal.[932]

468. In April 2015, TECO announced that it was considering selling TECO Coal to other potential buyers in the event that the deal with Cambrian fell through.[933] As it happened, TECO announced in June 2015, the last month of the study period, that the deal with Cambrian had not closed as scheduled, but that it had received a non-binding offer for TECO Coal from an undisclosed buyer. The IBES growth projections remained steady at 9.20 percent throughout April, May, and June, notwithstanding the multiple reports casting doubt on TECO's ability to complete the sale of TECO Coal.[934] In early

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[928] *Id*. P 24.

[929] Initial Decision (I), 153 FERC ¶ 63,027 at P 91; Ex. S-6 at 161.

[930] Initial Decision (I), 153 FERC ¶ 63,027 at P 98; Ex. S-3.

[931] Initial Decision (I), 153 FERC ¶ 63,027 at P 98. The terms of the sale were amended again in mid-April 2015.

[932] *Id.* P 101; Ex. S-4 at 15; S-6 at 147, 171.

[933] Initial Decision (I), 153 FERC ¶ 63,027 at P 99.

[934] *Id.* P 101; Ex.S-6 at 149, 151.

July 2015, TECO announced that it had failed to reach an agreement with the undisclosed buyer, but that a sale of TECO Coal to Cambrian remained a possibility. A week later, on July 13, 2015, IBES's growth projection for TECO declined to 7.68 percent.[935] The Presiding Judge used the 7.68 percent IBES growth projection in his DCF analysis of TECO.

469. Opinion No. 551 affirmed the Presiding Judge's conclusion that neither the acquisition of New Mexico Gas nor the attempted sale of TECO Coal was sufficient to "distort" the DCF inputs.[936] In Opinion No. 551, with respect to New Mexico Gas, the Commission noted the Initial Decision's finding that TECO's acquisition of New Mexico Gas was completed on September 2, 2014, nearly four months before the beginning of the updated study period, which covered January-June, 2015.[937] As such, the Commission determined that speculation about whether the acquisition would be completed could not have affected, much less distorted, the stock price or the other DCF inputs during the updated study period. The Commission rejected Complainants' contention that TECO should be excluded on the grounds that the acquisition of New Mexico Gas created a temporary and unsustainable increase in TECO's expected earnings. As an initial matter, the Commission found that, over the course of the updated study period, the IBES growth estimates increased 125 basis points, not 280 basis points that Complainants' witness Mr. Gorman testified to.[938] However, the Commission further noted, as illustrated by the July 13, 2015 *Yahoo! Finance* data included along with the testimony of Joint Consumer Advocates' witness Mr. Hill, the actual projected earnings growth for TECO at the end of

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[935] Initial Decision (I), 153 FERC ¶ 63,027 at P 101. The Presiding Judge's Order Establishing Procedural Schedule provided that the cut-off date for data to be used by any party in updates of ROE studies would be July 13, 2015. Ex. JCA-22.

[936] Initial Decision (I), 153 FERC ¶ 63,027 at PP 81, 96, 106.

[937] Opinion No. 551, 156 FERC ¶ 61,234 at P 38.

[938] *Id.* (citing Ex. JC-22 at 7). In making that finding, the Commission rejected Complainants' contention that there was a disputed issue of fact regarding the appropriate growth rate for TECO at the end of the updated study period. The Commission affirmed the Presiding Judge's decision to rely on Mr. Hill's 7.68 percent growth rate, determining that Mr. Hill's testimony states clearly that he relied upon the numbers from *Yahoo! Finance* on July 13, 2015, the cut-off date for ROE data used in the updated study period, to evaluate TECO's merger activity. By contrast, the Commission determined that there was nothing in Mr. Gorman's testimony that suggests that he used July 13, 2015 IBES data – and not data from earlier in the study period, when the IBES growth rate was 9.20 percent when deciding whether to exclude TECO from the proxy group. *Id*. P 50 n.88.

the updated study period used in the parties' DCF analysis was 7.68 percent, 125 basis points above the 6.43 percent at the beginning of the study period.[939]

470. The Commission concluded that there was no evidence in the record suggesting that the New Mexico Gas acquisition caused a significant and unsustainable increase in TECO's earnings expectations during the updated study period. The Commission determined that the May 22, 2015 *Value Line* report suggested that the acquisition will increase earnings "over and above" the savings TECO will realize from no longer paying transaction costs associated with the acquisition. The Commission found that there was nothing suggesting that the additional increase is unsustainable. After all, the Commission determined, all other things being equal, an earnings increase is what would be expected when a company increases its regulated gas and electric customers by 50 percent, as TECO did in acquiring New Mexico Gas.[940] The Commission further stated that, in any case, the acquisition was just one of many factors, along with rate increases for TECO's Florida utilities and an anticipated reduction in TECO's cost of debt, which supported *Value Line*'s increased earnings projections.[941] The Commission determined that the *Value Line* report thus was not evidence suggesting that the acquisition distorted TECO's expected growth rate based on temporary, short-term developments that are unlikely to continue.[942]

471. Regarding TECO's attempts to sell TECO Coal, the Commission similarly concluded that there was no evidence suggesting that those efforts "distorted" the DCF inputs. The Commission stated that, unlike the acquisition of New Mexico Gas, the efforts to sell TECO extended into the updated study period and, therefore, it was possible that speculation related to the potential merger could have affected TECO's DCF inputs. Nevertheless, the Commission concluded that any effect was either too small or

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[939] *Id*.

[940] *Id*. P 39. To the extent that the parties suggested that TECO should be excluded because its earnings outlook improved because it was no longer incurring the transaction cost associated with the acquisition, the Commission rejected their argument. The Commission stated that adopting that position would require that it exclude companies for a year after almost any major merger or acquisition as the savings from no longer incurring the transaction costs materialize in annual earnings. The Commission stated that that result is not the purpose of the M&A screen. *Id*. P 50 n.89.

[941] *Id*. P 39 (citing Initial Decision (I), 153 FERC ¶ 63,027 at P 91).

[942] *Id*.

too attenuated to rise to the level of a distortion requiring TECO's exclusion from the proxy group.[943]

472. The Commission found that that the record did not show that the attempted sale of TECO Coal distorted TECO's expected earnings. Noting that TECO Coal represents less than 1.5 percent of TECO's total market capitalization,[944] the Commission determined that the sale of such a relatively small asset is, as a general matter, not the type of input-distorting transaction that the M&A screen is intended to address. Additionally, the Commission stated that many of the public utilities, especially relatively large companies that make a good comparison for TECO, are regularly engaged in potential mergers or acquisitions of small business units or subsidiaries. It stated that excluding such companies from the proxy group on the basis of any small purchase or sale would unnecessarily shrink the group of representative companies, thereby making the proxy group, and the resulting DCF analysis, a less reliable tool for ensuring that the allowed ROE satisfies the requirements of *Hope* and *Bluefield*.[945]

473. The Commission determined that the evidence in this case confirmed that TECO's potential sale of its underperforming asset, TECO Coal, had little impact on its projected growth rates or stock prices. As the Presiding Judge observed, IBES's projected growth rates for TECO steadily increased throughout the first five months of the six-month study period, even as the prospects for selling TECO Coal steadily deteriorated.[946] The Commission stated that, if the potential sale of TECO Coal was a significant factor affecting TECO's DCF inputs, it would anticipate at least some decline in the expected growth rate as the prospects for a sale deteriorated between February and June, 2015. Instead, TECO's expected growth rate first increased between February and March and then held steady through June.[947] In short, the Commission concluded that the record

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[943] *Id*. PP 40-43.

[944] While noting the possibility that the expected earnings growth rate would have further increased during this period were it not for the eroding chances of a successful sale of TECO Coal, the Commission concluded that there was no evidence in the record suggesting that the decreasing likelihood of a sale provided any such drag on TECO's earnings expectations. *Id*. P 51 n.91.

[945] *Id.* P 41.

[946] Initial Decision (I), 153 FERC ¶ 63,027 at P 103.

[947] *Id.* P 101.

simply did not suggest that the potential sale had much, if any, effect on the growth rate used in the DCF analysis.[948]

474. Similarly, the Commission concluded that there was no evidence in the record that the attempted sale of TECO Coal caused a distortion in TECO's stock price. The comparison of TECO's stock price versus the Dow Jones Utility Average submitted by Dr. Avera showed that the two moved in near lockstep from November 2014 through April 2015, which significantly overlapped with the study period. In any case, Dr. Avera's graph showed that TECO outperformed the industry average by an even greater amount for much of March and April, 2015, when the chances of a successful sale appeared to be diminishing.[949] Once again, the Commission determined that, if the potential sale of TECO Coal was affecting TECO's DCF inputs in any significant way, it would not expect to see TECO's stock price performing well relative to the industry average even as the prospects for the sale declined. The Commission stated that, although it might be argued that looking at relative performance is somewhat misleading, and that TECO's stock would have performed consistently worse relative to the industry average were it not for the potential sale, there was no evidence in the record suggesting that that is the case here and the Commission's M&A screen did not require a company's exclusion from the proxy group on so speculative a basis.[950]

2. Request for Rehearing

475. CAPs state that because TECO's 11.35 percent market cost of equity is the highest of all proxy group companies, TECO, if it is included, sets the upper end of the zone of

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[948] Opinion No. 551, 156 FERC ¶ 61,234 at P 42.

[949] The Commission noted that the Presiding Judge did not rely on Dr. Avera's chart because the y-axis for TECO's stock price was smaller relative to the y-axis for the industry average, which, according to the Presiding Judge, caused Dr. Avera's chart to underrepresent the variation in TECO's stock price. But, the Commission stated, that observation did not require it to change its conclusion, which rested in part on the fact that TECO's stock price performed better relative to the industry average when the prospects for the sale dimmed, than when the sale appeared most likely to occur. *Id.* P 53 n.95.

[950] *Id.* P 43. Although there was evidence in the record that some analysts viewed TECO Coal as "a drag on shares" of TECO, the Commission found that that evidence did not suggest that the increasingly dim prospect of eliminating that "drag" was sufficient to "distort" the DCF inputs, especially given the absence of any apparent correlation between the DCF inputs and the prospects for a successful sale of TECO Coal. *Id.* P 56 n.97 (citing Initial Decision (I), 153 FERC ¶ 63,027 at P 100).

reasonableness, thereby having a significant impact on the determination of the midpoint. CAPs state that it is important in this case to ensure that the high end of the DCF range is not associated with DCF model inputs that may been distorted by merger-related activity. CAPs argue that, consistent with Commission precedent, TECO should be excluded from the proxy group due to M&A activity that distorted TECO's DCF inputs during the relevant study period.[951]

476. CAPs argue that, in Opinion No. 551, the Commission did not properly apply the standard established by the Commission in Opinion No. 531. They argue that the Commission's application of the M&A screen in Opinion No. 531 focused on whether the M&A activity is significant enough to cause a distortion to the DCF inputs, not whether the M&A activity distorts DCF inputs only on a basis that is "temporary" or "not sustainable." They argue that by imposing on parties the additional burden of demonstrating that the impact on DCF inputs will be temporary or unsustainable in Opinion No. 551, the Commission departed from established precedent without explanation. They further contend that the Commission failed to explain how a party can demonstrate in advance whether the effect of particular M&A activity will be sustainable.[952]

477. Citing TECO's acquisition of New Mexico Gas and the sale of its subsidiary TECO Coal, CAPs argue that the record demonstrates that TECO was engaged in various M&A activities throughout the study period and that such M&A activity distorted the DCF inputs.[953] CAPs contend that neither Opinion No. 531 nor any precedent cited therein supports the proposition that a certain level or duration of distortion is required to exclude a utility from the proxy group. They further contend that Commission precedent is also silent on whether the distortion must occur in a certain direction (positive or negative) in order to warrant removal group.[954] In addition, they argue that M&A activity

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[951] CAPs Rehearing Request at 9-10. CAPs state that the Joint Consumer Advocates opt out of CAPs' rehearing request on this issue.

[952] *Id*. at 10.

[953] *Id*. at 11 (citing Initial Decision (I), 153 FERC ¶ 63,027 at PP 100-101).

[954] *Id*. at 12 (citing Opinion No. 486-B, 126 FERC ¶ 61,034 at PP 79, 81 (explaining that, here, the Commission's removal of a utility from the proxy group was based, in part, on the basis that the utility's M&A activity "can distort that share prices by creating uncertainty (positive or negative) about the impact of change")).

is not limited to activity within the study period, but may include activity that is "recent, current, or forecasted."[955]

3. Briefs

478. CAPs witness Mr. Solomon argues for the exclusion of TECO from the proxy group.[956] Mr. Solomon asserts that TECO's DCF study inputs were distorted during the relevant study period, January to June 2015, as a result of its major M&A activity.[957] Mr. Solomon contends that the late October 2014 announcement of the agreement to sell TECO Coal had the effect of increasing TECO's price relative to the SNL Energy stock index, and it subsequently maintained that higher relative price throughout the study period ending June 30, 2015, demonstrating the continuing effect the expected sale of TECO Coal had on TECO's stock price. Mr. Solomon states that changes in TECO's stock price followed changes in the SNL Energy group average price relatively closely from July 1, 2014, until the late October 2014 announcement of the agreement to sell TECO Coal, when there was a clear increase in the price of TECO Energy stock relative to the SNL Energy average price. He states that, with some fluctuations, the TECO price subsequently maintained that relative price spread, indicating the continuing favorable effect the expected TECO Coal sale had on the TECO stock price. He argues that this effect on key market-based data requires TECO's exclusion from the proxy group.[958]

479. Mr. Solomon also states that, on July 16, 2015, shortly after the conclusion of the study period in this proceeding, TECO disclosed that it was exploring strategic alternatives, which could include a sale of the entire company. He states that in reaction, shares of TECO spiked that day, justifying excluding TECO from the proxy group.[959]

480. With regard to the Judge's conclusion that TECO should not be excluded from the proxy group because, if anything, the distortion reduces the resulting DCF study ROE input, Mr. Solomon contends that the purpose of the M&A screen is not to determine

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[955] *Id*. (citing *Atlantic Grid Operations*, 135 FERC ¶ 61,144, at P 88 n.55 (2011) (finding proxy group screens for "significant recent, current or forecasted merger activity to be appropriate)).

[956] CAPs Initial Br. (I), Ex. JCI-100 (Solomon Aff.) at 11.

[957] *Id*. at 54 (citing Initial Decision (I), 153 FERC ¶ 63,027 at PP 56 and 60; Opinion No. 551, 156 FERC ¶ 61,234 at P 19).

[958] *Id*. at 55.

[959] *Id*. at 55-56.

whether a distorted input causes an increase or decrease in the resulting ROE. He argues that the criterion described in Opinion No. 531 and elsewhere simply requires the exclusion of companies that engaged in significant M&A activity where such activity distorts study inputs, which compromises the integrity of the model's output in respect of the company subject to M&A activity.[960]

481. Mr. Solomon states that the Commission's rationale in affirming the Initial Decision is in contrast to the views expressed by the Judge. According to Mr. Solomon, whereas the Judge declined to exclude TECO from the proxy group on the ground that the price spike caused TECO's dividend yield and 11.35 percent DCF result, which set the top of the range, to be lower than it should be and that excluding TECO would lower the top of the range even more, the Commission instead found that the effect was too small to remove TECO Energy from the proxy group.[961] Mr. Solomon argues that the Commission responded only indirectly to the Judge's finding that TECO's stock price was affected by its announced intention and subsequent attempts to sell TECO Coal.

482. First, Mr. Solomon states that, in finding that the potential sale had little or no effect on the growth rate used in the DCF analysis, the Commission did not use the 9.20 percent growth rate that was in place from March through June in the approved DCF calculations, but rather used the 7.68 percent growth rate from July 13, 2015, which was some 152 basis points, or 16.5 percent, lower. Mr. Solomon further contends that although the Commission cited the Initial Decision at P 103 where the Presiding Judge concluded that there was no evidence "that the 7.68 percent projection was the result of distortions resulting from TECO's attempts to sell TECO Coal," the Presiding Judge also did not cite any evidence to the contrary. Nonetheless, Mr. Solomon argues, TECO's projected growth rate did drop in July 2015, likely for multiple reasons including its declining prospects for unloading TECO Coal. It was also not until July 6, 2015 that Standard and Poor's removed TECO Energy from CreditWatch due to its failure, to that point, to find a buyer for TECO Coal.[962]

483. Second, Mr. Solomon challenges what he characterizes as the Commission's apparent reliance upon a chart produced by MISO TO witness Dr. Avera that purportedly demonstrates that TECO's stock price moved in near lockstep with the Dow Jones Utility Average during much of the study period.[963] Mr. Solomon states that the Presiding Judge

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[960] *Id*. at 56-57.

[961] *Id*. at 57-58.

[962] *Id*. at 58-59.

[963] *Id*. at 59 (citing Opinion No. 551, 156 FERC ¶ 61,234 at P 43).

expressed concern that Dr. Avera's chart created an optical illusion (because the variation in the scale on the two axes was not equal) which, when corrected for the optical illusion, "would likely result in a price pattern comparable to that shown on Mr. Solomon's graph."[964]

484. In addition, Mr. Solomon notes that, on February 10, 2015, during the study period, a UBS securities analyst advised SNL Financial that the sale of TECO Coal would remove a large drag on shares. Thus, as the Presiding Judge found, there is evidence in the record to demonstrate that the TECO stock price was affected by TECO's announcement of an agreement to sell and subsequent attempts to sell its underperforming TECO Coal subsidiary prior to which *Value Line* had found had weighed on the stock.[965]

485. Mr. Solomon also argues that there was an increase in TECO's projected earnings growth rate during the study period that was at least partially attributable to TECO's acquisition of New Mexico Gas, which increased TECO's regulated gas and electric customers by 50 percent. Mr. Solomon argues that, while this acquisition was completed almost four months prior to the beginning of the DCF study period, it certainly impacted the expected growth rate for TECO Energy. Mr. Solomon states that it is undisputed that TECO's expected earnings growth rate increased from 6.43 percent at the beginning of study period, to the 7.68 percent the Commission found appropriate to use in the DCF analysis by the end of the study period. Mr. Solomon argues that, while the New Mexico Gas acquisition was likely only one of many factors, including rate increases for TECO's Florida utilities and an anticipated reduction in TECO Energy's cost of debt, contributing to the expected growth earnings increase, the resulting 50 percent in regulated gas and electric customers had to be a major contributor and there has been no showing that it was not.[966]

486. Further, Mr. Solomon disagrees with the Commission's conclusion in Opinion No. 551 that there was no evidence in the record suggesting that the New Mexico Generation acquisition caused a significant and unsustainable increase in TECO's earnings expectations during the updated study period. First, Mr. Solomon argues that an

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[964] *Id*. (quoting Initial Decision (I), 153 FERC ¶ 62,027 at P 105).

[965] *Id*. at 60.

[966] *Id*. at 60-61.

increase in TECO's expected earnings per share growth rate from 6.43 percent to 7.68 percent—a more than 19 percent increase—is not insignificant.[967]

487. Second, Mr. Solomon argues that the finding of sustainability is misdirected. Mr. Solomon argues that the Commission's statement that an earnings increase would be expected when a company increases its regulated gas and electric customers by 50 percent, as TECO did in acquiring New Mexico Gas, misses the point.[968] According to Mr. Solomon, the point is that the acquisition caused a one-time increase in the expected earnings growth rate, not a one-time increase in the absolute level of expected earnings. Mr. Solomon argues that, after the acquisition is assimilated with a higher base level of earnings, changes in the expected growth rate will not be as large. He contends that while some analysts may make adjustments in an attempt to restate the historical data to account for the acquisition, others may not and, in any event, such adjustments are difficult to quantify.[969]

488. Moreover, Mr. Solomon argues, the *Value Line* betas used for the CAPM analysis are based on historical prices for the last five years and are less certain to be representative of future betas for TECO now that TECO Energy has increased its regulated electric and gas customer base by 50 percent with the New Mexico Gas acquisition, which not only significantly changed the number, but also the composition of its electric versus gas service.[970]

489. MISO TOs respond that Mr. Solomon's argument that TECO is not a proper proxy due to its M&A activity flies in the face of the Commission's prior findings in Opinion No. 551 that there is no evidence in the record suggesting that the New Mexico Gas acquisition caused a significant and unsustainable increase in TECO's earnings expectations during the dated study period, or that such activity operated to distort the DCF inputs.[971]

490. In a reply affidavit, MISO TOs' witness, Mr. McKenzie, argues that Mr. Solomon's arguments to exclude TECO Energy from the proxy group should be rejected. First, Mr. McKenzie argues that the issue of whether to include TECO Energy

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[967] *Id*. at 61.

[968] *Id*. at 61-62 (citing Opinion No. 551, 156 FERC ¶ 61,234 at P 39).

[969] *Id*. at 62.

[970] *Id*.

[971] MISO TOs Reply Br. (I) at 51.

in the proxy group in Docket No. EL14-12-000 is not in any way related to the ROE methodology proposed in the Briefing Order.[972] Mr. McKenzie contends that neither the Court's findings in *Emera Maine* nor the Commission's ROE methodology in the Briefing Order pertain to the evaluation of proxy group companies. Mr. McKenzie argues that Mr. Solomon is improperly attempting to broaden the scope of inquiry, none of his arguments raised in his affidavit are based on new information and that Mr. Solomon is simply second-guessing the Commission's previous determination that TECO belongs in the proxy group.[973] Mr. McKenzie also states that the Commission, in Opinion No. 531, specifically ruled out excluding proxy companies without a demonstration that the transaction impacted the DCF results by distorting the companies' stock prices, dividends, or growth rates.[974]

491. In response to Mr. Solomon's assertion that Dr. Avera's chart created an optical illusion, Mr. McKenzie presents a chart using the same data comparing the TECO stock price with the Dow Jones Utility Average. But, in response to the Presiding Judge's concerns, the values on the two axes are both scaled by exactly 25 percent. Mr. McKenzie asserts that his chart shows that there is no indication of systemic distortion in TECO's stock prices, relative to broader trends for the utility industry.[975] Meanwhile, argues Mr. McKenzie, the chart presented by Mr. Solomon[976] does not compare the movement of TECO Energy's stock price to the corresponding trend for utilities as a whole. Mr. McKenzie contends that the diverse group of companies in the SNL Energy stock index used in Mr. Solomon's comparison is not indicative of price trends for a utility like TECO. Further, Mr. McKenzie argues that Mr. Solomon's figure is a comparison of cumulative percentage changes in value from a selected beginning point, which is arbitrary.[977]

492. Moreover, Mr. McKenzie states that, as Dr. Avera documented, the cash price for TECO's coal subsidiary represented less than 1.5 percent of TECO Energy's total capital. Mr. McKenzie argues that Mr. Solomon's speculation that the sale of an asset that had

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[972] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 126.

[973] *Id*.

[974] *Id*. at 127 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 114).

[975] *Id*. at 128-129.

[976] Ex. JCI-8 at 7.

[977] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 129-130.

already been classified as discontinued since the third quarter of 2014 would somehow motivate a 20 percent revaluation of TECO's stock price is illogical and unsupported.[978]

4. Determination

a. Commission Response to Rehearing Arguments

493. We are not persuaded by CAPs' argument, reiterated in their briefing arguments, that the Commission's application of the M&A screen in establishing the starting proxy group did not properly apply the standard established in Opinion No. 531. CAPs argue that Opinion No. 531 requires exclusion from the proxy group of any company whose M&A activity caused a change in its DCF inputs. They contend that Opinion No. 551 improperly altered that standard by requiring them to show not only that TECO's M&A activity had an impact on its DCF inputs, but also that that impact was "temporary" or "not sustainable."

494. Opinion No. 551 properly considered whether TECO's M&A activity "may cause temporary changes in DCF inputs that are not sustainable or representative of longer-term investor expectations for the company."[979] In Opinion No. 531, the Commission, citing precedent, noted that its practice is to eliminate from the proxy group any company engaged in M&A activity significant enough to distort the DCF inputs, based on the facts and circumstances of each case.[980] The DCF inputs are "distorted" if they are not representative of longer-term investor expectations for the company, for example because the M&A activity has caused a temporary jump in stock price or an unsustainable growth projection. However, if a completed M&A activity has caused a sustainable change in a DCF input, as the Commission found with respect to TECO's purchase of New Mexico Gas, then the DCF inputs are representative of longer-term investor expectations and the company is properly included in the proxy group.

495. Opinion No. 531 and the precedent it cited is not inconsistent with this interpretation of our M&A screen. For example, Opinion No. 531 cited the Presiding Judge's initial decision in *Bangor Hydro-Electric Co.*, which the Commission affirmed. In that initial decision, the presiding judge held that the facts and circumstances of that case did not warrant exclusion of the companies at issue from the proxy group:

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[978] *Id.* at 130.

[979] Opinion No. 551, 156 FERC ¶ 61,234 at P 37.

[980] Opinion No. 531, 147 FERC ¶ 61,234 at P 114 (citing, among other cases, *Bangor Hydro-Electric Co.*, 111 FERC ¶ 63,048, at PP 67-68, *aff'd in relevant part*, Opinion No. 489, 117 FERC ¶ 61,129).

> I agree with the testimony presented by the [New England TOs] that "Whether or not [the anticipation of a merger] does or does not [affect the market] *depends on the facts and circumstances*. If a very large company acquires a very small company, it typically is not very material to the very large company. It may be material to the small company, depending on whether there's a premium or investors revise their expectations markedly . . . *whether a merger makes a big effect or not depends on the facts and circumstances*." Tr. 297-98. In this the [New England TOs] presented testimony that the anticipation of merger did not distort stock prices, and therefore, although I agree that whether a company is engaged in merger activity should be a criterion for examination when choosing a proxy group, *in this case* neither PSEG nor Exelon should be eliminated on this basis.[981]

496. In Opinion No. 531 the Commission similarly analyzed whether the M&A activity was significant enough to distort the DCF inputs, based on the facts and circumstances of that case. It affirmed the initial decision's approval of the elimination of two utilities from the proxy group based on their recent M&A activity as well as finding that the record did not indicate that a third utility's recent M&A activity was significant enough to distort the DCF inputs.[982]

497. Sustainability of the impact of M&A activity on growth was not at issue in Opinion No. 531. By contrast, the record relied upon by the Commission in Opinion No. 551 does include evidence of the sustainability of the impact of the M&A activity, specifically the purchase of New Mexico Gas, on growth, and nothing in Opinion No. 531 restricted the Commission from considering such record evidence in making its determination in Opinion No. 551. Further, in the Briefing Order, the Commission "recognize[d] that in unusual circumstances the two-step DCF methodology may produce *unsustainably* high results for a particular proxy company."[983]

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[981] 111 FERC ¶ 63,048 at P 67 (emphasis added).

[982] Opinion No. 531, 147 FERC ¶ 61,234 at P 114.

[983] Briefing Order, 165 FERC ¶ 61,118 at P 53 (emphasis added). *See also, e.g.*, *Potomac-Appalachian Transmission Highline, L.L.C.*, 122 FERC ¶ 61,188, at P 98 (2008), *order on reh'g*, 133 FERC ¶ 61,152, at PP 20, 64 (2010); *ISO New England, Inc.*, 111 FERC ¶ 61,344, at P 8 (2005).

b. Commission Response to Briefing Arguments

498. We agree with MISO TOs that additional arguments and evidence regarding whether to exclude TECO from the starting proxy group that parties provided in their briefs is outside the scope of the Briefing Order. In the Coakley Briefing Order, the Commission set forth a framework for addressing proposed revised methodology for rate of return. As noted above, in the Briefing Order, the Commission sought comments on whether to apply the methodology it proposed in the Coakley Briefing Order. While the Commission said that all aspects of the proposed methodology were subject to comment and that parties could provide evidence, the Commission did not propose to change its screens for developing a proxy group, instead proposing to use the same screens as in Opinion Nos. 531 and 551.[984] Moreover, CAPS do not oppose the Briefing Order's proposed M&A screen itself.[985] Rather, CAPs briefing argument, through Mr. Solomon's testimony, is confined to reiterating CAPs' opposition to the inclusion of TECO in the proxy group. But, even if Mr. Solomon's arguments were properly within the scope of the Briefing Order, we find them unpersuasive, as discussed below.

499. Mr. Solomon's argument that the Commission's rationale with respect to the proposed sale of TECO Coal differed from that of the Presiding Judge is unpersuasive. The Commission may affirm the ultimate decision of the Initial Decision for different reasons than put forth by the Presiding Judge where, as in this case, there is a complete evidentiary record of the issue enabling the Commission to affirm the Initial Decision's ultimate conclusion.[986] Moreover, in this case, as we discuss below, the MISO TOs' introduced additional evidence in their reply to the CAPs' brief that addressed concerns raised by the Presiding Judge in his Initial Decision.

500. CAPs contend that TECOs' purchase of New Mexico Gas caused a one-time increase TECOs' growth rate by increasing TECOs' regulated gas and electric customers

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[984] *Id*. P 50.

[985] CAPs Initial Br. (I) at 25-26.

[986] *See, e.g., Old Dominion Elec. Coop*., 158 FERC ¶ 61,045, at P 72 n.107 (2017) (affirming the Initial Decision's ultimate conclusion that a revised base energy rate was just and reasonable, despite disagreeing with the Initial Decision's statement that it was an unchanged element of the applicant's formula rate, because there was a complete evidentiary record on the issue), *reh'g denied*, 162 FERC ¶ 61,262 (2018); *Pub. Serv. Co. of Indiana Inc.*, 7 FERC ¶ 61,319, at 61,701, *order on reh'g*, 8 FERC ¶ 61,224 (1979) (affirming the Initial Decision's finding that purchased power estimates were reasonable, but for different reasons than expressed in the Initial Decision), *order on reh'g*, 14 FERC ¶ 61,058 (1981).

by 50 percent. CAPs point out that the IBES short-term year growth projection for TECO increased from 6.43 percent at the beginning of the January to June 2015 study period to the 7.68 percent IBES growth projection on July 13, 2015, which the Commission found appropriate for use in TECO's DCF analysis. CAPs argue that, after TECO's acquisition of New Mexico Gas is assimilated with the higher base level of earnings resulting from the increase in its customers, the longer term increase in TECO's earnings will not be as large.

501. The Presiding Judge addressed this issue in his Initial Decision.[987] Relying on a May 22, 2015 *Value Line* report, the Presiding Judge found that there were additional reasons beyond the New Mexico Gas purchase for TECO's growth rate to increase. That report found that TECO's Tampa Electric and Peoples Gas utilities in Florida were experiencing strong customer growth as the Florida economy expands, and Tampa Electric was benefitting from a rate hike that took effect in November 2014. Also, TECO was planning to replace maturing high-cost debt with borrowings that had a much lower interest rate. Furthermore, the Presiding Judge pointed out that the May 22, 2015 *Value Line* report stated,

> *We forecast continued bottom-line growth in 2016.* We expect the favorable trends at the Florida utilities to persist, and New Mexico Gas is also experiencing some growth, albeit modest. We estimate that earnings will rise 4%-5%, to $1.15 a share. A more significant increase is likely in 2017, as Tampa Electric's rates will be raised by $110 million once an upgrade to a power plant is completed.[988]

The Presiding Judge reasonably found that this statement indicated that *Value Line* did not expect any one-time effects of the New Mexico Gas purchase to extend beyond 2015 into 2016. Rather, New Mexico Gas's contribution to TECO's growth after 2015 would derive not from the two companies' combination of earnings, but from New Mexico Gas' own modest increase in earnings. In these circumstances, we continue to find that the July 13, 2015 IBES projection of TECO's growth over the next three to five years may be treated as representative of longer-term investor expectations of sustainable growth and not significantly affected by any one-time effects of the New Mexico Gas purchase, which was completed over 10 months earlier.

502. CAPs also dispute Opinion No. 551's holding that TECO's October 20, 2014 announcement of an agreement to sell TECO Coal to Cambrian for $120 million and a contingent payment of up to $50 million, depending on coal prices, did not distort its

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[987] See Initial Decision (I), 153 FERC ¶ 63,027 at PP 89-96.

[988] *Id.* P 93 (citing Ex. MTO-54 at 41 (emphasis in *Value Line* report)).

DCF inputs during the January to June 2015 study period. CAPs cite various *Value Line* reports from before the October 20, 2014 announcement noting that the coal mining business had become a drag on TECO, and a November 21, 2014 *Value Line* report stating that TECO's stock had increased by 8 percent since the announcement.[989] CAPs also rely on a graph comparing the price of TECO stock during the July 1, 2014 to July 13, 2015 to the SNL Energy stock index. CAPs assert that that the graph shows that the October 20, 2014 announcement of the agreement to sell TECO Coal had the effect of increasing TECO's price relative to the SNL Energy stock index and it subsequently maintained that higher relative price throughout the study period, demonstrating the continuing effect of the expected sale of TECO Coal on TECO's stock price.

503. We continue to disagree with these contentions. Although the October 20, 2014 announcement had an immediate effect on the price of TECO stock, we find that there is insufficient evidence that the announcement continued to have a sufficient effect on TECO's stock during the January to June 2015 study period to justify excluding TECO from the proxy group. In the first place, there is no evidence that the average risk profile of the companies reflected in the SNL Energy stock index is comparable to TECO's risk profile. The SNL Energy stock index "[i]ncludes all publicly traded (NYSE, NYSE MKT, NASDAQ, OTC) Electric, Gas, Diversified, and Merchant companies in SNL's coverage universe."[990] About half the companies tracked are midstream gas and oil pipeline companies, and thus the SNL Energy stock index is more exposed to risks associated with changes in natural gas and crude oil commodity prices than an electric utility with some local gas distribution business such as TECO. As a result, there has been no showing that a comparison of how TECO stock performed versus the SNL Energy stock index provides any meaningful information as to how the announcement of the sale of TECO Coal may have affected TECO's stock price during the first half of 2015.

504. In contrast to CAPs, MISO TOs provided at the hearing a graph comparing the price of TECO's stock with the Dow Jones Utility Index from November 1, 2014 to June 30, 2015.[991] That graph shows TECO's stock moving in virtual lockstep with the Dow Jones Utility Index. During periods when the Dow Jones Utility Index increased, the price of TECO stock almost invariably also increased; similarly, when the Dow Jones Utility Index decreased, the price of TECO stock almost invariably also decreased. As CAPs point out, the Presiding Judge was concerned that the MISO TOs' graph used different scales to display the prices of TECO stock and the Dow Jones Utility Index, and

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[989] Ex. JCI-100 at 54-55 (I).

[990] Ex. JCI-10 at 271.

[991] Ex. MTO-23 at 99, Figure 1.

he asserted that if the same scale had been used to display both prices, the graph would have shown TECO stock prices increasing at a somewhat faster rate than the Dow Jones Utility Index.[992] However, in their reply brief in response to the Briefing Order, the MISO TOs have provided a revised graph comparing the TECO stock prices with the Dow Jones Utility Average, but using the same scale for both.[993] The revised graph continues to show TECO's stock moving in virtual lockstep with the Dow Jones Utility Index. CAPs' witness, Mr. Solomon, asserts that in late January/early February 2015, TECO's stock price was up approximately 20 percent compared to July 2014.[994] However, MISO TOs' revised graph shows a similar increase in the Dow Jones Utility Index. As MISO TOs' witness, Mr. McKenzie states, the revised graph indicates that there is no indication of systemic distortion in TECO's stock prices, relative to broader trends for the utility industry.[995] In fact, the revised graph shows, if anything, that during the latter part of the study period, the price of TECO stock declined at a slightly faster rate than the Dow Jones Utility Index did during that period, in further contradiction to CAPs' assertion that the TECO Coal sale announcement caused the price of TECO stock to increase during the study period, thus depressing its dividend yield.

505. Moreover, as the Commission pointed out in Opinion No. 551, TECO Coal represents less than 1.5 percent of TECO's total market capitalization.[996] We continue to find that the attempted sale of TECO coal appears too small relative to the size of the company to be responsible for significant changes in TECOs' stock price.

506. In addition, we are not persuaded by Mr. Solomon's argument disputing the Commission's determination, in Opinion No. 551, affirming the Initial Decision's finding that TECO's potential sale of TECO Coal had little impact on its projected growth rates. Opinion No. 551 pointed out that IBES's projected growth rates for TECO steadily increased throughout the first five months of the six-month study period, even as the

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[992] See Initial Decision (I), 153 FERC ¶ 61,027 at P 105. The Presiding Judge stated that while the TECO stock prices on the graph vary by 35.2 percent, the Dow Jones Utility Index varies by only 25.9 percent.

[993] MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (I) at 129. In the revised graph, both TECO stock prices and the Dow Jones Utility Average vary by 25 percent.

[994] Ex. JCI-100 at 57.

[995] *Id*. at 128-129.

[996] Ex. MTO-23 at 99 (valuing TECO Coal using the most recent non-contingent purchase price for the attempted sale to Cambrian).

prospects for selling TECO Coal steadily deteriorated.[997] If the potential sale of TECO Coal was a significant factor affecting TECO's DCF inputs, we would anticipate at least some decline in the expected growth rate as the prospects for a sale deteriorated between February and June, 2015. Instead, TECO's expected growth rate first increased from 6.43 percent in January 2015, to 7.08 percent in February, and to 9.20 percent in March, and held steady through June. CAPs point out that TECO's IBES growth projection fell to 7.68 percent in July, which was 152 basis points below the 9.20 percent growth projection in March, and the Commission used the 7.68 percent growth projection in its DCF analysis. CAPs suggest that the declining prospects for the sale of TECO Coal contributed to this decline. However, the 7.68 IBES growth projection in July was still above the January IBES growth projection of 6.43 percent and the February IBES growth projection of 7.08 percent, and thus simply returned TECO's growth projection to approximately the same level as at the start of the January to June 2015 study period. In short, the record simply does not suggest that the potential sale had much, if any, effect on the growth rate used in the DCF analysis. Mr. Solomon proffers no new evidence to the contrary.

507. Our merger screen seeks to exclude companies that are engaging in major mergers and acquisition activity. This attempted sale of TECO Coal does not reach this standard and appears to be the type of minor activity that occurs regularly in the course of business for utility holding companies. Accordingly, we deny rehearing of Opinion No. 551's holding that TECO should be included in the proxy group.

B. DCF Proxy Group and Analysis

508. In Opinion No. 551, the Commission affirmed the Presiding Judge's findings concerning how the two-step DCF analysis should be conducted. In this order, we have reaffirmed Opinion No. 551's approval of the Presiding Judge's DCF analysis, with one exception. In section V.C above, we have held that only the IBES short-term growth projection should be used for calculating the (1+.5g) adjustment to the dividend yield, instead of the composite growth rate used by the Presiding Judge. Accordingly, as shown in Appendix A to this order, we have revised the Presiding Judge's DCF analysis of the starting proxy group to reflect the revised calculation of the dividend yield.

509. We now turn to the issue of whether, for purposes of determining the DCF zone of reasonableness, any company in the starting proxy group should be excluded as a low- or high-end outlier. The Presiding Judge excluded three companies — Edison International, FirstEnergy Corporation (FirstEnergy), and Entergy Corporation (Entergy) — because

[997] Initial Decision (I), 153 FERC ¶ 63,027 at P 103.

their ROEs were less than 5.65 percent, which is 100 basis points above the average yield for public utility bonds rated Baa by Moody's.[998]

510. No party excepted to the Presiding Judge's ruling on this issue, and Opinion No. 551 accordingly adopted that ruling. However, as described above, in their brief responding to the Briefing Order, MISO TOs propose a revised low-end outlier test under which all companies whose ROEs are less than 254 basis points above the average yield for Baa utility bonds would be excluded from the proxy group. This revised test would exclude companies with ROEs below 7.19 percent.[999] Based on this revised test, MISO TOs propose to exclude from the DCF proxy group three companies in addition to the three that the Presiding Judge excluded. The additional three companies are Public Service Enterprise Group, Consolidated Edison, Inc., and OGE Energy Corp. The ROEs of those companies range from 7.23 percent to 7.28 percent. Although these ROEs exceed MISO TOs' 7.19 percent proposed threshold, MISO TOs nevertheless assert that they are sufficiently close to the threshold that an investor would consider the stock to yield essentially the same return as debt.[1000]

511. We reject MISO TOs' proposal to exclude Public Service Enterprise Group, Consolidated Edison, Inc., and OGE Energy Corp. from the DCF proxy group. In section X of this order, we rejected MISO TOs' proposed revised low-end outlier test. Instead, we adopted a revised low-end outlier test under which we exclude from the proxy group companies with ROEs that do not exceed the Baa bond yield by at least 20 percent of the risk premium from the CAPM analysis. In the First Complaint proceeding, the risk premium from the CAPM analysis is 9.12 percent. Twenty percent of that risk premium is 182 basis points. Adding 182 basis points to the 4.65 percent Baa bond yield produces a low-end outlier threshold in the First Complaint proceeding of 6.47 percent. Although that low-end outlier threshold is higher than the 5.65 percent low-end outlier threshold that the Presiding Judge applied, it does not exclude any additional companies from the proxy group. Public Service Enterprise Group and IDACORP, INC., both with ROEs of 7.23 percent, have the lowest DCF ROE of any company included in the proxy group. That ROE is well above the revised 6.47 percent low-end outlier threshold.

512. The Presiding Judge did not exclude any company from the DCF proxy group on the ground that it is a high-end outlier, nor does any participant seek to exclude any company on that ground. Under the high-end outlier test we have adopted in this order, we would, subject to the natural break analysis, exclude any DCF ROE that is more than 150 percent of the median of the starting proxy group DCF ROEs. In this case, the

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[998] *See id.* PP 66-67.

[999] MISO TOs Initial Br. (I), App.2 McKenzie Aff. (I) at 31.

[1000] *Id.* at 31 and n. 75.

median of the starting proxy group DCF ROEs, using the exclusions made by the Presiding Judge, is 8.68 percent. One-hundred-fifty percent of that median is 13.02 percent. TECO's DCF ROE of 11.37 percent is well below that amount. Accordingly, we do not exclude any company from the DCF proxy group as a high end-outlier. Based on this discussion, we conclude that the DCF zone of reasonableness is 7.23 percent to 11.37 percent.

C. CAPM Proxy Group and Analysis

513. In Opinion No. 551, the Commission affirmed the Presiding Judge's findings concerning how the CAPM analysis should be conducted. In this order, we have reaffirmed Opinion No. 551's approval of the Presiding Judge's CAPM analysis, with two exceptions related to the market risk premium. In section VII.C above, we have held that only the IBES short-term growth projection should be used in the one-step DCF analysis of the dividend paying members of the S&P 500, instead of the average of the IBES and *Value Line* growth projections approved by the Presiding Judge.[1001] In addition, we have held that companies with negative ROEs or ROEs above 20 percent should be excluded from that analysis. Accordingly, we have revised the CAPM analysis of the starting proxy group approved by the Presiding Judge to reflect this revision.[1002]

514. We now turn to the issue of whether, for purposes of determining the CAPM zone of reasonableness, any company in the starting proxy group should be excluded from the CAPM proxy group as a low- or high-end outlier. The Presiding Judge did not exclude any company from the proxy group on these grounds, nor does any participant contend that any company is a low or high-end outlier. As discussed in the preceding section, we have determined that the low-end outlier threshold in the First Complaint proceeding is 6.37 percent. The companies in the starting proxy group with the lowest ROE are Duke Energy Corp. and Southern Company, both with ROEs of 7.80 percent. Because that ROE is well above the 6.37 percent low-end outlier threshold, we do not exclude any company from the CAPM proxy group as a low-end outlier.

515. Under the high-end outlier test we have adopted in this order, we would exclude from the CAPM proxy group any ROE that is more than 150 percent of the median of the starting proxy group CAPM ROEs. In this case, the median of the starting proxy group CAPM ROEs is 10.3 percent. One-hundred-fifty percent of that median is 15.45 percent.

[1001] Opinion No. 551, 156 FERC ¶ 61,234 at PP 169, 172.

[1002] The results of the CAPM analysis incorporating this revision and the other revisions and clarifications discussed above (i.e., use of the one-step DCF, size adjustment, and only IBES growth rates) are reflected in page 6 of Attachment A to Trial Staff's Initial Briefs. *See* Trial Staff Initial Br. (I), Attachment A to App. 2 at 6; Trial Staff Initial Br. (II), Attachment A to App. 2 at 6.

The company with the highest CAPM ROE in the starting proxy group has an ROE of 13.09 percent, well below the 15.45 percent high-end outlier threshold. Accordingly, we do not exclude any company from the CAPM proxy group as a high end-outlier. Based on this discussion, we conclude that the CAPM zone of reasonableness is 7.80 percent to 13.09 percent.

D. Composite Zone of Reasonableness and FPA Section 206 Findings

516. Averaging the top and bottom of the DCF and CAPM zones of reasonableness determined above based on financial data for the first six months of 2015 produces a composite zone of reasonableness in the First Complaint proceeding of from 7.52 percent to 12.24 percent. The midpoint of that zone of reasonableness is 9.88 percent.

517. Having determined the composite zone of reasonableness based on financial data for the first half of 2015, we now turn to considering whether the MISO TOs' existing 12.38 percent ROE, which was determined based on financial data for the six months ending February 2002, may be found unjust and unreasonable pursuant to the first prong of FPA section 206. In section IV of this order, we have adopted the use of ranges of presumptively just and reasonable ROEs based on the risk profile of a utility or group of utilities to inform our decision whether an existing ROE has become unjust and unreasonable. Specifically, we have held that, for average risk utilities, the presumptively just and reasonable range is the quartile of the overall composite zone of reasonableness centered on the central tendency of the overall zone of reasonableness; for below average risk utilities, that range is the quartile of the zone of reasonableness centered on the central tendency of the lower half of the zone of reasonableness; and for above average risk utilities, that range is the quartile of the zone of reasonableness centered on the central tendency of the upper half of the zone of reasonableness.

518. We find that, for purposes of determining the range of presumptively just and reasonable ROEs applicable to the MISO TOs, they must be treated as of average risk. In their initial brief in response to the Briefing Order, CAPs question whether the MISO TOs should be treated as of average risk.[1003] They assert that the Briefing Order erroneously stated that this is an undisputed fact because MISO TOs' credit ratings and risk profiles do not support a finding that the MISO TOs are of average risk. CAPs state that MISO TOs have study-period credit ratings ranging from S&P BB+ to A+ and contend that such a broad range of risk profiles cannot be described as average risk. They further argue that the risk profile of the MISO TOs as a group was disputed in both of the MISO ROE complaint proceedings. CAPs assert that CAPs introduced evidence of risk mitigation factors such as transmission rate incentives, high equity levels for some MISO TOs, and formula rates and MISO TOs introduced evidence of factors that increase risk, such as high CAPEX levels and evidence of risk purportedly not addressed

[1003] CAPs Initial Br. (I) at 80; CAPs Initial Br. (II) at 80.

by transmission rate incentives. CAPs also assert that the Commission fails to explain why ROEs that exceed the cost-based level by as much as one-eighth of the composite zone of reasonableness are presumptively just and reasonable for all of the MISO TOs' broad risk profiles.[1004]

519. In Opinion No. 551, the Commission disagreed with CAPs' contentions that the MISO TOs' formula rates and the high equity ratios of some MISO TOs reduce their risk profile as compared to the proxy group. Among other things, Opinion No. 551 held that our criteria for selecting members of the proxy group are intended to produce a proxy group made up of companies of similar risk. Those criteria include screens to ensure that the proxy group contains only utilities with similar credit ratings to the utility at issue. To the extent that a higher percentage equity in the capital structure reduces a utility's risk, as CAPs assert, then the utility's credit rating would be correspondingly higher than that of a utility with a typical capital structure.[1005] Opinion No. 551 also found that, to the extent formula rates reduce risk, they would, similar to the use of more equity in the capital structure, improve utility credit ratings. This would, in turn, affect the DCF proxy group because the credit screens require a proxy group of similarly rated utilities, diminishing the ROE produced by the DCF analysis.[1006] CAPs did not seek rehearing of these holdings in Opinion No. 551. Moreover, CAPs' evidence indicates that MISO TOs' average credit ratings are comparable to the averages for the proxy group. As MISO TOs point out, the average credit ratings that CAPs' witness Dr. Berry reports for the MISO TOs are within one notch of the average ratings for the proxy group, which does not indicate that MISO TOs are demonstrably less risky than the proxy group companies.[1007]

520. The Commission recognizes that, because the various MISO TOs have a relatively wide range of credit ratings, the proxy group in this case contains companies with a similarly wide range of credit ratings. However, as discussed in section XI of this order, we have held that the MISO TOs' ROE should be set at the midpoint of the zone of reasonableness, for the very reason that they are a diverse group with a variety of risk profiles, and the court has affirmed that policy. The midpoint fully considers the range of reasonable returns, because it is derived directly from the endpoints of the range.

[1004] CAPs Initial Br. (I) at 80-82; CAPs Initial Br. (II) at 80-82.

[1005] Opinion No. 551, 156 FERC ¶ 61,234 at P 288.

[1006] *Id.* P 297.

[1007] *See* MISO TOs Reply Br. (I), App. 2 McKenzie Reply Aff. (II) at 121; CAPs Initial Br. (I), Ex. OMS-105; CAPs Initial Br. (II), Ex. OMS-205.

521. Given that Commission policy is to set an RTO-wide ROE at the midpoint of the zone of reasonableness and the other record evidence regarding MISO TOs' risk profile, we conclude that MISO TOs must be treated as of average risk and that the range of presumptively reasonable ROEs for consideration in determining whether an existing RTO-wide ROE is unjust and unreasonable should be the quartile of the zone of reasonableness centered on the midpoint of the composite zone of reasonableness. In the First Complaint proceeding, that quartile is from 9.29 percent to 10.47 percent.[1008] ROEs within this range may be treated as presumptively just and reasonable, because they are closer to the 9.88 midpoint of the overall composite zone of reasonableness where we would set the ROE for a diverse group of average risk utilities, than to either: (1) the 8.70 midpoint of the lower half of that zone where we would set the ROE for a diverse group of below risk utilities; or (2) the 11.06 midpoint of the upper half of that zone where we would set the ROE for a diverse group of above risk utilities.[1009]

522. The MISO TOs' existing 12.38 percent is 191 basis above the range of presumptively just and reasonable ROEs for a diverse group of average risk utilities. Accordingly, it is treated as presumptively unjust and unreasonable. In fact, the existing 12.38 percent ROE is higher than the 12.24 percent top of the overall zone of reasonableness.[1010] It is thus clear that, in light of our estimate of the current cost of capital, the MISO TOs' existing ROE is well outside any possible range of potentially just and reasonable ROEs for the MISO TOs. We see no other evidence in the record, such as state ROEs, ROEs of non-utility companies, ROEs produced by other methodologies, non-utility stock prices, investor expectations for non-utility stocks, various types of bond yields and their relation to stock prices, investor and other expert testimony, or testimony regarding the effects of rates on customers that would indicate that this is not the case. For example, the evidence in the record regarding state ROEs indicates that all state-authorized ROEs during the period April 1, 2013 through March 31, 2015 for integrated electric utilities providing generation, transmission, and distribution services ranged from 9.5 percent to 10.4 percent and that 87.34 percent of state-authorized ROEs for both integrated electric utilities and distribution-only electric utilities during that period were within this range.[1011] The fact that MISO TOs' 12.38

[1008] *See* Appendix C.

[1009] *Id.*

[1010] Although the 12.20 percent ATCLLC zone ROE is slightly below the top of the overall zone of reasonableness, it is 173 basis point above the range of presumptively reasonable ROEs established above. Therefore, our finding that MISO's existing 12.38 percent ROE is unjust and unreasonable applies equally to the 12.20 percent ATCLLC zone ROE.

[1011] *See, e.g.*, Opinion No. 551, 156 FERC ¶ 61,234 at P 240.

percent ROE is 198 basis points above this range further demonstrates that MISO TOs' 12.38 percent ROE is unjust and unreasonable. In these circumstances, we find under the first prong of FPA section 206 that the MISO TOs' existing 12.38 percent ROE has become unjust and unreasonable.

