

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 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

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

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 model⁶—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.

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 complainants⁹ 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

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 complainants²⁰ 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

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

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

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

³⁸ *Coakley v. Bangor Hydro-Elec. Co.*, 165 FERC ¶ 61,030 (2018) (*Coakley* Briefing Order).

³⁹ *See id.* PP 16, 30.

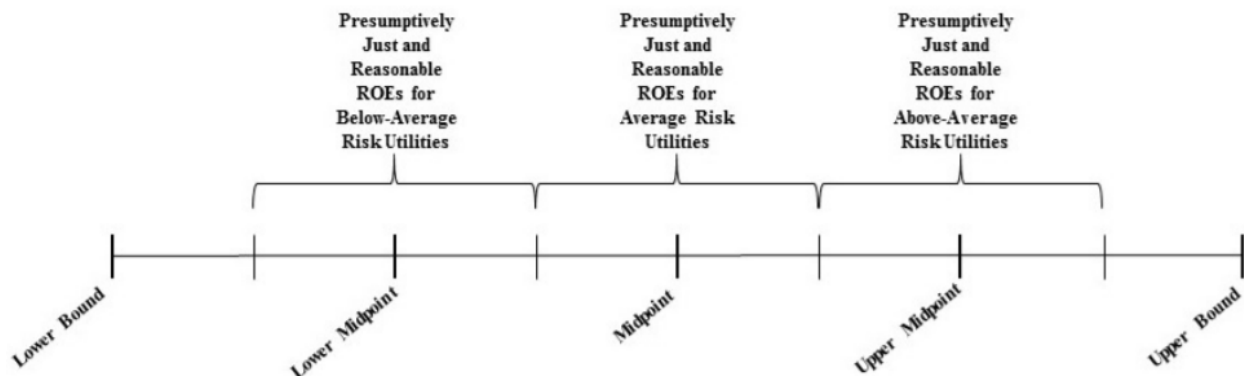
⁴⁰ *See id.* PP 16, 28.

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

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

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

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

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

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

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

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

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

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.

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

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

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

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

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 FPA¹¹² 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

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

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.

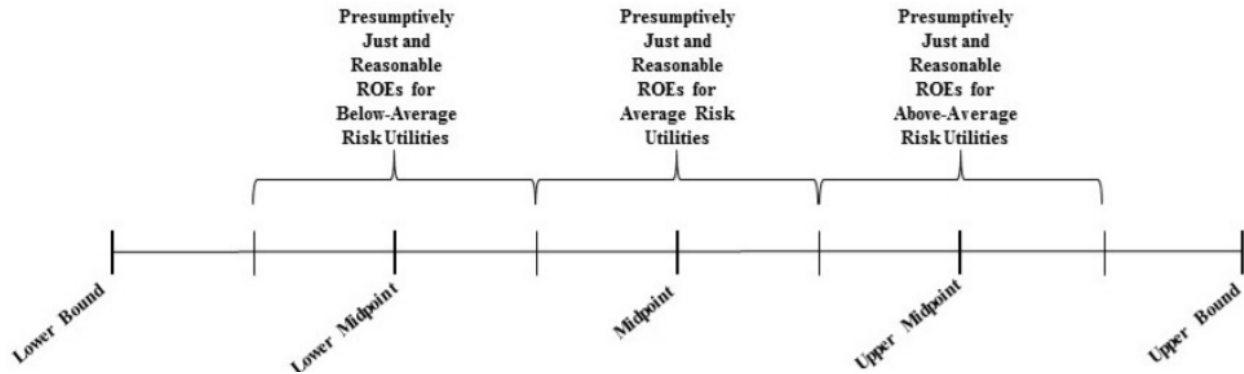
¹²⁰ RPGI Reply Br. (II) at 24-26.

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

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

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

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

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

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

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

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

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

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

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

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

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 profile¹⁸⁴ 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.

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

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

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,

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.

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

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

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

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

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

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

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

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

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 rates²⁵⁹ 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

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,

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

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

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

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 formula²⁸⁸ 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

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

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.

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

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

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

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

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

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

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

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*

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

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.

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.

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. 531³⁴⁶ 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

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

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

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.

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.

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

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

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

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

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

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

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 equity³⁹⁶ 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. 461³⁹⁸ 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

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

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

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

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 LPSC 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

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

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 model⁴²⁴ 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

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

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

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,

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.

⁴³⁹ Order No. 489, FERC Stats. & Regs. ¶ 30,795 at 30,994; *see 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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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 analysts 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,

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

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

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

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.

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

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 capitalization⁵⁷⁵ 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

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

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.

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'Brien⁵⁸⁶ 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

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

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

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

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

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

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

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

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

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. 2 McKenzie 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

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

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.

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*

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

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

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

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 proceeding⁶⁶¹ 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

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

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 the Commission's stated rationale 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

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 drawn 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

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

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

⁶⁸⁴ *Id.* at 32-33. LPSC explains that the 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

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 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

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

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 circularity of this approach, MISO TOs state that Dr. Morin, who the LPSC cites, found that such circularity concerns are mitigated in the risk premium context because the Commission-approved ROEs 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 company⁷⁰⁷ 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

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

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.

⁷¹³ Opinion No. 531-B, 150 FERC ¶ 61,165 at P 98.

⁷¹⁴ See *Dusquesne 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

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.

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

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

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

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

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. 531⁷⁴⁵ 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

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 deviations⁷⁵¹ 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

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

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

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

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 points⁷⁷¹ from 100 basis points to 254 basis points in the First Complaint proceeding, and by 91 basis points⁷⁷² 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

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

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

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.

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

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,

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.

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

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

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

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

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

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

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

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.

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

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

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

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

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 tendency⁸⁶⁶ 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

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 average⁸⁷² 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

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

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

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 of 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

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

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 of 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

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

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 procedures⁹⁰² and should continue to apply, unless and until it is changed through a subsequent formal rulemaking.

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

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

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

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.

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

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 Unutil Corporation (Unutil) from the proxy group because it is not one of the companies covered by *Value Line* and because, unlike the companies in *Value Line*, Unutil 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,

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

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

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

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

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

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 be 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

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

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

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

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

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. Solomon⁹⁷⁶ 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

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:

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

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

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

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

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

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

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. RPGI 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

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]hensoever 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

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 “‘[a]pprov[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

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

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

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.

<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

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

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

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

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

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 One-Step	Adjusted Dividend Yield	DCF Results
			Yahoo! Finance	GDP				
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%

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%
	10.71
High with Outlier Test	%
Midpoint	8.95%
Median Including Utilities Excluded with Outlier Test	8.70%
	13.05
High-End Outlier Test	%
Low-End Outlier Test	7.18%

Appendix C

MISO I	DCF Zone			Lower Zone		Middle Zone		Upper Zone		Median	Low-End Test (5)	High-End Test (6)
	Lower	Upper	1/8 Range	Lower	Upper	Lower	Upper	Lower	Upper			
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		Median	Low-End Test(7)	High-End Test
	Lower	Upper	1/8 Range	Lower	Upper	Lower	Upper	Lower	Upper			
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

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

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 consumers¹² and

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]"

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.

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)).