139 FERC ¶ 61,042
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
and Cheryl A. LaFleur.

Southern California Edison Company — Docket Nos. ER09-187-000, ER09-187-001, ER10-160-000

ORDER ON CONSOLIDATED PAPER HEARING

(Issued April 19, 2012)

1. This consolidated paper hearing order establishes base ROEs for three Southern California Edison transmission projects, the Devers-Palo Verde II Project (DPV2), the Tehachapi Transmission Project (Tehachapi) and the Rancho Vista transmission substation (Rancho Vista) (collectively, Transmission Projects) for the time periods January 1, 2009 through December 31, 2010. By prior order, the Commission approved incentive rate adders for the Transmission Projects.[1] In this paper hearing, the Commission approves a base ROE of 10.04 percent in Docket Nos. ER09-187-000 and ER09-187-001[2] for the period January 1, 2009 through May 31, 2010, and a base ROE of 10.33 percent in Docket No. ER10-160-000 for the period June 1, 2010 through December 31, 2010. The Commission directs a compliance filing in these dockets.

2. Accordingly, in Docket No. ER09-187-000, when the base ROE of 10.04 percent is combined with the incentive adders of 125 basis points for Rancho Vista and 175 basis points for the DPV2 and Tehachapi projects, the overall ROE for these projects will be 11.29 percent and 11.79 percent respectively. Further, in Docket No. ER10-160-000, combining the base ROE of 10.33 percent with the previously Commission-approved incentive adders for Rancho Vista and Tehachapi, results in an overall ROE for these projects of 11.58 percent and 12.08 percent respectively. Finally, in a settlement in the ER10-160-000 proceeding that addressed issues not subject to the instant paper hearing, the parties agreed to a reduction of the incentive adder for the California segment of the DPV2

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[1] *Southern California Edison Co*, 121 FERC ¶ 61,168 (2007) (Incentives Order).

[2] All subsequent references to Docket No. ER09-187-000 include the subdocket ER09-187-001.

Project[3] from 125 basis points to 100 basis points. Therefore, the negotiated project incentive adder, combined with the Commission's previously-approved 50 basis point adder for SoCal Edison's participation in the California Independent System Operator (CAISO), results in an overall ROE of 11.83 percent for the renamed DCR Project in Docket No. ER10-160-000.

I. Procedural History

3. On December 19, 2008, the Commission issued an order[4] in Docket No. ER09-187-000 accepting certain Transmission Owner Tariff (TO Tariff) revisions reflecting changes to SoCal Edison's transmission revenue requirement and transmission rates implementing CWIP rate incentives approved by the Commission for the three SoCal Edison Transmission Projects (2009 CWIP Update). The December 2008 Order suspended the tariff provisions, to be effective January 1, 2009, and established hearing and settlement judge procedures on all issues related to SoCal Edison's projected CWIP costs except for the proposed base Return on Equity (ROE), which was made subject to the determinations of the then-pending paper hearing proceeding in Docket No. ER08-375-000, SoCal Edison's 2008 CWIP Update.

4. Additionally, on December 31, 2009, the Commission issued an order[5] in Docket No. ER10-160-000 accepting certain TO Tariff revisions reflecting changes to SoCal Edison's transmission revenue requirement and transmission rates implementing CWIP rate incentives approved by the Commission for SoCal Edison's Projects (2010 CWIP Update). The December 2009 Order suspended the tariff provisions for five months, to be effective June 1, 2010, and established hearing and settlement judge procedures on all issues except for the base ROE. The Commission also granted the CPUC's Request for Rehearing in Docket No. ER09-187-002, agreeing with the CPUC that the parties should be permitted to submit new evidence addressing SoCal Edison's proposed base ROE for the 2009 CWIP update. Accordingly, in the December 2009 Order, the Commission established paper hearings for Docket No. ER09-187-000 and Docket No. ER10-160-000 and consolidated

[3] Because of changes to the Arizona segment of the DPV2 project, in the Offer of Settlement, the California segment of DPV2 is referred to as the Devers Colorado River (DCR) Project. *Southern California Edison Co*., 132 FERC ¶ 63,008, at P 15 (2010) (Settlement Judge's Certification of Uncontested Offer of Settlement); s*ee also SoCal Edison Co*., 132 FERC ¶ 61,213 (2010) (letter order accepting Offer of Settlement).

[4] *Southern California Edison Co*., 125 FERC ¶ 61,329 (2008) (December 2008 Order).

[5] *Southern California Edison Co*., 129 FERC ¶ 61,304 (2009) (December 2009 Order).

them, thereby establishing one consolidated paper hearing proceeding for determining the base ROEs in these dockets. The Commission also explained that the determination of the base ROEs in the consolidated paper hearing would be subject to the outcome of the then pending paper hearing proceeding in Docket Nos. ER08-375-000 and ER08-375-001.[6] Finally, in this same order, the Commission set a briefing schedule for the submission of evidence in the consolidated paper hearing proceedings.[7]

5. On April 15, 2010, the Commission issued an order in Docket Nos. ER08-375-000 and ER08-375-001 that established an incentive base ROE 9.54 percent for SoCal Edison's 2008 CWIP update.[8] Combined with the previously-approved incentive adders of 125 basis points for the Rancho Vista Project and 175 basis points for the DPV2 Project and the Tehachapi Project, the Commission established overall ROE for these projects of 10.79 percent and 11.29 percent respectively.[9]

6. Moreover, as previously stated, the Commission's 2010 Paper Hearing Order established the methodology the Commission will apply for setting the base ROE in this subsequent consolidated paper hearing proceeding. Therefore, the 2010 Paper Hearing Order provided guidance to the parties as to the issues they should address in their submission in this proceeding, including briefs, accompanying testimony and work papers. Accordingly, in this consolidated paper hearing, we will establish base ROEs by applying the methodology used in the 2010 Paper Hearing Order to the evidentiary records compiled in these dockets.

II. <u>Background</u>

7. In the Energy Policy Act of 2005 (EPAct 2005), Congress added a new section 219[10] to the Federal Power Act (FPA) directing the Commission to establish, by rule, incentive-based (including performance-based) rate treatments for electric transmission. The

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[6] December 2009 Order, 129 FERC ¶ 61,304 at PP 24, 27.

[7] *Id*. PP 34-35.

[8] *Southern California Edison*, 131 FERC ¶ 61,020 (2010) (2010 Paper Hearing Order); *order on reh'g*, 137 FERC ¶ 61,016 (2011) (Order on Rehearing).

[9] *Id*.

[10] Pub. L. No. 109-58, § 1241, 119 Stat 594, 961, *to be codified at* 16 U.S.C. § 824s (2006).

Commission issued Order No. 679,[11] which set forth processes by which a public utility could seek transmission rate incentives pursuant to section 219 of the FPA.

A. Incentives Order

8. In accordance with Order No. 679, on May 18, 2007, and as amended on August 16, 2007, SoCal Edison filed a petition for declaratory order seeking incentive rate treatment for its Transmission Projects, with capital expenditures totaling $2.5 billion. On November 16, 2007, the Commission issued the Incentives Order granting SoCal Edison's request for transmission rate incentives for the Transmission Projects.[12] Subsequently, on June 23, 2008, the Commission issued an order denying rehearing of the Incentives Order.[13]

9. In the Incentives Order, the Commission found that, consistent with Order No. 679, SoCal Edison's proposals for the construction of the DPV2 Project, the Tehachapi Project and the Rancho Vista Project would significantly improve the reliability of the CAISO's bulk power transmission system and would reduce the cost of delivered power to customers by reducing transmission congestion on the CAISO-controlled transmission grid.[14]

10. The Incentives Order granted rate incentives to SoCal Edison, including:

(1) ROE Project adders of 125 basis points for the DPV2 and Tehachapi Projects, and 75 basis points for the Rancho Vista Project;

(2) Recovery of 100 percent of any prudently-incurred abandonment costs for the DPV2 and Tehachapi Projects, if these projects, or any portion thereof, are cancelled due to factors beyond SoCal Edison's control;

(3) Recovery in the transmission rate base of 100 percent of CWIP during the construction of these Projects; and

(4) ROE adder of 50 basis points to its overall ROE based on SoCal Edison's participation in CAISO.

