172 FERC ¶ 61,242
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Neil Chatterjee, Chairman;
Richard Glick and James P. Danly.

Midcontinent Independent System Operator, Inc. Docket No. ER20-276-002

ORDER ADDRESSING ARGUMENTS RAISED ON REHEARING

(Issued September 17, 2020)

1. In a filing made on November 1, 2019 (Filing), as amended on January 29, 2020, pursuant to section 205 of the Federal Power Act (FPA),[1] Midcontinent Independent System Operator, Inc. (MISO), on behalf of Prairie Power, Inc. (Prairie Power), filed proposed revisions to Prairie Power's transmission formula rate in Attachment O-PPI to the MISO Open Access Transmission, Energy and Operating Reserve Markets Tariff (MISO Tariff).[2]

2. By order issued on March 27, 2020, the Commission rejected the proposed Tariff revisions.[3] On April 27, 2020, Prairie Power filed a request for rehearing of the Tariff Order.

3. Pursuant to *Allegheny Defense Project v. FERC*,[4] the rehearing request filed in this proceeding may be deemed denied by operation of law. As permitted by section 313(a)

[1] 16 U.S.C. § 824d (2018).

[2] MISO stated that it joined this filing as the administrator of the MISO Tariff, but took no position on the substance of the filing. For ease of reference herein, we refer to the applicant as Prairie Power.

[3] *Midcontinent Indep. Sys. Operator, Inc.*, 170 FERC ¶ 61,265 (2020) (Tariff Order).

[4] 964 F.3d 1 (D.C. Cir. 2020) (en banc).

of the FPA,[5] however, we are modifying the discussion in the Tariff Order and continue to reach the same result in this proceeding, as discussed below.[6]

## I. Background

4. A more detailed description of this proceeding is set forth in in the Tariff Order[7] and will not be repeated here.

5. Briefly, Prairie Power proposed revisions to the MISO Tariff that would allow Prairie Power to adopt a hypothetical capital structure of 50% equity and 50% long-term debt for purposes of determining its transmission revenue requirement, rather than using its actual capital structure of 18.9% equity and 81.1% debt.[8]

6. In the Tariff Order, the Commission found that Prairie Power failed to demonstrate that using its proposed hypothetical capital structure as a basis for its transmission revenue requirement was just and reasonable, and therefore rejected the filing.[9]

## II. Request for Rehearing

7. On rehearing, Prairie Power argues that the Tariff Order failed to follow the applicable three-part test for determining whether to apply a hypothetical capital structure for revenue requirements.[10]

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[5] 16 U.S.C. § 825*l*(a) ("Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b), the Commission may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this chapter.").

[6] *Allegheny Def. Project*, 964 F.3d at 16-17. The Commission is not changing the outcome of the Tariff Order. *See Smith Lake Improvement & Stakeholders Ass'n v. FERC*, 809 F.3d 55, 56-57 (D.C. Cir. 2015).

[7] Tariff Order, 170 FERC ¶ 61,265 at PP 2-29.

[8] Filing at 2.

[9] Tariff Order, 170 FERC ¶ 61,265 at PP 31-37.

[10] Request for Rehearing at 8-16.

8. Prairie Power further argues that the Commission erred in determining that the proposed capital structure was not justified by Prairie Power's use of the MISO-wide base return on equity (ROE).[11]

9. On May 19, 2020, Ameren Services Company, on behalf of Ameren Illinois Company (collectively, Ameren) filed a Motion for Leave to Answer and Answer. On June 16, 2020, Prairie Power filed a Motion to Reject Answer, or in the Alternative Motion for Leave to Answer and Answer. On July 30, 2020, Ameren filed a subsequent Motion for Leave to Answer and Answer.

## III. Discussion

### A. Procedural Matters

10. Rule 713(d)(1) of the Commission's Rules of Practice and Procedure prohibits an answer to a request for rehearing.[12] Thus, we deny Ameren's and Prairie Power's requests to answer, and reject the answers.

