FERC Revises Public Utility ROE Methodology; Sets Policy for Natural Gas, Oil Pipelines

The Federal Energy Regulatory Commission (FERC) today further refined its methodology for analyzing the base return on equity (ROE) component of public utility rates under section 206 of the Federal Power Act. In a related action, the Commission issued a Policy Statement that applies, with certain exceptions, this ROE methodology to natural gas and oil pipelines.

In Opinion No. 569, issued in November 2019, FERC said it will use the discounted cash flow (DCF) methodology and capital asset pricing model (CAPM) to determine if an existing base ROE is unjust and unreasonable, and, if so, what replacement ROE is appropriate. Applying the new methodology in a pair of complaints against the Midcontinent Independent System Operator (MISO) transmission owners, Opinion No. 569 determined that their base ROE should be 9.88 percent.

Today’s order on rehearing revises the methodology established in Opinion No. 569 and finds that the MISO transmission owners’ base ROE should be set at 10.02 percent. Primarily, the order grants rehearing of Opinion No. 569 to:

- Use the risk premium model, DCF model, and CAPM under both prongs of the FPA section 206 analysis instead of relying on only the DCF model and CAPM;
- Give the short-term growth rate 80% weighting and the long-term growth rate 20% weighting in the two-step DCF model;
- Clarify that the Commission will consider the use of Value Line growth rates in future proceedings’ CAPM analyses;
- Increase the high-end outlier test from 150% to 200% of the median result of all of the potential proxy group members in that model, subject to a natural break analysis; and
- Calculate the ranges of presumptively just and reasonable base ROEs by dividing the overall composite zone of reasonableness into equal thirds, instead of using the quartile approach that was applied in Opinion No. 569.

The policy statement on determining ROEs for natural gas and oil pipelines announces that, with certain exceptions to account for the statutory, operational, organizational and competitive differences among the industries, FERC will apply the same methodology used for analyzing electric utility ROEs under FPA section 206. Among the exceptions, the Commission will average the results of the DCF and CAPM analyses, giving equal weight to each model, but will not use the risk premium model because, for natural gas and oil pipelines, there is insufficient data to estimate cost of equity using the risk premium.

Further, unlike the Opinion No. 569 rehearing order, the policy statement does not alter the weighting of the short- and long-term growth rates in the two-step DCF model, and it declines to adopt specific outlier tests. The policy statement also clarifies the Commission’s policies for forming proxy groups in pipeline proceedings and encourages oil pipelines to file revised Form No. 6, page 700s reflecting the revised ROE policy.