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[11] *Promoting Transmission Investment through Pricing Reform*, Order No. 679, FERC Stats. & Regs. ¶ 31,222, *order on reh'g*, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 (2006), *order on reh'g*, 119 FERC ¶ 61,062 (2007).

[12] Incentives Order, 121 FERC ¶ 61,168.

[13] *Southern California Edison Co*., 123 FERC ¶ 61,293 (2008).

[14] Incentives Order, 121 FERC ¶ 61,168.

B. SoCal Edison's CWIP Rate Filing in Docket No. ER08-375-000

11. On December 21, 2007 (December 2007 filing), SoCal Edison filed revisions to its TO Tariff to reflect proposed changes to its transmission revenue requirement and transmission rates to implement the CWIP rate incentives granted in the Incentives Order. SoCal Edison also proposed to establish a base ROE.[15] For its calculation, SoCal Edison followed the Discounted Cash Flow (DCF) methodology, used a national proxy group, screened for a range of risk factors and, based upon this analysis, applied the midpoint of these calculations to establish a proposed base ROE of 11.5 percent. Using SoCal Edison's calculations, the incentive adders approved in the Incentives Order would result in overall ROEs of 12.75 percent for the Rancho Vista Project and 13.25 percent for the DPV2 and Tehachapi Projects.

C. February 2008 Order

12. The Commission's analysis of the December 2007 filing preliminarily determined that a just and reasonable ROE for SoCal Edison should be based upon a Western Electric Coordinating Council (WECC)-wide proxy group, with appropriate consideration for risk.[16] Specifically, the Commission applied the screening parameters that were accepted in *Atlantic Path 15*[17] and found that a reasonable range of return on equity for SoCal Edison appeared to be from 7.97 percent to 13.67 percent. The Commission concluded that SoCal Edison's proposed overall ROEs for its three projects, inclusive of incentive adders, were within the upper end of the zone of reasonableness. The Commission accepted SoCal Edison's proposed tariff revisions, and suspended them for a nominal period, to be effective March 1, 2008, subject to refund.

13. Additionally, because the Commission evaluated the range of reasonableness of the company's ROE using a different proxy group and screening criteria than those provided in SoCal Edison's application, the Commission established a paper hearing to allow parties the opportunity to analyze the Commission's preliminary conclusion.

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[15] SoCal Edison's Base Transmission Revenue Requirement in effect in December 2007 was adopted pursuant to a "black box" settlement accepted by the Commission in *Southern California Edison Co*, 116 FERC ¶ 61,010 (2006).

[16] *Southern California Edison Co*., 122 FERC ¶ 61,187 (2008) (February 2008 Order).

[17] 122 FERC ¶ 61,135 (2008).

D. Commission Determinations in the 2010 Paper Hearing Order

1. Proxy Group

14. As a result of the evidence submitted in the paper hearing proceeding for Docket No. ER08-375-000, the Commission found that the record developed by the parties supported using a national proxy group. The Commission noted that is was persuaded that using a national proxy group in this case complies with the *Hope* standard of risk that is necessary "to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[18] The Commission was also persuaded by the arguments of the parties that limiting the composition of the proxy group, as we proposed in the February 2008 Order, may not reflect SoCal Edison's business risks adequately. Therefore, in keeping with the *Consumers Energy*[19] standard that the proxy group reflects comparable risk, and in consideration of the record developed in that proceeding, the Commission accepted SoCal Edison's proposed national proxy group as an appropriate proxy group to determine its ROE.[20]

2. Risk Screening Factors

15. In the February 2008 Order, the Commission stated that once the appropriate proxy group is identified, it should be screened to ensure that only companies with comparable risks are included.[21] Accordingly, in the subsequent paper hearing, the Commission utilized the following screening parameters: (1) electric utilities that did not announce a merger; (2) electric utilities that paid dividends; (3) a national comparable group of electric utilities covered by Value Line; (4) electric utilities that have the same S&P corporate credit rating, as well as those utilities with corporate credit ratings one rating below and one rating above; (5) electric utilities having annual revenues above $1 billion; (6) electric utilities that are covered by two generally recognized utility industry analysts; (7) exclude any company whose low-end ROE fails to exceed the average bond yield by about 100 basis points or more; (8) exclude companies whose high-end DCF results are above 17.7 percent and/or companies whose growth rate is greater than or equal to 13.3 percent; and (9) when we

[18] 2010 Paper Hearing Order, 131 FERC ¶ 61,020 at P 29 (quoting *Fed. Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591, 603 (1994)).

[19] 86 FERC ¶ 63,004, at 65,023 (1999), *aff'd* Opinion No. 456, 98 FERC ¶ 61,333, at 62,412 (2002) (*Consumers Energy*).

[20] 2010 Paper Hearing Order, 131 FERC ¶ 61,020 at P 29.

[21] February 2008 Order, 122 FERC ¶ 61,187 at P 25.

eliminate either the high-end or low-end ROE outlier of a company, we will also eliminate that company's corresponding low-end or high-end ROE.[22]

3. Median and Midpoint[23]

16. The Commission explained in the 2010 Paper Hearing Order and affirmed on rehearing that when the Commission sets an ROE for a single electric utility of average risk, such as SoCal Edison, the Commission's analysis is designed to address the risks of the individual utility. The Commission's longstanding precedent recognizes the median as the most accurate measure of central tendency for individual utilities of average risk.[24] The Commission rejected SoCal Edison's arguments that the midpoint should be used to set its base ROE, explaining that the Commission's "approach recognizes important differences in the purpose of the analysis that the Commission conducts when it sets an ROE for an individual utility rather than for a group comprising all of the utilities within an ISO."[25] By applying the median, rather than the midpoint, the Commission gives "consideration to more of the companies in the proxy group, rather than only those at the top and bottom. This will lessen the impact of any single proxy company whose ROE is atypically high or low."[26] On rehearing, the Commission reaffirmed its finding that using the median and

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[22] 2010 Paper Hearing Order, 131 FERC ¶ 61,020 at PP 52, 57-59.

[23] The median is calculated by sorting the average of the high and low DCF results of each company in the proxy group from lowest value to highest value, and then selecting the central value of the sequence. Where there is an even number of results, the median is the average of the two central numbers. The midpoint is the average of the highest and lowest data points in the range of reasonable returns.

[24] 2010 Paper Hearing Order, 131 FERC ¶ 61,020 at P 92; Order on Rehearing, 137 FERC ¶ 61,016 at PP 17-25.

[25] Order on Rehearing, 137 FERC ¶ 61,016 at P 17.

[26] 2010 Paper Hearing Order, 131 FERC ¶ 61,020 at P 85 (quoting *Transcontinental Gas Pipe Line Corp*., Opinion No. 414-A, 84 FERC ¶ 61,084, at 61,427 (1998), *aff'd* Opinion No. 414-B, 85 FERC ¶ 61,323 (1998) (*Transcontinental Gas*), *petition for review* denied, *N.C. Util. Comm'n v. FERC*, 203 F.3d 53 (D.C. Cir. 2000)); *see also Williston Basin Interstate Pipeline Co*., 84 FERC ¶ 61,081 (1998) (relying on *Transcontinental Gas* and stating that the median is preferable to the midpoint in setting ROE because it lessens the impact of atypical outliers in the proxy group).

lessening the impact of atypically high or low ROEs establishes an ROE that accurately reflects the risk for an individual utility.[27]

17. This Commission's precedent for using the median to set an ROE for an individual utility applicant is well-established. In *Transcontinental Gas*,[28] the Commission explained that for a company of average risk, the ROE should be set "at the point in the zone of reasonableness where one-half of the returns have higher value and one-half have a lower value."[29] In *Northwest Pipeline Corp.*,[30] the Commission explained that the median is preferable to the midpoint or mean[31] because it aids the Commission in its effort to treat all companies that face average risk equally. Additionally, the Commission stated:

> The laws of statistics support the Commission's use of the median in setting ROE for a company facing average risk because it has important advantages over the mean and midpoint approaches in determining central tendency.
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> The median best represents central tendency in a skewed distribution over the mean because the latter is drawn in the direction of the skew more than the median. That is, in a very positively skewed distribution, the mean will be higher than the median. In a very negatively skewed distribution, the mean will be lower than the median. These statistical facts make the median an appropriate average to use to represent the typical observation in a skewed distribution because it is less affected by extreme numbers than the mean.[32] Similarly, the median is also less affected by extreme

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[27] Order on Rehearing, 137 FERC ¶ 61,016 at P 18.