523. Having found that the MISO TOs' existing ROE is unjust and unreasonable, we turn to the establishment of a just and reasonable replacement ROE under the second prong of FPA section 206. As discussed above, we have found that the midpoint of the composite zone of reasonable ROEs based on the most recent financial information in the record of the First Complaint proceeding is 9.88 percent. As discussed above, we find that MISO TOs are of average risk. Our policy is to set an RTO-wide ROE at the midpoint of the zone of reasonableness when the transmission owners receiving the RTO-wide ROE are of average risk. Accordingly, we find that the just and reasonable replacement ROE for the MISO TOs in the First Complaint proceeding is 9.88 percent. We therefore grant rehearing of Opinion No. 551 in part to require the MISO TOs to adopt a 9.88 percent ROE effective September 28, 2016, the date Opinion No. 551 required the MISO TOs to adopt a 10.32 percent ROE.

XVII. Complaint Specific Results: Second Complaint

A. Existing ROE for Purposes of Second Complaint

524. In the Briefing Order, the Commission stated that the issue to be addressed in the Second Complaint proceeding is whether the ROE established in the First Complaint remained just and reasonable based on financial data for the six-month period July to December 2015 presented by the participants at the hearing on the Second Complaint.[1012] However, certain parties dispute that the existing ROE to be analyzed for purposes of the Second Complaint is the ROE established in the First Complaint.

1. CAPs

525. CAPs argue that the Briefing Order errs in stating that the issue to be addressed in the Second Complaint proceeding is whether the ROE established in the First Complaint proceeding remained just and reasonable based on financial data for the six-month period from July to December 2015. CAPs contend that the existing ROE to which the July to December 2015 cost of equity should be compared is the 12.38 percent that was in effect from the time when the complaint was filed until September 28, 2016, when Opinion No. 551 was issued and reduced the ROE to 10.32 percent prospectively. They assert

[1012] *See* Briefing Order, 165 FERC ¶ 61,118 at P 61.

that this should be the case regardless of any relief that has been applied or will be applied as a remedy resulting from the First Complaint.[1013]

2. RPGI

526. RPGI argues that the Commission has not justified its interpretation that the "existing rate" for purposes of a section 206 complaint is the one that is determined in a prior proceeding. RGPI asserts that, in the context of successive complaint proceedings, that figure would be unknown when a second complaint is filed. RPGI states that this would present potential complainants with a choice of either awaiting the outcome of any pending 206 complaint to resolve the just and reasonable rate that would serve as the "existing rate" for purposes of framing a complaint, or file a complaint based on a rate that may not prove to be relevant under the Commission's proposed new ROE methodology. RPGI argues that the first choice foregoes any hope of receiving refunds for an unknown and potentially lengthy period of time, while the second choice is a gamble of investing in months or years of litigation that might prove fruitless or overtaken by events. RPGI asserts that the Commission's proposed approach would discourage the filing of complaints and that the Commission has not acknowledged or justified such a policy initiative.[1014]

3. MISO TOs

527. MISO TOs argue that the Briefing Order was correct in explaining that the existing base ROE for purposes of analyzing the Second Complaint is the ROE resulting from resolution of the First Complaint, as determined under the Commission's new ROE methodology. They assert that CAPs' objective in arguing that the 12.38 percent (or 12.20 percent) ROE should be the existing base ROE for purposes of the Second Complaint is to preserve a basis for refunds during the Second Complaint's refund period. MISO TOs contend that it would be illogical to evaluate the merits of a complaint against any rate other than the just and reasonable rate determined by the Commission from the preceding complaint. They argue that such an approach would lead to the meaningless outcome of forcing the Commission to re-examine a rate that it had already determined was unjust and unreasonable.[1015]

528. MISO TOs also assert that CAPs' interpretation of what the existing rate is for purposes of the Second Complaint would also violate section 206(b) of the FPA because

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[1013] CAPs Initial Br. (II) at 85-86.

[1014] RPGI Initial Br. (II) at 8-10.

[1015] MISO TOs Reply Br. (II) at 86-89.

it would, in this case, double the 15-month refund period in the statute. They argue that refunds arising by virtue of the Second Complaint, if any, will be based on the ROE determined in the First Complaint proceeding and the outcome of the First Complaint cannot legally serve as the predicate for refund liability for a period of thirty consecutive months, until the end of the Second Complaint refund period.[1016]

4. Commission Determination

529. FPA section 206(a) provides that "[w]henever the Commission, after a hearing held upon its own motion or upon complaint, shall find that any rate . . . charged, or collected by any public utility for any transmission . . . subject to the jurisdiction of the Commission . . . is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate . . . to be thereafter observed and in force, and shall the fix the same by order." For purposes of deciding whether a rate charged by a public utility is unjust and unreasonable and determining a new just and reasonable rate "to be thereafter observed" pursuant to FPA section 206(a), we must assess whether the public utility's currently effective rate is unjust and unreasonable, not some earlier rate that may have been in effect when the complaint was filed but has now been superseded. Any new just and reasonable rate that we require "to be thereafter observed" pursuant to section 206(a) will replace the currently effective rate, not some previously effective rate. In other words, in order to determine a new rate to be thereafter observed, we must examine what the currently effective rate is because that is the rate that will need to be replaced if it is unjust and unreasonable. It therefore follows that it is the currently effective rate that must be found unjust and unreasonable.

530. The 12.38 percent ROE in effect when Arkansas Electric Cooperative et al. filed the Second Complaint on February 12, 2015 has been superseded. As discussed in the preceding section, in the First Complaint proceeding, we are requiring MISO TOs to reduce their ROE to 9.88 percent effective prospectively from September 28, 2016. Therefore, that is the MISO TOs' currently effective ROE as of today when we are deciding whether MISO TOs' ROE is unjust and unreasonable and should be modified prospectively pursuant to FPA section 206 in the Second Complaint proceeding. Accordingly, 9.88 percent is the ROE which we would have to find unjust and unreasonable under the first prong of FPA section 206, before we could require a new ROE "to be thereafter observed" pursuant to the second prong of FPA section 206. Moreover, as MISO TOs note, it would be illogical for the Commission to re-examine an ROE that it has already determined is unjust and unreasonable and that has been superseded by a new ROE.

531. We also agree with MISO TOs that interpreting the existing rate to be examined in the Second Complaint to be the now-superseded 12.38 percent ROE would effectively

[1016] *Id.* at 90-91.

extends the refund period in the First Complaint proceeding beyond the 15-month limitation in section 206. The Commission's decision in the First Complaint proceeding—i.e., that the 12.38 percent ROE is unjust and unreasonable—would effectively serve as the predicate for allowing refunds in the Second Complaint proceeding if that ROE continues to be unjust and unreasonable based on the data for the Second Complaint's study period, which would allow refunds to extend beyond the 15-month refund period limitation. In other words, if the Commission used the 12.38 percent ROE as the existing rate for purposes of the Second Complaint, then the Commission would be permitted to merely repeat its decision in the First Complaint that the 12.38 percent ROE is unjust and unreasonable and this same decision could serve as the predicate for ordering refunds again, which would effectively extend the statutory 15-month limitation.

532. Under the framework that we have adopted above for analyzing whether a currently effective ROE can be found unjust and unreasonable, we must first develop a composite zone of reasonableness based on the most recent financial data in the Second Complaint proceeding record (i.e., financial data for the period July to December 2015), and then determine whether the currently effective 9.88 percent ROE falls within, or outside, the appropriate range of presumptively just and reasonable ROEs. For the reasons discussed below, in this section we find that the 9.88 percent ROE does fall within the range of presumptively just and reasonable ROEs from the Second Complaint proceeding and we find that this presumption has not been rebutted by the evidence in the Second Complaint proceeding. Accordingly, we cannot find that ROE unjust and unreasonable or require a prospective modification of that ROE. Below in section XVIII, we address the issue of whether, having made that finding, we can nevertheless require refunds for the 15-month refund period when the MISO TOs' pre-existing 12.38 percent ROE was in effect.

B. Composition of Starting Proxy Group

533. As described above in paragraph 461 and in the Briefing Order,[1017] the Commission uses five screens for developing a proxy group. The first four screens listed above evaluate particular characteristics of the companies in question that do not vary depending upon the results of the DCF or CAPM analyses. Accordingly, those screens may be used to develop a starting group of proxy companies eligible for inclusion in the proxy group to be used for the purposes of the DCF and CAPM models. The low-end and high-end outlier tests must then be applied separately to the results of the DCF and CAPM models to determine the final DCF and CAPM proxy groups. First, we address the determination of the composition of the starting proxy group in the Second Complaint proceeding. We then apply the low-end and high-end outlier tests to the results of the

[1017] Briefing Order, 165 FERC ¶ 61,118 at PP 50-51.

DCF and CAPM analyses in order to determine the DCF and CAPM zones of reasonableness.

534. For purposes of determining the starting proxy group, the Presiding Judge determined that the DCF Study Period for calculating the zone of reasonableness should be the most recent six-month period for which there is financial data in the record, July to December 2015.[1018]

535. At the hearing in the Second Complaint proceeding, the participants considered 45 companies included in *Value Line*'s list of electric utilities for inclusion in the proxy group. The Presiding Judge found that all the participants agreed that 11 of these companies should be excluded, primarily because they failed the merger and acquisition screen.[1019] In addition, the Presiding Judge agreed with CAPs that Duke Energy Corporation and NextEra Energy Inc., should also be excluded from the proxy group because of merger and acquisition activity.[1020] This left a proxy group of 32 companies before application of any low-end or high-end outlier tests,[1021] No participant filed an exception to these findings by the Presiding Judge, and accordingly we affirm the Presiding Judge's findings as to the composition of the starting proxy group before application of the high-end and low-end outlier tests.

C. DCF Proxy Group and Analysis

1. Dividend Yield Data

a. Initial Decision (II)

536. The Presiding Judge stated that all participants in the Second Complaint proceeding calculated dividends for purposes of the DCF using the average yield approach. However, the Presiding Judge noted that the dividend yields that the participants calculated vary from one another. He explained that, while some witnesses

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[1018] Initial Decision (II), 155 FERC ¶ 63,030 at P 24.

[1019] *Id.* P 50. These companies were Black Hills Corporation; Cleco Corporation; Empire District Electric Company; Exelon Corporation; Hawaiian Electric Industrial, Inc.; ITC Holdings Corporation; MGE Energy, Inc.; Pepco Holdings, Inc.; Southern Company; TECO Energy, Inc.; and UIL Holdings.

[1020] *Id.* P 51.

[1021] The 32 companies (together with the ROEs for each company adopted by the Presiding Judge) are listed in Appendix I of the CAPs' initial post-hearing brief.

provided workpapers, their underlying data differs in ways that are difficult to check (e.g., monthly stock prices).[1022]

537. The Presiding Judge stated that these variances only mattered with respect to OGE Energy and PNM Resources, the total returns of which constitute, respectively, the low and high ends of the range of reasonableness. He stated that the CAPs and the MISO TOs calculate a 3.81 percent dividend yield for OGE Energy, while Trial Staff witness Mr. Keyton calculates a dividend yield 3.87 percent for the company. He further explained that the CAPs and the MISO TOs calculate a 2.92 percent yield for PNM, while Mr. Keyton calculates a 2.97 percent yield for the company.[1023]

538. The Presiding Judge stated that the Initial Decision "uses a consensus approach" that adopted the dividend yields calculated by CAPs and MISO TOs, as opposed to those calculated by Trial Staff's witness.[1024]

b. MISO TOs' Exceptions

539. In their Brief on Exceptions to Initial Decision (II), MISO TOs take exception to the Presiding Judge's decision to use the dividend yields for OGE Energy and PNM Resources calculated by CAPs and MISO TOs, as opposed to the higher dividend yields calculated by Trial Staff's witness.[1025] MISO TOs argue that Trial Staff's higher dividend yields for those two companies are based on its witness's reliance on the proxy companies' respective declared dividends in each month of the study period, and that this approach is consistent with Commission precedent that "'approv[es] the use of the most recent dividend declared by the relevant company to determine the 'indicated annual dividend' for each of the six months'" of the DCF study period.[1026] MISO TOs further assert that this approach is appropriate because "'[a] reasonable investor would factor a change in dividend . . . into its risk assessment of a company as of the date the dividend is

[1022] Initial Decision (II), 155 FERC ¶ 63,030 at P 55.

[1023] *Id.* P 56.

[1024] *Id.* P 57.

[1025] MISO TOs Br. on Exceptions at 44-45.

[1026] *Id.* at 45-46 (quoting Opinion No. 531, 147 FERC ¶ 61,234 at P 77 n.135).

declared, not the date it is paid.'"[1027] MISO TOs argue that the Presiding Judge offers no rationale for disregarding the declared dividends that Trial Staff's witness used.

c. Briefs Opposing Exceptions

540. CAPs argue that the Commission should deny MISO TOs' exceptions to the Presiding Judge's decision regarding the appropriate dividend yields to utilize for OGE and PNM. CAPs contend that the MISO TOs' own witness used the same dividends and dividend timing as the Presiding Judge in Initial Decision (II). CAPs assert that nowhere in the record have MISO TOs previously advocated for the use of the dividend increase timing used by Trial Staff's witness. CAPs further argue that MISO TOs have not demonstrated that the approach used by Trial Staff's witness is more appropriate than the approach that was used by both CAPs' witnesses and MISO TOs' witnesses.[1028]

541. CAPs contend that MISO TOs have provided no evidence or argument that the approach taken by Trial Staff's witness is uniquely accurate in reflecting the dividend increase timing that was known to the investors who set each study month's high and low stock prices. CAPs assert that the mere existence of slight variances in the witnesses' approaches does not prove that the Trial Staff witness' approach was more accurate. CAPs argue that MISO TOs had opportunities during the proceeding to present a basis supporting the approach taken by Trial Staff's witness, but they instead elected to present the dividend increase timing used by their own witness and did not disclose their disagreement with their own witness, or their preference for the approach used by Trial Staff's witness until well after the record closed.[1029]

542. CAPs contend that, as the record stands, it is at least equally possible that CAPs and MISO TOs witnesses, rather than Trial Staff's witness, took the more accurate and reasonable approach to the fine points of determining just when a dividend increase should be recognized in calculating a dividend yield. CAPs argue that, faced with a limited record, the Presiding Judge made a reasonable and supportable decision to utilize the dividend increase timing, and resulting dividend yields, presented by most of the witnesses, including the MISO TOs witness. CAPs conclude that the fact that MISO TOs

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[1027] *Id.* at 46 (quoting *Portland Natural Gas Transmission Sys.*, Opinion No. 524, 142 FERC ¶ 61,197, at P 321 (2013), *reh'g denied*, Opinion No. 524-A, 150 FERC ¶ 61,107 (2015)).

[1028] CAPs Br. Opposing Exceptions at 45-46.

[1029] *Id.* at 47.

now prefer Trial Staff witness' slightly higher dividend yields is no reason to overturn the Presiding Judge's determination.[1030]

543. OMS and JCA also opposed MISO TOs' exception on this issue. They argue that MISO TOs should not be allowed to file exceptions after the close of the record that are contrary to positions that their own witnesses took during litigation because it would deprive other participants of fair notice of their positions and an opportunity to adequately defend against them. OMS and JCA further note that Trial Staff itself did not file exceptions on this point, thereby tacitly accepting the approach adopted by the Presiding Judge in Initial Decision (II).[1031]

544. RPGI similarly opposes MISO TOs' exception on this point. RPGI argues that its witness, Mr. Parcell, calculated the exact same results for PNM Resources as MISO TOs' Witness McKenzie and two other witnesses, and the exact same results for OGE Energy as every other single witness except Trial Staff witness Mr. Keyton. RPGI asserts that MISO TOs failed to raise this matter in answering testimony, in cross examination or any time before filing exceptions despite having ample opportunity to do so.[1032]

545. RPGI also contends that MISO TOs' attempt to introduce their new "Appendix 2"—which provides revised IBES-based DCF returns for OGE Energy and PNM Resources, using the dividend yield calculations of Trial Staff's witness—into the record now without evidentiary foundation is unfair to the Commission and the parties. RPGI asserts that their witness cannot, at this point, offer any explanation or elaboration upon his decision to apply the dividend increase in the months that he did, nor can RPGI question MISO TOs' witness Mr. McKenzie about why he chose the same methodology as RPGI's witness.[1033]

d. Commission Determination

546. We agree with MISO TOs that Commission precedent requires changes in dividends to be reflected as of the date changes in dividends are declared, not as of the date that they are paid.[1034] We have explained that "the most recent declared dividend as

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[1030] *Id.* at 48.

[1031] OMS-JCA Br. Opposing Exceptions at 26-27.

[1032] RPGI Br. Opposing Exceptions at 33.

[1033] *Id.* at 33-34.

[1034] MISO TOs Br. on Exceptions at 45-46. *See also* Opinion No. 524, 142 FERC ¶ 61,197 at P 321 ("Trial Staff correctly used the declared date of January 21, 2011 for

of the end of each month during the six-month period" should be used when calculating the estimated dividend yield for purposes of the DCF analysis.[1035] Similarly, "the Commission [has] approved the use of the most recent dividend declared by the relevant company to determine the 'indicated annual dividend' for each of the six months."[1036] However, there is insufficient evidence for us to conclude that the OGE Energy and PNM Resources dividend yield calculations of Trial Staff's witness rely upon the dates that dividends were declared, while the calculations adopted by the Presiding Judge do not and instead rely upon the date on which dividends were paid, such that the latter calculations are inconsistent with Commission precedent. We agree with the Presiding Judge's determination that the differences between the dividend yield calculations of Trial Staff's witness and those of CAPs and MISO TOs' witnesses result from "underlying data [that] differs in ways that are difficult to check."[1037] Under these circumstances, we find that there is insufficient evidence to reverse the Presiding Judge's decision to adopt the dividend yield calculations that were used by a greater number of expert witnesses in this proceeding.

547. It does appear, as MISO TOs suggest, that Trial Staff's dividend yield calculations may have accurately factored in dividend changes as of the dates the dividends were declared, consistent with Commission precedent. For example, it appears that Trial Staff's witness increased the dividend in its calculations for PNM Resources to $0.88 per share for the month of December 2015,[1038] but CAPs' witness used a dividend of $0.80 per share for the month of December 2015, which was the rate that prevailed in the preceding months of the study period.[1039] Assuming the parties were relying on PNM Resource's December 10, 2015 declaration of a dividend increase to an indicated annual rate of $0.88 per share of common stock,[1040] then Trial Staff's calculations appear to

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the dividend. A reasonable investor would factor a change in dividend (here, an increase) into its risk assessment of a company as of the date the dividend is declared, not the date it is paid.").

[1035] Opinion No. 554, 158 FERC ¶ 61,050 at P 249.

[1036] Opinion No. 531, 147 FERC ¶ 61,234 at P 77 n.135.

[1037] Initial Decision (II), 155 FERC ¶ 63,030 at P 56.

[1038] Trial Staff Ex. S-6 at 240

[1039] Joint Customer Complainants Ex. JCI-8 at 5.

[1040] PNM Resources, PNM Resources Board Increases Dividend Payment, Declares Quarterly Common Stock Dividend, (Dec. 10, 2015),

include the appropriate dividend value for December 2015. However, it is unclear if the dividend values in Trial Staff's calculations were necessarily changed in response to this announcement or if the dividend values in the calculations of CAPs' witness remained unchanged because the dividend was not paid until after December 2015, or for some other reason. There is no clear and explicit explanation in the record of the reason for the changes in the inputs to the participants' dividend yield calculations. Accordingly, there is not a sufficient basis to conclude that the dividend yield calculations adopted by the Presiding Judge in Initial Decision (II) were inconsistent with Commission precedent and we affirm his decision on this issue.

548. Moreover, as OMS and JCA note, Trial Staff did not file exceptions to the Presiding Judge's decision on this issue.[1041] This creates further uncertainty as to the source of the differences between Trial Staff's dividend yield calculations and the calculations adopted by the Presiding Judge. In particular, it means that the record does not contain an explanation from Trial Staff addressing whether or not they agree with MISO TOs' contention that Trial Staff's calculations are consistent with Commission precedent, while those adopted by the Presiding Judge are not. The issue is further obscured by the fact that the Presiding Judge relied on the dividend yield calculations submitted by MISO TOs but now MISO TOs favor Trial Staff's calculations instead of their own. MISO TOs contrast Trial Staff's workpapers and those of CAPs' witness to suggest that Trial Staff's calculations should be used, but they do not address whether the calculations that they submitted themselves are inappropriate and if so, why. MISO TOs' dividend yield calculations were one of the two sets of calculations that the Presiding Judge stated constituted the "consensus approach" that he adopted. MISO TOs' failure to address why their own calculations are no longer appropriate further weakens the case for reversing the Presiding Judge's decision on this issue.

549. In light of the lack of clarity in the record as to why the dividend calculations from Trial Staff and those adopted by the Presiding Judge are different, we find that there is not a sufficient basis on which to reverse the Presiding Judge's decision to adopt the calculations that were used by a greater number of expert witnesses in this proceeding. Accordingly, we affirm the Presiding Judge's decision regarding the dividend yields for OGE Energy and PNM Resources to be used in the DCF analysis and deny MISO TOs' exceptions on this issue.

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https://www.prnewswire.com/news-releases/pnm-resources-board-increases-dividend-payment-declares-quarterly-common-stock-dividend-300191646.html.

[1041] *See* OMS-JCA Br. Opposing Exceptions at 27.

2. Outlier Tests and Final DCF Analysis

550. We affirm the Presiding Judge's DCF analysis in Initial Decision (II) in the Second Complaint proceeding, with one exception. As discussed above in section V.C, we have held that only the IBES short-term growth projection should be used for calculating the (1+.5g) adjustment to the dividend yield, instead of the composite growth rate used by the Presiding Judge. Accordingly, as shown in Appendix B to this order, we have revised the Presiding Judge's DCF analysis of the starting proxy group to reflect the revised calculation of the dividend yield.

551. We now turn to the issue of whether, for purposes of determining the DCF zone of reasonableness, any company in the starting proxy group should be excluded as a low- or high-end outlier. The Presiding Judge excluded Edison International, Entergy, FirstEnergy, and Public Service Enterprise Group.[1042]

552. As described above, in their brief responding to the Briefing Order, MISO TOs propose a revised low-end outlier test. In the Second Complaint proceeding, MISO TOs' proposed revised test would exclude all companies whose ROEs are less than 191 basis points above the average yield for Baa utility bonds from the proxy group. This revised test would exclude companies with ROEs below 7.32 percent.[1043] Based on this revised test, MISO TOs propose to exclude from the DCF proxy group three companies in addition to the three that the Presiding Judge excluded. The additional three companies are OGE Energy Corp., CenterPoint Energy, and IDACORP, Inc.[1044]

553. We reject MISO TOs' proposal to exclude CenterPoint Energy and IDACORP, Inc. from the DCF proxy group. In section X of this order, we rejected MISO TOs' proposed revised low-end outlier test. Instead, we adopted a revised low-end outlier test under which we exclude from the proxy group companies with ROEs that do not exceed the Baa bond yield by at least 20 percent of the risk premium from the CAPM analysis. In the Second Complaint proceeding, the risk premium from the CAPM analysis is 8.85 percent. Twenty percent of that risk premium is 177 basis points. Adding 177 basis

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[1042] Initial Decision (II), 155 FERC ¶ 63,030 at P 171 and P 174 n.75; *id.* P 54 ("This Initial Decision adopts the proxy group and the DCF results developed by the CAPs in Appendix I."); CAPs Reply Br. (II) at n.300 (citing CAPs, March 30, 2016 Initial Brief of the CAPs at 45 ("Applying the Commission's low-end outlier screen, CAPs witnesses eliminated four companies from their respective proxy groups: Edison International, FirstEnergy Corp., Public Service Enterprise Group, and Entergy Corp.").

[1043] MISO TOs Initial Br. (II), App. 2 at 27.

[1044] *Id.* at 27-28 and Attachment 3.

points to the 5.41 percent Baa bond yield produces a low-end outlier threshold in the Second Complaint proceeding of 7.18 percent. That low-end outlier threshold is higher than the 6.41 percent low-end outlier threshold that the Presiding Judge applied, and excludes one additional company from the proxy group—OGE Energy Corp.—whose DCF ROE is 6.75 percent.

554. The Presiding Judge did not exclude any company from the DCF proxy group on the ground that it is a high-end outlier, nor does any participant seek to exclude any company on that ground. Under the high-end outlier test we have adopted in this order, we would exclude any DCF ROE that is more than 150 percent of the median of the starting proxy group DCF ROEs. In this case, the median of the starting proxy group DCF ROEs is 8.70 percent.[1045] One-hundred-fifty percent of that median is 13.01 percent. PNM Resources' DCF ROE of 10.71 percent is well below that amount. Accordingly, we do not exclude any company from the DCF proxy group as a high end-outlier. Based on this discussion, we conclude that the DCF zone of reasonableness is 7.20 percent to 10.71 percent.[1046]

D. CAPM Proxy Group and Analysis

555. We affirm the Presiding Judge's CAPM analysis in Initial Decision (II) in the Second Complaint proceeding, with one exception related to the market risk premium. In section VII.C above, we have held that only the IBES short-term growth projection should be used in the one-step DCF analysis of the dividend paying members of the S&P 500, which is consistent with the Presiding Judge's approach in Initial Decision (II).[1047] However, we have also held that companies with negative ROEs or ROEs above 20 percent should be excluded from that analysis. Accordingly, we have revised the CAPM analysis of the starting proxy group approved by the Presiding Judge to reflect this revision.[1048]

[1045] *See* Appendix C.

[1046] *Id.*

[1047] *See* Initial Decision (II), 155 FERC ¶ 63,030 at P 412.

[1048] The results of the CAPM analysis incorporating this revision and the other revisions and clarifications discussed above (i.e., use of the one-step DCF, size adjustment, and only IBES growth rates) are reflected in page 6 of Attachment A to Trial Staff's Initial Briefs. *See* Trial Staff Initial Br. (I), Attachment A to App. 2 at 6; Trial Staff Initial Br. (II), Attachment A to App. 2 at 6.

556. We now turn to the issue of whether, for purposes of determining the CAPM zone of reasonableness, any company in the starting proxy group should be excluded from the CAPM proxy group as a low- or high-end outlier. The Presiding Judge did not exclude any company from the proxy group on these grounds, not does any participant contend that any company is a low or high-end outlier. As discussed in the preceding section, we have determined that the low-end outlier threshold in the Second Complaint proceeding is 7.18 percent. The company in the starting proxy group with the lowest ROE is Pacific Gas and Electric Company, with an ROE of 8.35 percent.[1049] Because that ROE is well above the 7.18 percent low-end outlier threshold, we do not exclude any company from the CAPM proxy group as a low-end outlier.

557. Under the high-end outlier test that we have adopted in this order, we would exclude from the CAPM proxy group any ROE that is more than 150 percent of the median of the starting proxy group CAPM ROEs. In this case, the median of the starting proxy group CAPM ROEs is 10.51 percent.[1050] One-hundred-fifty percent of that median is 15.77 percent. The company with the highest CAPM ROE in the starting proxy group has an ROE of 12.63 percent,[1051] well below the 15.77 percent high-end outlier threshold. Accordingly, we are not excluding any company from the CAPM proxy group as a high end-outlier. Based on this discussion, we conclude that the CAPM zone of reasonableness is 8.35 percent to 12.63 percent.[1052]

E. Composite Zone of Reasonableness and FPA section 206 Findings

558. Based on the findings above concerning the DCF and CAPM zones of reasonableness in the Second Complaint proceeding, we find that the composite zone of reasonableness based on the most recent financial data in the record of the Second Complaint proceeding is from 7.78 percent to 11.66 percent. The midpoint and the lower and upper midpoints of that zone of reasonableness are 9.72 percent, 8.72 percent, and 10.7 percent respectively. This results in a range of presumptively just and reasonable ROEs for the MISO TOs in the Second Complaint proceeding of 9.23 percent to 10.20 percent. As discussed above, the issue to be addressed in the Second Complaint is whether the ROE established in the First Complaint remained just and reasonable during the applicable test period as addressed by the evidence presented by the participants in

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[1049] *See* Appendix C; Trial Staff Initial Br. (II), Attachment A to App. 2 at 6.

[1050] *See* Appendix C; Trial Staff Initial Br. (II), Attachment A to App. 2 at 6.

[1051] *See* Appendix C; Trial Staff Initial Br. (II), Attachment A to App. 2 at 6.

[1052] *See* Appendix C; Trial Staff Initial Br. (II), Attachment A to App. 2 at 6.

the Second Complaint.[1053] The MISO TOs' 9.88 ROE established upon resolution of the First Complaint proceeding falls within the range of presumptively just and reasonable ROEs that applies in the Second Complaint. We find that this presumption has not been rebutted by the evidence in the Second Complaint proceeding. We see no evidence in the record, such as state ROEs, ROEs of non-utility companies, and other methodologies demonstrating serving to rebut this presumption. Accordingly, we cannot find that the MISO TOs' ROE established in the First Complaint proceeding and in effect as of the date of this order is unjust and unreasonable under the first prong of FPA section 206. For that reason, we cannot establish a new just and reasonable ROE in the Second Complaint proceeding to be in effect prospectively from the date of this order.

XVIII. Refunds in Second Complaint Proceeding

559. Our holding in the preceding section that we cannot establish a new just and reasonable ROE in the Second Complaint proceeding to be in effect prospectively raises the question of whether we can nevertheless order refunds for the Second Complaint's 15-month refund period. That period includes the 15 months from February 12, 2015 to May 11, 2016, and thus precedes the September 28, 2016 date when the 9.88 percent ROE established in the First Complaint proceeding took effect. Thus, during the entire 15-month refund period, the pre-existing 12.38 percent ROE was in effect.

A. CAPs

560. CAPs assert that section 206 provides for "refunds of any amounts paid . . . in excess of those which would have been paid under the just and reasonable rate" and through the 15-month refund period for the Second Complaint, the "amounts paid" by transmission customers were based on the 12.38 percent base ROE. They argue that, therefore, even assuming the First Complaint results in an ROE reduction and that reduced ROE is found to be just and reasonable based on the record in the Second Complaint proceeding, MISO transmission customers would continue to be entitled to refunds of the difference between the 12.38 percent rate they actually paid for the refund period and the reduced ROE found to be just and reasonable in the First Complaint and Second Complaint proceedings.[1054]

561. CAPs argue that the base ROE established as a result of the outcome of the First Complaint should be applied only to the prospective relief aspect of the Second Complaint. In other words, they contend that the base ROE determined in the First Complaint could result in denying prospective relief in the Second Complaint, but that

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[1053] Briefing Order, 165 FERC ¶ 61,118 at P 61.

[1054] CAPS Reply Br. (II) at 10-11.

this should not necessarily result in a determination that the Second Complaint should yield no refunds during its applicable refund period. CAPs assert that, instead, refunds should apply to that period for the difference between the just and reasonable ROE determined in the Second Complaint proceeding (including if that remains the just and reasonable ROE determined in the First Complaint proceeding) and the 12.38 percent that was the existing base ROE for purposes of the Second Complaint.[1055]

562. CAPs contend that MISO TOs should not be allowed to keep revenues from the Second Complaint period, with no refund obligation, when those revenues reflect rates that incorporated a 12.38 percent ROE that was found to be unjust and unreasonable.[1056] They argue that this would be inconsistent with the principle that the FPA "meant to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges."[1057]

563. CAPs also assert that the Commission erroneously contemplates using its "broad remedial authority" to correct "legal error" only with respect to the First Complaint outcome that will apply from September 28, 2016 going forward and not with respect to the Second Complaint. They argue that, to the extent that resolution of the Second Complaint results in a reduced ROE, the finally-determined ROE should be given effect from the date that the Commission would have been able to resolve the Second Complaint had Opinions Nos. 531 and 551 been properly decided. CAPs submit that the fair estimate of that date is the one estimated for that event in the Second Complaint Hearing Order, which was May 31, 2017. CAPs contend that the "legal error" doctrine should apply to the Second Complaint because its resolution was delayed by the legal errors in the vacated Opinion No. 531 and the time that the Commission has subsequently taken to process the remand and related proceedings.[1058]

B. MISO TOs

564. MISO TOs argue that, because the existing ROE resulting from resolution of the First Complaint remains just and reasonable for the study period applicable to the Second Complaint, the Second Complaint must be dismissed and therefore it cannot provide the

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[1055] *Id.* at 86-87.

[1056] *Id.* at 12-13.

[1057] *Id.* at 13 (citing *Atl. Refining Co. v. Pub. Serv. Comm'n*, 360 U.S. 378, 388 (1959)).

[1058] CAPs Initial Br. (II) at 87-89.

basis for refunds under section 206.[1059] MISO TOs contend that, because the Second Complaint must be dismissed, no action by the Commission in response to the Second Complaint can establish a rate to be "thereafter observed," which is a prerequisite to the Commission's ability to order refunds under FPA section 206. MISO TOs further argue that the Second Complaint cannot give rise to refunds because that would exceed the refund period limitation prescribed by section 206(b). They assert that, because refunds arising by virtue of the Second Complaint, if any, will be based on the ROE determined in the First Complaint proceeding, that outcome of that proceeding cannot legally serve as the predicate for refund liability for a period of thirty consecutive months from November 12, 2013 (the First Complaint refund effective date), through May 11, 2016 (the end of the Second Complaint refund period).[1060]

565. MISO TOs contend that CAPs' proposed May 31, 2017 date for relief resulting from the Second Complaint on the theory of "legal error" is moot because the Second Complaint will be dismissed based on the ROE established in the First Complaint. They argue that the ROE established in the First Complaint will be effective as of September 28, 2016, with refunds due for the 15-month refund period established in the First Complaint, and the Second Complaint will be dismissed, therefore the "legal error" theory provides no basis for relief in the Second Complaint proceeding. MISO TOs argue that, even if the Second Complaint would not be dismissed, the legal error theory does not apply to the Second Complaint because the Commission has not made any findings with respect to the Second Complaint and therefore there has been no Commission action in the Second Complaint proceeding that can be said to constitute legal error.[1061]

C. Commission Determination

566. As discussed above, the question on this issue is whether the Commission can order refunds of the 12.38 percent ROE that was in effect during the 15-month refund period in the Second Complaint proceeding despite the fact that the Commission is not granting any prospective relief with respect to the 9.88 percent ROE that is in effect as of the date we are acting on the Second Complaint.

567. Resolution of this issue requires the Commission to determine the extent of the refund authority granted the Commission by the following language of FPA section 206(b):

[1059] MISO TOs Reply Br. (II) at 87-88.

[1060] *Id.* at 89-90.

[1061] *Id.* at 91-93.

> At the conclusion of any proceeding under this section, the Commission may order refunds of any amounts paid, for the period subsequent to the refund date through a date fifteen months after such refund effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force: *Provided*, That if the proceeding is not concluded within fifteen months after the refund effective date and if the Commission determines at the conclusion of the proceeding that the proceeding was not resolved within the fifteen-month period primarily because of dilatory behavior by the public utility, the Commission may order refunds of any or all amounts paid for the period subsequent to the refund effective date and prior to the conclusion of the proceeding.[1062]

568. As discussed below, we find that the Commission cannot order refunds in the Second Complaint proceeding because of the limits of our statutory authority under FPA section 206. The language of section 206(b) states that "[a]t the conclusion of any proceeding under this section" the Commission may order refunds for amounts paid during the 15-month refund period in excess of "what would have been paid under" the just and reasonable rate that "the Commission orders to be thereafter observed and in force." We interpret this language to mean that refunds may be ordered in a complaint proceeding only when the Commission grants prospective relief in that proceeding—i.e., the Commission sets a new just and reasonable rate which it "orders to be thereafter observed and in force." Here, as discussed above, we cannot find the 9.88 percent ROE in effect as of the date we are acting on the Second Complaint to be unjust and unreasonable and therefore we are not ordering any new just and reasonable rate "to be thereafter observed and in force." Having not ordered a new just and reasonable rate to be thereafter observed, there are no "amounts paid . . . in excess of" that rate that the Commission can order to be refunded.

569. In addition, we find that ordering refunds in the Second Complaint proceeding despite the fact that we are granting no prospective relief would exceed the statutory authority granted to us in FPA section 206 because it would effectively extend the 15-month refund period for the First Complaint. Section 206 explicitly limits the length of time that public utilities may be subject to potential refunds as a result of a Commission determination in a proceeding to 15 months after the refund effective date in that

[1062] 16 U.S.C. § 824e(b) (2018).

proceeding. Moreover, Congress indicated that the 15-month refund period was intended to limit the refund exposure of public utilities.[1063] Here, in the First Complaint proceeding, we have found the MISO TOs' pre-existing 12.38 percent ROE unjust and unreasonable and ordered that ROE reduced to 9.88 percent effective September 28, 2016 and ordered refunds for the November 12, 2013 to February 11, 2015 15-month refund period in the First Complaint proceeding. In the Second Complaint proceeding, we are not granting any prospective relief and allowing the 9.88 percent ROE determined in the First Complaint proceeding to continue. Accordingly, we find that ordering refunds in the Second Complaint proceeding on the basis of our ROE determination in the First Complaint proceeding, would exceed our statutory authority under FPA section 206 because it would effectively extend the refund period in the First Complaint proceeding beyond the statutory 15-month limit.

570. Moreover, section 206(b) indicates that Congress contemplated the possibility that the Commission could order refunds for periods outside of a proceeding's 15-month refund period, but only provided for that possibility in one instance that is not applicable here. Specifically, section 206(b) provides that, if a proceeding is not concluded within 15 months after the refund effective date, the Commission may order refunds for periods beyond the 15-month period if "the proceeding was not resolved within the fifteen-month period primarily because of dilatory behavior by the public utility." The statute provides only this one exception to the 15-month refund period limitation and that exception does not apply to the Second Complaint. Accordingly, because any refunds that would be ordered in the Second Complaint proceeding would be refunds that were triggered by the Commission's determination in the First Complaint proceeding, the 15-month refund period in that First Complaint proceeding would apply, and there is no exception in the statute that would allow the Commission to order refunds beyond the 15-month refund period in that proceeding, there having been no dilatory behavior by the MISO TOs in either proceeding. The existence of this single explicit exception to the 15-month refund period limitation also indicates that Congress contemplated the possibility that a complainant may not necessarily receive refunds to make it completely whole if the 15-month refund period has expired, for example if conclusion of a complaint proceeding takes longer than 15 months but the delay is not primarily because of dilatory behavior by the public utility. Accordingly, while it may appear unusual at first glance to evaluate a complaint on the basis of whether an existing base ROE remains just and reasonable, but then deny the refunds that would be owed if that ROE actually was in effect, the statute explicitly contemplates that even successful complainants may not be made completely whole by refunds.

[1063] S. Rep. No. 100-491, at 6 (1988) (describing the fifteen-month refund period as a limit on "the time period during which refund liability can accrue.").

571. In addition, the legislative history indicates that Congress was aware that section 206 proceedings typically required two years to resolve but nonetheless adopted only a 15-month refund period.[1064] This further indicates that Congress was aware that even successful complainants may not be made completely whole by the refunds provided for in section 206. This is also consistent with other language in the legislative history which provides that the 15-month period is intended limit a respondent's refund liability, without reference to the success or merits of a complaint. Specifically, the Senate Report on the Regulatory Fairness Act states that

> While giving FERC the discretionary authority to grant refunds, the Committee amendment in several respects limits the time period during which refund liability can accrue. In general, refunds may only be ordered for amounts paid in excess of lawful rates during the period within 15 months of the refund effective date.[1065]

572. This approach is consistent with Commission precedent. In *San Diego Gas & Electric*,[1066] the Commission stated that "Under FPA section 206, as amended by the Regulatory Fairness Act, upon instituting a proceeding under section 206, the Commission establishes a refund effective date and *may order refunds*, commencing with the refund effective date and for up to 15 months thereafter, *if it finds an existing rate to be unjust, unreasonable or unduly discriminatory or preferential*."[1067] As described in that case, the Commission can only order refunds if it finds an existing rate to be unjust, unreasonable or unduly discriminatory or preferential. We are not finding an existing rate to be unjust, unreasonable or unduly discriminatory or preferential in the Second Complaint proceeding and we cannot order refunds in that proceeding.

573. As a result, we will dismiss the Second Complaint and not order MISO TOs to make any refunds for the applicable 15-month refund period in that proceeding. In light of this determination, we find that CAPs' request that any relief that is granted in the Second Complaint be granted effective as of May 31, 2017 because of the legal error doctrine is moot. The ROE established in the First Complaint will be effective as of September 28, 2016, with refunds due for the 15-month refund period established in the

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[1064] *See id.* ("Resolution of section 206 proceedings requires two years on average.").

[1065] *Id.*

[1066] *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 127 FERC ¶ 61,191 (2009).

[1067] *Id.* P 17 (emphasis added).

First Complaint, and the Second Complaint will be dismissed; therefore, no relief will be granted in the Second Complaint proceeding. In other words, dismissal of the Second Complaint means that there will be no refund obligation associated with the Second Complaint, thus the Commission need not determine the time period applicable to that refund obligation, and the legal error doctrine is inapplicable.

XIX. Conclusion

574. For the reasons discussed above, we adopt the revised methodology described above for determining whether an existing base ROE is unjust and unreasonable under the first prong of FPA section 206, and for determining a new just and reasonable replacement base ROE under the second prong of FPA section 206 when an existing ROE has been shown to be unjust and unreasonable. Applying this revised methodology to the First Complaint proceeding results in a finding that MISO TOs' 12.38 percent ROE, which is pending before us on rehearing of Opinion No. 551, is unjust and unreasonable, thus resulting in us granting the First Complaint, and finding that 9.88 percent is a just and reasonable replacement ROE for MISO TOs. Accordingly, we grant in part and deny in part rehearing of Opinion No. 551 and require the MISO TOs to adopt a 9.88 percent ROE effective September 28, 2016, the date Opinion No. 551 required the MISO TOs to adopt a 10.32 percent ROE. As a result, we require MISO TOs to provide refunds, with interest for the First Complaint proceeding's 15-month refund period from November 12, 2013 through February 11, 2015, as discussed in the body of this order.

575. Applying this revised methodology to the Second Complaint proceeding results in a finding that the MISO TOs' 9.88 percent ROE established in the First Complaint proceeding to be effective prospectively from September 28, 2016, remains just and reasonable. Accordingly, we affirm in part and reverse in part Initial Decision (II) in the Second Complaint proceeding, grant in part and deny in part the exceptions to Initial Decision (II) as discussed above, and dismiss the Second Complaint. As a result, we find that no refunds should be issued as a result of the resolution of the Second Complaint, as discussed above.

The Commission orders:

(A) Rehearing of Opinion No. 551 is granted in part and denied in part, as discussed in the body of this order.

(B) MISO TOs' base ROE is set at 9.88 percent with a total or maximum ROE including incentives not to exceed 12.24 percent, effective as of September 28, 2016, as discussed in the body of this order.

(C) MISO and MISO TOs are directed to provide refunds, with interest calculated pursuant to 18 C.F.R. § 35.19a (2019), within thirty (30) days of the date of this order, for the 15-month refund period for the First Complaint from November 12,

2013 through February 11, 2015 and for the period from September 28, 2016 to the date of this order, as discussed in the body of this order.

(D) MISO and MISO TOs are directed to file a refund report detailing the principal amounts plus interest paid to each of their customers within forty-five (45) days of the date of this order.

(E) The Initial Decision in the Second Complaint proceeding is affirmed in part and reversed in part, as discussed in the body of this order.

(F) The Second Complaint is dismissed, as discussed in the body of this order.

By the Commission. Commissioner Glick is dissenting in part with a separate statement attached.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

Appendix A

Line	Company	Unadjusted Dividend Yield	Short-Term	Long-Term	Composite Growth	Dividend Yield Adjustment	Adjusted Dividend Yield	DCF Results
			Yahoo! Finance	GDP		One-Step		
1	Public Service Enterprise Group	3.74%	2.95%	4.39%	3.43%	101.48%	3.80%	7.23%
2	Consolidated Edison, Inc.	4.14%	2.38%	4.39%	3.05%	101.19%	4.19%	7.24%
3	OGE Energy Corp.	3.09%	4.00%	4.39%	4.13%	102.00%	3.15%	7.28%
4	IDACORP Inc.	3.04%	4.00%	4.39%	4.13%	102.00%	3.10%	7.23%
5	PPL Corporation	4.39%	2.23%	4.39%	2.95%	101.12%	4.44%	7.39%
6	CenterPoint Energy, Inc.	4.69%	1.91%	4.39%	2.74%	100.96%	4.73%	7.47%
7	Westar Energy Inc.	3.74%	3.40%	4.39%	3.73%	101.70%	3.80%	7.53%
8	Portland General Electric Co.	3.11%	4.70%	4.39%	4.60%	102.35%	3.18%	7.78%
9	DTE Energy Co.	3.38%	4.51%	4.39%	4.47%	102.26%	3.46%	7.93%
10	PG&E Corp.	3.39%	4.71%	4.39%	4.60%	102.36%	3.47%	8.07%
11	SCANA Corp.	3.91%	4.30%	4.39%	4.33%	102.15%	3.99%	8.32%
12	The Southern Co.	4.62%	3.32%	4.39%	3.68%	101.66%	4.70%	8.37%
13	Xcel Energy Inc.	3.68%	4.69%	4.39%	4.59%	102.35%	3.77%	8.36%
14	NorthWestern Corp.	3.60%	5.00%	4.39%	4.80%	102.50%	3.69%	8.49%
15	Duke Energy Corp.	4.05%	4.49%	4.39%	4.46%	102.25%	4.14%	8.60%
16	American Electric Power Co. Inc.	3.68%	5.08%	4.39%	4.85%	102.54%	3.77%	8.62%
17	NextEra Energy, Inc.	2.94%	6.27%	4.39%	5.64%	103.14%	3.03%	8.68%
18	Vectren Corp.	3.46%	5.50%	4.39%	5.13%	102.75%	3.56%	8.69%
19	Alliant Energy Corp.	3.50%	5.45%	4.39%	5.10%	102.73%	3.60%	8.69%
20	Avista Corp.	3.93%	5.00%	4.39%	4.80%	102.50%	4.03%	8.82%
21	Pinnacle West Capital Corp.	3.74%	5.30%	4.39%	5.00%	102.65%	3.84%	8.84%

22	Empire District Electric Co.	4.12%	5.00%	4.39%	4.80%	102.50%	4.22%	9.02%
23	Dominion Resources, Inc.	3.58%	5.89%	4.39%	5.39%	102.95%	3.69%	9.08%
24	Eversource Energy (Northeast Utilities)	3.27%	6.60%	4.39%	5.86%	103.30%	3.38%	9.24%
25	El Paso Electric Co.	3.01%	7.00%	4.39%	6.13%	103.50%	3.12%	9.25%
26	Ameren Corp.	3.91%	5.85%	4.39%	5.36%	102.93%	4.02%	9.39%
27	CMS Energy Corp.	3.35%	6.73%	4.39%	5.95%	103.37%	3.46%	9.41%
28	ALLETE Inc.	3.85%	6.00%	4.39%	5.46%	103.00%	3.97%	9.43%
29	Sempra Energy	2.59%	7.93%	4.39%	6.75%	103.97%	2.69%	9.44%
30	Great Plains Energy, Inc.	3.65%	6.37%	4.39%	5.71%	103.19%	3.77%	9.48%
31	Black Hills Corp.	3.28%	7.00%	4.39%	6.13%	103.50%	3.39%	9.52%
32	Otter Tail Corp.	4.06%	6.00%	4.39%	5.46%	103.00%	4.18%	9.65%
33	Exelon	3.64%	6.81%	4.39%	6.00%	103.41%	3.76%	9.77%
34	PNM Resources	2.85%	8.56%	4.39%	7.17%	104.28%	2.97%	10.14%
35	UIL Holdings	3.59%	7.79%	4.39%	6.66%	103.90%	3.73%	10.39%
36	ITC Holdings Corp.	1.76%	11.66%	4.39%	9.24%	105.83%	1.86%	11.10%
37	TECO Energy	4.61%	7.68%	4.39%	6.58%	103.84%	4.79%	11.37%
38	Unitil Corp.	Merger						
39	MGE Energy	Merger						
40	Edison International	2.66%	0.37%	4.39%	1.71%	100.19%	2.66%	4.37%
41	FirstEnergy Corp.	3.97%	-0.64%	4.39%	1.04%	99.68%	3.96%	4.99%
42	Entergy Corp.	4.21%	-0.48%	4.39%	1.14%	99.76%	4.20%	5.34%

Moodys Baa Utility Bonds	4.65%
Low With Outlier Test	7.23%
High with Outlier Test	11.37%
Midpoint	9.30%
Median Including Utilities Excluded with Outlier Test	8.68%
High-End Outlier Test	13.02%
Low-End Outlier Test	6.47%

Appendix B

			Short-Term	Long-Term		Dividend Yield Adjustment		
Line	Company	Unadjusted Dividend Yield	Yahoo! Finance	GDP	Composite	One-Step	Adjusted Dividend Yield	DCF Results
19	PNM Resources, Inc.	2.92%	9.30%	4.35%	7.65%	104.65%	3.06%	10.71%
23	Sempra Energy	2.84%	9.35%	4.35%	7.68%	104.68%	2.97%	10.66%
25	WEC Energy Group, Inc.	3.58%	7.55%	4.35%	6.48%	103.78%	3.72%	10.20%
15	NorthWestern Corp.	3.61%	6.81%	4.35%	5.99%	103.41%	3.73%	9.72%
16	Otter Tail Corp.	4.05%	6.00%	4.35%	5.45%	103.00%	4.17%	9.62%
3	Ameren Corporation	3.96%	6.00%	4.35%	5.45%	103.00%	4.08%	9.53%
11	El Paso Elec. Co.	3.20%	7.00%	4.35%	6.12%	103.50%	3.31%	9.43%
7	CMS Energy Corp.	3.36%	6.72%	4.35%	5.93%	103.36%	3.47%	9.40%
12	Eversource Energy	3.39%	6.57%	4.35%	5.83%	103.29%	3.50%	9.33%
1	ALLETE, Inc.	4.16%	5.00%	4.35%	4.78%	102.50%	4.26%	9.05%
2	Alliant Energy	3.72%	5.55%	4.35%	5.15%	102.78%	3.82%	8.97%
9	Dominion Resources, Inc.	3.72%	5.49%	4.35%	5.11%	102.75%	3.82%	8.93%
17	PG&E Corp.	3.50%	5.80%	4.35%	5.32%	102.90%	3.60%	8.92%
5	Avista Corp.	3.98%	5.00%	4.35%	4.78%	102.50%	4.08%	8.86%
18	Pinnacle West Capital Corp.	3.92%	4.95%	4.35%	4.75%	102.48%	4.02%	8.77%
21	PPL Corp.	4.67%	3.74%	4.35%	3.94%	101.87%	4.76%	8.70%
10	DTE Energy Co.	3.75%	5.00%	4.35%	4.78%	102.50%	3.84%	8.63%
13	Great Plains Energy	3.83%	4.80%	4.35%	4.65%	102.40%	3.92%	8.57%
22	SCANA Corp.	3.90%	4.45%	4.35%	4.42%	102.23%	3.99%	8.40%
4	Amer. Elec. Power Co., Inc.	3.84%	4.47%	4.35%	4.43%	102.24%	3.93%	8.36%
27	Xcel Energy, Inc.	3.68%	4.68%	4.35%	4.57%	102.34%	3.77%	8.34%
24	Vectren Corp.	3.10%	5.00%	4.35%	4.78%	102.50%	3.18%	7.96%
20	Portland General Electric Co.	3.33%	4.11%	4.35%	4.19%	102.06%	3.40%	7.59%
8	Consol. Edison, Inc.	4.08%	2.95%	4.35%	3.42%	101.48%	4.14%	7.56%
26	Westar Energy Inc.	3.70%	3.50%	4.35%	3.78%	101.75%	3.76%	7.55%
14	IDACOPR, Inc.	3.03%	4.00%	4.35%	4.12%	102.00%	3.09%	7.21%
6	CenterPoint Energy, Inc.	5.47%	0.40%	4.35%	1.72%	100.20%	5.48%	7.20%
28	OGE Energy Corp.	3.81%	2.17%	4.35%	2.90%	101.09%	3.85%	6.75%
31	Public Service Enterprise Group							6.28%
30	FirstEnergy Corp.							5.38%
29	Edison International							3.92%

32	Black Hills Corp.	Merger						
33	Cleco Corp.	Merger						
34	Duke Energy Corp.	Merger						
35	Empire District	Merger						
36	Exelon Corp.	Merger						
37	Hawaii Elec. Ind. Inc.	Merger						
38	ITC Holdings	Merger						
39	NextEra Energy Inc.	Merger						
40	Pepco Holdings Inc.	Merger						
41	Southern Co.	Merger						
42	TECO Energy Inc.	Merger						
43	UIL Energy	Merger						

Moodys Baa Utility Bonds	5.41%
Low With Outlier Test	7.20%
High with Outlier Test	10.71 %
Midpoint	8.95%
Median Including Utilities Excluded with Outlier Test	8.70%
High-End Outlier Test	13.05 %
Low-End Outlier Test	7.18%

Appendix C

MISO I	DCF Zone			Lower Zone		Middle Zone		Upper Zone			Low-End Test	High-End Test
	Lower	Upper	1/8 Range	Lower	Upper	Lower	Upper	Lower	Upper	Median	(5)	(6)
DCF (1)	7.23%	11.37%	0.52%	7.75%	8.79%	8.79%	9.82%	9.82%	10.86%	8.65%	6.47%	12.98%
CAPM (2)	7.80%	13.09%	0.66%	8.46%	9.78%	9.78%	11.11%	11.11%	12.43%	10.30%	6.47%	15.45%
Average	7.52%	12.24%	0.59%	8.11%	9.29%	9.29%	10.47%	10.47%	11.65%			
Midpoint	**9.88%**											

MISO II	DCF Zone			Lower Zone		Middle Zone		Upper Zone			Low-End Test	High-End Test
	Lower	Upper	1/8 Range	Lower	Upper	Lower	Upper	Lower	Upper	Median	(7)	
DCF (3)	7.20%	10.71%	0.44%	7.64%	8.52%	8.52%	9.39%	9.39%	10.27%	8.7%	7.18%	13.01%
CAPM (4)	8.35%	12.63%	0.54%	8.89%	9.96%	9.96%	11.03%	11.03%	12.10%	10.51%	7.18%	15.77%
Average	7.78%	11.67%	0.49%	8.26%	9.24%	9.24%	10.21%	10.21%	11.18%			
Midpoint	**9.72%**											

(1) See Appendix A
(2) See p 6 of Attachment A of Trial Staff Initial Brief in Docket No. EL14-12
(3) See Appendix B
(4) See p 6 of Attachment A of Trial Staff Initial Brief in Docket No. El15-45
(5) 4.65% Baa Bond Yield found in Order No. 551 + 20% x 9.12 CAPM Risk Premium
(6) 150% of the median
(7) 5.41% Baa bond from MISO II Initial Decision + 20% x 8.85 CAPM risk premium

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Association of Businesses Advocating Tariff Equity Docket No. EL14-12-003
Coalition of MISO Transmission Customers
Illinois Industrial Energy Consumers
Indiana Industrial Energy Consumers, Inc.
Minnesota Large Industrial Group
Wisconsin Industrial Energy Group

v.

