



Federal Energy Regulatory Commission
November 15, 2019
Open Commission Meeting
Staff Presentation
Items E-6 & E-20

Good morning Mr. Chairman and Commissioners,

We will provide a presentation on the two items on today's agenda that involve return on equity, or ROE. These are items E-6 and E-20.

Item E-6 is a draft order directing parties in two proceedings involving the base ROE of the transmission owning members of MISO submit briefs concerning a proposed change in the Commission's approach to determining the base ROE of public utilities. The proposed approach in this draft order is the same as the proposed approach in *Martha Coakley v. Bangor Hydro-Elec. Co.* (or the Coakley Briefing Order). The Coakley Briefing Order addressed issues that the D.C. Circuit remanded to the Commission in *Emera Maine v. FERC*, related to the New England Transmission Owners' base ROE as provided for in the ISO New England tariff, which the Commission approved in Opinion No. 531.

In Opinion No. 531, the Commission adopted certain changes to its use of the discounted cash flow methodology, or DCF, for evaluating and setting the Commission-allowed base ROE for New England transmission owners. Following that opinion, the Commission applied this methodology to the MISO transmission owners in Opinion No. 551. In particular, the Commission elected to replace the one-step DCF methodology, which considers only short-term growth projections for a public utility, with a two-step DCF methodology that considers both short- and long-term growth projections. In addition, the Commission looked to four alternative benchmark methodologies to inform the just and reasonable placement of the base ROE within the zone of reasonableness established by the DCF methodology. The four methodologies consisted of three financial models—a risk premium analysis, a capital-asset pricing model, or CAPM, analysis, and an expected earnings analysis—as well as a comparison with ROEs approved by state public utility commissions.

In *Emera Maine*, the D.C. Circuit vacated and remanded Opinion No. 531 with regard to how the Commission determined that the existing ROE was not just and reasonable and how it determined that the just and reasonable ROE should be within the upper half of the zone of reasonableness. The court's opinion affected the MISO proceedings as well because the Commission relied upon Opinion No. 531 extensively for its determination in Opinion No. 551.

This draft order, like the Coakley briefing order, proposes to change the Commission's approach for determining base ROE by giving equal weight to four financial models, instead of primarily relying on the DCF methodology. By relying on a broader range of evidence to determine a public utility's base ROE, the Commission's ROE determinations will be based on

substantial evidence and will be in closer alignment with how investors inform their investment decisions. 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 the Commission's decision will accurately reflect how investors make their investment decisions.

Specifically, the draft order here, as in the Coakley Briefing Order, proposes to rely on three financial models that produce zones of reasonableness—the DCF model, the CAPM, and the expected earnings model—to establish a composite zone of reasonableness. The zone of reasonableness produced by each model will be given equal weight and averaged to determine the composite zone of reasonableness. The Commission will use that composite zone of reasonableness to evaluate whether an existing base ROE remains just and reasonable. Specifically, the draft order proposes to establish a range of presumptively just and reasonable ROEs within which an existing ROE would not be found unjust and unreasonable, absent additional evidence to the contrary. The range for each utility or group of utilities would be based on its risk profile. For example, the range of presumptively just and reasonable ROEs for an average risk group of utilities would be the quarter of the zone of reasonableness centered on the midpoint of the zone.

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 draft order proposes to rely on four financial models—the DCF model, the CAPM, the expected earnings model, and the risk premium model—to produce four separate base ROE estimates that will then be averaged to produce a specific just and reasonable base ROE. The risk premium model produces a single numerical point rather than a range, therefore it cannot be used in establishing a composite zone of reasonableness.

The draft order here establishes a paper hearing and directs the parties to the two proceedings involving the MISO Transmission Owners' base ROE to submit briefs regarding whether this proposed new approach should apply, and if so, how to apply it to these two proceedings. This order, as in the Coakley Briefing Order, does not make any final determinations with respect to the proposed new methodology for analyzing the base ROE component of rates under section 206 of the FPA. This ensures that all parties to these proceedings will have an opportunity to present evidence and arguments concerning the proposed new approach to determining a public utility's ROE.

Turning now to item E-20, this is a draft order that provides guidance regarding the effect of the Coakley Briefing Order on pending proceedings involving base ROE issues that have been set for hearing and settlement judge procedures. Last month, the Chief Administrative Law Judge issued an order that held an ROE proceeding in abeyance until the Commission resolves the issues set for the paper hearing in the Coakley Briefing Order or the Commission issues further guidance concerning ROE proceedings.

This draft order clarifies that in proceedings involving base ROE issues that have been set for hearing and settlement judge procedures, including FPA section 206 proceedings, the Commission expects the participants to address the Coakley Briefing Order's proposed new methodology in the context of their respective proceedings. This includes presenting evidence on the merits of the proposed methodology and whether and how to apply the proposed new methodology to the facts of their respective proceedings. While the Commission acknowledges that the Coakley Briefing Order's proposed new methodology is a proposal, and not yet a final policy, that order also indicated that, in the interim, the new proposed policy would apply to proceedings currently pending before the Commission. In this draft order, the Commission clarifies that it expects the participants in ongoing ROE proceedings to address the merits and application of the proposed methodology in their proceedings. By allowing these proceedings to continue to be adjudicated, it will enable parties to add evidence to the records, to respond to the proposed methodology in the Coakley briefing order, and ultimately enable quicker resolution of these proceedings.

Thank you. We are happy to answer any questions you might have.