[28] *Transcontinental Gas*, 84 FERC ¶ 61,084.

[29] *Id*. at 61,427.

[30] 99 FERC ¶ 61,305, at 62,274 (2002) (*Northwest Pipeline*).

[31] The mean is the average of all of the numbers in the data set.

[32] *Northwest Pipeline*, 99 FERC at 62,276 (citing Robert D. Mason, Statistical Techniques in Business and Economics 86-7 (3d ed. 1974) (stating that "[o]ne disadvantage of the mean is that it is unduly affected by extremely high or low values. This feature makes it an inappropriate average to use when the distribution is highly skewed. … [The median] is not affected by a few extremely high or low values, as is the mean. This characteristic makes it an appropriate average to use to represent the typical observation in a

(continued…)

> numbers than the midpoint in a skewed distribution. Since the midpoint is the average of the highest and lowest numbers in the group, it is clearly subject to distortion by extremely high or low values.[33]

18. In the 2010 Paper Hearing Order the Commission applied this precedent using the median, explaining that this approach "aids the Commission in its efforts to treat all companies that face average risk equally."[34] On rehearing, the Commission reaffirmed using the median for determining an ROE for a utility of average risk, and concluded it was not persuaded that this established procedure was not just and reasonable for setting SoCal Edison's ROE.[35]

19. Additionally, in the 2010 Paper Hearing Order, the Commission rejected SoCal Edison's arguments in support of applying the midpoint, which the Commission uses for setting an ROE for a group comprising all of the utilities within an independent system operator (ISO) or a regional transmission organization (RTO). On rehearing, the Commission was not persuaded that applying the median and not the midpoint constitutes undue discrimination. The Commission relied upon a series of orders where it determined a generic ROE to be applied to a diverse group of electric transmission owners comprising the Midwest Independent Transmission System Operator (Midwest ISO).[36] In these orders, the Commission explained that because the ROE would apply across-the-board to all Midwest ISO Transmission Owners (TO) and not to an individual utility of average risk, the Commission must consider the full range of risks and business profiles of all of the companies within the ISO. The Commission stated:

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skewed distribution); and A.J. Jaffe & Herbert F. Spirer, Misused Statistics Straight Talk for Twisted Numbers 90 (1987)).

[33] *Id*.

[34] 2010 Paper Hearing Order, 131 FERC ¶ 61,020 at P 86; *see also Potomac-Appalachian Transmission Highline, L.L.C.*, 133 FERC ¶ 61,152, at P 65 (2010); *Pioneer Transmission, LLC*, 126 FERC ¶ 61,281, at P 95 (2009), *order on reh'g*, 130 FERC ¶ 61,044, at P 40 (2010) (citing *Golden Spread Elec. Coop. Inc. v. Southern Public Serv. Co.*, Opinion No. 501, 123 FERC ¶ 61,047, at PP 62-63 (2008) and *Va. Elec. and Power Co.*, 123 FERC ¶ 61,098, at P 66 (2008)).

[35] Order on Rehearing, 137 FERC ¶ 61,016 at P 20.

[36] 2010 Paper Hearing Order, 131 FERC ¶ 61,020 at PP 90-91 (citing *Midwest Indep. Transmission Sys. Operator*, 106 FERC ¶ 61,302 (2004), *aff'd in relevant part sub nom. Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004, 1010-1011 (D.C. Cir. 2005) (Midwest ISO Order on Remand)).

> [W]e 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. We believe it is important to note that the highest and lowest values should be included in this range of reasonableness as likely representative of other Midwest ISO members that, because they are non-publicly traded companies, could not be included in the group analysis. Because the ROE in this case will apply to a diverse group of companies, the entire range of results yielded by the subset is relevant here. Thus, we find that using the midpoint is the most appropriate measure for determining a single ROE for all Midwest ISO TOs, since it fully considers that range.[37]

20. Consequently, when the Commission sets an ROE for a group comprising all members of an RTO, the Commission's goal is not to select the most refined measure of central tendency, as is the case where the Commission is setting an ROE for a single utility of average risk. Rather, the Commission has explained that it "must use the measure that produces the most just and reasonable ROE for all of the Midwest ISO TOs," and that it was "not as concerned here that the high or low results represent different risks from the single company because the range encompasses only publicly traded Midwest ISO TOs."[38] In the Order on Rehearing, the Commission concluded that, in light of these important differences, which the Commission continues to find relevant, it would reject SoCal Edison's arguments that application of the median or the midpoint in distinct circumstances constitutes undue discrimination.[39] For similar reasons, the Commission also rejected SoCal Edison's arguments that policy adopted to address the specific set of circumstances involving the establishment of an ROE for a diverse group of utilities, as constitute an ISO, should be expanded to all of the Commission's ROE determinations.[40]

4. <u>Updating of Financial Data</u>

21. In the 2010 Paper Hearing Order, the Commission stated that its well-established policy for updating equity allowances in rates has been to accept an appropriate equity return, within a zone of reasonableness, based upon test period evidence. Next, to account for market conditions that often change substantially between the time a utility files its case-

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[37] Midwest ISO Order on Remand, 106 FERC ¶ 61,302 at PP 9-10.

[38] *Id*. P 10.

[39] Order on Rehearing, 137 FERC ¶ 61,016 at P 23.

[40] *Id*. P 24.

in-chief and the date the Commission issues a final decision, we update the return on equity.[41] Where the rate under consideration is "locked-in" (that is, the rate being litigated has been superseded or is otherwise no longer in effect), the Commission updates the equity allowances for the locked-in period based on the change in average yields on ten-year constant maturity U.S. Treasury bonds (ten-year Treasury bonds).[42]

22. In the 2010 Paper Hearing Order, the Commission rejected SoCal Edison's arguments that the Commission should not apply its established updating procedures. In the Order on Rehearing, the Commission denied SoCal Edison's arguments that the Commission should not apply any updating procedures at all. The Commission explained that the purpose of using ten-year Treasury bonds is to account for changes in market conditions that can and do occur between the time a utility files its case-in-chief and the time the Commission issues its final decision. The Commission stated that, as such, "regardless of whether ten-year bonds perfectly capture every short-term variation in the costs of equity, we continue to find the use of ten-year bonds to be a just and reasonable means of approximating such costs over time."[43] Therefore, in the Order on Rehearing, the Commission concluded that it would continue to apply the precedent of updating equity allowances for locked-in periods using the average yields on ten-year Treasury bonds.

III. Consolidated Paper Hearing: Docket Nos. ER09-187-000 and ER10-160-000

A. Introduction

23. In the December 2009 Order, the Commission stated that its determination of SoCal Edison's base ROE in these dockets would be subject to its determination in SoCal Edison's 2008 CWIP paper hearing, Docket Nos. ER08-375-000 and ER08-375-001. Accordingly, in the instant proceeding, we establish a base ROE applying the same methodology relied upon in the 2008 CWIP paper hearing, including its proxy group selection, selection of the measure of central tendency, and risk and cost of capital determinations.

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[41] *See City of Vernon, Cal.,* Opinion No. 479, 111 FERC ¶ 61,092 (2005); *Jersey Cent. Power and Light Co.*, Opinion No. 408, 77 FERC ¶ 61,001 (1996) (*Jersey Cent. Power*).

[42] *Jersey Cent. Power*, 77 FERC ¶ 61,001.

[43] Order on Rehearing, 137 FERC ¶ 61,016 at P 33; *see also Union Electric Co*., Opinion No. 279, 40 FERC ¶ 61,046, *order on reh'g*, Opinion No. 279-A, 41 FERC ¶ 61,343 (1987) (*Union Electric*).