Midcontinent Independent System Operator, Inc.
ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

Arkansas Electric Cooperative Corporation
Mississippi Delta Energy Agency
Clarksdale Public Utilities Commission
Public Service Commission of Yazoo City
Hoosier Energy Rural Electric Cooperative, Inc.

Docket No. EL15-45-000

v.

ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

(Issued November 21, 2019)

GLICK, Commissioner, *dissenting in part*:

1. Although I join most of today's order, I dissent in part because I disagree with the Commission's decision not to order refunds of rates that we all agree were unjust and unreasonable. I fully support the Commission's conclusion that the MISO Transmission

Owners' (MISO TOs) pre-existing 12.38 percent ROE was unjust and unreasonable and its decision to fix the new just and reasonable ROE at 9.88 percent. Hopefully these determinations will provide some much-needed certainty to all MISO stakeholders. That being said, I disagree with the Commission's refusal to order refunds of the unjust and unreasonable rates collected during the refund period for the second of the two complaints pending before us. The law permits us to order those refunds and I see no reason to deprive customers of the full protections afforded by the Federal Power Act (FPA).

* * *

2. It helps to have the basic facts in one place. On November 12, 2013, multiple parties filed a complaint (First Complaint) alleging that the MISO TOs' 12.38 percent ROE was unjust and unreasonable.[1] The Commission set the matter for hearing and established a refund effective date of November 12, 2013 (the date the First Complaint was filed),[2] meaning that the 15-month refund period for the First Complaint lasted until February 12, 2015.[3] On February 12, 2015, a different set of parties filed another complaint (Second Complaint) against the MISO TOs' ROE. The Commission again set the matter for hearing and established a refund effective date of February 12, 2015,[4] meaning that the 15-month refund period for the Second Complaint lasted until May 12, 2016. On December 22, 2015, an Administrative Law Judge issued an initial decision recommending that the Commission grant the First Complaint and establish a new just

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[1] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 169 FERC ¶ 61,129, at P 3 (2019) (Order). The authorized base ROE for the ATCLLC zone was 12.20 percent, but I will follow the Order's practice of referring to the MISO-wide ROE as 12.38. *Id.* P 3 & n.11. The overall ROE that the MISO TOs could earn—*i.e.*, the sum of the base ROE and any incentives—was capped at 15.96. *Id.*

[2] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 149 FERC ¶ 61,049, at P 188 (2014), *order on reh'g*, 156 FERC ¶ 61,060 (2016).

[3] As discussed further below, pursuant to the Regulatory Fairness Act, Pub. L. No. 100-473, § 2, 102 Stat 2299 (1988) (codified at 16 U.S.C. § 824e(b)), as part of any proceeding under section 206 of the FPA, the Commission shall establish a refund effective date and, at the conclusion of that proceeding, it may order refunds for the difference between an unjust and unreasonable rate in effect during the period up to 15 months following the refund effective date and the new just and reasonable rate fixed by the Commission.

[4] *Ark. Elec. Coop. Corp. v. ALLETE, Inc.*, 151 FERC ¶ 61,219, at P 1 (2015), *order on reh'g*, 156 FERC ¶ 61,061 (2016) (Second Complaint Rehearing Order).

and reasonable ROE.[5] On June 30, 2016, a second Administrative Law Judge issued an initial decision, this time on the Second Complaint, again finding the MISO TOs' ROE to be unjust and unreasonable and establishing a new just and reasonable ROE.[6] And on September 28, 2016, the Commission issued Opinion No. 551, which largely affirmed the initial decision on the First Complaint, finding that the MISO TOs' 12.38 percent ROE was unjust and unreasonable and establishing a new just and reasonable ROE of 10.32 percent.[7] That is where things stood when the United States Court of Appeals for the District of Columbia Circuit issued its decision in *Emera Maine v. FERC*,[8] which vacated the Commission's decision in Opinion No. 531—on which Opinion No. 551 was based.

3. Today's order responds to *Emera Maine* by granting rehearing of Order No. 551 and (1) establishing a new process for evaluating whether an existing ROE is unjust and unreasonable, (2) applying that process to these proceedings to find that the MISO TOs' 12.38 percent ROE was unjust and unreasonable, and then (3) setting a new just and reasonable ROE of 9.88 percent. I join my colleagues on all three determinations. Nevertheless, I dissent in part because today's order requires the MISO TOs to pay refunds only for the First Complaint, and not the Second Complaint, even though it is undisputed that the unjust and unreasonable 12.38 percent ROE was in effect for the entire refund period established for the Second Complaint. I see nothing in section 206(b) of the FPA that prevents us from providing MISO customers with relief from that unjust and unreasonable ROE.

4. Section 206(b) provides that, at the conclusion of a proceeding under section 206, "the Commission may order refunds of any amounts paid [during the 15-month refund period] in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force."[9] All that text requires is that the Commission

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[5] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 153 FERC ¶ 63,027 (2015).

[6] *Ark. Elec. Coop. Corp. v. ALLETE, Inc.*, 155 FERC ¶ 63,030 (2016).

[7] *Ass'n of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 551, 156 FERC ¶ 61,234, at P 9 (2016).

[8] 854 F.3d 9 (D.C. Cir. 2017).

[9] 16 U.S.C. § 824e(b). The full text of the relevant portion of section 206(b) is:

> At the conclusion of any proceeding under this section, the Commission may order refunds of any amounts paid, for the period subsequent to the refund effective date through a date fifteen months after such refund

find that customers paid an unjust and unreasonable rate during the refund period and that the Commission identify a replacement just and reasonable rate, so that it can calculate refunds equal to the difference between the two rates. Both conditions are satisfied here.

5. After all, there is no dispute that all parties were on notice that the Commission would require refunds in the event that it found the existing 12.38 percent ROE unjust and reasonable.[10] And there similarly is no dispute among my colleagues that the MISO TOs' 12.38 percent ROE was unjust and unreasonable and substantially in excess of the 9.88 percent just and reasonable ROE that the Commission is establishing pursuant to section 206. Applying the plain text of section 206(b), I believe that the Commission had ample authority to order refunds pursuant to the Second Complaint and should have done so here.[11] In addition, interpreting Section 206(b) to permit refunds in this instance is both more consistent with the FPA's primary purpose of protecting consumers[12] and

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> effective date, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force: *Provided*, That if the proceeding is not concluded within fifteen months after the refund effective date and if the Commission determines at the conclusion of the proceeding that the proceeding was not resolved within the fifteen-month period primarily because of dilatory behavior by the public utility, the Commission may order refunds of any or all amounts paid for the period subsequent to the refund effective date and prior to the conclusion of the proceeding.

[10] *Cf. La. Pub. Serv. Comm'n v. FERC*, 482 F.3d 510, 520 (D.C. Cir. 2007).

[11] The Commission relies on its decision in *San Diego Gas & Electric* for the proposition that it can only order refunds when it grants a particular complaint. Order, 169 FERC ¶ 61,129 at P 572 (quoting *San Diego Gas & Elec. Co. v. Sellers of Energy and Ancillary Servs.*, 127 FERC ¶ 61,191 (2009)). But the quoted language merely restates the statutory text (albeit embellished with italics) without shedding any light on the Commission's authority to order refunds for subsequent pancaked complaints, which was not at issue in that decision.

[12] *See, e.g.*, *California ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1017 (9th Cir. 2004); *City of Chicago, Ill. v. FPC*, 458 F.2d 731, 751 (D.C. Cir. 1971) ("[T]he primary purpose of the Natural Gas Act is to protect consumers." (citing, *inter alia*, *City of Detroit v. FPC*, 230 F.2d 810, 815 (1955)); *see also* S. Rep. 100-491, 5-6 (1988) ("The Committee intends the Commission to exercise its refund authority under section 206 in a manner that furthers the long-term objective of achieving the lowest cost for consumers consistent with the maintenance of safe and reliable service.").

more equitable given that the only reason we are faced with this question is that the Commission did not act on the First Complaint in the 15-month period before the Second Complaint was filed.

6. The Commission, by contrast, reads into the text of section 206(b) a pair of implicit limitations on its refund authority. But neither limitation is as well-founded as today's order would have you believe. First, the Commission interprets the presence of the word "thereafter" in section 206(b) "to mean that refunds may be ordered in a complaint proceeding only when the Commission grants prospective relief in that proceeding."[13] In other words, if the Commission does not fix a new just and reasonable ROE pursuant to each pancaked complaint, then it cannot order refunds of unjust and unreasonable rates collected during the relevant refund periods. I believe that the "thereafter observed and in force" language is better read as a reference to the identical language in section 206(a).[14] Under my reading, all the "thereafter observed and in force" language does is clarify that the ceiling on the Commission's refund authority pursuant to section 206(b) is the difference between the rate in effect during the refund period and the just and reasonable rate that the Commission subsequently established pursuant to subsection 206(a).[15] Accordingly, where the Commission finds that the rate that prevailed in the refund period exceeded the just and reasonable rate, the Commission has the authority to order refunds for the difference. That straightforward interpretation has the unremarkable result of allowing the Commission to protect customers by ordering refunds for any duly established refund period in which a public utility collected a rate in excess of the just and reasonable rate.

7. That brings us to the Commission's second limitation. The Commission contends that ordering refunds for the Second Complaint would, in essence, be an end run around the 15-month limit on refunds established in section 206(b).[16] But the Commission has repeatedly held that the FPA permits successive or "pancaked" complaints and those complaints are "'entirely new proceeding[s]'" and not "'duplicative proceeding[s]

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[13] Order, 169 FERC ¶ 61,129 at P 568.

[14] *See* 16 U.S.C. § 824e(a) (requiring the Commission to establish a new just and reasonable rate to be "thereafter observed and in force" whenever it finds that an existing rate is unjust and unreasonable or unduly discriminatory or preferential).

[15] That interpretation makes even more sense when you consider that section 206(b) was added more than 50 years after section 206(a), which was part of the original FPA, and so it would have been necessary to clarify how the amendment worked in conjunction with the pre-existing language.

[16] Order, 169 FERC ¶ 61,129 at P 569.

intended solely to expand the amount of refund protection beyond 15 months.'"[17] Accordingly, under the Commission's own interpretation of section 206, ordering refunds for the Second Complaint is not an end run around the 15-month limit on the refund period, but rather is consistent with customers' right under the FPA to file multiple complaints under section 206.

8. It may be that allowing refunds for pancaked complaints creates undue and unfair uncertainty for public utilities. But those policy considerations should not—and, in my opinion, do not—control our interpretation of the text of section 206(b). Perhaps Congress should consider revising section 206 to prohibit pancaked complaints. But it is not our job to do Congress' work for it. Unless and until Congress amends the FPA to prohibit pancaked complaints, the Commission should not permit its dislike of pancaked complaints to deprive customers of the full protections provided by the FPA.

For these reasons, I respectfully dissent in part.

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Richard Glick
Commissioner

[17] Second Complaint Rehearing Order, 156 FERC ¶ 61,061 at P 33 (quoting *Southern Co. Servs. Inc.*, 83 FERC ¶ 61,079, 61,386 (1998)).

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EXHIBIT C

171 FERC ¶ 61,154
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Neil Chatterjee, Chairman;
Richard Glick, Bernard L. McNamee,
and James P. Danly.

Association of Businesses Advocating Tariff Equity
Coalition of MISO Transmission Customers
Illinois Industrial Energy Consumers
Indiana Industrial Energy Consumers, Inc.
Minnesota Large Industrial Group
Wisconsin Industrial Energy Group

Docket No. EL14-12-004

v.

Midcontinent Independent System Operator, Inc.
ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

Arkansas Electric Cooperative Corporation
Mississippi Delta Energy Agency
Clarksdale Public Utilities Commission
Public Service Commission of Yazoo City
Hoosier Energy Rural Electric Cooperative, Inc.

Docket No. EL15-45-013

v.

ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

OPINION NO. 569-A

ORDER ON REHEARING

(Issued May 21, 2020)

1. On November 21, 2019, the Commission issued Opinion No. 569.[1] In that order, the Commission acted on the then-pending rehearing requests and the Initial Decision, as well the Order Directing Briefs,[2] in the above-captioned proceedings. In brief, Opinion No. 569 applied a revised methodology for analyzing the base return on equity (ROE) component of public utility rates under section 206 of the Federal Power Act (FPA) that used the discounted cash flow (DCF) model and capital-asset pricing model (CAPM), instead of only the DCF model, and established a range of presumptively just and reasonable ROEs based on the quartiles of the zone of reasonableness. Multiple parties request rehearing of Opinion No. 569.[3] In this order, we grant in part and deny in part the requests for rehearing.

2. In particular, in Opinion No. 569, the Commission used the DCF model and CAPM in its determinations under the first and second prongs of section 206, giving each model equal weight under both prongs, and did not use the expected earnings (Expected Earnings) or risk premium (Risk Premium) models, as proposed in the Briefing Order. In addition, the Commission used the ranges of presumptively just and reasonable ROEs in its analysis under the first prong of section 206, as the Commission proposed in the Briefing Order, used the high-end outlier test as proposed in the Briefing Order, used the Institutional Brokers' Estimate System (IBES) as the source of short-term earnings growth estimates in the DCF and CAPM, and used a revised low-end outlier test that eliminates DCF and CAPM proxy group ROE results that are less than the yields of generic corporate Baa bonds plus 20% of the CAPM risk premium. In this order, we are granting rehearing of Opinion No. 569 to use the Risk Premium model under both prongs of our section 206 analysis, to give the short-term growth rate 80% weighting and the long-term growth rate 20% weighting in the two-step DCF model, to modify the high-end outlier test to treat any proxy company as high-end outlier if its cost of equity estimated under the model in question is more than 200% of the median result of all of the potential proxy group members in that model[4] before any high or low-end outlier test is applied, subject to a "natural break" analysis, to consider the use of *Value Line* short-term earnings growth estimates in the CAPM in future proceedings, and to calculate the ranges

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[1] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 569, 169 FERC ¶ 61,129 (2019).

[2] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 165 FERC ¶ 61,118 (2018) (Briefing Order).

[3] *See infra* PP 23-24.

[4] As noted below, the high-end outlier test only applies to the DCF model and CAPM because they utilize results of the relevant analysis applied to a proxy group, while the Risk Premium model is derived from actual ROEs.

of presumptively just and reasonable base ROEs by dividing the overall composite zone of reasonableness into equal thirds.

3. Applying this revised methodology to the facts of the November 12, 2013, complaint filed in Docket No. EL14-12-000 pursuant to section 206 (First Complaint), we review the Midcontinent Independent System Operator, Inc. (MISO) transmission-owning members' (MISO TOs) 12.38% base ROE that was the existing ROE reviewed in Opinion No. 551, which was pending on rehearing before the Commission when it issued Opinion No. 569, and continue to find that this base ROE is unjust and unreasonable. Having found that MISO TOs' 12.38% ROE is unjust and unreasonable, we then find that a just and reasonable replacement ROE for the MISO TOs in the First Complaint proceeding is 10.02%. As discussed further below, in the second section 206 complaint (Second Complaint) proceeding in Docket No. EL15-45-000, the ROE to be reviewed is the 10.02% base ROE established in the First Complaint proceeding that is effective prospectively from September 28, 2016—the date of the issuance of Opinion No. 551. Under the revised base ROE methodology applied in this order, the 10.02% base ROE that the Commission is reviewing for purposes of the Second Complaint proceeding falls within the applicable range of presumptively just and reasonable base ROEs, therefore, the Commission presumes it to be just and reasonable. As discussed below, we find that this presumption has not been rebutted by the evidence in the Second Complaint proceeding. Accordingly, we affirm the Commission's decision in Opinion No. 569 to dismiss the Second Complaint, and its finding that no refunds should be issued as a result of the resolution of that complaint.

I. Background

A. Opinion No. 531 *et seq.*

4. In Opinion No. 531, the Commission adopted certain changes to its use of the DCF methodology for evaluating and setting the Commission-allowed ROE for the New England transmission owners (New England TOs). In particular, the Commission elected to replace the "one-step" DCF model, which considers only short-term growth projections for a public utility, with a "two-step" model that considers both short- and long-term growth projections.[5] The Commission also departed from its typical practice of setting the just and reasonable ROE of a group of utilities at the midpoint of the zone of reasonableness. The Commission explained that evidence of "anomalous" capital

[5] *See generally Coakley Mass. Attorney Gen. v. Bangor Hydro-Elec. Co.*, Opinion No. 531, 147 FERC ¶ 61,234, at PP 8, 32-41, *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), *rev'd, Emera Maine v. FERC*, 854 F.3d 9 (D.C. Cir. 2017) (*Emera Maine*).

market conditions, including "bond yields [that were] at historic lows," made the Commission "less confiden[t] that the midpoint of the zone of reasonableness . . . accurately reflects the [ROE] necessary to meet the *Hope* and *Bluefield* capital attraction standards."[6] The Commission therefore looked to four alternative benchmark models: three financial models—the Risk Premium model, CAPM, and Expected Earnings model[7]—as well as a comparison with the ROEs approved by state public utility commissions.[8] In considering those models, the Commission emphasized that it was not departing from its long-standing reliance on the DCF model, but rather relying on those models only to "inform the just and reasonable placement of the ROE within the zone of reasonableness established . . . by the DCF methodology."[9] Based on these alternative models, the Commission determined that an ROE of 10.57%, the midpoint of the upper half of the zone of reasonableness produced by the two-step DCF model, would be just and reasonable. Because that figure differed from New England TOs' existing 11.14% ROE, the Commission concluded that the existing base ROE had become unjust and unreasonable and it therefore set New England TOs' base ROE at 10.57%, pending a paper hearing concerning the long-term growth projection to use in the DCF analysis. Following that hearing, in Opinion No. 531-A the Commission reaffirmed its conclusion that New England TOs' existing ROE was unjust and unreasonable and that 10.57% was the just and reasonable ROE. The Commission required New England TOs to submit a compliance filing to implement their new ROEs effective October 16, 2014—the date of issuance of Opinion No. 531-A.

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[6] Opinion No. 531, 147 FERC ¶ 61,234 at PP 144-145 & n.285. "*Hope*" and "*Bluefield*" refer to a pair of U.S. Supreme Court cases that require the Commission "to set a rate of return commensurate with other enterprises of comparable risk and sufficient to assure that enough capital is attracted to the utility to enable it to meet the public's needs." *Boroughs of Ellwood City, Grove City, New Wilmington, Wampum, & Zelienople, Pa. v. FERC*, 731 F.2d 959, 967 (D.C. Cir. 1984) (citing *FPC v. Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944) (*Hope*) and *Bluefield Waterworks Improvement Co. v. Pub. Serv. Comm'n of W.V.*, 262 U.S. 679 (1923) (*Bluefield*)).

[7] As discussed further below, the Risk Premium model estimates cost of equity using the implied premium that provided over Baa-rated utility bonds by regulatory decisions and settlements. The CAPM derives the ROE through the risk premium observed from the risk premium of a DCF analysis of S&P 500 dividend-paying companies. The Expected Earnings model is a method of calculating the earnings that an investor expects to receive on the book value of a particular stock.

[8] Opinion No. 531, 147 FERC ¶ 61,234 at PP 147-149.

[9] *Id.* P 146.

B. Opinion No. 551 *et seq.*

5. On November 12, 2013, multiple complainants[10] filed the First Complaint in Docket No. EL14-12-000 pursuant to section 206 of the FPA, alleging, among other things, that the MISO TOs' base ROE reflected in MISO's Open Access Transmission, Energy and Operating Reserve Markets Tariff was unjust and unreasonable.[11] At the time of the First Complaint, MISO TOs had a base ROE of 12.38% (except for the ATCLLC zone which had a 12.20% ROE),[12] and their total ROE (i.e., the base ROE plus any ROE adders approved by the Commission) was not permitted to exceed 15.96%. The Commission established the MISO TOs' preexisting 12.38% ROE in a 2002 decision.[13] That ROE was based on a DCF analysis using financial data for the

[10] The complainants consist of a group of large industrial customers: Association of Businesses Advocating Tariff Equity (ABATE); Coalition of MISO Transmission Customers (Coalition of MISO Customers); Illinois Industrial Energy Consumers (IIEC); Indiana Industrial Energy Consumers, Inc. (INDIEC); Minnesota Large Industrial Group (MLIG); and Wisconsin Industrial Energy Group.

[11] The following MISO transmission owners were named in the First Complaint: ALLETE, Inc. for its operating division Minnesota Power (and its subsidiary Superior Water, L&P); Ameren Services Company, as agent for Union Electric Company, Ameren Illinois Company, and Ameren Transmission Company of Illinois; American Transmission Company LLC (ATC); Cleco Power LLC; Duke Energy Corporation for Duke Energy Indiana, Inc.; Entergy Arkansas, Inc.; Entergy Louisiana, LLC; Entergy Gulf States Louisiana, L.L.C.; Entergy Mississippi, Inc.; Entergy New Orleans, Inc.; Entergy Texas, Inc.; Indianapolis Power & Light Company; International Transmission Company; ITC Midwest LLC; METC; 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; and Wolverine Power Supply Cooperative, Inc. Intervenor Xcel Energy Services Inc. did not join certain of the MISO TOs' pleadings in this proceeding, but generally supported the brief on behalf of respondents Northern States Power Company, a Minnesota corporation, and Northern States Power Company, a Wisconsin corporation.

[12] For the sake of clarity, we refer to this ROE of the MISO TOs as 12.38% in this order, without separately identifying that the ATCLLC zone had a 12.20% ROE. Our discussion and decisions with respect to the MISO TOs' 12.38% ROE also apply to the 12.20% ATCLLC ROE.

[13] *See Midwest Indep. Transmission Sys. Operator, Inc.*, 99 FERC ¶ 63,011, *initial decision affirmed as to base ROE*, 100 FERC ¶ 61,292 (2002), *reh'g denied*, 102 FERC

six-month period ending February 2002.[14] On October 16, 2014, the same date that the Commission issued Opinion No. 531-A, it set the First Complaint for hearing before an Administrative Law Judge and established a refund effective date of November 12, 2013.[15]

6. Following the hearing, the Presiding Judge issued an Initial Decision,[16] and the Commission subsequently issued Opinion No. 551.[17] In Opinion No. 551, the Commission calculated the just and reasonable ROE using the two-step DCF methodology from Opinion No. 531 and financial data for the period January 1 through June 30, 2015. The Commission affirmed the conclusions of Initial Decision (I), finding that the Presiding Judge correctly applied the two-step DCF analysis required by Opinion No. 531.[18] The Commission also affirmed the Presiding Judge's determination that, as in Opinion No. 531, there were anomalous capital market conditions such that the Commission had less confidence that the midpoint of the zone of reasonableness produced by a mechanical application of the DCF methodology satisfied the capital attraction standards of *Hope* and *Bluefield*.[19] The Commission found that the Presiding Judge reasonably considered evidence of alternative methodologies for determining the

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¶ 61,143 (2003), *order on remand*, 106 FERC ¶ 61,302 (2004). The ATCLLC zone base ROE of 12.20% was established as part of a settlement agreement that was filed with the Commission on March 26, 2004. In Docket No. ER04-108-000, the Commission approved the uncontested settlement. *Am. Transmission Co. LLC*, 107 FERC ¶ 61,117 (2004).

[14] *Midwest Indep. Transmission Sys. Operator, Inc.*, 99 FERC ¶ 63,011, app. A.

[15] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 149 FERC ¶ 61,049, at P 188 (2014) (MISO I Hearing Order), *order on reh'g*, 156 FERC ¶ 61,060 (2016) (MISO I Rehearing Order). In the MISO I Rehearing Order, the Commission denied requests for rehearing and clarification of the MISO I Hearing Order and clarified that non-public utility transmission owners are subject to the outcome of that proceeding. MISO I Rehearing Order, 156 FERC ¶ 61,060 at PP 47-48.

[16] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 153 FERC ¶ 63,027 (2015) (Initial Decision (I)).

[17] *Ass'n of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 551, 156 FERC ¶ 61,234 (2016) (affirming Initial Decision (I), 153 FERC ¶ 63,027).

[18] *See generally* Opinion No. 551, 156 FERC ¶ 61,234 at P 9.

[19] *Id.*

ROE and the ROEs approved by state regulatory commissions, for purposes of deciding to set the ROE at the central tendency of the upper half of the zone of reasonableness, setting the base ROE for MISO TOs at 10.32%.[20] The Commission required MISO TOs to submit a compliance filing to implement their new ROEs effective September 28, 2016, the date of Opinion No. 551, and to provide refunds for the November 12, 2013-February 11, 2015 refund period. Following the issuance of Opinion No. 551, numerous parties submitted requests for rehearing.

C. Second Complaint Against MISO TOs' ROE

7. On February 12, 2015, a new set of complainants[21] filed the Second Complaint in Docket No. EL15-45-000 also alleging that the MISO TOs' base ROE of 12.38% was unjust and unreasonable.[22] Relying on an updated two-step DCF analysis, the Second Complaint complainants argued that the base ROE should be no higher than 8.67%.[23] On

[20] *Id.*

[21] Complainants for the Second Complaint consist of: Arkansas Electric Cooperative Corporation (Arkansas Electric Cooperative); Mississippi Delta Energy Agency and its two members, Clarksdale Public Utilities Commission of the City of Clarksdale, Mississippi and Public Service Commission of Yazoo City of the City of Yazoo City, Mississippi; and Hoosier Energy Rural Electric Cooperative, Inc. (Hoosier Cooperative).

[22] The following MISO transmission owners were named in the Second Complaint: ALLETE, Inc. (for its operating division Minnesota Power, Inc. and its wholly-owned subsidiary Superior Water Light, & Power Company); Ameren Illinois Company; Union Electric Company (identified as Ameren Missouri); Ameren Transmission Company of Illinois; ATC; Cleco Power LLC; Duke Energy Business Services, LLC; Entergy Arkansas, Inc.; Entergy Gulf States Louisiana, LLC; Entergy Louisiana, LLC; Entergy Mississippi, Inc.; Entergy New Orleans, Inc.; Entergy Texas, Inc.; Indianapolis Power & Light Company; International Transmission Company, ITC Midwest LLC, and Michigan Electric Transmission Company, LLC; MidAmerican Energy Company; Montana-Dakota Utilities Co.; Northern Indiana Public Service Company; Northern States Power Company-Minnesota; Northern States Power Company-Wisconsin; Otter Tail Power Company; and Southern Indiana Gas & Electric Company.

[23] *Ark. Elec. Coop. Corp. v. ALLETE, Inc.*, 151 FERC ¶ 61,219, at P 1 (2015) (MISO II Hearing Order), *order on reh'g*, 156 FERC ¶ 61,061 (2016) (MISO II Rehearing Order).

June 18, 2015, the Commission established hearing procedures and set a refund effective date of February 12, 2015.[24]

8. Parties filed requests for rehearing of the MISO II Hearing Order, and on July 21, 2016, the Commission generally denied these rehearing requests.[25] Following the MISO II Hearing Order, the Presiding Judge issued the Initial Decision on June 30, 2016.[26] The Presiding Judge adopted a zone of reasonableness of 6.75% to 10.68% based on financial data for the period July 1, 2015 through December 31, 2015. The Presiding Judge also determined that the anomalous capital market conditions identified in Opinion No. 531 persisted and, after considering the alternative benchmark methodologies, that the just and reasonable ROE was 9.70%—halfway between the midpoint and the upper bound of the zone of reasonableness. The participants filed briefs on and opposing exception.

D. ***Emera Maine***

9. On April 14, 2017, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) issued its *Emera Maine* decision, vacating and remanding Opinion No. 531 *et seq*. As an initial matter, the D.C. Circuit was not persuaded by New England TOs' argument that an ROE within the DCF-produced zone of reasonableness could not be deemed unjust and unreasonable. The D.C. Circuit explained that the zone of reasonableness established by the DCF is not "coextensive" with the "statutory" zone of reasonableness envisioned by the FPA.[27] Accordingly, the D.C. Circuit concluded that the fact that New England TOs' existing ROE fell within the zone of reasonableness produced by the DCF did not necessarily indicate that it was just and reasonable for the purposes of the FPA.[28]

10. Nevertheless, the D.C. Circuit found that the Commission had not adequately shown that New England TOs' existing ROE was unjust and unreasonable. The D.C. Circuit explained that the FPA's statutory "zone of reasonableness creates a broad range of potentially lawful ROEs rather than a single just and reasonable ROE" and that whether a particular ROE is unjust and unreasonable depends on the "particular

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[24] MISO II Hearing Order, 151 FERC ¶ 61,219 at P 1.

[25] *See* MISO II Rehearing Order, 156 FERC ¶ 61,061.

[26] *Ark. Elec. Coop. Corp. v. ALLETE, Inc.*, 155 FERC ¶ 63,030 (2016) (Initial Decision (II)).

[27] *Emera Maine*, 854 F.3d at 22-23.

[28] *Id.* at 23.

circumstances of the case."[29] Thus, the fact that New England TOs' existing ROE did not equal the just and reasonable ROE that the Commission would have set using the current DCF inputs did not necessarily indicate that New England TOs' existing ROE fell outside the statutory zone of reasonableness.[30] As such, the D.C. Circuit concluded that Opinion No. 531 "failed to include an actual finding as to the lawfulness of [New England TOs'] existing base ROE" and that its conclusion that their existing ROE was unjust and unreasonable was itself arbitrary and capricious.[31]

11. The D.C. Circuit also found that the Commission had not adequately shown that the 10.57% ROE that it set was just and reasonable. Although recognizing that the Commission has the authority "to make 'pragmatic adjustments' to a utility's ROE based on the 'particular circumstances' of a case," the D.C. Circuit nevertheless concluded that the Commission had not explained why setting the ROE at the upper midpoint was just and reasonable.[32] The D.C. Circuit noted, in particular, that the Commission relied on the alternative models and state-regulated ROEs to support a base ROE above the midpoint, but that it did not rely on that evidence to support an ROE at the upper midpoint.[33] Similarly, the D.C. Circuit noted that the Commission had concluded that a base ROE of 9.39%—the midpoint of the zone of reasonableness—might not be sufficient to satisfy *Hope* and *Bluefield* or to allow the utility to attract capital, but that the Commission had not similarly explained how a 10.57% base ROE was sufficient to meet either of those conditions. Because the D.C. Circuit found that the Commission had not pointed to record evidence supporting the specific point at which it set New England TOs' ROE, the

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[29] *Id.* at 23, 26.

[30] *Id.* at 27 ("To satisfy its dual burden under section 206, FERC was required to do more than show that its single ROE analysis generated a new just and reasonable ROE and conclusively declare that, consequently, the existing ROE was per se unjust and unreasonable.").

[31] *Id.*

[32] *Id.* (quoting *FPC v. Nat. Gas Pipeline Co. of America*, 315 U.S. 575, 586 (1942)).

[33] *Id.* at 29 ("FERC's reasoning is unclear. On the one hand, it argued that the alternative analyses supported its decision to place the base ROE above the midpoint, but on the other hand, it stressed that none of these analyses were used to select the 10.57% base ROE.").

D.C. Circuit held that the Commission had not articulated the "rational connection" between the evidence and the rate that the FPA demands.[34]

12. Based on the D.C. Circuit's conclusion that the Commission had not met its burden either under the first or the second prong of section 206 of the FPA, it vacated and remanded Opinion No. 531 *et seq.*,[35] meaning that Opinion No. 531 is no longer precedential,[36] even though the Commission remained free to re-adopt those determinations on remand as long as it provided a reasoned basis for doing so.[37] The Commission relied extensively on its determinations in Opinion No. 531 in its order on the First Complaint (i.e., Opinion No. 551).

E. Briefing Orders

13. On October 16, 2018, the Commission issued an order proposing a methodology for addressing the issues that were remanded to the Commission in *Emera Maine* and established a paper hearing on whether and how this methodology should apply to the four complaint proceedings concerning New England TOs' ROE.[38] In the *Coakley* Briefing Order, the Commission proposed to change its approach to determining base ROE by giving equal weight to four financial models, instead of primarily relying on the DCF methodology. The Commission stated that evidence indicates that investors do not rely on any one model to the exclusion of others. Therefore, relying on multiple financial models made it more likely that the Commission's ROE determination would accurately reflect how investors make their investment decisions.

14. Specifically, the Commission proposed to rely on three financial models that produce zones of reasonableness—the DCF model, CAPM, 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.[39]

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[34] *Id.* at 28-30.

[35] *Id.* at 30.

[36] *Id.*

[37] *Id.*

[38] *Coakley v. Bangor Hydro-Elec. Co.*, 165 FERC ¶ 61,030 (2018) (*Coakley* Briefing Order).

[39] *See id.* PP 16, 30.

15. The Commission also proposed a framework for using the composite zone of reasonableness in evaluating whether an existing base ROE remains just and reasonable. The Commission proposed that, in order to find a utility's existing ROE unjust and unreasonable under the first prong of section 206 of the FPA, its ROE must be outside a range of presumptively just and reasonable ROEs for a utility of its risk profile, absent additional evidence to the contrary. In other words, the Commission would dismiss an ROE complaint if the targeted utility's existing ROE falls within the range of presumptively just and reasonable ROEs for a utility of its risk profile unless that presumption is sufficiently rebutted. The Commission explained that, by the same token, a finding that the existing ROE of a utility falls outside that range would support a holding that the ROE has become unjust and unreasonable, absent additional evidence to the contrary.[40]

16. The Commission explained that it would be appropriate to calculate the applicable ranges of presumptively just and reasonable ROEs based on a utility's risk profile because a utility's risk profile remains the "particular circumstance[]" most relevant to determining whether a point within a zone of reasonableness is a just and reasonable ROE for that utility.[41] The Commission further concluded that the "principal consideration for determining whether an existing ROE within the overall zone of reasonableness has become unjust and unreasonable is the risk profile of the utility or utilities for which the Commission is setting the ROE."[42]

17. The Commission proposed that the applicable range of presumptively just and reasonable ROEs for a utility should correspond to those points that are closer to the ROE that the Commission should set for that utility than to the ROE for a utility of a different risk profile.[43] For example, the Commission explained that it typically would be unjust and unreasonable for an average risk utility to receive an ROE that is closer to the ROE that would be just and reasonable for a utility of above- or below-average risk.[44] In particular, for average risk utilities, the Commission proposed that the presumptively just and reasonable range would be the quartile of the zone of reasonableness centered on the central tendency of the composite zone of reasonableness. For below average risk utilities, the Commission proposed that such range would be the quartile of the zone of reasonableness centered on the central tendency of the lower half of the zone of

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[40] *See id.* PP 16, 28.

[41] *Id.* P 24 (quoting *Emera Maine*, 854 F.3d at 23).

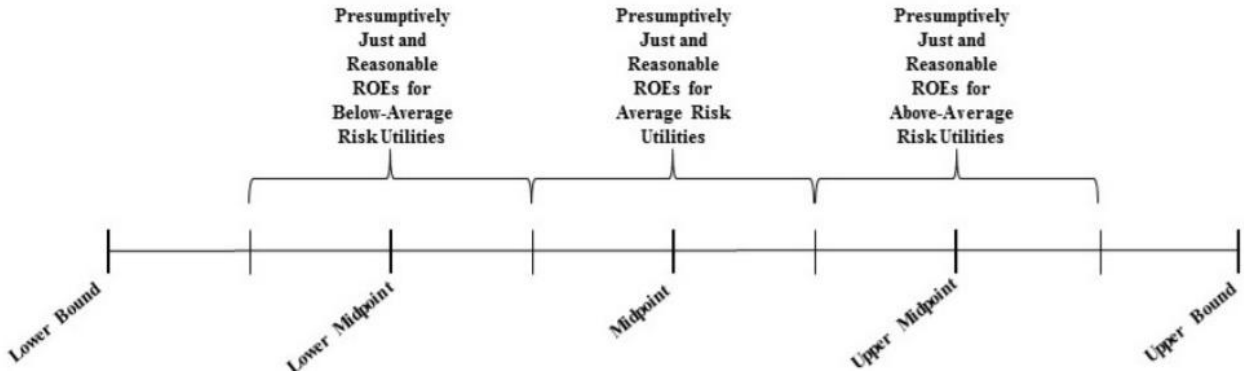
[42] *Id.* P 28.

[43] *Id.* P 27.

[44] *Id.* P 26.

reasonableness. For above average risk utilities, the Commission proposed that such range would be the quartile of the zone of reasonableness centered on the central tendency of the upper half of the zone of reasonableness.[45] The Commission illustrated how these presumptively just and reasonable quartile ranges would be divided as follows:

Figure 1: Zone of Reasonableness Quartiles



18. For purposes of establishing a new just and reasonable base ROE when the existing base ROE has been shown to be unjust and unreasonable, the Commission proposed using the above three models, plus the Risk Premium model. The Risk Premium model produces a single numerical point rather than a range; therefore, the Commission did not propose to use it to establish a composite zone of reasonableness. The Commission proposed to determine a new just and reasonable ROE for average risk utilities by determining the midpoint/medians of each zone of reasonableness produced by the DCF, CAPM, and Expected Earnings models and averaging those ROEs with the Risk Premium ROE, giving equal weight to each of the four figures.[46] The Commission

[45] *Id.*

[46] *See* Opinion No. 569, 169 FERC ¶ 61,129 at P 344 ("In determining the central tendency of the zone of reasonableness, the Commission has distinguished between cases involving an RTO-wide ROE and cases involving the ROE of a single utility (or pipeline). In cases involving an RTO-wide ROE, the Commission has held that the midpoint is appropriate. The Commission has reasoned that, because an RTO-wide ROE will apply to a diverse set of companies, the range of results becomes as important as the central value, and the midpoint fully considers that range, because it is derived directly from the endpoints of the range . . . By contrast, in cases involving a single utility, the Commission has held that using the median is appropriate, because the median 'is the most accurate measure of central tendency for a single utility of average risk.'") (citing *SoCal Edison*, 131 FERC ¶ 61,020, at P 91 (2010), *remanded on other grounds sub nom. S. Cal. Edison Co. v. FERC*, 717 F.3d 177, 183-87 (D.C. Cir. 2013) (*S. Cal. Edison v. FERC*)); Briefing Order, 165 FERC ¶ 61,118 at n.40: "The Commission will continue to use the midpoint of the zone of reasonableness as the appropriate measure of central

proposed to use the midpoint/medians of the lower and upper halves of the zones of reasonableness to determine ROEs for below average and above average risk utilities, respectively, and average those ROEs with the Risk Premium ROE.[47]

19. On November 15, 2018, the Commission issued the Briefing Order in these proceedings. In that order, the Commission similarly established a paper hearing on whether and how the methodology proposed in the *Coakley* Briefing Order should apply to the two proceedings pending before the Commission involving MISO TOs' ROE.[48]

F. Opinion No. 569

20. On November 21, 2019, the Commission issued Opinion No. 569 in which it applied a revised methodology for analyzing existing base ROEs under section 206 of the FPA. The revised methodology applied in Opinion No. 569 did not use the Expected Earnings or Risk Premium models as was proposed in the Briefing Order, and instead used only the DCF model and CAPM in the Commission's determinations under the first and second prongs of section 206. The methodology applied in Opinion No. 569 gave equal weight to the DCF model and CAPM by averaging the top and bottom of the DCF and CAPM zones of reasonableness to produce a composite zone of reasonableness.[49] In addition, in Opinion No. 569, the Commission reaffirmed its use of a two-step DCF analysis that gives one-third weight to a long-term growth rate based on projected growth in gross domestic product (GDP).[50] The Commission also held that it would continue to rely exclusively on the IBES as the preferred source for the DCF short-term growth projection, absent compelling reasons otherwise.[51] The Commission further held that only the short-term growth rate should be used to calculate the (1+.5g) adjustment to dividend yield in the DCF analysis for the CAPM.[52]

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tendency for a diverse group of average risk utilities and the median as the measure of central tendency for a single utility."

[47] *Id.* P 17.

[48] *See* Briefing Order, 165 FERC ¶ 61,118 at P 1.

[49] *See, e.g.*, Opinion No. 569, 169 FERC ¶ 61,129 at PP 37, 276.

[50] *Id.* PP 151-159.

[51] *Id.* P 133.

[52] *Id.* PP 98-100.

21. In Opinion No. 569, the Commission also adopted a specific CAPM methodology. First, the Commission adopted the use of the 30-year U.S. Treasury average historical bond yield over a six-month period as the risk free rate.[53] Second, the Commission held that the CAPM expected market return should be estimated using a forward-looking approach based on applying the DCF model to the dividend paying members of the S&P 500.[54] In addition, the Commission approved the use of a one-step DCF model using only short-term three to five-year growth projections for the DCF analysis of the dividend paying members of the S&P 500. The Commission also held that IBES should be the sole source of the short-term earnings growth estimates used in the DCF analysis that is part of the CAPM analysis[55] and that S&P 500 companies with growth rates that are negative or in excess of 20% should be screened from the DCF analysis.[56] Finally, the Commission held that the CAPM analysis should include a size premium adjustment.[57]

22. In addition to the above holdings concerning the DCF and CAPM models, the Commission also adopted a revised low-end outlier test that eliminates DCF and CAPM proxy group ROE results that are less than the yields of generic corporate Baa bonds plus 20% of the CAPM risk premium.[58] The Commission also adopted the high-end outlier test that was proposed in the *Coakley* Briefing Order and the Briefing Order in these proceedings, which treats as high-end outliers any proxy company whose cost of equity estimated under the model in question is more than 150% of the median result of all of the potential proxy group members in that model before any high or low-end outlier test is applied, subject to a "natural break" analysis.[59] The Commission also reaffirmed its use of the midpoint, rather than the median, as the measure of central tendency for ROEs that applied to groups of utilities.[60]

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[53] *Id.* P 238.

[54] *Id.* PP 260-273.

[55] *Id.* PP 274-276.

[56] *Id.* PP 267-268.

[57] *Id.* PP 296-303.

[58] *Id.* PP 19, 387-89.

[59] *See id.* PP 367-68, 375.

[60] *Id.* PP 409-413.

G. Requests for Rehearing

23. On December 23, 2019, the following parties to one or both of these proceedings filed requests for rehearing of Opinion No. 569: MISO TOs, the Complaint-Aligned Parties (CAP);[61] the Resale Power Group of Iowa (RPGI); Louisiana Public Service Commission (LPSC); Exelon Corporation (Exelon); Transource Energy, LLC (Transource Energy); and Ameren Services Company, on behalf of its transmission-owning public utility affiliates Ameren Illinois Company d/b/a Ameren Illinois, Union Electric Company d/b/a Ameren Missouri, and Ameren Transmission Company of Illinois (collectively, Ameren). In addition, on December 20, 2019, DTE Electric Company, Consumers Energy Company and Alliant Energy Corporate Services, Inc. (collectively, DTE), parties to both proceedings, filed a request for rehearing. On December 23, 2019, the Indicated PJM Transmission Owners (PJM TO)[62] filed a motion to lodge and request for rehearing.

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[61] For purposes of the their request for rehearing, CAPs include the following entities: American Municipal Power, Inc. (AMP); ABATE, Coalition of MISO Customers, IIEC, INDIEC, MLIG, and Wisconsin Industrial Group (WIEC) (collectively, Joint Complainants); Joint Consumer Advocates, including Indiana Office of Utility Consumer Counselor, Iowa Office of Consumer Advocate, Michigan Citizens Against Rate Excess, Minnesota Department of Commerce, and Citizens Utility Board of Wisconsin; Joint Customers, including Arkansas Electric Cooperative, Cooperative Energy, and Hoosier Cooperative; Organization of MISO States, Inc. (OMS); Mississippi Public Service Commission (MS PSC), Missouri Public Service Commission (MO PSC) and Missouri Joint Municipal Electric Utility Commission (MJMEUC) (collectively, Missouri-Mississippi Parties or MOMs); and Southwest Electric Cooperative, Inc. (SWEC). For purposes of the CAPs briefs in the Second Complaint proceeding, CAPs include Industrial Consumer Groups (ICG), comprising ABATE, Coalition of MISO Customers, IIEC, INDIEC, MLIG, and WIEC; Joint Consumer Advocates, comprising Illinois Citizens Utility Board, Indiana Office of Utility Consumer Counselor, Iowa Office of Consumer Advocate, Michigan Citizens Against Rate Excess, Minnesota Department of Commerce, and Citizens Utility Board of Wisconsin; Joint Complainants and Intervenor (JCI), comprising Arkansas Electric Cooperative, Cooperative Energy, and Hoosier Cooperative; OMS; Missouri-Mississippi Parties; and SWEC.

[62] For purposes of this filing, the PJM TOs are American Electric Power Service Corporation, on behalf of its affiliates, Appalachian Power Company, Indiana Michigan Power Company, Kentucky Power Company, Kingsport Power Company, Ohio Power Company, Wheeling Power Company, AEP Appalachian Transmission Company, AEP Indiana Michigan Transmission Company, AEP Kentucky Transmission Company, AEP Ohio Transmission Company, and AEP West Virginia Transmission Company; Duquesne Light Company; Exelon; PPL Electric Utilities Corporation; and Public

24. In addition, multiple non-parties filed requests for rehearing and other motions. On December 23, 2019, the following entities filed such requests and/or motions: PPL Electric Utilities Corporation (PPL Electric) filed a motion to intervene out-of-time and motion to lodge; Southern California Edison Company (SoCal Edison) filed a motion to comment; American Electric Power Service Corporation[63] (AEP) filed a motion to intervene out-of-time and motion to lodge; San Diego Gas & Electric Company (SDG&E) filed a motion to intervene out-of-time and motion for Clarification, or in the alternative, request for rehearing; FirstEnergy Service Company (FirstEnergy) filed a request for rehearing and motion for late intervention; WIRES LLC filed a motion to intervene out-of-time, motion to lodge, and request for rehearing; Public Service Electric and Gas Company (PSEG) filed a motion to intervene out-of-time; Edison Electric Institute (EEI) filed a motion to intervene out-of-time, motion to lodge, and request for rehearing; AEP Indiana Michigan Transmission Company, Inc. filed a motion to intervene out-of-time; and the Southwest Power Pool, Inc. (SPP) Transmission Group[64] filed public comments concerning Opinion No. 569. On December 23, 2019, New England TOs[65] filed a letter requesting that, if the Commission intends to use the

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Service Electric and Gas Company. Some, but not all, of the PJM TOs have timely intervened in these proceedings.

[63] American Electric Power Service Corporation filed on behalf of Appalachian Power Company, Indiana Michigan Power Company, Kentucky Power Company, Kingsport Power Company, Ohio Power Company, Wheeling Power Company, AEP Appalachian Transmission Company, AEP Kentucky Transmission Company, AEP Ohio Transmission Company, and AEP West Virginia Transmission Company.

[64] For purposes of this filing, the SPP Transmission Group is Evergy Kansas Central, Inc., Evergy Metro, Inc., Evergy Missouri West, Inc. (subsidiaries of Evergy, Inc. that were formerly known as Westar Energy, Inc., Kansas City Power & Light Company, and KCP&L Greater Missouri Operations Company, respectively), American Electric Power Service Corporation, on behalf of its affiliates, Public Service Company of Oklahoma, Southwestern Electric Power Company, Oklahoma Transmission Company and Southwestern Transmission Company (collectively AEP-West), The Empire District Electric Company (a Liberty Utilities company), Oklahoma Gas & Electric Company, and Southwestern Public Service Company.

[65] For purposes of this letter, the New England TOs are: Emera Maine f/k/a Bangor Hydro-Electric Company, Central Maine Power Company, New England Power Company d/b/a National Grid, New Hampshire Transmission LLC, Eversource Energy Service Company (on behalf of its operating company affiliates: The Connecticut Light and Power Company; NSTAR Electric Company; and Public Service Company of New Hampshire, each of which is doing business as Eversource Energy), The United

outcome of these proceedings to establish any ROE policies or precedent that would apply to the New England TOs, then the Commission consider the arguments that the New England TOs made in their supplemental brief in the complaint proceedings regarding their base ROE in which the *Coakley* Briefing Order was issued. On January 7, 2020, the American Public Power Association (APPA) and Transmission Access Policy Study Group (TAPS) filed a conditional motion to intervene out-of-time and conditional motion to lodge.

H. Subsequent Filings

25. On January 7, 2020, CAPs filed an answer in opposition to the late motions to intervene and alternative motion for leave to respond to non-party comments. On January 10, 2020, EEI and WIRES LLC filed a motion for leave to answer and answer to CAPs' January 7 answer. On January 13, 2020, FirstEnergy filed a motion for leave to answer and answer to CAPs' January 7 answer. On January 21, 2020, PPL Electric filed a motion for leave to answer and answer to CAPs' January 7 answer. On January 28, 2020, CAPs filed a motion to strike portions of various entities' requests for rehearing and motions. On February 12, 2020, MISO TOs filed a motion for leave to answer and answer to certain portions of entities' requests for rehearing, as well as CAPs' January 7 answer and the APPA and TAPS January 7 conditional motion to intervene out-of-time and conditional motion to lodge. On February 12, 2020, the PJM TOs, MISO TOs and Exelon filed separate answers to CAPs' January 28 motion to strike. On February 13, 2020, Transource Energy also filed an answer to CAPs' January 28 motion to strike. On February 27, 2020, CAPs filed an answer to MISO TOs' February 12 answer.

II. Procedural Matters

26. We deny the motions to intervene out-of-time and the requests for rehearing and other motions included with those motions to intervene out-of-time. In ruling on a motion to intervene out-of-time, we apply the criteria set forth in Rule 214(d) of the Commission's Rules of Practice and Procedure.[66] When late intervention is sought after the issuance of a dispositive order, the prejudice to other parties and burden upon the Commission of granting the late intervention may be substantial. Thus, movants bear a higher burden to demonstrate good cause for the granting of such late intervention.[67] In addition, it is generally Commission policy to deny late intervention at the rehearing

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Illuminating Company, Unitil Energy Systems, Inc., Fitchburg Gas and Electric Light Company, and Vermont Transco, LLC.