### B. Substantive Matters

11. We are not persuaded by Prairie Power's arguments and sustain the result of the Tariff Order, as discussed below.

12. As the Commission found in the Tariff Order,[13] rates are intended to provide utilities the opportunity to recover their costs of providing service, including the cost of capital, and the Commission's default preference is to base rates on a company's actual capital structure.[14] While using a hypothetical cost of capital may be appropriate in some

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[11] *Id.* at 16-19.

[12] 18 C.F.R. § 385.713 (2020).

[13] Tariff Order, 170 FERC ¶ 61,265 at PP 31-37.

[14] *ITC Holdings Corp. v. Interstate Power and Light*, 121 FERC ¶ 61,229, at P 49 (2007) (noting Commission's "preference to use a utility's own capital structure" absent exceptions); *Arkansas La. Gas Co.*, 31 FERC ¶ 61,318, at 61,726 (1985) (holding that "as a matter of general policy … actual rather than hypothetical capital structures should be used for developing an overall rate of return…"); *Ky. W. Va. Gas Co.*, 2 FERC ¶ 61,139, at 61,325 (1978) ("The first choice is to use the actual capital structure of the firm being regulated.").

circumstances, Prairie Power has failed to demonstrate that its situation warrants such an exception.

13. We are not convinced by Prairie Power's argument[15] that the Commission failed to follow the applicable three-part test for determining whether to apply a hypothetical capital structure for revenue requirements. As the Tariff Order noted, the three-part test cited is typically followed to determine whether to use for ratemaking a subsidiary's actual capital structure or the parent company's actual capital structure.[16] The Commission noted that no such parent-subsidiary relationship existed in this case and the three-part test did not apply.[17] Prairie Power argues on rehearing that in the past the Commission did not limit the three-part test to parent-subsidiary contexts, only that it would "most often" impute the capital structure of a corporate parent.[18] However, as Opinion No. 414-A shows, the three-part test was created to examine whether a regulated entity's "financing is controlled by another entity, such as a corporate parent."[19] In light of this background, we find that the language cited by Prairie Power was merely an acknowledgement that a company other than a direct parent might control the financing of a regulated entity, and was not intended to broaden the three-part test to situations where no parent-subsidiary relationship exists.[20]

14. Prairie Power conflates precedent concerning the applicability of the three-part test with separate lines of Commission precedent that have developed with respect to use of hypothetical capital structures.[21] However, these cases are not applications of the three-

[15] Request for Rehearing at 8-16.

[16] Tariff Order, 170 FERC ¶ 61,265 at P 34.

[17] *Id.*

[18] Request for Rehearing at 8 (quoting *Transcon. Gas Pipe Line Corp*., Opinion No. 414, 80 FERC ¶ 61,157, *granting reh'g in part*, Opinion No. 414-A, 84 FERC ¶ 61,084, at 61,413 (1998), *reh'g denied*, Opinion No. 414-B, 85 FERC ¶ 61,323 (1998), *pet. for review denied*, *N.C. Utils. Comm'n v. FERC*, 203 F.3d 53 (D.C. Cir. 2000)).

[19] Opinion No. 414-A, 84 FERC at 61,412-13; *see also Enbridge Pipelines LLC*, 139 FERC ¶ 63,015, at P 231 (2012) (noting that the three-part showing "is designed to establish a company as an independent financing entity").

[20] Prairie Power cites no case where the Commission applied the three-part test outside the parent-subsidiary context, and we are aware of none.

[21] Request for Rehearing at 12-13 (citing *Mo. Interstate Gas, LLC*, 119 FERC ¶ 61,074, at P 62 (2007), *vacated on other grounds sub nom. Mo. Pub. Serv. Comm'n v.*

part test at all, but rather stand for the proposition that "the Commission may use a hypothetical capital structure if the capital structure of the entity obtaining the financing is anomalous."[22]