B. Procedural Matters

24. Initial and Reply Briefs in the consolidated paper hearing were filed by SoCal Edison, the California Public Utility Commission (CPUC), M-S-R Public Power Agency (M-S-R), Six Cities,[44] and the California Department of Water Resources State Water Project (SWP).

C. 2009 CWIP Update – Docket No. ER09-187-000

25. SoCal Edison's 2009 CWIP Update seeks to revise its TO Tariff to reflect changes to its TRR and transmission rates implementing CWIP rate incentives effective January 1, 2009.[45]

1. Time Period for the Base ROE Data Set

26. In its October 2008 Filing in Docket No. ER09-187-000, SoCal Edison supported its proposed 12.0 percent base ROE with financial data from the six-month period ending September 30, 2008. None of the parties in the Docket No. ER09-187-000 proceeding take issue with SoCal Edison's utilizing a data set inclusive of the six months from April, 2008 through September, 2008.

27. We find that it is appropriate to establish the base ROE using financial data for the six-month period ending September 30, 2008 because at the time of SoCal Edison's filing in October 2008, this six-month time period was the latest six-month data available to support its filing.

2. ROE Proposals

28. In the 2009 CWIP Update, SoCal Edison submitted a DCF analysis in support of its requested base ROE. Six Cities, SWP and the CPUC argue that SoCal Edison's DCF analysis and resulting ROE is not consistent with the Commission's findings in the 2010 Paper Hearing Order. Additionally, M-S-R submitted its own DCF analysis with testimony

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[44] Six Cities includes the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California.

[45] SoCal Edison's 2009 CWIP Update was accepted by the Commission to become effective January 1, 2009. SoCal Edison's 2010 CWIP Update was accepted by the Commission, suspended for five months, and made subject to hearing and settlement judge proceeding. As a result of the five month suspension of the 2010 CWIP rates, the rates for the 2009 CWIP will remain in effect through May 31, 2010.

and workpapers to determine a reasonable base ROE for SoCal Edison. The positions of the parties regarding the determination of SoCal Edison's base ROE are explained below.

a. SoCal Edison

29. SoCal Edison originally proposed in its October 2008 Filing to establish a base ROE by using the DCF methodology, beginning with a national proxy group comprising 23 investor-owned utilities from throughout the country. Thereafter, in response to the Commission's December 2008 Order establishing a paper hearing, and to conform to the methodology established in the 2010 Paper Hearing Order, SoCal Edison submitted an Initial Brief, with testimony and workpapers, that include some revisions to its DCF analysis. Specifically, SoCal Edison modified its analysis to include the Cleco Corporation, which increases SoCal Edison's proposed national proxy group to 24 companies. All of these companies are categorized as electric utilities by Value Line Investment Survey. SoCal Edison then selected from this group companies with Standard and Poor's issuer credit rating of A-, BBB+ or BBB. Further, SoCal Edison selected companies having annual electric revenues of at least $1 billion, that were paying a stock dividend as of the time of this analysis, and that were expected to continue paying dividends. Finally, none of the selected companies was involved in merger activity or major restructuring during the period of analysis.[46] In addition, SoCal Edison applied two additional screening criteria prescribed by the 2010 Paper Hearing Order. That is, SoCal Edison excluded results for companies whose low-end DCF results were less than 100 basis points above the yields for A and Baa utility bonds,[47] as well as high-end DCF results that were 17.7 percent or higher and whose growth rates were 13.3 percent or higher. SoCal Edison states that the remaining 19 companies result in a DCF range from 8.05 percent to 16.28 percent, with a midpoint of 12.17 percent, which supports the proposed base ROE of 12.0 percent.[48]

b. Six Cities

30. Six Cities argue that SoCal Edison's requested base ROE of 12.0 percent is unjust and unreasonable, and is inconsistent with Commission precedent governing the calculation of ROE, including the principles set forth in the 2010 Paper Hearing Order. Six Cities notes that SoCal Edison's elimination of companies from the proxy group is generally consistent

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[46] SoCal Edison Brief at 7.

[47] As stated in the 2010 Paper Hearing Order, SoCal Edison took into account the extent to which the excluded low-end ROEs are outliers from the low-end ROEs of other proxy group companies.

[48] SoCal Edison Brief at 8. SoCal Edison also comments that the median is 10.53 percent. *Id.*

with the Commission's findings in the 2010 Paper Hearing Order.[49] However, Six Cities argues that SoCal Edison departed from the principles in the 2010 Paper Hearing Order by failing to eliminate the corresponding high-end ROE results for the companies whose low-end ROE results were discarded, or the corresponding high-end ROE results for companies whose high-end results were discarded. Six Cities contends that after adjusting for consistency with the 2010 Paper Hearing Order, the results of the proxy group analysis produce a range of 8.03 percent to 15.26 percent, with a median base ROE of 10.47 percent.

c. <u>CPUC</u>

31. The CPUC utilizes the same proxy group as SoCal Edison. To this proxy group, the CPUC's applies adjustments that are similar to those used by Six Cities. Additionally, the CPUC notes that there are unexplained variations between the analysis contained in the testimony SoCal Edison submitted in its original 2009 CWIP Update filing and the analysis in SoCal Edison's Initial Brief. The CPUC argues that, based on its analysis, SoCal Edison's base ROE should be 10.9 percent, which is the median of the range.[50]

d. <u>SWP</u>

32. SWP also uses SoCal Edison's proposed beginning proxy group and argues that the Commission should apply the determinations made in the 2010 Paper Hearing Order to determine a range of reasonableness and then apply the median value of the range to set the base ROE. Additionally, just as the CPUC argued, SWP asserts that there are numerous unexplained inconsistencies in the financial data submitted by SoCal Edison in its original testimony for the 2009 CWIP Update and the financial data submitted by SoCal Edison in its June 2010 Brief. SWP also notes that SoCal Edison included a new proxy group member, Cleco Corporation, in its June 2010 Brief. Therefore, SWP questions how there can be inconsistencies in the DCF analysis when the data underlying the calculations have come from the same time period. Nonetheless, SWP concludes that applying the determinations made in the 2010 Paper Hearing Order results in a range of reasonableness from 8.03 percent to 15.26 percent, with a median base ROE of 10.47 percent.[51]

e. <u>M-S-R</u>

33. M-S-R proposes its own DCF analysis, which includes a different proxy group than the one proposed by SoCal Edison. M-S-R asserts that the Commission should evaluate

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[49] *Id*. at 7 (citing Affidavit of Mr. Solomon, Exhibit Nos. SC-1, SC-2, SC-3).

[50] CPUC Brief at 8, Exhibit PUC-1 at 21-23; Reply Brief at 6.

[51] SWP Brief at 4-7.

and give substantial consideration to the competing proxy groups in this proceeding rather than basing its determination on the SoCal Edison proxy group. Further, M-S-R asserts that its DCF analysis is consistent with the Commission's determinations in the 2010 Paper Hearing Order. M-S-R began its proxy group analysis with 54 utilities covered by Value Line and applied the screening criteria used by the Commission in the 2010 Paper Hearing Order. Next, M-S-R applied two additional screening criteria: (1) it removed SoCal Edison from the proxy group because of concerns over the circularity between the subject utilities' estimated ROE and its stock price; and (2) in addition to excluding electric utilities that did not pay dividends, M-S-R also excluded utilities that recently reduced their dividends because such reductions can indicate that the utility is in some financial distress. After applying the screening factors approved by the Commission in the 2010 Paper Hearing Order as well as the two additional screens, M-S-R reduced the number of utilities in the proxy group from 54 to 14.[52] M-S-R concludes that the remaining 14 companies result in a DCF range from 7.70 percent to 14.97 percent, with a median of 10.77 percent.[53]

f. Commission Determination

34. The Commission explained in the respective orders establishing the two instant paper hearings that the Commission would apply the determination of the 2010 Paper Hearing Order to the subsequent consolidated proceeding. We find that SoCal Edison's proposed national proxy group and DCF analysis is, for the most part, consistent with our *2*010 Paper Hearing Order. However, as discussed below, our review of the record, including intervenors' alternative DCF analyses, indicates that modifications to SoCal Edison's proposed DCF analysis are required, and that these modifications result in a slightly different proxy group and resulting range of reasonableness than that proposed by SoCal Edison.