[66] 18 C.F.R. § 385.214(d) (2019).

[67] *See, e.g., Midwest Indep. Transmission Sys. Operator, Inc.*, 102 FERC ¶ 61,250, at P 7 (2003).

stage, including when the petitioner claims that the decision establishes a broad policy of general application.[68]

27. None of the entities that filed motions to intervene out-of-time have met their burden to justify granting late intervention, and we therefore deny their motions to intervene. We find that granting these late interventions at this stage of the proceedings would substantially disrupt the proceedings,[69] as well as prejudice and place significant additional burdens on the existing parties to these proceedings.[70] The entities seeking late intervention have not demonstrated good cause that would justify granting late intervention despite these negative consequences. This is particularly true in light of the fact that, as discussed below, parties will have an opportunity to argue that the base ROE methodology applied in any of these proceedings should be modified or applied differently because of the specific facts and circumstances of the proceeding involving that party.[71] Accordingly, we deny the motions to intervene out-of-time of PPL Electric, AEP, SDG&E, FirstEnergy, WIRES LLC, PSEG, EEI, AEP Indiana Michigan Transmission Company, Inc., and APPA and TAPS. As these entities are not parties to these proceedings, they may not seek rehearing of Opinion No. 569, and we reject their respective pleadings on that basis.[72]

28. SoCal Edison filed a motion to comment and the SPP Transmission Group filed what it styled as "public comments" regarding Opinion No. 569, without motions to intervene out-of-time. We find that these pleadings are effectively requests for rehearing and, because these entities are not parties to these proceedings, they may not seek rehearing of Opinion No. 569, and we reject their respective pleadings on that basis. We note that only some of the PJM TOs have timely intervened in these proceedings—Duquesne Light Company and Exelon—therefore we will address the requests for rehearing that those two parties made as part of the PJM TOs.

29. The motions to lodge filed by PPL Electric, AEP, WIRES LLC, EEI, and APPA and TAPS are essentially components of requests for rehearing of Opinion No. 569, and

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[68] *See, e.g., Seminole Elec. Coop., Inc.*, 153 FERC ¶ 61,037, at P 11 & n.14 (2015) (citing *PáTu Wind Farm LLC v. Portland General Elec. Co.*, 151 FERC ¶ 61,223, at P 39 & n.85 (2015) (citing *Columbia Gas Transmission Co.*, 113 FERC ¶ 61,066, at 61,243 (2005))).

[69] *See* 18 C.F.R. § 385.214(d)(1)(ii).

[70] 18 C.F.R. § 385.214(d)(1)(iv).

[71] *See infra* at P 204.

[72] 16 U.S.C. § 825*l* (2018); 18 C.F.R. § 385.713(b).

we therefore deny those motions because those entities are not parties to these proceedings. Moreover, even if we were to consider those motions to lodge, and the motion to lodge filed by PJM TOs, as not a component of a request for rehearing, we would deny those motions on the merits. Rule 716 provides that a proceeding may be reopened only when reopening is warranted by a change in condition of fact or law, or by public interest.[73] Additionally, a decision to reopen the record is a discretionary one for the Commission, and Commission policy discourages reopening records, except in extraordinary circumstances in order to prevent administrative chaos and provide finality to proceedings.[74] Further, a demonstration of extraordinary circumstances requires a showing of a material change that goes to the very heart of the case.[75] We find that the entities that filed motions to lodge have failed to show any compelling changes in law, fact, or public interest that would necessitate reopening of the record to lodge the materials that they seek to lodge. As discussed further below in section XV, to the extent that these entities are concerned that Commission actions in these proceedings will affect them and they have filed pleadings or materials in other proceedings that they want the Commission to consider before taking action with respect to their base ROEs, such entities will have an opportunity to present those pleadings or materials and argue that any Commission actions in these proceedings should be modified or applied differently because of the specific facts and circumstances of the proceeding involving that entity.

30. Given that we are denying the motions to intervene out-of-time, we find that CAPs' January 7 answer in opposition to the late motions to intervene or, in the alternative, motion for leave to respond to the pleadings, comments and requests for rehearing submitted by those entities, is moot and we reject it. We therefore also reject the answers to CAPs' January 7 answer submitted by EEI, WIRES LLC, FirstEnergy, PPL Electric, and MISO TOs. We also reject CAPs' January 28 motion to strike portions of various entities' requests for rehearing and motions. To the extent that this motion relates to contents of a motion to lodge that has been denied, as discussed above, we find that it is moot. To the extent that this motion relates to requests for rehearing, it is an answer to a request for rehearing and we reject it because it is prohibited by Rule 713(d)(1) of the Commission's Rules of Practice and Procedure.[76] We find that

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[73] 18 C.F.R. § 385.716(c).

[74] *See, e.g., Gas Producing Enterprises, Inc.*, 28 FERC ¶ 61,008 (1984) (citing *Consolidated Gas Supply Corp.*, 24 FERC ¶ 61,283 (1983), *Transcontinental Gas Pipe Line Corp.*, 23 FERC ¶ 61,152 (1983), and *ICC v. Jersey City*, 322 U.S. 503 (1944)).

[75] *See, e.g., CMS Midland, Inc., Midland Cogeneration Venture Limited Partnership*, 56 FERC ¶ 61,177, at 61,624 (1991).

[76] 18 C.F.R. § 385.713(d)(1).

CAPs have not shown good cause for us to waive this rule to allow their answer.[77] Because we are rejecting CAPs' January 28 motion to strike, we also reject the answers to that motion filed by PJM TOs, MISO TOs, Exelon, and Transource Energy. We reject MISO TOs' February 12 answer to requests for rehearing for the same reasons, and find that this answer is moot as it relates to the APPA and TAPS January 7 conditional motion to intervene out-of-time because, as discussed above, we are denying that motion to intervene out-of-time. Given that we are rejecting MISO TOs' February 12 answer, we also reject CAPs' February 27 answer to that answer.

III. General Model Issues

31. This section pertains to the Commission's decision in Opinion No. 569 to use two models in its base ROE analysis under section 206 of the FPA, rather than either using only the DCF model or using all four models proposed in the Briefing Order. It does not address the specific merits of the individual models, which are discussed in subsequent sections.

A. Opinion No. 569

32. The Commission found that averaging of multiple models reflected how investors made investment decisions and reduced model risk to the greatest extent possible. The Commission cited MISO TOs' witness, Mr. McKenzie, who explained that "when conditions associated with a model are outside of the normal range, there is a risk . . . that the theoretical model will fail to predict or represent the real phenomenon that is being modeled."[78] The Commission also cited Dr. Morin, who found that "Reliance on any single method or preset formula is inappropriate when dealing with investor expectations because of possible measurement difficulties and vagaries in individual companies' market data."[79]

33. The Commission, for reasons specific to the Risk Premium and Expected Earnings Models, determined that they were not appropriate to use for determination of ROEs, for either the first or second prong of section 206 analyses. Opinion No. 569, applying the DCF model and CAPM, reduced the MISO TOs' ROE from the 10.32% prescribed in Opinion No. 551, which was itself a reduction from 12.38%, to 9.88%.

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[77] *See id.* § 385.101(e).

[78] Opinion No. 569, 169 FERC ¶ 61,129 at PP 38-39 (citing Docket No. EL14-12-001, Ex. MTO-22, at 18-19).

[79] *Id*. (citing Roger A. Morin, James, *New Regulatory Finance* (Public Utilities Reports, Inc. 2006) (Morin) at 428).

B. Requests for Rehearing

34. CAPs contend that the Commission erred by finding that the results of the DCF model alone were not just and reasonable. Specifically, CAPs contend that the Commission did not address the testimony of its expert, Dr. Keith Berry, arguing against the Commission's finding of model risk justifying the use of multiple models.[80]

35. Certain parties argue that the Commission acted arbitrarily and capriciously or otherwise did not engage in reasoned decision-making when it determined that the Risk Premium and Expected Earnings models should not be used for ROE determinations. Parties point out that the Commission endorsed using the Risk Premium and Expected Earnings Models in Opinion Nos. 531, 531-A, and 551, as well as the Briefing Order in these proceedings. Specifically, Exelon states that, in the Briefing Order, the Commission found that "it is clear that investors place greater weight on one or more of the other methods for estimating the expected returns from utility investments, as well as taking other factors into account."[81] Exelon contends that the Commission, in Opinion No. 569, insufficiently justified reversing course on this point. Exelon also argues that the Risk Premium and Expected Earnings Models should not be ignored due to their alleged deficiencies, asserting that the CAPM and DCF also have deficiencies. Ameren similarly contends that the Commission's reversal from the Briefing Order was unsupported and contradictory to its findings that investors rely on a diverse set of data sources.[82]

36. Transource Energy argues that the Commission, in Opinion No. 569, was internally inconsistent by giving no weight to the Expected Earnings and Risk Premium Models despite finding that investors rely on multiple models.[83] Transource Energy contends that four models provide a more complete picture than two models, which themselves share many common inputs. Transource Energy asserts that the Commission in Opinion No. 569 issued findings inconsistent with those in Opinion No. 531, which considered three other models, and notes that the Court did not find fault with this finding.[84] Transource Energy states that the CAPM results indicate that a 9.88% ROE was inadequate. Transource Energy also states that the midpoint of the CAPM was 10.45% and contends that no record evidence suggests that 10.45% is overstated.

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[80] CAPs Rehearing Request at 85-87.

[81] Exelon Rehearing Request (citing Briefing Order, 165 FERC ¶ 61,118 at P 37).

[82] Ameren Rehearing Request at 11-13.

[83] Transource Energy Rehearing Request at 15-16.

[84] *Id.* at 17-18

Transource Energy argues that the Commission has previously determined that the DCF is not reliable and that substantial evidence in the record demonstrates that the cost of capital is more consistent with the CAPM result than the DCF result for the complaint time period.[85]

37. Certain parties also argue that the reduction of MISO TOs' ROE in Opinion No. 569 is unjust and unreasonable on the basis that it reduces MISO TOs' ROE to an unreasonably low level. MISO TOs state that, in Opinion No. 551, "the Commission concluded that a 175-basis point ROE reduction . . . could put transmission investment at risk."[86] MISO TOs also argue that the ROE resulting from Opinion No. 569 could cause capital to be diverted to other purposes. Transource Energy similarly contends that the Commission has not supported a 9.88% ROE, and notes that it is below many of the benchmarks provided by state ROEs and other models.[87] Ameren also contends that this methodology threatens utility credit ratings and thus violates *Hope* and *Bluefield*. Specifically, they cite *Bluefield's* finding that the return "should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[88]

38. Ameren and Transource Energy state that the Commission should not have excluded the Expected Earnings and Risk Premium models because they have flaws while keeping the DCF and CAPM models, which the Commission acknowledged also have flaws.[89] As an example of DCF and CAPM flaws, Transource Energy notes the Commission's finding in Opinion No. 551 that the DCF model is distorted by a low-interest rate capital market.[90] Ameren and Transource Energy argue, therefore, that the Commission's assertion that there exist imperfections in the Expected Earnings and Risk Premium models is not a valid justification for excluding those models.[91] According to Transource Energy, excluding the Expected Earnings and Risk Premium models results in twice the weighting for the DCF model, and Transource Energy notes

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[85] *Id.* at 14-15.

[86] MISO TOs Rehearing Request at 19 (citing Opinion No. 551, 156 FERC ¶ 61,234 at P 263).

[87] Transource Energy Rehearing Request at 11.

[88] *See, e.g., id*. at 6 (citing *Bluefield*, 262 U.S. at 693).

[89] Ameren Rehearing Request at 12; Transource Energy Rehearing Request at 23.

[90] Transource Energy Rehearing Request at 21-22.

[91] Ameren Rehearing Request at 12; Transource Energy Rehearing Request at 23.

that only including one other model with inputs which share similar characteristics to the DCF does not obviate the issue of whether the DCF is less reliable due to capital market conditions.[92]

39. Ameren and Transource Energy argue that the Commission should keep the four-model framework proposed in the Briefing Order because the Commission has stated that use of multiple models provides more accuracy, consistency with investor expectations, and robustness.[93] Ameren contends that the addition of the Expected Earnings and Risk Premium models would prevent an unreasonable restriction of the zone of reasonableness, and Transource Energy notes that the DCF and CAPM models provide the least diversification benefits of the four the Commission originally proposed.[94] Ameren argues that, when the Commission moved to a two-model ROE methodology, it failed to explain why it excluded certain models (i.e., the Expected Earnings and Risk Premium models) that are relied upon by investors. Ultimately, the new methodology gives zero weight to the excluded models when they were previously assigned a 25% weight in Opinion No. 569. Ameren asserts that the resulting ROE based on only the CAPM and DCF models is not supported by the record and is therefore arbitrary and capricious.[95] Ameren and Transource Energy state that the Commission's use of only the DCF and CAPM models fails to compensate MISO TOs for the actual risks associated with transmission infrastructure development.[96] Ameren and Transource Energy argue that this inadequacy amounts to failure of the capital attraction standards and threatens utility credit metrics, in violation of *Hope* and *Bluefield*.[97]

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[92] Transource Energy Rehearing Request at 21-22.

[93] Ameren Rehearing Request at 12-13; Transource Energy Rehearing Request at 15, 26.

[94] Ameren Rehearing Request at 12-13; Transource Energy Rehearing Request at 16-17, 19.

[95] SoCal Edison Comment, Docket No. EL14-12, at 11-12; Indicated PJM TOs Rehearing Request, Docket No. EL14-12, at 11; Ameren Rehearing Request, Docket No. EL14-12, at 23-25; Wires Comment Rehearing Request, Docket No. EL15-45, et al., at 17; Wires Comment Rehearing Request, Docket No. EL14-12, et al., at 7, 17; FirstEnergy Hearing Request, Docket No. EL15-45, at 3; Transource Energy Rehearing Request, Docket No. EL14-12, at 18-19.

[96] Ameren Rehearing Request at 6; Transource Energy Rehearing Request at 9-12.

[97] Ameren Rehearing Request at 6-7; Transource Energy Rehearing Request at 9-12.

40. MISO TOs also argue that the court's analysis in *Emera Maine* did not require the Commission to construct a new paradigm to satisfy the second prong of section 206. Instead, they argue, the Commission can remedy its error simply by evaluating "the alternative benchmarks and additional record evidence" that warrant selecting a base ROE greater than the midpoint (of whatever range of estimated returns on which the Commission elects to rely) to determine a new, just and reasonable base ROE.[98]

41. MISO TOs contend that, regardless of whether the base ROE prescribed by Opinion No. 569 is a midpoint value of some range of estimated ROEs, section 206 still requires the Commission to explain why, based on the evidence in the record, the new ROE is just and reasonable. MISO TOs contend that the Commission's new approach still fails to do so. MISO TOs contend that the mere fact that the newly prescribed ROE is the midpoint of the composite DCF-CAPM range of estimates does not make that value a just and reasonable ROE. According to MISO TOs, the Commission's selection of the average of the DCF and CAPM midpoints is no better justified in Opinion No. 569 than was the selection of the upper half midpoint found to be arbitrary and capricious in *Emera Maine*.[99]

42. With regard to the First Complaint, MISO TOs argue that *Emera Maine* does not require, and establishes no reason why, the Commission should fundamentally modify the approach of Opinion Nos. 531 and 551, other than to correct or avoid the specific errors the court pinpointed. They argue that the evidence more than amply supports the Commission's conclusion in Opinion No. 551 that the DCF midpoint of 9.29% (stated as 9.3% in Opinion No. 569) is too low to pass muster under *Hope* and *Bluefield*.[100]

C. Commission Determination

43. We disagree with CAPs' contention that the record does not support our finding of model risk as justifying no longer relying solely on the DCF model. Model risk includes the broad conceptual issue of models being imperfect and not always working well in all situations. It also entails errors of specific model inputs, such as the error discussed with respect to the Portland General Electric inputs, discussed in paragraph 145 below. We continue to find that ROE determinations should consider multiple models, both to capture the variety of models used by investors and to mitigate model risk. With respect to the former, we reiterate our findings from Opinion No. 569 in support of the finding

[98] MISO TOs Rehearing Request at 30-31.

[99] *Id.* at 31-32.

[100] *Id.* at 32.

that use of multiple models reduces model risk. Dr. Morin speaks of the type of potential model errors that comprise "model risk" and why use of additional models is warranted:

> In the absence of any hard evidence as to which method outdoes the other, all relevant evidence should be used and weighted equally, in order to minimize judgmental error, measurement error, and conceptual infirmities. A regulator should rely on the results of a variety of methods applied to a variety of comparable groups, and not on one particular method. There is no guarantee that a single DCF result is necessarily the ideal predictor of the stock price and of the cost of equity reflected in that price, just as there is no guarantee that a single CAPM or Risk Premium result constitutes the perfect explanation of that stock price.[101]

44. We also disagree with contentions that Opinion No. 569 resulted in rates that fail to meet the *Hope* and *Bluefield* standards for just and reasonable rates because they reduce the ROE. As an initial matter, the ROE resulting from this order will be materially higher than the 9.88% resulting from Opinion No. 569 for the First Complaint, rendering such concerns at least partially addressed. Second, cost-of-service principles dictate that the ROE should increase or decrease with the cost of capital. The Commission employs, and at times modifies, financial models, to determine this cost of capital. Although any rate reduction, by reducing earnings, will necessarily adversely affect certain financial metrics, that does not preclude the Commission from reducing rates. It is not incumbent on the Commission to demonstrate that any rate reduction, if supported by evidence demonstrating reduced cost of capital, would not adversely affect utilities' financial metrics. By the logic of certain parties, virtually any rate reduction would be unjust and unreasonable simply because it reduces the ROE and thus harms financial metrics for the affected utilities. In this case, the reduction in ROE from 10.32% in Opinion No. 551 to 9.88% in Opinion No. 569 was less than 4% and Opinion No. 569 extensively supported this such reduction.

45. As described below, we now find that the flaws for the Risk Premium model, when mitigated by certain adjustments, do not render use of the model unreasonable, while the flaws of the Expected Earnings model are significant enough to render the model inappropriate for ROE calculations. We are not persuaded by Ameren's and Transource Energy's arguments that the Expected Earnings model's flaws constitute an insufficient reason to exclude the model because the Commission has acknowledged that other models also have flaws. As the Commission explained in Opinion No. 569, the Commission considered the disadvantages and advantages of each model and concluded that, on balance, the disadvantages of the Expected Earnings model outweigh its

[101] Morin at 429.

advantages.[102] Simply because other models also have disadvantages does not mean that they have the same level of disadvantages or advantages as those of the Expected Earnings model. The Commission may use its discretion to determine which flaws in various models render the models unreasonable, and thus unusable, and which do not.

46. Regarding arguments that the Commission should include all four models because more models provide additional robustness, we agree—if the models are methodologically and legally sound. As described below, we conclude that the Risk Premium model, with adjustments, is sound, while the Expected Earnings model is not. We are not persuaded by arguments that all four models should be included because they broaden the zone of reasonableness. Such assertions, without support, suggest adopting a zone of reasonableness that is far wider than what the Commission has historically determined would be just and reasonable without sufficient justification as to why such a broader zone of reasonableness is appropriate. Nonetheless, our decision to now construct the ranges of presumptively just and reasonable ROEs by dividing the full zone of reasonableness into equal thirds instead of using the quartiles applied in Opinion No. 569, as discussed in section XIV below, at least in part addresses such concerns by widening the range of presumptively just and reasonable existing ROEs.

IV. DCF

A. Opinion No. 569

1. Short-Term Growth Rate

47. In Opinion No. 569, the Commission found that the DCF and CAPM models should employ IBES short-term growth rates.[103] In the context of the DCF, the Commission explained that IBES was preferable because the IBES growth projections generally represent consensus growth estimates by a number of analysts while *Value Line* growth estimates represent the growth projection of a single analyst.[104] The Commission explained that, while many investors use both IBES and *Value Line* growth rates, only IBES growth rates reflect the analysis of a diverse group of persons in the investment community.[105] The Commission cited academic research that supported the use of IBES

[102] *See* Opinion No. 569, 169 FERC ¶ 61,129 at P 209.

[103] *Id.* P 251.

[104] *Id.* P 125.

[105] *Id.*

because of its use of multiple analysts' growth projections instead of a single analyst.[106] In addition, the Commission noted that IBES growth projections are generally more timely than the *Value Line* projections because IBES updates its data base on a daily basis as participating analysts revise their forecasts, whereas *Value Line* publishes its projections on a rolling quarterly basis.[107]

2. Long-Term Growth Rate Weighting

48. In Opinion No. 531, the Commission adopted the same two-step DCF model for electric utilities as it has used for natural gas and oil pipelines since the mid-1990s. That model includes a projection of the long-term growth in dividends based on the growth in GDP, in addition to the short-term three to five-year growth projection. The long-term growth projection is given one-third weight, with a short-term growth projection given two-thirds weight.

49. In the Briefing Order, the Commission proposed no changes to its existing two-step DCF model. In Opinion No. 569, the Commission rejected the MISO TOs' contention that, if the Commission applied a high-end outlier test to the ROE results produced by the two-step DCF analysis, the Commission should eliminate the long-term growth projection.[108] Specifically, the Commission rejected MISO TOs' assertion that, if the Commission applies a high-end outlier test to the DCF model, there will remain no rationale for requiring the long-term growth component of the two-step DCF model.[109] The Commission found that the existence of the high-end outlier test is irrelevant to the question of whether a long-term growth projection should be included in a DCF analysis of public utilities.[110] The Commission stated that the high-end outlier test eliminates outlier proxy group members and that it does not address the fact that, over the long-term, companies cannot maintain their short-term growth rates and must, to some extent, converge on the growth rate of the overall economy.[111] Furthermore, the Commission stated that the high-end outlier test that it adopted in Opinion No. 569 does not screen out any of the ROEs produced by the DCF analysis of the proxy groups in these two cases,

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[106] *Id.*

[107] *Id.* P 128.

[108] *Id.* PP 151-159.

[109] *Id.* P 159

[110] *Id.*

[111] *Id.*

including the ROE results discussed above that establish the top of the zones of reasonableness in these two cases.[112]

B. Rehearing Requests

1. Short-Term Growth Rate

50. RPGI states that the Commission correctly used IBES consensus earnings growth estimates rather than *Value Line* earning growth estimates.[113]

51. MISO TOs state that the Commission erred in finding that "IBES is more reliable and robust" than *Value Line* and choosing to use the IBES three to five-year growth projection over *Value Line* growth projections.[114] MISO TOs assert that the Commission erred in finding that there was a general consensus by citing a witness's belief that IBES growth estimates have a higher potential for representing a broader investor community, and the Commission cannot accurately characterize IBES estimates as consensus estimates.[115]

52. MISO TOs assert that the Commission wrongly attempted to relegate *Value Line*'s estimates as "projections by a single institution."[116] MISO TOs argue that the Commission's statement minimizes the fact that *Value Line* estimates are consensus estimates that are the results of a committee composed of peer analysts, and not simply the product of a single analyst.[117] MISO TOs also state that merely averaging analysts' estimates does not create a consensus, and there is no indication that the analysts behind the IBES estimates agree on the published value.[118]

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[112] *Id.*

[113] RPGI Rehearing Request at 61.

[114] MISO TOs Rehearing Request at 63 (citing Opinion No. 569, 169 FERC ¶ 61,129 at P 133).

[115] *Id.* at 64 (citing Opinion No. 569, 169 FERC ¶ 61,129 at P 127 (quoting Commission Trial Staff witness Mr. Robert J. Keyton)).

[116] *Id.* (citing Opinion No. 569, 169 FERC ¶ 61,129 at P 125 n.278).

[117] *Id.* at 64-65.

[118] *Id.* at 65.

53. MISO TOs assert that the Commission's stated preference for IBES over *Value Line* because it is more current is not supported by the record and is arbitrary and capricious.[119] MISO TOs state that the Commission appears to rely on the misperception that IBES' estimates are more up-to-date than *Value Line* simply because IBES can update its daily estimates on a daily basis.[120]

2. Long-Term Growth Rate Weighting

54. MISO TOs request rehearing of the Commission's decision not to adopt any changes to its existing two-step DCF model, averring that, if the Commission adopts a high-end outlier test, it should remove the long-term growth rate portion of the two-step DCF analysis.[121] MISO TOs contend that although no single approach provides a "one-size-fits-all" scenario for estimating the cost of capital, a constant growth DCF better represents investor expectations for the MISO TOs than a two-step DCF model using a long-term growth rate component.[122]

C. Commission Determinate

1. Short-Term Growth Rate

55. We will maintain the longstanding practice of using IBES short-term growth rates for the DCF model, absent compelling reasons for using an alternative source.[123] The record in this and numerous prior proceedings illustrates that the IBES growth rates appropriately inform the DCF analysis.[124] We continue to find that IBES is a reliable source of short-term growth rate data for the DCF model[125] and find that it is appropriate to continue to rely on IBES short-term growth rates in the DCF model given the

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[119] *Id.* at 66.

[120] *Id.* at 66-67.

[121] *Id.* at 77.

[122] *Id.* at 80 (citing McKenzie Supplemental Initial Brief Affidavit, Docket No. EL14-12, at 51–52).

[123] *See, e.g.*, Opinion No. 569, 169 FERC ¶ 61,129 at P 133 ("absent compelling reasons why, we will continue to rely exclusively on IBES as the preferred source for short-term growth projections for the purpose of performing the DCF analysis.").

[124] *See, e.g.*, *id.* at PP 120-133.

[125] *See id.* PP 125-128.

Commission's longstanding practice of relying on those IBES short-term growth rates in the DCF model[126] and the experience that entities coming before the Commission have gained in using IBES in the DCF model in light of that practice. However, we find that, although IBES short-term growth rates should be used for the DCF model,[127] the Commission will consider use of *Value Line* in future proceedings for the CAPM methodology, as discussed below.

2. Long-Term Growth Rate Weighting

56. We disagree with the MISO TOs' request that, if the Commission adopts a high-end outlier test, it should remove the long-term growth rate portion of the two-step DCF analysis and that a constant growth DCF better represents investor expectations for a two-step DCF model using a long-term growth rate component. However, as we note below, we are modifying the high-end outlier test to treat any proxy company as high-end outlier if its cost of equity estimated under the model in question is more than 200% of the median result of all of the potential proxy group members in that model before any high or low-end outlier test is applied, subject to a "natural break" analysis. Although we are not adopting MISO TOs' proposed change, upon reconsideration, we agree that changes to the long-term growth rate are warranted.

57. We grant rehearing to give the short-term growth rate 80% weighting and the long-term growth rate 20% weighting. We note that the court in *CAPP v. FERC*[128] held that the Commission has broad discretion in its weighting choice. Since the Commission established its one-third weighting policy of the GDP in the long-term growth rate, short-term growth rate projections for electric utilities have declined and are now closer to the current GDP growth projection than those from the 1990s when the Commission adopted the two-step DCF using one-third weighting for GDP in the long-term growth

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[126] *See id.* PP 121-123.

[127] In addition, with respect to the First Complaint proceeding, IBES short-term growth rates are the only data available in the record for the study period. *See, e.g.*, MISO TOs Initial Br. (I) at 22 ("MISO Transmission Owners do not propose reliance on growth rates from a source other than IBES to resolve the First Complaint."); MISO TOs Rehearing Request, Docket No. EL14-12-000, at 3 ("The MISO Transmission Owners . . . did not take exception to the Presiding Judge's adoption of the June 2015 Update Period as the appropriate study period for this case. Since they did not object to the June 2015 Update Period, and since there was no *Value Line* growth rate evidence related to that period, the MISO Transmission Owners had no quarrel with, and did not take exception to, the ALJ's ruling that his adoption of the June 2015 Study Period "dictate[d] use of IBES growth rates" insofar as Docket No. EL14-12 was concerned.").

[128] 254 F.3d 289 (D.C. Cir. 2001).

rate for natural gas and oil pipelines[129] that was subsequently adopted for public utilities.[130] For example, in Opinion No. 531, which considered market conditions during the time period from October 2012 to March 2013, the IBES growth projections of the proxy group (before the exclusion of low-end outliers) ranged from -1.90% to 8.10% and averaged 4.58%, only 19 basis points above the 4.39% GDP growth projection in that proceeding.[131] In the First Complaint proceeding, which considered market conditions during the time period from January 2015 to June 2015, the IBES growth projections of the proxy group (before the exclusion of low-end outliers) ranged from -0.64% to 11.66% and averaged 5.03%, 64 basis points above the projected growth in GDP in that proceeding of 4.39%.[132] By contrast, when MISO's 12.38% base ROE was established in 2002, the average IBES short-term growth rate estimate for that year was 7.79%,[133] a full 158 basis points above the estimated 6.21% GDP growth rate from a contemporaneous natural gas pipeline filing.[134]

58. Additionally, average electric utility IBES growth projections are only marginally higher than GDP growth projections. Under these circumstances, investors are likely to view electric utility IBES growth projections as more sustainable than the substantially higher natural gas pipeline IBES growth projections when the Commission established its two-thirds/one-third weighting policy. Therefore, it is reasonable to give the IBES growth projection more weight and give the GDP growth projection less weight. This finding is consistent with Opinion No. 414-A's findings that "long-term projections are

[129] For example, *New York State Electric & Gas Corp.*, 85 FERC ¶ 63,002 (1998). In Footnote 22, the Initial Order references a GDP growth rate of 5.08%, which was an average of three estimates: 5.10% from Data Resources Inc., 4.95% from Wharton Econometric Forecasting Associates, Inc., and 5.20% from the Energy Information Administration.

[130] *See* Opinion No. 531, 147 FERC ¶ 61,234 at PP 17-23, 32.

[131] *See id.* P 38 and Appendix.

[132] Opinion No. 569, 169 FERC ¶ 61,129 at P 135; Appendix A.

[133] *See Midwest Indep. Transmission Sys. Operator, Inc.*, 100 FERC ¶ 61,292 at app. A.

[134] *See* Trailblazer Pipeline Company, Testimony of Peter J. Williamson, Docket No. RP03-162-000, at P 19.

inherently more difficult to make, and thus are less reliable than short-term projections."[135]

59. We still believe that it is appropriate to consider the long-term growth rate to some extent, but now find that it is appropriate to afford less influence to the long-term growth rate. As the Commission held in Opinion No. 531:

> The DCF model is based on the premise that an investment in common stock is worth the present value of the infinite stream of future dividends discounted at a market rate commensurate with the investment's risk.[136] Corporations have indefinite lives and therefore will pay dividends for an indefinite period. For that reason, the Commission stated as long ago as 1983, when it first adopted the constant growth DCF model for gas pipeline cases, that 'projections by investment advisory services of growth for relatively short periods of years into the future' cannot be relied on 'without further consideration.' Thus, as the Commission held in *Ozark*, the constant growth DCF model requires consideration of long-term growth projections.[137]

60. As the Commission found in Opinion No. 531, we continue to recognize the need for a long-term growth projection to "aid in normalizing any distortions that might be reflected in short-term data limited to a narrow segment of the economy."[138]

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[135] *Transcontinental Gas Pipe Line Corp.*, Opinion No. 414-A, 84 FERC ¶ 61,084, at 61,423 (1998).

[136] As the Commission explained, "The DCF model assumes growth for an infinite period of time. This can be approximated as 50 years because the present value of a one dollar dividend received 50 years in the future, discounted at 12%, is less than one cent." *Ozark Gas Transmission Sys.*, 68 FERC at 61,105 n.32 (citing Eugene F. Brigham & Louis C. Gapenski, Financial Management 291 (1991)).

[137] Opinion No. 531, 147 FERC ¶ 61,234 at P 33 (quoting *Consol. Gas Supply Corp.*, 24 FERC ¶ 61,046, at 61,105 (1983)) (footnotes omitted).

[138] *Id.* P 38 (quoting Opinion No. 414-A, 84 FERC at 61,423-24).

V. CAPM

A. Opinion No. 569

1. Use of Betas and Size Adjustments

61. In Opinion No. 569, the Commission noted that the Commission found in Opinion No. 531-B that the size adjustment was "a generally accepted approach to CAPM analyses" and continued to find this to be the case.[139] The Commission stated that there was substantial evidence in the record that investors rely on *Value Line* betas. While the Commission acknowledged that there is an imperfect correspondence between the size premia being developed with different betas, it concluded that the size adjustments improve the accuracy of the CAPM results and cause it to better correspond to the costs of capital estimates employed by investors.[140]

62. The Commission also found that the application of size adjustments based on the New York Stock Exchange (NYSE) to dividend-paying members of the S&P 500 is acceptable, as the use of the NYSE for the size premium adjustment enabled Ibbotson Associates to develop a rich data set,[141] and found no evidence that companies in the S&P 500 feature different risk premiums than those in the NYSE.[142]

63. The Commission disagreed with intervenors that the utility industry is unique, and that the size premium adjustment would therefore be inapplicable, as the size premium adjustments are supported by a robust data set. The Commission noted that there are variations in the risk profiles of firms of any industry and there was insufficient evidence in the record to conclude that factors specific to the utility industry insulate smaller utilities from risks such that the CAPM betas sufficiently account for any increased risks and corresponding returns demanded by investors.[143]

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[139] Opinion No. 569, 169 FERC ¶ 61,129 at P 296 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 117).

[140] *Id.* P 297.

[141] Ibbotson Associates, now under Duff & Phelps, has long published a series quantifying this effect for various sizes of firms, pulling from data going back to 1926.

[142] *Id.* P 298.

[143] *Id.* P 303.

2. Exclusion of Growth Rates

64. In Opinion No. 569, the Commission accepted Trial Staff's proposal to screen from the CAPM analysis S&P 500 companies with growth rates that are negative or in excess of 20%. The Commission stated that such a screen is consistent with the elimination of outliers elsewhere in the ROE methodology, as such high or low growth rates are highly unsustainable and non-representative of the growth rates of the electric utilities in the proxy groups.[144]

B. Rehearing Requests

1. Use of Betas and Size Adjustments

65. CAPs state that the size adjustment is inconsistent with other elements of the adopted CAPM model. CAPs explain that the CAPM analysis incorporating a *Value Line* adjusted beta designed to measure market capitalization and a size premium adjustment based on raw betas is not based on substantial evidence.[145] Additionally, CAPs assert that the academic articles cited in Opinion No. 569 do not support the notion that investors rely on size factors.[146]

66. CAPs also argue that Opinion No. 569 appears to have misunderstood CAPs' concerns about the impact of mismatched betas as being whether the *Value Line* adjusted betas are appropriate for use in the CAPM. RPGI states that the issue before the Commission, however, was whether it is appropriate to combine adjusted and raw betas when performing a base CAPM analysis and applying a size premium adjustment.[147]

67. LPSC contends that the size adjustment is flawed because including such an adjustment conflicts with the Commission's determinations that utility growth rates will, in the long run, grow at the rate of the average firm in the economy.[148] LPSC also states that the Commission failed to address its contention that *Value Line* betas are methodologically mismatched to the S&P 500 because *Value Line* betas are calculated

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[144] *Id.* P 267.

[145] CAPs Rehearing Request at 77.

[146] *Id.* at 80.

[147] RPGI Rehearing Request at 77.

[148] LPSC Rehearing Request at 10.

using the NYSE, a different stock index.[149] LPSC asserts that the Commission incorrectly relies on raw betas in its size adjustment portion of the CAPM, while relying on adjusted betas in the rest of its CAPM analysis.[150]

68. RPGI states that the Commission erred by authorizing a size adjustment to the CAPM methodology that is unsupported by substantial record evidence and which arbitrarily inflated the ROE to an unjust and unreasonable level.[151] RPGI asserts that MISO TOs' comments did not recognize that the size premium adjustment is narrowly tailored to address an inability of beta to fully account for the impact of firm size within the CAPM, but failed to recognize that the size adjustment is of firms across the entire economy.[152] RPGI contends that Mr. Parcell's analysis shows that the size adjustment is inappropriate for regulated monopoly electric utilities. They aver that the Commission's silence on the simplification of Mr. Parcell's analysis is a central issue, and that the evidence contradicts the Commission's analysis.[153]

2. Exclusion of Growth Rates

69. MISO TOs argue that the Commission erred in excluding growth rates that are negative or in excess of 20% and argue that this adjustment has no economic justification.[154]

70. Exelon asserts that the Commission discards without justification companies with an IBES growth rate of greater than 20% from the CAPM.[155]

71. CAPs contend that the equity market return estimate, if calculated based on the short-term growth rate, should not exclude S&P 500 companies with negative growth rates. They aver that such exclusions are inappropriate because companies can feature negative growth rates for an extended period. Further, CAPs argue that, for the analysis

[149] *Id.* at 11.

[150] *Id.* at 14-15.

[151] RPGI Rehearing Request at 31.

[152] *Id.* at 32.

[153] *Id.* at 32-33.

[154] MISO TOs Rehearing Request at 69.

[155] Exelon Rehearing Request at 13.

to be appropriately diverse, these companies should be included, noting that such exclusions include some companies in the electric proxy group.[156]

3. Other Issues

72. Transource Energy asserts that the anomalous capital market conditions that called the DCF midpoint into question also suggest that the CAPM result would be too low, as the CAPM is premised in part on long-term Treasury bond yields.[157]

73. CAPs state that Opinion No. 569's specification of the CAPM methodology is erroneous and produces excessive results.[158] CAPs also note that independent estimates of the CAPM equity market return by financial institutions and other regulators are much lower than the Commission's estimates in Opinion No. 569.[159]

74. LPSC argues that the use of a one-step market DCF analysis in the CAPM fails to account for the long-term growth of stocks in the S&P 500, despite that utility stocks are long-term investments.[160] LPSC argues that the dividend-paying firms in the S&P 500 are not representative of the required return of the market as a whole, and solely relying on those firms results in the required market return being overstated. LPSC further argues that the exclusion of long-term GDP growth rates suggests that these high short-term growth rates will continue in perpetuity, which cannot be true.[161] LPSC further argues that the inclusion of mature, large market cap companies is not a remedy, as even these companies have an average growth rate significantly higher than long-term GDP growth.[162]

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[156] CAPs Rehearing Request at 65-68.

[157] Transource Energy Rehearing Request at 14-15.

[158] CAPs Rehearing Request at 59.

[159] *Id.* at 61-65.

[160] LPSC Rehearing Request at 6.

[161] *Id.* at 7-8 (citing Opinion No. 569, 169 FERC ¶ 61,129 at P 264).

[162] *Id.* at 8 (citing Opinion No. 569, 169 FERC ¶ 61,129 at P 265).

C. Commission Determination

1. Use of Betas and Size Adjustments

75. We continue to find reasonable the use of *Value Line* adjusted betas in the CAPM methodology, as well as the use of raw betas based on the NYSE in the size premium adjustment. We also continue to find that the size adjustment is necessary to correct for the CAPM's inability to fully account for the impact of firm size when determining the cost of equity. As we found in Opinion No. 569, there is substantial evidence indicating that investors rely on *Value Line* betas in making investment decisions.[163] Furthermore, we are not persuaded by LPSC's argument that betas calculated based on the NYSE cannot be used with the S&P 500. We continue to find that size adjustments are appropriate for the utility industry and improve the overall accuracy of the CAPM results.[164]

76. We agree with LPSC that there is imperfect correspondence with applying *Value Line* betas derived from the NYSE to risk premiums developed using the S&P 500. However, we find that it is not reasonable to calculate the risk premium using the full 2800 companies in the NYSE. Furthermore, no parties assert that investors do not use *Value Line* betas or that such betas are materially different from betas derived from only the S&P 500. Thus, while not a perfect match, we find that the use of *Value Line* betas is appropriate for the CAPM calculation.

2. Exclusion of Growth Rates

77. We are not persuaded by MISO TOs' arguments that the CAPM methodology should consider growth rates that are negative or above 20% and continue to find that such a screen is consistent with the elimination of outliers elsewhere in the ROE methodology. Similarly, we disagree with CAPs that negative growth rates should be included. Negative and very high growth rates are both unsustainable and should thus be excluded from the determination of the CAPM risk premium, even if they enhance the diversity of covered companies.[165]

3. Source of Short-Term Growth Rates

78. For the reasons discussed above, we find that IBES is a reliable source of short-term growth rate data and therefore we find it reasonable for IBES growth rates to

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[163] *See* Opinion No. 569, 169 FERC ¶ 61,129 at P 297.

[164] *See id.* PP 297-298, 301, 303.

[165] *See id.* PP 267-268.

be used in the CAPM model. However, we clarify here that we will consider the use of *Value Line* short-term growth rates for the CAPM model in future proceedings. Consistent with our finding that it is beneficial to use different models in the ROE methodology, we find that it may be beneficial to diversify the data sources as well. We believe that diversifying data sources may better reflect the data sources that investors consider in making investment decisions and mitigate the effect of any unusual or incorrect data in a given source. Furthermore, as MISO TOs assert, there is substantial evidence that *Value Line* is used by numerous investors.[166] The Commission has, since Opinion No. 531, recognized the merit of *Value Line* data, as illustrated by its support for *Value Line* betas, discussed above.

79. We are purposefully taking different approaches for the sources of short-term growth rate data in the DCF and CAPM. We believe that, in keeping with the Commission's historic use of IBES for the DCF, the DCF should continue to use IBES short-term growth rate data, as discussed above. By contrast, we believe that the CAPM is a better candidate for a new growth rate data source given that the Commission is newly adopting the CAPM as a direct input into its determination of the zone of reasonableness under the first prong of section 206 and its selection of a just and reasonable replacement ROE under the second prong of section 206.

80. While the Commission found in Opinion No. 569 that IBES data is preferable because it represents consensus growth estimates by a number of analysts, upon further consideration, we conclude that, while *Value Line* estimates may come from a single analyst, those estimates are vetted through internal processes, including review by a committee composed of peer analysts, and thus they similarly incorporate the input of multiple analysts.

81. The Commission also found in Opinion No. 569 that IBES data is preferable because IBES projections are updated more often than the *Value Line* projections. However, after further consideration of the record, including broad requests to allow the use *Value Line* projections,[167] we find here that there is also value in including *Value Line* projections because they are updated on a more predictable basis. *Value Line*'s regular updates provide certainty about updates to key model inputs.

82. Therefore, we conclude that IBES and *Value Line* data both have advantages and thus it is appropriate to consider both data sources. As stated above, however, we believe

[166] *See, e.g.*, MISO TOs Rehearing Request at 63-69.

[167] *See, e.g.*, *id.* at 63-67; MISO TOs Initial Br. (I) at 22-23; MISO TOs Initial Br. (II), App. 2 McKenzie Aff. (II) at 19-20.

it is appropriate to only consider using *Value Line* in the CAPM, which is being newly adopted, while continuing the traditional exclusive use of IBES data in the DCF model.

83. Although we find it appropriate to consider the use of *Value Line* short-term growth rates in the CAPM in future proceedings, we find that the record in these proceedings is insufficient to adopt use of *Value Line* growth rates for the CAPM at this time. Rather, we will evaluate proposals to use *Value Line* short term growth rates in the CAPM based on evidence produced in future proceedings. As we determine here, consistent with Opinion No. 569,[168] the Commission will screen from the CAPM analysis S&P 500 companies with growth rates that are negative or in excess of 20%. The only CAPM analyses in the record here that apply this screen are those provided by Trial Staff, which use only IBES short-term growth rates.[169] Thus, there is no CAPM analysis in the record that applies the growth rate screen to *Value Line* short-term growth rates. Moreover, we note that, even if we could determine a way in which to apply this screen to the data available in the record, no party has provided a CAPM analysis using only *Value Line* short-term growth rates or another analysis that would allow us to reliably derive a CAPM analysis using only *Value Line* short-term growth rates. The CAPM analyses provided by MISO TOs in these proceedings, which average IBES and *Value Line* short-term growth rates, do not contain sufficient information to allow us to reliably produce a CAPM analysis using only *Value Line* short-term growth rates because those analyses do not specify the weighted average earnings growth rates from *Value Line* that were used in arriving at the short-term growth rates which average IBES and *Value Line*.[170] Accordingly, although we believe, as discussed above, that it may be appropriate to use *Value Line* short-term growth rates in the CAPM, we find that we do not have sufficient record evidence to support adopting such use in these proceedings. Therefore, we will continue to use the CAPM analyses provided by Trial Staff here, but we will consider *Value Line* data in future proceedings.[171]

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[168] *See* Opinion No. 569, 169 FERC ¶ 61,129 at PP 19, 267-268.

[169] *See id.* PP 513 n.1002, 555 n.1048.

[170] *See also* CAPs Rehearing Request, Docket No. EL14-12-002 at 55-56 n.193 ("The record on this issue . . . does not break out the Ex. MTO-30 growth inputs either by source or by S&P 500 company.").

[171] These analyses are reflected in page 6 of Attachment A to Trial Staff's Initial Briefs. *See also* Trial Staff Initial Br. (I), Attachment A to App. 2 at 6; Trial Staff Initial Br. (II), Attachment A to App. 2 at 6.

4. Other Issues

84. We disagree with Transource Energy's and CAPs' assertions that the Commission's CAPM methodology produces inadequate and excessive results, respectively, and continue to find the Commission's CAPM methodology to be consistent with conventional CAPM methodologies. Regarding assertions that the CAPM results here exceed those used in other contexts, the Commission is not obligated to use the same exact ROE calculations as other regulatory bodies or investment services, and our CAPM calculations are specific to the electric utility industry. Regarding assertions that the results are unreasonably low, as discussed above, the mere decline of the ROE does not demonstrate that results are unreasonable, and, as discussed below, state-jurisdictional retail ROEs do not serve as an explicit floor on Commission-jurisdictional transmission ROEs.

85. We also continue to find that the CAPM should use a one-step DCF for its risk premium. This is because the rationale for using a two-step DCF methodology for a specific group of utilities does not apply when conducting a DCF study of the dividend-paying companies in the S&P 500, as the Commission found in Opinion Nos. 531-B and 569.[172] A long-term component is unnecessary because of the regular updates to the S&P 500, which allows it to continue to grow at a short-term growth rate and because S&P 500 companies include stocks that are both new and mature, the latter of which have a moderating effect on the short-term growth rates.[173]

86. We also find unsupported Transource Energy's assertion that the anomalous capital market conditions the Commission found rendered the DCF results too low also render the CAPM too low. We are no longer relying on such arguments based on the court's remand of Opinion No. 531. Furthermore, Transource Energy offers no evidence that the CAPM results in this proceeding were unreasonably low.

VI. Risk Premium

A. Opinion No. 569

87. In Opinion No. 569, the Commission determined that it would not use the Risk Premium model for either the first or second prong of the ROE analysis under section 206 of the FPA. It concluded that the Risk Premium model's deficiencies outweigh the additional robustness that it provides. Furthermore, the Commission found that the Risk Premium model requires methodological decisions that would likely

[172] *See* Opinion No. 531-B, 150 FERC ¶ 61,165 at P 113; Opinion No. 569, 169 FERC ¶ 61,129 at P 263.

[173] *See* Opinion No. 569, 169 FERC ¶ 61,129 at PP 264-266.

undermine transparency and predictability in Commission outcomes.[174] The Commission also explained that the Risk Premium model is largely redundant with the CAPM in that both models use indirect measures to ascertain the risk premium.[175]

88. The Commission agreed with CAPs that the Risk Premium model is likely to provide a less accurate current cost of equity estimate than the DCF model or CAPM because it relies on previous ROE determinations. It found that those determinations' ROE results may not necessarily be directly determined by a market-based method, whereas the DCF and CAPM methods apply a market-based method to primary data. The Commission noted that many previous ROE determinations used in the Risk Premium model were from rate case settlements and that such settlements often involve compromises on a variety of non-ROE issues.[176]

89. The Commission also determined that circularity is particularly direct and acute with the Risk Premium model because it relies on past Commission ROE decisions. The Commission found that MISO TOs' regression analysis accentuates such circularity by largely offsetting the effects of changes in interest rates.[177]

90. The Commission also expressed doubt concerning the application of the regression analyses used by MISO TOs in their Risk Premium model. The Commission contrasted the impact of MISO TOs' analysis, which indicated an increase in the risk premium of 75 basis points for every 100 basis point decline in interest rates, with Dr. Morin's analysis, which indicated an adjustment of 48 basis points. The Commission found that, unlike for DCF and CAPM calculations, MISO TOs did not update and add to the data set for ROE proceedings through the end of the test period in June of 2015, further reducing the robustness of the data set. The Commission observed that, due to using the average of ROEs from each year, MISO TOs' regression in the First Complaint proceeding only has nine observations in its regression, which is a low number of observations for a linear regression and could impact the reliability of the results. The Commission found that MISO TOs' regression created a dynamic in which the Risk Premium analysis will keep the ROE essentially stable in contravention of general financial logic that lower interest rates make it easier to raise capital based on both the reduced opportunity cost of investing in bonds and greater availability of revenue to

[174] *Id.* P 340.

[175] *Id.* P 341.

[176] *Id.* P 342.

[177] *Id.* P 343.

invest due to the opportunity for carry trades where borrowing low-cost debt is used to finance equity purchases.[178]

91. Additionally, the Commission found that there was insufficient record evidence to conclude that investors rely on risk premium analyses utilizing historic Commission ROE determinations or settlement approvals to determine the cost of capital and make investment decisions.[179] The Commission was also unpersuaded by MISO TOs' arguments that the nature of the industry and the resulting risk premiums changed following the Energy Policy Act of 2005 sufficiently to ignore prior data.

92. The Commission also reconsidered its finding in Opinion No. 531-B that "[g]iven the varying duration of regulatory proceedings, it is difficult, if not impossible, to ensure precise contemporaneity between long-term Treasury bond yields and the cost of equity allowed by a regulator."[180] The Commission found that, although an analysis with such imprecision may have been sufficient for using the Risk Premium model for corroborative purposes, direct use of the model to determine the risk premium would require actual alignment of the test periods and the dates assigned for purposes of comparing the ROE to the risk free rate of return. The Commission stated that, if it were to adopt a precise timing in this proceeding, as a practical matter, such a decision would likely require the Commission to exclude certain proceedings whose test periods predate 2006 and include others, as well as potentially change the dates assigned to yet other proceedings.[181]

93. The Commission also noted that the Risk Premium model entails numerous judgment calls which could be disputed by parties, such as: determining the risk premium resulting from proceedings resolved by settlements with different ROEs for different parties or time periods; whether the ROEs should be assigned to different times for purposes of the Risk Premium analysis; and whether ROEs from settlements resolving multiple proceedings with the same ROE should be counted once or twice. The Commission also noted other methodological decisions, including whether to look at the annual average of ROEs and corresponding risk-free rates of return or look at them individually. Because of this, the Commission found that the Risk Premium model

[178] *Id.* P 344.

[179] *Id.* P 345.

[180] *Id.* P 348 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 98).

[181] *Id.*

features far more ambiguity and potential for dispute than the DCF and CAPM models, which would lead to higher costs for participation and less predictable results.[182]

94. The Commission stated that the output that the Risk Premium model produces is a single numerical point, and therefore, it does not produce a range which can be used to determine a zone of reasonableness. Accordingly, the Commission explained, the Briefing Order proposed to only use the Risk Premium model in the second prong of the section 206 analysis, but not in the first prong. The Commission stated that it preferred to use the same models in the prong one and prong two analyses to ensure that our ROE determinations under each prong are based on the same data and models and that there was no compelling justification to use different models and data sources to apply this same standard under the two prongs.

B. Rehearing Requests

95. Transource Energy argues that the Commission should utilize the Risk Premium model. Transource Energy argues that none of the Commission's justifications for using the DCF model and CAPM but not the Risk Premium model support reversing its prior findings that the imperfections of the Expected Earnings analysis and Risk Premium models do "not undermine" their usefulness.[183] Transource Energy contends that the Risk Premium model adds useful information that does not rely on the same assumptions as the DCF and CAPM models.[184]

96. Transource Energy also avers that the Commission has not shown that investors do not rely on the Risk Premium (or Expected Earnings) model and that, at most, the Commission shows that investors use those approaches differently than the DCF and

[182] *Id.* PP 346-350.

[183] Transource Energy Rehearing Request at 23 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 98).