15. We are not persuaded that Prairie Power's situation is anomalous such that it warrants a hypothetical capital structure. The Commission has stated that two circumstances demonstrate that a structure is anomalous: when "(a) the capital structure of the financing entity is not representative of the regulated [entity's] risk profile, or (b) the capital structure is different from the capital structure approved for other [regulated entities], or if a [discounted cash flow (DCF)] analysis is performed, outside the range of the proxy group used in the DCF analysis."[23] Here, the financing entity and the regulated entity are the same, and so the risk profile is identical. Prairie Power argues that its capital structure fits in the second type of circumstance demonstrating anomalousness because Prairie Power is taking on higher risk than its peers based on the fact that it has a high amount of debt compared to equity.[24] However, when evaluating the second type of circumstance, the analysis "is performed primarily to determine if the equity component of the capital structure of the financing entity (either the pipeline or its parent) is atypically high" and "'[i]n general, the Commission does not impute equity because this can over compensate the equity holder at the expense of the ratepayer.'"[25] Thus, as the Commission found in the Tariff Order,[26] the factual circumstances presented by Prairie Power are not comparable to precedent finding that an entity's actual capital structure was anomalous.

16. Moreover, the Commission did not reject Prairie Power's request for hypothetical capital structure solely because of its reliance on the three-part test. Rather, the Commission reviewed all evidence and precedent that Prairie Power submitted – including responses to the Commission's deficiency letter regarding, credit ratings

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*FERC*, 601 F.3d 581 (D.C. Cir. 2010); *High Island Offshore Sys., L.L.C.*, 107 FERC ¶ 63,019 (2004), *order on initial decision*, 110 FERC ¶ 61,043, at PP 143-147 (2005)).

[22] *High Island Offshore Sys.*, 110 FERC ¶ 61,043 at P 143.

[23] *Id*. (quoting *Enbridge Pipelines (KPC)*, 109 FERC ¶ 61,042, at P 89 (2004)).

[24] Request for Rehearing at 15-16. Prairie Power's arguments are limited to generalities. It does not identify a target credit rating or how its proposal would affect that rating or cash flow targets.

[25] *Enbridge Pipelines (KPC)*, 109 FERC ¶ 61,042 at PP 92-94 (quoting *Transcontinental Gas Pipe Line Co.,* 71 FERC ¶ 61,305, at 62,193 n.14 (1995)).

[26] Tariff Order, 170 FERC ¶ 61,265 at P 35.

changes, financial metrics, and the effects of cost overruns – and concluded that Prairie Power had not justified its proposed departure from cost-based ratemaking.

17. Finally, we remain unpersuaded by Prairie Power's argument that the MISO base ROE for transmission owners, as a small component of Prairie Power's overall return due to its low percentage equity, inadequately compensates Prairie Power for its risk and thus justifies the use of a hypothetical capital structure.[27] As the Tariff Order noted, to the extent that Prairie Power believes that its risks are not captured by the MISO transmission owners' ROE in its actual capital structure, Prairie Power may file to request a different ROE under FPA section 205.[28] Prairie Power argues that this solution is unworkable in practice because the values necessary to compensate it for its risk "would substantially exceed the upper bound of the zone of reasonableness."[29] Assuming this is the case, it is unclear why the Commission should grant through the use of a hypothetical capital structure a level of revenue that would "substantially exceed" the zone of reasonableness if sought through requested change in ROE under FPA section 205. As the Commission has previously found, "use of a hypothetical capital structure for the purpose of justifying a lower return on equity would be no 'more than a device to mask an otherwise anomalous return as something more appealing.'"[30] Thus, we remain convinced that Prairie Power's appropriate recourse if it believes it is being under compensated for risk is to make a filing requesting authorization to use an ROE other than the ROE accepted for general use by MISO transmission owners.

<u>The Commission orders</u>:

In response to Prairie Power's request for rehearing, the Tariff Order is hereby modified and the result sustained, as discussed in the body of this order.

By the Commission.

( S E A L )

Kimberly D. Bose,
Secretary.

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[27] Request for Rehearing at 16-19.

[28] Tariff Order, 170 FERC ¶ 61,265 at P 36.

[29] Request for Rehearing at 19.

[30] *Enbridge Pipelines (KPC)*, 109 FERC ¶ 61,042 at P 95 (citation omitted).