35. Specifically, we find that SoCal Edison's inclusion of Cleco Corporation in its revised DCF analysis is reasonable because it satisfies the $1-billion minimum annual revenue screen.[54] Further, while we agree with the intervenors that there are minor discrepancies in the underlying financial data SoCal Edison submitted in its initial filing as compared with the revised financial data submitted in its Initial Brief, we find that these minor discrepancies are the result of further refinements to the underlying data and have a de minimus effect on the overall result of the DCF analysis. Additionally, we find that SoCal Edison did not apply the procedures we used in the 2010 Paper Hearing Order concerning the removal of corresponding outliers. Specifically, we find that when SoCal

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[52] M-S-R Brief, Exhibit MSR-5.

[53] *Id*.

[54] 2010 Paper Hearing Order, 131 FERC ¶ 61,020 at P 51.

Edison removed Hawaiian Electric Co., the low-end outlier, from its proxy group analysis, it did not remove the high-end result. As we stated in the 2010 Paper Hearing Order, when we eliminate either the high-end or low-end ROE outlier of a company, we must also eliminate the corresponding low-end or high-end ROE of that company.[55] Thus, when we make this necessary adjustment to SoCal Edison's proxy group, we determine that the zone of reasonableness for SoCal Edison is between 8.05 percent and 16.22 percent.

3. Median and Midpoint

36. SoCal Edison states that at the time it submitted its brief in this proceeding, pending before the Commission was its Application for Rehearing, in which it challenged the Commission's use of the median for setting its ROE in the 2010 Paper Hearing Order. SoCal Edison seeks to incorporate by reference the arguments on rehearing into the instant paper hearings. Consistent with this position, SoCal Edison asserts that in this paper hearing the Commission should use the midpoint to set the 2009 ROE, and it seeks to incorporate by reference the arguments it presents in the rehearing request that support the use of the midpoint. Further, SoCal Edison argues that applying the midpoint in this proceeding would result in a base ROE of 12.0 percent. SoCal Edison also notes that if the Commission uses the median, the base ROE would be set at 10.53 percent. All of the intervenors assert that the median should be used to set SoCal Edison's base ROE.

Commission Determination

37. As we explained in the 2010 Paper Hearing Order and the Order on Rehearing, it is the Commission's longstanding policy to apply the median to set the ROE for individual utilities of average risk. By applying the median, rather than the midpoint, the Commission gives "consideration to more of the companies in the proxy group, rather than only those at the top and bottom. This will lessen the impact of any single proxy company whose ROE is atypically high or low."[56] We are not persuaded that our established procedures for determining an ROE for a utility of average risk are not just and reasonable for setting SoCal Edison's base ROE in this proceeding. Therefore, we deny SoCal Edison's request that the midpoint be applied in this DCF analysis.[57] When we apply the median to the

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[55] *Id*. P 58.

[56] *Id*. P 85 (quoting *Transcontinental Gas*, 84 FERC ¶ 61,084, at 61,427, *aff'd* 85 FERC ¶ 61,323).

[57] The Commission generally rejects the incorporation by reference of arguments from a prior pleading into another proceeding because the Commission must decide each case on the record in that case. Moreover, incorporation by reference usually fails to inform the Commission as to which arguments are relevant and how they are relevant. *See ISO New England, Inc*., 119 FERC ¶ 61,161, at P 16 (2007). We note that for the purposes of

(continued…)

revised national proxy group in Docket No. ER09-187-002, screened for risk, as explained above, we determine the base ROE for SoCal Edison to be 10.53 percent.

4. Updating of Financial Data

38. SoCal Edison argues that due to the abnormal economic conditions during this rate effectiveness period, it is appropriate for the Commission to forego applying its updating procedures to SoCal Edison's base ROE. SoCal Edison asserts that the Commission must determine whether the change in yields in ten-year Treasury bonds are rationally related to the change in SoCal Edison's cost of equity. Otherwise, SoCal Edison contends that using the yield on ten-year Treasury bonds is arbitrary and capricious. Moreover, SoCal Edison asserts that the abnormal economic conditions that created a "flight to quality" in 2008 continued into 2009, with the effect of increasing the costs of equity for SoCal Edison even as the yield on ten-year Treasury bonds declined.[58] SoCal Edison also argues that the Commission must consider whether it is appropriate to apply the updating procedures on a case-by-case basis, because these procedures were not developed in a rulemaking process. For these reasons, SoCal Edison concludes that changes in ten-year Treasury bonds constitute an unsuitable proxy for setting SoCal Edison's base ROE. Consequently, the Commission should not apply its updating procedures here.[59]

39. However, SoCal Edison also comments that, should the Commission follow its updating procedures to this analysis, SoCal Edison's calculation of the difference in yields of the ten-year Treasury bonds for the data set period (3.88 percent) and the locked–in period (3.39 percent) is a difference of 49 basis points.[60]

40. All of the intervenors support the application of the Commission's updating procedure to the base ROE using the average yield of ten-year Treasury bonds. We note

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this paper hearing proceeding, the Commission directed that the methodology established in the 2010 Paper Hearing Order would be applied to set the base ROEs for the two dockets herein. Because the Commission is applying the same methodology in each of these dockets, we conclude that SoCal Edison intends that its arguments protesting the use of the median in the 2010 Paper Hearing Order apply similarly in scope and relevance to the instant dockets.

[58] SoCal Edison Brief at 11-12 (citing Hunt Affidavit at 6-8).

[59] SoCal Edison Brief at 12-13.

[60] SoCal Edison asserts that where the difference between the data set period and the rate effectiveness period is not significant, the Commission may elect to not update. SoCal Edison Brief at 11 (citing *Montaup Electric Co*., 38 FERC ¶ 61,252 (1987)).

however, that the intervenors' updating calculations vary. That is, Six Cities' and M-S-R's updating calculation results in a 50 basis point ROE reduction; the CPUC's updating calculation results in an 84 basis point ROE reduction; and SWP's updating calculation results in a 47 basis point ROE reduction.

Commission Determination

i. Updating Calculation

41. In keeping with the Commission's well-established policy, we will update the base ROE using the yield on ten-year Treasury bonds. SoCal Edison's base ROE in Docket No. ER09-187-000 became effective on January 1, 2009 and was superseded by a new base ROE that became effective on June 1, 2010 with our preliminary acceptance, subject to refund of SoCal Edison's updated ROE filed in Docket No. ER10-160-000. Thus, we consider the appropriate ROE for consideration in the instant proceeding to be effective from January 1, 2009 through May 31, 2010. The 10.53 percent base ROE that we adopt was calculated based upon a DCF analysis using data for the six-month period ending September, 2008. Federal Reserve Bulletins indicate that during this period, the average yield on ten-year Treasury bonds was 3.88 percent. During the period in which the base ROE was in effect in Docket No. ER09-187-000 (January 2009 through May 2010), the average yield on ten-year Treasury bonds was 3.39 percent. This represents a .49 percentage point (49 basis points) reduction in yield (3.88 – 3.39 = 0.49) which, when subtracted from the 10.53 percent base ROE accepted herein, results in an adjusted base ROE of 10.04 percent.

ii. Updating Precedent

42. For the purposes of establishing a base ROE in this docket, we apply the Commission's updating procedures, consistent with our findings in the 2010 Paper Hearing Order and upheld in the Order on Rehearing. We find that our precedent for setting and updating utilities' ROEs is equally applicable here. In the 2010 Paper Hearing Order we determined that there were no compelling reasons to depart from the Commission's precedent and in the Order on Rehearing we denied SoCal Edison's assertion that updating the base ROE was in error. In this proceeding, and in keeping with our prior determinations, we find that there is no basis for departing from this updating process for setting SoCal Edison's base ROE.