[184] *Id*. (citing Avera Test., Ex. MTO-1, Docket No. EL14-12, at 94 (explaining that unlike DCF models, which indirectly impute the cost of equity, risk premium methods directly estimate investors' required rate of return by adding an equity risk premium to observable bond yields)).

CAPM models.[185] Transource Energy further points to the publication of returns granted by regulators as evidence that investors rely on the Risk Premium model.[186]

97. MISO TOs contend that the implementation questions raised in Opinion No. 569 do not undermine the probity of the Risk Premium analysis supplied by MISO TOs. MISO TOs contend that the Commission's decision in Opinion No. 569 to disregard this evidence is inconsistent with Opinion No. 551, where the Commission evaluated those issues and found that the model was probative.[187]

98. MISO TOs disagree with the Commission's finding that the Risk Premium model is redundant with the CAPM. MISO TOs note that the Risk Premium model focuses on the bond market while the CAPM focuses on the equity market, using different inputs. MISO TOs contend that investors independently rely on both models and note that many jurisdictions employ a Risk Premium approach for determining utilities' cost of equity.[188] MISO TOs argue that the Commission's finding that the stability of the Risk Premium model "defies general financial logic" overlooks that the data inputs used in the Risk Premium model inherently smooth out volatility.[189] They also argue that the Commission's assertion that the DCF and CAPM approaches may have a greater prevalence does not go to the merits of the Risk Premium approach, and it contradicts the record and the Commission's prior finding that Risk Premium is a traditional method investors may use to estimate the expected return from an investment in a company.[190]

99. MISO TOs argue that implementation issues associated with the Risk Premium method are neither insurmountable nor unique to the Risk Premium method. They argue that the Commission's concerns about which ROE inputs to include and "how far back such data should go" are directly analogous to questions regarding proxy group selection and the determination of the study period for the DCF analysis.[191]

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[185] *Id*. at 24.

[186] *Id*. at 25, n.13 (citing MISO TOs, Supplemental Reply Brief, Docket No. EL14-12-003, App. 2 at 44).

[187] MISO TOs Rehearing Request at 52-53.

[188] *Id*. at 47-49.

[189] *Id*. at 48.

[190] *Id.* at 49 (citing Briefing Order, 165 FERC ¶ 61,118 at P 36).

[191] *Id.* at 50.

100. MISO TOs assert that the Commission's concerns regarding circularity arising from using Commission-approved ROEs as inputs are overblown and present in other methodologies. MISO TOs contend that such circularity is limited because of the presumption that orders and settlements are based on market-based methodologies.[192] MISO TOs also aver that the lack of a resulting zone of reasonableness from the Risk Premium model is not a problem because the evaluation of whether an ROE remains just and reasonable is less exact than setting a new base ROE. MISO TOs contend that, while the Commission should include the Risk Premium in setting new ROEs, it does not necessarily need to include it in evaluating existing ROEs.[193]

101. MISO TOs also contend that the Commission's failure to provide guidance on the Risk Premium model's implementation is not a valid justification for omitting the model, particularly since the Commission has reopened the implementation of the models in this proceeding.[194]

102. PJM TOs contend that investors recognize that each of the four financial models in the Briefing Order has its own advantages and disadvantages. PJM TOs contend that investors use multiple models because no single model provides accurate results under all market conditions.[195]

103. PJM TOs argue that the Risk Premium model complements the Commission's DCF model by recognizing that the Risk Premium varies over time and with interest rates whereas the DCF model does not account for this variation.[196] PJM TOs argue that the Commission-authorized ROEs used in the Risk Premium model reflect inputs and analyses of multiple experts as well as the Commission's judgment concerning factors that affect the cost of equity, and contend that investors are likely to consider Commission-authorized ROEs to an extent.[197]

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[192] *Id*. at 50-51.

[193] *Id*. at 51-52.

[194] *Id*. at 49-50.

[195] PJM TOs Rehearing Request at 12.

[196] *Id.* at 26.

[197] *Id*. at 15-16.

C. Commission Determination

104. Upon reconsideration and with the modifications described below, we find that the defects of the Risk Premium model do not outweigh the benefits of model diversity and reduced volatility resulting from the averaging of more models.

105. In Opinion No. 569, the Commission expressed concerns that the Risk Premium model was an iteration of the CAPM, where both compared a derived return to a risk-free rate of return, affording too much weight to similar models. Upon reconsideration, we agree with the PJM TOs that the Risk Premium model is sufficiently distinct from the CAPM to use in our ROE analysis. The Risk Premium relies on corporate utility bonds while the CAPM uses Treasury Bond yields. Additionally, the Risk Premium model relies on the risk premiums implicit in regulatory judgements, including those using the DCF model, while the CAPM relies upon a different set of inputs, including S&P 500 dividend yields and growth rates as well as adjusted betas.

106. The Commission, in Opinion No. 569, found that the Risk Premium model contained substantial circularity. Upon reconsideration, we agree with MISO TOs[198] and find that, while it contains some circularity, the averaging of the results with those of the DCF and CAPM models sufficiently mitigates that circularity. Additionally, all of the models contain some circularity. And, upon consideration of the rehearing requests, we believe that the level of circularity in the Risk Premium model is acceptable.

107. The Commission also found that use of the Risk Premium model was inconsistent with the other models because it could only be used for the second prong of the section 206 analysis because it does not produce a zone of reasonableness. We continue to find that this is a serious concern, particularly in a circumstance where the Risk Premium model's ROE differs substantially from those of the DCF and CAPM models, such that the ROE produced in the second prong could fall within the applicable presumptively just and reasonable range from the first prong despite the challenged ROE falling outside that range or vice versa. To remedy this problem, we will impute the average width of the zones of reasonableness from the CAPM and DCF models onto the ROE produced by the Risk Premium model, with that ROE serving as the measure of central tendency of the zone of reasonableness. Doing so creates a zone of reasonableness for the ROE from the Risk Premium model, which can then be averaged with those of the other models in the first prong of the section 206 analysis. For example, if the Risk Premium model produces an ROE of 10% while the CAPM and DCF produce zones of reasonableness that average 400 basis points wide, the imputed zone of reasonableness for the Risk Premium would be 8% to 12%. We find that this is appropriate because the average width of those zones of reasonableness from models that

[198] *See* MISO TOs Rehearing Request at 51.

produce a zone of reasonableness is the best estimate of how far a zone of reasonableness should span from a single point like that produced by the Risk Premium model. Moreover, addition of the Risk Premium model to our analysis under the first prong of section 206 will not impact the size of the overall composite zone of reasonableness. Instead, it will merely reflect the Risk Premium model in the zone of reasonableness, based on equally weighted information from the models that directly produce a zone of reasonableness, allowing the Commission to use this model in both prongs. Accordingly, we find that it is appropriate to impute a zone of reasonableness for the Risk Premium model so that our ROE determinations under both prongs of section 206 are based on the same data and models.[199]

108. The Commission also expressed concerns regarding the regression analysis, noting specifically that the low number of observations could impact the reliability of the results.[200] Here we propose to use the individual cases for the Risk Premium analysis and not the average of the data from each year. Consequently, instead of nine observations in the regression analysis as proposed by the MISO TOs, there are 71 observations used in the First Complaint regression and 77 in the Second Complaint regression, leading to a much more robust and reliable result. Although the resulting regression coefficients are similar to those in the MISO TOs' calculations, we conclude that they are now based on more sound inputs and are thus more reliable.

109. The Commission cited use of settlements as a deficiency of the Risk Premium model. Parties may consider many factors when settling rate case proceedings. However, because of how directly ROEs affect rates, we conclude that parties engaged in arms-length negotiations seriously consider the ROE in the course of reaching settlements, even if the records in certain proceedings do not contain specific ROE calculations or testimony. Consequently, upon further consideration, we find that the ROEs from such settlements are reasonable to include in the Risk Premium analysis. However, because of the need to more precisely correspond the timing of ROEs to the corresponding bond yields, discussed below, we revise the bond yields (and corresponding risk premiums) to correspond to the six months preceding the offer of settlement and not Commission orders approving the settlements, as discussed below.

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[199] *See* Opinion No. 569, 169 FERC ¶ 61,129 at P 351 ("We would prefer to use the same models in the prong one and prong two analyses to ensure that our ROE determinations under each prong are based on the same data and models. It would not be logical to use different models and data sources to apply this same standard under the two prongs unless there is some compelling justification for the difference.").

[200] *See* Opinion No. 569, 169 FERC ¶ 61,129 at P 344.

This period, not the six months preceding Commission approval of settlements, best reflects when parties evaluated the ROE.

110. We also find that it is appropriate to eliminate certain cases from the Risk Premium analysis where the Commission did not consider the justness and reasonableness of the base ROE or the zone of reasonableness in making decisions. For example, we are excluding cases where transmission owners joined MISO and received the prevailing 12.38% ROE that was approved in 2002 without examination of the justness and reasonableness of that ROE. Similarly, in an order on a transmission rate incentives filing by PSEG,[201] the Commission explicitly stated that the ROE was beyond the scope of the proceeding.[202] In other cases, the MISO TOs' analysis unjustifiably contained multiple ROEs counted in the analysis from the same case.[203] We are also eliminating cases where the test period is in 2004, well before other proceedings on the list, given that there were likely other proceedings with test periods during 2004 and 2005 that were not included. We also propose, in order for the results of the Risk Premium analysis to be consistent with those of other models, to update the list of applicable cases to include data up through the conclusion of the test periods, which conclude June 2015 and December 2015 for the First Complaint and Second Complaint, respectively.

111. The Commission, in Opinion No. 569, also considered whether the bond yields used to determine the risk premium should more precisely align with test periods of Risk Premium cases. It found that, although a misalignment of the timing of bond yields and test periods might be acceptable when using the Risk Premium model corroboratively, using the model to set the actual ROE demanded correcting this imprecision. We continue to find that the risk premiums should not contain inconsistent dates for the ROEs and for the bond yields. Rather, they should be aligned by corresponding the ROE to the test periods on which it is based. For settlements, the relevant date is the date that parties file the settlement, not when the Commission approves it. Consequently, the six-month time period bond yields should be the six months preceding the settlements. Such information is reflected in the data in Appendix I.

112. In Opinion No. 569, the Commission also found that the record contained insufficient evidence to conclude that investors rely on risk premium analyses utilizing historic Commission ROE determinations or settlement approvals to determine the cost

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[201] *PJM Interconnection, L.L.C. and Pub. Serv. Elec. & Gas Co.*, 147 FERC ¶ 61,142, at P 48 (2014).

[202] However, the analysis does include those cases where the Commission made this finding, but the ROE was modified by settlement.

[203] *See* Appendix I. Note that when a case has multiple *different* ROEs, each of those are counted in the analysis.

of capital and make investment decisions. On rehearing, we find that investors do expect to earn a return on a stock investment that reflects a premium above the return they expect to earn on a bond investment,[204] and that the Risk Premium model is a method of estimating the premium over bond yields that investors require to invest in electric utility equities. In addition, as the Commission noted in Opinion No. 569, investors do observe regulatory ROEs and how changes in authorized ROE levels could affect utility earnings,[205] and while such considerations differ from the type of analysis employed by the Risk Premium model, it is a model that considers regulatory ROEs in estimating the premium that investors require to make equity investments instead of bond investments.

113. The Commission discussed in Opinion No. 569 that the MISO TOs' sample period, beginning in 2006, was substantially shorter than the period used by Dr. Morin, potentially leading to less credible results. We find that, although the data set for determining the risk premium would ideally be longer, that 10 years of data yielding over 60 observations is sufficient, noting that we are extending the sample periods slightly to the end of the updated test periods, as discussed above. Furthermore, the record lacks information on ROE proceedings whose order dates precede 2006.

114. The Commission also noted concerns, raised by Trial Staff, that the Risk Premium model should exclude periods of high volatility, specifically around the beginning of the Great Recession. We conclude that all periods should be included because the Risk Premium analysis should factor in periods where the bond yields change. A full sample size in this case *does* include the outlying periods because they reflect the Risk Premium at the time and such economic disturbances, which periodically recur.

VII. Expected Earnings

A. Opinion No. 569

115. In Opinion No. 569, the Commission determined that, in light of the record as supplemented after issuance of the Briefing Order, it is not appropriate to use the Expected Earnings model in our new base ROE methodology.[206]

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[204] *See, e.g.*, Morin at 108 ("[B]ased on the simple idea that since investors in stocks take greater risk than investors in bonds, the former expect to earn a return on a stock investment that reflects a 'premium' over and above the return they expect to earn on a bond investment.").

[205] Opinion No. 569, 169 FERC ¶ 61,129 at P 345.

[206] *Id.* P 200.

116. In particular, the Commission found that the record does not support departing from our traditional use of market-based approaches to determine base ROE.[207] The Commission determined that under *Hope*—which declares that "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks"[208]—it is appropriate to consider the value of investment that is actually available to an investor in the market. Outside of the unlikely situation in which the market value and book value are exactly equal, investors do not have the opportunity to invest in an enterprise at its book value. Accordingly, the Commission deemed it most appropriate to exclude the Expected Earnings model, which relies on an enterprise's book value instead of the market value.

117. The Commission explained that the return on book value is not indicative of what return an *investor* requires to invest in the utility's equity or what return an investor receives on the equity investment, because those returns are determined with respect to the current market price that an investor must pay in order to invest in the equity.[209] Specifically, the Commission found that the Expected Earnings model measures returns on book value, without consideration of what market price an investor would have to pay to invest in the relevant company, so it does not accurately measure the investor's expected returns on its investment, and, therefore, has been "thoroughly discredited."[210] In other words, the return on book value does not reflect "the return to the equity owner" that we must ensure is "commensurate with returns on investments in other enterprises," as *Hope* requires; therefore, the Commission found that this model is not useful in ensuring that these standards are satisfied.[211] Furthermore, the Commission found that there was insufficient record evidence to conclude that investors rely on the Expected Earnings analysis to estimate the opportunity cost of investing in a particular utility.[212]

118. The Commission also explained that, while it may be true that the Expected Earnings model does not involve the same complexities as the market-based approaches, this is because it does not reflect a utility's cost of equity.[213] Furthermore, applying the

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[207] *Id.* PP 201, 221.

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

[209] Opinion No. 569, 169 FERC ¶ 61,129 at P 202.

[210] *Id.* PP 205, 221.

[211] *Id.* PP 202, 221-22.

[212] *Id.* P 210.

[213] *Id.* P 204.

Expected Earnings model in the cost-of-service context would lead to illogical results because a company in such a context would receive a higher overall return when it features a higher equity ratio, despite this indicating a lower risk (and thereby indicating a lower required rate of return by investors) than a company featuring a lower equity ratio.[214] Even though companies with more depreciated assets are generally of lower risk and therefore would merit a lower return, the Expected Earnings model would instead provide higher returns to such companies.[215]

B. Rehearing Requests

119. MISO TOs, Ameren, and Transource Energy seek rehearing of the Commission's decision to exclude the Expected Earnings model in determining base ROEs.[216] Transource Energy argues that the alleged flaws in the Expected Earnings approach actually become strengths when combined with the other models.[217]

120. Transource Energy asserts that the Expected Earnings model is actually market-based in the sense that market participants use it for investment decisions and that the Commission's definition of "market-based" is too narrow.[218] Furthermore, Transource Energy argues that the fact that the Expected Earnings model does not fit into the Commission's narrow definition of "market-based" highlights that it is needed to diversify the other models.[219] On the other hand, MISO TOs contend that the Expected Earnings approach helps ensure a base ROE that meets the requirements of *Hope* precisely because it is *not* market-based.[220]

121. According to MISO TOs, the record demonstrates that the Expected Earnings approach provides a unique perspective that no other model addresses and thus provides

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[214] *Id.* P 223.

[215] *Id.* P 224.

[216] Ameren Rehearing Request at 2, 4-6, 10-13, 23-25; MISO TOs Rehearing Request at 8, 13, 53-62; Transource Energy Rehearing Request at 3-4, 6, 8-10, 15-26.

[217] Transource Energy Rehearing Request at 23.

[218] *Id.* at 16.

[219] *Id.*

[220] MISO TOs Rehearing Request at 59-61.

a check on the market-based cost of equity approaches.[221] MISO TOs assert that, because regulators do not set the returns that investors earn in the capital markets, the Expected Earnings approach provides a direct guide to ensure that the allowed ROE is similar to what other utilities of comparable risk will earn on invested capital.[222] In other words, MISO TOs explain, the Expected Earnings approach measures whether the allowed ROE is sufficient to assure confidence in the financial integrity of an enterprise so as to maintain its credit and attract capital.[223] In addition, MISO TOs state that, because it is not market-based, the Expected Earnings approach avoids the complexities, controversies, and limitations of capital market methods.[224] Transource Energy argues that the fact that Expected Earnings is not used independently of stock price is not disqualifying, because, under the four-model framework originally proposed, this approach actually works in concert with market-based methods like the included CAPM and DCF models.[225] According to MISO TOs, it is precisely because the Expected Earnings method examines the books of a proxy company rather than relying on market data that the approach provides a unique value in assessing whether a Commission-determined ROE meets the *Hope* and *Bluefield* standards.[226]

122. MISO TOs, Transource Energy, and Exelon assert that the Commission's finding that investors do not rely on the Expected Earnings analysis to estimate the ROE that a utility will earn in the future is contrary to the record in this proceeding and the record in the Commission's Notice of Inquiry proceeding[227] regarding its base ROE policy.[228] Transource Energy argues that Opinion No. 569 did not identify changed circumstances regarding how investors use the Expected Earnings and Risk Premium models and does

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[221] *Id.* at 59.

[222] *Id.*

[223] *Id.*

[224] *Id.* at 60 (citing MISO TOs, Supplemental Reply Brief, Docket No. EL14-12-003, App. 2 at 65 (filed Apr. 10, 2019) (McKenzie Supplemental Reply Brief Affidavit)).

[225] Transource Energy Rehearing Request at 24.

[226] MISO TOs Rehearing Request at 62.

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

[228] MISO TOs Rehearing Request at 54-58; Transource Energy Rehearing Request at 18, 20-21, 24.

not find that investors no longer rely on them in evaluating investment decisions.[229] MISO TOs contend that testimony filed by multiple commenters in the Base ROE NOI proceeding, including MISO TOs, the New England TOs, the PJM TOs, and EEI, clearly demonstrates that investors do rely on the Expected Earnings analysis when making investment choices.[230] Exelon notes that the Commission stated in the Briefing Order that investors use the Expected Earnings model, but then later in Opinion No. 569 stated that there is insufficient evidence that investors rely on the Expected Earnings model. Exelon argues that the Expected Earnings model should be included in the ROE methodology even if only some investors rely on it.[231]

123. MISO TOs and Transource Energy also argue that the Commission cannot ignore evidence concerning the Expected Earnings model that it already found probative.[232] They contend that the Commission found the Expected Earnings approach to be reliable, corroborative evidence of the proper base ROE for electric utilities in Opinion Nos. 531, 531-B, and 551, and cannot now simply ignore evidence pertinent to the question before it with no basis for the sudden change.[233] Ameren contends that the Commission's assertion that the exclusion of the Expected Earnings model in Opinion No. 569 is not inconsistent with its determination in Opinion No. 551 is circular because the question on whether to exclude the model was never asked in Opinion No. 551.[234] Ameren explains that, in Opinion No. 551, the Commission relied on the Expected Earnings model to corroborate its finding and provides no explanation here for completely ignoring it. Ameren contends that this failure to at least consider the Expected Earnings model cannot be reconciled with the Commission's prior finding.[235] According to MISO TOs, the Expected Earnings analysis can inform whether the ROE produced by the Commission's methodology is appropriate, and ignoring pertinent evidence rooted in controlling Supreme Court precedent is arbitrary and capricious and not the product of reasoned

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[229] Transource Energy Rehearing Request at 21.

[230] MISO TOs Rehearing Request at 54-58.

[231] Exelon Rehearing Request, Docket No. EL14-12, at 12-13.

[232] MISO TOs Rehearing Request at 61-62; Transource Energy Rehearing Request at 18, 20-21, 24.

[233] MISO TOs Rehearing Request at 61.

[234] Ameren Rehearing Request at 25.

[235] *Id.*

decision-making.[236] Moreover, Ameren argues that this exclusion constitutes reversible error because the Commission never proposed the two-model approach in the Briefing Order or the Base ROE NOI, no party advocated for this approach in the instant docket, and the record does not support exclusion of the Expected Earnings model.[237]

124. MISO TOs and Transource Energy also assert that the Commission cannot deny the historical and regulatory acceptance of the Expected Earnings approach, as it was used in the Commission's prior "br + sv" approach for determining public utility ROEs and is closely related to the comparable earnings approach that originated in *Hope*.[238] Accordingly, they contend that the Commission can rely on the Expected Earnings model to determine whether a prospective base ROE meets the requirements of *Hope*, and to the extent a base ROE is inconsistent with the Expected Earnings analysis, significant explanation is needed as to how such a base ROE meets the requirements of *Hope*.[239] MISO TOs assert that the Commission should employ the Expected Earnings approach in setting the MISO TOs' base ROE or, failing that, should at least consider it as a check on the base ROE yielded by the Commission's alternative approach.[240]

C. Commission Determination

125. We deny requests for rehearing of the Commission's decision to exclude the Expected Earnings model from its base ROE analysis under section 206 of the FPA. As an initial matter, we note that the requests for rehearing largely repeat arguments parties previously made and which the Commission addressed in Opinion No. 569. Nothing in the rehearing requests persuades us to alter our decision here.

126. We are not persuaded by MISO TOs', Transource Energy's, and Exelon's arguments that investors rely on the Expected Earnings analysis to project utilities' earned ROE. While the record in this proceeding contains evidence that investors have access to data on earnings per book value, we continue to find that it lacks evidence that investors use such data to directly value equities, determine the cost of equity, or make investment decisions without consideration of the market price of the relevant equities.

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[236] MISO TOs Rehearing Request at 62.

[237] Ameren Rehearing Request at 23-24.

[238] MISO TOs Rehearing Request at 60; Transource Energy Rehearing Request at 20-21, 24-25.

[239] MISO TOs Rehearing Request at 60-61; Transource Energy Rehearing Request at 20-21, 24-25.

[240] MISO TOs Rehearing Request at 62.

As the Commission explained in Opinion No. 569,[241] investors cannot use the Expected Earnings model to directly determine the return they would earn from purchasing a company's stock, because the return estimated by that model is a return on the company's book value, not a return on the current stock price, which is what the investor must pay in order to invest in the company. Therefore, the returns estimated by the Expected Earnings model are divorced from the returns required by investors, because investors cannot purchase a company's stock at its book value (except in the very rare instance where a utility's market capitalization happens to exactly equal its book value). Similarly, we are not persuaded by MISO TOs' and Transource Energy's arguments that the Expected Earnings analysis is probative because the Commission, until Opinion No. 531, considered book value in the "br + sv" calculations. Our decision to exclude the Expected Earnings model from our base ROE analysis is not inconsistent with the Commission's prior consideration of book value in this context because such information was used in conjunction with, rather than instead of, the market price of the stocks.

127. Moreover, because the current market values of utility stocks substantially exceed utilities' book value, a utility's expected earnings on its book value will inevitably exceed the return that investors require in order to purchase the utility's higher-value stock, which means that the Expected Earnings model does not accurately measure the returns that investors require to invest in utilities.[242]

128. As explained in Opinion No. 569, the Commission has found that it is important to base the ROE on the returns currently required by investors, and the Expected Earnings model does not measure those returns. Specifically, since the 1980s, the Commission has rejected the use of returns on book value in determining the cost of equity and emphasized the importance of incorporating the market cost of equity when estimating ROEs because the market price is what investors must pay when making an investment and therefore is the basis on which investors measure the return on their investment.[243] As discussed in Opinion No. 569, this is also supported by a variety of academic literature indicating that the Expected Earnings model is not relied upon to directly estimate cost of equity.[244]

129. We are also not persuaded by MISO TOs' arguments that the Expected Earnings model should be used because it provides a unique, non-market-based perspective, and thus increases model diversity. Simply because a model increases model diversity does

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[241] Opinion No. 569, 169 FERC ¶ 61,129 at PP 201-202.

[242] *See id.* P 211.

[243] *See id.* PP 201 & n.426, 202, 216-18.

[244] *Id.* P 218.

not mean that it is necessarily appropriate to include, if the model is fatally flawed. This is the case because the returns on investment received depend on the market price that investors must pay to make their investment, which the accounting-based Expected Earnings model does not consider.

130. In response to MISO TOs' argument that the Expected Earnings model should be used because it avoids the complexities, controversies, and limitations of market-based methods, we stand by the Commission's explanation in Opinion No. 569[245] that the Expected Earnings model is simpler because it does not take into account the vitally important market cost of investing in a utility's equity. The market price that an investor must pay for an investment is a critical factor in determining a utility's cost of equity, and a model that ignores that factor is not useful in estimating cost of equity. The Expected Earnings model's relative simplicity is due to and invalidated by this deficiency.

131. Finally, we disagree with MISO TOs' and Transource Energy's arguments that the Commission cannot exclude the Expected Earnings model now because it already relied on the model as corroborative evidence in the underlying Opinion No. 551 in these proceedings. As the Commission explained in Opinion No. 569,[246] the Commission is now deciding whether to use the Expected Earnings model as a direct input in its ROE estimates—not merely whether to use it as corroborative evidence—and more convincing evidence is required to justify using the model as a direct input. We continue to find that parties have not supplemented the record with this more convincing evidence. We further note that no parties have explained or refuted the Commission's observation in Opinion No. 569 that the use of the Expected Earnings model in this context leads to illogical results of higher ROEs from companies with more equity in their capital structure or more depreciated assets.[247] Furthermore, Opinion No. 531, whose logic and methodology the Commission adopted in Opinion No. 551, was vacated by the court, such that neither form binding precedent.

132. While we do not adopt the Expected Earnings model in our revised methodology here for the reasons discussed above, we do not necessarily foreclose its use in future proceedings if parties can demonstrate that the concerns discussed above have been addressed.

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[245] *Id.* PP 203-204.

[246] *Id.* P 226.

[247] *See id.* P 223.

VIII. Weighting of Models

133. A number of parties made general comments that the Commission erred in overweighting the DCF and CAPM models by excluding the Risk Premium and Expected Earnings models. Section III above addresses such arguments.

A. Opinion No. 569

134. In Opinion No. 569, the Commission chose to use the DCF and CAPM models to determine base ROE, with both approaches being given equal weight. The Commission argued that it was inappropriate to include the Expected Earnings and Risk Premium models, as discussed above. By excluding them, the Commission effectively gave those models a weight of zero in its analysis under prongs one and two of section 206 of the FPA.[248]

135. The Commission also described why it would create the zones of reasonableness for each model based on the proxy company results for those individual models, average the midpoints/medians and zones of reasonableness bounds for the used models, and then determine the midpoints and applicable quartiles based on the averaged zones of reasonableness.[249] The Commission declined to adopt CAPs' proposed alternative of averaging the results for multiple models for each proxy group company before determining the applicable midpoint/median and zone of reasonableness. Further, the Commission noted that there was no record evidence of the models being applied this way in other regulatory proceedings or that the assumptions and structure of the DCF and CAPM models contemplate the isolation of results for specific proxy group companies as the CAPs' proposal would do.

B. Rehearing Requests

136. CAPs state that the Commission should not have equally weighted the results of the DCF and CAPM models in determining the composite zone of reasonableness. According to CAPs, the Commission disregarded the complainants' arguments regarding the "superiority of the DCF model, including evidence of broad industry recognition of the DCF model as the most appropriate way to determine allowable rates of return that meet the standards set out in *Hope* and *Bluefield*."[250] CAPs claim that the Commission relied more heavily on the MISO TOs' assertion that "investors base their decisions on factors more closely aligned with CAPM factors to disregard long-standing precedent

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[248] *Id.* PP 424-427.

[249] *Id.* PP 437-438.

[250] CAPs Rehearing Request at 85.

stating the superiority of the DCF model." CAPs argue that the equal weighting of the DCF and CAPM models is not supported by the record evidence or Commission precedent indicating that the DCF model is superior to the CAPM.

137. CAPs assert that the Commission did not explain its conclusion that equal weighting will reduce model risk associated with a given model more so than giving one model greater weight over the other. CAPs note that the DCF model has not become less reliable over the time that the Commission used it exclusively to determine cost of equity. Lastly, CAPs criticize the Commission for not considering Dr. Berry's rebuttal of the Briefing Order's basis for its new concerns regarding the DCF model's risk. According to CAPs, disregarding parties' arguments constitutes arbitrary and capricious decision making.[251] CAPs also aver that the Commission did not address Dr. Berry's testimony regarding the sequencing of model calculations.

138. Transource Energy argues that the Commission's rationale does not support a 50% weight for the DCF model. Previously with a four-model methodology, the DCF approach received a 25% weight. That approach led to a diverse methodology that minimized measurement errors. According to Transource Energy, assigning no weight to the Expected Earnings and Risk Premium models does not mean that the DCF model should be weighted equally with the CAPM.[252]

139. MISO TOs state that benchmark estimates of utilities' cost of equity using the Risk Premium and Expected Earnings models substantially exceed the Commission's composite midpoint ROE. In addition, MISO TOs state that anomalous capital market conditions undercut the validity of the DCF analysis where that model holds a 50% weight in deriving the composite zone of reasonableness from which the Commission derived the new base ROE it adopted in Opinion No. 569.[253] MISO TOs also note that the Commission previously agreed with Ms. Lapson's conclusion that using the DCF model does not satisfy *Hope* and *Bluefield*. MISO TOs assert that the DCF model does not satisfy *Hope* and *Bluefield* and therefore question the validity of the new ROE methodology when assigning a 50% weight to the DCF model. According to MISO TOs, the "same evidence of prevailing state ROEs on which the Commission relied in Opinion No. 551 undercuts the 50% weighting of the very same DCF analysis in Opinion No. 569."[254] They argue that the Expected Earnings and Risk Premium models can be used to show that the DCF model has a downward bias on the resulting base ROE.

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[251] *Id.* at 85-87.

[252] Transource Energy Rehearing Request, Docket No. EL14-12, at 21-22.

[253] MISO TOs Rehearing Request, Docket No. EL14-12, at 13.

[254] *Id.* at 18-19.

Furthermore, the Commission had previously noted that investors utilize the Expected Earnings and Risk Premium models.[255]

C. Commission Determination

140. We disagree with parties that assert that low reliability of the DCF model, the DCF model's similarity to the CAPM in terms of inputs, and the drawbacks of those two models as reasons against equal weighting. We also disagree with other parties that argue that the DCF should receive more weighting than other models given that it has been long-used by regulators. Parties arguing for less weighting do not suggest a specific alternative weighting scheme other than simply reducing the DCF's weight to less than 50% and overlook the distinctions between it and the other models. We disagree with contentions that, because the DCF gives results in these proceedings that are lower than those of the other models, that it should receive *less* weight than they do. The DCF model is clearly used by investors[256] and has been subject to extensive regulatory review and refinement. We also disagree with parties arguing for more weighting of the DCF model, because, as discussed above, we find substantial value in the CAPM and Risk Premium models and the evidence indicates that none of the three models is conclusively superior to any other. As discussed in this order and in Opinion No. 569, each model has unique aspects, and advantages and disadvantages that make it preferable to the other model in some respects, but not other respects.

141. We continue to find that the models used in our methodology should be afforded equal weighting to fully capture the model diversity that each brings. The evidence does not indicate that there is a clearly superior model for estimating cost of equity that should be given more weight than the others and we find that equally weighting the three models will reduce the model risk associated with any particular model more than giving one model greater weight than the other. Consequently, each model shall receive one-third weighting for both the first and second prongs of the section 206 analysis. The revised methodology ultimately addresses the concerns of certain commenters by reducing the weight attributed to the DCF model while expanding the diversity of the ROE methodology by including the Risk Premium model. We disagree with CAPs' assertion that the Commission in Opinion No. 569 failed to address Dr. Berry's concerns regarding model sequencing. The Commission provided a full and reasoned description of why it employed the sequencing order for ROE calculations that it had described in the Briefing Order.

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[255] *Id.* at 22.

[256] *See, e.g.*, Opinion No. 569, 169 FERC ¶ 61,129 at PP 171, 426.

IX. Natural Break Analysis

A. Opinion No. 569

142. In Opinion No. 569, the Commission affirmed the use of a natural break analysis to both the high and low-end outlier screens but declined to set a specific threshold level or formula to use in the analysis. The Commission stated that any numerical outlier test will necessarily be somewhat arbitrary, and that the natural break analysis gives the Commission the flexibility to determine whether a given proxy group company is truly an outlier, or whether it contains useful information.[257]

B. Rehearing Requests

143. MISO TOs argue that, if the Commission retains the high-end outlier test and the natural break analysis, the high-end outlier threshold should be useable as evidence for retaining one or more cost-of-equity estimates that might otherwise be excluded because of a subjectively identified "natural break."[258]

144. MISO TOs contend that the natural break analysis utilized by the Commission has no foundation and invites arbitrary application. MISO TOs contend that the analysis is especially erroneous when applied to the high-end outlier test.[259] MISO TOs also argue that, if the Commission continues to apply a natural break standard to its low-end outlier test, it should not use this threshold to include companies that investors would ignore as unrepresentative of acceptable equity returns.[260]

C. Commission Determination

145. We deny MISO TOs' request for rehearing on the natural break analysis. We note that the high and low-end outlier tests are not meant to be purely statistical tests and refute MISO TOs' assertion that the natural break analysis is inherently flawed because it is subjective. Additionally, we clarify that the natural break analysis may be used as evidence for retaining one or more cost-of-equity estimates that might otherwise be excluded because of a high-end or low-end outlier test. Observations that are shown to be rational and not the result of error may still be included, even if they otherwise would fail one of the outlier tests. By the same logic, the natural break analysis can be used to

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[257] Opinion No. 569, 169 FERC ¶ 61,129 at PP 187-188.

[258] MISO TOs Rehearing Request at 76-77.

[259] *Id.* at 80-82.

[260] *Id.* at 83.

argue for exclusion of cost-of-equity estimates that do not fail either outlier test but can be shown to be irrational, anomalous, or the result of human error.

146. Model inputs can be flawed, due to incorrect inputs or the result of poor judgement by analysts. Such errors can improperly influence the analysis, especially when they affect estimates at the high and low end of the proxy group. As the Commission noted in the Briefing Order, one analyst's error involving the growth projections for Portland General Electric Company reduced the overall Reuters consensus projected short-term percentage growth in earnings from 10.96% to 7.8%.[261] This case illustrates the fallibility of model inputs and the importance of having a natural break analysis to enable the Commission to use its discretion with respect to high or low values.

X. High-End Outlier Test

A. Opinion No. 569

147. In Opinion No. 569, the Commission adopted the high-end outlier test proposed in the Briefing Order, which excludes from the proxy group any company whose cost of equity estimated under the model in question is more than 150% of the median result of all of the potential proxy group members in that model before any high or low-end outlier test is applied, subject to a natural break analysis. The Commission noted that financial metrics for individual utilities can fluctuate dramatically, potentially affecting ROEs that use midpoints as measures of central tendency and found that it was appropriate to eliminate members of the proxy group whose ROEs are unreasonably high.[262]

B. Rehearing Requests

148. MISO TOs argue that the Commission should not adopt any high-end outlier test. MISO TOs argue that the high-end outlier test artificially narrows the zone of reasonableness. MISO TOs further argue that if the Commission retains the high-end outlier test, it should be used only as a rebuttable presumption, and then applied only to the highest of the median values produced by the analyses used.[263]

149. MISO TOs further argue that, even if the Commission retains the high-end outlier test, it should not be applied to the two-step DCF analysis. MISO TOs argue that,

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[261] Briefing Order, 165 FERC ¶ 61,118 at P 19 n.95 (*Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 47).

[262] Opinion No. 569, 169 FERC ¶ 61,129 at P 179.

[263] MISO TOs Rehearing Request at 70-73.

because the median of the two-step DCF may be unreliable or produce unjust and unreasonable results, its use in the high-end outlier test is similarly unreliable.[264]

150. Transource Energy contends that there is no evidence that a logical high-end outlier test exists that would apply generically as the low-end outlier test does. Transource Energy argues that a generic exclusion based on distance from the median may reject potentially useful observations. Transource Energy contends that, if the Commission were to utilize a high-end outlier test, the Commission should treat the test as a high-end cap on the result and not a high-end exclusion of data points.[265]

151. Exelon contends that the high-end proxy group utilities that are excluded under the high-end outlier test represent actual data regarding utilities of a similar risk profile, and thus application of the test changes the range of studied ROEs from those that actual investors consider in the market.[266]

C. Commission Determination

152. We grant in part and deny in part the requests for rehearing on the high-end outlier test. While the high-end outlier test uses the median, it is not solely meant to serve as a statistical test to remove proxy group companies that are not representative of typical utilities. Rather, the high-end outlier test, when coupled with a natural break analysis, screens for observations that are irrationally or anomalously high.

153. As an initial matter, we note that some parties have characterized the high-end outlier test as stricter than it is. As noted above, the high-end outlier test is subject to a natural break analysis, meaning observations that are shown to be rational and not the result of error may still be included, even if they are over the threshold.

154. However, we find that it is appropriate to modify the high-end outlier test to treat any proxy company as high-end outlier if its cost of equity estimated under the model in question is more than 200% of the median—as opposed to the 150% of the median threshold applied in Opinion No. 569—result of all of the potential proxy group members in that model before any high or low-end outlier test is applied, subject to a "natural break" analysis. The high-end outlier test is the Commission's best attempt to use an objective test to identify proxy group ROEs that are irrationally or anomalously high because, for example, they are the result of atypical circumstances that are unrepresentative of the subject utility's risk profile or otherwise likely to be in error.

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[264] *Id.* at 74-76.

[265] Transource Energy Rehearing Request at 28-29.

[266] Exelon Rehearing Request at 13-14.

We recognize such a test with a bright-line threshold could inappropriately exclude ROEs that are rational and not anomalous for the subject utility. In recognition of this risk, we find that increasing the threshold for the high-end outlier test to 200% of the median result of all of the potential proxy group members in the applicable model[267] is appropriate because it will reduce the risk that such rational results are inappropriately excluded. However, as we note above, the continued application of the natural break analysis will still allow the exclusion of ROEs that are truly irrational or anomalously high, even if they fall under the threshold set by this high-end outlier test.

155. While we are modifying the high-end outlier test to increase its exclusion threshold, we find that it is still appropriate to maintain the test as an objective check to help identify observations that are irrationally or anomalously high. This is especially true because we will continue to use the midpoint as a baseline to determine region-wide ROEs for groups of utilities and potentially flawed high-end observations from the proxy group play a large role in an ROE analysis that uses the midpoint. While we note that the addition of the Risk Premium model to the analysis diminishes the impact of outliers, we do not find this to be enough to warrant removal of the high-end outlier test entirely. Thus, the high-end outlier test continues to apply, but with the modification described above.

XI. Low-End Outlier Test

A. Opinion No. 569

156. In Opinion No. 569, the Commission adjusted the low-end outlier test to eliminate from the proxy group ROE results that are less than the yields of generic corporate Baa bonds plus 20% of the CAPM risk premium. The Commission found that it was necessary to exclude ROEs whose yield was "essentially the same expected return" as debt in order to determine the low end of the zone of reasonableness. The Commission noted that the risk premium that investors demand changes over time and found that using 20% of the CAPM risk premium struck an appropriate balance of accounting for the additional risk of equities over bonds while not inappropriately excluding proxy group members whose ROE is distinguishable from debt.[268]

[267] The high-end outlier test only applies to the DCF model and CAPM because they utilize results of the relevant analysis applied to a proxy group, while the Risk Premium model is derived from actual ROEs.

[268] Opinion No. 569, 169 FERC ¶ 61,129 at PP 184-185.

B. Rehearing Requests

157. RPGI argues that the Commission has not justified revising the low-end outlier test, and specifically has not supported including 20% of the CAPM risk premium.[269]

158. CAPs contend that using the Baa bond yield index is an inappropriate way to determine whether a ROE is an unreliable low-end outlier. CAPs further contend that this is inconsistent with Commission precedent, noting the Commission's explanation in Opinion No. 489 that, when applying a low-end outlier test, "it is appropriate to consider the company's own cost of debt, not the composite debt of the proxy group."[270] CAPs note that applying this to a company's own cost of debt results in OGE Energy being added back into the proxy group for the Second Complaint.[271]

159. CAPs similarly argue that the Commission's use of the risk premium should be rejected. However, CAPs contend that, if the Commission continues to utilize a risk premium, it should instead be 20% of the difference between the CAPM equity market return and the Moody's Baa utility bond yield.[272]

160. MISO TOs argue that the Commission erred in adopting its low-end outlier test and should instead apply the low-end methodology described by Mr. McKenzie in order to account for the inverse relationship between equity risk premiums and bond yields.[273]

C. Commission Determination

161. We deny the requests for rehearing on the low-end outlier test. We are not persuaded by RPGI's and MISO TOs' assertions that the Commission erred in adopting its low-end outlier test based on 20% of the CAPM risk premium. Likewise, we disagree with CAPs that the low-end outlier test is inconsistent with prior Commission precedent. As the Commission noted in Opinion No. 569, the Commission has applied this test differently in the past and did not always examine a company's own cost of debt.[274]

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[269] RPGI Rehearing Request at 27-31.

[270] CAPs Rehearing Request at 88-90.

[271] *Id.* at 94.

[272] *Id.* at 90-92.

[273] MISO TOs Rehearing Request at 83-84.

[274] Opinion No. 569, 169 FERC ¶ 61,129 at P 389 n.783 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 123).

The Commission also found that "using the specific bond yield for each company . . . renders [the calculations] (and the resulting ROE) less predictable, as the credit ratings for individual companies are likely more volatile than the generic corporate rate Baa credit rating."[275] Thus, we reiterate our finding here that applying the low-end outlier test to the Baa bond yield is appropriate. We also decline to adopt CAPs' proposal to instead use 20% of the difference between the CAPM equity market return and the Moody's Baa utility bond yield, and affirm our use of the United States 30 year treasury note in calculating the CAPM equity risk premium. There is no compelling evidence that, with respect to determining the risk premium, using Moody's Baa utility bond yields is superior to the treasury yields. Treasury yields are generally more stable than corporate bond yields, which here increases model stability. Furthermore, the low-end outlier test already incorporates the Moody's Baa utility bond, to which it adds 20% of the risk premium to determine the test. Using it twice would be unnecessarily duplicative. Additionally, we note that the risk premium is meant to reflect the opportunity cost of investing in equities generally, and therefore, using an industry-specific measure to determine the low end of the risk premium's range is inappropriate.

162. We also decline to adopt MISO TOs' proposed methodology. Opinion No. 569's proposed low-end outlier test methodology recognizes the dynamic nature of risk premiums without eliminating numerous proxy group members as the MISO TOs' methodology might in certain conditions. In Mr. McKenzie's example, use of his proposed test leads to the exclusion of six rather than three companies, the upper three of which feature ROEs very close to those of other companies.[276] This indicates that MISO TOs' proposed outlier test is excluding more than just outliers, systematically adding a significant upward bias to the DCF results.

XII. Consideration of State ROEs

A. Opinion No. 569

163. The Commission found that the ROE determination in these proceedings did not need to consider state-authorized ROEs. The Commission agreed with MISO TOs that there are material differences between state and Commission ROEs. As a result, the Commission stated that it would only consider state-authorized ROEs on a case-by-case

[275] *Id.*

[276] Appendix 3 to McKenzie Affidavit in MISO TOs Initial Brief.

basis to the extent that the state-authorized ROEs demonstrate that the results of the Commission's CAPM and DCF analyses are substantially excessive or deficient.[277]

B. Requests for Rehearing

164. Ameren, MISO TOs, and Transource Energy all note that the Commission stated in Opinion No. 569 that its new ROE approach would consider state-authorized ROEs, but argue that, despite the express inclusion, the Commission failed to perform this check. These parties assert that the Commission has previously found that transmission ROEs generally should be higher relative to those of distribution-only and integrated electric utilities. These parties claim that the Commission disregarded record evidence of state-authorized ROEs above 9.88%, and argue that this evidence demonstrates that, relative to the risk to transmission, 9.88% is an insufficient level of return to attract capital under the *Hope* and *Bluefield* standards.[278]

165. According to MISO TOs, the Commission's findings that transmission is riskier than state-regulated retail utility operations and that the MISO TOs are at least as risky as integrated utilities require that the MISO TOs' base ROE be somewhat higher than most, if not all, contemporaneous state-authorized ROEs. MISO TOs state that all state ROEs allowed during the Docket No. EL14-12 study period exceeded the DCF midpoint. Indeed, even the midpoint of all state-allowed ROEs, 9.95%, exceeded the base ROE of Opinion No. 569, and 31 out of 58 state-authorized ROEs for integrated utilities were between 10% and 10.4%.[279]

166. MISO TOs argue that *Emera Maine* did not disturb the Commission's finding in Opinion No. 531-B that the proper use of state commission ROEs is to compare the "significant number of state commission-authorized ROEs to the midpoint produced by the application of the Commission's traditional methodology" and 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." They contend that evidence of prevailing state ROEs during the study period indicates that a base ROE equal to or higher than 10.32% is justified.[280] They state that other estimates of the MISO TOs' cost of equity support the same inference, and thus support the Opinion No. 551 outcome. They note that: the Commission's

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[277] Opinion No. 569, 169 FERC ¶ 61,129 at P 363.

[278] Ameren Rehearing Request at 8-10; MISO TOs Rehearing Request at 14-16; Transource Energy Rehearing Request at 10-14.

[279] MISO TOs Rehearing Request at 33.

[280] *Id.* at 33-34 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 88).

application of the CAPM in Opinion No. 569 resulted in a midpoint of 10.45%; the Commission in Opinion No. 551 accepted a Risk Premium estimate of 10.36% and an Expected Earnings midpoint estimate of 11.99%; and the Briefing Order presented a restated Expected Earnings analysis with a midpoint of 11.41%, and repeated the Risk Premium estimate of 10.36%.[281]

C. Commission Determination

167. As an initial matter, the modifications made in this order to the ROE determination methodology result in higher ROEs in these proceedings, at least in part rendering moot concerns about the relative levels of state-authorized ROEs for integrated utility operations versus Commission-authorized transmission ROEs. Furthermore, the 10.02% ROE resulting from this order exceeds the average ROEs in the MISO TOs' analysis for both vertically-integrated utilities and for all utilities.[282] Moreover, MISO TOs' comparison of Commission ROEs in this proceeding with state ROEs over a two-year period, concluding in 2014, before the test period in this proceeding, is inappropriate. As illustrated by the fact that the DCF and CAPM midpoint ROEs in the Second Complaint are lower than those in the First Complaint, capital market conditions can change over time, rendering past comparisons obsolete. The ROEs in this proceeding must reflect capital market conditions during the first half of 2015 for the First Complaint and the second half of 2015 for the Second Complaint, so comparisons to state ROEs during the preceding two years are of limited value. We also continue to find that state-authorized and Commission-authorized ROEs are conceptually distinct and do not necessarily need to be aligned. In Opinion No. 569, the Commission indicated that state-authorized ROEs would only be considered on a case-by-case basis and not as a necessary part of the Commission's ROE methodology, and accordingly we disagree that we were required to consider state-authorized ROEs as part of the ROE determination in this proceeding. Although the Commission may consider a wide range of evidence in its ROE determinations, it is not legally required to base its jurisdictional transmission ROE determinations on the ROEs determined by state utility commissions. Furthermore, that the Commission relied on state ROEs corroboratively in the vacated Opinion No. 531 and in Opinion No. 551 that was pending before the Commission on rehearing, does not create binding precedent that the Commission must justify departure from in its finding that it will not necessarily consider state ROEs when determining transmission ROEs.

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[281] *Id*. at 34.

[282] *See* MTO-20 at 1-2.

XIII. Use of the Midpoint

A. Opinion No. 569

168. The Commission stated that it will continue to use the midpoint to determine the central tendency of the zone of reasonableness in cases involving an RTO-wide ROE, consistent with the policy set forth in the *MISO Remand Order*,[283] and that intervenors did not present a compelling reason as to why that policy should not be applied in this ROE proceeding.[284] The Commission explained that MISO TOs are a diverse set of companies and the central value becomes an important part in determining RTO-wide ROE.[285] The Commission also found that the high and low ends of the DCF and CAPM zones of reasonableness were representative of the highest and lowest risk profiles among the MISO TOs.[286]

B. Requests for Rehearing

169. CAPs contend that the Commission erred in using the midpoint, rather than the median, as the measure of central tendency for the ROE under the second prong of the section 206 analysis. CAPs point out that the Commission has found that the median best represents the central tendency in a skewed distribution[287] and is "less affected by extreme numbers than the midpoint."[288] CAPs find unpersuasive the Commission's finding in Opinion No. 569 that the companies that set the high and the low end of the zone of reasonableness in Opinion No. 569's DCF and CAPM analyses have similar risk

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[283] *Midwest Indep. Transmission Sys. Operator, Inc.*, 106 FERC ¶ 61,302, at PP 9-10 (2004) (*MISO Remand Order*), *aff'd*, *Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005).

[284] Opinion No. 569, 169 FERC ¶ 61,129 at P 409.

[285] *Id.* PP 410-411.

[286] *Id*. PP 412-413.

[287] CAPs Rehearing Request at 83 (citing *S. Cal. Edison Co.*, 131 FERC ¶ 61,020 at PP 114-116, *reh'g denied*, 137 FERC ¶ 61,016 (2011) (SCE Rehearing), *aff'd in relevant part sub nom. S. Cal. Edison Co. v. FERC*, 717 F.3d 177 (D.C. Cir. 2013); *Northwest Pipeline Corp.*, 99 FERC ¶ 61,305, at 62,276 (2002). *See also Transcontinental Gas Pipe Line Corp.*, Opinion No. 414-A, 84 FERC at 61,427, *aff'd* Opinion No. 414-B, 85 FERC ¶ 61,323 (1998), *rev. denied sub nom., N.C. Util. Comm'n v. FERC*, 203 F.3d 53 (D.C. Cir. 2000)).

[288] *Id.* (citing SCE Rehearing, 137 FERC ¶ 61,016 at P 19).

profiles to the MISO TOs. CAPs contend that this explanation misses the point because, even if the risk profile of the proxy group companies setting the high and low ends of the DCF and CAPM zones of reasonableness are within that wide variation, the averaged DCF and CAPM midpoints do not correspond to the highest and lowest cost of capital among Respondent MISO TOs. Consequently, according to CAPs, using the highest and lowest ROEs in the DCF and CAPM zones to calculate the presumptively just and reasonable zones or to determine the replacement ROE does not result in emphasizing the full range of the individual MISO TOs' costs of equity to serve a diverse group of TOs.

170. CAPs state that the premise for use of the midpoint is counter-factual because there is no direct correlation between credit ratings and the utilities setting the upper and lower bounds of the composite zone of reasonableness and the highest and lowest credit ratings of the MISO TOs.[289] CAPs state that the Commission dismissed this concern on the basis that such lack of correlation is not a problem because the credit ratings of the proxy companies that turn out to define the DCF-CAPM combined range are within the MISO TOs' wide variation of credit ratings.

C. Commission Determination

171. We disagree with arguments on rehearing that the Commission erred in continuing to use the midpoint as the measure of central tendency when establishing an ROE for groups of utilities like the MISO TOs. Such arguments fail to provide a basis for reversing a court-affirmed finding that it is just and reasonable to use the midpoint as the measure of central tendency for groups of utilities.[290] Additionally, the Commission described in great detail the general correspondence between the credit rating of proxy group companies and those at the high and low end of the zone of reasonableness, even if this examination was not specific to the MISO TOs.[291] The fact that the MISO TOs' highest and lowest credit ratings do not fully correspond to the high and the low ends of the CAPM and DCF zone of reasonableness in this particular proceeding does not change the fundamental purpose of applying the midpoint to groups of utilities, which is capturing a variety of risks that they feature.

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[289] *Id.*

[290] *See Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d at 1004, 1010.

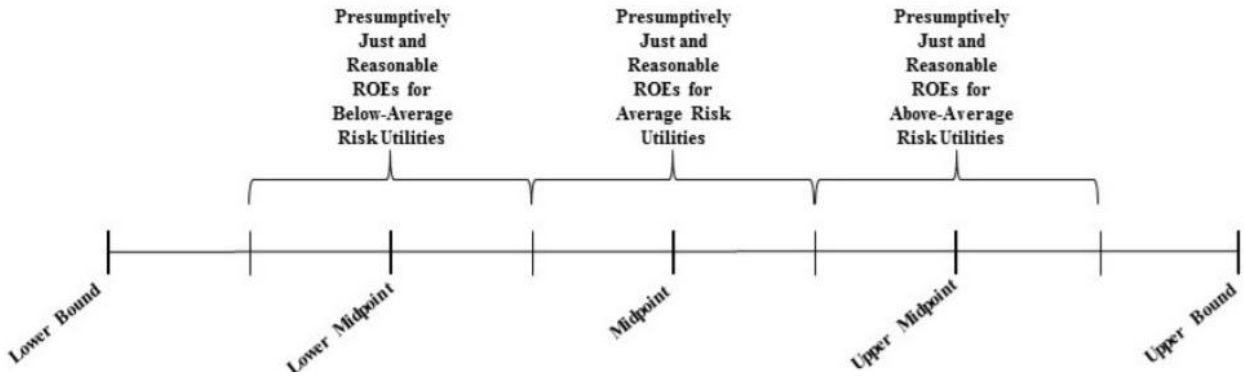
[291] *See* Opinion No. 569, 169 FERC ¶ 61,129 at P 412.

XIV. Ranges of Presumptively Just and Reasonable ROEs

A. Opinion No. 569

172. In Opinion No. 569, the Commission adopted the use of ranges of presumptively just and reasonable ROEs based on the risk profile of a utility or group of utilities to inform the Commission's decision of whether an existing ROE has become unjust and unreasonable, as proposed in the Briefing Order.[292] Specifically, the Commission found that, for average risk utilities, the presumptively just and reasonable range is the quartile of the overall composite zone of reasonableness centered on the central tendency of the overall zone of reasonableness; for below average risk utilities, that range is the quartile of the zone of reasonableness centered on the central tendency of the lower half of the zone of reasonableness; and for above average risk utilities, that range is the quartile of the zone of reasonableness centered on the central tendency of the upper half of the zone of reasonableness. These ranges of presumptively just and reasonable base ROEs located within the overall composite zone of reasonableness are illustrated below.

Figure 1: Zone of Reasonableness Quartiles



173. In constructing the ranges of presumptively just and reasonable base ROEs, the Commission noted its precedent that the midpoint of the overall zone of reasonableness is a good starting place for the placement of an ROE and found that the measure of central tendency for the entire zone of reasonableness should be the starting point for identifying the range of presumptively just and reasonable base ROEs for utilities with an average risk profile.[293] The Commission then found that, similarly, the starting points for identifying the ranges of presumptively just and reasonable base ROEs for utilities with above or below average risk profiles should be the historic measures of central tendency

[292] *See id.* P 57.

[293] *Id.* P 63 (citing *Emera Maine*, 854 F.3d at 27 (citing *Tenn. Gas Pipeline Co. v. FERC*, 926 F.2d 1206, 1213 (D.C. Cir. 1991)) ("We have noted that the midpoint is a good 'starting place' for the placement of the ROE.")).

of the upper and lower halves of the zone of reasonableness, respectively – their respective midpoints.[294] The Commission explained that it was logical for the end points of those ranges to not be closer to the starting points for the ranges of utilities with different risk profiles than they are to their own starting point. Applying this rationale, the Commission found that the range within the overall zone of reasonableness that best represents presumptively just and reasonable ROEs for average risk utilities is the quartile of the zone of reasonableness centered on the central tendency of the entire zone of reasonableness, while the ranges within the overall zone of reasonableness that best represent presumptively just and reasonable ROEs for above- and below- average utilities are the quartiles centered on the central tendencies of the upper and lower halves of the zone of reasonableness, respectively.[295]

174. The Commission explained that adopting the use of ranges of presumptively just and reasonable base ROEs was necessary to satisfy the requirements of the *Emera Maine* decision, which found that the Commission's decision that "a single ROE analysis generating a new just and reasonable ROE necessarily proved that the Transmission Owners' existing ROE was unjust and unreasonable" is contrary to the FPA.[296] Such ranges were also necessary, the Commission reasoned, because, according to the *Emera Maine* decision, "the zone of reasonableness creates a broad range of potentially lawful ROEs rather than a single just and reasonable ROE," and thus that a finding that a particular ROE is just and reasonable, "standing alone, 'does not amount to a finding that every other rate of return'" is not just and reasonable.[297] The Commission found that, in light of these findings, the Commission's explanation of the particular circumstances that support an explicit finding that the existing ROE has become unjust and unreasonable must include a showing that the existing ROE is now outside some range of potentially just and reasonable ROEs within the zone of reasonableness for the public utility at issue, in light of our estimate of the current market cost of equity. Alternatively, the Commission found that it could find that it could determine that other evidence

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[294] *Id.* (citing *Emera Maine*, 854 F.3d at 30 (citing *Tenn. Gas Pipeline*, 926 F.2d at 1213) ("[Where] the utility at issue was riskier than the proxy group . . . the midpoint of the upper half was 'an obvious place to begin.'"); *Potomac-Appalachian Transmission Highline, LLC*, 158 FERC ¶ 61,050, at PP 270, 273 (2017) (setting ROE at the "measure of central tendency of the lower half of the zone of reasonableness . . . [g]iven [the utility's] low level of risk as compared to the proxy group.")).

[295] *Id.*

[296] *Id.* P 57 (citing *Emera Maine*, 854 F.3d at 26).

[297] *Id.* (citing *Emera Maine*, 854 F.3d at 26 (quoting *Papago Tribal Util. Auth. v. FERC*, 723 F.2d 950, 857 (D.C. Cir. 1983))).

convincingly demonstrates that the existing ROE is unjust and unreasonable despite it falling within that range.[298]

175. The Commission also explained that the base ROEs that fall within the applicable range of presumptively just and reasonable base ROEs will be presumed to be just and reasonable, and those that fall outside of the applicable range will be presumed to be unjust and unreasonable.[299] The Commission further found that those presumptions would only be rebuttable presumptions because the ultimate determination of whether an existing ROE is unjust and unreasonable still "depends on the particular circumstances of the case."[300] The Commission noted that other evidence regarding the particular circumstances of the case could rebut a presumption that applies, such as evidence regarding non-utility stock prices, investor expectations for non-utility stocks, various types of bond yields and their relation to stock prices, investor and other expert testimony, and testimony regarding the effects of rates on customers.[301]

B. Rehearing Requests

176. MISO TOs argue that, while the concept of a range of presumptively just and reasonable ROE values has merit, there are problems with the quartile approach used in Opinion No. 569. First, MISO TOs contend that the Commission never reconciles its concept of risk-associated sub-ranges with its long-standing rationale for using the midpoint to establish base ROEs for groups of utilities (i.e., to reflect such a group's broad range of risks). They contend that, while the midpoint rationale dovetails with *Emera Maine*'s recognition that "the zone of reasonableness creates a broad range of potentially lawful ROEs," the quartile approach of Opinion No. 569 does not. MISO TOs state that the Commission's historical reference to the midpoint explicitly recognizes the need to reflect the full range of required returns for a proxy group determined to be representative of a group of utilities such as the MISO TOs. But they contend that the Commission's attempt to further parse this composite zone uses an unexplained and arbitrary notion of relative risk based on arbitrary quartiles and is inconsistent with the Commission's own rationale for referencing the midpoint. Moreover, they assert that, as applied in Opinion No. 569, the effort lacks any foundation in case-specific evidence.[302]

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[298] *Id.* PP 61-62.

[299] *Id.* P 85.

[300] *Id.* P 68 (citing *Emera Maine*, 854 F.3d at 23).

[301] *Id.*

[302] MISO TOs Rehearing Request at 29.

177. In addition, MISO TOs contend that the Commission's new approach is inconsistent with the logic it uses to select the proxy group. They state that the proxy group is assembled using criteria which limit the proxies to companies that are considered to present investment risks comparable to those of the utility or group of utilities whose rates are at issue. Nevertheless, they argue, the Commission's quartile approach effectively truncates the zone of reasonableness by omitting from consideration the top one-eighth and the bottom one-eighth of the composite zone. They argue that the Commission's reasoning departs without explanation from the principle that every value in the zone of reasonableness is potentially a lawful ROE.[303]

178. MISO TOs further argue that the Commission derives its quartiles from the composite range of DCF and CAPM results but overlooks that different proxy companies' results are found at the low end, the middle, and the high end of each of the two analyses on which the Commission relies. Thus, MISO TOs assert, one or more proxies that fall within the "above average risk" quartile in the results of the DCF model appear in a different quartile of the CAPM results. MISO TOs argue that the Commission therefore cannot rationally distinguish "high risk" proxy companies from "low risk" proxies in its composite zone. They contend that the Commission has not provided an economic or financial rationale for the quartile approach.[304]

179. With regard to the Second Complaint, MISO TOs contend that there likewise is no need for a new ROE methodology to justify dismissal of the Second Complaint. According to MISO TOs, the upper midpoint of the Commission's IBES-based DCF analysis for the Second Complaint study period is only 9.83%, reflecting—just as in the First Complaint—anomalous capital market conditions. But they assert that alternative benchmark estimates and state ROE data demonstrate, as the Presiding Judge found, that the DCF outcome is unreliable. They argue that midpoint CAPM and Expected Earnings estimates (10.49% and 11.41%, respectively), as well as a Risk Premium estimate of 10.36%, establish that the Second Complaint record does not support a finding that the 10.32% base ROE determined in Opinion No. 551 was unjust and unreasonable for the Second Complaint study period.[305] They state that state-authorized ROEs for lower-risk integrated and distribution utilities further corroborate that conclusion, citing witness Lapson's national survey of state regulatory decisions in 2014-2015 that authorized base ROEs of 10% or more for retail utility operations in states within the MISO region.[306]

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[303] *Id.* at 29-30.

[304] *Id.* at 30.

[305] *Id.* at 35.

[306] *Id.* at 35-37.

180. MISO TOs state that, if the Commission continues to pursue Opinion No. 569's approach to using ranges of presumptively just and reasonable ROEs based on a portion of the zone of reasonableness, two alternative approaches would remedy the principal shortcoming of the Commission's quartile approach (i.e., its excision of the highest and lowest eighths of the composite zone). They state that this can be resolved either by dividing the entire zone of reasonableness into equal thirds, rather than quarters, or by using the upper and lower midpoints of the zone of reasonableness to segregate the three portions of the zone.[307]

181. Exelon argues that the Commission's ranges of presumptively just and reasonable ROEs are too narrow. Exelon contends that the Commission does not explain why it makes sense to treat only 25% of the range of investor expectations that is developed by the financial models as presumptively just and reasonable. Exelon asserts that the Commission already identifies a screened peer group with comparable risk to the subject utility when it selects a proxy group, and that it is unreasonable to adjust again for that same risk in determining quartiles for ranges of presumptively just and reasonable ROEs.[308]

182. Exelon also argues that there is no rationale for placing the top eighth and bottom eighth of the zone of reasonableness out of the ranges of presumptively just and reasonable ROEs. Exelon further contends that, while quartiles result in an even division, the Commission never justifies its use of quartiles.[309] In addition, Exelon asserts that the Commission's ranges of presumptively just and reasonable ROEs are so narrow that small proxy group changes, such as the exclusion of a proxy group company or a change in the performance of a particular proxy group company, could result in a utility's ROE changing from presumptively just and reasonable to presumptively unjust and unreasonable. Exelon argues that this will create rate instability that will chill investment.[310]

183. Exelon also disagrees with the Commission's conclusion in Opinion No. 569 that the use of ranges of presumptively just and reasonable ROEs does not change the burdens that apply in the context of section 206 complaints. Exelon contends that, under Opinion No. 569, an average risk utility whose base ROE is above the applicable range of presumptively just and reasonable ROEs bears the burden of overcoming a presumption that its ROE is unjust and unreasonable, which removes the burden on the complainant to

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[307] *Id.* at 38.

[308] Exelon Rehearing Request at 8-10.

[309] *Id.* at 10-11.

[310] *Id.* at 15-17.

demonstrate that such an ROE is unjust and unreasonable. Exelon asserts that this departure from section 206 is especially unreasonable because the upper and lower eighths of the zone of reasonableness can never be presumptively just and reasonable.[311]

184. Transource Energy argues that the full zone of reasonableness represents the broad range of potentially reasonable ROEs, as the court stated in *Emera Maine*, and thus that full zone presents the best evidence of what is a potentially lawful ROE, not a subzone within the overall zone. Transource Energy contends that the full zone of reasonableness already accounts for risk and contains comparable and representative companies. Transource Energy asserts that the Commission does not provide evidence justifying that there are identifiable distinctions in the risk profiles of firms that constitute the proxy group which fall neatly into quartiles. Transource Energy further argues that the Commission's exclusion of the top and bottom eighths of the zone of reasonableness ignore otherwise valid ROE estimates in the ranges of presumptively just and reasonable ROEs.[312]

185. CAPs argue that *Emera Maine* did not require the Commission to adopt a new methodology, but only to better explain Opinion No. 531's finding that the New England TOs' existing 11.14% base ROE was unjust and unreasonable.[313] If the Commission decides to adopt a new methodology, CAPs argue that the quartile approach is flawed. CAPs argue that the presumptively just and reasonable zones raise the customers' burden of proof to challenge ROEs that may have become unjust and unreasonable. CAPs assert that the presumptively just and reasonable zones are contrary to the customer protection principles embodied in the FPA and introduces an unlawful asymmetry between rate increases sought by utilities under section 205 of the FPA and rate reductions sought by customers under section 206 of the FPA.[314]

186. If the Commission keeps the presumptively just and reasonable zones, CAPs argue that the Commission should narrow these zones. They contend that the quartile approach results in unnecessarily broad presumptive zones. They reiterate their argument from their initial briefs that the Commission could narrow the presumptive immunity zones by, for example, establishing five risk groups:ver y-low risk; moderately low risk; average risk; moderately high risk; and very high risk. Under this approach, CAPs argue, the zones would be narrower, representing sextiles rather than quartiles of the composite

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[311] *Id.* at 19-22.

[312] Transource Energy Rehearing Request at 30-35.

[313] CAPs Rehearing Request at 12-16.

[314] *Id.* at 16.

range.[315] Regarding the Commission's statement that the quartile approach using three risk groups strikes an appropriate balance between the interests of customers and utilities, CAPs argue that the very establishment of presumptively just and reasonable zones already tilts the balance of interests in favor of shareholders.[316]

187. CAPs argue that the Commission did not explain why the "traditional" starting point for assessing risk is relevant or even preferable to a narrower and more precise definition of risk that would better protect customers. CAPs argue that it is possible to start the risk assessment at a point of central tendency within any sub-range of the zone of reasonableness. Furthermore, CAPs assert that the proximity of potentially lawful ROEs to the just and reasonable ROE does not render these ROEs presumably just and reasonable (i.e., ROEs within the zone of reasonableness that are close to the just and reasonable ROE may be a little less unjust and unreasonable, but remain unjust and unreasonable nonetheless). They argue that the courts have ruled that the just and reasonable standard does not permit "even a little unlawfulness."[317]

188. CAPs also argue that the notion of presuming the justness and reasonableness of ROEs close to the lawful ROE runs afoul of multiple rulings made by the court in *Emera Maine*: (1) it is arbitrary and capricious to assume that there are only three possible stopping points—lower midpoint, midpoint, and upper midpoint—on the continuum of "potentially just and reasonable" ROEs that lie within the range of adopted proxy results; (2) the fact that a rate falls within the zone of reasonableness does not establish that the rate is the just and reasonable rate for the utility at issue; and (3) whether a rate, even one within the zone of reasonableness, is unlawful depends on the particular circumstances of the case, and, therefore, requires that a numerical comparison of model results to an existing ROE be accompanied by a narrative explanation of what made a difference between the two unreasonable.[318] CAPs argue that, if the proximity of an ROE to the just and reasonable ROE does not conclusively prove the justness and reasonableness of an ROE, then such proximity cannot be used to infer that all ROEs that are close to the just and reasonable ROE within a certain range "may" be just and reasonable.[319]

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[315] *Id.* at 16-17.

[316] *Id.* at 17.

[317] *Id.* at 18 (citing *Consumers Fed'n of Am. v. FPC*, 515 F.2d 347, 358 n.64 (D.C. Cir. 1975) (quoting *FPC v. Texaco*, 417 U.S. 380, 399 (1974))).

[318] *Id.* at 18-19.

[319] *Id.* at 19-20.

189. RPGI asserts that, for average risk utilities, the midpoint of the zone of reasonableness is what the existing ROE must be compared to—not a range of presumptively just and reasonable ROEs—and any existing ROE that exceeds that midpoint should be presumed unjust and unreasonable. RPGI also contends that the use of ranges of presumptively just and reasonable ROEs contravenes the FPA's consumer protection purpose because it can insulate an existing ROE from a section 206 challenge even if, for example, an existing ROE for an average-risk group of utilities exceeds the midpoint. In addition, RPGI argues that, while the Commission states that the ranges of presumptively just and reasonable ROEs create only a rebuttable presumption, it is difficult to imagine the circumstances under which the presumption could be rebutted. RPGI asks the Commission to grant rehearing to reject the use of ranges of presumptively just and reasonable ROEs.[320]

C. Commission Determination

190. We grant rehearing and hold that the ranges of presumptively just and reasonable base ROEs will be calculated by dividing the overall composite zone of reasonableness into three equal portions. We are persuaded by the requests for rehearing that contend that the Commission's ranges of presumptively just and reasonable base ROEs should encompass the entire composite zone of reasonableness. The court in *Emera Maine* stated that "the zone of reasonableness creates a broad range of potentially lawful ROEs[,]"[321] and we now find that excluding the bottom eighth and top eighth of the overall zone of reasonableness, as the Commission's approach in Opinion No. 569 did, is inappropriate because it will ignore some "potentially lawful ROEs" when determining which ranges of ROEs should be considered presumptively just and reasonable. The ranges of presumptively just and reasonable base ROEs are intended to help inform the Commission's analysis under section 206 by identifying what subset of the "potentially lawful ROEs" for given utilities represents the range of base ROEs that would likely be just and reasonable for utilities of that risk profile. We find that it would be inappropriate to identify a subset of "potentially lawful ROEs" for given utilities without considering all of those potentially lawful ROEs.

191. We are further persuaded by arguments that it is inappropriate to exclude the bottom eighth and top eighth of the overall composite zone of reasonableness because even those portions of the overall composite zone of reasonableness are results from proxy group companies that have been screened using criteria which limit the proxies to companies that are considered to present investment risks comparable to those of the utility or group of utilities whose rates are at issue. We find that, when we have already

[320] RPGI Rehearing Request at 9-16.

[321] *Emera Maine*, 854 F.3d at 26.

constructed a proxy group using limitations for comparable risk, it would be too restrictive to then construct ranges of presumptively just and reasonable base ROEs using only the results of some of those risk-screen proxy group companies. That initial proxy group screening process is intended to lead to the "broad range of potentially lawful ROEs" for a given utility or utilities, and we find that is more appropriate for the ranges of presumptively just and reasonable base ROEs to encompass the results from all of the proxy group companies that were identified in that process, rather than to exclude the results of the bottom eighth and top eighth of those results.

192. Exelon argues that the ranges of presumptively just and reasonable ROEs used in Opinion No. 569 are too narrow. MISO TOs make a similar argument, contending that the Commission's ranges of presumptively just and reasonable ROEs are inappropriate because they overlook that one or more proxies that fall within a particular risk profile range for one of the models used by the Commission may fall within a different risk profile range for a different model. CAPs make an opposing argument, asserting that the Commission's ranges are unnecessarily broad. We continue to find that using three risk groups strikes an appropriate balance between the interests of customers and utilities because they will be narrow enough to protect customers from unjust and unreasonable ROEs while also providing utilities and all market participants with an additional objective benchmark that the Commission will use to assess whether an ROE is likely unjust and unreasonable.[322] With respect to MISO TOs' argument that the ranges are inappropriate because the proxies that fall within a particular risk profile range for one of the models used by the Commission may fall within a different risk profile range for a different model, we find that this concern is addressed by averaging the results of the different models. We recognize that proxy group companies may fall within different risk profile ranges in different models, and this is why we average the results of those models. Indeed, this is a significant reason why we are considering different models and averaging their results—so that we can consider and give equal weight to the different results that are produced by these models, reflecting to a greater extent the models that investors consider.

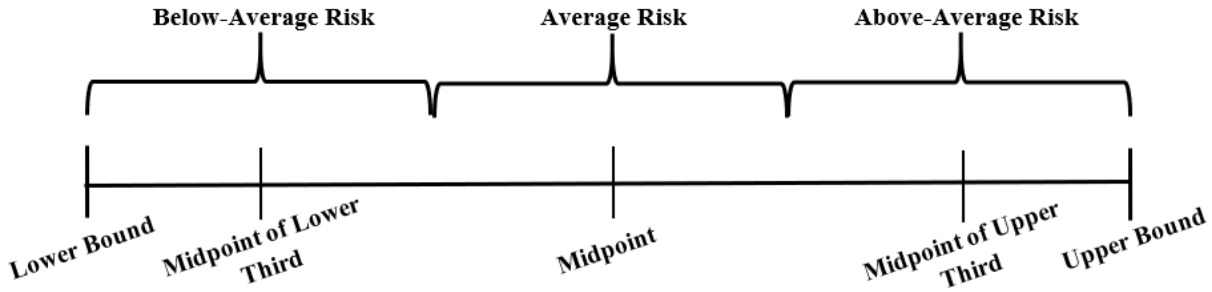
193. Accordingly, we will continue to use three ranges of presumptively just and reasonable base ROEs and that they should be constructed by dividing the overall zone of reasonableness into three equal segments. This construction will include all of the "potentially lawful ROEs" in the zone of reasonableness in one of the ranges of presumptively just and reasonable base ROEs.

194. The Commission explained that its approach to constructing the ranges of presumptively just and reasonable base ROEs in Opinion No. 569 was based on the logic that the end points of a range for a given risk profile should be closer to the traditional

[322] *See id.* P 84.

starting point for analyzing the ROEs of utilities with that risk profile than they are to the traditional starting points for utilities with a different risk profile.[323] Upon further consideration, given our decision to use three ranges of presumptively just and reasonable base ROEs that together encompass the overall zone of reasonableness, we find it appropriate to modify the traditional starting points for below-average and above-average risk utilities to be the midpoint of the lower and upper thirds, respectively. Applying these new starting points, as well as the traditional midpoint of the zone of reasonableness starting point for average risk utilities, will ensure that the end points for all three risk profile ranges will be closer to the starting point for analyzing ROEs of utilities with each respective risk profile than they are to the starting points for utilities with different risk profiles. Below is an illustration of the overall composite zone of reasonableness divided into three equal ranges of presumptively just and reasonable base ROEs.

Figure 2: Ranges of Presumptively Just and Reasonable Base ROEs



195. Exelon asserts that the use of ranges of presumptively just and reasonable base ROEs removes the burden on the complainant to demonstrate that an existing base ROE is unjust and unreasonable when such a base ROE is above the applicable range of presumptively just and reasonable ROEs because the utility or utilities then bear the burden of overcoming a presumption that its ROE is unjust and unreasonable. CAPs make a similar argument in the opposite direction, contending that the presumptively just and reasonable zones raise the customers' burden of proof to challenge ROEs that may have become unjust and unreasonable. We find these arguments unavailing. As the

[323] Opinion No. 569, 169 FERC ¶ 61,129 at P 63. Those traditional starting points were the midpoint of the zone of reasonableness for average risk utilities, the midpoint of the lower half of the zone for below-average risk utilities, and the midpoint of the upper half of the zone for above-average risk utilities.

Commission explained in Opinion No. 569,[324] the change to our ROE methodology to utilize ranges of presumptively just and reasonable ROEs does not change the burdens that parties face under section 206. It is merely an objective benchmark that will be used in our overall analysis of base ROEs to help determine if an existing rate has been shown to be unjust and unreasonable under section 206. It remains the case, as it was before implementing this modification to our ROE methodology, that "[t]he proponent of a rate change under section 206 . . . bears 'the burden of proving that the existing rate is *unlawful*.'"[325] The use of ranges of presumptively just and reasonable ROEs does not change this burden. Those ranges will merely serve to inform our assessment of ROEs. The fact that our use of those ranges will involve employing a rebuttable presumption does not change the burdens that apply.

196. MISO TOs and CAPs also take issue with the use of presumptively just and reasonable base ROEs because they assert that *Emera Maine* did not require the Commission to adopt the use of such ranges. As the Commission explained in Opinion No. 569,[326] the use of ranges of presumptively just and reasonable ROEs in our ROE methodology ensures that our determinations satisfy the requirements of the *Emera Maine* decision. The court in *Emera Maine* found that the Commission must "explain what circumstances" support its "actual finding as to the lawfulness" of an existing base ROE in a section 206 proceeding, and the use of ranges of presumptively just and reasonable base ROEs will allow us to do so in a structured manner. Using such ranges will produce a specific result from our risk profile determination—a rebuttable presumption—and then we will make an explicit finding as to whether the other evidence presented by the parties in the case has rebutted that presumption; therefore, this analysis will require us to "explain what circumstances" support our "actual finding as to the lawfulness" of an existing base ROE. Moreover, because risk profile is the particular circumstance most relevant to determining whether an existing ROE is unjust and unreasonable, using ranges of presumptively just and reasonable ROEs based on a utility's risk profile will ensure that the risk profile determination has a clear and significant connection to our ultimate finding relating to lawfulness. Accordingly, we continue to find that that the use of ranges of presumptively just and reasonable ROEs in our ROE methodology will ensure that our determinations satisfy the requirements of the *Emera Maine* decision.

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[324] *See id.* P 79.

[325] *Emera Maine*, 854 F.3d at 24 (emphasis in original) (quoting *Ala. Power Co. v. FERC*, 993 F.2d 1557, 1571 (D.C. Cir. 1993)).

[326] *See* Opinion No. 569, 169 FERC ¶ 61,129 at PP 70-71.

197. CAPs and RPGI assert that the use of ranges of presumptively just and reasonable base ROEs is inappropriate because any base ROE that exceeds the applicable base ROE produced by the Commission's analyses should be found unjust and unreasonable. We disagree. As the Commission stated in Opinion No. 569,[327] the court in *Emera Maine* rejected this approach, finding that the Commission must do more than simply identify a single ROE from its own analysis and then determine if the existing ROE is unjust and unreasonable based on whether it exceeds that single ROE. Accordingly, we affirm the Commission's finding that it should not continue to follow the approach that was reversed in *Emera Maine* of identifying a single cost of equity result and then finding that an existing ROE is unjust and unreasonable under prong one of section 206 if it exceeds that cost of equity.

198. CAPs also reiterate their argument that the use of ranges of presumptively just and reasonable base ROEs creates an unlawful asymmetry between rate increases sought by utilities under section 205 and rate reductions sought by customers under section 206. We disagree and affirm the Commission's finding that the use of presumptively just and reasonable ranges does not create any such unlawful asymmetry.[328] As the Commission explained, the showing that is required under section 206 differs from the showing that is required under section 205. The D.C. Circuit explained that "[t]he purpose of section 206 is 'quite different' from that of section 205,"[329] "[s]ection 206's procedures are 'entirely different' and 'stricter' than those of section 205," and that, while "[a] utility filing a rate adjustment under section 205 must show that the adjustment is *lawful* . . . [t]he proponent of a rate change under section 206 [] bears 'the burden of proving that the existing rate is *unlawful*.'"[330] The Commission does not have the authority to change those standards and our modification of the Commission's ROE methodology to use ranges of presumptively just and reasonable ROEs adheres to those standards; therefore, we reject CAPs' argument on this point.

199. We also are not persuaded by CAPs' argument that the use of ranges of presumptively just and reasonable base ROEs is inconsistent with other rulings made by the court in *Emera Maine*. Contrary to CAPs' assertion, the use of such ranges does not assume that there are only three possible stopping points—lower midpoint, midpoint, and upper midpoint—on the continuum of "potentially just and reasonable" ROEs. In fact, it

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[327] *See id.* P 73.

[328] *See id.* P 74.

[329] *Emera Maine*, 854 F.3d at 24 (quoting *City of Winnfield, La. v. FERC*, 744 F.2d 871, 875 (D.C. Cir. 1984)).

[330] *Id.* (emphasis in original) (quoting *Ala. Power Co. v. FERC*, 993 F.2d 1557, 1571 (D.C. Cir. 1993)).

does the opposite—it recognizes that there may be more than one just and reasonable return and employs ranges of just and reasonable ROEs to help determine if a particular existing base ROE is just and reasonable in light of the overall composite zone of reasonableness and the risk profile of the utilities at issue. The use of presumptively just and reasonable ranges also does not find that if a rate falls within the zone of reasonableness, then it is just and reasonable, as CAPs suggest. As described above, the fact that a rate falls within the zone of reasonableness will not result in a finding that such a rate is just and reasonable. In fact, it is possible that a rate that falls within the overall zone, but outside of the applicable presumptively just and reasonable range, would be presumed unjust and unreasonable. Similarly, whether an existing ROE is unjust and unreasonable, even one that falls within the applicable range of presumptively just and reasonable ROEs, still "depends on the particular circumstances of the case."[331] Accordingly, if an existing ROE falls within the applicable range of presumptively just and reasonable ROEs, the presumption that the ROE is just and reasonable is a rebuttable presumption. Therefore, other evidence regarding the particular circumstances of the case can demonstrate that an existing ROE is unjust and unreasonable even if it falls within the applicable range of presumptively just and reasonable ROEs, such as evidence regarding non-utility stock prices, investor expectations for non-utility stocks, various types of bond yields and their relation to stock prices, investor and other expert testimony, and testimony regarding the effects of rates on customers.

XV. Acting in these Proceedings as Opposed to in Base ROE NOI Proceeding

A. Rehearing Requests

200. Parties on rehearing argue that, because the Commission has sought public input on the Commission's base ROE policy from all interested parties in the Base ROE NOI proceeding,[332] it would be inappropriate for the Commission to establish a new base ROE policy in these MISO ROE proceedings without considering the broader universe of comments and evidence submitted in response to the Base ROE NOI.

201. Specifically, Exelon states that the thousands of pages of comments from utilities, industry groups, and other interested parties provided the Commission with a wide range of perspectives and valuable data. Exelon, MISO TOs, and Ameren argue that promulgating a new ROE method in an individual proceeding ignores the evidence submitted in the Base ROE NOI docket.[333] Moreover, Exelon, Transource Energy, and

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[331] *Id.*

[332] Base ROE NOI, 166 FERC ¶ 61,207.

[333] Exelon Rehearing Request at 27; *see also* MISO TOs Rehearing Request at 56-57; Ameren Rehearing Request at 27.

Ameren explain that, in the Base ROE NOI proceeding, the Commission specifically sought comments regarding the ROE four-financial model approach and, therefore, those parties participating in the Base ROE NOI proceeding did not address the new ROE two-model method that was introduced in Opinion No. 569 or the potential issues with the ROE four-model financial model approach revealed in Opinion No. 569.[334] Exelon and Ameren comment that establishing a new base ROE policy in these proceedings, as opposed to the Base ROE NOI proceeding, is inappropriate because the Commission's actions here will not reflect the input and evidence that was provided in the Base ROE NOI proceeding by other stakeholders who are not parties to these proceedings.[335] Exelon argues that the Commission should not rely on the fact that an outcome is reasonable as applied to this group of transmission owners, without analyzing the potential outcomes that will result from wider application of this method.[336] Transource Energy recognizes that the Commission has some discretion to enact policies through adjudication. However, it contends that under this set of circumstances the Commission's reliance on an adjudication and not the pending Base Roe NOI "amounts[s] to an abuse of discretion" that violates the Administrative Procedure Act.[337]

202. MISO TOs also assert that the Commission does not engage in reasoned decision-making when it disregards relevant evidence available to it, even if the evidence is in a different docket,[338] and it would be arbitrary and capricious for the Commission to set an industry-wide, binding precedent while ignoring this evidence.[339] Accordingly, MISO TOs argue that the Commission should take official notice in this proceeding of pertinent evidence introduced in the NOI docket.[340] MISO TOs state that the Commission's generic, industry-wide NOI on the methodology for determining base ROEs provides a more logical and reasonable forum for the Commission to develop, with

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[334] Exelon Rehearing Request at 27-28; Transource Energy Rehearing Request at 36-37; Ameren Rehearing Request at 24.

[335] Exelon Rehearing Request at 5, 12, 27; Ameren Rehearing Request at 24.

[336] Exelon Rehearing Request at 27.

[337] Transource Energy Rehearing Request at 37 (quoting *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 294 (1974)).

[338] MISO TOs Rehearing Request at 55.

[339] *Id.* at 58.

[340] *Id.* at 55.

the benefit of the extensive stakeholder input it solicited, any changes to its ROE methodology that it may find to be appropriate.[341]

203. Ameren argues that the fact that the Commission has left open the generic NOI docket, while at the same time making an industry-wide policy change in this adjudicated proceeding, constitutes arbitrary and capricious agency decision-making.[342]

204. Finally, Exelon asserts that the Commission should limit the application of any new method for assessing base ROEs adopted by Opinion No. 569 to these MISO cases and clarify that the Commission is not prejudging the application of any new method to other utilities.[343]

B. Commission Determination

205. We are not persuaded that it is inappropriate for the Commission to establish a new base ROE policy in these MISO complaint proceedings when it has also issued the Base ROE NOI to obtain input on this topic from interested parties. The Commission "has substantial discretion to establish rules of general application by case-specific adjudication and is not restricted to the use of a separate generic proceeding"[344] to

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[341] *Id*. at 37.

[342] Ameren Rehearing Request at 24.

[343] Exelon Rehearing Request at 28.

[344] Opinion No. 569, 169 FERC ¶ 61,129 at P 449 (quoting *Procedures for Disposition of Contested Audit*, Order No. 675, 114 FERC ¶ 61,178, at P 32 (2006). *See also NLRB v. Bell Aerospace Corp*., 416 U.S. 267, 294 (1974) ("[A]djudicative cases may and do serve as vehicles for the formulation of agency policies."); *SEC v. Chenery Corp*., 332 U.S. 194, 203 (1974) ("[T]he choice made between proceeding by general rule or by individual, ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency."); *Michigan-Wisconsin Pipeline Co. v. FPC*, 520 F.2d 84, 89 (D.C. Cir. 1975) ("[T]here is no question that the Commission may attach precedential and even controlling weight to principles developed in one proceeding and then apply them under appropriate circumstances in a stare decisis manner."); *Pac. Gas and Electric Co. v. FPC*, 506 F.2d. 33, 38 (D.C. Cir. 1974) ("[A]gency may establish binding policy through rulemaking procedures . . . or through adjudications which constitute binding precedents."); *AEP Power Mktg., Inc*., 108 FERC ¶ 61,026, at P 187 (2004) ("Our decision to establish new policy in the context of case-specific proceedings is clearly within our authority."); *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 103 FERC ¶ 61,349, at P 51 (2003) ("The Commission, moreover, is not limited to notice and comment rulemaking to develop

establish such rules. The Commission similarly has explained that "[o]ur decision to establish new policy in the context of case-specific proceedings is clearly within our authority."[345] Thus, while the Commission issued the Base ROE NOI, this did not prohibit it from changing its base ROE policy in an adjudication nor require that changes in base ROE policy occur in that Base ROE NOI proceeding. Importantly, we note that the due process protections afforded to all parties to these proceedings are available to every party to Commission proceedings. Any party in other proceedings will be free to argue, just as the parties to these proceedings were, that the base ROE methodology applied in any of these proceedings should be modified or applied differently because of the specific facts and circumstances of the proceeding involving that party.

XVI. Complaint-Specific Results: First Complaint

206. As discussed in this order, we are revising the methodology for determining whether an existing ROE is unjust and unreasonable and, if so, what is a just and reasonable ROE pursuant to section 206 of the FPA. Applying this methodology to the First Complaint proceeding, we continue to find that the rate to be reviewed in that proceeding— MISO TOs' 12.38% ROE—is unjust and unreasonable. Having addressed the first prong of the Commission's dual burden under section 206 and thus satisfied the "condition precedent"[346] to exercising our authority to change a rate under section 206, we grant rehearing of Opinion No. 569 and find that a just and reasonable replacement ROE for MISO TOs in the First Complaint proceeding is 10.02% under the second prong of section 206.

207. Below we address the "specific findings"[347] as to the "'particular circumstances'"[348] of the First Complaint proceeding that establish "'a rational connection'"[349] between the record evidence in that proceeding and our decisions under both prongs of section 206 herein to establish that we have "'made a principled and

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policy. Agencies generally are permitted considerable discretion to choose whether to proceed by rulemaking or by adjudication.")).

[345] *AEP Power Mktg.*, 107 FERC ¶ 61,018, at P 199 (2004).

[346] *Emera Maine*, 854 F.3d at 25 (citing *FPC v. Sierra Pac. Power*, 350 U.S. 348, 353 (1956)).

[347] *Id.* at 30.

[348] *Id.* at 27 (citing *FPC v. Nat. Gas Pipeline Co.*, 315 U.S. 575, 586 (1942)).

[349] *Id.* at 28 (citing *FERC v. Elec. Power Supply Ass'n*, 136 S.Ct. 760, 782 (2016)).

reasoned decision supported by the evidentiary record.'"[350] The Commission bases its decisions concerning just and reasonable ROEs for public utilities on the most recent information in the record regarding market cost of equity. Consequently, the starting point for determining whether MISO TOs' existing ROE has become unjust and unreasonable must be a consideration of whether the current market cost of equity has changed since the MISO TOs' existing ROE was established based on financial data for the six months ending February 2002, such that the existing base ROE is no longer just and reasonable. Accordingly, we begin by determining a composite zone of reasonableness using the most recent financial information in the record of the First Complaint proceeding. We continue to find that the appropriate study period including this most recent financial information is the first six months of 2015.[351]

A. DCF Analysis

208. In Opinion No. 569, the Commission affirmed Opinion No. 551's approval of the Presiding Judge's DCF analysis, with one exception. In Opinion No. 569, the Commission held that only the IBES short-term growth projection should be used for calculating the (1+.5g) adjustment to the dividend yield, instead of the composite growth rate including both short- and long-term growth rates that was used by the Presiding Judge. Here, we affirm the Commission's holding on that issue and the Commission's use of the low-end outlier test applied in Opinion No. 569. Accordingly, our determinations on those issues do not result in any changes to the DCF analysis that was used in Opinion No. 569 for the First Complaint proceeding.

209. As discussed above, we grant rehearing of Opinion No. 569 to modify the high-end outlier test that was used there to now treat any proxy company as high-end outlier if its cost of equity estimated under the model in question is more than 200% of the median result of all of the potential proxy group members in that model before any high or low-end outlier test is applied, subject to a "natural break" analysis. The Commission explained in Opinion No. 569 that applying the version of the high-end outlier test that was used there did not result in the exclusion of any company from the DCF proxy group as a high-end outlier.[352] The high-end outlier test as modified in this order also does not result in any exclusions. Accordingly, our determination on this issue also does not result in any changes to the DCF analysis that was used in Opinion No. 569. We also grant rehearing of Opinion No. 569 to find that the long-term growth rate should be given 20% weighting and the short-term growth rate 80% weighting in the two-step

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[350] *Id.* at 30 (citing *S. Cal. Edison v. FERC*, 717 F.3d at 181).

[351] *See* Opinion No. 569, 169 FERC ¶ 61,129 at P 460; Opinion No. 551, 156 FERC ¶ 61,234 P 19.

[352] Opinion No. 569, 169 FERC ¶ 61,129 at P 512.

DCF model. Our DCF analysis in the First Complaint proceeding reflecting this finding is shown in Appendix II to this order. Based on these determinations, we conclude that the DCF zone of reasonableness is 6.97% to 12.07%.

B. CAPM Analysis

210. In Opinion No. 569, the Commission affirmed Opinion No. 551's approval of the Presiding Judge's CAPM analysis in the First Complaint proceeding, with two exceptions related to the market risk premium. The Commission held that only the IBES short-term growth projection should be used in the one-step DCF analysis of the dividend paying members of the S&P 500, instead of the average of the IBES and *Value Line* growth projections approved by the Presiding Judge.[353] In addition, the Commission held that companies with negative ROEs or ROEs above 20% should be excluded from that analysis.[354]

211. As discussed above in section IV.C.1, we grant rehearing of Opinion No. 569 to, in future proceedings, consider the use of *Value Line* short-term growth rate projections in the one-step DCF analysis of the dividend paying members of the S&P 500 that is conducted in the CAPM. However, we find that the record is insufficient to allow us to use only *Value Line* short-term growth rates in the CAPM in the First Complaint proceeding. In addition, we affirm the Commission's application of the low-end outlier test and grant rehearing to modify the high-end outlier test, as described above. As the Commission explained in Opinion No. 569, the application of the low-end outlier test and the version of the high-end outlier that was used there did not result in the exclusion of any company from the CAPM proxy group.[355] The low-end outlier test and the modified high-end outlier test adopted herein also do not result in the exclusion of any company from the CAPM proxy group. Accordingly, we will continue to use the CAPM analysis that was relied upon in Opinion No. 569 for the First Complaint proceeding.[356] Based on these determinations, we conclude that the CAPM zone of reasonableness is 7.80% to 13.09%.

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[353] Opinion No. 551, 156 FERC ¶ 61,234 at PP 169, 172.

[354] Opinion No. 569, 169 FERC ¶ 61,129 at P 513.

[355] *See id.* PP 514-515.

[356] *See id.* P 513. The results of this CAPM analysis are reflected in page 6 of Attachment A to Trial Staff's Initial Briefs. *See* Trial Staff Initial Br. (II), Attachment A to App. 2 at 6.

C. Risk Premium Analysis

212. As discussed above, we grant rehearing of Opinion No. 569 to find that the Risk Premium Model should be used in our ROE analysis under section 206 of the FPA. As described above, we adopt modifications to the Risk Premium analysis that was provided by MISO TOs in the record for the First Complaint proceeding. Appendix I to this order shows the results of the Risk Premium Model, as applied with modifications adopted herein.

213. This Risk Premium Model produces an ROE result of 10.10%.[357] As further discussed above, we will impute a zone of reasonableness from the ROE produced by the Risk Premium model for purposes of using the Risk Premium model in our analysis under the first prong of section 206. We do so by applying the average of the widths of the zones of reasonableness from the CAPM and DCF models to the ROE produced by the Risk Premium model, with that ROE serving as the measure of central tendency of the zone of reasonableness. In the First Complaint proceeding, the result of the Risk Premium Model is 10.10% and the average width of the zones of reasonableness produced by the CAPM and DCF models is 520 basis points. Applying this value to the Risk Premium result to impute a zone of reasonableness results in a Risk Premium zone of reasonableness of 7.50% to 12.70%.[358]

D. Composite Zone of Reasonableness and Section 206 Findings

214. Averaging the top and bottom of the DCF, CAPM, and Risk Premium zones of reasonableness determined above based on financial data for the first six months of 2015 produces a composite zone of reasonableness in the First Complaint proceeding of 7.42% to 12.62%. The midpoint of that zone of reasonableness is 10.02%.

215. Having determined the composite zone of reasonableness based on financial data for the first half of 2015, we now turn to considering whether the MISO TOs' 12.38% ROE, which was determined based on financial data for the six months ending February 2002, may be found unjust and unreasonable pursuant to the first prong of section 206. In this order, we affirm the Commission's decision in Opinion No. 569 to use ranges of presumptively just and reasonable ROEs based on the risk profile of the MISO TOs to inform our decision whether their ROE has become unjust and unreasonable. However, as discussed above, we grant rehearing of Opinion No. 569 to find that those ranges should be calculated by dividing the overall composite zone of reasonableness into equal thirds.

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[357] *See* Appendix I.

[358] *Id.*

216. We affirm the Commission's determination in Opinion No. 569 that the MISO TOs should be treated as of average risk for purposes of determining the range of presumptively just and reasonable ROEs applicable to the MISO TOs.[359] In light of this determination, we find that the range of presumptively reasonable ROEs for consideration in determining whether MISO TOs' base ROE of 12.38% ROE in the First Complaint proceeding is unjust and unreasonable should be the middle third of the zone of reasonableness based on the revised construction of the presumptively just and reasonable zones adopted in this order. In the First Complaint proceeding, that range is from 9.15% to 10.89%.[360]

217. The MISO TOs' 12.38% is 149 basis points above the range of presumptively just and reasonable ROEs for the MISO TOs. Accordingly, we find that it is presumptively unjust and unreasonable. It is thus clear that, in light of our estimate of the cost of capital, the MISO TOs' 12.38% ROE is well outside any possible range of potentially just and reasonable ROEs for the MISO TOs. In order to rebut the presumption that the ROE is unjust and unreasonable, we would look at other evidence, such as state ROEs, ROEs of non-utility companies, ROEs produced by other methodologies, non-utility stock prices, investor expectations for non-utility stocks, various types of bond yields and their relation to stock prices, investor and other expert testimony, or testimony regarding the effects of rates on customers that would indicate that this is not the case. However, the record lacks such evidence sufficient to rebut the presumption. For example, the evidence in the record regarding state ROEs indicates that all state-authorized ROEs during the period April 1, 2013 through March 31, 2015 for integrated electric utilities providing generation, transmission, and distribution services ranged from 9.5% to 10.4% and that 87.34% of state-authorized ROEs for both integrated electric utilities and distribution-only electric utilities during that period were within this range.[361] The fact that MISO TOs' 12.38% ROE is 198 basis points above this range further demonstrates that MISO TOs' 12.38% ROE is unjust and unreasonable. In these circumstances, we find under the first prong of section 206 that the MISO TOs' 12.38% ROE that is the subject of the First Complaint proceeding has become unjust and unreasonable.

218. Having found that the MISO TOs' existing ROE is unjust and unreasonable, we turn to the establishment of a just and reasonable replacement ROE under the second prong of section 206. As discussed above, we have found that the midpoint of the composite zone of reasonable ROEs based on the most recent financial information in the record of the First Complaint proceeding is 10.02%. As discussed above, we find that the

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[359] *See id.* PP 518-521.

[360] *See* Appendix III.

[361] *See, e.g.*, Opinion No. 551, 156 FERC ¶ 61,234 at P 240.

MISO TOs are of average risk. Our policy is to set an RTO-wide ROE at the midpoint of the zone of reasonableness when the transmission owners receiving the RTO-wide ROE are of average risk. Accordingly, we find that the just and reasonable replacement ROE for the MISO TOs in the First Complaint proceeding is 10.02%. We therefore grant rehearing of Opinion No. 569 in part to require the MISO TOs to adopt a 10.02% ROE effective September 28, 2016, the date Opinion No. 551 required the MISO TOs to adopt a 10.32% ROE.

XVII. Complaint Specific Results: Second Complaint

A. Existing Rate for Purposes of Second Complaint and Overview

219. As discussed further below, we affirm the Commission's finding in Opinion No. 569 that the 10.02% base ROE established in the First Complaint proceeding is the existing rate to be reviewed for purposes of the Second Complaint proceeding because that is the rate which we would have to find unjust and unreasonable under the first prong of section 206 of the FPA, before we could require a new ROE "to be thereafter observed" pursuant to the second prong of section 206. As the Commission explained in Opinion No. 569, any new just and reasonable rate that we require "to be thereafter observed" pursuant to section 206(a) will replace the currently effective rate, not some previously effective rate. Accordingly, in order to determine a new rate to be thereafter observed, we must examine what the currently effective rate is because that is the rate that will need to be replaced if it is unjust and unreasonable. As discussed in the preceding section, in the First Complaint proceeding, we require MISO TOs to reduce their ROE to 10.02% effective prospectively from September 28, 2016. Therefore, that is the MISO TOs' currently effective ROE when we are deciding whether MISO TOs' ROE is unjust and unreasonable and should be modified prospectively pursuant to section 206 in the Second Complaint proceeding.

220. As discussed in this order, we are revising the methodology for determining whether an existing ROE is unjust and unreasonable and, if so, what is a just and reasonable ROE pursuant to section 206. Applying this methodology to the Second Complaint proceeding, we continue to find that the rate to be reviewed in that proceeding— 10.02% base ROE established in the First Complaint proceeding—has not been shown to be unjust and unreasonable.

221. Below we address the "specific findings"[362] as to the "'particular circumstances'"[363] of the Second Complaint proceeding that establish "'a rational

[362] *Emera Maine*, 854 F.3d at 30.

[363] *Id.* at 27 (citing *FPC v. Nat. Gas Pipeline Co.*, 315 U.S. 575, 586 (1942)).

connection'"[364] between the record evidence in that proceeding and our decisions under both prongs of section 206 herein to establish that we have "'made a principled and reasoned decision supported by the evidentiary record.'"[365] Because the Commission bases its decisions concerning just and reasonable ROEs for public utilities on the most recent information in the record regarding market cost of equity, the starting point for determining whether the MISO TOs' existing ROE has become unjust and unreasonable must be a consideration of whether the current market cost of equity has changed such that the 10.02% base ROE established in the First Complaint proceeding is unjust and unreasonable. Accordingly, we begin by determining a composite zone of reasonableness using the most recent financial information in the record of the Second Complaint proceeding. We continue to find that the appropriate study period including this most recent financial information is July 1, 2015 through December 31, 2015.[366]

B. DCF Analysis

222. In Opinion No. 569, the Commission affirmed the Presiding Judge's DCF analysis in Initial Decision (II) with one exception. The Commission held that only the IBES short-term growth projection should be used for calculating the (1+.5g) adjustment to the dividend yield, instead of the composite growth rate including both short- and long-term growth rates that was used by the Presiding Judge. Here, we affirm the Commission's holding on that issue and the Commission's use of the low-end outlier test applied in Opinion No. 569. Accordingly, our determinations on those issues do not result in any changes to the DCF analysis that was used in Opinion No. 569 for the Second Complaint proceeding.

223. As discussed above, we grant rehearing of Opinion No. 569 to modify the high-end outlier test that was used there. The Commission explained in Opinion No. 569 that applying the version of the high-end outlier test that was used there did not result in the exclusion of any company from the DCF proxy group as a high-end outlier.[367] The high-end outlier test as modified in this order also does not result in any exclusions. Accordingly, our determination on this issue also does not result in any changes to the DCF analysis that was used in Opinion No. 569. We also grant rehearing of Opinion No. 569 to find that the long-term growth rate should be given 20% weighting and the short-term growth rate 80% weighting in the two-step DCF model. Our DCF analysis in the Second Complaint proceeding reflecting this finding is shown in Appendix II to this

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[364] *Id.* at 28 (citing *FERC v. Elec. Power Supply Ass'n*, 136 S.Ct. 760, 782 (2016)).

[365] *Id.* at 30 (citing *S. Cal. Edison v. FERC*, 717 F.3d at 181).

[366] *See* Opinion No. 569, 169 FERC ¶ 61,129 at P 524.

[367] *Id.* P 554.

order. Based on these determinations, we conclude that the DCF zone of reasonableness is 7.37% to 11.37%.

C. CAPM Analysis

224. In Opinion No. 569, the Commission affirmed the Presiding Judge's CAPM analysis in the Second Complaint proceeding, with one exception related to the market risk premium. The Commission held that only the IBES short-term growth projection should be used in the one-step DCF analysis of the dividend paying members of the S&P 500, which was consistent with the Presiding Judge's approach in Initial Decision (II).[368] In addition, the Commission held that companies with negative ROEs or ROEs above 20% should be excluded from that analysis.[369]

225. As discussed above in section IV.C.1, we grant rehearing of Opinion No. 569 to, in future proceedings, consider the use of *Value Line* short-term growth rate projections in the one-step DCF analysis of the dividend paying members of the S&P 500 that is conducted in the CAPM. However, we find that the record is insufficient to allow us to use only *Value Line* short-term growth rates in the CAPM in the Second Complaint proceeding. In addition, we affirm the Commission's application of the low-end outlier test and grant rehearing to modify the high-end outlier test as described above. As the Commission explained in Opinion No. 569, the application of the low-end outlier test and the version of the high-end outlier test that was used there did not result in the exclusion of any company from the CAPM proxy group.[370] The low-end outlier test and modified high-end outlier test adopted herein also do not result in the exclusion of any company from the CAPM proxy group. Accordingly, we will continue to use the CAPM analysis that was relied upon in Opinion No. 569 for the Second Complaint proceeding.[371] Based on these determinations, we conclude that the CAPM zone of reasonableness is 8.35% to 12.63%.