43. SoCal Edison repeats its arguments in this proceeding that the Commission should not follow its well-established updating procedures because the Commission's procedures do not reflect SoCal Edison's cost of equity. Because of this alleged disparity, SoCal Edison argues that the Commission should not update its ROE calculation. However, despite the economic conditions that existed in the 2009 to 2010 rate effective period for the instant ROE, we are not persuaded that SoCal Edison's base ROE calculation should be exempt from the updating procedures we apply in similar ROE proceedings.

44. As we explained in the Order on Rehearing, the Commission precedent requiring updating ROEs has been applied over the course of more than 25 years,[61] during which time the U.S. economy has experienced many fluctuations. The Commission's updating procedures are based upon the recognition that changes in market conditions can and do occur between the time a utility files its case-in-chief and the date the Commission issues its final decision.[62] To account for these changes, the Commission "has consistently required the use of updated data in setting a company's ROE."[63]

45. Where the rate under consideration is for a "locked-in" period, that is, the rate has been superseded or is otherwise no longer in effect, the Commission updates the equity allowances for the locked-in period.[64] As the Commission explained in the Order on Rehearing, regardless of whether use of the ten-year Treasury bonds perfectly captures every short-term variation in the costs of equity, we continue to find the use of ten-year Treasury bonds to be a just and reasonable means of approximating such costs over time. While there may be some short-term positive or negative variations in the ten-year Treasury bond yield as compared to the utilities' cost of equity over certain limited periods, over time the ten-year Treasury bond index continues to be "a reliable barometer of overall market conditions."[65] Moreover, this updating procedure adheres to the Commission's precedent

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[61] *See Nantahala Power and Light Co.*, Opinion No. 139, 19 FERC ¶ 61,152 (1982); *N.Y. State Elec. and Gas Corp*., Opinion No. 254, 37 FERC ¶ 61,151 (1986); *Union Electric*, 40 FERC ¶ 61,046; *Boston Edison Co*., Opinion No. 299, 42 FERC ¶ 61,374 (1988).

[62] 2010 Paper Hearing Order, 131 FERC ¶ 61,020 at P 100 and n.207 (citing *City of Vernon, Cal*., 111 FERC ¶ 61,092 (2005) (*City of Vernon*) and *Jersey Cent. Power*, 77 FERC ¶ 61,001).

[63] Order on Rehearing, 137 FERC ¶ 61,016 at P 32 (quoting *Bangor Hydro-Elec. Co*., 117 FERC ¶ 61,129, at P 81 (2006) (*Bangor Hydro*) and citing *Union Electric*, 40 FERC ¶ 61,046).

[64] Also, the Commission may adjust the updated base ROE where the ROE is outside of the zone of reasonable returns established through the DCF analysis. Here, the updated base ROE was within the zone of reasonableness. *See, e.g., Boston Edison Co. v. FERC,* 885 F.2d 962, 967 (1st Cir. 1989) (*Boston Edison*).

[65] *Union Electric*, 40 FERC at 61,138.

that generally supports placing the updated ROE within the zone of reasonableness established in the record.[66]

46. Consistent with our analysis in the Order on Rehearin*g*, we are not persuaded to grant SoCal Edison's request to exclude its ROE calculation from the updating process because of "unique" economic circumstances. We find that not adhering to Commission precedent would create the potential that any time the economy experiences a short-term anomaly, such as a downward trend, utilities might advance similar arguments of unique circumstances. The Commission would be confronted with having to determine what defines a unique circumstance on a base-by-case basis, a determination that would be highly subjective. Thus, we reaffirm here our conclusion that the effect of not updating the ROE in accordance with our established procedures can undermine the Commission's ability to efficiently apply objective standards for establishing just and reasonable ROEs. As the courts have recognized, the Commission's ratemaking responsibilities involve "complex industry analyses and difficult policy choices."[67] For these reasons, we are not persuaded that this record supports excluding the calculation of SoCal Edison's ROE from the Commission's updating precedent and, therefore, we will update SoCal Edison's base ROE in this proceeding. We also do not agree with SoCal Edison's argument that the Commission is required to justify its ROE updating procedures on a case-by-case basis because these procedures were not developed through a rulemaking process. Whether the Commission had developed policy through rulemaking procedures or adjudications is within the province of the Commission's authority and, under either approach, the policy is legally-binding.[68]

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[66] *See S.C. Generating Co., Inc.*, 44 FERC ¶ 61,008, at 61,039 (1988) (The updating methodology "does not take into account changes in company-specific business or financial risk. This is not critical as long as the Commission is operating within the zone of reasonableness established in the record."); *see also Boston Edison*, 885 F.2d 967 (quoting *Fed. Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591, 602 (1994) (The U.S. Court of Appeals upheld the Commission's updating procedures using ten-year Treasury bonds, explaining that "even if we assume, for the sake of argument, that changes in reasonable utility share returns do not exactly track changes in bond interest rates, the Supreme Court has made clear that 'infirmities' in Commission methodology are 'not . . . important,' provided that the 'results reached,' the 'impact of the rate order,' cannot 'be said to be unjust and unreasonable.'")).

[67] *Assoc. of Oil Pipe Lines v. FERC*, 83 F.3d 1424, 1431 (D.C. Cir. 1996).

[68] *See Pac. Gas and Elec. v. FPC*, 506 F.2d 33, 38 (1974) ("An administrative agency has available two methods for formulating policy that will have the force of law. An agency may establish binding policy through rulemaking procedures by which it

(continued…)

5. Results of the 2009 CWIP Update Paper Hearing

47. As a result of the evidence submitted in the paper hearing, and considering the arguments of the parties, we establish a base ROE for SoCal Edison by applying a DCF analysis to a national proxy group, consisting of 24 companies proposed by SoCal Edison and using data for the six month period ending September 30, 2008. We applied the same screening factors as determined in the 2010 Paper Hearing Order to ensure that only companies with comparable risks are included. Based upon the risk factors that we applied, as described herein, we narrowed the proxy group down to 19 companies and determined a zone of reasonableness for SoCal Edison between 8.05 percent and 16.22 percent. Thereafter, we applied the median of the proxy group to establish a base ROE of 10.53 percent. After updating the base ROE by adjusting for the change in average yields on ten-year Treasury bonds, we determine the revised base ROE to be 10.04 percent. When we add to this base the previously-approved incentive adders of 125 basis points for the Rancho Vista Project and 175 basis points for the DPV2 and Tehachapi Projects, we establish overall ROEs for these projects of 11.29 percent and 11.79 percent, respectively. We conclude that, pursuant to Order No. 679, because the overall ROEs are set within the zone of reasonableness, they are consistent with the just and reasonable requirements of section 205 of the FPA.[69]

48. Therefore, SoCal Edison is directed to submit, within 30 days of the issuance of this order, revised tariff provisions to reflect the Commission's establishment of a base ROE of 10.04 percent for the period January 1, 2009 through May 31, 2010. Further, we direct SoCal Edison to make refunds, with interest calculated pursuant to section 35.19a of the Commission's regulations, within 30 days of the date of this order.[70] We also direct SoCal Edison to file a refund report with the Commission within 15 days of the date refunds are made.

D. 2010 CWIP Update – Docket No. ER10-160-000

49. SoCal Edison's 2010 CWIP Update seeks to revise its TO Tariff to reflect changes to its TRR and transmission rates implementing CWIP rate incentives. Because the

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promulgates substantive rules, or through adjudications which constitute binding precedent."); s*ee also Am. Forest and Paper Ass'n v. FERC*, 550 F.3d 1179, 1183 (D.C. Cir. 2008) (commenting that "we have long held . . . 'the decision whether to proceed by rulemaking or adjudication lies within the [agency's] discretion'" and citing *N.Y. State Comm'n on Cable Television v. FCC*, 749 F.2d 804, 815 (D.C. Cir. 1984)).

[69] Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 93.

[70] 18 C.F.R. § 35.19a (2011).

Commission accepted these tariff revisions subject to a five-month suspension, the effective date for the 2010 CWIP Update was established by the Commission as June 1, 2010.