D. Risk Premium Analysis

226. As discussed above, we grant rehearing of Opinion No. 569 to find that the Risk Premium Model should be used in our ROE analysis under section 206 of the FPA. As

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[368] *See* Initial Decision (II), 155 FERC ¶ 63,030 at P 412.

[369] Opinion No. 569, 169 FERC ¶ 61,129 at P 555.

[370] *See id.* PP 556-557.

[371] *See id.* P 513. The results of this CAPM analysis are reflected in page 6 of Attachment A to Trial Staff's Initial Briefs. *See* Trial Staff Initial Br. (II), Attachment A to App. 2 at 6.

described above, we are adopting modifications to the Risk Premium analysis that was provided by the MISO TOs in the record for the Second Complaint proceeding. Appendix I of this order shows the results of the Risk Premium Model, as applied with modifications adopted herein.

227. This Risk Premium analysis produces an ROE result of 10.29%.[372] As further discussed above, we find that we will impute a zone of reasonableness from the ROE produced by the Risk Premium model for purposes of using the Risk Premium model in our analysis under the first prong of section 206. We do so by applying the average of the widths of the zones of reasonableness from the CAPM and DCF models to the ROE produced by the Risk Premium model, with that ROE serving as the measure of central tendency of the zone of reasonableness. In the Second Complaint proceeding, the result of the Risk Premium analysis is 10.29% and the average width of the zones of reasonableness produced by the CAPM and DCF models is 414 basis points. Applying this value to the Risk Premium result to impute a zone of reasonableness results in a Risk Premium zone of reasonableness of 8.22% to 12.36%.[373]

E. Composite Zone of Reasonableness and Section 206 Findings

228. Averaging the top and bottom of the DCF, CAPM, and Risk Premium zones of reasonableness determined above based on the most recent financial data in the record of the Second Complaint proceeding produces a composite zone of reasonableness in the Second Complaint proceeding of 7.98% to 12.12%. The midpoint of that zone of reasonableness is 10.05%.

229. The applicable range of presumptively just and reasonable ROEs for the MISO TOs in the Second Complaint proceeding is from 9.36% to 10.74%. As discussed above, the issue to be addressed in the Second Complaint is whether the ROE established in the First Complaint remains just and reasonable during the applicable test period as addressed by the evidence presented by the participants in the Second Complaint. The MISO TOs' 10.02% ROE established upon resolution of the First Complaint proceeding falls within the range of presumptively just and reasonable ROEs that applies in the Second Complaint. We find that this presumption has not been rebutted by the evidence in the Second Complaint proceeding. We see no evidence in the record, such as state ROEs, ROEs of non-utility companies, and other methodologies that rebuts this presumption. Accordingly, we do not find that the MISO TOs' ROE established in the First Complaint proceeding and in effect as of the date of this order is unjust and unreasonable under the first prong of section 206. For that reason, we do not establish a

[372] *See* Appendix I.

[373] *Id.*

new just and reasonable ROE in the Second Complaint proceeding to be in effect prospectively from the date of this order.

XVIII. Refund Issues

A. Opinion No. 569

230. In Opinion No. 569, the Commission granted rehearing of Opinion No. 551 in part, found that the challenged 12.38% base ROE in the First Complaint proceeding was unjust and unreasonable, and additionally found that a replacement base ROE of 9.88% was just and reasonable—instead of the 10.32% replacement ROE that was set in Opinion No. 551. The Commission made the 9.88% ROE effective as of September 28, 2016, the date on which Opinion No. 551 was issued.[374] The Commission ordered MISO and the MISO TOs to provide refunds, with interest calculated pursuant to 18 C.F.R. § 35.19a, for the 15-month refund period for the First Complaint proceeding from November 12, 2013 through February 11, 2015 and for the period from September 28, 2016—the date on which Opinion No. 551 was issued—to the date of Opinion No. 569.[375]

231. The Commission then found that the 9.88% base ROE established in the First Complaint proceeding was the existing rate to be analyzed for purposes of the Second Complaint proceeding. In brief, the Commission reasoned that, for purposes of deciding whether a rate charged by a utility is unjust and unreasonable and determining a new just and reasonable rate "to be thereafter observed" pursuant to section 206(a) of the FPA, it must assess whether the public utility's currently effective rate is unjust and unreasonable, not some earlier rate that may have been in effect when the complaint was filed but has now been superseded. The Commission explained that, in other words, in order to determine a new rate to be thereafter observed, it must examine the currently effective rate because that is the rate that will need to be replaced if it is unjust and unreasonable. The Commission then explained that, because the 9.88% base ROE established in the First Complaint proceeding is effective prospectively from September 28, 2016, that is the currently effective rate that the Commission would have to find unjust and unreasonable under the first prong of section 206, before we could require a new ROE "to be thereafter observed" pursuant to the second prong of section 206.[376]

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[374] *See* Opinion No. 569, 169 FERC ¶ 61,129 at P 20.

[375] *Id.* at ordering para. (B).

[376] *Id.* P 530.

232. The Commission then concluded that the 9.88% ROE was just and reasonable based on the facts and circumstances of the Second Complaint and therefore dismissed the Second Complaint. The Commission then found that section 206 dictates that refunds may be ordered in a complaint proceeding only when the Commission grants prospective relief in that proceeding (i.e., the Commission sets a new just and reasonable rate which it "orders to be thereafter observed and in force.").[377] The Commission concluded that it could not order refunds for the Second Complaint proceeding's refund period because it was dismissing the complaint and not granting any prospective relief. The Commission found that ordering refunds in the Second Complaint proceeding despite the fact that it was granting no prospective relief would exceed the statutory authority in section 206 because it would effectively extend the 15-month refund period for the First Complaint since the refunds would be based on the relief granted in the First Complaint and not any action taken in the Second Complaint.

B. First Complaint Proceeding Refunds

1. Rehearing Requests

233. MISO TOs argue that the Commission erred in directing refunds for the period from September 28, 2016, through the date of Opinion No. 569 based on the new ROE set in the First Complaint proceeding. MISO TOs contend that the effective date of the new base ROE resulting from resolution of the First Complaint proceeding should be November 21, 2019, the date on which Opinion No. 569 was issued. MISO TOs acknowledge that, in cases of legal error, the proper remedy is one that puts the parties in the position they would have been in had the error not been made, but they assert that this is not a case of legal error because Opinion No. 569's adoption of a new ROE methodology goes beyond what is necessary to fix the problems identified by the *Emera Maine* court. MISO TOs contend that the court merely found that the Commission never explained how its ultimate placement of the base ROE was just and reasonable and that the Commission could correct this error by better tying the 10.32% base ROE set in Opinion No. 551 to the evidence in the record, rather than adopting a new base ROE methodology.[378] MISO TOs maintain that, therefore, the Commission's adoption of the 9.88% ROE for the First Complaint proceeding in Opinion No. 569 does not remedy a legal error.[379]

234. MISO TOs further argue that this is also not a case where the Commission fixed an error on rehearing of Opinion No. 551. They contend that, while the Commission

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[377] *Id.* P 568.

[378] MISO TOs Rehearing Request at 84-85 (citing *Emera Maine*, 854 F.3d at 28).

[379] *Id.*

"grant[ed] rehearing of Opinion No. 551 in part to require the MISO TOs to adopt a 9.88% ROE effective September 28, 2016, the date Opinion No. 551 required the MISO TOs to adopt a 10.32% ROE,"[380] it is unclear as to which issue presented on rehearing the Commission actually granted. MISO TOs assert that none of the rehearing requests asked the Commission to adopt a new ROE methodology, and instead opposing parties requested rehearing on the grounds that the composition of the DCF proxy group was incorrect, and that Commission should consider only DCF results, ignore the anomalous capital market conditions that impacted the DCF model inputs, and ignore cost of equity evidence produced by alternative models.[381]

235. MISO TOs argue that, therefore, in establishing the new 9.88% base ROE upon resolution of the First Complaint proceeding, the Commission was acting on its own motion pursuant to its authority under section 313(a) of the FPA[382] to modify Opinion No. 551. They contend that, as a result, the 9.88% base ROE that the Commission established upon resolution of the First Complaint proceeding can be effective only prospectively as of the date of the issuance of Opinion No. 569—November 21, 2019.[383]

236. MISO TOs argue that, if the Commission holds that it did fix a legal error through the adoption of the new methodology for determining a base ROE, the Commission should nonetheless use its discretion not to require the payment of interest on the refunds directed. MISO TOs note that "the Commission is not required to order that interest be paid on all refunds"[384] and contend that the Commission should use its discretion not to include interest with the refunds for the period from September 28, 2016, going forward because the full status quo ante cannot be restored in this case. They assert that this is the case because the Commission has implicitly recognized that some non-public utility members of MISO do not have a refund obligation relating to complaints that were filed prior to 2017,[385] and thus that non-public utility members of MISO may not have an obligation to make refunds for the First Complaint, which was filed in 2013. MISO TOs

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[380] *Id.* at 85-86 (citing Opinion No. 569, 169 FERC ¶ 61,129 at PP 20, 523).

[381] *Id.* at 86.

[382] *Id.* (citing 16 U.S.C. § 825l(a) (2018)).

[383] *Id.* at 86-87.

[384] *Id.* at 87 (citing *Trunkline Gas Co.*, 69 FERC ¶ 61,047, at 61,183 (1994) (citing *Estate of French v. FERC*, 603 F.2d 1158, at 1167–68 (5th Cir. 1979))).

[385] *Id.* at 88-89 (citing *Midcontinent Indep. Sys. Operator, Inc.*, 151 FERC ¶ 61,050, at P 24 (2015) (only as of the effective date of their RTO adder are non-public utilities obligated to make refunds for Docket Nos. EL14-12 and EL15-45)).

argue that, without all transmission-owning members of MISO contributing their share of refunds, it will be impossible to reinstitute the full status quo ante.[386]

237. Ameren similarly argues that the 9.88% base ROE that the Commission found to be a new just and reasonable base ROE in the First Complaint proceeding cannot be made effective as of the date of Opinion No. 551, and thus no refunds can be directed for the period from September 28, 2016 to November 21, 2019. Ameren contends that section 206 of the FPA only permits the Commission to make a new just and reasonable rate effective prospectively and that, therefore, the Commission acted beyond its authority in making the 9.88% base ROE established in Opinion No. 569 effective as of the date of Opinion No. 551.[387]

238. Ameren asserts that the D.C. Circuit's decision in *City of Anaheim v. FERC* also prohibits the Commission from requiring refunds for the period from September 28, 2016 to November 21, 2019, based on its finding in the First Complaint proceeding that 9.88% is a new just and reasonable base ROE. Ameren contends that, in that case the Commission granted a complaint, but stated that it would set a just and reasonable rate in the future, and the court found that the Commission could not make the rate that it set in the future effective retroactively. Ameren argues that there is no meaningful difference between postponing the fixing of a new rate as the Commission did in *City of Anaheim* and modifying Opinion No. 551 and replacing the rate fixed there with another one calculated by a different method, as the Commission did in Opinion No. 569. Ameren contends that the act of fixing a new rate undersection 206 cannot be a three-year process because that would impermissibly expand the Commission's refund authority.[388]

239. Ameren argues that the legal error doctrine does not give the Commission authority to direct refunds for the period from September 28, 2016, to November 21, 2019, as a result of its decision in the First Complaint proceeding. Ameren asserts that, unlike the *ISO New England Inc. v. Bangor Hydro-Electric Co.*[389] case that the Commission cites in Opinion No. 569, a court has not vacated any of the Commission decisions in these proceedings and therefore the legal error doctrine does not apply in these proceedings. Ameren acknowledges that the Commission is empowered to change

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[386] *Id.* at 89.

[387] Ameren Rehearing Request at 13-20.

[388] *Id.* at 17-19.

[389] 161 FERC ¶ 61,031 (2017).

its order on rehearing, but argues that, when doing so, it can only fix a new rate that is "thereafter observed."[390]

240. Transource Energy argues that the Commission can only make the rate that it adopts for the First Complaint proceeding effective prospectively, and not effective as of the date of Opinion No. 551.[391] Transource Energy asserts that, if the Commission believes it has the discretion to make the rate adopted upon resolution of the First Complaint proceeding effective as of the date of Opinion No. 551, it should find that the 10.32% ROE ordered in Opinion No. 551 is just and reasonable. Transource Energy further contends that under the Commission's methodology adopted in Opinion No. 569, there is no evidence showing that a 10.32% ROE is not just and reasonable. Transource Energy notes that the 10.32% base ROE adopted in Opinion No. 551 falls within the quartile range of presumptively just and reasonable ROEs for the period at issue in Opinion No. 551, which is 9.29% to 10.47%. Transource Energy further contends that the Commission's decision in Opinion No. 569 represents a change in policy and not a correction of a legal error. In addition, Transource Energy argues that the Commission should use its discretion to not order additional refunds for the First Complaint proceeding's 15-month refund period because customers benefitted from investments during the refund period.[392]

2. Commission Determination

241. We deny the requests for rehearing of the Commission's decision in Opinion No. 569 to order refunds for the period from September 28, 2016, to November 21, 2019, based on its decision in the First Complaint proceeding. In Opinion No. 569, the Commission granted rehearing of the Commission's decision in Opinion No. 551 that, in the First Complaint proceeding, a 10.32% base ROE was a just and reasonable new ROE under the second prong of section 206, instead finding that a 9.88% base ROE was a just and reasonable new ROE. Accordingly, the Commission's decision in Opinion No. 569 granted rehearing of the decision in Opinion No. 551 to make 10.32% the new base ROE effective prospectively from the date of Opinion No. 551. Consequently, the new ROE that the Commission set in Opinion No. 569 in granting rehearing, and which is modified in this order, is effective as of the date of the original decision which is being modified on rehearing (i.e., the date of Opinion No. 551).

242. As the Commission has explained, "[R]ate changes required in section 206 proceedings should take effect as of the date of the order setting rates, *not* the date of the

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[390] Ameren Rehearing Request at 20-23.

[391] Transource Energy Rehearing Request at 36-38.

[392] *Id.*

rehearing—regardless of whether and to what extent the rehearing order changes the rates originally allowed."[393] The Commission further explained that "[s]uch a policy is fair to both utilities and ratepayers since it allows finally determined just and reasonable rates to go into effect at the earliest possible date, thereby preventing unjust enrichment of one party for any period of time. It also eliminates any incentive parties would have to delay the effective date of new rates."[394] Accordingly, the Commission's decision to grant rehearing of Opinion No. 551 to modify the rate established in that order for the First Complaint proceeding under section 206 takes effect as of the date of the order setting that rate (i.e., Opinion No. 551), not as of the date of Opinion No. 569 or this order. As discussed further below, because the changed rate set on rehearing of Opinion No. 551 is effective as of the date of that order, it is appropriate to direct refunds for the period from that date through the date of this order, which establishes the finally determined just and reasonable rate.

243. We disagree with MISO TOs' argument that this is not a case where the Commission fixed an error on rehearing of Opinion No. 551, and with Ameren's and Transource Energy's arguments that the new replacement base ROE established in granting rehearing of Opinion No. 551 can only be effective prospectively from the date of Opinion No. 569. MISO TOs contend that, while the Commission granted rehearing of Opinion No. 551 in part, it is unclear as to which issue presented on rehearing the Commission granted because none of the rehearing requests asked the Commission to adopt a new ROE methodology.[395] MISO TOs, instead, contend that opposing parties requested rehearing on the grounds that the composition of the DCF proxy group was incorrect, and that Commission should consider only DCF results, ignore the anomalous capital market conditions that impacted the DCF model inputs, and ignore cost of equity evidence produced by alternative models.[396] While it may be true that a party did not explicitly request that the Commission reach each and every exact decision that it made in Opinion No. 569, the Commission nonetheless acted within its discretion to reach its conclusions and these conclusions involved granting rehearing of the Commission's decision in Opinion No. 551 to establish a 10.32% base ROE as the new ROE under the second prong of section 206 in the First Complaint proceeding.

244. In Opinion No. 551, the Commission relied on the DCF analysis and looked to the CAPM, Risk Premium, and Expected Earnings models as corroborative evidence to support its decision. On rehearing, certain parties argued, as MISO TOs note, that the

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[393] *Ariz. Pub. Serv. Co.*, 26 FERC ¶ 61,087, at 61,221 (1984).

[394] *Id.*

[395] MISO TOs Rehearing Request at 85-86.

[396] *Id.* at 86.

Commission should have considered only DCF results and ignored those alternative models.[397] In Opinion No. 569, as modified in this order, the Commission granted rehearing to reach a logical middle ground that does not consider only DCF, as those parties requested, but does depart from Opinion No. 551 by considering only some of the other three models that the Commission initially considered in Opinion No. 551. Specifically, here we consider the CAPM and Risk Premium models in addition to the DCF model, but not the Expected Earnings model, which the Commission initially did consider in Opinion No. 551. In reaching its decision on rehearing of Opinion No. 551, the Commission is not limited to only reaching a conclusion that replicated every detail of a conclusion that a party had explicitly proposed.[398] In relevant part, the Commission, upon a party's application for rehearing, "shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing."[399] Accordingly, the Commission may modify its order on rehearing as it has here, because there exists no such limitation as a requirement that the Commission may only modify its order if the exact modification is explicitly proposed by a party on rehearing. The Commission found merit in some of the arguments against considering all of the non-DCF models but was not persuaded to ignore all of the models. Accordingly, it reached a conclusion arising from compromise that considered some, but not all, of the alternative models that were considered in Opinion No. 551. As a result of partially granting rehearing on these issues, the Commission granted rehearing of its decision to establish 10.32% as a new replacement base ROE in the First Complaint proceeding. Accordingly, this is a case where the Commission granted rehearing to modify Opinion No. 551, and that modified conclusion is effective as of the date of Opinion No. 551.

245. While the Commission's grant of rehearing of Opinion No. 551 is sufficient to justify the Commission's ordering of refunds from the date of Opinion No. 551—September 28, 2016—through the date of this order, the Commission's decision to order such refunds is further justified by the fact that it is correcting a legal error in granting rehearing to change the new just and reasonable ROE established for the First Complaint proceeding in Opinion No. 551. Although Ameren is correct that none of the Commission decisions in these proceedings have been vacated by a court, that does not mean that there was no legal error in the Commission's decisions in these proceedings. In *Emera Maine*, the D.C. Circuit found that the Commission failed to satisfy its dual burden under section 206 of the FPA by finding that the result of a single ROE analysis was sufficient to demonstrate that an existing base ROE was unjust and unreasonable if it exceeded that result and that such result was a just and reasonable

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[397] *See id.* at 86.

[398] *See* 16 U.S.C. § 825*l*.

[399] *Id.*

replacement ROE. Opinion No. 551 and Initial Decision (II) in the Second Complaint proceeding both used the same reasoning that the D.C. Circuit found was insufficient to satisfy the Commission's burden under section 206. Accordingly, while no court has vacated a specific decision in this case, the rationale on which Opinion No. 551 and Initial Decision (II) in the Second Complaint proceeding are based has been rejected by the D.C. Circuit as in violation of section 206. As a result, those Commission decisions are based on a legal error identified by the D.C. Circuit. The fact that the court did not explicitly identify that legal error in a case involving a decision in these proceedings does not mean that there is no error in Opinion No. 551 and Initial Decision (II). To find otherwise would allow the Commission to continue to make decisions that are based on reasoning that has been found to be unlawful and only require the Commission to correct those decisions when a court has repeated its previous conclusion in every individual applicable case.

246. MISO TOs and Transource Energy also argue that the legal error doctrine does not apply here because the methodology adopted in Opinion No. 569 goes beyond what they contend is necessary to fix the problems identified by the *Emera Maine* court, and therefore represents a change in policy and not correction of a legal error. We disagree. The court in *Emera Maine* found that the Commission acted arbitrarily and outside of its statutory authority because its single ROE analysis failed to include an actual finding as to the lawfulness of the existing base ROE at issue. The court remanded the proceeding for the Commission to make that actual finding, but it did not specify exactly how the Commission needed to make that finding. In Opinion No. 569, as modified herein, the Commission concluded that the best way to make that finding in these proceedings in light of its statutory obligations was to revise its methodology for analyzing base ROEs under section 206 as explained herein. Accordingly, while MISO TOs and Transource Energy would prefer the Commission to arrive at this finding in a different way, that does not mean that the Commission's action is a change in policy instead of a correction of a legal error.

247. We are also not persuaded by arguments that the Commission should exercise its discretion to not order interest on the refunds for the period from the date of Opinion No. 551 through the date of this order replacing the base ROE set in in Opinion No. 551. While MISO TOs are correct that the Commission is not required to order that interest be paid on all refunds, we find that there are no equitable reasons that would warrant not ordering interest on the refunds ordered from the date of Opinion No. 551 through the date of this order. The parties to the First Complaint proceeding had notice that the base ROE established to be prospective from the date of Opinion No. 551 was subject to rehearing and therefore could be modified such that the modified rate would result in refunds, with interest pursuant to the Commission's authority under section 206. We are also not persuaded by MISO TOs' argument that the Commission should exercise its discretion to not require interest on the refunds because the status quo ante cannot be

fully restored since a separate Commission order "implicitly has recognized"[400] that some non-public utility members of MISO do not have a refund obligation relating to complaints that were filed prior to 2017.[401] As the precedent cited by MISO TOs provides, the Commission is not restricted to only requiring interest on refunds when it can completely restore the status quo ante, but rather, whether the status quo ante can be fully restored is merely a consideration that "may . . . offset . . . at least in part"[402] a full refund. MISO TOs also correctly recognize that "whether to order interest in crafting a remedy is a matter of Commission discretion."[403] MISO TOs have not persuaded us that the fact that some members of MISO may have different obligations with respect to the subject refunds is sufficient to use to our discretion to deny the complainants a full refund with interest. The payment of interest on refunds merely "ensures that the amounts to be refunded are, in fact, refunded through the addition of interest so that the recipient receives payment in inflation-adjusted dollars . . . to make the recipients whole,"[404] consistent with the Commission's "general policy of granting full refunds" for overcharges.'"[405] While we may exercise our discretion to decline to make recipients whole through the payment of interest on refunds, MISO TOs' argument on this point is not a sufficient reason to do so. On balance, we find that is more appropriate to ensure that the overcharged entities are made whole through the payment of interest on refunds than it is to decline to require interest because some members of MISO may have different obligations with respect to the subject refunds such that the refunds paid do not exactly reconstitute the status quo ante.

248. Transource Energy argues that the Commission should use its discretion to not order additional refunds for the First Complaint proceeding's 15-month refund period because customers benefitted from investments during the refund period.[406] We find that this argument is similarly unavailing. Transmission owners are constantly making new

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[400] MISO TOs Rehearing Request at 89.

[401] *Id.* at 88-89 (citing *Midcontinent Indep. Sys. Operator, Inc.*, 151 FERC ¶ 61,050 at P 24).

[402] *Panhandle E. Pipe Line Co.*, 69 FERC ¶ 61,048, at 61,189 (1994) (quoting *Consumer Fed'n of America v. FPC*, 515 F.2d 347, 359 (D.C. Cir. 1975)).

[403] MISO TOs Rehearing Request at 87 (quoting *Transcon. Gas Pipe Line Corp.*, 71 FERC ¶ 61,108, at 61,361 (1995)).

[404] *La. Pub. Serv. Comm'n*, 153 FERC ¶ 61,033, at P 14 (2015).

[405] *Consolidated Edison Co. of N.Y. v. FERC*, 347 F.3d 964, 972 (D.C. Cir. 2003).

[406] Transource Energy Rehearing Request at 38.

investments and changing investments during proceedings that may result in refund obligations. Therefore, to find that the existence of these investments alone would absolve such transmission owners from ordering refunds resulting from a Commission decision would mean that transmission owners would only owe refunds in the rarest of circumstances. We find that this would be contrary to the purpose of the refund obligation in section 206.

249. Consequently, we deny rehearing on this issue and find that, by granting rehearing of the decision in Opinion No. 551 to establish a new just and reasonable base ROE, and by acting to correct a legal error, it is appropriate to direct refunds, with interest, for the period from the effective date of the just and reasonable base ROE that was set in Opinion No. 551 which is being replaced in this order— September 28, 2016—through the date of this order, based on the new 10.02% base ROE established for the First Complaint proceeding in this order.

C. Second Complaint Proceeding Refunds

1. Rehearing Requests

250. CAPs argue that the Commission erred in not requiring refunds for the Second Complaint proceeding's refund period. They contend that the First Complaint and Second Complaint each challenged the base ROE in effect as of the date of filing of each complaint and had separate refund periods.[407] CAPs assert that, therefore, the mere fact that the two separate refund periods exceed 15 months does not mean that section 206 of the FPA is violated, "particularly in view of the fact that Commission orders set both refund periods, and the Commission itself acknowledged that the ROE in force when each complaint was filed was demonstrated to be unjust and unreasonable based on evidence of market conditions during the relevant study period."[408]

251. CAPs further contend that the Commission's interpretation of the existing rate to be analyzed in the Second Complaint proceeding creates a loophole that utilities could exploit to vitiate the consumer protection intended by section 206. In particular, CAPs assert that a utility could make a tactical section 205 filing after a section 206 filing is signaled or underway to undermine section 206's refund and prospective relief remedies. CAPs argue that, for example, if an initial decision identifies a new just and reasonable base ROE resulting from a section 206 complaint, the subject utility could make a section 205 filing before issuance of a Commission order on the initial decision that reduces its base ROE to a level well above the base ROE the initial decision determined was just and reasonable, but just within the top end of what the initial decision identifies

[407] CAPs Rehearing Request at 52-53.

[408] *Id.* at 53.

as the zone of presumptively just and reasonable ROEs, such that the utility's proposed base ROE in the section 205 filing would likely be accepted by the Commission. CAPs argue that, under the Commission's rationale in Opinion No. 569, in such a case, the base ROE in the utility's section 205 filing would become the currently effective base ROE that the Commission would examine for purposes of acting on the initial decision, meaning that this base ROE would likely not be found unjust and unreasonable in the Commission's order on the initial decision because it falls within the zone of presumptively just and reasonable ROEs identified in the initial decision. CAPs contend that, in such a case, the utility would have successfully shielded itself both from refunds and from a prospective reduction down to the cost-based level found in the initial decision. CAPs argue that, because of this possibility, the Commission should reconsider its finding that the FPA requires section 206 relief to be denied if the rate in effect just before a final order applying section 206 is just and reasonable, or at least clarify how it would prevent such tactics from vitiating relief under section 206.[409]

252. CAPs further contend that, even if the Commission does not reverse its determination that the outcome of the Second Complaint was dependent on the outcome of the First Complaint, it still has and should exercise discretion to order refunds for the Second Complaint proceeding. CAPs assert that, because section 206 contains no deadline for the Commission to act on a complaint, where two complaints raising overlapping issues are pending before the Commission simultaneously, the order in which the Commission acts on the complaints is within the Commission's discretion. CAPs argue that the Commission should have acted on the Second Complaint before acting on rehearing of Opinion No. 551 because this would have kept prospective rates, which can affect future conduct, aligned with the most recent and accurate evidence of the MISO TOs' cost of equity. CAPs contend that, by acting in this sequence, MISO transmission customers would have been entitled to refunds for the Second Complaint proceeding's refund period and the First Complaint proceeding's refund period because the ROE set by an order in the Second Complaint could not be deemed to be the "existing" ROE for purposes of deciding the First Complaint. CAPs assert that, therefore, the Commission's rationale for denying refunds in the Second Complaint proceeding effectively claims that the Commission's procedural decisions can expand or contract the statutory rights of public utility customers.[410]

253. LPSC argues that Opinion No. 569 interprets section 206 to mean that the Commission must decide whether the rate that is "currently effective" at the time it issues its opinion is just and reasonable, as opposed to the rate that was in effect at the time the

[409] *Id.* at 53-54.

[410] *Id.* at 56-59.

complaint was filed and contends that this interpretation violates the FPA.[411] LPSC contends that section 206 provides that the Commission shall determine the just and reasonable rate, if the Commission determines that the rate "demanded, observed, charged, or collected by any public utility . . . is unjust, unreasonable, unduly discriminatory or preferential."[412] LPSC asserts that Opinion No. 569 is inconsistent with this plain language because it requires an analysis of whether a new rate that had never been charged or collected by the utility is just and reasonable. LPSC contends that the MISO TOs have never "demanded, observed, charged, or collected" the 9.88% ROE that was established in Opinion No. 569 from their customers, so the FPA could not have intended for that to be the rate analyzed by the Commission.[413]

254. LPSC argues that the Commission's interpretation of the existing rate to be analyzed in the Second Complaint proceeding would prevent the Commission from ever granting refunds in a second ROE proceeding, even if the Commission found that the newly effective ROE that resulted from the first ROE proceeding had become unjust and unreasonable by the time the second complaint was filed. LPSC contends that this is the case because section 206 provides for refunds to "persons who have paid those rates" but no person would have paid the rate established in such a first complaint proceeding.[414]

255. LPSC also contends that the Commission's interpretation on this point is inconsistent with the Commission's precedent in *Golden Spread Elec. Coop., Inc. v. Southwestern Pub. Serv. Co.*[415] LPSC asserts that, in that case, the Commission rejected a company's argument that a 2013 ROE complaint should be dismissed because it served only to extend the refund effective period associated with a 2012 ROE complaint, and explained that, "In assessing the 2013 Complaint, the relevant comparison is between the current ROE and the ROE sought in the 2013 Complaint."[416]

256. LPSC further argues that Opinion No. 569 is also arbitrary because its conclusions rely entirely on the order that the Commission decides the ROE proceedings, but there is no statute or regulation that requires the Commission to resolve section 206 proceedings

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[411] LPSC Rehearing Request at 17-19.

[412] *Id.* at 19 (citing 16 U.S.C. § 824e (2018)).

[413] *Id.*

[414] *Id.* at 19-20.

[415] 151 FERC ¶ 61,126 (2015).

[416] LPSC Rehearing Request at 21 (citing *Golden Spread Elec. Coop., Inc. v. Southwestern Pub. Serv. Co.*, 151 FERC ¶ 61,126 at P 24).

chronologically. LPSC contends that refunds could have been granted for the second complaint proceeding and a different ROE would have applied prospectively if Opinion No. 569 had resolved the second complaint proceeding first. LPSC asserts that Congress did not intend to give the Commission the power to decide the justness and reasonableness of rates and whether refunds should be granted based on the order that it chooses to decide complaints.[417]

257. In addition, LPSC argues that Opinion No. 569 is inconsistent with the Commission's precedent that a second ROE complaint can be filed and a second refund effective period can be ordered, as long as the second complaint is based on new analyses and data. LPSC contends that, "Contrary to its precedent, Opinion No. 569 now finds that determining whether the ROE in a second ROE complaint proceeding is unjust and unreasonable by analyzing the ROE that was in effect when the complaint was filed would effectively extend the statutory fifteen-month refund effective period."[418] LPSC argues that, in *Firstenergy Service Co. v. FERC*, 758 F.3d 346 (D.C. Cir. 2014), the D.C. Circuit stated that "FERC is required to evaluate a 206 complaint as to existing rates specifically because they might have become unjust and unreasonable by intervening shifts in circumstances"[419] and that the Commission should do the same here and rule that the rate in effect at the time the Second Complaint was filed should be analyzed to assess possible "intervening shifts in circumstances."[420]

258. RPGI similarly argues that the Commission's interpretation of section 206 to not permit refunds for the Second Complaint proceeding is unsupported. RPGI asserts that the Commission's interpretation sets up a scenario in which the ROE in force on a second complaint's date of filing becomes virtually irrelevant. RPGI contends that a complainant would know that, if it filed, the benchmark against which its case would be evaluated would not be the ROE in effect on the date the second complaint would be filed—which is known—but rather the ROE set by the first proceeding and where it falls in the second proceeding's updated zone of reasonableness, neither of which is known at the second proceeding's outset. RPGI asserts that, thus, after Opinion No. 569, filing a second complaint upon the expiration of a first complaint's refund period represents such

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[417] *Id.* at 21-23.

[418] *Id.* at 24.

[419] *Id.* at 27-28 (citing *Firstenergy Service Co. v. FERC*, 758 F.3d at 356).

[420] *Id.*

a high risk of a "no-change" outcome as to effectively bar successive complaints, even if the data from the second proceeding supports an ROE lower than that set by the first.[421]

259. RPGI argues that, if the Commission's concern is that successive complaints require it to make duplicative findings of one ROE's unlawfulness, then it could consolidate proceedings. RPGI further contends that, if the Commission's concern is the effect of successive refund periods on the MISO TOs, the appropriate course of action is seeking a statutory change, not adopting a strained statutory interpretation.[422]

2. Commission Determination

260. We deny rehearing on this issue. We continue to find, as the Commission did in Opinion No. 569, that, for purposes of deciding whether a rate charged by a public utility is unjust and unreasonable and determining a new just and reasonable rate "to be thereafter observed" pursuant to section 206(a) of the FPA, we must assess whether the public utility's currently effective rate is unjust and unreasonable, not some earlier rate that may have been in effect when the complaint was filed but has now been superseded. As explained in Opinion No. 569, in the context of successive, or pancaked, complaints like those in these proceedings, if the Commission's analysis in the successive complaint analyzed some earlier rate that may have been in effect when the complaint was filed but has since been superseded, it would permit the Commission to order refunds for a period beyond the 15-month statutory refund period based on a single decision in the preceding complaint decision. We find that this would allow the Commission to use a single decision as the predicate for issuing refunds beyond the refund period applicable to that decision, which would exceed the refund authority granted to the Commission in section 206.

261. CAPs argue that the First Complaint and Second Complaint each challenged the base ROE in effect as of the date of filing of each complaint and had separate refund periods, and the mere fact that the two separate refund periods exceed 15 months does not mean that section 206 is violated. CAPs misinterpret the Commission's finding in Opinion No. 569. In Opinion No. 569, the Commission did not find that the mere fact that the First Complaint and Second Complaint proceedings had separate refund periods that combined exceed 15 months rendered the Commission unable to issue refunds in the Second Complaint proceeding. It would have been possible for the Commission to order refunds for the refund periods in both complaint proceedings if the base ROE resulting from resolution of the First Complaint proceeding was no longer just and reasonable based on the facts and circumstances of the Second Complaint proceeding. However, complainants did not show that the existing rate reviewed in the Second Complaint

[421] RPGI Rehearing Request at 17-21.

[422] *Id.* at 22-23.

proceeding was unjust and unreasonable under the facts and circumstances of that proceeding.

262. Both complaints challenged the MISO TOs' base ROE, and the Commission established a new just and reasonable base ROE in the First Complaint proceeding that was filed first chronologically. As discussed above, the Commission found that it was required to review that new base ROE as the existing rate for purposes of the Second Complaint and complainants did not show that this existing rate was unjust and unreasonable. The Commission then found that section 206 provides that refunds may be ordered in a complaint proceeding only when the Commission grants prospective relief in that proceeding because section 206 only permits refunds in proceedings where the Commission sets a new rate to be "thereafter observed and in force."[423] As a result, the Commission found that it did not have authority under section 206 to order refunds in the Second Complaint proceeding because it did not grant prospective relief by establishing a new base ROE in that proceeding. The Commission further explained that ordering refunds in the Second Complaint proceeding even though it did not grant prospective relief in that proceeding would in fact allow its determination in the First Complaint proceeding to serve as the predicate for two 15-month refund periods, which is beyond the Commission's authority in section 206. Accordingly, the fact that the First Complaint and Second Complaint proceedings had separate refund periods that together exceeded 15 months did not render the Commission unable to issue refunds in the Second Complaint proceeding. Rather, it was the fact that the Commission could not grant prospective relief in the Second Complaint proceeding because the complainants did not show that the rate that was reviewed in that Second Complaint proceeding was unjust and unreasonable. Had the complainants made that showing, the Commission could have ordered refunds in the Second Complaint proceeding, regardless of the fact that the refund periods in the First Complaint proceeding and Second Complaint proceeding add up to more than 15 months. However, that was not the case and consequently we find CAPs' argument on this point unavailing.

263. CAPs argue that the Commission's interpretation of the existing rate to be analyzed in the Second Complaint proceeding creates a loophole pursuant to which a utility could make a tactical section 205 filing after a section 206 filing is signaled or underway to undermine section 206's refund and prospective relief remedies. CAPs assert that such a filing could, for example, propose to reduce the utility's base ROE to a level well above the base ROE the initial decision determined was just and reasonable, but just within the top end of what the initial decision identifies as the zone of presumptively just and reasonable ROEs, such that the utility's proposed base ROE in the section 205 filing would likely be accepted by the Commission and then become the currently effective base ROE that the Commission would examine for purposes of acting

[423] Opinion No. 569, 169 FERC ¶ 61,129 at P 568.

on the initial decision. This argument does not persuade us that our interpretation is inappropriate. As an initial matter, we note that the presumptively just and reasonable ranges applied in this order are limited to our analysis of complaints filed under section 206. There is no section 205 filing before us in this proceeding and we are not making any determinations regarding whether or how the presumptively just and reasonable ranges used in this order would apply in the context of a section 205 filing. Moreover, if a utility were to make such a tactical section 205 filing proposing a new base ROE while a section 206 proceeding challenging the utility's base ROE is still pending a final Commission decision, then the Commission could consider such a section 205 filing in light of the pending section 206 proceeding. "The Commission has broad discretion to structure its proceedings so as to resolve a controversy in the way it best sees fit,"[424] and, in addressing such a section 205 filing, the Commission could consider the common issues that would likely be raised by a section 205 filing to change the same base ROE that is being challenged in a pending section 206 proceeding. For example, in analogous circumstances, the Commission consolidated a rate filing pursuant to section 4 of the Natural Gas Act (NGA) with an ongoing complaint proceeding pursuant to section 5 of the NGA involving the same rates. There the Commission noted that "KCC asserts that Southwest Gas's instant section 4 rate filing is nothing more than an attempt to circumvent the ongoing section 5 complaint proceeding"[425] and found that "the section 4 filing appears as an outgrowth of the section 5 complaint proceeding"[426] for which consolidation would "provide the most efficient and effective forum to handle issues common to both proceedings."[427] Any section 205 filing like the type suggested by CAPs would be considered by the Commission in light of any other proceedings

[424] *PJM Transmission Owners*, 120 FERC ¶ 61,013, at P 12 (2007). *See also Ameren Energy Generating Co.*, 108 FERC ¶ 61,081, at P 23 (2004) ("The courts have repeatedly recognized that the Commission has broad discretion in managing its proceedings."); *Fla. Mun. Power Agency v. FERC*, 315 F.3d 362, 366 (D.C. Cir. 2003) (citing *Telecomm. Resellers Assoc. v. FCC*, 141 F.3d 1193, 1196 (D.C. Cir. 1998) (stating that administrative agencies enjoy broad discretion to manage their own dockets); *FPC v. Transcontinental Gas Pipe Line Corp.*, 423 U.S. 326, 333 (1976) (stating that agencies can determine how best proceed to develop the needed evidence); *Richmond Power & Light v. FERC*, 574 F.2d 610, 624 (D.C. Cir. 1978) (stating that agencies have wide leeway in controlling their calendars)).

[425] *Panhandle Complainants v. Sw. Gas Storage Co.*, 120 FERC ¶ 61,207, at P 19 (2007).

[426] *Id.* P 20.

[427] *Id.* P 21.

involving common issues, including section 206 proceedings.[428] We do not believe that the Commission's interpretation of the existing rate to be analyzed in the Second Complaint proceeding would somehow allow utilities to make section 205 filings that would dictate or otherwise limit the Commission's ability to appropriately determine just and reasonable rates in section 206 proceedings.

264. LPSC argues that Opinion No. 569's decision to not order refunds in the Second Complaint proceeding is inconsistent with section 206 because section 206 requires the Commission to determine whether a rate "demanded, observed, charged, or collected by any public utility . . . is unjust, unreasonable, unduly discriminatory or preferential"[429] but MISO TOs have never "demanded, observed, charged, or collected" the base ROE that was established in the First Complaint proceeding from their customers, but that is the rate that the Commission analyzed in making its determination in the Second Complaint proceeding. We find this argument unavailing. While at the time the Second Complaint was filed, the new just and reasonable rate established in the First Complaint proceeding had not yet been demanded, observed, charged or collected, the Commission's decision in the First Complaint proceeding made the new base ROE established in that proceeding the rate that was demanded, observed, charged and collected for the First Complaint proceeding's refund period. Therefore, when the Commission analyzed the new just and reasonable rate established in the First Complaint proceeding in making its determination in the Second Complaint proceeding, that rate was the one demanded, observed, charged and collected for the First Complaint proceeding's refund period, which is consistent with the language of section 206. The fact that the Commission acted on the successive complaints in the First Complaint and Second Complaint proceedings in a single order instead of in two separate sequential ones does not render the new base ROE established in the First Complaint proceeding a fiction that is not actually applied by the MISO TOs. Rather, the Commission's decision in the First Complaint proceeding made the rate established there the rate "demanded, observed, charged, or collected" for purposes of the First Complaint proceeding and the Commission then reviewed that rate as the existing rate in making its decision on the Second Complaint which followed the First Complaint. We are not persuaded that this analysis is inconsistent with section 206.

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[428] *See, e.g., Mobil Oil Explor. & Prod. SE Inc. v. United Distrib. Cos.*, 498 U.S. 211, 230 (1991) ("An agency enjoys broad discretion in determining how best to handle related, yet discrete, issues in terms of procedures."); *Nadar v. FCC*, 520 F.2d 182, 195 (D.C. Cir. 1975) ("[T]his court has upheld in the strongest terms the discretion of regulatory agencies to control the disposition of their caseload.").

[429] LPSC Rehearing Request at 19 (citing 16 U.S.C. § 824e).

265. CAPs and LPSC argue that the Commission is not required to act on the First Complaint proceeding first and should have acted on the Second Complaint proceeding first. They contend that there is no requirement that the Commission resolve section 206 proceedings chronologically. As an initial matter, we note that, "The Commission has broad discretion to structure its proceedings so as to resolve a controversy in the way it best sees fit."[430] The Commission "is generally master of its own calendar and procedures."[431] In these proceedings, we find that it is appropriate to act on the First Complaint proceeding first and then the Second Complaint proceeding. The Commission permitted the Second Complaint because it was "was based on financial data from a different time period, and produced a different proxy group, than the DCF analysis set forth in the [First Complaint]."[432] In that order, the Commission explained that it "has allowed multiple complaints regarding the same ROE, where the subsequent complaints are based on 'new, more current data.'"[433] Accordingly, the premise for permitting the Second Complaint was that it was based on different, more current data, than the data in the First Complaint proceeding. We find that it is appropriate to address the First Complaint first because the Commission must first determine what the final data and results from the First Complaint are before determining whether the Second Complaint can be granted based on how the Second Complaint's data have changed as compared to the data in the First Complaint. Moreover, we find that it would not be appropriate to follow the approach suggested by CAPs and LPSC because it could force the Commission to delay action on a preceding complaint that is likely closer to resolution until it has first acted on a successive complaint because that successive complaint is

[430] *PJM Transmission Owners*, 120 FERC ¶ 61,013 at P 12.

[431] *Stowers Oil and Gas Co.*, 27 FERC ¶ 61,001 (1984); *see also Ameren Energy Generating Co.*, 108 FERC ¶ 61,081 at P 23 ("The courts have repeatedly recognized that the Commission has broad discretion in managing its proceedings."); *Fla. Mun. Power Agency v. FERC*, 315 F.3d 362, 366 (D.C. Cir. 2003) (citing *Telecomm. Resellers Assoc. v. FCC*, 141 F.3d 1193, 1196 (D.C. Cir. 1998) (stating that administrative agencies enjoy broad discretion to manage their own dockets); *FPC v. Transcontinental Gas Pipe Line Corp.*, 423 U.S. 326, 333 (1976) (stating that agencies can determine how best proceed to develop the needed evidence); *Richmond Power & Light v. FERC*, 574 F.2d 610, 624 (D.C. Cir. 1978) (stating that agencies have wide leeway in controlling their calendars)).

[432] MISO II Rehearing Order, 156 FERC ¶ 61,061 at P 34.

[433] *Id.* P 33 (quoting *Consumer Advocate Div. of the Pub. Serv. Of West Virginia v. Allegheny Generating Co.*, 67 FERC ¶ 61,288, *order on reh'g*, 68 FERC ¶ 61,207, at 61,998 (1994)).

"aligned with the most recent and accurate evidence."[434] This could further delay Commission action on section 206 complaint proceedings that are often already very protracted. In addition, CAPs' and LPSC's approach would not always benefit ratepayers over utilities. For example, it is possible that, in resolving a successive complaint first, ratepayers would be subject a higher rate during such a complaint's refund period than they would have been subject to if the preceding complaint resulted in a prospectively effective rate that overlapped with the successive complaint's refund period which was lower than the rate resulting from the successive complaint. Accordingly, we find that it is appropriate to address the complaints in these proceedings in chronological order by deciding the First Complaint before deciding the Second Complaint.

266. RPGI argues that, if the Commission's concern in deciding to not order refunds in the Second Complaint proceeding was that it would be required to make duplicative findings of one ROE's unlawfulness, then it could consolidate the First Complaint and Second Complaint proceedings. We find this argument unavailing. The Commission has explained that "[i]n general, the Commission consolidates matters only if . . . consolidation will ultimately result in greater administrative efficiency."[435] However, these proceedings have progressed through hearing, initial decision and, in the case of the First Complaint proceeding, Commission decision, separately with separate records. At this point there would be no greater administrative efficiency in consolidating these two proceedings because they are already close to final resolution. Moreover, RPGI does not explain how consolidation would eliminate the need to identify the existing rate to be analyzed in the Second Complaint proceeding and then determine whether refunds could be issued based on the Commission's analysis of that rate under section 206. Thus, RPGI has not explained how consolidation would change the analysis underlying our decision to not order refunds in the Second Complaint proceeding.

267. RPGI also contends that, if the Commission's concern in making its decision in Second Complaint proceeding is the effect of successive refund periods on the MISO TOs, the appropriate course of action is seeking a statutory change, not adopting a strained statutory interpretation. However, here we must determine how to act in these section 206 complaint proceedings and in order to do so we must determine how to interpret and apply section 206 to these proceedings. The issue before us is not whether it would be appropriate or preferable to seek a statutory change. We must apply the statute as it exists to these proceedings. The fact that RPGI would prefer that the Commission adopt a different interpretation does not mean that the Commission had the option of not applying section 206 as it exists to these proceedings. For the reasons discussed in this order, we find that the application of section 206 to the Second

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[434] *See* CAPs Rehearing Request at 59.

[435] *See, e.g., Startrans IO, LLC*, 122 FERC ¶ 61,253, at P 25 (2008).

Complaint proceeding requires us to dismiss the complaint and not order refunds in that proceeding. Accordingly, we find that RPGI's argument on this point does not persuade us to grant rehearing of our decision to not order refunds in the Second Complaint proceeding.

XIX. Conclusion

268. For the reasons discussed above, we grant in part and deny in part the requests for rehearing of Opinion No. 569. In particular, we require the MISO TOs to adopt a 10.02% base ROE effective September 28, 2016, the date Opinion No. 551 initially required the MISO TOs to adopt a 10.32% ROE. As discussed above, we therefore require the MISO TOs to provide refunds based on that 10.02% base ROE, with interest, for the First Complaint proceeding's 15-month refund period from November 12, 2013 through February 11, 2015, and for the period from September 28, 2016 to the date of this order. Further, as discussed above we are denying rehearing of the Commission's dismissal of the Second Complaint in Opinion No. 569 and its finding that no refunds will be ordered in the Second Complaint proceeding.

The Commission orders:

(A) Rehearing of Opinion No. 569 is granted in part and denied in part, as discussed in the body of this order.

(B) MISO TOs' base ROE is set at 10.02% with a total or maximum ROE including incentives not to exceed 12.62%, effective as of September 28, 2016, as discussed in the body of this order.

(C) MISO and MISO TOs are directed to provide refunds, with interest calculated pursuant to 18 C.F.R. § 35.19a (2019), by December 23, 2020, for the 15-month refund period for the First Complaint from November 12, 2013 through February 11, 2015 and for the period from September 28, 2016 to the date of this order, as discussed in the body of this order.

(D) MISO and MISO TOs are directed to file a refund report a detailing the principal amounts plus interest paid to each of their customers by December 23, 2020.