1. Time Period for the Base ROE Data Set

50. In its October 2009 Filing in Docket No ER10-160-000, SoCal Edison supported its proposed 12.25 percent base ROE with financial data from the six-month period ending September 30, 2009, and relied upon this same six month data set period in its Initial Brief.[71]

51. Six Cities asserts that the data set period proposed by SoCal Edison does not conform to the Commission's practice of accepting updated DCF data to reflect the most current financial information available at the time parties submit their testimony. For the 2010 CWIP Update, Six Cities argues that instead of using SoCal Edison's data set ending September 30, 2009, the Commission should use data for the six-month period ending April 30, 2010, which was the most recent data available at the time of the filing of its Initial Brief and prior to the June 1, 2010 effective date for the 2010 CWIP TRR.[72]

Commission Determination

52. We accept SoCal Edison's proposed six-month data set ending September, 2009. When SoCal Edison submitted its 2010 CWIP Update filing in October, 2009, its proposed six-month data set reflected the latest available financial data. Thereafter, while the paper hearing proceeding in this docket was pending before the Commission, SoCal Edison submitted and the Commission accepted its proposed 2011 CWIP Update, as modified, and suspended it for a nominal period, subject to refund and the establishment of hearing and settlement judge procedures.[73] In the December 2010 Order, the Commission established a base ROE of 10.30 percent without further procedures, to be effective January 1, 2011. The effect of SoCal Edison's new base ROE of 10.30 percent beginning January 1, 2011 is that it creates a locked-in period for the base ROE in the instant paper hearing proceeding (from June 1, 2010 through December 31, 2010). Whenever an ROE effective period is for a locked-in period, the Commission's procedure is to update the locked-in ROE effective

[71] In its Initial Brief, SoCal Edison provided some data corrections to the information it originally submitted in its October 2009 Filing. It did not revise the six month data set period.

[72] Six Cities Brief at 9, n.9 and Reply Brief at 14-18 (citing *Bangor Hydro*, 117 FERC ¶ 61,129 at P 80).

[73] *See Southern California Edison*, 133 FERC ¶ 61,269 (2010) (December 2010 Order).

period.[74] Thus, because we will update the ROE using ten-year Treasury bonds, we conclude that this updating process will adjust the financial data to accurately reflect the impact of any possible financial changes and, therefore, we conclude that it is not necessary to adjust the underlying six-month data set.

2. ROE Proposals

53. In the 2010 CWIP update, SoCal Edison submitted a DCF analysis in support of its requested base ROE. Six Cities, SWP and the CPUC argue that SoCal Edison's DCF analysis and resulting ROE is not consistent with the Commission's findings in the 2010 Paper Hearing Order. Additionally, M-S-R submitted its own DCF analysis with testimony and workpapers to determine a reasonable base ROE for SoCal Edison. The positions of the parties regarding the determination of SoCal Edison's base ROE are explained below.

a. SoCal Edison

54. SoCal Edison originally proposed in its October 2009 Filing to establish a base ROE by using the DCF methodology, beginning with a national proxy group comprising 25 investor-owned utilities from throughout the country. Thereafter, in response to the Commission's December 2009 Order establishing the paper hearing, and to conform to the methodology established in the 2010 Paper Hearing Order, SoCal Edison submitted an Initial Brief, with testimony and workpapers, that include some revisions to its DCF analysis. Specifically, SoCal Edison's analysis, as modified, includes IDACORP, Inc., which increases SoCal Edison's proposed national proxy group to 26 companies. All of these companies are categorized as electric utilities by Value Line Investment Survey. SoCal Edison then selected from this group companies with Standard and Poor's issuer credit rating of A-, BBB+ or BBB. Further, SoCal Edison selected companies having annual electric revenues of at least $1 billion, that were paying a stock dividend as of the time of this analysis, and that were expected to continue paying dividends. Finally, none of the selected companies was involved in merger activity or major restructuring during the period of analysis.[75] In addition, SoCal Edison applied two additional screening criteria prescribed by the 2010 Paper Hearing Order. That is, SoCal Edison excluded results for companies whose low-end DCF results were less than 100 basis points above the yields for A and Baa utility bonds,[76] as well as high-end DCF results that were 17.7 percent or higher

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[74] *Jersey Central Power*, 77 FERC ¶ 61,001.

[75] SoCal Edison Brief at 7.

[76] As stated in the 2010 Paper Hearing Order, SoCal Edison took into account the extent to which the excluded low-end ROEs are outliers from the low-end ROEs of other proxy group companies.

and whose growth rates were 13.3 percent or higher. SoCal Edison states that the remaining 20 companies result in a DCF range from 7.43 percent to 17.47 percent, with a midpoint of 12.45 percent, which supports the proposed base ROE of 12.25 percent.[77]

b. <u>Six Cities</u>

55. Six Cities argue that SoCal Edison's requested base ROE of 12.25 percent is unjust and unreasonable, and is inconsistent with Commission precedent governing the calculation of ROE, including the principles set forth in the 2010 Paper Hearing Order. Six Cities states that it has conducted an updated DCF analysis based on market data for the six months ending April 2010, and that, after adjusting the analysis to conform with the 2010 Paper Hearing Order, the results of the updated proxy group analysis produce a range of 7.47 percent to 16.15 percent, with a median of 10.13 percent.[78]

c. <u>CPUC</u>

56. The CPUC utilized the same proxy group as SoCal Edison. To this proxy group, the CPUC applies adjustments that are similar to those used by Six Cities. Additionally, the CPUC notes that there are unexplained variations between the analysis presented in the testimony SoCal Edison submitted in its original 2010 CWIP Update Filing and with the analysis in SoCal Edison's Initial Brief. The CPUC argues that, based on its analysis SoCal Edison's base ROE should be set at 9.66 percent, which is the median of the range.[79]

d. <u>SWP</u>

57. SWP also uses SoCal Edison's proposed beginning proxy group and argues that the Commission should apply the determinations made in the 2010 Paper Hearing Order to determine a range of reasonableness, and then it should apply the median value of the range to set the base ROE. Additionally, just as the CPUC argued, SWP asserts that there are numerous unexplained inconsistencies between the underlying financial data submitted by SoCal Edison in its original testimony for the 2010 CWIP Update and the financial data submitted by SoCal Edison in its June 2010 Brief. SWP also notes that SoCal Edison included a new proxy group member, IDACORP, Inc., in its June 2010 Brief. Therefore, SWP questions how there can be inconsistencies in the DCF analysis when the data underlying the calculations have come from the same time period. Nonetheless, SWP

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[77] SoCal Edison Brief at 8. SoCal Edison also comments that the median is 10.53 percent. *Id.*

[78] Six Cities Brief at 11.

[79] CPUC Brief at 13, Exhibit PUC-1 at 27.

concludes that applying the determinations made in the 2010 Paper Hearing Order results in a range of reasonableness from 7.41 percent to 17.47 percent, with a median base ROE of 10.84 percent.[80]

e. M-S-R

58. M-S-R proposes its own DCF analysis, which includes a different proxy group than the one proposed by SoCal Edison, and states that its calculations are consistent with the Commission's pronouncements in the 2010 Paper Hearing Order. Following the DCF analysis utilized in Docket No. ER09-187-000, M-S-R applied the screening factors approved by the Commission in the 2010 Paper Hearing Order as well as its two additional screens and reduced the number of utilities in the proxy group from 54 to 20.[81] M-S-R concludes that the remaining 20 companies result in a DCF range from 7.72 percent to 17.56 percent, with a median of 10.35 percent.[82]

f. Commission Determination

59. Consistent with our determination herein in the Docket No. ER09-187-000 paper hearing and as we explained in the respective orders establishing the two instant paper hearings, we will apply the determination of the 2010 Paper Hearing Order to this proceeding. Based upon our analysis of the record, we find that SoCal Edison's proposed national proxy group and DCF analysis is consistent with our 2010 Paper Hearing Order.

60. Specifically, we find that SoCal Edison's inclusion of IDACORP, Inc. in its revised DCF analysis is reasonable because IDACORP, Inc. satisfies the $1 billion minimum annual revenue screen. Further, as noted earlier, while we agree with the intervenors that there are minor discrepancies in the underlying financial data SoCal Edison submitted in its initial filing as compared with the revised financial data submitted in its Initial Brief, we find that these minor discrepancies are the result of further refinements to the underlying data and have a de minimus effect on the overall result of the DCF analysis. Based upon this analysis, we find SoCal Edison's zone of reasonableness is between 7.43 percent and 17.47 percent.

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[80] SWP Brief at 4-7.

[81] M-S-R Brief, Exhibit MSR-6.

[82] *Id*.

3. Median vs. Midpoint

61. SoCal Edison asserts that the Commission should use the midpoint to set the 2010 ROE, which would result in a base ROE of 12.25 percent SoCal Edison also makes reference to its arguments presented in its Application for Rehearing, as explained in greater detail herein. Nonetheless, SoCal Edison also notes that if the Commission uses the median, SoCal Edison's calculation of the median of its range of reasonableness is 10.86 percent.[83] All of the intervenors assert that the median should be used to set SoCal Edison's base ROE.

Commission Determination

62. As discussed earlier, consistent with our determination in the 2010 Paper Hearing Order and the Order on Rehearing, we find that the median is the proper measure of central tendency to set the base ROE for SoCal Edison as an individual electric utility of average risk. Applying the median for establishing SoCal Edison's base ROE "aids the Commission in its effort to treat all companies that face average risk equally."[84] Therefore, we conclude that it is appropriate to use the median in this proceeding. When applying the median to the national proxy group in Docket No. ER10-160-000, screened for risk, as explained above, we determine the base ROE for SoCal Edison to be 10.86 percent.

4. Updating of Financial Data

63. SoCal Edison asserts that it is premature to determine whether the ROE should be updated because, as of the date of its Initial Brief, SoCal Edison states that the rate effectiveness period had just begun. Consequently, SoCal Edison comments that it is not possible to assess whether updating the base ROE using ten-year Treasury bonds is reasonable without the benefit of knowing the amount of the update or the performance of other financial data.[85] Similarly, M-S-R argues that because the rate for the 2010 CWIP Update just became effective on June 1, 2010, and has not been superseded by a new rate, there is no locked-in period, so it is not appropriate to update the 2010 base ROE.[86] In

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[83] SoCal Edison Brief at 8.

[84] Order on Rehearing, 137 FERC ¶ 61,016 at P 20 (quoting 2010 Paper Hearing Order, 131 FERC ¶ 61,020 at P 86).

[85] SoCal Edison Brief at 13-14.

[86] *Id*. at 9. The rate has since been superseded by a new rate effective January 1, 2011 in Docket No. ER11-1952-000, as we discuss herein.

contrast, the CPUC asserts that if updating is appropriate in this docket, its updating calculation results in a 30 basis point increase to its calculated base ROE.[87]

Commission Determination

64. SoCal Edison is correct to note that at the time of its filing, the rate effectiveness period had just begun and that those rates had not been superseded by a new rate. However, since the filing of its Initial Brief in this proceeding, SoCal Edison submitted, and the Commission conditionally accepted, its 2011 CWIP Update effective January 1, 2011.[88] Therefore, in Docket No. ER10-160-000, SoCal Edison's base ROE was effective for the locked-in period of June 1, 2010 through December 31, 2010. Accordingly, where the rate under consideration is for a "locked-in" period, Commission precedent is to update the equity allowances for the locked-in period using the yield of ten-year Treasury bonds.[89] The 10.86 percent base ROE adopted above was calculated based upon a DCF analysis using data for the six-month period ending September, 2009. Federal Reserve Bulletins indicate that, during this time period, the average yield on ten-year Treasury bonds was 3.41 percent. During the time period in which the base ROE was in effect in Docket No. ER10-160-000 (June 2010 through December 2010), the average yield on ten-year Treasury bonds was 2.88 percent. This represents a .53 percentage point (53 basis points) reduction in yield (3.41 – 2.88 = 0.53) which, when subtracted from the 10.86 percent base ROE accepted herein, results in an adjusted base ROE of 10.33 percent.

5. Results of the 2010 CWIP Update Paper Hearing

65. As a result of the evidence submitted in the paper hearing, and considering the arguments of the parties, we establish a base ROE for SoCal Edison by applying a DCF analysis to a national proxy group, consisting of 26 companies proposed by SoCal Edison and using data for the six month period ending September 30, 2009. We applied the same screening factors as determined in the 2010 Paper Hearing Order to ensure that only companies with comparable risks are included.[90] Based upon the risk factors that we

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[87] Given that the Initial Briefs were filed on June 1, 2010, which is the date that the rates went into effect, the CPUC states that it is unclear whether an updating adjustment is appropriate in the 2010 CWIP proceeding.

[88] *Southern California Edison Co*., 133 FERC ¶ 61,269 (2010).

[89] Order on Rehearing, 137 FERC ¶ 61,016 at P 33.

[90] The CPUC argues that, in addition to the screens applied in the DCF analysis, the Commission's assessment of SoCal Edison's risk should consider factors regarding the California regulatory and business environment. (CPUC Brief at 9-11, citing PUC -2, Appendix R.) As we explained in the 2010 Paper Hearing Order, the Commission

(continued…)

applied, we narrowed the proxy group down to 20 companies and determined a zone of reasonableness for SoCal Edison between 7.43 percent and 17.47 percent. Thereafter, we applied the median of the proxy group to establish a base ROE of 10.86 percent. After updating the base ROE by adjusting for the change in average yields on ten-year Treasury bonds, we determine the revised base ROE to be 10.33 percent. When we add to this base the previously-approved incentive adders of 125 basis points for the Rancho Vista Project and 175 basis points for the Tehachapi Projects, we establish overall ROEs for these projects of 11.58 percent and 12.08 percent, respectively. Further, with respect to the renamed DCR Project,[91] because the parties negotiated a settlement in Docket No. ER10-160-000 that included a reduction of the previously-approved incentive adder from an overall 175 basis points to 150 basis points, we establish an overall ROE of 11.83 percent for the DCR Project. We conclude that, pursuant to Order No. 679, because the overall ROEs are set within the zone of reasonableness, they are consistent with the just and reasonable requirements of section 205 of the FPA.[92]

66. Therefore, SoCal Edison is directed to submit, within 30 days of the issuance of this order, revised tariff provisions to reflect the Commission's establishment of a base ROE of 10.33 percent for the period June 1, 2010 through December 31, 2010. Further, we direct SoCal Edison to make refunds, with interest calculated pursuant to section 35.19a of the Commission's regulations, within 30 days of the date of this order.[93] We also direct SoCal Edison to file a refund report with the Commission within 15 days of the date refunds are made.

<u>The Commission orders</u>:

(A) In Docket No. ER09-187-000, the Commission establishes a base ROE for SoCal Edison to be 10.04 percent, as discussed in the body of the order.

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considered these additional California-specific risk factors in the Incentives Order, 121 FERC ¶ 61,168. Moreover, these factors are not applicable when determining the base ROE. For these reasons, the Commission did not apply them in the 2010 Paper Hearing Order, and will not apply them in the instant proceeding. *See* 2010 Paper Hearing Order, 131 FERC ¶ 61,020 at P 67.

[91] *Southern California Edison Co*., 132 FERC ¶ 63,008, at P 15 (2010) (Settlement Judge's Certification of Uncontested Offer of Settlement).

[92] Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 93.

[93] 18 C.F.R. § 35.19a (2011).

(B) In Docket No. ER10-160-000, the Commission establishes a base ROE for SoCal Edison to be 10.33 percent, as discussed in the body of the order.

(C) SoCal Edison is directed to submit a compliance filing, within 30 days from the issuance of this order, revising tariff provisions to reflect the use of a base ROE of (1) 10.04 percent for the rate effectiveness period from January 1, 2009 through May 31, 2010, and (2) 10.33 percent for the rate effectiveness period of June 1, 2010 through December 31, 2010, as discussed in the body of this order.

(D) SoCal Edison is hereby ordered to make refunds in Docket Nos. ER09-187-003 and ER10-160-002, respectively, within 30 days of the date of issuance of this order and to file a refund report with the Commission within 15 days thereafter, as discussed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.