By the Commission. Commissioner Glick is concurring in part and dissenting in part in a separate statement attached.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

Appendix I: Risk Premium Results

Risk Premium Model Results

Current Equity Risk Premium	MISO I	MISO II
Average Yield Over Study Period	6.10%	6.02%
Baa Utility Bond Yield	4.65%	5.41%
Change in Bond Yield	-1.45%	-0.61%
Risk Premium/Interest Rate Relationship	-0.7006	-0.6866
Adjustment to Average Risk	1.02%	0.42%
Average Risk Premium over Study Period	4.43%	4.46%
Adjusted Risk Premium	**5.45%**	**4.88%**
Implied Cost of Equity		
Baa Utility Bond Yield	4.65%	5.41%
Adjusted Equity Risk Premium	5.45%	4.88%
Risk Premium Cost of Equity	**10.10%**	**10.29%**

Risk Premium Model Inputs

Docket Number	Utility	Type	Date	Base ROE	Baa Bond Yield	Implied Risk Premium
ER05-515	BG&E	Settlement - Uncontested	Feb-06	10.80	6.07	4.73
ER05-515	BG&E	Settlement - Uncontested	Feb-06	11.30	6.07	5.23
ER05-925	Westar	Settlement - Uncontested	Jun-06	10.80	6.36	4.44
ER07-284	SDG&E	Settlement - Uncontested	Feb-07	11.35	6.14	5.21
ER06-787	Idaho Pwr	Settlement - Uncontested	May-07	10.70	6.15	4.55
ER06-1320	Wisconsin Elec. Pwr	Settlement - Uncontested	May-07	11.00	6.15	4.85
ER07-583	Commonwealth Edison	Settlement - Uncontested	Sep-07	11.00	6.41	4.59
ER06-1549	Duquesne	Settlement - Uncontested	Sep-07	10.90	6.41	4.49
ER08-92	VEPCO	Order	Oct-07	10.90	6.43	4.47
ER08-374	Atlantic Path	Order	Nov-07	10.65	6.44	4.21
ER08-413	Startrans IO	Order	Nov-07	10.65	6.44	4.21
ER08-396	Westar	Declaratory order.	Nov-07	10.80	6.44	4.36
ER08-686	Pepco Holdings	Order	Jan-08	11.30	6.41	4.89
ER07-562	Allegheny	Settlement	Feb-08	11.20	6.42	4.78

ER07-1142	Ariz. Pub. Service	Settlement - uncontested	Apr-08	10.75	6.54	4.21
ER08-1207	VEPCO	Order	May-08	10.90	6.62	4.28
ER08-1402	Duqesne	Order	Jun-08	10.90	6.69	4.21
ER08-1423	Pepco Holdings	Order	Jun-08	10.80	6.69	4.11
ER08-1584	Black Hlls	Settlement - Uncontested	Jun-08	10.80	6.69	4.11
ER09-35/36	Tallgrass / Prairie Wind	Commission Order	Jul-08	10.80	6.80	4.00
ER09-249	Public Service Elec. & Gas	Accepted by FERC	Aug-08	11.18	6.86	4.32
ER09-548	ITC Great Plains	Settlement - Uncontested	Sep-08	10.66	6.94	3.72
ER09-75	Pioneer	Order	Sep-08	10.54	6.94	3.60
ER09-187	SoCal Edison	Order on Paper Hearing	Sep-08	10.04	6.94	3.10
ER08-375	SoCal Edison	Order on Paper Hearing	Nov-08	10.55	7.60	2.95
ER09-745	Baltimore Gas & Elec.	Accepted by FERC	Dec-08	11.30	7.80	3.50
ER07-1069	AEP - SPP Zone	Settlement - Uncontested	Jan-09	10.70	7.95	2.75
ER09-681	Green Power Express	Commission Order	Jan-09	10.78	7.95	2.83
ER08-281	Oklahoma Gas & Elec.	Settlement - Uncontested	Apr-09	10.60	8.13	2.47
ER08-1457	PPL Elec. Utilities Corp.	Settlement - Uncontested	Apr-09	11.00	8.13	2.87

ER08-1457	PPL Elec. Utilities Corp.	Settlement - Uncontested	Apr-09	11.14	8.13	3.01
ER08-1588	Kentucky Utilities Co.	Settlement - Uncontested	Apr-09	11.00	8.13	2.87
ER08-552	Niagara Mohawk	Settlement - Uncontested	Jul-09	11.00	7.62	3.38
ER09-628	National Grid Generation LLC	Settlement - Uncontested	Aug-09	10.75	7.39	3.36
ER08-313	Southwestern Public Service Co.	Settlement - Uncontested	Aug-09	10.77	7.39	3.38
ER10-160	SoCal Edison	Order on Paper Hearing	Sep-09	10.33	7.08	3.25
ER08-1329	AEP - PJM Zone	Settlement - Uncontested	Mar-10	10.99	6.20	4.79
ER10-230	Kansas City Power & Light Co.	Settlement - Uncontested	Aug-10	10.60	6.05	4.56
ER10-355	AEP Transcos - PJM	Settlement - Contested	Aug-10	10.99	6.05	4.95
ER10-355	AEP Transcos - SPP	Settlement - Contested	Aug-10	10.70	6.05	4.66
ER11-1952	SoCal Edison	Order	Sep-10	10.30	5.93	4.37
EL11-13	Atlantic Grid Operations	Declaratory Order	Oct-10	10.09	5.84	4.26
ER11-2895	Duke Energy Carolinas	Settlement - Initial Filing	Oct-10	10.20	5.84	4.37
ER11-2377	Northern Pass Tx	Order	Nov-10	10.40	5.79	4.62
ER12-2300	PSCo	Order	Nov-10	10.25	5.79	4.47

ER10-1377	Northern States Power Co. (MN)	Settlement - Uncontested	Mar-11	10.40	5.94	4.46
ER10-992	Northern States Power Co.	Settlement - Uncontested	Apr-11	10.20	6.00	4.20
ER10-516	South Carolina Electric and Gas	Settlement - Uncontested	Apr-11	10.55	6.00	4.55
ER11-4069	RITELine	Order	May-11	9.93	5.98	3.95
ER12-296	PSEG	Order	Aug-11	11.18	5.71	5.47
ER08-386	PATH	Settlement - uncontested	Sep-11	10.40	5.57	4.83
ER11-2560	Entergy Arkansas, Inc.	Settlement - Uncontested	Dec-11	10.20	5.21	4.99
ER11-2853	PSCo	Settlement - Uncontested	Mar-12	10.10	5.08	5.03
ER11-2853	PSCo	Settlement - Uncontested	Mar-12	10.40	5.08	5.33
ER12-1378	Cleco	Settlement - Uncontested	Nov-12	10.50	4.74	5.77
ER12-2554	Transource Missouri	Settlement - Uncontested	Jan-13	9.80	4.65	5.16
ER12-778	Puget Sound Energy	Settlement - Uncontested	Jan-13	9.80	4.65	5.16
ER12-778	Puget Sound Energy	Settlement - Uncontested	Jan-13	10.30	4.65	5.66
ER11-3643	PacifiCorp Inc.	Settlement - Uncontested	Feb-13	9.80	4.62	5.18
ER12-1650	Maine Public Service Co.	Settlement - Uncontested	Feb-13	9.75	4.62	5.13

ER11-3697	SoCal Edison	Settlement - Uncontested	Jul-13	9.30	4.82	4.49
ER13-941	San Diego Gas and Electric	Settlement - Uncontested	Jan-14	9.55	5.22	4.33
ER12-1589	PSCo	Settlement	Aug-14	9.72	4.76	4.96
ER12-91	Duke Energy Ohio	Settlement - Uncontested	Sep-14	10.88	4.73	6.15
EL12-101	Niagara Mohawk	Settlement - Uncontested	Jan-15	9.80	4.66	5.14
ER13-685	Public Service Company New Mexico	Settlement - Uncontested	Feb-15	10.00	4.62	5.38
ER14-1661	MidAmerican Central California	Settlement - Uncontested	Mar-15	9.80	4.58	5.22
ER15-303	American Transmission Systems, Inc.	Settlement - Uncontested	May-15	9.88	4.58	5.30
ER15-303	American Transmission Systems, Inc.	Settlement - Uncontested	May-15	10.56	4.58	5.98
EL14-93	Westar Energy	Settlement - Uncontested	May-15	9.80	4.58	5.22
EL12-39	Duke Energy Florida	Settlement - Uncontested	Jun-15	10.00	4.65	5.35
ER14-192	SPS	Settlement - Uncontested	Jul-15	10.00	4.79	5.21
ER13-2428	Kentucky Utilities	Settlement - Uncontested	Jul-15	10.25	4.79	5.46
ER14-2751	XEST	Settlement - Uncontested	Sep-15	10.20	5.07	5.13

ER15-572	New York Transco LLC	Settlement - Uncontested	Oct-15	9.50	5.23	4.27
ER15-2237	Kanstar Transmission LLC	Settlement - Uncontested	Dec-15	9.80	5.41	4.39
ER15-2114	Transource West Virginia	Settlement - Uncontested	Dec-15	10.00	5.41	4.59

*Highlighted cases only included in MISO II

Cases removed from the Risk Premium Model

As noted above, the Commission refined the Risk Premium Model by, among other things, removing some cases from the analysis. A full list of those cases, along with the reason for their removal, is below:

Cases removed because the utility was merely adopting an existing ROE, such as the MISO ROE, without consideration of whether that ROE would be determined to be just and reasonable under fresh analysis:

- EL08-77, *Central Maine Power Co.*
- ER08-1548, *Northeast Utilities Service Co.*
- ER09-14, *NSTAR Elec. Co.*
- ER07-694, *New England Power Co.*
- EL10-80, *Ameren*
- ER12-1593, *DATC Midwest Holdings*
- ER12-2681, *ITC Holdings*

Cases removed because the ROE was clearly not under consideration:

- ER08-10, *Pepco Holdings, Inc.*
- ER11-3352, *PJM and Public Service Enterprise Group*

Cases removed for being duplicative:

- EL13-86, *Public Service Co. of Colorado*

Cases removed because the ROE was set for a definite future date, and the Commission could not have evaluated a risk premium for a future date:

- ER08-1457, *PPL Elec. Utilities Corp.*[436]

Cases removed because the test period predates 2006:

- EL05-19, *Golden Spread Electric Cooperative, Inc.*
- ER05-154, *Bangor Hydro Electric Company*

[436] Only the 11.18% was removed from consideration. The other two resulting ROEs, because they were not solely applied to a future period, are still included in the analysis.

Appendix II: DCF Results

MISO I DCF Results

Line	Company	Unadjusted Dividend Yield	Short-Term Yahoo! Finance	Long-Term GDP	Composite Growth	Dividend Yield Adjustment One-Step	Adjusted Dividend Yield	DCF Results
1	Consolidated Edison, Inc.	4.14%	2.38%	4.39%	2.78%	101.19%	4.19%	6.97%
2	Public Service Enterprise Group	3.74%	2.95%	4.39%	3.24%	101.48%	3.80%	7.03%
3	PPL Corporation	4.39%	2.23%	4.39%	2.66%	101.12%	4.44%	7.10%
4	CenterPoint Energy, Inc.	4.69%	1.91%	4.39%	2.41%	100.96%	4.73%	7.14%
5	IDACORP Inc.	3.04%	4.00%	4.39%	4.08%	102.00%	3.10%	7.18%
6	OGE Energy Corp.	3.09%	4.00%	4.39%	4.08%	102.00%	3.15%	7.23%
7	Westar Energy Inc.	3.74%	3.40%	4.39%	3.60%	101.70%	3.80%	7.40%
8	Portland General Electric Co.	3.11%	4.70%	4.39%	4.64%	102.35%	3.18%	7.82%
9	DTE Energy Co.	3.38%	4.51%	4.39%	4.49%	102.26%	3.46%	7.94%
10	PG&E Corp.	3.39%	4.71%	4.39%	4.65%	102.36%	3.47%	8.12%
11	The Southern Co.	4.62%	3.32%	4.39%	3.53%	101.66%	4.70%	8.23%
12	SCANA Corp.	3.91%	4.30%	4.39%	4.32%	102.15%	3.99%	8.31%
13	Xcel Energy Inc.	3.68%	4.69%	4.39%	4.63%	102.35%	3.77%	8.40%
14	NorthWestern Corp.	3.60%	5.00%	4.39%	4.88%	102.50%	3.69%	8.57%
15	Duke Energy Corp.	4.05%	4.49%	4.39%	4.47%	102.25%	4.14%	8.61%
16	American Electric Power Co. Inc.	3.68%	5.08%	4.39%	4.94%	102.54%	3.77%	8.72%
17	Vectren Corp.	3.46%	5.50%	4.39%	5.28%	102.75%	3.56%	8.83%
18	Alliant Energy Corp.	3.50%	5.45%	4.39%	5.24%	102.73%	3.60%	8.83%

19	Avista Corp.	3.93%	5.00%	4.39%	4.88%	102.50%	4.03%	8.91%
20	NextEra Energy, Inc.	2.94%	6.27%	4.39%	5.89%	103.14%	3.03%	8.93%
21	Pinnacle West Capital Corp.	3.74%	5.30%	4.39%	5.12%	102.65%	3.84%	8.96%
22	Empire District Electric Co.	4.12%	5.00%	4.39%	4.88%	102.50%	4.22%	9.10%
23	Dominion Resources, Inc.	3.58%	5.89%	4.39%	5.59%	102.95%	3.69%	9.28%
24	Eversource Energy (Northeast Utilities)	3.27%	6.60%	4.39%	6.16%	103.30%	3.38%	9.54%
25	Ameren Corp.	3.91%	5.85%	4.39%	5.56%	102.93%	4.02%	9.58%
26	El Paso Electric Co.	3.01%	7.00%	4.39%	6.48%	103.50%	3.12%	9.59%
27	ALLETE Inc.	3.85%	6.00%	4.39%	5.68%	103.00%	3.97%	9.64%
28	CMS Energy Corp.	3.35%	6.73%	4.39%	6.26%	103.37%	3.46%	9.72%
29	Great Plains Energy, Inc.	3.65%	6.37%	4.39%	5.97%	103.19%	3.77%	9.74%
30	Otter Tail Corp.	4.06%	6.00%	4.39%	5.68%	103.00%	4.18%	9.86%
31	Black Hills Corp.	3.28%	7.00%	4.39%	6.48%	103.50%	3.39%	9.87%
32	Sempra Energy	2.59%	7.93%	4.39%	7.22%	103.97%	2.69%	9.91%
33	Exelon	3.64%	6.81%	4.39%	6.33%	103.41%	3.76%	10.09%
34	PNM Resources	2.85%	8.56%	4.39%	7.73%	104.28%	2.97%	10.70%
35	UIL Holdings	3.59%	7.79%	4.39%	7.11%	103.90%	3.73%	10.84%
36	TECO Energy	4.61%	7.68%	4.39%	7.02%	103.84%	4.79%	11.81%
37	ITC Holdings Corp.	1.76%	11.66%	4.39%	10.21%	105.83%	1.86%	12.07%
38	Unitil Corp.	Merger						
39	MGE Energy	Merger						
40	Edison International	2.66%	0.37%	4.39%	1.17%	100.19%	2.66%	4.38%
41	FirstEnergy Corp.	3.97%	-0.64%	4.39%	0.37%	99.68%	3.96%	5.01%
42	Entergy Corp.	4.21%	-0.48%	4.39%	0.49%	99.76%	4.20%	5.36%

Moodys Baa Utility Bonds	4.65%
Low With Outlier Test	6.97%
High	12.07%

Midpoint	9.52%
Low-End Outlier Test	6.47%
High-End Outlier Test	17.67%
Mean	8.93%

MISO II DCF Results

			Short-Term	Long-Term		Dividend Yield Adjustment		
Line	Company	Unadjusted Dividend Yield	Yahoo! Finance	GDP	Composite	One-Step	Adjusted Dividend Yield	DCF Results
1	Consol. Edison, Inc.	4.08%	2.95%	4.35%	3.23%	101.48%	4.14%	7.37%
2	Westar Energy Inc.	3.70%	3.50%	4.35%	3.67%	101.75%	3.76%	7.43%
3	Portland General Electric Co.	3.33%	4.11%	4.35%	4.16%	102.06%	3.40%	7.56%
4	Vectren Corp.	3.10%	5.00%	4.35%	4.87%	102.50%	3.18%	8.05%
5	Amer. Elec. Power Co., Inc.	3.84%	4.47%	4.35%	4.45%	102.24%	3.93%	8.37%
6	Xcel Energy, Inc.	3.68%	4.68%	4.35%	4.61%	102.34%	3.77%	8.38%
7	SCANA Corp.	3.90%	4.45%	4.35%	4.43%	102.23%	3.99%	8.42%
8	PPL Corp.	4.67%	3.74%	4.35%	3.86%	101.87%	4.76%	8.62%
9	Great Plains Energy	3.83%	4.80%	4.35%	4.71%	102.40%	3.92%	8.63%
10	DTE Energy Co.	3.75%	5.00%	4.35%	4.87%	102.50%	3.84%	8.71%
11	Pinnacle West Capital Corp.	3.92%	4.95%	4.35%	4.83%	102.48%	4.02%	8.85%
12	Avista Corp.	3.98%	5.00%	4.35%	4.87%	102.50%	4.08%	8.95%
13	Dominion Resources, Inc.	3.72%	5.49%	4.35%	5.26%	102.75%	3.82%	9.08%
14	PG&E Corp.	3.50%	5.80%	4.35%	5.51%	102.90%	3.60%	9.11%
15	Alliant Energy	3.72%	5.55%	4.35%	5.31%	102.78%	3.82%	9.13%
16	ALLETE, Inc.	4.16%	5.00%	4.35%	4.87%	102.50%	4.26%	9.13%
17	Eversource Energy	3.39%	6.57%	4.35%	6.13%	103.29%	3.50%	9.63%
18	CMS Energy Corp.	3.36%	6.72%	4.35%	6.25%	103.36%	3.47%	9.72%
19	Ameren Corporation	3.96%	6.00%	4.35%	5.67%	103.00%	4.08%	9.75%
20	El Paso Elec. Co.	3.20%	7.00%	4.35%	6.47%	103.50%	3.31%	9.78%
21	Otter Tail Corp.	4.05%	6.00%	4.35%	5.67%	103.00%	4.17%	9.84%
22	NorthWestern Corp.	3.61%	6.81%	4.35%	6.32%	103.41%	3.73%	10.05%
23	WEC Energy Group, Inc.	3.58%	7.55%	4.35%	6.91%	103.78%	3.72%	10.63%
24	Sempra Energy	2.84%	9.35%	4.35%	8.35%	104.68%	2.97%	11.32%
25	PNM Resources, Inc.	2.92%	9.30%	4.35%	8.31%	104.65%	3.06%	11.37%
27	IDACORP, Inc.	3.03%	4.00%	4.35%	4.07%	102.00%	3.09%	7.16%
26	CenterPoint Energy, Inc.	5.47%	0.40%	4.35%	1.19%	100.20%	5.48%	6.67%
28	OGE Energy Corp.	3.81%	2.17%	4.35%	2.61%	101.09%	3.85%	6.46%
29	Public Service Enterprise Group	3.85%	1.38%	4.35%	1.97%	100.69%	3.88%	6.28%

30	FirstEnergy Corp.	4.51%	-0.92%	4.35%	0.13%	99.54%	4.49%	5.38%
31	Edison International	2.85%	-0.51%	4.35%	0.46%	99.75%	2.84%	3.92%
32	Black Hills Corp.	Merger						
33	Cleco Corp.	Merger						
34	Duke Enegy Corp.	Merger						
35	Empire District	Merger						
36	Exelon Corp.	Merger						
37	Hawaii Elec. Ind. Inc.	Merger						
38	ITC Holdings	Merger						
39	NextEra Energy Inc.	Merger						
40	Pepco Holdings Inc.	Merger						
41	Souther Co.	Merger						
42	TECO Energy Inc.	Merger						
43	UIL Energy	Merger						

Moodys Baa Utility Bonds	5.41%
Low With Outlier Test	7.37%
High	11.37%
Midpoint	9.37%
High-End Outlier Test	17.43%
Low-End Outlier Test	7.18%

Appendix III: Overall Results

MISO I	Zone of Reasonableness		Lower Third		Middle Third		Upper Third	
	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper
DCF (1)	6.97%	12.07%	6.97%	8.67%	8.67%	10.37%	10.37%	12.07%
CAPM (2)	7.80%	13.09%	7.80%	9.56%	9.56%	11.33%	11.33%	13.09%
Risk Premium (3)	7.50%	12.70%	7.50%	9.23%	9.23%	10.97%	10.97%	12.70%
Average	7.42%	12.62%	7.42%	9.16%	9.16%	10.89%	10.89%	12.62%
Midpoint	**10.02%**							
Average Width of DCF and CAPM Zones of Reasonableness:					5.195			
Risk Premium ROE:		10.10%						
Risk Premium Imputed Zone of Reasonableness:					7.50%	to	12.70%	

MISO II	Zone of Reasonableness		Lower Third		Middle Third		Upper Third	
	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper
DCF (4)	7.37%	11.37%	7.37%	8.70%	8.70%	10.04%	10.04%	11.37%
CAPM (5)	8.35%	12.63%	8.35%	9.78%	9.78%	11.20%	11.20%	12.63%
Risk Premium (6)	8.22%	12.36%	8.22%	9.60%	9.60%	10.98%	10.98%	12.36%
Average	7.98%	12.12%	7.98%	9.36%	9.36%	10.74%	10.74%	12.12%
Midpoint	**10.05%**							
Average Width of DCF and CAPM Zones of Reasonableness:					4.14			
Risk Premium ROE:		10.29%						
Risk Premium Imputed Zone of Reasonableness:					8.23%	to	12.37%	

(1) See Appendix II
(2) See Trial Staff Initial Br. (I), Attachment A to App. 2 at 6.
(3) See Appendix I
(4) See Appendix II
(5) See Trial Staff Initial Br. (II), Attachment A to App. 2 at 6.
(6) See Appendix I

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Association of Businesses Advocating Tariff Equity Docket No. EL14-12-004
Coalition of MISO Transmission Customers
Illinois Industrial Energy Consumers
Indiana Industrial Energy Consumers, Inc.
Minnesota Large Industrial Group
Wisconsin Industrial Energy Group

v.

Midcontinent Independent System Operator, Inc.
ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

Arkansas Electric Cooperative Corporation
Mississippi Delta Energy Agency
Clarksdale Public Utilities Commission
Public Service Commission of Yazoo City
Hoosier Energy Rural Electric Cooperative, Inc.

Docket No. EL15-45-001

v.

ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

(Issued May 21, 2020)

GLICK, Commissioner, *concurring in part and dissenting in part*:

1. Today's order is yet another twist in the Commission's decade-long effort to adapt its methodology for setting public utilities' return on equity (ROE) to the low-interest rate conditions that have prevailed since the late 2000s. In that time, the Commission has proposed multiple different ways of dealing with the fact that its long-standing ROE methodology produces cost-of-equity estimates well below the ROEs it generally permitted public utilities to collect in the years before the Great Recession. The

Commission's most recent attempt to address this issue, Opinion No. 569,[1] was far from perfect. Nevertheless, I supported it because it represented a reasonable compromise that I hoped would bring some much-needed certainty and predictability to the Commission's approach to setting public utilities' ROEs.

2. So much for that. Today, we are once again changing course and revamping our ROE methodology. And, in so doing, we are sacrificing whatever certainty Opinion No. 569 might have provided.

3. In addition, I am particularly troubled that the Commission is portraying its change of heart as a dispassionate assessment of various technical questions—the comparative merits of one financial model, the right source of data for another, or the appropriate application of various assumptions. It is hard for me to believe that anyone buys that this latest twist is a genuine reassessment of those technical minutiae or that those details are what led Chairman Chatterjee to express his eagerness to consider rehearing requests at the December 2019 Open Meeting, before those requests were even filed. Instead, it appears that the Commission again has chosen a path directed by the results, in this case the perceived need to award a higher ROE, rather than the law and the facts.

4. In fairness, it may be that the methodology established in Opinion No. 569 would yield ROEs that are too low. And it may also be that the ROE established in this proceeding—10.02 percent—is a just and reasonable number. But, even so, the Commission must be transparent about the factors driving its decisionmaking process. If we think the ROEs set by the Commission's methodology are too low—or, for that matter, too high—we ought to say so and explain our reasoning, rather than pretending to be concerned only with the technical details of our models, data, and assumptions. Accordingly, I dissent in part because I do not believe that today's order adequately justifies several of the changes it adopts, even if the end result is an appropriate number.

5. Finally, today's order affirms the one aspect of Opinion No. 569 that merited a grant of rehearing. Opinion No. 569 declined to order refunds for a period in which everyone agrees customers paid an unjust and unreasonable rate. I continue to believe that decision was an abdication of our responsibility to protect consumers. As a result, I also dissent from the portion of today's order that affirms that decision.

* * *

[1] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 569, 169 FERC ¶ 61,129 (2019).

I. The Commission Must Stop the Endless Fiddling with Its ROE Methodology

6. Between 2011 and 2015, various entities representing customers' interests filed a series of complaints under section 206 of the Federal Power Act[2] (FPA) arguing that the base ROE available to transmission owners in ISO New England, Inc. and the Midcontinent Independent System Operator (MISO) was unjust and unreasonable. In Opinion No. 531, the Commission addressed the first of those complaints, with its most significant findings being that "anomalous capital market conditions" required the Commission to consider a variety of financial models and that those models supported an elevated ROE.[3] The Commission subsequently applied that approach to a similar complaint involving the MISO Transmission Owners.[4] Shortly thereafter, however, the D.C. Circuit vacated Opinion No. 531, sending it back to the Commission and the Commission back to the drawing board.[5] Following that remand, the Commission proposed to expressly rely on the four financial models considered in Opinion No. 531.[6] A year later, in Opinion No. 569, we narrowed it to two models, while making a number of changes to how we implemented those models.[7] Today, we're back up to three models, with another round of tweaks to those models.[8]

7. With the exception of the Commission's finding of anomalous market conditions, which at least hinted at its real concern, the Commission's various orders in this saga have suggested that each new iteration of its ROE methodology is a largely technical affair that turns on the Commission's evaluation of discrete issues with the various

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[2] 16 U.S.C. ¶ 824e (2018).

[3] *Coakley Mass. Attorney Gen. v. Bangor Hydro-Elec. Co.*, Opinion No. 531, 147 FERC ¶ 61,234, at PP 41, 152 (2014).

[4] *Ass'n of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 551, 156 FERC ¶ 61,234 (2016).

[5] *Emera Maine v. FERC*, 854 F.3d 9 (2017).

[6] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 165 FERC ¶ 61,118 (2018) (Briefing Order).

[7] Opinion No. 569, 169 FERC ¶ 61,129.

[8] Although the complaints against the RTO-wide ROEs in MISO and ISO New England garnered the most attention, the last ten years have also seen a host of other complaints against individual transmission owner's ROEs, which have also been affected by the Commission's back-and-forth over these complaints.

financial models. In so doing, the Commission has added new models,[9] removed some of those models,[10] tweaked some of those models,[11] introduced new inputs,[12] modified existing inputs,[13] introduced new screens,[14] modified existing screens,[15] and even altered how the Commission places the ROE within the zone of reasonableness.[16] But, with each

[9] *See, e.g.*, Opinion No. 551, 156 FERC ¶ 61,234 at P 9 (relying on four alternative models to place the ROE within the zone of reasonableness).

[10] *See, e.g.*, Opinion No. 569, 169 FERC ¶ 61,129 at PP 200, 340 (declining to rely on the Expected Earnings or Risk Premium methodologies). Indeed, at this point, the Commission has considered, but not relied on the risk premium model, Opinion No. 551, 156 FERC ¶ 61,234 at P 191, proposed relying on the risk premium model, Briefing Order, 165 FERC ¶ 61,118 at PP 18-19**,** declined to rely on the risk premium model, Opinion No. 569, 169 FERC ¶ 61,129 at P 340, and, with today's order, now elected to rely on the rely risk premium model, *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 569, 171 FERC ¶ 61,154, at P 104 (2020).

[11] *See, e.g.*, Opinion No. 569-A, 171 FERC ¶ 61,154 at P 107 (modifying the risk premium model to produce a zone of reasonableness rather than a single point estimate).

[12] *Compare* Opinion No. 569, 169 FERC ¶ 61,129 at P 274 (rejecting the use of *Value Line* short-term growth rates in the Capital Asset Pricing Model (CAPM)) *with* Opinion No. 569-A, 171 FERC ¶ 61,154 at P 78 ("clarify[ing]" that the Commission will consider *Value Line* short-term growth rates in the CAPM).

[13] *See, e.g.*, Opinion No. 569-A, 171 FERC ¶ 61,154 at P 57 (reducing the weighting of the long-term growth rate in the two-step Discounted Cash Flow model (DCF) from one-third to one-fifth).

[14] Briefing Order, 165 FERC ¶ 61,118 at P 54 (proposing a high-end outlier screen that would apply to "any proxy company whose cost of equity estimated with a given model is more than 150 percent of the median result of all of the potential proxy group members in that model"); Opinion No. 569, 169 FERC ¶ 61,129 at P 375 (adopting the proposed high-end outlier screen).

[15] *See, e.g.*, Opinion No. 569-A, 171 FERC ¶ 61,154 at P 154 (increasing the threshold for the high-end outlier test from 150 percent of the median of the zone of reasonableness to 200 percent of the median of the zone of reasonableness).

[16] *See, e.g.*, *id.* P 193 (changing the start points for setting ROEs for above- and below-average ROEs); Opinion No. 551, 156 FERC ¶ 61,234 at P 275 (setting the MISO-wide ROE at the midpoint of the upper half of the zone of reasonableness).

new twist, it becomes harder to buy that the Commission is genuinely reassessing the mechanics of each model rather than disagreeing with the ROE numbers those models produce.[17]

8. Today's order is the culmination of all that. Not long after completing a year-long process to re-evaluate our approach to setting ROEs following the D.C. Circuit's decision in *Emera Maine*, the Commission is now once again charting a major change of course. In so doing, the Commission is again portraying its change of heart as a technical matter based on its reassessment of a handful of discrete issues rather than what it is: A determination that the old number was too low and now we need a higher one.

9. To be fair, I am sympathetic to the impulse to consider subjective factors. The Commission's approach to setting a just and reasonable ROE will often implicate broader policy considerations, equity, and other factors that cannot be captured in, for example, a discussion of dividend yields or the appropriate sources of growth rate calculations. But while ROE policy will always be as much art as science, that is no excuse to pretend that art is science.

10. If broader considerations, including policy goals, are preventing the Commission from settling on or consistently applying an ROE methodology, then we must acknowledge those goals and give the interested entities the chance to weigh in on them just as they do for the intricacies of dividend yields, growth rates, and the like. All approaches to setting ROEs have their shortcomings, but the worst result by far is to continually fiddle with those approaches, undermining the certainty and predictability that help transmission owners make long-term investments. If the Commission is going to purport to rely entirely on financial models to evaluate and set ROEs, it has to take those models at face value without second-guessing them when it does not like the results.

11. In addition, today's order illustrates the problems with disguising subjective policy considerations as technical determinations. In a number of instances, the Commission is reversing determinations made in Opinion No. 569 using rationales that are far less convincing than those that supported the opposite outcome in Opinion No. 569. Shifting

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[17] It is also worth noting that, today, the Commission is adding even more complexity to its approach to setting ROE methodologies by also issuing a policy statement regarding oil and natural gas pipelines that largely follows the approach outlined in Opinion No. 569 rather than this order. In particular, that policy statement does not use the risk premium model, adjust the weighting of long- and short-term growth rates for the two-step DCF model, or adopt a particular high-end outlier screen. *See Policy Statement on Determining Return on Equity for Natural Gas and Oil Pipelines*, 171 FERC ¶ 61,155 at PP 2, 87 (2020). The Commission, it seems, just cannot settle on an analytically consistent approach to this important issue.

from such strong arguments to such suspect ones underscores the extent to which subjective factors seem to be operating in the background while also opening the Commission up to considerable risk on judicial review, creating even more of the uncertainty we ought to be trying to minimize.

12. Take the example of the risk premium model. Although Opinion No. 569 declined to utilize the risk premium model based on a long list of shortcomings, today's order reverses course, adding it to the DCF and CAPM on which the Commission previously relied. The record before us does not support that choice.

13. As an initial matter, and as explained in Opinion No. 569, the risk premium model does essentially the same thing as the CAPM by attempting to calculate the "premium that investors require over the risk-free rate of return."[18] Opinion No. 569 rightly pointed out that nothing in the record supports having two thirds of the Commission's ROE methodology composed of such analytically redundant approaches.[19] Today's order tersely responds to that concern by asserting that the two models are "sufficiently distinct" since they use different inputs.[20] But that ignores the point in Opinion No. 569 that the problem with relying on both models is that they replicate the same basic methodology, irrespective of their inputs.[21]

14. Opinion No. 569 also explained how the risk premium model is, in most respects, just an inferior version of the CAPM in so far as it does not consider market-based cost-of-equity estimates[22] and introduces significant circularity concerns by relying on *past*

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[18] Opinion No. 569, 169 FERC ¶ 61,129 at P 341.

[19] *Id.*

[20] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 105.

[21] Opinion No. 569, 169 FERC ¶ 61,129 at P 341 ("We find that using the Risk Premium model in conjunction with the CAPM model would confer too much weight towards risk premium methodologies. The Commission has long used and, over time, refined the DCF model and we find that it would be inappropriate for variations of the risk premium model to receive twice its weight.").

[22] *Id.* P 342 ("[T]he Risk Premium model is likely to provide a less accurate current cost of equity estimate than the DCF model or CAPM because it relies on previous ROE determinations, whose resulting ROE may not necessarily be directly determined by a market-based method, whereas the DCF and CAPM methods apply a market-based method to primary data."). In addition, as the Commission noted, many of the ROEs included in the risk premium analyses in the record were never determined to be just and reasonable. For example, many of the ROEs were set through uncontested settlements, which involve compromise across a host of issues of which ROE is just one.

judgments, which may not reflect the appropriate risk premium under current conditions.[23] The Commission responds to those circularity concerns by contending that they are "mitigate[d]" by the fact that the Commission will average the results of the risk premium with the DCF and the CAPM, which do not present the same concerns.[24] But observing that the Commission will *also* use models without significant circularity concerns is not a reasoned response to the argument that you should not use circular models in the first place.

15. In addition, the Commission convincingly explained in Opinion No. 569 how "the record contains insufficient evidence to conclude that investors rely on risk premium analyses utilizing historic Commission ROE determinations or settlement approvals to determine the cost of capital and make investment decisions."[25] The Commission noted that, while allowed ROEs are certainly important to investors' decisionmaking, that does not suggest that investors' perform anything remotely close to the analysis contemplated by the risk premium model—*i.e.*, a backward looking comparison between riskless assets and allowed ROEs—when making their investment decisions.[26] Today's order now takes the opposite position, observing only that investors in regulated utilities expect to earn a return above a risk-free asset (which is obviously true) and that "investors . . . observe regulatory ROEs and how changes in authorized ROE levels could affect utility earnings" (which is equally obvious).[27] It should go without saying that investors pay attention to ROEs earned by public utilities and expect them to be higher than debt backed by the U.S. government. But neither of those self-evident statements provides *any* reason—much less substantial evidence—to believe that investors perform a risk premium analysis comparing past differences between risk free assets and Commission-allowed ROEs when evaluating whether to invest in Commission-regulated public utilities.

16. And, finally, the risk premium model does not at all fit with the Commission's new approach for evaluating whether an existing ROE is just and reasonable. Opinion No. 569 established a framework for evaluating whether an existing ROE is just and

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The Commission frequently approves uncontested without directly passing on whether the individual terms are just and reasonable. *See id.*

[23] *See id.* P 343 (explaining that the circularity concerns with the risk premium model are "particularly direct and acute").

[24] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 106.

[25] Opinion No. 569, 169 FERC ¶ 61,129 at P 345.

[26] *Id.*

[27] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 112.

reasonable based on ranges of presumptively just and reasonable results derived from the financial models used by the Commission.[28] Unlike every other financial model used, or even considered by the Commission in Opinion No. 569,[29] the risk premium model produces a single point estimate of the just and reasonable ROE, not a zone of reasonableness.[30]

17. Recognizing this "serious concern," but nevertheless determined to fit a square peg into a round hole, today's order resolves to "impute" the average width of the zone of reasonableness created by the DCF and CAPM methodologies to the risk premium model.[31] For example, if the DCF and CAPM produce an average zone of 200 basis points, it seems that the Commission will just assume that the risk premium model does too. Today's order, however, does not point to any evidence suggesting that such imputation is appropriate or that any investors or financial experts have sanctioned the Commission's method. Presumably that is because the record lacks any evidence supporting such an odd repurposing of the risk premium model.[32] After all, the Commission's approach to using the risk premium in evaluating whether an existing ROE is just and reasonable is the equivalent of making someone a "custom" suit based on their siblings' measurements: Maybe it will fit, but there is no reason to believe that it will and, in any case, it misses the point of the exercise.

18. In addition, today's order adopts a series of equally unreasoned modifications to Opinion No. 569's framework for conducting the first step of the section 206 inquiry. As noted, Opinion No. 569 established a practice of dividing the zone of reasonableness into ranges of presumptively just and reasonable ROEs within the broader zone of reasonableness.[33] In particular, the Commission created risk-adjusted "quartiles" of the

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[28] Opinion No. 569, 169 FERC ¶ 61,129 at P 57.

[29] The Commission also considered, but rejected, relying upon an expected earnings model as well. *Id.* P 200.

[30] *Id.* P 351.

[31] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 107.

[32] That become especially clear when compared with the Commission's thorough and well-reasoned rejection of the risk premium on this basis, among others, in Opinion No. 569. *Compare id* P 107 *with* Opinion No. 569, 169 FERC ¶ 61,129 at P 351.

[33] That change responded to the D.C. Circuit's holding that the FPA contemplates "a 'broad' range of potentially just and reasonable ROEs, 'not an exact dollar figure.'" *Emera Maine v. FERC*, 854 F.3d 9, 23 (D.C. Cir. 2017) (quoting *Panhandle E. Pipe Line Co. v. FERC*, 777 F.2d 739, 746 (D.C. Cir. 1985)).

zone of reasonableness centered on the three points that the Commission uses as the starting point for setting ROEs for utilities of different risk profiles[34]—the midpoint of the entire zone of reasonableness for average-risk utilities, the midpoint of the lower half of the zone of reasonableness for below-average risk utilities, and the midpoint of the upper half of the zone of reasonableness for above-average risk utilities.[35]

19. The Commission justified the end points of each quartile by explaining that "[l]ogic dictates that the end points of those ranges should not be closer to the starting points for the ranges of utilities with different risk profiles than they are to their own starting point."[36] In other words, it would not make sense to presume that an existing ROE is just and reasonable if it was closer to the starting point used to set the ROE for a utility of a different risk profile than the starting point for a utility of the same risk profile. The Commission's quartile-based approach made sense given the emphasis that the Commission has historically placed on relative risk profiles when placing ROEs within the zone of reasonableness[37] and it ensured that the ranges of presumptively just and reasonable results were not just arbitrary sub-sections of the zone of reasonableness.

20. Today's order abandons that well-reasoned approach and arbitrarily divides the entire zone of reasonableness into thirds, with each third providing a presumptively just and reasonable range of ROEs for certain utilities. The Commission appears to suggest[38] that this maneuver is necessary to comply with the D.C. Circuit's statement in *Emera Maine* that "the zone of reasonableness creates a broad range of *potentially* lawful

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[34] Opinion No. 569, 169 FERC ¶ 61,129 at P 57.

[35] *Id.* The midpoint is the measure of central tendency that the Commission uses when setting the ROE for a diverse range of utilities. *Id.* PP 398, 409. By contrast, the Commission uses the median as the measure of central tendency when setting the ROE for a single utility. *Id.* P 398.

[36] *Id.* P 63.

[37] *See* Opinion No. 569, 169 FERC ¶ 61,129 at P 62 ("We also find that the circumstance most relevant to determining that range is the utility's risk profile."); *see also FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) ("[T]he return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks."); *Petal Gas Storage, L.L.C. v. FERC*, 496 F.3d 695, 6-99700 (D.C. Cir. 2007) (explaining the emphasis that the Commission and courts have placed on the role of risk in setting ROEs).

[38] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 190.

ROEs."[39] But *Emera Maine* requires nothing of the sort. Read in context, the quoted language stands only for the proposition that the Commission cannot prove that an existing rate is unjust and unreasonable simply by showing that its ROE methodology would produce a different number using current data.[40] The court certainly did not suggest that every point within the zone of reasonableness must be *presumptively* just and reasonable for some utility, which is how today's order appears to understand that language. In any case, the quartile-based approach in Opinion No. 569 easily complied with even the Commission's reading of the language in *Emera Maine*. Because the ranges only represented presumptive findings, a public utility could still argue that an ROE outside those ranges was nevertheless just and reasonable based on other considerations,[41] making every ROE within the zone of reasonableness at least "potentially" just and reasonable.

21. And that's just the start of it. Recognizing that the decision to divide the zone of reasonableness into thirds obliterates the rationale for the ranges outlined in Opinion No. 569,[42] the Commission announces, without any explanation, that it will change the starting points it uses when setting the ROE for below- and above-average risk utilities to the midpoint of the lower third of the zone of reasonableness and the midpoint of the upper third of the zone of reasonableness, respectively.[43] Now the tail is truly wagging the dog. In Opinion No. 569, the Commission justified the ranges of presumptively just and reasonable ROEs based on the Commission's longstanding approach to handling companies' relative risk profiles, namely the use of the upper and lower midpoints for utilities of above- and below-average risk, respectively.[44] In today's order, the Commission uproots that longstanding approach, selecting entirely new starting points for placing ROEs within the zone of reasonableness in order to support its new ranges of

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[39] *Emera Maine*, 854 F.3d at 26 (emphasis added).

[40] *Id.* ("But, as we have explained, the zone of reasonableness creates a broad range of potentially lawful ROEs rather than a single just and reasonable ROE, meaning that FERC's finding that 10.57 percent was a just and reasonable ROE, standing alone, did not amount to a finding that every other rate of return was not." (internal quotation marks omitted)).

[41] Opinion No. 569, 169 FERC ¶ 61,129 at PP 60-64, 68 (discussing how the Commission would apply the new framework, including what other factors it would consider).

[42] *See supra* P 20 & note 37.

[43] Opinion No. 569-A, 171 FERC ¶ 61,154 at 194.

[44] Opinion No. 569, 169 FERC ¶ 61,129 at PP 62-64.

presumptively just and reasonable results. That gets it entirely backwards; the ranges of presumptively just and reasonable results should reflect how we set ROEs, not the other way around. In any case, at no point in today's order does the Commission explain why the new starting points themselves are an appropriate place to begin the process of placing the ROE for an above- or below-average risk utility within the zone of reasonableness.[45]

22. Suffice it to say, the Commission has not justified its change of course with respect to either the risk premium model or its approach to step one of the section 206 inquiry. Nevertheless, while I believe that Opinion No. 569 was a superior approach to setting ROEs, I also recognize that the roughly 10 percent ROE established in today's order may well be a just and reasonable end result.[46] In addition, for the reasons explained above, I firmly believe that the Commission must finally bring some certainty and predictability to how its sets transmission owner ROEs.

II. The Commission Should Order Refunds for Unjust and Unreasonable Rates Paid by Consumers

23. I continue to disagree with the Commission's refusal to order refunds for the fifteen-month refund period established pursuant to the Second Complaint.[47] Throughout that period, customers within MISO paid an unjust and unreasonable ROE. Nevertheless, the Commission refuses to order refunds on the specious basis that the FPA requires it to act as if the 10.02 percent ROE set in today's order was in effect throughout that fifteen-month period. In reality, however, customers actually paid a 12.38 percent ROE—a difference worth tens of millions of dollars—and nothing in the law requires us to pretend otherwise.

24. The facts relevant to the issue of refunds are straightforward. On November 12, 2013, multiple parties filed a complaint (First Complaint) alleging that the MISO Transmission Owners' 12.38 percent ROE was unjust and unreasonable.[48] The

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[45] That failure is particularly glaring because the new starting points will be closer to either the top or bottom of the zone of reasonableness than the midpoint. Nothing in today's order—or the record before us—explains why those starting points should be biased towards the most extreme costs of equity in the zone of reasonableness.

[46] *Cf. Hope*, 320 U.S. 591, 602 (1944) ("Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling.").

[47] *See* Opinion No. 569, 169 FERC ¶ 61,129 (Glick, Comm'r, dissenting in part).

[48] *Id.* P 3. The authorized base ROE for the ATCLLC zone was 12.20 percent, but I will follow the underlying order's practice of referring to the MISO-wide ROE as 12.38.

Commission set the matter for hearing and established a refund effective date of November 12, 2013 (the date the First Complaint was filed),[49] meaning that the 15-month refund period for the First Complaint lasted until February 12, 2015.[50] On February 12, 2015, a different set of parties filed another complaint (Second Complaint) against the MISO Transmission Owners' ROE. The Commission again set the matter for hearing and established a refund effective date of February 12, 2015,[51] meaning that the 15-month refund period for the Second Complaint lasted until May 12, 2016. Both proceedings were fully litigated and produced initial decisions by Administrative Law Judges.[52] And, in both cases, the Commission did not get around to issuing orders on the initial decisions until well after both refund periods expired, meaning that customers paid rates reflecting a 12.38 percent ROE throughout both refund periods.[53]

25. In today's order, the Commission affirms its conclusion in Opinion No. 569 that the 12.38 percent ROE was unjust and unreasonable and it establishes a new just and reasonable ROE of 10.02 percent. That is sufficient to order refunds for the refund

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Id. P 3 & n.11.

[49] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 149 FERC ¶ 61,049, at P 188 (2014), *order on reh'g*, 156 FERC ¶ 61,060 (2016).

[50] As discussed further below, pursuant to the Regulatory Fairness Act, Pub. L. No. 100-473, § 2, 102 Stat 2299 (1988) (codified at 16 U.S.C. § 824e(b)), as part of any proceeding under section 206 of the FPA, the Commission shall establish a refund effective date and, at the conclusion of that proceeding, it may order refunds for the difference between an unjust and unreasonable rate in effect during the period up to 15 months following the refund effective date and the new just and reasonable rate fixed by the Commission.

[51] *Ark. Elec. Coop. Corp. v. ALLETE, Inc.*, 151 FERC ¶ 61,219, at P 1 (2015), *order on reh'g*, 156 FERC ¶ 61,061 (2016) (Second Complaint Rehearing Order).

[52] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 153 FERC ¶ 63,027 (2015); *Ark. Elec. Coop. Corp. v. ALLETE, Inc.*, 155 FERC ¶ 63,030 (2016).

[53] The Commission originally issued an order on the First Complaint in September 2016. *See Ass'n of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 551, 156 FERC ¶ 61,234, at P 9 (2016). But, shortly thereafter, the D.C. Circuit issued its opinion in *Emera Maine*, 854 F.3d 9, which vacated the precedent on which Opinion No. 551 relied. Following briefing on remand, the Commission issued Opinion No. 569, which elicited the rehearing requests addressed in today's order.

periods established pursuant to *both* the First and Second Complaints. To see why, let's start with the text of section 206(b), which provides that

> At the conclusion of any proceeding under this section [i.e., section 206], the Commission may 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, in excess of those which would have been paid under the just and reasonable rate, charge, classification, rule, regulation, practice, or contract which the Commission orders to be thereafter observed and in force.[54]

All that text requires is that the Commission find that customers paid an unjust and unreasonable rate during the refund period and that the Commission have set a just and reasonable replacement rate, so that it can calculate refunds equal to the difference between those two rates. Both conditions are satisfied here: Customers paid 12.38 percent through the Second Complaint refund period and the Commission has determined that they should have paid 10.02 percent. That is sufficient to order refunds pursuant to section 206(b).

26. Contrary to the suggestion in today's order,[55] the text of section 206(b) does not limit the Commission's refund authority to only those individual proceedings in which it sets a new rate. Instead, it provides the Commission with the authority to order refunds "[a]t the *conclusion* of *any* proceeding under this section"—*i.e.*, section 206."[56] Congress surely understood that not every section 206 proceeding would be resolved against the public utility and, had it so desired, it could have conditioned the Commission's refund authority accordingly. But by pairing the word "conclusion"—which would seem to contemplate proceedings in which the public utility prevailed as well as those in which it did not—with the phrase "any proceeding"—which is equally unlimited—Congress rejected such a narrow interpretation of the Commission's refund authority. Instead, as noted, the plain text of section 206 indicates that the Commission's refund authority turns on the presence of a difference between the unjust and unreasonable rate that customers paid during the refund period and the just and reasonable rate that they should have paid, not whether the Commission set a new rate in every complaint it resolves.

27. Recognizing that Congress did not explicitly limit the Commission's refund authority, the Commission responds that it did so implicitly when it inserted the phrase

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[54] 16 U.S.C. § 824e(b) (emphasis added).

[55] Opinion No. 569-A, 171 FERC ¶ 61,154 at PP 260-262.

[56] 16 U.S.C. § 824e(b) (emphasis added).

"thereafter observed and in force" in section 206(b).[57] The idea, as I understand it, is that "thereafter observed and in force" is supposed to reflect Congress' understanding that the Commission would be setting a new rate in each complaint prior to ordering any refunds.[58] Thus, the argument appears to go, the Commission cannot order refunds unless it sets a new rate in the complaint corresponding to each individual refund period.

28. As an initial matter, that would be a remarkably convoluted way of limiting the Commission's refund authority under section 206. It envisions that, instead of limiting the Commission's refund authority in the statutory text that establishes the proceedings in which the Commission can order refunds, Congress elected to do so through an opaque reference in the discussion of how the Commission should calculate any refunds that it may order. That is a bizarre—and overly complicated—way to read an otherwise straightforward statute.[59]

29. In any case, the "thereafter observed and in force" language is better read as a reference to the identical language in section 206(a).[60] Under that reading, all that "thereafter observed and in force" does is clarify that the ceiling on the Commission's refund authority under section 206(b) is the difference between the rate in effect during the refund period and the just and reasonable rate that the Commission established pursuant to subsection 206(a).[61] In other words, that language specifies *how* the Commission should calculate any refunds it orders, not *when* it may order refunds. As noted, my reading makes far more sense given the fact that the "thereafter observed and in force" language appears in the portion of 206(b) that defines how the Commission should calculate refunds, not when it should order them. I see no reason to abandon that

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[57] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 262.

[58] *Id.*

[59] *Cf. City of Anaheim v. FERC*, 558 F.3d 521, 525 (D.C. Cir. 2009) ("declin[ing] FERC's invitation to mangle the statute").

[60] *See* 16 U.S.C. § 824e(a) (requiring the Commission to establish a new just and reasonable rate to be "thereafter observed and in force" whenever it finds that an existing rate is unjust and unreasonable or unduly discriminatory or preferential).

[61] That interpretation makes even more sense when you consider that section 206(b) was added more than 50 years after section 206(a), which was part of the original FPA, and so it would have been necessary to clarify how the amendment worked in conjunction with the pre-existing language.

straightforward reading of the statute, which protects customers from paying unjust and unreasonable rates, in favor of a convoluted one that does not.[62]

30. The Commission's next argument is even more of a head scratcher. The Louisiana Public Service Commission argues that it is irrational to use the ROE set in Opinion No. 569 as the baseline for evaluating whether to order refunds for the Second Complaint refund period because that ROE was never "demanded, observed, charged, or collected," as section 206 requires. The Commission responds with what might charitably be called a regulatory fiction. It argues that Opinion No. 569 made the new just and reasonable ROE set in the First Complaint proceeding effective as of the beginning of the First Complaint refund period, which, the Commission argues, means that we must pretend that that lower ROE was in effect throughout the refund period for the Second Complaint as well. The Commission seems to be suggesting that it must pretend that the 10.02 ROE established today was "demanded, observed, charged, or collected" during the second refund period.[63]

31. But that interpretation is both demonstrably false and squarely foreclosed by section 206. First and foremost, the ROE that the MISO Transmission Owners collected during the refund period for the Second Complaint was 12.38 percent, no ifs, ands, or buts. In addition, the FPA flatly prohibited the MISO Transmission Owners from collecting any other ROE during that period. As noted, section 206 is forward looking in that it gives the Commission the ability to set a new just and reasonable rate as of the date on which the Commission makes the findings required by section 206.[64] The only exception to that rule is for the refund period, during which time the Commission is

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[62] *Cf., e.g., California ex rel. Lockyer v. FERC*, 383 F.3d 1006, 1017 (9th Cir. 2004) (rejecting "an interpretation [that] comports neither with the statutory text nor with the Act's 'primary purpose' of protecting consumers"); *City of Chicago, Ill. v. FPC*, 458 F.2d 731, 751 (D.C. Cir. 1971) ("[T]he primary purpose of the Natural Gas Act is to protect consumers." (citing, *inter alia*, *City of Detroit v. FPC*, 230 F.2d 810, 815 (D.C. Cir. 1955)); S. Rep. 100-491, 5-6 (1988) ("The Committee intends the Commission to exercise its refund authority under section 206 in a manner that furthers the long-term objective of achieving the lowest cost for consumers consistent with the maintenance of safe and reliable service.").

[63] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 264.

[64] *See, e.g., Louisiana Pub. Serv. Comm'n v. FERC*, 772 F.3d 1297, 1299 (D.C. Cir. 2014) (explaining that section 206 provides for prospective relief only with the exception of the refund period).

permitted to act as if the new rate were in effect when ordering refunds.[65] The refund period for the Second Complaint, however, fell *after* the conclusion of the refund period for the First Complaint and *before* the date on which the Commission issued Opinion No. 569. Suffice it to say, it is arbitrary and capricious for the Commission to assume that it did that which it is legally prohibited from doing.

32. The Commission's next argument is that ordering refunds for the Second Complaint would represent an end-run around the 15-month limitation on refunds enshrined in section 206(b).[66] That argument appears to have both a legal dimension and a policy dimension. Beginning with the former, the Commission seems to be taking the position that ordering refunds in the Second Complaint period would effectively extend the refund period established for the First Complaint. But the Commission has repeatedly held that the FPA permits such successive or "pancaked" complaints, which are "'entirely new proceeding[s]'" and not "'duplicative proceeding[s] intended solely to expand the amount of refund protection beyond 15 months,'"[67] provided that they raise new facts or arguments,[68] which the Commission held that the Second Complaint did.[69] Accordingly, rather than extending the refund period for the First Complaint, ordering refunds pursuant to the Second Complaint would simply reflect the fact that the MISO Transmission Owners collected an unjust and unreasonable ROE during a period when all parties were on notice that the Commission might order refunds of such excessive rates.[70]

33. From the perspective of public policy, I recognize that permitting pancaked complaints with multiple refund periods may be sub-optimal. After all, pancaked complaints can create significant uncertainty in an area where certainty is especially

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[65] *Id.*

[66] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 259.

[67] Second Complaint Rehearing Order, 156 FERC ¶ 61,061 at P 33 (quoting *Southern Co. Servs. Inc*., 83 FERC ¶ 61,079, 61,386 (1998)).

[68] *Id.* P 33 ("[T]he Commission has allowed multiple complaints regarding the same ROE, where the subsequent complaints are based on new, more current data, explaining that this is particularly critical given that what is at issue is return on equity, which, in contrast to other cost of service issues can be particularly volatile. (internal alterations and quotation marks omitted)).

[69] *Id.* P 34.

[70] *Cf. La. Pub. Serv. Comm'n v. FERC*, 482 F.3d 510, 520 (D.C. Cir. 2007) (noting that the filing of a section 206 put all parties on notice of the possibility that the Commission would order refunds).

important as transmission owners decide whether and how to invest in transmission infrastructure. But the desirability of pancaked complaints is something for Congress to consider, not a reason for us to twist the text of the FPA. So long as the FPA and the Commission's precedents permit pancaked complaints, then the Commission should not let its antipathy toward such complaints prevent customers from receiving the refunds to which they are entitled.

For these reasons, I respectfully concur in part and dissent in part.

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Richard Glick
Commissioner

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